Guests at the Table?: Independent Directors in Family-Influenced Public Companies

Deborah A. DeMott*

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I. INTRODUCTION

Companies within the sphere of public capital markets in the United States that retain characteristics of family firms pose a series of intriguing questions about

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* David F. Cavers Professor of Law, Duke University School of Law. Many thanks to Evelyn Brody, James D. Cox, Ian Ramsay, and Andrew Tuch for comments on the manuscript. I presented an earlier version of this article as the W.E. Hearn lecture at Melbourne Law School in December 2006 and benefitted from the audience's questions and reactions.

corporate governance that warrant examination in light of the surprising incidence and size of such firms. In particular, a family-influenced or family-controlled firm with nonfamily equity investors is an environment in which directors' roles and duties require careful assessment. Although in many reported cases—some well-known for other reasons—directors' performance within family-controlled companies appears to have ranged in quality from exemplary to deplorable, the underlying issues surrounding directors remain unexplored in legal scholarship. Moreover, questions concerning the governance of such companies regularly surface in highly visible ways. For example, in 2006 directors of the Ford Motor Company confronted the difficult question of whether a descendant of the firm's founder, one bearing the last name "Ford," should continue serving as the company's CEO.¹ More recently, directors of Dow Jones & Co.—62% of its voting power represented by shares held by trusts on behalf of the Bancroft family—assessed the company's response to a financially generous offer for its shares made by News Corporation (News Corp.), while the Bancrofts and their trustees determined their responses as Dow Jones's controlling shareholders.² News Corp. itself, originally Australian but since reincorporated in Delaware,³ is controlled by Rupert Murdoch and, through a trust, the Murdoch family controls around 30% of News Corp.'s shares.⁴ The past and possibly future roles for Mr. Murdoch's own children within News Corp. bear

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1. See Phred Dvorak & Jaclyne Badal, *Relative Problems—Boards of Family Businesses Grapple With How to Sack Executives Who Are Kin*, WALL ST. J., July 24, 2006, at B1 (reporting that, following losses, directors of the Ford Motor Co. might find that the Ford family's "long involvement at the company could complicate matters" concerning William Ford, the company's incumbent CEO). Mr. Ford, great-grandson of the company's founder Henry Ford, succeeded a nonfamily CEO in 2001. *Id.* The Ford family reportedly controls 40% of the company's voting shares. *Id.*

2. Dow Jones went public in 1963. Cynthia Crossen, *It All Began in the Basement of a Candy Store—Dow Jones Saga Reflects the Forces That Shaped the Wall Street Journal*, WALL ST. J., Aug. 1, 2007, at B1. In 1986, a stock split created a new class of B shares with ten times the voting power of common shares. *Id.* Each shareholder received one B share for every two shares of common stock, which became Class A stock. Floyd Norris, *How Minority Could Rule in a Fight for Dow Jones*, N.Y. TIMES, June 5, 2007, at C9. Most shareholders (other than the Bancroft trusts) sold their B shares, with the exception of members of the Ottaway family, who received Dow Jones stock when they sold a chain of local newspapers to Dow Jones. *Id.* The former chairman of Ottaway Newspapers, who owns or controls 6.2% of Dow Jones's Class B stock, is the largest holder of voting power outside the Bancroft family. Ken Auletta, *Promises, Promises*, NEW YORKER, July 2, 2007, at 43, 49. When sold, Class B shares in Dow Jones became Class A shares, losing their super-voting rights, which increased the voting power of the remaining B shares. Norris, *supra*. Additionally, the Bancroft family agreed to a provision that converted all of their Class B holdings to Class A if their total holdings fell beneath 7.5 million shares. See Sarah Ellison & Laurie P. Cohen, *Dow Jones Chairman Emerges as Key Player in Bid*, WALL ST. J., June 6, 2007, at B4.

3. For a full account, see Jennifer G. Hill, *The Shifting Balance of Power Between Shareholders and the Board: News Corp's Exodus to Delaware and Other Antipodean Tales* (Sydney Law Sch., Working Paper No. 08/20, 2008), available at <http://ssrn.com/abstract=1086477>.

4. Richard Siklos, *Meet the Murdochs*, N.Y. TIMES, May 21, 2007, at C1. The family's stake will increase to 38% once News Corp. sells DirecTV to Liberty Media. *Id.* After working for News Corp., two of Rupert Murdoch's three children from his second marriage left amid clashes with other executives, wishing to "strike out on their own." *Id.* Relationships between Rupert and his older children reportedly became strained when he attempted to add the two much younger children of his third marriage as beneficiaries to a trust because the terms of Rupert's divorce from his second wife assured his older children of equal decision-making power over the trust. *Id.* The dispute was resolved without litigation through an agreement distributing direct ownership of \$100 million of News Corp. stock to each child. *Id.*

on the company's future, as do allegiances and disaffections internal to the family.⁵ On a darker note, members of the Rigas family, who founded and controlled the large telecommunications company Adelphia, were convicted of federal felonies grounded in their apparent disregard of common sense and legal boundaries between the company's assets and their own entitlements, compounded by federal securities fraud.⁶

Public companies that are either controlled by individual founders or members of the founder's family or, more loosely, influenced by them, are a significant phenomenon in the United States. Definitional and measurement questions aside for the moment, such firms are often said to account for about one third of the Fortune 500.⁷ Although that is a minority of the Fortune 500, it represents a substantial minority and a substantial fraction of overall market capitalization. Its substantiality calls into question the wisdom of premising one's perspective on corporate governance in the United States on a stylized fact of diffuse ownership⁸ and then identifying the consequences that stem from a separation between ownership and control as the sole governance concerns for publicly held companies in the United States, in contrast with their counterparts elsewhere.⁹ That is, a single focus on diffused ownership and its consequences may tend to slight the governance implications of less typical ownership structures. Moreover, within a cohort of family-controlled public firms, dual-voting structures enable the preservation of control in the absence of a proportionate investment in the firm's equity. Within this cohort of firms the market for corporate control does not operate with the

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5 See Siklos, *supra* note 4 (discussing the relationships between Murdoch and the children from his second and third marriages).

6. See *infra* note 110.

7. See *infra* Part II.A.

8. For a critique of the "stylized fact" of diffuse ownership, see Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, REV. FIN. STUD. ADVANCE ACCESS, Dec. 10, 2007, <http://rfs.oxfordjournals.org> (search "Search This Journal" for "The Myth of Diffuse Ownership") (reporting the extent of blockholding within a sample of public companies).

9. Many studies focus on family-controlled firms and instances of concentrated ownership outside the United States. See, e.g., Henrik Cronqvist & Mattias Nilsson, *Agency Costs of Controlling Minority Shareholders*, 38 J. FIN. & QUANT. ANALYSIS 695, 701-04 (2003) (within sample representing 95% of publicly-traded Swedish firms, 75.7% have dual-class share structures and 58.8% are controlled by a family owning shares carrying at least 25% of voting power); Asjeet S. Lamba & Geoffrey P. Stapledon, *The Determinants of Corporate Ownership Structure: Australian Evidence* (The Univ. of Melbourne Faculty of Law, Pub. and Legal Theory, Working Paper No. 20, 2001) (reporting that, based on a sample of Australian-listed companies through the end of 1998, 45% had a blockholder controlling 25% or more of the company's equity and 72% had a blockholder controlling 10% or more of the company's equity; families accounted for 70% of the 10% and over blocks), available at <http://ssrn.com/abstract=279015>; Randall Morck et al., *Inherited Wealth, Corporate Control, and Economic Growth: The Canadian Disease?*, in CONCENTRATED CORPORATE OWNERSHIP 319, 327-29 (Randall K. Morck ed., 2000) (presenting ownership concentration data for Canada, and noting that of the 246 publicly-traded firms among the top 500 Canadian firms (by sales) in 1988, 44 had a controlling shareholder who was an heir of the firm's founder); Mike W. Peng & Yi Jiang, *Family Ownership and Control in Large Firms: The Good, the Bad, the Irrelevant—And Why* (William Davidson Inst., Working Paper No. 840, 2006) (examining concentrated family ownership and firm performance in publicly-listed firms in eight Asian countries), available at <http://ssrn.com/abstract=938173>. On broader social outcomes and family control, see Kathy Fogel, *Oligarchic Family Control, Social Economic Outcomes, and the Quality of Government*, 37 J. INT'L BUS. STUD. 603 (2006). On the range of mechanisms used to enhance control within European Union countries, see INST. S'HOLDER SERVS. ET AL., REPORT ON THE PROPORTIONALITY PRINCIPLE IN THE EUROPEAN UNION (2007) [hereinafter EU PROPORTIONALITY REPORT], available at http://www.ecgi.org/osov/documents/final_report_en.pdf.

immediacy and vigor observed elsewhere. Transactions in control occur only through processes of negotiation and consent, which heightens the importance of governance mechanisms that operate within dual-class firms.

To be sure, the same firm does not necessarily remain family-controlled or family-influenced throughout its existence. Family influence and presence within a publicly held firm may dissipate within a generation of the firm's founding or may endure through multiple generations. Many firms that have a controlling shareholder following an initial public offering (IPO) subsequently have widely dispersed ownership with no controlling shareholder.¹⁰ In other firms, control and influence descend from the founder to children and other members of the founder's family, whether during or after the founder's association with the company, thereby creating a cohort of owners who may not view their shares in the family firm as fungible investment interests.¹¹

Additionally, family companies with public shareholders are interesting simply because they may exhibit many of the characteristics of family businesses more generally. Hierarchies and patterns of deference rooted in the family may echo within the firm. Individuals' roles—as family member, equity owner, or participant in business management or operations—may overlap and, at times, collide. Tensions within the family may be reflected in decisions that formally concern the business or its ownership structure. Family stories and business stories often coincide.¹² Family history may shape how a participant understands the company's business and the terms on which the participant identifies with the business. Within a family company, particular business assets and operations may carry symbolic values for family members that inhibit their ability or willingness to listen to or otherwise learn the facts as viewed more objectively.¹³ These factors differentiate family groups from other types of controlling shareholders. Moreover, within family companies, even the financial ties among members are complicated by the possibility and vicissitudes of anticipated inheritance, uniquely personalized contingencies that do not accompany ties with other types of controlling shareholders.

These characteristics make service as a director challenging. The challenges are especially severe for independent directors, in part because the concept of independence is poorly defined in this context. Analyses of the roles and duties of independent

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10. See John C. Coates IV, *Measuring the Domain of Mediating Hierarchy: How Contestable Are U.S. Public Corporations?*, 24 J. CORP. L. 837, 863 (1999) (discussing the choice of ownership structure). A comparable pattern of concentrated equity ownership followed by dispersion accompanies transactions in which a smaller corporation with few shareholders is acquired by a larger firm in exchange for stock in the acquiring corporation. See DAVID SKEEL, *ICARUS IN THE BOARDROOM* 78 (2005). The pattern was central to the merger wave in the United States in the nineteenth century. *Id.* Indeed, the pattern was crucial to the emergence of public corporations in which ownership and control were separated. See *id.* at 76-80 (discussing and critiquing ADOLPH A. BERLE & GARDINER MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932)).

11. On the assumption of fungibility and its implication for conceptions of shareholders, see Jennifer Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMP. L. 39, 58-59 (2000).

12. See KELIN GERSICK ET AL., *GENERATION TO GENERATION: LIFE CYCLES OF THE FAMILY BUSINESS* 3 (1997) ("Companies owned and managed by families are a special organizational form whose 'specialness' has both positive and negative effects.").

13. Joan Magretta, *Governing the Family-Owned Enterprise: An Interview with Finland's Krister Ahlström*, HARV. BUS. REV., Jan.-Feb. 1998, at 113, 116.

directors typically focus on a director's ties to the company's business and its senior management, not allegiances to particular shareholders. Moreover, the composition of family-company boards is distinctive because such boards often include members of the family or directors who are formally designated as family representatives.¹⁴ Family representation on the board may be formally assured through voting agreements among family shareholders.¹⁵ Effective service as an independent director in this context may require buffering senior management from family shareholders, whether or not they are fellow members of the board, as well as difficult assessments of the stated preferences of family shareholders in light of the corporation's business situation and the interests of its nonfamily shareholders.

The questions examined in this Article are relevant to debates within the ample scholarly literature on corporate governance. A focus on family firms with public shareholders furnishes an oblique and revealing angle of vision into ongoing debates and questions concerning corporate governance within public companies more generally. Something like a raking light cast across the surface of a painting or manuscript, this focus illumines features and limitations otherwise overlooked. Publicly held family firms may be ones in which basic questions about the corporation's overall objectives and their implications for directors are more difficult to answer. For example, directors are often urged to adopt, as a lodestar, the maximization of shareholder value. However, in family-controlled firms, the definition and measurement of "shareholder value" turns on which cohort of shareholders is relevant. For family shareholders, value may encompass expectations, commitments, and measures not relevant to other shareholders. Additionally, a focus on these firms may prompt one to doubt the wisdom of urging that directors translate shareholders' stated preferences directly into action, given the prospect that shareholders' interests may so sharply diverge. Even if viewed as transitional forms of indeterminate duration—as an interlude between a firm's IPO and wide dispersion of its shares—some family-controlled firms endure through multiple generations, and even those in which the founder's or family's interest diffuses more rapidly nonetheless represent a sizable fraction of public companies in the United States.

Moreover, although it is clear that the possession and exercise of control may benefit shareholders, the personal benefits of control are diverse. The law legitimates some and proscribes others. In many ways, the law insulates the infusion of a family's values and interests into the culture of the corporation it controls, recognizing that such

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14. The Dow Jones board was a notable recent instance; its sixteen members include three members of the Bancroft family plus the trustee for the family trust with the largest holding of Dow Jones stock. See Sarah Ellison et al., *Dow Jones Board Takes over Talks on Firm's Future*, WALL ST. J., June 21, 2007, at A1 (noting that the Bancrofts control 64% of the company's voting power).

15. For example, in the Estée Lauder Companies, members of the Lauder family control over 82% of the voting shares. *Loveman v. Lauder*, 484 F. Supp. 2d 259, 263 (S.D.N.Y. 2007). A stockholders' agreement obliges family members to vote all their shares for Leonard and Ronald Lauder (Estée's sons) as directors, plus a designee of each son. *Id.* The board also includes the CEO/chairman of a large public company who serves as a trustee of a trust benefitting members of the Lauder family. *Id.* at 263-64. The other seven members of the twelve-member board are nonfamily outsiders. *Id.* at 264. The *Loveman* court held that the plaintiff failed to allege circumstances raising a reasonable doubt about the nonfamily directors' ability to bring independent judgment to bear in assessing the merits of claims allegedly arising from a transaction in which the corporation repurchased 1.872 million shares of Class A common stock from Ronald Lauder. *Id.* at 262, 271.

an infusion is often either benign or beyond the effective reach of the law. Delaware's Court of Chancery recently acknowledged that founders and their descendants commonly "believe that their businesses stand for something more than their stock price. Founders therefore often care how their family legacy—in the form of a corporate culture that treats workers and consumers well, or a commitment to product quality—will fare if the corporation is placed under new stewardship."¹⁶ It is also noteworthy how often controlling shareholders use the vocabulary of stewardship and responsibility, not personal benefit, to characterize their perspective on their shareholdings and relationship to the corporation. Most strikingly, a matriarch of the Bancroft family, speaking at a family meeting in opposition to selling Dow Jones to News Corp., invoked the memory of the *Wall Street Journal's* reporter Daniel Pearl, saying "[h]e put his life on the line for the paper," with the objective of persuading other family members to avoid the risk of jeopardizing the *Journal's* integrity through a sale.¹⁷

My thesis is that directors who are independent of both management and the founding family serve distinct functions within the complex environment of a family-influenced public company. Independent directors are the sole actors at the highest level of firm governance who have the capacity to bring appropriate detachment to bear in resolving difficult questions that implicate family ties as well as business necessity, including management succession and external threats to the firm's position and separate existence. Independent directors may help assure the board's appropriate focus on the corporation's business despite the distracting influence or overhang of frictions internal to the founding family. Additionally, independent directors, by acting vigilantly, may guard the corporation's assets against legally problematic extractions by a controlling shareholder, whether or not that shareholder acts in cahoots with senior management.

My argument relies on a series of recent empirical studies demonstrating associations between family firms' performance and their governance structures, as well

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16. *In re Topps Co. S'holders Litig.*, 926 A.2d 58, 90 (Del. Ch. 2007). The court's observation is consistent with hypotheses articulated more formally in recent scholarship. Focusing on developing countries with poor enforcement mechanisms for commercial law, Ronald Gilson's conjecture is that family control may facilitate a public firm's long-term reputation in product markets. See Ronald J. Gilson, *Controlling Family Shareholders in Developing Countries Anchoring Relational Exchange*, 60 STAN. L. REV. 633, 641-42 (2007) (discussing how family information is less costly to convey and still contributes information about the corporation's internal structure required for long-term reputation). Moreover, a recent study of European countries finds family control more prevalent where labor relations are more difficult, which suggests that family control is consistent with a longer time horizon and an interest in guarding implicit contracts with workers. See Holger M. Mueller & Thomas Philippon, *Family Firms, Paternalism, and Labor Relations 4* (European Corporate Governance Inst., Finance Working Paper No. 186/2007, 2007) (discussing how regardless of family ownership measurements or geographical subsamples, family control is more prevalent in European countries with difficult labor relations), available at http://ssrn.com/abstract_id=945388. Mueller and Phillipon's study also found that among the 1,000 largest public firms in the United States, those having an owner holding at least five percent of the firm's equity were less likely to reduce employment than were widely held firms. *Id.* at 9.

