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Beyond Beholden

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Corporate law has long been concerned with director independence. In controlled companies, the conventional wisdom focuses on "beholdenness" as the main threat to independence. The prevailing theory argues that directors might feel pressured to reciprocate a past kindness from the controlling shareholder or fear retaliation. This Article argues that this conventional narrative is troublingly incomplete. I show that directors are also influenced by the prospect of rewards, or patronage, from the controller.

This Article is the first to identify controlling shareholder patronage as a systemic phenomenon and to explore how anticipation of future patronage can affect director behavior. It presents an original empirical study on professional relationships between directors who are nominally independent and the controlling shareholders of their firms. My findings reveal that these relationships are far more pervasive than is usually recognized. In fact, some controlling shareholders regularly re-appoint cooperative "independent" directors to senior positions and directorships at other firms under their control. From a director's perspective, this pattern of behavior means that the potential upside of getting along with the controlling shareholder is significant. I further demonstrate that the likelihood of patronage from the controlling shareholder depends on two factors: the controlling shareholder's base of controlled entities and the concentration of its decision-making authority. Together, these factors provide an analytic framework for assessing which controllers have greater potential to create conflicts of interest. Disaggregating controlling shareholders in this way opens up opportunities and new challenges for how we define independence, analyze decisions made by putatively independent directors, and judge the utility of independent directors as a safeguard against controller opportunism.

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I. INTRODUCTION

Independent directors have long been a core part of corporate law's answer to the agency problem that arises in controlled companies. The presence of a controlling shareholder produces the potential for private benefits: the controlling shareholder can extract benefits from the corporation at the expense of other shareholders.[1] To contain this risk of opportunism, courts and policymakers have promoted the engagement of independent directors to vet contracts between companies and their controllers.[2] As Guhan Subramanian observes, the move to independent directors is now "standard practice" in

1. *See infra* notes 24–25 and accompanying text. In this Article, I use both "minority shareholders" and "public shareholders" to refer to investors other than the controller. Controllers can hold an effective majority of the firm's votes without owning a majority of equity rights. For instance, in a firm with a dual-class structure or another capital structure that separates voting rights from cash rights, controllers can have a lock on control while holding only a minority—even a small fraction—of total outstanding shares. *See, e.g.*, Lucian Arye Bebchuk et al., *Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, *in* CONCENTRATED CORPORATE OWNERSHIP 295, 297–301 (Randall K. Morck ed., 2000) [hereinafter Bebchuk et al., *Stock Pyramids*].

2. *See, e.g.*, *In re* MFW S'holders Litig., 67 A.3d 496, 529–30 (Del. Ch. 2013), *aff'd sub nom.* Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014) ("The premise that independent directors with the right incentives can play an effective role on behalf of minority investors is one shared by respected scholars sincerely concerned with protecting minority investors from unfair treatment by controlling stockholders."); Kahn v. Lynch Commc'n Sys., 638 A.2d 1110, 1120–21 (Del. 1994) (stating that approval by a special committee of independent directors shifts the burden of proving the fairness of a transaction to the plaintiff); Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 677–78 (2005) (explaining how Delaware's approach to conflict of interest transactions encourages the use of independent directors). *See generally* Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2, 11–17 (2005) (documenting the judiciary's promotion of independent directors as a protective device for minority shareholders in freezeout mergers).

controlled firms.[3]

The conventional notion of independence translates roughly into the absence of substantial prior or ongoing relationships to the controlling shareholder.[4] This definition reflects corporate law's persistent preoccupation with "beholdenness" as the main threat to independence.[5] The paradigmatic concern is that a director with lucrative ties to the controlling shareholder may be subtly pressured by the fact that the controller can cut off those ties or even unseat her from the board.[6] This diagnosis, in turn, has prompted calls to insulate nominally independent directors from the controlling shareholder's ire.[7]

Corporate governance scholarship focuses extensively on the incentives generated by the controlling shareholder's ability to *retaliate* against insubordinate directors. What the literature overlooks, however, is that directors may also be influenced by the prospect of *reward.* What happens when the controlling shareholder is not angered but instead pleased?

The result, it turns out, is often new opportunities or future benefits from the controlling shareholder to the favored directors. Controlling shareholders can direct their resources or those owned by the controlled company in ways that reward friends. For instance, Charles Dolan, whose family controlled Cablevision Systems until 2016, invested his own money with a fund founded by one of Cablevision's former "independent" directors.[8] Some controllers have substantial influence over other companies as well. When the controlling shareholder of M & F Worldwide, Ronald Perelman, sought to "freeze out"[9]

3. Subramanian, *supra* note 2, at 12.

4. *See infra* Part II.B.1 (discussing Delaware courts' approach to independence). There is a separate inquiry for assessing director independence under listing standards promulgated by the New York Stock Exchange (NYSE) and NASDAQ. *See* N.Y.S.E., INC., NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 303A.02 (2013) ("Independence Tests"); NASDAQ, INC., NASDAQ STOCK MARKET RULES § 5605(a)(2) (2013) (definition of "Independent Director"). In cases involving controlling shareholder conflicts, Delaware courts treat the listing standards as illustrative but emphasize that directors' compliance with the standards "does not mean that they are necessarily independent [from the controller] under [Delaware] law." Kahn v. M & F Worldwide Corp., 88 A.3d 635, 648 n.26 (Del. 2014).