17. See Sarah Ellison et al., *Relative Uncertainty: As Sale Decision Nears, Family Split Persists*, WALL ST. J., July 25, 2007, at A1 (quoting Jane Cox MacElree). Another family member who opposed the sale reportedly "expressed to others his belief the family's responsibility as stewards of Dow Jones should trump any monetary gain the family could reap" from News Corp.'s offer. Susan Warren et al., *Key Bancroft Aims for a Long Shot*, WALL ST. J., July 16, 2007, at A6.

as studies that find indicia within cohorts of family firms of indulgence in private benefits associated with control. Although it has long been theorized that family control should reduce agency costs stemming from the separation of ownership and control that is associated with diffusely owned public firms, other sorts of agency costs appear worrisome in some publicly held family firms.¹⁸ I rely as well on a series of reported cases that illustrate governance characteristics and failures within family firms with public shareholders. Among other things, the cases demonstrate that independent directors vary widely in how effectively they appear to fulfill the functions they are uniquely positioned to serve within family companies that have public shareholders.

Part II introduces the empirical studies, beginning with analysis of a set of definitional issues, in particular the definition of “family firm” and the firm’s “founder.” The Part then presents results—not all consistent with each other—concerning the performance and governance characteristics of publicly held family firms. Part III provides an account of the legal treatment of benefits associated with holding a controlling interest in a firm’s shares and then turns to recent illustrations of conduct in the family-firm context that contravenes well-established legal norms in a strikingly crude fashion. Part IV begins with a brief discussion of the legal content of duties owed by directors and then examines how best to define independence within the setting of boards of family-controlled public companies. The Part next articulates a series of functions that independent directors may usefully and distinctively serve, illustrating with a series of examples drawn from reported cases. The Article concludes by sketching a few observations about the importance of this cohort of companies for debates about corporate governance more generally.

II. PUBLICLY HELD FAMILY COMPANIES

Several recent empirical studies bear on the phenomenon of family firms that are public companies with nonfamily equity holders. This Part begins with a discussion of data relevant to the incidence of such firms, which requires examining how empirical researchers specify characteristics to define a “family firm” and its “founder.” The Part then turns to results of studies that test how family firms perform in contrast to other publicly held firms. Although these studies use different measures and methodologies and reach results that are not entirely consistent, some findings are revealing. In particular, capital markets reward identifiable cohorts of family firms while assigning a discount to the publicly-traded shares of others. The Part concludes with the results of still other studies that are helpful in identifying circumstances that may bear on a family firm’s relative performance as valued by capital markets.

A. Definitions and Incidence

Ronald Anderson and David Reeb’s study of Standard & Poor’s (S&P) 500 largest firms from 1992 through 1999 was the first large-sample study comparing the

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18. See, e.g., Luca Enriques & Paolo Volpin, *Corporate Governance Reforms in Continental Europe*, J. ECON. PERSP., Winter 2007, at 117, 117 (“On the one hand, dominant shareholders have both the incentive and power to discipline management. On the other hand, concentrated ownership can create conditions for a new agency problem, because the interests of controlling and minority shareholders are not aligned.”).

performance of firms with substantial founding-family ownership or participation in governance with other large U.S. firms.¹⁹ Anderson and Reeb found that family firms constituted over 35% of the S&P 500 and that founding families on average owned almost 18% of their equity.²⁰ To identify a “family firm,” Anderson and Reeb used equity ownership on the part of the founding family “and (or) the presence of family members on the board of directors . . . .”²¹ A later study by Belén Villalonga and Raphael Amit of Fortune 500 firms from 1995 to 2000 confirmed the substance of Anderson and Reeb’s findings about the incidence of family firms among large public companies, using the same definition of family firm.²² Villalonga and Amit also measured the incidence of family firms using a more restrictive definition that included only firms associated with a founding family’s second or later generation (thereby excluding, for example, Microsoft) in which the family owned at least 20% of the voting equity, was the largest equity holder, and had a member who served the firm as an officer or director. By this measure, seven percent of the Fortune 500 were family firms in the last half of the 1990s.²³

These studies use numerical and other externally-observable indicia of a family’s association with any given firm, a methodological necessity that creates the risk of over-including firms in which the founding family does not exercise control. Moreover, in a corporation in which all shares have equal voting rights, a 20% ownership stake may represent the largest blockholding but still constitute far less than the simple majority typically required to take action as a shareholder.²⁴ On the other hand, a restrictive definition of “family firm” may be under inclusive. Consider the impact of adding current family membership in senior management to Anderson and Reeb’s definition.²⁵ With this addition, the definition would exclude Dow Jones & Co. because no member of the Bancroft family recently served as a top-level executive within the firm.

Another basic question about the incidence of family firms among public companies is whether they typify specific industries. Anderson and Reeb, like

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19. Ronald C. Anderson & David M. Reeb, *Founding-Family Ownership and Firm Performance: Evidence from the S&P 500*, 58 J. FIN. 1301, 1302 (2003) [hereinafter Anderson & Reeb, *S&P 500*]. The study excluded banks and public utilities due to the difficulty of calculating Tobin’s *q*, the measure used for performance. *Id.* at 1308. By the end of the period (1999), 329 firms remained. *Id.* at 1308 n.12.

20. *Id.* at 1302.

21. *Id.* at 1308. For generations after the founder—when last names may diverge—Anderson and Reeb researched corporate histories for each firm in their sample. Anderson & Reeb, *S&P 500*, *supra* note 19, at 1308. The authors note that a family’s ownership stake in a firm’s equity “may not represent the influence that family members exert on the firm,” citing the Ablon family, which “is viewed as controlling the Ogden Corporation as if they were the majority owners but they hold roughly two percent of the outstanding shares.” *Id.* at 1308-10.

22. Belén Villalonga & Raphael Amit, *How Do Family Ownership, Control and Management Affect Firm Value?*, 80 J. FIN. ECON. 385, 294 (2006) [hereinafter Villalonga & Amit, *Family Ownership*].

23. *Id.* at 412. Definitions of a firm’s ownership characteristics are often important for regulatory purposes. For discussion of the exemption from several of the New York Stock Exchange’s corporate governance rules available to a “controlled” listed company, see *infra* text accompanying note 137.

24. For discussion of implications of this point, see *infra* text accompanying note 186.

25. For an example of a study using restrictive criteria, including service as CEO or as a key member of the board of directors, see Nicholas A. Mroczkowski & George Tanewski, *Delineating Publicly Listed Family and Nonfamily Controlled Firms. An Approach for Capital Market Research in Australia*, 45 J. SMALL BUS. MGMT. 320 (2007).

Villalonga and Amit, examined the industry distribution of family firms. Although present in a wide array of industries, they are clustered: Anderson and Reeb found family firms predominant in lumber and wood products; printing and publishing; rubber and miscellaneous plastic products; electric, gas, and sanitary services; food stores; apparel and accessory stores; eating and drinking establishments; miscellaneous retail; and business services.²⁶ Villalonga and Amit found comparable clusters and absences;²⁷ in both studies, no family firms appeared in the metal mining and transportation services industries.²⁸ What is interesting about the industry clusters is their dispersion across a range of businesses, some appearing to lack glamour, social cachet,²⁹ and opportunities to shape opinion on matters of general concern.

In contrast, studies of firms that adopt a dual-class capital structure—designed to maintain voting control without a proportionate equity interest—find them disproportionately in the high-visibility businesses of printing, publishing and communications, media, and sports teams.³⁰ Despite this concentration, dual-class firms appear in a wide range of industries.³¹ Dual-class firms represent about six percent of public companies in the United States and about eight percent of the market capitalization of all firms.³² In a recent and comprehensive study of dual-class firms by Paul Gompers et al., the most powerful predictor at the time of a firm's IPO of dual-class status was the inclusion of a person's name in the firm's name.³³ This confirms

26. Anderson & Reeb, *S&P 500*, *supra* note 19, at 1308.

27. See Villalonga & Amit, *Family Ownership*, *supra* note 22, at 398 tbl.3 (listing percentage of firms within different industries that are family firms).

28. *Id.*; Anderson & Reeb, *S&P 500*, *supra* note 19, at 1309.

29. Even within the same industry, glamour and social cachet may not be comparably associated with all companies. For example, it is reported that ownership of the *Telegraph* newspaper means that “you can have dinner with the Queen.” *Hollinger Inc. v. Hollinger Int'l, Inc.*, 858 A.2d 342, 384 (Del. Ch. 2004) (quoting an officer of corporate owner). Not all newspapers are associated with comparable “prestige and access to the intelligentsia, the literary and social elite, and high government officials.” *Id.* For further discussion of *Hollinger*-related matters, see *infra* text accompanying notes 105-120.

30. See Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1666-67 (2006) (citing Paul Gompers et. al, *Incentives vs. Control: An Analysis of U.S. Dual Class Companies* 9-10, 25, tbl.2 (Nat'l Bureau of Econ. Research, Working Paper No. 10240, 2004), available at <http://www.nber.org/papers/wq10240>).

31. Examples in a comprehensive sample from 1994 to 2002, apart from media and publishing firms, include Berkshire Hathaway, Inc., America West and Continental Airlines, Fairchild Corp., Bowl America, Inc., Coca-Cola Bottling, Inc., Adolph Coors, Inc., Freeport McMoran Copper & Gold, Ford Motor Co., Hershey Foods Corp., Sequa Corp., Tootsie Roll, United Parcel Services, Oshkosh Trucking Corp., and Sotheby's Holdings, Inc. For a complete list, see Andrew Metrick, *Dual Class Firms, 1994-2002*, <http://finance.wharton.upenn.edu/~metrick/data.htm> (last visited Apr. 4, 2008).

32. See Paul A. Gompers et al., *Extreme Governance: An Analysis of Dual-Class Firms in the United States* 1, 3 (Rodney L. White Center for Fin. Research, Working Paper No. 12-04, 2007), available at <http://ssrn.com/abstract=562511>. The sample for this comprehensive study was all firms in the Compustat data base from 1995 to 2002. *Id.* at 2. In contrast, within Canadian publicly held firms, about 14% have dual-class structures. See Michael R. King & Eric Santor, *Family Values: Ownership Structure and Performance of Canadian Firms* 4 (Mar. 1, 2007) (unpublished manuscript), available at <http://ssrn.com/abstract=967812>. Over 88% of dual-class firms are also family firms, defined by King and Santor as firms in which a family's ownership meets a threshold of at least 20%. *Id.* About one-third of Canadian firms in their sample are family-controlled by this measure. *Id.* By implication, only 40% of family firms within the cohort of Canadian public companies have a single class of shares. *Id.*

33. Gompers et al., *supra* note 32, at 4.

earlier and less comprehensive studies finding a firm's family-ownership status to be predictive of dual-class status.³⁴

A separate question is how best to determine who counts as a firm's "founder." Villalonga and Amit included within their samples individuals who founded either the firm or a predecessor firm.³⁵ When a firm had more than one founder, Villalonga and Amit assigned "founding family" status to the family with the largest voting stake.³⁶ Their study acknowledges with "founder" recognition the individual "responsible for the firm's early growth and development into the business that it became known for," not necessarily the individual responsible for the firm's initial incorporation or even its IPO.³⁷ Thus, the Ochs-Sulzberger family, acknowledged as the founders of the New York Times Corp., began by rescuing a bankrupt predecessor,³⁸ as did Eugene Meyer, acknowledged founder of the Washington Post Co.³⁹ Even a company's use of an individual's name, and that individual's origination of essential intellectual property, does not necessarily identify that individual as the company's founder. In an early example, the Singer Manufacturing Company emerged from the reorganization of I.M. Singer & Co., founded to exploit Isaac Singer's innovations in sewing machine design.⁴⁰ In lieu of payment for his legal work in resolving the patent law disputes engendered by Singer's innovations, Edward Clark became Isaac Singer's partner and by 1876, half-owner of the firm's equity and its president.⁴¹ Later generations of Clarks were Singer's controlling shareholders and active in its management.⁴² More generally,

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34. *Id.* at 17 (citing Harry DeAngelo & Linda DeAngelo, *Managerial Ownership of Voting Rights: A Study of Public Corporations with Dual Classes of Common Stock*, 14 J. FIN. ECON. 33 (1985); Ben Amoaka-Adu & Brian F. Smith, *Dual Class Firms: Capitalization, Ownership Structure and Recapitalization Back into Single Class*, 25 J. BANKING & FIN. 1083 (2001)).

35. See Villalonga & Amit, *Family Ownership*, *supra* note 22, at 389.

36. *Id.* at 391.

37. *Id.* at 392.

38. *Id.*

39. See *id.* Eugene Meyer's son-in-law, Philip Graham, joined the *Post* as associate publisher in 1946. See KATHARINE GRAHAM, *PERSONAL HISTORY* 161 (1997). In 1948, Mr. Meyer transferred ownership of a majority of the voting shares in the corporation to Philip, and the minority to his daughter, Katharine. *Id.* at 180-81. Katharine reports: "Phil received the larger share of the stock because, as Dad explained to me, no man should be in the position of working for his wife. Curiously I not only concurred but was in complete accord with this idea." *Id.* Philip later attempted to purchase Katharine's share during a period of instability in his life. *Id.* at 314. Following Philip's death in 1963, Katharine—who inherited Philip's stake in the company—was elected its president. *Id.* at 340. On preferences for male successors as family-member CEOs, see *infra* text accompanying notes 54-55.

40. See Michael Conforti, *The Clark Brothers: An Introduction*, in THE CLARK BROTHERS COLLECT: IMPRESSIONIST AND EARLY MODERN PAINTINGS 3, 9-10 (2006). Isaac Singer "tinkered" with a sewing machine patented by Elias Howe in 1846. *Id.* at 10.

41. *Id.* Margaret Blair credits Edward Clark's shrewdness in foreseeing the advantage of reorganizing as a corporation. Although the firm did not need to raise additional capital and its partners faced little realistic risk of liability for partnership obligations, Singer's relatively advanced age, irregular marital history, and large number of legitimate and illegitimate offspring meant that his death would result in competing claimants to his estate, many with legal claims to some portion of the firm's business. Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 U.C.L.A. L. REV. 387, 446 (2003). Incorporation insulated the firm's assets against claimants like Singer's heirs, situating them instead as holders of shares whose claim to distributions required a determination by the corporation's directors. *Id.*

42. Edward Clark's will requested that his son, Alfred Corning Clark,

self-identification as a “founder” or an “entrepreneur” as opposed to a founder’s “heir” may be attractive in cultures that celebrate self-made over inherited wealth and its incidents, which often include positions within family companies that are occupied by the founder’s descendants.⁴³

B. Firm Performance

How family firms perform in comparison with other public companies is the ultimate question addressed in several recent empirical studies. The answer varies depending on the cohort of firms targeted. Anderson and Reeb’s 2003 study found that family-associated firms in the Fortune 500 performed better than nonfamily firms, controlling for industry and other firm characteristics and measuring firm performance by using Tobin’s *q* and returns on assets.⁴⁴ The relationship between founding-family ownership and firm performance is nonmonotonic; that is, as family ownership first increases, so does relative performance, but performance then decreases with further increases in family ownership.⁴⁵ Anderson and Reeb also found that the identity of the CEO matters. Family firms with either founders who serve as CEOs or nonfamily CEOs show a positive relation to accounting measures of profitability, but service by a founder’s descendant as CEO appeared to have no effect on the firm’s market

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cause himself to be elected a director of the said Company and to take such part in the management of its affairs as may be necessary to watch over and protect the interests of the family therein. It is desirable and my wish that one of my grandsons shall be educated and prepared to succeed at the proper time to a Directorship in the Singer Manufacturing Company.

Conforti, *supra* note 40, at 15-17. Alfred, characterized as “someone who had no interest in being a captain of industry,” died in 1896. *Id.* at 17, 20. His son, Stephen, became the sole family director following his mother’s death in 1909. *Id.* at 20. All the Clarks benefitted from the effort and talent of nonfamily managers as the company expanded. *Id.* Stephen, who had an office in Singer’s then-new building at 149 Broadway in New York City, oversaw the company’s expansion through the 1950s. *Id.* at 29. Stephen’s position as steward of the Clark family’s business interests generated tension in his relationship with his brother, Sterling, when Stephen resisted changes to family trusts that would give each brother direct control over assets. See Gilbert T. Vincent & Sarah Lees, *A Life with Art: Stephen Carlton Clark as Collector and Philanthropist*, in *THE CLARK BROTHERS COLLECT: IMPRESSIONIST AND EARLY MODERN PAINTINGS* 123, 135-36 (2006).

43. See Gilson, *supra* note 30, at 1672-73 (suggesting that “local culture” may shape whether public opinion approved a particular “nonpecuniary private benefit[] of control” and noting that “the extent to which nepotism is viewed as improper may vary widely among jurisdictions”). When I have discussed this project with descendants of a founder who serve as senior executives within a family firm, the executive often makes the point that his or her generation should be viewed as the firm’s “true founder,” in light of its major evolution during his or her tenure.

44. See Anderson & Reeb, *S&P 500*, *supra* note 19, at 1303, 1315. Tobin’s *q*, a widely-used measure of firms’ relative performance, was determined by dividing the market value of a firm’s total assets by their replacement cost. The authors computed return on assets two ways (1) scaling net income by the book value of total assets; and (2) dividing earnings before interest, depreciation, and amortization (EBITDA) by the book value of total assets. *Id.* at 1310.

45. *Id.* at 1303. It has been suggested that a deeper understanding of types of families and their characteristics would help predict firm performance because family types vary in traits relevant to success. W. Gibb Dyer, Jr., *Examining the “Family Effect” on Firm Performance*, 19 *FAM. BUS. REV.* 253, 270 (2006). This insight has methodological implications because “[d]efinitions of family firms based strictly on percentages of ownership and management control . . . will likely not differentiate the various family effects . . . Behavioral definitions . . . will likely be more useful.” *Id.*

performance.⁴⁶ Villalonga and Amit's study of Fortune 500 firms generally found that nonfamily shareholders were better or at least no worse off investing in a family firm.⁴⁷ However, the "family-firm" premium identified by Anderson and Reeb was contingent on the identity of the firm's CEO. The premium disappeared—and in fact became a discount—when a first-generation descendant of the founder served as CEO.⁴⁸ In subsequent generational shifts, Villalonga and Amit found no comparable drop in performance measured by Tobin's *q*, which isolates the decrease in value to transitions from first-generation founder-CEOs to the next family generation.⁴⁹

One possible explanation for the observed decrease in firm performance is that it stems from choosing top management from a limited talent pool. Once family ties diffuse beyond the second generation, family shareholders' perspectives on the value of having a family CEO may coalesce with those of other holders. A recent study by Morten Bennedsen et al. is suggestive of at least some of the factors that may be associated with the second-generation's value-destroying effect. Bennedsen and his co-authors used a dataset from Denmark to examine the relationship between family characteristics and firm performance, focusing on the decision whether to appoint, as successor to a retiring CEO, either a family member or someone external to the family.⁵⁰ Their study found that firms that appoint a family-CEO underperform compared to firms in which an outgoing CEO's successor is not a family member.⁵¹ Interestingly, the study focuses separately on variables that may lead to appointment of a CEO from among family members.⁵² Among those members, family firms appear to exhibit a preference for a founder's children over surviving spouses, parents, and siblings.⁵³ The study also identified primogeniture and gender effects. That is, when an outgoing CEO's first-born child was female, the frequency of CEO succession by a

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46. Anderson & Reeb, *S&P 500*, *supra* note 19, at 1303.

47. See Villalonga & Amit, *Family Ownership*, *supra* note 22, at 414.

48. *Id.* at 406. In contrast, a recent study of all family firms listed on the French stock market between 1994 and 2000 that used accounting profitability as the measure of performance found that firms managed by the founder's descendant did better than nonfamily firms and marginally better than firms run by nonfamily managers. See David Sraer & David Thesmar, *Performance and Behavior of Family Firms: Evidence from the French Stock Market 3* (European Corporate Governance Inst., Fin. Working Paper No. 130/2006, 2006), available at http://ssrn.com/abstract_id=925415. Family CEOs appear to elicit greater labor productivity, while nonfamily CEOs make more efficient use of capital. *Id.* at 4. A very large proportion of French public firms are family-controlled, in contrast with their counterparts in the United States and Canada. Defining a family-controlled firm as one in which a founder or member of the founder's family holds a block of more than 20% of voting rights, Sraer and Thesmar found that 70% of all firms in their sample were family-controlled. *Id.* at 7-8.

49. Villalonga & Amit, *Family Ownership*, *supra* note 22, at 406.

50. Morten Bennedsen et al., *Inside the Family Firm: The Role of Families in Succession Decisions and Performance* (Nat'l Bureau of Econ. Research, Working Paper No. 12,356, 2006), available at <http://www.nber.org/papers/w12356>. Their dataset included 5334 CEO successions between 1994 and 2002 in all Danish limited liability companies. *Id.* at 7. Thus, it was not limited to companies with publicly held shares. The study also analyzed detailed information about family structure available through the official Danish Civil Registration System. *Id.* at 2. This system is unusually informative because it includes information concerning individuals' marital histories and children, which enabled the researchers to construct detailed family trees for CEOs. *Id.*

51. *Id.* at 3.

52. Bennedsen et al., *supra* note 50, at 3.

53. *Id.* at 13.

family member was 29.4%.⁵⁴ When the first-born child was male, the frequency increased to 39% (a 32.7% increase).⁵⁵ The gender of the first-born child was not correlated with firm characteristics, such as profitability and size. And the gender of the firstborns in this study was likely determined by nature because 80% of the first-child births reflected in the study occurred before 1980 and the development of reliable techniques to determine gender prior to a child's birth.⁵⁶ Thus, the potential talent pool for top management becomes even more constrained when its composition reflects not just a preference for family members, but also the birth-order and gender of the incumbent CEO's children.

Another dimension of the relative performance of family firms is the market's valuation of companies with dual-class shares, which typify a subset of family firms.⁵⁷ The recent and comprehensive study of firms with dual-class shares by Gompers et al. used a sample from the United States from 1995 to 2002.⁵⁸ The study found a positive association between firm value and insiders' cash-flow rights and a negative association between firm value and insiders' voting rights.⁵⁹ Firm value was negatively associated with a "wedge" between cash-flow and voting rights.⁶⁰ That is, firm value declines the

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54. *Id.*

55. *Id.* at 14, 38 tbl.2. The study notes that this finding is consistent both "with anecdotal evidence that male children are preferred to female at the time of succession" and with the "low levels of female participation among top management positions in Denmark." *Id.* The finding is even more striking in light of the assessment that Denmark has relatively high levels of gender equality. Bennedsen et al., *supra* note 50, at 14, 38 tbl. 2 (citing a survey of 58 countries by the World Economic Forum that rated Denmark fourth). For an example from the United States of a founder's gender-based selection of a successor, see *supra* note 39.

56. Bennedsen et al., *supra* note 50, at 14. Another exogenous event that may be associated with a market reaction is the death of an executive who owns a substantial block of shares. One study finds that the market's reaction is positive when the block consists of more than ten percent ownership. Moreover, distribution of the blockholder's estate tends to make ownership of the firm less concentrated. See Renée Adams & Daniel Ferreira, *One Share, One Vote: The Empirical Evidence* 45 (European Corporate Governance Inst., Fin. Working Paper No. 177/2007, 2007) (citing Myron B. Slovin & Marie E. Sushka, *Ownership Concentration, Corporate Control Activity, and Firm Value: Evidence from the Death of Large Blockholders*, 48 J. FIN. 1293 (1993)), available at http://ssrn.com/abstract_id=987488. In contrast, an earlier study found a negative market reaction to deaths of executives in higher positions within a firm. *Id.* at 46 (citing W. Bruce Johnson et al., *An Analysis of the Stock Price Reaction to Sudden Executive Death*, 7 J. ACCT. & ECON. 151 (1985)). The market's reaction is less negative when the holder's block is greater than 40%. *Id.* (citing Slovin & Sushka, *supra*, while noting that study, in contrast to Johnson et al., does not discuss whether deaths were accidental or otherwise sudden as opposed to ones that may have been anticipated).

57. On dual-class share structures as a mechanism for maintaining or enhancing control within a founding family, see Belén Villalonga & Raphael Amit, *How are U.S. Family Firms Controlled?* (July 2007) (unpublished manuscript), available at <http://ssrn.com/abstract=891004>. Dual-class share structures are the second most common mechanism for enhancing family control in firms in the United States, following disproportional board representation. *Id.* at 30. Third are voting agreements among shareholders. *Id.* In some other countries, pyramid holding structures are more common than in the United States. Randall Morck et al., *Corporate Governance, Economic Entrenchment and Growth* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 10692, 2004), available at <http://www.nber.org/papers/w10692>.

58. Gompers et al., *supra* note 32, at 2.

59. *Id.* at 6, 37.

60. *Id.* at 37. This study used stock returns as its measure of value. A recent study of Canadian public companies with concentrated ownership found that the market valued family-controlled firms at a 12%-17% discount on average and attributed this result to family firms with dual-class structures. King & Santor, *supra* note 32, at 4-5.

greater the disproportion between insiders' economic interest in the firm and their degree of voting control. The authors suggest that a controlling shareholder could rationally decide to sacrifice some portion of firm value to maintain private benefits of control, such as "[t]he ability to control editorial policy at a newspaper, corporate strategy at a software company, or brand identity at a consumer company" and suggest that the willingness to trade off financial loss for ongoing control is especially likely when "insiders are already very wealthy."⁶¹

A final question on which recent empirical work provides illumination is whether corporate governance choices within family firms are associated with differences in firm performance. Anderson and Reeb's 2004 study examined the performance of family firms within the S&P 500, using as variables different choices about the composition of each firm's board of directors.⁶² Their study differentiated directors who were neither present or past employees nor immediate family members into two categories: (1) "affiliate" directors, who had present or potential business relationships with the firm; and (2) "independent" directors whose directorship constituted the director's sole relationship to the firm. In nonfamily firms, independent directors held 61.2% of seats on boards, as opposed to 43.9% in family firms.⁶³ Family members held almost 20% of seats in family firms.⁶⁴ Greater family presence on the board's nominating committee was associated with a smaller fraction of independent directors on the board.⁶⁵ Consistent with some (but not all) prior research,⁶⁶ Anderson and Reeb observed no significant relationship across the entire S&P 500 between firm performance and board independence.⁶⁷ But for family firms, a higher proportion of independent directors on the board was associated with significantly better firm performance.⁶⁸ Allocating a

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61. Gompers et al., *supra* note 32, at 38. The stability of consolidated control created by dual-class structures may be stressed by sustained declines in the price at which publicly held shares trade. For discussion in connection with the New York Times Co., see John Foley & Dwight Cass, *Financial Insight: A Couple of Beer Chasers; Carlsberg, Heineken Weight Bid for U.K. Rival S&N, Other Offers Could Pour In*, WALL ST. J., Oct. 18, 2007, at C16 (suggesting that price drop may make it attractive for a controlling family to take the company private); Sarah Ellison, *Sign of Times: Don't Fight the Family?—A Money Manager Gives Up His Quest for Change of Publisher*, WALL ST. J., Oct. 18, 2007, at C1 (noting that refusal of controlling shareholders to jettison dual-class structure was followed by an annual meeting at which 42% of publicly held shares withheld consent to election of directors).

62. Ronald C. Anderson & David M. Reeb, *Board Composition: Balancing Family Influence in S&P 500 Firms*, 49 ADMIN. SCI. Q. 209 (2004) [hereinafter Anderson & Reeb, *Board Composition*].

63. *Id.* at 221. Similarly, an earlier study found both a lower absolute number of outside directors and a lower ratio of outsiders to insiders on boards of companies with a 20% or larger blockholder, in contrast to otherwise comparable firms with diffuse ownership. Clifford G. Holderness & Dennis P. Sheehan, *Constraints on Large-Block Holders*, in CONCENTRATED CORPORATE OWNERSHIP 139, 148 (Randall K. Morck ed., 2000). Holderness and Sheehan attribute the difference largely to firms with individual blockholders, in contrast to corporate owners. *Id.* at 148-49.

64. Anderson & Reeb, *Board Composition*, *supra* note 62, at 221. The study used Tobin's *q* as its primary measure of firm performance. *Id.* at 218.

65. *Id.* at 228.

66. For prior research on relationships between firm performance and board independence, see Sanjai Bhagat & Bernard S. Black, *The Non-Correlation Between Board Independence and Long Term Firm Performance*, 27 J. CORP. L. 231 (2002); Laura Lin, *The Effectiveness of Independent Directors as a Corporate Governance Mechanism: Theories and Evidence*, 90 NW. U. L. REV. 898 (1996).

67. Anderson & Reeb, *Board Composition*, *supra* note 62, at 223.

68. *Id.* at 224-25. For findings suggestive of a causative effect between the mandated inclusion of

greater proportion of board seats to affiliate directors was associated with worse performance.⁶⁹ Anderson and Reeb suggest that the negative association between relative board independence and family representation on the board's nominating committee implies that family firms select independent directors in response to outside shareholders' demands that the founding family be monitored and not the demand of family members for the expert advice that independent directors may provide.⁷⁰

As is well known, the composition of public-company boards became subject to more specific mandates as a consequence of the Sarbanes-Oxley legislation, SEC rules, and stock-exchange listing requirements, all oriented toward assuring greater presence of independent members on certain board committees and, in many instances, on the board as a whole.⁷¹ Although Anderson and Reeb's study, based on data from 1992 to 1999, necessarily pre-dated these changes, it remains an intriguing demonstration of associations between governance choices and firm performance.⁷² Further support for the significance of monitoring that independent directors may provide comes from a recent study of public companies in Hong Kong that were associated with insider trading from 1995 to 1999. Although the authors found a positive association between insider trading and indicia of earnings management, the association lessened with higher percentages of independent directors on company boards.⁷³ As it happens, this study also suggests circumstances that may compromise independent directors' ability to act as effective monitors. In firms controlled by a family—typical for Hong Kong—the moderating effect of independent directors was especially strong when no member of the controlling family served on the board. Moreover, family-firm directors may perceive tensions between the personalized presence of family shareholders on boards and the more abstract demands of loyalty to the interests of all shareholders.

C. Suggestive Circumstances

Within empirical scholarship related to corporate governance, family-influenced

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independent directors on boards of Korean companies and increases in share prices, see Bernard S. Black & Woonchan Kim, *The Effect of Board Structure on Firm Value: A Multiple Identification Strategies Approach Using Korean Data* (European Corporate Governance Inst., Fin. Working Paper No. 179/2007, 2008), available at <http://ssrn.com/abstract=968287>.

69. Anderson & Reeb, *Board Composition*, *supra* note 62, at 226.

70. *Id.* at 232. Investor demand for particular governance mechanisms is posited as the prime explanation for voluntary implementation by Canadian firms of recommended best practices and governance practices mandated in the United States after 2002. See Anita Anand et al., *Voluntary Adoption of Corporate Governance Mechanisms* 25-26 (May 10, 2006) (unpublished manuscript), available at <http://ssrn.com/abstract=921450>. Within Canadian firms, the presence of a large blockholder is negatively associated with voluntary adoption. *Id.* at 25. Firms with high levels of research and development expenditure tended to be voluntary adopters. *Id.* The authors also suggest that voluntary compliance with what is mandated by Sarbanes-Oxley may reflect cross-border competition among firms for capital, making SOX-compliance requisite to cross-list in order to attract investment from the United States. *Id.*

71. For further discussion, see *infra* text accompanying notes 136-144.

72. Another association, not limited to family firms, is the negative relationship observed between evidence of earnings management and the proportion of independent directors on the audit committee. See April Klein, *Audit Committee, Board of Director Characteristics, and Earnings Management*, 33 J. ACCT. & ECON. 375, 376 (2002) (studying this association through a sample of U.S. publicly traded firms).

73. See Bikki Jaggi & Judy Tsui, *Insider Trading, Earnings Management and Corporate Governance: Empirical Evidence from Hong Kong Firms*, 18 J. INT'L FIN. MGMT. & ACCT. 192 (2007).

public firms still constitute a relatively recent focus, especially for larger and more comprehensive studies.⁷⁴ Nonetheless, one recent empirical study suggests that within at least one cohort of family firms, members of the founding family may not always draw sufficient boundaries between their own entitlements and corporate property. Ronald Masulis et al. focused on companies with dual-class stock.⁷⁵ The authors found that, as the wedge increased between insiders' voting and cash-flow rights, dual-class companies that acquired other companies experienced lower abnormal stock returns during the public announcement period associated with the acquisition.⁷⁶ Additionally, increases in the wedge were associated with higher compensation for CEOs,⁷⁷ plus lower market values assigned to capital expenditures⁷⁸ and to corporate holdings of cash.⁷⁹ Overall, the authors find these results to be consistent with the hypothesis that "insiders holding more voting rights relative to cash flow rights extract more private benefits at the expense of outside shareholders."⁸⁰

One intriguing aspect of this study is that it is not evident how best to characterize conduct on the ground within family firms that may lead to the study's results. For example, Masulis et al. find that the greater the wedge between voting rights and cash-flow rights, the more likely it is that individuals in control of dual-class firms "tend to make shareholder value-destroying acquisitions."⁸¹ Decisions to pursue acquisitions that have this effect may be related to insiders' economic interests if, for example, their compensation is likely to rise as the firm grows larger. Alternatively, the power to pursue a particular acquisition may represent another instance of a nonpecuniary benefit of control, comparable to the power to control a newspaper's editorial policies. As Part III explains, doctrines within the law—not limited to corporate law—necessarily draw sharper distinctions among the benefits associated with control, legitimating some while prohibiting others.

III. PRIVATE BENEFITS OF CONTROL

The studies surveyed by Part II articulate and test hypotheses using numerical indicia—data—that signify externally observable phenomena. These studies are salient in the context of this Article because they apply analytic rigor to large sets of data in which it is possible to specify variables that may be relevant to questions about corporate performance and governance practices. This Part, in contrast, begins by discussing the legal treatment of benefits associated with holding a controlling block of

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74. One explanation is the labor intensity of identifying firms with specific characteristics, such as dual-class shares. See Gompers et al., *supra* note 32, at 2 (explaining that identification of dual-class firms is labor intensive and that assembling a comprehensive list for study only recently became feasible with the availability of electronic documents from the SEC).

75. Ronald W. Masulis et al., Agency Problems at Dual-Class Companies (Nov. 12, 2006) (unpublished manuscript), available at <http://ssrn.com/abstract=961158>. This study uses the comprehensive list of dual-class companies constructed by Gompers et al. See *supra* note 32.

76. Masulis et al., *supra* note 75, at 14.

77. *Id.* at 16.

78. *Id.* at 22-23.

79. *Id.* at 20.

80. *Id.* at 27.

81. Masulis et al., *supra* note 75, at 14.

shares. While the law legitimates some benefits of control, it proscribes others or makes them problematic. This Part then turns to recent instances of the extraction of private pecuniary benefits within publicly held family firms by controlling shareholders and their allies. These concrete instances underline the significance of findings in the empirical literature⁸² and furnish initial illustrations of the significance of roles played by independent directors, alas through unhappy examples in which directors appear to have failed in relatively basic ways.