5. *See* Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447, 486 (2008) (describing Delaware's approach to independence as one that focuses on "ties that can generate a sense of 'beholdenness'").

6. *See, e.g.*, Leo E. Strine, Jr., *The Inescapably Empirical Foundation of the Common Law of Corporations*, 27 DEL. J. CORP. L. 499, 504 (2002) [hereinafter Strine, *The Inescapably Empirical Foundation*] (observing that "even the independent directors will be subtly influenced by the fact that [the controlling shareholder] has the voting power to unseat them"); Larkin v. Shah, C.A. No. 10918-VCS, 2016 WL 4485447, at *9 (Del. Ch. Aug. 25, 2016) (explaining that directors "might feel beholden to a controller who placed them on the board, supported them during election season, or could fire them at any moment"); Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997) (describing the risk that "those who pass upon the propriety of the transaction might perceive that disapproval may result in retaliation by the controlling shareholder"); Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors and Controlling Shareholders*, 165 U. PA. L. REV. 1271, 1274 (2017) [hereinafter Bebchuk & Hamdani, *Independent Directors*] (arguing that because "controllers [have] decisive power to appoint independent directors and decide whether to retain them, independent directors have significant incentives to side with the controller and insufficient countervailing incentives to protect public investors in conflicted decisions").

7. For example, Lucian Bebchuk and Assaf Hamdani recently proposed increasing minority shareholders' role in director elections, such as giving them veto rights over the appointment and termination of certain "enhanced-independence" directors. *See generally* Bebchuk & Hamdani, *Independent Directors*, *supra* note 6.

8. *See* Cablevision Sys. Corp., Proxy Statement (Schedule 14A), at 6 (May 21, 2007) ("Since 1995, Charles F. Dolan, the Company's Chairman, has had a personal investment in Regent Equity Partners, a limited partnership in which Mr. Hochman is one of the general partners.").

9. A freezeout is a transaction in which the controlling shareholder buys out the public shareholders of a

the company's minority shareholders, the company formed a special committee of four "independent" directors to negotiate with Perelman over the terms of his acquisition.[10] Less than a year after the deal closed, two members of the special committee—including the chairman—joined the boards of other firms under Perelman's control.[11]

This Article is the first to identify controlling shareholder patronage as a systemic phenomenon and to consider how anticipation of future patronage can influence director behavior. I study these issues using an original dataset of nominally independent directors who negotiated with a controlling shareholder over a freezeout transaction between 2000 and 2014. Examining the professional connections—specifically, directorship and employment relationships—between those directors and controllers, I find that some controlling shareholders regularly re-appoint cooperative "independent" directors to executive and board positions at other firms under their control. 36% of the controlling shareholders in my sample have re-appointed at least one nominally independent director in this way. Illustrating this point from a different angle, 20% of the directors in my data have served on the board or as an executive in at least two different companies controlled by the same controlling shareholder. In many cases, the director was independent in the conventional sense when she negotiated the freezeout, meaning that she had no ongoing or prior connections with the controller at that time. But after the freezeout closed, she obtained a job at another company that the controlling shareholder controlled. From a director's perspective, these findings mean that she can obtain future benefits from the controlling shareholder if she acts in the controlling shareholder's interests.

The likelihood of future patronage from the controlling shareholder is driven by factors that have not been recognized by courts. The current doctrinal regime is based on a generic and stylized idea of the controlling shareholder. But in reality, controlling shareholders come in different forms, hold control through different mechanisms, and acquire control for different reasons. Treating controlling shareholders as monolithic obscures the many moving parts that can affect their power to influence director behavior. As I show, two important determinants of this power are what I call the *base* of controlled entities and the *concentration* of decision-making authority.

Base refers to the size of the network of companies over which a controlling shareholder has control. I find that controllers with a wider base—those that control multiple public companies—are much more likely to have repeat relationships with the nominally independent directors who serve on their boards (54.8% compared with 4.5%). This result makes intuitive sense: controllers with a wider base have greater ability to reward or sanction because they have power over more resources and more boards.

Concentration refers to the number of actors that share the power to control within the controlling shareholder. I find that controllers who are single natural persons, as opposed to family groups or widely-held corporations, are also more likely to have repeat relationships with the nominally independent directors that they appoint (48.3% compared with 30.4% for widely-held corporations and 25% for family groups). This finding is consistent with classic narratives about power: a single person with consolidated control

publicly-traded corporation.

10. *In re* MFW S'holders Litig., 67 A.3d 496, 505–07 (Del. Ch. 2013).

11. This information was collected from the Boardex database. *See infra* Part III.A for a description of my methodology.

has greater power to reward or sanction than a group of decision-makers who share control because the single person can act unilaterally and her authority over the controlled company is plenary.[12]

Together, these two factors provide an analytic framework for assessing which controlling shareholders have greater potential to create conflicts of interest. By disaggregating controllers in this way, courts can move toward a more nuanced doctrine for constraining private benefits of control. Most concretely, courts can tailor the level of scrutiny given to independent directors' decisions, such as approval of a transaction proposed by the controlling shareholder, to the controlling shareholder's ability to influence director behavior.