A. Complexities of Control and the Benefits It Confers

The concept of control within the corporate setting is more complex than it may initially seem to be, as are the benefits associated with its possession or exercise. Much turns on the role that the controlling shareholder plays and when and how the shareholder exercises power.⁸³ Basic corporate law doctrines in the United States acknowledge that a controlling block of shares carries valuable powers that the holder may exercise and impose constraints on transactions through which a controlling shareholder deals with the corporation. Moreover, extralegal circumstances may also constrain the exercise of control. As articulated by the Delaware Supreme Court, through the exercise of voting power, a controlling shareholder of a public company may:

(a) elect directors; (b) cause a break-up of the corporation; (c) merge it with another company; (d) cash-out the public shareholders; (e) amend the certificate of incorporation; (f) sell all or substantially all of the corporate assets; or (g) otherwise alter materially the nature of the corporation and the public stockholders' interests.⁸⁴

Control blocks thus sell for premiums over the market price of noncontrol shares.⁸⁵

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82. The window into family firms that case reports can furnish may be especially helpful if such firms are more opaque than their nonfamily counterparts. Defining corporate opacity by financial measures (trading volume, bid-ask spread, analyst following, and analyst forecast errors), a recent study found family firms to be more opaque than nonfamily public companies. See Ronald Anderson et al., *Family Ownership and Corporate Opacity in the U.S.* (Nov. 10, 2006) (unpublished manuscript), available at <http://astro.temple.edu/~dreeb/Corporate%20Opacity%20and%20Family%20Ownership.pdf>. In all but the most transparent firms, the authors found a negative relationship between firm value and family ownership. *Id.* at 34. The data in the study covered 2000 firms from 2001 to 2003. *Id.* at 23. Family firms within the S&P 500 make fewer disclosures about corporate governance practices than do nonfamily firms but report better quality earnings. Ashiq Ali et al., *Corporate Disclosure By Family Firms*, 44 J. ACCT. & ECON. 238, 238 (2007). The authors interpreted their finding that family firms make better financial disclosures as consistent with a lower degree of managerial opportunism and lessened agency problems. *Id.* at 241.

83. See *Thorpe v. CERBCO, Inc.*, 676 A.2d 436, 442 (Del. 1996) (holding that controlling shareholders also acting as directors of the company have a duty to inform the company of an opportunity provided to them while acting as directors).

84. *Paramount Commc'ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 43 (Del. 1994).

85. With few exceptions, corporate law in the United States does not require that sales of control shares be structured with "tag-along" rights that assure comparable treatment for noncontrolling shares. See *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1087 (Del. Ch. 2004), *aff'd*, 872 A.2d 559 (Del. 2005); AM. LAW INST., *PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS* § 5.16, cmt. a (1994) [hereinafter *PRINCIPLES*]. The source of control premiums is open to debate; "disentangl[ing] the amount of the premium paid on the basis of efficiency considerations from any amount that might be paid based on the

A controlling shareholder's dealings with the corporation itself—distinct from the shareholder's exercise of voting rights—are subject to a fiduciary standard that requires fairness to the corporation.⁸⁶ Control may be exercised directly—for example through the removal and replacement of directors when the controlling shareholder has the requisite voting power—or more indirectly—for example through explicit or implicit threats to remove insubordinate directors.⁸⁷ However, a controlling shareholder's exercise of the power to remove directors is a visible assertion of power that may invite enhanced publicity, heightened regulatory scrutiny, and other unwanted attention.⁸⁸

Corporate law thus legitimates benefits of control that stem from selling shares or exercising voting rights associated with them. On the other hand, a controlling shareholder may not benefit from dealing with the corporation itself or use its property or nonpublic information except on terms that are fair to the corporation or that make the benefit proportionately available to all shareholders.⁸⁹ Self-dealing by a controlling shareholder occurs when the shareholder, through its domination of the corporation, receives something of value from it “to the exclusion of, and detriment to” the noncontrolling shareholders.⁹⁰ This principle is also applicable when a controlling shareholder takes for itself a business or investment opportunity that came to the

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prospect of exploitation would be impracticable.” *Id.* cmt. c. However, a controlling shareholder who sells to a buyer under circumstances that would alert a prudent person to a risk that the buyer is dishonest or otherwise likely to engage in conduct that breaches the fiduciary duties of a controlling shareholder has been held to have a duty to make reasonable inquiries. *Id.* cmt. e; *Harris v. Carter*, 582 A.2d 222, 234-35 (Del. Ch. 1990). A controlling shareholder is under no duty to sell simply because the sale would be beneficial to noncontrolling shareholders. *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, 845 (Del. 1987).

86. See PRINCIPLES, *supra* note 85, § 5.10. It is well established in Delaware cases that ownership of shares carrying more than half of a corporation's voting power constitutes control. See *Weinstein Enters., Inc. v. Orloff*, 870 A.2d 499, 507 (Del. 2005) (“[C]ontrol exists when a stockholder owns . . . more than half of a corporation's voting power.”). A shareholder with less than half of a corporation's shares generally is not deemed to be a controlling shareholder; fiduciary responsibility attaches to such a shareholder when the “actual exercise” of control occurs. *Id.* (noting that a plaintiff challenging a shareholder's conduct must establish actual exercise of control for purposes of fiduciary accountability when the shareholder owns less than a numerical majority); see also *Perlman v. Feldmann*, 219 F.2d 173, 174 n.1 (2d Cir. 1955) (applying Indiana law; a family block of 33% of outstanding stock gave “working control” to the family member who served as the corporation's chairman and president).

87. On the distinction between direct and indirect power held by controlling shareholders, see Deborah A. DeMott, *The Mechanisms of Control*, 13 CONN. J. INT'L L. 233, 236-38 (1999) [hereinafter DeMott, *Mechanisms*]. Within a Delaware corporation, directors may be made nonremovable except for cause by staggering their terms and not providing for removal without cause in the certificate of incorporation. See DEL. CODE ANN. tit. 8 § 141(k) (2008).

88. DeMott, *Mechanisms*, *supra* note 87, at 251. For a concrete illustration of this point, see *Hollinger Int'l*, 844 A.2d at 1029 (noting that a corporation's controlling shareholder, when confronted by directors' accusations of illicit self-dealing, could have taken steps to remove directors but knew “he faced serious personal repercussions if he took that aggressive step”). Directors breach their fiduciary duties by acting surreptitiously to trick a controlling shareholder into foregoing the exercise of the power to remove them before they take action detrimental to the controlling shareholder, such as issuing preferred stock with conversion rights that will dilute the controlling shareholder's stake. *Adlerstein v. Wertheimer*, No. CIV.A.19101, 2002 WL 205684, at *10-11 (Del. Ch. Jan. 25, 2002).

89. See PRINCIPLES, *supra* note 85, § 5.11.

90. *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971). On the applicability of the *Sinclair* test for participation by shareholders in a subsidiary in a sale of control transaction, see Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 813 (2003).

corporation.⁹¹ Although a controlling shareholder may legitimately exercise voting rights to defeat a corporate-level transaction with a third party that would benefit all shareholders, it is a breach of fiduciary duty for the shareholder to redirect the third party's interest toward an alternate transaction solely with the shareholder.⁹²

If the benefit received by a controlling shareholder, such as the payment of a dividend, is also proportionately received by the noncontrolling shareholders, the controlling shareholder has not benefitted to the exclusion of and detriment to the noncontrolling shareholders.⁹³ The decision to declare a dividend, like more general decisions about the financial policy a solvent corporation will follow, is within the business judgment of its directors.⁹⁴ That a controlling shareholder may place a different value on receiving dividends—shareholders within a controlling family group may value cash dividends more highly than shareholders who would prefer that the corporation reinvest its earnings to support growth—is beside the point.⁹⁵

Thus, the legal treatment of the benefits associated with control neither condemns all benefits uniquely derived by a controlling shareholder nor does it draw a simple distinction between pecuniary and nonpecuniary benefit. For example, although the right to sell a controlling block of shares at a premium price not made available to the noncontrolling shares appears to represent a pecuniary benefit to the selling shareholder, the law legitimates receiving the benefit.⁹⁶ While some of the powers associated with control, such as the power to elect directors, appear not to generate pecuniary benefits for the controlling shareholder, such a benefit may later materialize as a consequence of action taken by the directors. Thus, a controlling shareholder who exercises effective power over the selection of senior managers may use the power to install members of the shareholder's family, likely a benefit within the family, but not necessarily one associated with pecuniary benefit to the shareholder.

B. Illicit Pecuniary Benefits

The full implications of this legal complexity aside, recent cases contain troubling illustrations of the direct extraction of illicit pecuniary benefits by controlling shareholders (and their family members, friends, and other allies) within the context of

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91. *Sinclair Oil*, 280 A.2d at 722.

92. *Thorpe v. CERBCO, Inc.*, 676 A.2d 436, 442 (Del. 1996). As a consequence, the controlling shareholder is not subject to liability for the nonoccurrence of the corporate-level transaction. *Thorpe* involved a proposed sale of all of the corporation's assets that the controlling shareholders did not present to the corporation's board, instead refocusing the prospective purchaser's interest on acquiring their control block. *Id.* The shareholder's liability is limited to damages incidental to its breach of duty. *Id.* at 445.

93. *Sinclair Oil*, 280 A.2d at 721.

94. Corporation statutes impose outer financial limits on the legality of dividend payments, including a solvency test. *See, e.g.*, DEL. CODE ANN. tit. 8, § 170 (2008) (imposing a solvency test on dividend distributions).

95. For example, the dividend policies followed by Dow Jones, which met the income needs of the Bancroft family, may have disabled the company's internal investments in new business opportunities. *See* Crossen, *supra* note 2; Lauren Silva & John Christy, *Would Mr. Barron Approve?*, WALL ST. J., Aug. 1, 2007, at C14 (stating that "[f]or decades, the family has extracted punishing dividends from the company").

96. On the duties of controlling shareholders to deal fairly with the corporation and minority shareholders, see James D. Cox, *Equal Treatment for Shareholders. An Essay*, 19 CARDOZO L. REV. 615 (1997).

publicly held family companies in which independent directors' services appear to have been flawed. The judge characterized a leading case within this group as regrettably *not* one of "the most interesting corporate law cases [which] involve the color gray, with contending parties dueling over close questions of law, in circumstances when it is possible for each of the contestants to claim she was acting in good faith."⁹⁷ That is, these cases focus on transactions that clearly breach well-established fiduciary norms applicable to the actors who initiate and benefit from them. The cases also represent concrete examples of the phenomena suggested in aggregate terms in the study by Masulis et al. discussed in Part II.C.⁹⁸

A question to consider at the outset is whether the occurrence of such cases is an indication of the high quality of substantive corporate law in the United States, buttressed by an effective enforcement system.⁹⁹ One might view these cases as evidence that corporate law in the United States articulates a relatively rigorous body of fiduciary doctrine and furnishes effective mechanisms through which private litigants and public agents enforce fiduciary constraints against actors who transgress them. A less sanguine perspective is also plausible. It would begin with the aggregate results in the empirical studies, then dwell next on the internal failures that facilitated or permitted the transactions at issue in the cases, and then gape at the effrontery of the principal protagonists.

Consider for starters the facts alleged by the plaintiffs in *In re Tyson Foods, Inc. Consolidated Shareholder Litigation*.¹⁰⁰ At the time of the facts alleged in the complaint, the corporation had dual-class stock, three members of the Tyson family within its senior governance cohort, and a prior track record of litigation and regulatory investigations focused on self-dealing transactions and executive perquisites. Don Tyson controlled 99% of a family limited partnership that owned 99.9% of the corporation's class B stock. Through this structure the partnership controlled 80% of voting power within the corporation; the class B stock represented about 22.6% of the corporation's common equity.¹⁰¹ Don, a director of the corporation since 1952, served as Senior Chairman of its board of directors from 1995 to 2001 and later continued as a consultant to the corporation and managing general partner of the family partnership. His son, John, became a director in 1984, the board's chairman in 1998, and the corporation's CEO in 2000. Don's sister-in-law, Barbara, retired as a vice president in 2002, but continued as a consultant, having become a director in 1998.

To settle prior litigation challenging self-dealing transactions between the corporation and the Tyson family, the corporation agreed to the creation of a "Special Committee" composed of three outside directors and charged with conducting an annual

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97. *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1028 (Del. Ch. 2004), *aff'd*, 872 A.2d 559 (Del. 2005).

98. See *supra* text accompanying notes 75-80 (discussing study focused on dual-class stock companies).

99. See, e.g., Gilson, *supra* note 30, at 1653 n.33 (citing *Hollinger* as "a good example of judicial standard-setting" within a regime of good law). For discussion of *Hollinger*-related incidents, see *infra* text accompanying notes 105-120.

100. *In re Tyson Foods, Inc. Consol. S'holder Litig.*, 919 A.2d 563, 573-80 (Del. Ch. 2007).

101. *Id.* at 571-72. According to its 2006 proxy statement, Tyson had outstanding 273,911,430 shares of Class A stock and 80,883,320 shares of Class B. Tyson Foods, Inc., Proxy Statement (Schedule 14A) (Feb. 2, 2006). All of its directors combined owned 3.96% of the Class A shares, including John Tyson, who owned 1.4%. *Id.*

review of the terms and fairness of such transactions. The plaintiff alleged that, although the Special Committee met annually, its review did not encompass all related-party transactions or all of Don Tyson's requests for reimbursements and that its successor, the Governance Committee, met much less frequently than required by its charter. The complaint alleged numerous instances of problematic transactions, including consulting agreements under which no work was performed plus a "motley"¹⁰² list of related-party transactions that amounted to over ten percent of Tyson's net earnings between 1998 and 2004. These transactions were disclosed to Tyson's shareholders only cursorily. Moreover, the board's compensation committee allegedly granted stock options to John Tyson and other senior executives and "spring-loaded" them, that is, timed the options' release to occur prior to the company's release of material information likely to move its stock price upward.¹⁰³ Finally, the corporation's failure to adequately disclose perquisites and other personal benefits Don Tyson received led to an investigation by the SEC that culminated in findings of numerous disclosure violations and inadequate internal controls.

Of particular interest for present purposes is one of the bases on which the court permitted many of the plaintiffs' claims to proceed. The court held that, in determining whether Tyson family members would receive financial benefits not equally shared with shareholders, the Tysons could be deemed to be "interested" in related-party transactions that benefitted other directors: If true, the allegations in the complaint made "unearned benefits to non-Tyson family directors . . . the *quid pro quo* for approval of perquisites to the Tyson family."¹⁰⁴ Thus, directors may fail in this context because they are in complicity with controlling shareholders in reciprocal patterns of self-dealing.

Directors may also fail because they are not diligent in monitoring the conduct of the controlling shareholder and the shareholder's family and nonfamily allies, a failing easily compounded if members of the controlling group are less than candid with the remainder of the board. The most instructive recent illustration is the board of Hollinger International, Inc. (Hollinger) during the period of its domination by its then-controlling shareholder, Conrad M. Black.¹⁰⁵ Like Tyson Foods, Hollinger, which owned several newspapers, had a dual-class share structure. An intermediate holding company,

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102. *Tyson Foods*, 919 A.2d at 577.

103. The complaint alleged that Tyson's shareholders approved the company's stock option plan on the basis that it would be used only to furnish incentives for future performance, not as a mechanism to reward past performance, as spring-loaded grants would do. The plan also required that option grants be issued at fair market value. *Id.* at 575. Thus, the complaint alleges circumvention of the terms of a stockholder-approved plan through deceptive means. Analysis is more complicated if the plan's terms expressly permit grants at below-market prices and it is alleged that those awarding the options secretly manipulated the exercise price. *See Desimone v. Barrows*, 924 A.2d 908, 930-34 (Del. Ch. 2007) (stating that the issue was whether officers who appear to be granting a fair market value option but actually manipulated the exercise price of the option would breach their fiduciary duty). Secretly (and knowingly) backdating the grants, thereby exposing the corporation to adverse regulatory and legal consequences, would constitute disloyal conduct. *Id.* at 934-36.

104. *Tyson Foods*, 919 A.2d at 583. This would make it highly unlikely that either set of directors would pursue claims against the other.

105. Conrad M. Black is also known as "Lord Black of Crossharbour," having renounced Canadian citizenship in 2001 to become a member of the House of Lords. *See Joe Schneider & Theophilos Argitis, Canada: Black Has No Clout*, CHI. TRIB., July 19, 2007, at C1 (describing how Black renounced his Canadian citizenship). He may seek to regain Canadian citizenship in the wake of his conviction on fraud charges in the United States. *Id.*

Hollinger, Inc., (Inc.) controlled 72.8% of the voting power in Hollinger.¹⁰⁶ Conrad owned over 65% of a private company, The Ravelston Corporation Limited (Ravelston), which owned about 78% of Inc.'s common stock.¹⁰⁷ He also served as Hollinger's chairman and CEO. Conrad's wife, Barbara Amiel, was a member of Hollinger's board and its Vice President, Editorial.¹⁰⁸ From 1999 through 2003, she received over \$1.1 million in salary and bonus payments from Hollinger, but an internal investigation found that she performed "no meaningful work" in return.¹⁰⁹

Conrad Black's extractions from Hollinger are of a type and magnitude readily made the subject of parody.¹¹⁰ They included cash compensation excessive by any reasonable standard, plus proceeds from the sale of corporate assets reallocated at Black's direction to undisclosed private side-payments to him and his allies under the guise of payments for covenants not to compete with the assets' purchasers. On the perquisites front, Conrad and Barbara Black made extensive private use of corporate aircraft,¹¹¹ while Conrad spent at least \$8.9 million of Hollinger's funds on papers and

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106. Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1031 (Del. Ch. 2004), *aff'd*, 872 A.2d 559 (Del. 2005).

107. *Id.* at 1031-33.

108. See Hollinger Int'l Inc., Current Report (Form 8-K), exhibit 99-2, at 48 (Aug. 30, 2004) (Report of Investigation by the Special Committee of the Board of Directors), *available at* <http://secinfo.com/dsvr4.1A52.c.htm> [hereinafter Hollinger Report]. During the same time, Hollinger also employed the daughter of its President, who worked as a journalist. She received one atypically large raise in salary at the direction of her father. See *id.* at 388 n.270.

109. *Id.* at 143-44. The committee's report characterized her description of her work as a vice-president as "nothing more than euphemisms for ordinary activities such as reading the newspaper, having lunch, and chatting with her husband about current events," and the salary and bonus as payments she would not have received but for her marriage to Conrad Black. *Id.* at 145.

110. Overall cash extractions by Black, Hollinger's COO, and their associates amounted to 95.2% of the company's adjusted net income between 1997 and 2003. *Id.* at 1. Coupled with material misstatements in securities filings, Black's extractions led to his conviction on federal criminal charges, including one count of obstruction of justice. In late 2007, Black was sentenced to six and a half years in prison. Tim Arango, *Black Given Prison Term over Fraud*, N.Y. TIMES, Dec. 11, 2007, at C1. In its post-Black era, Hollinger reached an agreement with its principal law firm to release malpractice claims in exchange for \$30 million. The law firm remains a defendant in three shareholder class actions in Canada. See Julie Triedman, *Caught in the Web*, AM. LAWYER, Aug. 2007, at 79, 80.

For another example of criminal consequences stemming from personal pecuniary benefits extracted from a publicly held family company, see *In re Adelphia Commc'ns Corp.*, No. 03-CV-5750, 2006 WL 2463355, at *3 (S.D.N.Y. Aug. 23, 2006). Adelphia itself remains in bankruptcy proceedings. Zach Fox, *Adelphia Bankruptcy Drags*, DENVER POST, July 10, 2007, at C1. Adelphia's founder, John Rigas, was sentenced to 15 years in prison following his conviction on federal securities- and bank-fraud charges. *Id.* His son, Timothy, who served as Adelphia's CFO, received a 20-year sentence. *Id.* John's poor health, not unrelated to his age (82), may lead to a reduction in his sentence. *Id.*

111. Most memorably, Conrad and Barbara used a Hollinger jet for a ten-day vacation in Bora Bora in French Polynesia. The cost was \$530,000, 50% of which appears to have been borne by Hollinger. See Hollinger Report, *supra* note 108, at 398-99.

On CEOs' private usage of corporate aircraft more generally, see David Yermack, *Flights of Fancy: Corporate Jets, CEO Perquisites, and Inferior Shareholder Returns*, 80 J. FIN. ECON. 211 (2006). Yermack's study found that in firms in which directors grant the CEO the perquisite of personal use of corporate aircraft, average shareholder returns underperform market benchmarks by about four percent annually, which greatly exceeds the direct cost of the aircraft usage. *Id.* at 213. However, sometimes the direct costs associated with private aircraft amount to a large number in relationship to the corporation in question, especially when acquiring or maintaining the craft lacks a convincing business justification. At Conrad Black's behest, between 1995 and 2003, Hollinger incurred total costs of \$61.3 million to acquire, maintain, and operate two jets.

other memorabilia associated with Franklin D. Roosevelt, the subject of a biography he wrote.¹¹²

The performance of Hollinger's board is also troubling. To be sure, some of the problematic transactions—such as the side-payments disguised as payments for noncompete agreements—were not disclosed to the relevant board committees. For other transactions, board committees acquiesced.¹¹³ Overall, Hollinger's board evidenced “consistent inaction” during the extractive sprees of Conrad and his managerial allies, in the assessment of a subsequent internal review.¹¹⁴ The Audit Committee, which was charged with reviewing the transactions between Ravelston and Hollinger through which Hollinger paid Ravelston for Conrad's managerial services, retained neither its own compensation consultant nor its own legal counsel.¹¹⁵ It asked no questions about components of the management fees and never inquired about the rationale for the noncompete fees to be paid to Conrad Black and other individual officers.¹¹⁶ Many members of the board had additional ties to the Blacks and to Hollinger that may help explain their quiescence. Some directors socialized with the Blacks,¹¹⁷ while Hollinger made generous donations to cultural and other non-profit organizations associated with several directors.¹¹⁸ The outside director who was a member of the board's Executive Committee understood the committee's function to be processing paper that would eventually be presented to the entire board.¹¹⁹ He also served as the well-compensated CEO of a Hollinger subsidiary engaged in private equity investing.¹²⁰

It is a fair question how a founder's dominance, or dominance by a founder's descendants, may contribute to inadequate performance by directors. Two basic lines of explanation seem evident: (1) the traits of individuals nominated for election to the board; and (2) the impact of board service on a director's orientation and conduct. Both explanations are plausible. Consider first the implications of Anderson and Reeb's 2004

Hollinger Report, *supra* note 108, at 394. The report of Hollinger's special board committee found these costs unwarranted once Hollinger sold the far-flung media properties that had furnished the jets' business rationale. *Id.* at 393-99.

112. Hollinger Report, *supra* note 108, at 373-74. He kept most of the FDR items in his private residences. *Id.* at 374. Some items in the FDR collection may have been worth much less than Conrad Black paid for them; he bought all through the same dealer in a series of transactions without obtaining prior appraisals. *Id.* In its post-Black era, Hollinger accepted an offer from Christie's auction house to sell a large portion of the collection (for which Black paid \$8 million) for \$2.4 million. *Id.* at 78-80, 385.

113. For example, two years following Black's \$8 million purchase of a large collection of FDR memorabilia, the board's Executive Committee—consisting of Black, Hollinger's president, and one outside director—approved the purchase in a telephonic meeting. *Id.* at 381.

114. Hollinger Report, *supra* note 108, at 31.

115. *Id.* at 32.

116. *Id.* at 32, 35.

117. *Id.* at 423. Social ties between an outside director and a controlling shareholder do not by themselves rebut the presumption that the director can act independently in assessing claims against the shareholder. *Beam ex rel Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1051-52 (Del. 2004).

118. Hollinger Report, *supra* note 108, at 423. Large philanthropic contributions by a controlling shareholder to a non-profit headed by a director sufficed to create reasonable doubts about the director's independence in *In re The Limited, Inc. Shareholders Litigation*, No. CIV.A.17148-NC, 2002 WL 537692 (Del. Ch. Mar. 27, 2002), and *Lewis v. Fuqua*, 502 A.2d 962 (Del. Ch. 1985).

119. Hollinger Report, *supra* note 108, at 483.

120. *Id.*

examination of corporate governance characteristics of publicly held family firms.¹²¹ Family firms had fewer nonaffiliated independent directors than did nonfamily firms. And greater family presence on the board's nominating committee was associated with a smaller fraction of independent directors on the board. Family dominance of the nominating committee may enable the selection of individuals believed less likely to be inquisitive about the merits of the family-endorsed practices. Second, the preceding narratives of governance failures within Tyson Foods and Hollinger are concrete illustrations of directors' entanglements that may lead to either acquiescent or nonchalant orientations toward self-dealing by members of controlling families. Once a director participates in transactions that compromise the likelihood that the director will be vigilant in the future, further participation—and less vigilance—may follow.

Moreover, effective service as an independent director requires sufficient access to information so that the director is aware of problematic situations and is able to ask hard questions about them. Informal practices of decision-making within family-influenced companies may have the consequence of keeping independent directors out of the loop of information flow until they are asked to ratify a decision made earlier and less formally, a phenomenon discussed in Part IV.B.4. Separately, an independent director's position may be paradoxical because maintaining an "outsider" stance relative to the family and the company's senior management may jeopardize the director's effectiveness, either because the director is excluded from the company's patterns of information-sharing and decision-making or because the director, perceived as an "outsider," lacks powers of persuasion. Key to resolving this paradox, at least some of the time, is the subjective orientation with which an independent director serves, discussed in Part IV.A.2.

IV. DISTINCTIVE FUNCTIONS OF INDEPENDENT DIRECTORS

The materials analyzed in Parts II and III, although disparate in methodology, carry evident implications for the roles and purposes best served by independent directors within family firms that have public equity investors. Recent events also demonstrate that independent directors are able to act independently of the demands of controlling shareholders to serve the objective of protecting the interests of noncontrolling shareholders. During deliberations of the Bancroft family over whether to sell Dow Jones Co. to News Corp. in response to News Corp.'s offer to buy all shares for \$60 per share, the trustee for a family trust holding 9.1% of the voting power in Dow Jones demanded that News Corp. pay a premium of 10-20% per share for the class of stock held by family members, and if necessary lower to \$58 the amount to be paid to public shareholders.¹²² Dow Jones's board indicated that it would not support any deal that treated family shares differently from nonfamily shares,¹²³ even if no sale were the consequence.¹²⁴ A person with knowledge of the Dow Jones board's deliberations said

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121. See *supra* text accompanying notes 63-70.

122. Richard Pérez-Peña & Andrew Ross Sorkin, *Family Shifts Add to Doubt at Dow Jones*, N.Y. TIMES, July 28, 2007, at C1.

123. See Matthew Karnitschnig et al., *Bancroft Wrangling Intensifies*, WALL ST. J., July 28, 2007, at A3 (stating that the "price differential" strategy is opposed by the Dow Jones board).

124. Pérez-Peña & Sorkin, *supra* note 122. To support such a pricing structure, said Dow Jones's

of the trust's demands: "in today's corporate governance, these guys are dinosaurs."¹²⁵

This Part begins with a brief discussion of the legal content of duties that directors owe to a corporation and then focuses on how best to understand independence in the context of boards of family-controlled firms. This Part then articulates several functions that independent directors might usefully and distinctively serve. Its discussion draws on a series of cases involving family firms.

A. Directors' Duties and Definitions of Independence

1. Directors' Duties

Directors of companies incorporated in Delaware have long been understood to owe duties of care, loyalty, and good faith to the corporation. The Delaware Supreme Court recently clarified the specific content and character of the duty of good faith. In *In re The Walt Disney Co. Derivative Litigation*,¹²⁶ the court divided the range of directors' duties into three categories for this purpose, emphasizing the negative (acting in bad faith) as a way of defining the positive (acting in good faith). At one end of the range, a director's conduct is in bad faith when it is "motivated by an actual intent to do harm" to the corporation.¹²⁷ At the opposite end of the range lies conduct involving only a failure to use due care, "taken solely by reason of gross negligence and without any malevolent intent."¹²⁸ Conduct that is negligent is not conduct in bad faith because statutory provisions that permit charter provisions that exculpate directors from liability¹²⁹ and empower the corporation to indemnify directors¹³⁰ differentiate between bad faith and a failure to act with due care. In the middle of the range is conduct that consists of an intentional (as opposed to a careless) disregard of duties or responsibilities, which would, in the court's assessment, constitute conduct in bad faith. In *Stone v. Ritter*, the court held that a failure to act in good faith does not result, "*ipso facto*, in the direct imposition of fiduciary liability."¹³¹ Instead, failing to act in good faith may result in liability because the duty to act in good faith is a subsidiary element of a director's "fundamental duty of loyalty."¹³²

Stone thus makes explicit that a director's duty of loyalty reaches more widely than

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chairman, would "invite" lawsuits from public investors who received the lower price. *Id.* News Corp. also rejected the possibility of a two-price deal and refused to raise the overall price of its offer. *Id.*

125. *Id.* (quoting unnamed source). Another account interpreted the demand, also made by trustees on behalf of another trust, as possibly a "tactic designed to flush out" a higher bid from News Corp. or even "stoked in part by opponents of the deal who want to cause delays," hoping that Rupert Murdoch would give up in frustration. Sarah Ellison & Matthew Karnitschnig, *Bancrofts' Jockeying over Murdoch Deal Goes Down to the Wire*, WALL ST. J., July 30, 2007, at A3. Although unusual, two-tiered pricing in merger and acquisition transactions is not unheard of. Reportedly from 1995 to mid-2007, in seven transactions shareholders with super-voting shares received more per share than other holders. Sarah Ellison & Matthew Karnitschnig, *Family Advisers Seek Votes to Clinch Dow Jones Deal*, WALL ST. J., July 31, 2007, at A3.

126. *In re The Walt Disney Co. Derivative Litig.*, 906 A.2d 27 (Del. 2006).

127. *Id.* at 64.

128. *Id.*

129. DEL. CODE ANN. tit. 8, § 102(b)(7) (2008).

130. *Id.* § 145(a)-(b).

131. *Stone v. Ritter*, 911 A.2d 362, 369 (Del. 2006).

132. *Id.* at 370 (quoting *Guttman v. Huang*, 832 A.2d 492, 506 n.34 (Del. Ch. 2003)).

transactions with the corporation in which the director has an individual and direct pecuniary interest. It also ties liability under the “good faith” rubric to conduct performed with scienter.¹³³ Applying these formulations, the court in *In re Tyson Foods, Inc. Consolidated Shareholders Litigation*, discussed in Part III.B, held that directors on Tyson’s compensation committee would have breached their duties of loyalty and good faith if, as alleged, they awarded options knowing the shares to be worth more than the strike price while purporting to make the awards in compliance with a stockholder-approved plan requiring options to have a market-value strike price.¹³⁴ Thus, a director acts in bad faith, although the director receives no personal benefit, when the director knowingly deceives the corporation’s shareholders.

2. Definitions of Independence

Donald Langevoort defines “independence” as “a subjective concept that connotes a willingness to bring a high degree of rigor and skeptical objectivity to the evaluation of company management and its plans and proposals.”¹³⁵ In the context of family-influenced public firms, independence also requires both the willingness and ability to sustain such “rigor and skeptical objectivity” when its object is sponsored by or especially beneficial to the family. Formal definitions of independence that identify objectively-determinable markers of independence are commonly used for regulatory purposes but cannot predict how well an individual who meets the definition’s criteria will perform. In particular, a prospective director whose perspective on the firm is defined by its controlling family may well satisfy formal definitions of independence but prove unable or unwilling to bring “rigor and skeptical objectivity” to bear.

General definitions of independence for public-company directors focus predominantly on criteria indicative of a director’s independence from the company’s management. For example, corporate governance rules adopted in 2002 by the New York Stock Exchange (NYSE) require that independent directors comprise a majority of the board and that the board’s audit, compensation, and nominating/corporate governance committees be composed entirely of independent committees.¹³⁶ However, if more than 50% of the company’s voting power is held by an individual, a group, or another company, the company (as a “controlled company”) may elect not to comply with these independence requirements, except those applicable to its audit committee.¹³⁷ The board must make an affirmative determination whether each of its members is independent, applying criteria that begin with whether the director has a material relationship with the company that would interfere with the exercise of responsible

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133. See *Desimone v. Barrows*, 924 A.2d 908, 935 (Del. Ch. 2007) (noting that *Stone* reinforced a “scienter-based standard”).

134. *In re Tyson Foods, Inc. Consol. S’holders Litig.*, 919 A.2d 563, 593 (Del. Ch. 2007). Although the plaintiffs did not sufficiently allege that members of the compensation committee lacked independence, the option grants would fall outside the bounds of the committee’s business judgment if, as alleged, its members acted in bad faith by deliberately deceiving Tyson’s shareholders. *Id.* On this basis, members of the compensation committee could be subject to individual liability for breach of fiduciary duty. *Id.*

135. Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797, 798 (2001).

136. NYSE, Inc., Listed Company Manual § 303A.01 (2004).

137. *Id.* intro.

judgment in carrying out a director's duties.¹³⁸ More specific criteria include an employment relationship, a nonemployment relationship under which the director or an affiliate has received substantial payments from the corporation, a family relationship with an executive officer of the corporation, or service as an executive officer of another entity with which the corporation has an economically material relationship.¹³⁹ The NYSE makes explicit that share ownership is not a relationship that precludes a determination that a director is independent.¹⁴⁰

However, not all regulatory definitions focus solely on criteria indicative of independence from management. SOX section 301(3), applicable to members of audit committees, defines independence for that purpose using two components: (1) a director may not accept any direct or indirect consulting, advisory, or other compensatory fees from the company other than fees for service as a director or member of the audit or other committee; and (2) a director may not be "affiliated" with the company or any of its subsidiaries.¹⁴¹ The SEC defines a person as a company's "affiliate" or "affiliated person" if the person controls the company, is controlled by it, or is under common control with it.¹⁴² A person is not deemed to control a company if the person is not the direct or indirect beneficial owner of more than ten percent of any class of voting securities of the company or an executive officer of such an owner.¹⁴³ As a consequence, a ten percent equity ownership threshold bars the door to audit committee service by such owners and their executive officers.¹⁴⁴ As noted above, a corporation that is a "controlled company" within the NYSE's definition may not exempt out of complying with the independence requirements applicable to audit committees.

The fact that an individual satisfies formal indicia of independence does not, of course, assure that the director might not have other ties that compromise the individual's ability to bring rigor and objectivity to bear as a board member. In contrast, judicial opinions that assess directors' independence—necessarily after the fact of a transaction or other incident that has prompted litigation—develop more nuanced analyses of independence focused on a range of circumstances that may impair the detached exercise of judgment.¹⁴⁵ Overall, the relationship between formal requirements that boards have independent directors and the likelihood that directors who meet formal definitional criteria of independence will, in fact, bring rigor and dispassionate judgment to bear has likely been strengthened by the widespread advocacy of director

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138. *Id.* § 303A.02(a).

139. *Id.* § 303A.02(b).

140. "[A]s the concern is independence from management, the Exchange does not view ownership of even a significant amount of stock, by itself, as a bar to an independence finding." *Id.* § 303A.02(a) cmt.

141. 15 U.S.C. § 78j-1(m)(3)(B) (2000 & Supp. V 2005).

142. Standards Relating to Listed Company Audit Committees, Securities Act Release No. 8220, Exchange Act Release No. 47,654, Investment Company Release No. 26,001, 68 Fed. Reg. 18,788 (April 16, 2003) (adopting definition in 17 C.F.R. § 240.12b-2 (2003)).

143. 17 C.F.R. § 240.10A-3(e)(ii)(A).

144. For a defense of this bar, see Deborah A. DeMott, *The Texture of Loyalty*, in *CORPORATE GOVERNANCE POST-ENRON: COMPARATIVE AND INTERNATIONAL PERSPECTIVES* (J. Norton et al. eds., 2006).

145. See, e.g., *Beam ex rel Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1049-50 (Del. 2004) (noting that "[i]ndependence is a fact-specific determination made in the context of a particular case").

independence as an important norm within corporate governance.¹⁴⁶ Although the family firm context is more complex, generalized advocacy of the importance of independence is no less likely to be persuasive.