Ultimately, my findings illustrate how undertheorized controlling shareholders and the risks they pose to director independence remain. For example, doctrines concerning controlling shareholders do not account for real differences among the people and entities within that broad category; nor do they provide any explanation for why we presume that the bargaining dynamics are the same when nominally independent directors negotiate with controllers who are repeat players—such as venture capital firms that routinely obtain control over the firms they invest in—and when those directors negotiate with one-off controllers.[13] There has also been no serious discussion about how courts might obtain information on a director's expectations about future events, even though basic game theory teaches us that the director's behavior will be shaped by these beliefs.[14] Courts are sometimes presented with evidence that a director received post-negotiation benefits from the controlling shareholder[15] or that a particular controlling shareholder has a reputation for re-appointing friendly directors to other boards,[16] but we have no principled framework for incorporating these insights into doctrine. This Article fills these gaps.

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12. *See infra* notes 129–131 and accompanying text.

13. *See In re* Trados Inc. S'holder Litig., 73 A.3d 17, 54 (Del. Ch. 2013) (acknowledging but disregarding the fact that the nominally independent directors negotiated in the shadow of the "VC ecosystem").

14. *See generally* DOUGLAS G. BAIRD ET AL., GAME THEORY AND THE LAW 1 (1994) (explaining that game theory studies strategic behavior, which arises "when two or more individuals interact and each individual's decision turns on what that individual expects the others to do"); ERIC RASMUSEN, GAMES AND INFORMATION: AN INTRODUCTION TO GAME THEORY 11 (4th ed. 2007) ("Game theory is concerned with the actions of decision makers who are conscious that their actions affect each other."). For examples of this insight in other contexts, see, e.g., Rui J. P. de Figueiredo et al., *The New Separation-of-Powers Approach to American Politics*, *in* THE OXFORD HANDBOOK OF POLITICAL ECONOMY 208 (Donald A. Wittman & Barry R. Weingast eds., 2008) ("The courts also constrain the other players in separation-of-powers games. Because judicial action shapes policy outcomes, Congress, the president, and agencies will anticipate court decisions, and the potential for judicial review will be taken into account during the law-making process."); JOHN C. COFFEE, JR., GATEKEEPERS: THE ROLE OF THE PROFESSIONS AND CORPORATE GOVERNANCE 66 (2006) ("[I]f accounting firms were intent on maximizing consulting revenues, they should be prepared to acquiesce to the demands of any client in a position to potentially direct consulting business to them.").

15. For example, in *In re MFW S'holders Litig.*, the plaintiffs presented evidence that one of the nominally independent directors on MFW's special committee joined the board of another firm controlled by MFW's controlling shareholder, Ronald Perelman, after the freezeout. 67 A.3d at 512.

16. For example, in *In re Ezcorp, Inc. Consulting Agreement Derivative Litigation*, the plaintiffs presented evidence that EZCORP's controlling shareholder, Phillip Ean Cohen, had in the past invited EZCORP's nominally independent directors to join the boards of EZCORP's affiliates. *In re* Ezcorp Inc. Consulting Agreement Derivative Litig., C.A. No. 9962–VCL, 2016 WL 301245, at *4 (Del. Ch. Jan. 25, 2016). The plaintiffs also offered evidence that Cohen "clean[ed] house" by firing those directors after they displeased him. *Id.* at *6.

This Article proceeds in four parts. Part II provides background on controlled companies and independent directors. It briefly describes the conventional marker of independence—that is, the absence of any ongoing or prior relationship with the controller other than as a director. It also summarizes several other factors, such as social norms and reputation, whose impact on director independence has been the subject of some debate. Part II shows that, while controlling shareholders can influence nominally independent directors through negative threats or positive incentives, the contemporary discourse has overwhelmingly focused on threats. Part III presents my empirical findings on the professional ties between nominally independent directors and controlling shareholders. Building on these findings, Part III also presents a taxonomy of controlling shareholders. Part IV provides implications for policymakers and the Delaware courts, and Part V concludes.

Before I proceed, a caveat is in order. While independent boards have become a mandatory part of good governance in practice, debate about the value of independent directors persists in the scholarly literature.[17] This Article does not enter that debate. My critique of directors' independence-in-fact is not meant to suggest that genuinely independent directors are an unalloyed good. Rather, my objective is to show that so long as independent directors continue to play an important role in monitoring controlling shareholders, we need to have a fuller account of their incentives.

II. INDEPENDENT DIRECTORS IN CONTROLLED COMPANIES: THE STANDARD ACCOUNT

The focus of this Article is on American companies with a controlling shareholder. While firms in the United States have historically been characterized by a dispersed ownership structure, controlled companies—such as Google, Facebook, and CBS—are becoming an important part of the modern U.S. corporate landscape.[18] According to a 2014 study by the law firm Davis Polk & Wardwell LLP, 54 of the 100 largest initial public offerings between September 2011 and October 2013 were of companies with one shareholder holding more than 50% of the voting power.[19] As of 2015, seven percent of companies in the S&P 1500 index have one shareholder or group holding more than 30%