B. Functions Served by Independent Directors

In Jeffrey Gordon's recent and comprehensive account of the rise of independent directors in public companies in the United States from 1950 to the present, he found that independent directors help assure that management will be responsive to signals generated by the stock market, while also, in the takeover context, slowing the pace of market activity when market-price signals may be unreliable.¹⁴⁷ Independent directors, in Gordon's account, are the centerpiece crucial to "a new corporate governance paradigm that looks to the stock price as the measure of most things,"¹⁴⁸ in particular as a measure of shareholder value. Increasingly informative market prices over this period enabled independent directors to assess senior management's strategy, looking to outside indicia of the firm's and management's performance.

Within this larger corporate panorama, the smaller vista of family-influenced firms is more complicated. Reality as defined by the family, in contrast to reality as measured by the market, may more readily capture a director's vision even when the director satisfies formal definitional criteria of independence.¹⁴⁹ Moreover, the many and disparate benefits of holding and exercising control make "maximizing shareholder value" less of a unifying norm for directors, whether or not defined to be independent. Finally, influence over the selection of directors exercised directly or indirectly by the family may call into question how effective independent directors will be as champions or protectors of public shareholders.¹⁵⁰

Nonetheless, complexity does not always result in a gloomy outcome. It is possible to identify several functions that independent directors are uniquely positioned to exercise that are useful counterweights to the presence and influence of controlling shareholders within family firms. These include: (1) vigilance on behalf of the interests of public shareholders; (2) furnishing a reality check that may helpfully complement or challenge the perceptions of management and the controlling family and that may protect the primacy of the firm's business needs and interests, while assuring that high-level decision-making is not dominated by spillover from intra family dynamics; (3) serving an intermediary function between the controlling family and senior

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146. See Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1499-1500 (2007) (noting the significance of the "constant advocacy of director independence"). Of course, other factors may also heighten the likelihood that a director will act independently. On the likely impact of the SOX legislation and its aftermath in reorienting directors' allegiances away from management, see Donald C. Langevoort, *The Social Construction of Sarbanes-Oxley*, 105 MICH. L. REV. 1817, 1847-50 (2007).

147. Gordon, *supra* note 146, at 1470-71.

148. *Id.* at 1472.

149. See *id.* at 1499 (acknowledging that "independence is more a disposition, a state of mind, than a concrete fact").

150. See Donald C. Clarke, *Three Concepts of the Independent Director*, 32 DEL. J. CORP. L. 73, 80 (2007) ("[G]iven that corporate law is generally designed to give the largest shareholders the largest voice in choosing directors, it is hard to see how directors representing minority shareholders could be elected to the board in the first place, unless the basic principles of director selection were changed.").

management, whether or not members of the family; and (4) reinforcing formal institutions and practices of governance. Independent directors' positioning is unique because no other set of actors within the corporation is systematically unaffiliated with its senior management and controlling shareholders. Ideally, some of the functions performed by independent directors will at least be facilitated by the corporation's general counsel. Although it is clear that the object of counsel's duties is the corporation and not any constituent (including the CEO or members of the founding family), realities for general counsel may prove to be more complicated.¹⁵¹

1. Vigilance

Actions taken by independent directors may demonstrate the exercise of vigilance on behalf of the firm's public shareholders, as in the refusal of Dow Jones's board to accede to demands that some or all shares owned by Bancroft family trusts be acquired by News Corp. at a higher price even if the consequence was to lower the price received by holders of nonfamily shares. To be sure, a possible consequence of the board's refusal was that no sale at all would occur, which would disappoint any public shareholder willing to sell at a price less than the \$60 per share offered by News Corp. But once News Corp. offered \$60 for all shares, acceding to demands for a higher price for family shares, especially as a direct trade-off in exchange for a lower price for public shares, would require that the board explicitly extract value from Dow Jones's public investors to benefit its controlling shareholders.

More generally, vigilance by independent directors should extend to legally problematic self-dealing between the controlling shareholder and the corporation, as seems not to have happened in the cases discussed in Part III.B. An independent director's alertness and willingness to question and object may lead a controlling shareholder to abandon a proposed course of action or to undo what has already been done. Vigilance in this form also forces the hand of a recalcitrant controlling shareholder by forcing an explicit confrontation. A controlling shareholder who retaliates against a vigilant independent director, for example by removing the director from the board, has taken a visible step that may attract unwanted external attention. This risk may inhibit retaliation or channel it into less immediate or visible measures.¹⁵²

It is also demonstrable that independent directors can negotiate effectively on behalf of public shareholders when the controlling shareholder proposes to cash out the public equity in a going-private transaction, depending of course on how powerfully the directors are armed with negotiation tactics, including the power to reject the transaction.¹⁵³ Noting that noncontrolling shareholders also have the power to trigger

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151. For example, the general counsel of the drugstore chain Rite Aid engaged in backdating and other illegal practices in an unsuccessful attempt to hide misconduct by the founder's son who served as Rite Aid's CEO. For a full elaboration, see Deborah A. DeMott, *The Discrete Roles of General Counsel*, 74 FORDHAM L. REV. 955, 975-77 (2005).

152. See *supra* text accompanying note 88.

153. See Gilson & Gordon, *supra* note 90, at 839 (discussing a proposal that would give a special committee's decision to reject an offer more power). For a more skeptical view, see Faith Stevelman, *Going Private at the Intersection of the Market and the Law*, 62 BUS. LAW. 775, 898-900 (2007) (explaining that "there are no empirical studies that support the conclusion that committees can reject unfair freezeout proposals").

judicial scrutiny of the transaction's fairness, Delaware's Court of Chancery observed that "the threat of bare knuckles litigation over fairness is not as important as the special [directors'] committee's role as a negotiating force."¹⁵⁴ To be sure, pending litigation may spur greater aggression by independent directors as negotiators, but that possibility is not inconsistent with their capacity to negotiate effectively on behalf of public shareholders.

2. Reality Checks

Beyond scrutinizing explicit instances of self-dealing, independent directors may also focus boardroom discussion on business questions and how best to resolve them. Independent directors may do this by providing a reality check distinct from the family-defined perspective. This extrafamilial perspective is especially salient in two instances: (1) transactions that may shift equity control of the corporation; and (2) CEO succession.

a. Family Identity and Transactions in Control

A public company's ongoing association with its founding family may raise difficult questions for the board's independent members in connection with transactions—whether friendly or hostile—that will shift equity control of the firm. A different owner of the firm's controlling equity stake may, of course, determine to "alter materially the nature of the corporation,"¹⁵⁵ including fundamental changes in its business activities and practices. Also likely to follow are changes in the composition of the firm's board of directors and, potentially, its senior management. Although it is clear that such changes may be in the interests of the company's nonfamily shareholders, it is also evident why they may be resisted by family members serving on the board and within senior management. Moreover, public shareholders may challenge the value of maintaining family control and the appropriateness of tactics that directors may deploy toward that end. Three Delaware cases of different vintages are illustrative of boards that appear to have understood reality too exclusively from the perspective of the founding family.

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154. *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 631 (Del. Ch. 2005). The evidence supporting this proposition is the absence of any refusal to settle by "traditional" plaintiffs' lawyers "once they have received the signal that the defendants have put on the table their best and final offer—i.e., an offer that is acceptable to the special committee." *Id.* Some assessments of the performance of committees of independent directors as negotiators in the MBO context of the 1980s were less than sanguine. See William T. Allen, *Independent Directors in MBO Transactions: Are They Fact or Fantasy?*, 45 BUS. LAW. 2055, 2062 (1990) (noting that process may be subverted by professional advisers who substitute "theatre" for facilitating the service of "informed, energetic and committed" service by directors). Nonetheless, it has long been recognized that shareholders are at a disadvantage when they are presented with a self-interested transaction negotiated by interested directors and given the opportunity to approve or disapprove the transaction without having had a disinterested representative at the bargaining table. See Harold Marsh, Jr., *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 BUS. LAW. 35, 49 (1966) (explaining that shareholders can only accept or reject a proposed transaction and "cannot as a practical matter negotiate for the corporation").

155. *Paramount Commc'ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 43 (Del. 1994).

Consider first *Cheff v. Mathes*,¹⁵⁶ best known for the Delaware Supreme Court's first articulation of standards and burdens applicable in litigation that challenges actions taken by directors to defeat or frustrate a challenge to their incumbent control. Shares in the target company, Holland Furnace Co. (Holland), were listed on the New York Stock Exchange.¹⁵⁷ Its CEO at the time, Paul Cheff, was the son-in-law of the firm's founder. Due to declining sales, Holland's business (and the price at which its stock traded) had not thrived.¹⁵⁸ A block of shares was assembled by an investor who proposed changes in Holland's sales patterns.¹⁵⁹ Investigation by the board determined that the investor had an established business pattern of acquiring control of companies and liquidating them. Holland's board perceived the investor's stake as a threat to Holland, its policy, and its effectiveness. The board had seven members: Paul Cheff; his wife, Katharine; Katharine's nephew; Holland's outside lawyer; its investment banker; and two CEOs of unrelated corporations.¹⁶⁰ The investor expressed willingness to sell his Holland shares to Katharine's family's investment bank, adding to its existing 19% ownership stake in Holland.¹⁶¹ Although a majority of the bank's directors supported making the acquisition, its finance committee referred the offer to Holland's board on the basis that it was of primary interest to the company.¹⁶² Holland's board authorized the purchase of the stake at a price per share slightly above market price (an early "greenmail" transaction) although the board knew that the family investment firm would make the purchase if Holland itself failed to do so.¹⁶³ Funding Holland's repurchase required substantial borrowings from commercial banks.

Cheff v. Mathes is best known for its articulation of the showing that directors must make when they authorize a share repurchase and the consequence is maintaining themselves in office and control.¹⁶⁴ The court held that Holland's directors established that they reasonably believed the unwelcome investor represented a threat to the

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156. *Cheff v. Mathes*, 199 A.2d 548 (Del. 1964).

157. *Id.* at 551.

158. *Id.* at 550-51.

159. Holland was unique in the furnace industry in selling directly to consumers through an employed sales force, some 8500 strong, as opposed to distributing furnaces through intermediate dealers. *Id.* at 550-51. At the time of the transactions involved in the case, Holland was under investigation by the Federal Trade Commission (FTC) because its sales personnel, when visiting customers' homes, would sometimes misrepresent themselves as heating engineers, proceed to dismantle the furnace, refuse to reassemble it claiming it to be defective, and then close the sale of a new furnace. *In re Holland Furnace Co.*, 55 F.T.C. 55, 1958 FTC LEXIS 65, at *20-22 (1958). The aftermath of the FTC's investigation eventually led to Paul Cheff's incarceration for willful disregard of a cease-and-desist order. *Cheff v. Schnackenberg*, 384 U.S. 373, 375-78 (1966).

160. *Cheff*, 199 A.2d at 550.

161. *Id.* at 552.

162. *Id.*

163. *Id.*

164. Under *Cheff v. Mathes*, directors have the burden of establishing that they had reasonable grounds to believe in the existence of a threat to corporate policy and effectiveness. If the burden is met, the directors' decision is protected as an exercise of business judgment and spared after-the-fact scrutiny of its merits by the court. *Id.* at 555. *Cheff* thus erects a threshold—albeit one often surmounted—to the protective embrace of the business judgment rule because ordinarily directors are presumed to have acted in good faith, in a sufficiently informed manner, and without conflicting interests. For a more recent example of a selective repurchase targeted at a single dissident shareholder, see *Grobow v. Perot*, 539 A.2d 180 (Del. 1988) (discussing General Motors's attempt to buy out Ross Perot).

corporation and that their motivation for authorizing the stock repurchase was proper. Although Paul Cheff and the company's lawyer, as directors, had more direct financial interests in repelling the perceived threat, that fact did not preclude a finding that the board acted with a proper motive. It seems likely that the family dimensions of Holland shaped what the board perceived and how it reacted. Holland's seven-member board included three members of the founding family, plus the corporation's lawyer and its investment banker. The board repurchased the unwelcome investor's stock, all the while knowing that the family's own investment bank was willing to make the purchase by using its assets and not those of Holland itself. Thus, the board appears to have believed that maintaining family control was of sufficient value to Holland to warrant the expenditure of corporate funds. Given the firm's poor performance and its associated legal problems, the board appears not to have questioned the wisdom of so tightly tying its understanding of the company's identity and interests to those of the founding family. Although the court held that the directors acted within the scope of their business judgment by paying greenmail to repel a threat to the firm's incumbent family management, it is open to debate how that decision would fare in a boardroom in which the implications borne by market signals had a vocal proponent. The market is, as Jeffrey Gordon argues, an important measure of reality,¹⁶⁵ and independent directors may be more receptive to the implications of the information impounded in the corporation's share price than are members of management and the controlling family.

A more recent case, *In re Topps Co. Shareholders Litigation*,¹⁶⁶ illustrates that directors may attempt to assure a firm's family identity even in the context of selling equity control of the firm, a context in which directors of a Delaware company have a well-established duty to take reasonable measures to assure that shareholders receive the highest value that is reasonably attainable.¹⁶⁷ Topps's CEO, Arthur Shorin, is the son of Joseph Shorin, one of the firm's founders and inspiration for the firm's eponymous "Bazooka Joe" brand.¹⁶⁸ Arthur's son-in-law, Scott, serves as Topps's President and Chief Operating Officer. Arthur owns about seven percent of Topps's equity. Following flagging performance and a threatened proxy contest in 2005, the board explored strategic options, including a sale of the firm's confectionary division. When no serious buyer for the division emerged through an auction, Arthur began negotiations with a prospect potentially interested in acquiring the entire firm through a negotiated going-private merger. Shortly before the board's approval of a merger agreement with this acquirer, a competitor of Topps in the trading card business expressed willingness to make an offer. After Topps signed the merger agreement without replying to the competitor, a "Go Shop" period followed under the merger agreement during which Topps was free to seek other bidders. The only serious bidder was Topps's competitor, which offered \$10.75 per share. This bested the \$9.75 price set in the merger agreement.

Nonetheless, Topps's directors refused to treat the competitor's offer as a "Superior Proposal," a defined term in the merger agreement that would require the merger partner

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165. Gordon, *supra* note 146, at 1541, 1563.

166. *In re Topps Co. S'holders Litig.*, 926 A.2d 58 (Del. Ch. 2007).

167. See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) (holding that when the sale of the company becomes inevitable, the duty of the board of directors becomes one of maximizing the company's value at a sale for stockholders' benefit).

168. *Topps*, 926 A.2d at 60.

to match the price or desist.¹⁶⁹ Topps's directors also refused to release the competitor from the standstill provision that prevented it from making a tender offer to Topps's shareholders,¹⁷⁰ an element of the agreement under which the competitor had conducted its due diligence investigation into Topps following its bid during the "Go Shop" period.¹⁷¹ Topps's public statements also disparaged the competitor's bid. The court enjoined a shareholder vote on the merger agreement until Topps issued corrective disclosures about its dealings with the bidders and waived the standstill agreement, holding that a trial would likely establish breaches of fiduciary duties by Topps's directors.¹⁷²

The directors' likely motivations are revealing. In the court's assessment of the record, Arthur Shorin "was never enthusiastic about the idea of having his family company end up in the hands of an upstart rival."¹⁷³ The merger partner, in contrast, assured "continuity of management and involvement of the Shorin family going forward"¹⁷⁴ through an agreement that encompassed Arthur's retirement as CEO to become a consultant to Topps within 60 days following consummation of the merger and the continuing presence of Arthur's son-in-law Scott as a member of Topps's senior management. The court noted that Arthur and Scott appear by all accounts to have track records as skilled and successful executives and acknowledged that founders and their descendants may value their family's legacy of control in non-monetary terms, viewing it as an assurance that the firm's corporate culture will remain intact, assuring the quality of its products or the fair treatment of its employees and consumers.¹⁷⁵ It is unsurprising that nonfamily members of a corporation's board might share these beliefs. But once the board initiates a sale of control, the emergence of a higher price by a less favored acquisition partner requires engagement by the board with the higher bidder to determine whether its offer is truly superior to the deal negotiated with the preferred partner.¹⁷⁶ The value of assuring family control does not trump the board's duties to act reasonably to secure the best deal for all shareholders, a perspective that may find its most likely advocates in directors who act independently of management and the founding family.

As noted, although Topps was a family-run public company, family equity ownership amounted to only about seven percent. This fact would make the firm vulnerable to a hostile take-over bid—one not supported by its incumbent directors—unless the firm had a dual-class share structure that allocated sufficient voting power to members of the family, which Topps did not. Invulnerability to a hostile take-over bid may explain some of the negative association between firm value and the "wedge" between voting rights and cash-flow rights identified by Gompers et al.¹⁷⁷ But retaining family control through a dual-class structure imposes a discount on the price at which

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169. *Id.* at 62.

170. *Id.* at 91-92.

171. *Id.* at 66.

172. *Id.* at 92-93.

173. *Topps*, 926 A.2d at 90.

174. *Id.* at 91.

175. *Id.* at 90.

176. *Paramount Commc'ns, Inc. v. QVC Networks, Inc.*, 637 A.2d 34, 43-44 (Del. 1994).

177. *See supra* text accompanying notes 60-61.

the public shares will trade.¹⁷⁸

Consider in this light the judicial condemnation of a particularly aggressive defense against hostile bids—the “dead hand” poison pill—in *Carmody v. Toll Brothers, Inc.*¹⁷⁹ Founded in 1967 by two brothers, Bruce and Robert Toll, the firm is a successful builder of luxury homes. It went public through an IPO in 1986. By 1997, Bruce and Robert served as the firm’s CEO and COO and, between them, owned about 37.5% of the company’s one class of common shares.¹⁸⁰ The board had nine members: Bruce, Robert, two other senior officers, a partner in the company’s outside law firm, plus four other members.¹⁸¹ Despite Toll Brothers’s business success, its stock traded in mid-1997 at the low end of its established range. In light of conditions generally in the home-building industry, the board feared the company might become an acquisition target for others in the industry.¹⁸² The board responded by adopting a poison pill designed to push the outer limits of accepted practice.

When a board adopts a poison pill, it adopts a plan under which it will subsequently issue rights respecting shares with features that are subject to the occurrence of a trigger event, such as a hostile bid, the acquisition by a third party of a stated fraction of the company’s shares, or a merger between the issuing company and another. The rights entitle their holders (parties whose conduct triggers the pill are excluded by its terms from any entitlement to receive rights) to acquire shares at a highly discounted price.¹⁸³ But—the prelude to the Toll Brothers’s pill—a company wishing to acquire control of another over the opposition of its directors might seek to persuade the target’s shareholders to elect directors who will be sympathetic to putting the target in play and who will vote accordingly to redeem the rights created by the poison pill. Anticipating this contingency, the pill adopted by Toll Brothers’s directors had a “dead hand” feature providing that only directors in office when the pill was adopted, or their designated successors, had authority subsequently to vote to redeem the pill.

The court held that the “dead hand” feature was illegal on several grounds. By adopting the pill the directors unilaterally created distinctions in voting power among directors, while the Delaware corporation statute requires authorization for such distinctions in the corporation’s certificate of incorporation.¹⁸⁴ The pill also impermissibly coerced shareholders into voting for candidates for the board who were endorsed by incumbent directors because only such nominees would have full voting authority as directors. Finally, adopting a pill with “dead hand” features also breached the directors’ fiduciary duties in connection with takeover defenses because the feature purposefully disenfranchised Toll Brothers’s shareholders with no compelling reason to do so,¹⁸⁵ while also precluding the possibility of a successful proxy challenge to the

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178. Gompers et al., *supra* note 32, at 15

179. *Carmody v. Toll Brothers, Inc.*, 723 A.2d 1180 (Del. Ch. 1998).

180. *Id.* at 1182

181. *Id.*

182. *Id.* at 1182-83.

183. A pill’s “flip-in” feature entitles the holder to acquire more shares in the company that issued the rights, the bargain price assuring that the value of any shares held by the party whose conduct triggered the pill will be reduced in value. A pill’s “flip-over” feature creates an entitlement to acquire, at a bargain price, shares in the company whose conduct triggered the pill.

184. DEL. CODE ANN. tit. 8, § 141(d) (2008).

185. The “compelling justification” standard was articulated in *Blasius Indus. v. Atlas Corp.*, 564 A.2d

incumbent directors' control. The court's reaction cannot have come as a complete surprise to the company's directors and their legal advisors, given the aggressive novelty of the "dead hand" feature.

Thus, the fact that Toll Brothers remained a family company under many of the definitions discussed in Part II did not legitimize action by its directors that disenfranchised the company's public shareholders. Although Bruce and Robert's combined shareholding was large (37.5%), the company's single-class structure left open the possibility that a majority of shares and of voting power might be assembled over their opposition. Given the discount assigned by the market to publicly traded shares in dual-class firms,¹⁸⁶ the "dead hand" pill adopted by Toll Brothers looks like an after-the-fact maneuver that would impose one of the consequences of a dual-class scheme on public shareholders, one in which discrimination formally occurs at the level of voting by directors but costs are disproportionately borne by public shareholders who invested into what appeared to be a firm with shares carrying equal voting rights. Instead, at least as to the prospect of a hostile takeover bid, the firm acquired an "extreme governance"¹⁸⁷ trait associated with dual-class shares. Had this trait been present when public investors bought shares, it would likely have attracted a market discount. The court's prohibition of "dead hand" pills thus constrains a post-IPO loophole to the efficacy of market responses to an equivalent of dual-class extreme governance.

b. CEO Succession and Tenure

Whether an independent director performs a reality-check function is also important when questions of management succession are on the table. Some possibilities, such as appointing a nonfamily CEO to succeed a founder or a founder's descendant, may merit serious consideration when viewed objectively, but may be so fraught with implications internal to the family that they will receive their due only if pressed by members of the board. Keeping management within the family, although not an illegitimate benefit of control, may systematically be valued by family shareholders, but not by nonfamily equity investors. Indeed, Douglas Baird and Robert Rasmussen argue that the most important challenge that directors confront is "the challenge of hiring and firing managers" and not the reduction of agency costs once those managers have been chosen.¹⁸⁸ When the question is intrafamily succession in management at the top, in the absence of effective service by independent directors the board may focus too readily on whether the designated family successor will be "good enough" as the firm's CEO. This is not the same conversation as whether the designated successor represents the "best" available choice.¹⁸⁹

651, 661 (Del. Ch. 1988).

186. In general, most investors expect discounted prices in firms in which control-enhancing mechanisms are in place. See EU PROPORTIONALITY REPORT, *supra* note 9, at 139 (finding that 80% of investors surveyed in the study expect a discount on the share price of companies with control-enhancing mechanisms).

187. The term "extreme governance" comes from the title of a paper by Paul Gompers and his co-authors. See Gompers et al., *supra* note 32.

188. Douglas Baird & Robert Rasmussen, *The Prime Directive*, 75 U. CIN. L. REV. 921, 923 (2007).

189. A separate question is whether a preference for succession by founding-family CEOs deprives the firm of general managerial abilities that may be enhanced by prior service as CEO of another public firm. See

Likewise, if it is difficult for boards to fire CEOs due to commitment biases in judgment that stem from having made the decision to hire an individual as CEO,¹⁹⁰ family-company boards may even more readily overlook the shortcomings of a CEO who is a family member. An independent director, free of family allegiances, may more readily recognize when change is needed. It is relevant that public-company CEOs view firing as a sufficiently salient risk to bargain for contractual protection from firing without just cause. In a recent study of public-company CEOs' employment agreements drawn from a large sample of S&P 1500 companies, Stewart Schwab and Randall Thomas found that almost all gave the CEO greater rights against the company in the event of termination without cause.¹⁹¹ Their study does not differentiate between family and nonfamily public firms. An interesting avenue for further inquiry would be determining whether family-company CEOs differ in the contractual protections they obtain and whether nonfamily and family CEOs diverge in the degree to which they obtain contractual security against the risk of termination without just cause. Family firms no longer under the control of their founder are believed to act more slowly to replace executives who do not perform well,¹⁹² a belief that may shape the contractual protections for which executives negotiate. Perceived family loyalties, that is, may substitute for formal contractual assurances.

3. Intermediating Between Management and Family Shareholders

Independent directors often serve an intermediary function between the company's senior management and its shareholders, whether or not members of the founding family.¹⁹³ Two dimensions of this function are insulating senior management from an overbearing founder and intermediating within the board between management and family directors, some of whom may become estranged both from management and other family members.

a. Independent Directors and Founders

*Benihana of Tokyo, Inc. v. Benihana, Inc.*¹⁹⁴ is a good recent example of tensions

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Kevin J. Murphy & Ján Zábónik, *Managerial Capital and the Market for CEOs* (Apr. 2007) (unpublished manuscript) (examining the effect of hiring CEOs from outside corporations), *available at* <http://ssrn.com/abstract=984376>. Within S&P 500 firms from 1970-2005, this study found an association between higher levels of CEO compensation and hiring from outside the firm, attributing it to the higher value of generalized managerial experience as opposed to firm-specific exposure. *Id.* at 10-11. The study did not separately study family-controlled firms within the S&P 500 cohort. *Id.* at 1-7 (outlining the scope of the study). It is possible, of course, that some founding-family members who become CEOs of family firms have had high-level managerial experience in other public companies.

190. See *id.* at 27 (discussing another study that suggests that board members are loyal to their CEOs for nonbusiness related reasons).

191. Stewart J. Schwab & Randall S. Thomas, *An Empirical Analysis of CEO Employment Contracts: What Do Top Executives Bargain For?*, 63 WASH. & LEE L. REV. 231, 266 (2006).

192. See Dvorak & Badal, *supra* note 1 (suggesting that either family loyalties or not knowing "when to pull the trigger" may explain delays).

193. Bengt Holmstrom, *Pay Without Performance and the Managerial Power Hypothesis: A Comment*, 30 J. CORP. L. 703, 711 (2005).

194. *Benihana of Tokyo, Inc. v. Benihana, Inc. (Benihana I)*, 891 A.2d 150 (Del. Ch. 2005), *aff'd*, 906 A.2d 114 (Del. 2006).

between, on the one hand, a corporation's founder and, on the other, its senior management, board of directors, and various of the founder's descendants, all accompanied by divisions internal to the founder's family. Rocky Aoki, who emigrated from Japan to the United States in the early 1960s, founded the Benihana chain of restaurants in 1964.¹⁹⁵ The firm was organized with a holding company—Benihana of Tokyo, Inc.—in which Rocky was the sole shareholder. Its subsidiary, Benihana, Inc., is a public company whose shares trade on NASDAQ.¹⁹⁶ The board had nine members (including Rocky's son, Kevin), each elected for three-year staggered terms.¹⁹⁷ The holding company owned 50.9% of Benihana's common and 2% of the Class A stock. Following Rocky's guilty plea in 1998 to insider trading charges not related to Benihana, he transferred ownership of his 100% stake in the holding company to a trust. Three of his children and Benihana, Inc.'s general counsel served as trustees.¹⁹⁸

Family developments proved to have corporate repercussions. In 2003, Rocky revised his will to transfer control over the trust to his third wife, upsetting his children as well as Benihana, Inc.'s CEO, who was not a family member. Rocky refused to meet with his children except in the presence of counsel.¹⁹⁹ Strife internal to the Aoki family coincided with business and financial challenges for Benihana, Inc. Many of its restaurants had become outmoded and the estimated cost of renovations was at least \$56 million, which the corporation was unable to fund from its existing lines of credit. Benihana's best option, in the opinion of an investment banker retained by senior management, was to issue \$20 million in convertible preferred stock, given relatively favorable conditions in equity markets.²⁰⁰ An investment bank affiliated with one of Benihana's directors expressed interest in acquiring the preferred stock. Following negotiations between the director and Benihana's investment banker, the preferred stock was structured to give the investor rights which, inter alia, had the consequence of diluting the holding company's stake to less than an outright majority.²⁰¹

Rocky, outraged when he learned about the transaction's terms, demanded through his lawyer that Benihana's board seek other financing options. After the board nonetheless approved the transaction, the holding company sued all of Benihana's directors (except Keith Aoki, against whom Rocky reportedly had another lawsuit pending),²⁰² plus the investment bank that purchased the shares. Delaware's Court of

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195. Now the leading Asian restaurant chain in the United States, Benihana's uniqueness was based on then-novel table-side antics by chefs, including knife- and shrimp-tossing. Rocky also claims to have invented green-tea ice cream and the saketini drink. See Logan Hill, *Rocky's Family Horror Show: Rocky Aoki and His Feuding Heirs Are Bringing Out the Knives, to Slice and Dice His Benihana Fortune*, N.Y. MAG., Oct. 29, 2006 (explaining Rocky Aoki's rise to fame), available at <http://nymag.com/guides/money/2006/23465/>.

196. Benihana, Inc. was organized with two classes of shares, Class A and common. Class A stock had one-tenth of a vote per share and was entitled to elect 25% of the board of directors. *Benihana I*, 891 A.2d at 156.

197. Under Delaware law, where Benihana, Inc. was incorporated, its directors would not be removable by a shareholder vote except for cause. See DEL. CODE ANN. tit. 8, § 141(k) (2008).

198. *Benihana I*, 891 A.2d at 156.

199. *Id.* at 159.

200. *Benihana of Tokyo, Inc. v. Benihana, Inc. (Benihana II)*, 906 A.2d 114, 117 (Del. 2006).

201. The preferred stock was structured to give its holder the right to elect one director, plus the right to elect another if Benihana failed to pay dividends for two consecutive quarters. The preferred stock also gave the holder immediate "as if converted" voting rights, which diluted the holding company's stake. *Id.* at 118.

202. Hill, *supra* note 195.

Chancery, affirmed by its Supreme Court, held that the board's approval of the preferred stock financing was a valid exercise of its business judgment. The court held that the directors' primary purpose in approving the transaction was providing what they subjectively believed to be the best financing to meet Benihana's business needs.²⁰³ Only one director—the purchaser's affiliate on the board—had an individual interest in the transaction, which he sufficiently disclosed to his fellow directors. That the transactions also diluted the holding company's position and voting control did not disqualify the board's decision as a valid exercise of business judgment, nor did Rocky's opposition as the company's founder.

Thus, a corporation's identification with a family and with its founder assures neither the implementation of the founder's wishes nor his control over decisions made by the corporation's directors. Benihana's directors, in contrast with others discussed earlier within this Part, discharged their duties with an orientation toward the business and financial needs of the corporation, which enabled action outside the founder's frame of reference. Had the board instead acceded to Rocky's opposition, at best any solution for Benihana's financial needs would have been delayed.

b. Family Rebels on the Board

An intriguing—if small—number of directors of family companies are dissident members of the founding family who act in opposition to the firm's senior management and management's allies among other family members. Directors in this group may have distinctive understandings of the company's business and its ongoing legacy. A prominent example is Walter Hewlett, a director for 15 years of the Hewlett-Packard Co. (H-P) and son of Bill Hewlett, the company's co-founder. Walter participated in the unanimous vote of H-P's directors to acquire Compaq Corporation through a merger.²⁰⁴ Following the companies' public announcement of the merger, but prior to the shareholders' meetings requisite to approval, Walter decided to vote against the merger at the H-P shareholders' meeting. H-P's then-CEO suggests in a memoir that perhaps Walter "thought the memory of his recently-deceased father would fade too quickly in the new company, particularly since Compaq employees would have no historical connection to Bill and Dave [Packard] at all."²⁰⁵ Having publicly announced his opposition to the merger, Walter began a proxy contest in opposition to H-P's solicitation of shareholders' authority to vote in favor of the merger. He questioned whether the merger would deliver the enhanced value claimed by H-P's (nonfamily) senior management. After H-P's shareholders approved the merger by a slender but legally sufficient margin, Walter sued, challenging the validity of the vote. Although he lost, the trial revealed a troubling (and embarrassing) incident in which a bank, seeking H-P's business, switched its voting position on shares it held for clients in a fiduciary capacity following a direct solicitation by H-P's CEO.²⁰⁶

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203. *Benihana II*, 906 A.2d at 114, *aff'g Benihana I*, 891 A.2d 150.

204. H-P's then-CEO reports that Walter was "the quietest person in the room" during the nine months when the board deliberated on the Compaq acquisition and that "[h]e was also the only member of the Board who missed meetings." CARLY FIORINA, *TOUGH CHOICES: A MEMOIR* 239 (2006).

205. *Id.* at 247.

206. *Hewlett v. Hewlett Packard Co.*, No. CIV.A.191513-NC, 2002 WL 818091, at *14 (Del. Ch. Apr. 30,

Turbulence associated with The Walt Disney Company also featured a dissident director, Walt Disney's nephew, Roy E. Disney. In addition to serving as a director for many years, Roy headed the firm's animation division, the home of its original product line (animated films), which furnished many of Disney's iconic figures and images. Roy became disillusioned with the company's senior management and its business plan. Disney's CEO demanded Roy's exclusion from animation meetings, following a series of aesthetic and business disagreements between them.²⁰⁷ Roy's estrangement from Disney's CEO became even more pronounced when he was informed he would not be renominated to the board.²⁰⁸ Roy then resigned from the board and, associated with another former director and long-term ally, they made innovative use of the internet to rally shareholder opposition to the re-election of four of the company's incumbent directors, in particular its CEO.²⁰⁹ A record number of Disney's shareholders withheld consent to vote their shares to re-elect the CEO as a director, followed soon thereafter by the CEO's announcement that he would retire.²¹⁰

Roy Disney, like Walter Hewlett, exemplifies the complications that may be present in one family member's ties to a company. Both were major shareholders and directors, once allied with nonfamily management, who became management's fiercest critics and adversaries. Many factors may motivate such a shift, including possible resentment at exclusion from more effective power within the company. Additionally, both Roy and Walter appear to have been motivated by fidelity to an understanding of their company's culture and core commitments, an understanding that may have diverged from that of senior management and of shareholders more generally. On both boards, though, the dissident directors' impact was muted by the presence of a cohort of independent directors who supported senior management. To be sure, with the benefit of hindsight, the degree of insulation furnished to management by independent directors may prove unwise. Thus, it is telling that Roy Disney's success in forcing the retirement of Disney's incumbent CEO came in the wake of the blunt instrument of a proxy contest as opposed to Roy's service as a Disney director.

4. Formal Institutions and Practices of Governance

A separate function that independent directors may serve is attentiveness to the value of formal institutions and practices of corporate governance. Even though a family company has public shareholders, it may prove tempting to operate more informally than public-company norms expect. Lack of transparency may result, as may an inability to adequately establish after the fact how decisions were made. One key aspect of informality is a mismatch between formal titles and how power is in fact allocated

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2002).

207. JAMES B. STEWART, *DISNEYWAR* 415 (2005).

208. *Id.* at 1-4. Earlier, the CEO had cultivated Roy, leading an astute observer to note that "[i]n many ways, keeping large shareholders happy is eminently sensible from management's perspective, but it raises the additional issue in considering reform of shareholder powers of any existing unequal treatment of different shareholders." Kenneth M. Rosen, *Mickey, Can You Spare a Dime? DisneyWar, Executive Compensation, Corporate Governance, and Business Law Pedagogy*, 105 MICH. L. REV. 1151, 1165 (2007) (reviewing JAMES B. STEWART, *DISNEYWAR* (2005)).