17. *Compare* 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 (2007) (providing an account of independent directors as "an essential part of a new corporate governance paradigm" oriented toward shareholder wealth maximization), *and* Usha Rodrigues, *supra* note 5, at 486 (arguing that independent directors have value "in the specific situations where a conflict exists between the interests of management and those of the shareholder"), *with* STEPHEN M. BAINBRIDGE, CORPORATE GOVERNANCE AFTER THE FINANCIAL CRISIS 101–02 (2012) (observing that "the empirical evidence on the merits of board independence is mixed" and arguing that "[b]y establishing a highly restrictive definition of director independence and mandating that such directors dominate both the board and its required committees, the [stock exchange listing standards] fail to take into account the diversity and variance among firms"), *and* Sanjai Bhagat & Bernard Black, *The Non-Correlation Between Board Independence and Long-Term Firm Performance*, 27 J. CORP. L. 231, 247–48 (2002) (concluding that the evidence suggests that increased board independence does not lead to better firm performance).

18. *See, e.g.*, Bebchuk & Hamdani, *Independent Directors*, *supra* note 6, at 1279 ("As of December 31, 2016, there were 379 Russell 3000 companies with a shareholder holding more than 30% of the company's voting shares, and 220 of these companies had one shareholder holding more than 50% of such shares.").

19. DAVIS POLK & WARDWELL LLP, CORPORATE GOVERNANCE PRACTICES IN U.S. INITIAL PUBLIC OFFERINGS 3 (2014), https://www.davispolk.com/files/ControlledCompanySurvey.pdf.

of the company's voting shares.[20]

This Part explains the role of independent directors in the governance of controlled companies, laying the groundwork for the empirical analysis in Part III. In broad strokes, I show that courts turned to independent directors as the best available protection against private benefits of control—benefits obtained by diverting value from the company and its other investors. I then unpack the concept of "independence" in the context of controlled companies, exploring both the conventional marker of independence and other prominent views.

A. Independent Directors as Monitors

Controlled companies pose different governance challenges than do widely-held companies.[21] The agency problem facing widely-held corporations arises from the separation of ownership and control, which produces the potential for opportunism by corporate officers.[22] Because these officers are "managers of other people's money,"[23] they lack the incentive to look after the money with the same care as they would with their own money. In widely-held companies, therefore, governance devices—most notably the board of directors—monitor corporate officers.

At controlled companies, the controlling shareholder has the ability and incentive to police management effectively because of its large equity stake.[24] But the controller can also use its voting clout to self-deal and extract private benefits of control.[25] Controllers can, for example, cause the controlled company to enter into transactions on terms that favor them, such as compensation arrangements that overpay them. They can also acquire

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20. EDWARD KAMONJOH, CONTROLLED COMPANIES IN THE STANDARD & POOR'S 1500: A FOLLOW-UP REVIEW OF PERFORMANCE & RISK 15 (2016), https://www.weinberg.udel.edu/IIRCiResearchDocuments/2016/03/Controlled-Companies-IRRCI-2015-FINAL-3-16-16.pdf.

21. For an in-depth comparison of the nature of the agency problem in controlled and widely-held firms, see Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Global Governance Standards*, 157 U. PA. L. REV. 1263, 1281–82 (2009) [hereinafter Bebchuk & Hamdani, *The Elusive Quest*].

22. *See id.* (arguing that, in widely-held firms, "the fundamental concern that governance arrangements need to address is management's potential to behave opportunistically at the expense of shareholders"); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 312–13 (1976) (arguing that the separation between ownership and control creates incentives for managers to engage in self-interested behavior that reduces the firm's value).

23. In *The Wealth of Nations*, Adam Smith argued that "managers of other people's money" would never watch over this money with the "same anxious vigilance with which the partners in a private copartnery frequently watch over their own." 2 ADAM SMITH, THE WEALTH OF NATIONS 229 (J.M. Dent & Sons, 1963) (1776).

24. *See* Bebchuk & Hamdani, *The Elusive Quest*, *supra* note 21, at 1281 (arguing that, in controlled firms, "controlling shareholders commonly have both the effective means to monitor management and the incentives to do so"); Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1651 (2006) ("Because she holds a large equity stake, a controlling shareholder is more likely to have the incentive either to monitor managers effectively or to manage the company itself and, because of proximity and lower information costs, may be able to catch problems earlier.").

25. *See In re* Ezcorp Inc. Consulting Agreement Derivative Litig., C.A. No. 9962–VCL, 2016 WL 301245, at *11 (Del. Ch. Jan. 25, 2016) ("A controlling stockholder occupies a uniquely advantageous position for extracting differential benefits from the corporation at the expense of minority stockholders."). For a review of different methods of extracting private benefits of control, see Ronald J. Gilson & Jeffery N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 786 (2003), which identifies three methods: taking from the firm's ongoing earnings, selling control, and freezing out the minority shareholders.

equity at below-market prices from either the firm or other shareholders in a freezeout transaction. Governance devices at controlled companies, therefore, protect the public shareholders vis-à-vis the controlling shareholder.