209. STEWART, *supra* note 207, at 493-94, 502-04.

210. *Id.* at 526.

within the firm. Such a mismatch may follow when a founder-CEO is reluctant to retire, vacillates about whether a chosen successor is suitable, or retires as CEO but continues to exert a lingering influence within the company's senior management.²¹¹ By engendering uncertainty, each prospect places stress on other relationships within the company's board and its senior management. To be sure, a former CEO's lingering influence may be benign and reflect no more than a successor's adoption of successful operational and financial policies developed by the prior CEO.²¹²

A former CEO who continues to assert a lingering influence may also destabilize the corporation's dealings with third parties. Litigation involving Tyson Foods again furnishes an intriguing illustration. In *IBP, Inc. v. Tyson Foods, Inc.*,²¹³ IBP, a beef distributor, sought specific enforcement of a merger agreement entered into by Tyson Foods.²¹⁴ After signing the merger agreement through which it would acquire IBP and following shareholder ratification of the transaction, Tyson's business performance was weak, as was IBP's.²¹⁵ Tyson began to stall taking the steps requisite to consummating the merger. In the court's assessment, Tyson experienced "buyer's regret" wishing "it had paid less especially in view of its own compromised . . . performance and IBP's slow . . . results."²¹⁶ The IBP merger was negotiated by Tyson's senior management, led by its CEO/chairman, John Tyson. However, the decision to abandon the merger was made by John's father, Don Tyson, the company's controlling shareholder.²¹⁷ John and other members of senior management followed Don's instructions and then, as the court reports, "[a]fter the business decision was made to terminate, Tyson's legal team swung into action."²¹⁸ Tyson resisted IBP's demand that the agreement be performed, claiming that it had been fraudulently induced to agree to the merger, but the court was unpersuaded. The court also found that none of IBP's circumstances constituted the occurrence of a "Material Adverse Effect" under terms of the agreement that would excuse Tyson's failure to perform.²¹⁹

Although IBP succeeded in obtaining specific enforcement of its merger agreement with Tyson, its travails illustrate the complications of dealing with a firm in which allocations of effective power may be disconnected from formal titles and positions within the firm. Family-controlled firms may be more opaque in this respect, leaving outsiders in doubt about whose assent suffices to bind the firm to particular transactions. It is evident that, although John Tyson occupied the offices of CEO/Chairman, his

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211. For example, it is reported that William Lauder, CEO of Estée Lauder Cos. since 2004, served "under the watchful eye of his charismatic 74-year-old father Leonard Lauder," the firm's chairman. Ellen Byron & Joann S. Lublin, *Lauder Scion on Way Out, P&G Executive on Way In*, WALL ST. J., Nov. 9, 2007, at B1. Additionally, William's uncle Ronald was said by "company observers" to have undermined William's leadership by selling company shares to fund his purchases of art when the company faced competitive and other business challenges. *Id.*

212. See Joe Nocera, *Giving Nepotism a Good Name*, N.Y. TIMES, July 7, 2007, at C1 (reporting that the CEO of Comcast, son of the firm's founder, has continued to follow conservative policies on debt financing).

213. *IBP, Inc. v. Tyson Foods, Inc.*, 789 A.2d 14 (Del. Ch. 2001).

214. *Id.* at 21.

215. *Id.* at 22.

216. *Id.*

217. *Id.* at 23.

218. *Tyson Foods*, 789 A.2d at 23.

219. *Id.* at 68.

father, Don, made the decision to jettison Tyson's merger with IBP. Don retained informal powers of direction as the firm's controlling shareholder.²²⁰ In contrast, Rocky Aoki (founder of Benihana, Inc.) no longer possessed such powers.²²¹ Firm insiders who are situated lower within the firm's internal hierarchies may also be wary of the risk that power will be asserted outside formally-defined channels of managerial responsibility. A mismatch between a firm's formal allocations of responsibility and the actual possession of managerial power may prove destabilizing and perplexing to organizational actors situated farther down its managerial hierarchies. Thus, when the chairman and controlling shareholder of Viacom, Inc. publicly denounced the actor Tom Cruise and declined to renew his production deal with Viacom's Paramount subsidiary, the result was to undercut the evident authority of Viacom's then-CEO and Paramount's head.²²² Patterns of repeated or notorious instances in which power is exercised within a firm in disregard of formal allocations of managerial responsibility may also have implications for the firm's ability to attract and retain skilled and ambitious executives.

Another aspect of informality is slippage in documentation. Although one's perspective may of course be biased as a lawyer (in a prodocumentation direction!), the actors in some of the specific examples detailed in Part III manifested a distinct disregard for adequate record-keeping practices. Hollinger, for example, had discrepant versions of minutes of executive committee meetings concerning key self-dealing transactions, culminating in final minutes that misdescribed who acted on behalf of the company.²²³

Resolving a question through informal family channels may also conflict with the formal allocation of functions to the board or a board committee, thereby calling into question what reality is operative within the company. Consider in this light the 2007 announcement that Sumner Redstone, chairman of Viacom, Inc. and CBS Corporation, had decided to change his earlier decision that his daughter, Shari, would succeed him as Viacom's controlling shareholder and chairman.²²⁴ To be sure, were Shari to become

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220. Control may also be exercised in much subtler and indirect ways. One news industry source characterized the relationship between Rupert Murdoch and editors of papers owned by News Corp. as "auto-editing, or osmosis, rather than overtly directional." Auletta, *supra* note 2, at 50. Likewise, an editor at the *New York Times* said of Arthur Sulzberger Jr., chairman of the New York Times Co., "[i]t's in choosing editors that Arthur gets what he wants." *Id.* at 49. Another industry observer reports that "[y]ou shouldn't underestimate the power of repeatedly expressed opinions from corporate headquarters" on newspapers' publishers and editors. *Id.* at 50.

221. See text accompanying notes 199-203.

222. See Brian Burrough, *Sleeping with the Fishes*, VANITY FAIR, Dec. 2006, at 244, 260 (noting Viacom's chairman, Sumner Redstone, later fired Tom Freston, Viacom's CEO, after only eight months of service).

223. See Hollinger Report, *supra* note 108, at 381-82 (detailing the ratification of Conrad Black's acquisition of a collection of FDR memorabilia).

224. See Richard Siklos & Geraldine Fabrikant, *Family Feud at CBS and Viacom*, N.Y. TIMES, July 20, 2007, at C1. As a result of her father's change of heart, Shari is reportedly likely to leave the boards of Viacom and CBS, on which she serves as executive vice chairman, and her father is likely to buy out her 16% ownership interest. See Matthew Peers et al., *Redstone Split Bears on Future of Viacom, CBS*, WALL ST. J., July 20, 2007, at A1. Litigation has not been infrequent within the Redstone family. See Johnnie L. Roberts, *Off with Their Heads*, NEWSWEEK, July 30, 2007, at 41 (noting that Redstone settled a multimillion dollar lawsuit with his son for allegedly freezing him out and is currently facing suits filed by his nephew and sister regarding the family business).

the controlling shareholder and wish also to become chairman of Viacom and CBS, her wish would likely come true. Nonetheless, the incumbent chairman's designation of his successor in office appears to conflict with the bylaws of Viacom and CBS, which unsurprisingly allocate to the board the responsibility of selecting a chairman.²²⁵ At a minimum, it is important that independent directors not simply acquiesce in resolutions reached through informal family channels without considering whether they are satisfactory from a perspective that is detached from the family's.

Finally, formal institutions of governance may represent the sole vehicle through which action may be taken when a corporation's controlling family is unable to reach agreement. Disarray may be more likely when shares are dispersed across multiple family members with the passage of generations and nothing consolidates the power to exercise control in the hands of a single individual or cohesive family group.²²⁶ After receiving News Corp.'s offer to buy Dow Jones, the Bancroft family initially manifested a lack of interest in selling, followed a month later by a softened response indicating interest in a possible combination with another company, followed by several weeks of direct negotiations between family members and News Corp.'s chairman over assuring editorial independence for the *Wall Street Journal*.²²⁷ As time passed, the likelihood that Dow Jones could obtain a higher price from News Corp. diminished, as did the likelihood of a contested auction for the company.²²⁸ With no resolution in sight, Dow Jones's board took over responsibility for negotiations.²²⁹

V. CONCLUSION: DEBATES VIEWED UNDER THE RAKING LIGHT

Many scholarly accounts of corporate governance begin with severely stylized facts that typify governance arrangements within particular national systems. This approach tends to ignore atypical arrangements and their problematic features in favor of a cleaner emphasis on the typical and its strengths and weaknesses. The subset of public companies explored in this Article have elements that are atypical for the United States: ownership structures that are concentrated, not diffuse; a mix of formal and informal allocations of power at the highest levels within the corporation; a complex definition of "shareholder value" and different understandings of how best to maximize it;²³⁰ and the

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225. Siklos & Fabrikant, *supra* note 224. In contrast, the CEO/Chairman of News Corp., Rupert Murdoch, has not designated a successor and has stated the decision will be the board's. Siklos, *supra* note 4.

226. See Auletta, *supra* note 2, at 24 (noting that families that control the New York Times Co. and the Washington Post Co. each have a single leader empowered to exercise the family's control).

227. See Ellison & Cohen, *supra* note 2 (noting that M. Peter McPherson, newly appointed Board Chairman of the Dow Jones, was involved in trying to bridge the communication gap between the Bancroft family and the board to complete a deal with News Corp.).

228. See *id.*; Rob Cox, *Sage Advice? "Just Say No,"* WALL ST. J., July 6, 2007, at C10 (reporting that the most promising prospects for competing bids pulled out the day after the Dow Jones board took over discussions).

229. See Sarah Ellison et al., *Dow Jones Board Takes Over Talks on Firm's Future*, WALL ST. J., June 21, 2007, at A1. After Dow Jones executed a merger agreement with News Corp., continuing disarray within the Bancroft family caused it to miss the opportunity to choose a family representative to serve as a director on the News Corp. board, which under the parties' agreement left the choice to be made by Rupert Murdoch as News Corp.'s chairman. Matthew Karnitschnig & Sarah Ellison, *Bancrofts Bicker, Miss a Deadline, Lose Board Choice*, WALL ST. J., Nov. 7, 2007, at B1.

230. On the heterogeneity of shareholders and its impact on the notion of shareholder primacy, see Jill E.

possibility of ongoing family ties to the firm's founder within its senior management. Some firms with these traits maintain them over long periods of time and through multiple generations of the founder's family. Successful performance by independent directors of the governance functions they are uniquely positioned to fulfill resolves a number of governance problems to which family-controlled firms are otherwise vulnerable. Such performance may help explain the positive association found by Anderson and Reeb between better firm performance and greater proportions of independent directors on boards of family-controlled public companies.²³¹ It also furnishes an echo within a smaller context of Jeffrey Gordon's broader assessment of reasons for the increased dominance of independent directors within public companies.²³²

Family-influenced public firms, admittedly a minority of public firms in the United States, are nonetheless significant for debates about corporate governance more generally. Consider first the orientation with which directors discharge their duties. Warren Buffett, the source of much wisdom on investing and corporate governance, urges directors to "[b]ehave as if the corporation you serve had a single absentee owner, and do your best to further his long-term interests in all proper ways."²³³ However, the heuristic of the single hypothetical owner, while useful in the context of a diffusely-held firm, is less immediately helpful when a corporation has a coherent group of family-allied shareholders as well as nonfamily shareholders. In many ways, as detailed earlier in this Article, the family's interests may diverge from those of the corporation's other shareholders, and the law may legitimize action by directors that furthers the family's interests. For example, by adopting a dividend policy that meets family shareholders' needs for cash, a corporation's directors do not breach their fiduciary duties to other shareholders if all shares receive the same payment per share.²³⁴ If polled, shareholders outside the family might prefer instead that the corporation reinvest its earnings internally—and time may prove them correct—but the law does not translate the directors' noncompliance with the nonfamily shareholders' preference into a breach of fiduciary duty.

Moreover, family-allied shareholders within a family-controlled firm are not likely to resemble the hypothetical abstraction of an "absentee owner" that Buffett's heuristic posits. Family-allied shareholders are highly personalized presences, often explicitly represented within the boardroom, who may not be reticent about expressing their preferences. The challenge for independent directors does not, as the heuristic of the single absentee owner suggests, turn on minding the interests of a hypothetical abstraction. Instead, it turns on the exercise of detached judgment in an ongoing

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Fisch, *Measuring Efficiency in Corporate Law. The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 661-62 (2006).

231. See Anderson & Reeb, *Board Composition*, *supra* note 62.

232. Gordon, *supra* note 146 (listing reasons for increased dominance of independent directors such as enhanced fidelity of managers to shareholder objectives, enhanced reliability of the firm's public disclosure, and providing a mechanism that binds the responsiveness of firms to stock market signals).

233. See John C. Bogle, *Democracy in Corporate America*, DAEDALUS, Summer 2007, at 24, 28 (quoting Warren Buffett).

234. See *supra* text accompanying notes 93-95 (explaining that if all shareholders receive a dividend proportionally, then the controlling shareholder is not benefitted to the exclusion of the noncontrolling shareholders).

relationship with shareholders who are the antithesis of hypothetical abstractions. The heuristic of the single hypothetical owner may nonetheless be helpful as a benchmark—an independent director might usefully ask herself whether the family's interests alone justify a proposed transaction or course of conduct, or put differently, whether the proposed transaction or course of conduct would be the best course for the corporation in the absence of its founding family's interests and preferences. To the degree the justification turns more strongly on the family's interests or preferences, an independent director should press harder for explanations and alternatives.²³⁵ In this respect, like others, effective service as an independent director requires a facility for initiating and conducting conversations that may prove awkward, in a context in which continued service is not assured.

The persistence of a family-influenced cohort within public companies in the United States is also a useful vantage point from which to assess claims about convergence in patterns of ownership and governance practices, whether among firms in the same country and its capital markets or among national systems. Some of the firms discussed specifically in this Article, like some undoubtedly present in the data analyzed in the empirical studies, have traits reminiscent of firms that to the business historian Alfred Chandler typified "personal capitalism."²³⁶ In Chandler's comparative account of the development of modern industrial enterprises, the ongoing commitment of British firms as recently as World War II to management by the founder or members of the founder's family impeded the growth of the central corporate offices, staffed by skilled managers, that are essential to managing large capital-intensive firms. Moreover, in personally managed firms, preferences for dividends dominated preferences for reinvestment into the firm beyond maintaining existing facilities.²³⁷ As a consequence, the firms on which this Article focuses may seem to be either anachronisms or instances of the inevitable sports of nature that occur in the course of any evolutionary process.²³⁸

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235. When a corporation has a controlling shareholder, regardless of its identity or nature, unaffiliated directors have been urged to be aware of the "low-level divergences of interest" inherent in routine board matters, as well as the major divergences present in transactions such as a proposed merger with the controlling shareholder. Comm. on Corporate Laws, *Guidelines for the Unaffiliated Director of the Controlled Corporation*, 45 BUS. LAW. 429, 432 (1989). Likewise, "the controlling shareholder should be made aware, in advance, that any responsible unaffiliated director may, on particular issues, raise or adopt positions from time to time which may appear unnecessary and unreasonable to the controlling shareholder, but which the director may perceive as matters of fiduciary duty." *Id.*

236. See ALFRED D. CHANDLER JR., *SCALE AND SCOPE: THE DYNAMICS OF INDUSTRIAL CAPITALISM* 12, 235-36 (1990).

237. *Id.* at 595. Another economic historian, emphasizing the innovativeness of some family managers, concluded that "[p]erhaps there is as much variation, if not more, within the two groups of firms—those still controlled by family and those run by salaried managers—as there is between them." Leslie Hannah, *Visible and Invisible Hands in Great Britain*, in *MANAGERIAL HIERARCHIES: COMPARATIVE PERSPECTIVES ON THE RISE OF THE MODERN INDUSTRIAL ENTERPRISE* 41, 55 (Alfred D. Chandler, Jr. & Herman Daems eds., 1980). In Hannah's view, management by family may have been a rational response to underinvestment in managerial talent and formal management education: "[P]atronage had to replace professionalism. A young man who wished to learn the business of management could often envisage no better training than in the family firm, where many potential managers both within and outside the family sought it." *Id.* at 69.

238. These firms also furnish memorable exceptions to the generalization that bureaucratic system has replaced personality within the large contemporary corporation. For development of the generalization, see Mae Kuykendall, *No Imagination. The Marginal Role of Narrative in Corporate Law*, 55 BUFF. L. REV. 537, 580 (2007).

However, the ongoing personalized presence of a founder or members of the founder's family may be key to the quality of a firm's performance and may help explain the market premium associated overall with firms in which the founder serves as CEO.²³⁹ Moreover, the population of firms with public shareholders is dynamic, not static. An individual firm may vanish as a consequence of business failure, leading to the sale of its assets, or as a consequence of acquisition by another firm. New firms become public companies through IPOs, many retaining²⁴⁰ traits associated with the personal capitalism of the founder or members of the founder's family. This dynamic quality assures that the cohort of public firms will continue over time to include some with ownership characteristics that are atypical. Overall, effective service by independent directors moderates the impact of divergence between the interests of nonfamily shareholders and those of the founder and the founder's family. Unlike a reliably affable guest at the family dinner table, an effective director in a public company brings a capacity for skeptical assessment to the boardroom table.

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239 See *supra* text accompanying notes 46-48 (noting the positive impact on accounting measures of profitability in firms where the founder serves as CEO).

240. An IPO is not the sole route through which a large family firm may furnish control over liquid assets to individual family members. By selling minority stakes to a small number of large investors, the firm may fund distributions to family members while retaining family control. See Mark Maremont & Gary McWilliams, *Hyatt Sells Stake to Wal-Mart Heirs, Goldman Division*, WALL ST. J., Aug. 30, 2007, at A2 (reporting a sale by the Pritzker family of minority equity stakes in Global Hyatt Corp. to an investment firm affiliated with Wal-Mart Stores heirs and a private equity affiliate of Goldman Sachs & Co. in exchange for \$1 billion; although each investor will have a seat on Hyatt's board, three Pritzker cousins are likely to continue running the firm).