In the United States, the traditional approach for constraining the controller's ability to extract private benefits is to encourage board processes that give a strong hand to independent directors.[26] To be clear, "independence" is measured in different ways depending on the conflict at hand.[27] In the special litigation committee context, for example, where independent directors must evaluate the merits of a lawsuit against the company's officers or fellow directors, "independence" is tested as independence from the interested officers or directors.[28] In the context of a transaction between a controller and the controlled company, "independence" means independent from the controller.[29]

Delaware courts, in particular, have strengthened the appeal of independent directors by giving credit to conflicted transactions that were vetted and approved by a special committee comprised of independent directors. Under Delaware law, controlling shareholders are normally required to prove the intrinsic fairness of their transactions with the companies they control.[30] If, however, the interested transaction was negotiated and approved by an independent special committee, the burden of proving the deal's fairness shifts to the plaintiffs.[31] Recently, in 2014, the Delaware Supreme Court added a new doctrinal twist. In *Kahn v. M&F Worldwide Corp.*, the court held that a freezeout merger initiated by a controlling shareholder that is conditioned on approval by both an independent special committee and a majority-of-the-minority shareholder vote should be

26. *See In re* MFW S'holders Litig., 67 A.3d 496, 529–30 (Del. Ch. 2013) ("The premise that independent directors with the right incentives can play an effective role on behalf of minority investors is one shared by respected scholars sincerely concerned with protecting minority investors from unfair treatment by controlling stockholders."). But some scholars have voiced concerns that independent directors, as they are currently defined, will inevitably be conflicted in representing the minority's interests. For recent examples of this literature, see, for instance, Bebchuk & Hamdani, *Independent Directors*, *supra* note 6, *and* María Gutiérrez & Maribel Sáez, *Deconstructing Independent Directors*, 13 J. CORP. L. STUD. 63 (2013).

27. For a careful and extensive discussion of how Delaware's approach to "independence" varies with context, see generally Rodrigues, *supra* note 5, at 464–84.

28. *See* James D. Cox & Donald E. Schwartz, *The Business Judgment Rule in the Context of Termination of Derivative Suits by Independent Committees*, 61 N.C. L. REV. 541, 542–43 (1983) (describing independence as "judged by objective evidence regarding the [special litigation] committee members' relationship to the defendants and the misconduct underlying the suit").

29. *See* Strine, *The Inescapably Empirical Foundation*, *supra* note 6, at 507 (asking "[d]oes the average independent director have sufficient integrity, information, and motivation to resist overreaching by a majority stockholder?").

30. Kahn v. M & F Worldwide Corp., 88 A.3d 635, 642 (Del. 2014).

31. *Id.* Until recently, it was unclear whether Delaware courts would give more credit to independent shareholder approval as a cleansing device outside of the freezeout context. Some earlier opinions had applied the business judgment rule to non-merger transactions approved by a special committee of independent directors, *see* Friedman v. Dolan, C.A. No. 9425–VCN, 2015 WL 4040806, at *6 (Del. Ch. June 30, 2015) (controller compensation); *In re* Tyson Foods, Inc. S'holders Litig., 919 A.2d 563, 587 (Del. Ch. 2007) (consulting agreement with controller), but more recent decisions generally endorse the view that the same standard of judicial review should apply to the different mechanisms by which controllers can extract private benefits of control. *See, e.g.*, *In re* Ezcorp Inc. Consulting Agreement Derivative Litig., C.A. No. 9962–VCL, 2016 WL 301245, at *20–30 (Del. Ch. Jan. 25, 2016) (advisory services agreements with entities affiliated with controller); *In re* Martha Stewart Living Omnimedia, Inc. Stockholder Litig., C.A. No. 11202–VCS, 2017 WL 3568089, at *18 (Del. Ch. Aug. 18, 2017) (one-sided controlling shareholder transaction involving allegations of disparate consideration).

reviewed under the highly deferential business judgement standard.[32] The court reasoned that this deal structure would afford minority shareholders the same robust protections that are built into an arms-length merger process, so the same standard of review should apply.[33]

Delaware courts thus place great faith in the ability of independent directors to bargain meaningfully with the controlling shareholder. Whether ostensibly independent directors can serve this role depends on what exactly constitutes "independence." I now turn to this question.

B. Who is Independent?

According to the conventional understanding, independent directors are directors without substantial prior or ongoing professional or personal connections to the controlling shareholder.[34] This is the marker of "independence" that the Delaware courts have mostly focused on.[35] Of course, the absence of ties to the controller does not guarantee independence in fact. A broad scholarly debate has emerged about other mechanisms that might influence directors' ability to be objective, including the controlling shareholder's power over director retention and termination, psychological or norm-based constraints, and reputational penalties.

1. Past and Ongoing Relationships

Delaware law frames the independence inquiry as a simple question: whether "through personal or other relationships the directors are beholden to the controlling person."[36] Although seemingly straightforward, Delaware's conception of disqualifying relationships is in fact highly contextual, deliberately infused with an air of "I know it when I see it" mushiness.[37] Still, broad patterns emerge.

For example, the mere fact that the controlling shareholder elected a director to the

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32. *M & F Worldwide*, 88 A.3d at 644.

33. *See id.* (explaining that "where the controller irrevocably and publicly disables itself from using its control to dictate the outcome of the negotiations and the shareholder vote [by employing both procedural protections], the controlled merger then acquires the shareholder-protective characteristics of third-party, arm's-length mergers, which are reviewed under the business judgment standard").

34. *See, e.g.*, Bebchuk & Hamdani, *Independent Directors*, *supra* note 6, at 1274 (defining independent directors as "directors who have no ties to the controller or the company other than their service on the board"); *cf.* Rodrigues, *supra* note 5, at 453 ("The conventional corporate governance understanding of 'independence' translates roughly as 'lack of ties to the corporation.'").

35. Usha Rodrigues has observed that, under Delaware's approach, "the independence of directors is evaluated not just in terms of their lack of ties with the acquirer, but also in terms of their behavior." Rodrigues, *supra* note 5, at 478.

36. Aronson v. Lewis, 473 A.2d 805, 815 (Del. 1984).

37. *See In re* Oracle Corp. Derivative Litig., 824 A.2d 917, 941 (Del. Ch. 2003) (explaining that "[b]y taking into account all circumstances, the Delaware approach undoubtedly results in some level of indeterminacy, but with the compensating benefit that independence determinations are tailored to the precise situation at issue"); Charles M. Elson, *What's Wrong with Executive Compensation*, 81 HARV. BUS. REV. 68, 68 (2003) (quoting former Chief Justice of the Delaware Supreme Court, E. Norman Veasey, as saying that "[w]e can't set down rules for independence . . . But we didn't just fall off the turnip truck, you know. We can tell whether somebody is acting independently or not").

board is insufficient to raise doubts about the director's independence.[38] As the Delaware Supreme Court wryly explained in *Aronson v. Lewis*, "[t]hat is the usual way a person becomes a corporate director."[39] Friendship or social ties are treated much in the same way. Mere allegations that "directors are friendly with [or] travel in the same social circles" as the controller are not usually enough to taint a director's independence.[40] An extremely "close" relationship, such as a friendship that lasted for more than 50 years, could however be disqualifying.[41]

Familial relationships, on the other hand, will normally discredit a director's independence. In *Mizel v. Connelly*, for instance, the Delaware Chancery Court did not believe that a director could impartially consider a lawsuit adverse to his grandfather's interests, calling the grandfather-grandson relationship one of "great consequence."[42] But courts have not treated family ties with perfect consistency either. In *Seibert v. Harper & Row, Publishers, Inc.*, the Chancery Court determined that a director was independent even though the interested party was his cousin.[43]

Many independence cases involve business dealings, such as fees from consulting or legal services. Delaware judges have recognized that when a controlling shareholder has the power to decide whether a director "continues to receive a benefit," such as fees from professional services, there is reason to doubt the director's impartiality.[44] But this taint only exists if the benefit is material to the director given her actual economic circumstances.[45] Thus, in *In re MFW Shareholders Litigation*, the Chancery Court found that the receipt of $100,000 in consulting fees did not call into question a director's independence, because she was a wealthy "banking big shot."[46] In contrast, in *In re The Limited, Inc. Shareholders Litigation*, the Chancery Court concluded that annual consulting fees of $150,000 compromised the independence of a director who worked as a university official.[47] Given the university official's modest existing wealth, it was

38. *Aronson*, 473 A.2d at 816.

39. *Id.*

40. *In re* Martha Stewart Living Omnimedia, Inc. Stockholder Litig., C.A. No. 11202-VCS, 2017 WL 3568089, at *19 (Del. Ch. Aug. 18, 2017).

41. Del. Cty. Emps. Ret. Fund v. Sanchez, 124 A.3d 1017, 1023 (Del. 2015) (concluding that a fifty-year friendship with the interested party creates a reasonable doubt as to a director's independence); *see also* Sandys v. Pincus, 152 A.3d 124, 130 (Del. 2016) (noting that co-ownership of the private airplane with the controlling shareholder "signaled an extremely close, personal bond" that provides reason to doubt the director's independence).

42. Mizel v. Connelly, No. CIV.A. 16638, 1999 WL 550369, at *4 (Del. Ch. July 22, 1999).

43. Seibert v. Harper & Row, Publishers, Inc., No. CIV.A. 6639, 1984 WL 21874, at *3 (Del. Ch. Dec. 5, 1984).

44. Orman v. Cullman, 794 A.2d 5, 25 n.50 (Del. Ch. 2002).

45. *See id.* ("The key issue is not simply . . . whether another person or entity has the ability to take some benefit away from a particular director, but whether the possibility of gaining some benefit or the fear of losing a benefit is likely to be of such importance to that director that it is reasonable for the Court to question whether valid business judgment or selfish considerations animated that director's vote on the challenged transaction."); *In re* MFW S'holders Litig., 67 A.3d 496, 509–10 (Del. Ch. 2013) (noting that "[c]onsistent with the overarching requirement that any disqualifying tie be material, the simple fact that there are some financial ties between the interested party and the director is not disqualifying," and "it is necessary to look to the financial circumstances of the director in question to determine materiality").

46. *In re MFW S'holders Litig.*, 67 A.3d at 511–12 n.54.

47. *In re* The Limited, Inc. S'holders Litig., No. CIV.A. 17148–NC, 2002 WL 537692, at *6 (Del. Ch. Mar.

reasonable to infer that he "was 'beholden' to [the company's CEO] because of a desire to continue with those consulting services."[48]

To be sure, controlling shareholders can have the power to benefit a director in the future even if they have had no relationships with each other in the past. Consider, for example, a director who is a partner in a law firm that has never provided services to the controller. The controller or the companies under its control can still be the director's future clients. Delaware courts, however, have been reluctant to conclude that the prospect of future benefits, without more, can compromise independence. In *In re MFW Shareholders Litigation*, one member of the special committee that negotiated and approved the freezeout transaction, Viet Dinh, subsequently joined the board of another company controlled by the same controller, but the court nevertheless found that Dinh was independent.[49] Then-Chancellor Strine explained:

> If Dinh's [subsequent] directorship . . . were to be relevant to his independence at the time of the MFW transaction, the plaintiffs would need to provide record evidence creating a triable issue of fact that he was offered the directorship *before* the special committee approved the deal, or that it had at least been discussed with him before this time.[50]

Plainly, what Strine was looking for is evidence that the second directorship was used as a bribe. Applying this standard, in *In re Orchard Enterprises, Inc. Stockholder Litigation*, the Chancery Court found a director potentially lacking in independence because he solicited a post-deal consulting engagement with the controlled company *during* the freezeout negotiations.[51]

In sum, Delaware's approach to independence is unquestionably nuanced, probing deeply into relationships to determine if the director is capable of truly independent judgment. But it is also starkly lopsided. It concentrates on negative incentives, such as the prospect of retribution from the controller or the prospect of losing a lucrative stream of income, while all but ignoring positive ones, such as the prospect of reward.

2. The Controller's Power over Director Retention and Termination

In the scholarly literature, the absence of disqualifying ties to the controlling shareholder is just the first criterion. Other mechanisms can also create incentives for director behavior.

Some commentators, for example, argue that controlling shareholders' decisive influence over director re-election and termination can undermine directors' impartiality.[52]

27, 2002).

48. *Id.* at *6–7; *see also In re* Ply Gem Indus., Inc. S'holders Litig., No. CIV.A. 15779–NC, 2001 WL 755133, at *8 (Del. Ch. June 26, 2001) (finding that a director's receipt of $1 million in legal fees raised a reasonable doubt as to his independence where the facts showed that "his was a small law firm").

49. *In re MFW S'holders Litig.*, 67 A.3d at 513, *aff'd sub nom.* Kahn v. M & F Worldwide Corp., 88 A.3d 635, 648 (Del. 2014).

50. *Id.* at 513 n.65.

51. *In re* Orchard Enter., Inc. Stockholder Litig., 88 A.3d 1, 21, 26 (Del. Ch. 2014).

52. For an excellent recent article arguing that controlling shareholders' decisive power to appoint and terminate independent directors undermine the effectiveness of those directors' oversight, see Bebchuk & Hamdani, *Independent Directors*, *supra* note 6. Bebchuk and Jesse Fried have made a similar point in the

It is well known that corporate directorships are coveted. After all, the median annual director compensation of Russell 3000 companies in 2017 is $203,380.[53] In addition to income, there are often lavish perks; for example, General Motors' directors can use a new company car every six months and every year after retirement.[54] Board experience can also lead to business contacts and help executives advance in their own careers. Indeed, Steven Boivie and his co-authors find that a board seat improves executives' likelihood of being promoted to CEO and boosts their subsequent pay.[55]

Controlling shareholders possess a formidable weapon to distort the incentives of directors who wish to stay on the board. As Lucian Bebchuk and Assaf Hamdani have observed, "[d]irectors at firms with controlling shareholders—including independent directors—cannot be elected or reelected following their initial term—unless the controlling shareholder supports their candidacies. Nor will they stay in office once the controlling shareholder decides to end their service on the board."[56] To put this point bluntly, directors depend on controllers for their board seats. As a result, they have substantial incentives to go along with the controllers' proposals.

As a theoretical matter, the controlling shareholder's power to remove an uncooperative director from the board is merely a manifestation of her power to withdraw a benefit that the director is currently getting. As the previous section explained, Delaware decisions have held that a director's independence could be tainted by the fear that the controller would withdraw an ongoing business benefit in retribution.[57] But Delaware courts have firmly refused to hold that a director's independence could be similarly compromised by the fear that the controller would take away the directorship—unless the controller has explicitly threatened to do so.[58] At the same time, Delaware judges worry that the power imbalances could create an inherently coercive environment: that is, "when

executive pay context, arguing that the CEO's influence over director nominations prevents directors from bargaining effectively with the CEO over pay. *See* LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 25–27 (2004).

53. EY CTR. FOR BD. MATTERS, CORPORATE GOVERNANCE BY THE NUMBERS 1 (2017), http://www.ey.com/Publication/vwLUAssets/ey-cgbtn-monthly-print-version-sept-2017/$FILE/ey-cgbtn-monthly-print-version-sept-2017.pdf.

54. Theo Francis & Joann S. Lublin, *Corporate Directors' Pay Ratchets Higher as Risks Grow*, WALL STREET J. (Feb. 24, 2016), https://www.wsj.com/articles/corporate-directors-pay-ratchets-higher-as-risks-grow-1456279452.

55. *See generally* Steven Boivie et al., *Come Aboard! Exploring the Effects of Directorships in the Executive Labor Market*, 59 ACAD. MGMT. J. 1681 (2016); *see also* Joann S. Lublin, *Grooming Top Executives Includes Outside Board Experience*, WALL STREET J. (Mar. 29, 2016), https://www.wsj.com/articles/grooming-top-executives-includes-outside-board-experience-1459243802 (observing that "external directorships have become a key ingredient of executive-development efforts").

56. Bebchuk & Hamdani, *Independent Directors*, *supra* note 6, at 1287.

57. *See supra* notes 44–48 and accompanying text.

58. *See In re* Dole Food Co., Inc. Stockholder Litig., C.A. No. 8703–VCL, 2015 WL 5052214, at *28 n.15 (Del. Ch. Aug. 27, 2015) (noting that "controlling stockholder status does not, standing alone, give rise to concern," but "when controllers actually make retributive threats, that fact is evidence of unfair dealing"); Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1114 (Del. 1994) (holding that the special committee's ability to negotiate effectively was compromised by threats from the controlling shareholder); *cf. In re* Ezcorp Inc. Consulting Agreement Derivative Litig., C.A. No. 9962–VCL, 2016 WL 301245, at *41–42 (Del. Ch. Jan. 25, 2016) (citing retributive behavior by the controlling shareholder as a reason to doubt a director's ability to consider a litigation demand).

an 800-pound gorilla[, the controlling shareholder] wants the rest of the bananas, little chimpanzees, like independent directors and minority stockholders, cannot be expected to stand in the way."[59]

Reconciling these seemingly contradictory positions is a Herculean task. At bottom, the likely answer to the tangle is Chief Justice Strine's statement that the fact "[t]hat a director sits on a controlled company board is not, and cannot of course, be determinative of director independence . . . as that would make the question of independence tautological."[60] Whatever its reality, the claim that directors in controlled companies could be structurally or *per se* biased has been emphatically rejected by the Delaware courts.[61]

3. *"Boardroom Atmosphere" and Psychological Factors*

Another strand of scholarship focuses on social and psychological factors that could subtly undercut independence.[62] Commentators have identified at least three forms of cognitive bias.

First, a director's judgment may be tainted by ingroup bias, the unconscious tendency to "evaluate one's own groups more positively in relation to other groups."[63] As James Cox and Harry Munsinger lamented in their classic article on director bias, "the boards of American corporations continue to be distinguished by their homogeneity."[64] With a median age of 63,[65] directors today are predominantly white males with experiences as CEOs or executive officers of other corporations.[66] Cox and Munsinger explained that the

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59. Strine, *The Inescapably Empirical Foundation*, *supra* note 6, at 509. Recent Delaware decisions, however, have shown less concern with the specter of coercion present in controlling shareholder relationships. *See, e.g.*, *In re* CNX Gas Corp. S'holders Litig., 4 A.3d 397, 413 (Del. Ch. 2010) ("Post-*Lynch* experience shows that special committees can negotiate effectively with controllers and . . . reject squeeze-out proposals."); *In re* Pure Res., Inc. S'holders Litig., 808 A.2d 421, 436 n.17 (Del. Ch. 2002) (describing concerns about the integrity of the special committee process as "premised on a less trusting view of independent directors").

60. Sandys v. Pincus, 152 A.3d 124, 133 (Del. 2016).

61. Chief Justice Strine has expressly made this point to explain Delaware courts' reluctance to find that director independence can be compromised by structural realities. *See* Leo E. Strine, Jr., *Derivative Impact? Some Early Reflections on the Corporation Law Implications of the Enron Debacle*, 57 BUS. LAW. 1371, 1378–79 (2002) (describing judges' concern that, if the presumption of independence can be lightly pierced, "in any scenario in which the role of independent directors has been declared most useful—such as the approval of an interested transaction or a takeover fight—the independent directors simply do not exist").

62. For a classic account of this problem, see James D. Cox & Harry L. Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, 48 LAW & CONTEMP. PROBS. 83 (1985). For a more recent article arguing that courts have not responded to social and psychological bias in a consistent manner, see Julian Velasco, *Structural Bias and the Need for Substantive Review*, 82 WASH. U. L.Q. 821 (2004). For a skeptical discussion of these factors, see Michael P. Dooley & E. Norman Veasey, *The Role of the Board in Derivative Litigation: Delaware Law and the Current ALI Proposals Compared*, 44 BUS. LAW. 503, 534–35 (1989) (arguing that the structural bias argument is unconvincing because it presumes that independent directors are more willing to risk financial income and reputational harm than question insider misbehavior).

63. Christopher L. Aberson et al., *Ingroup Bias and Self-Esteem: A Meta-Analysis*, 4 PERSONALITY & SOC. PSYCHOL. REV. 157, 157 (2000).

64. Cox & Munsinger, *supra* note 62, at 105.

65. *See* Jon Lukomnik, *Board Refreshment Trends at S&P 1500 Firms*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Feb. 9, 2017), https://corpgov.law.harvard.edu/2017/02/09/board-refreshment-trends-at-sp-1500-firms.

66. *See id.* (reporting that women hold 17.8% of S&P 1500 board seats and minorities hold just over 10%); Stephen Foley et al., *US Board Composition: Male, Stale and Frail?*, FIN. TIMES (Aug. 15, 2016),

cultural and socioeconomic similarities among directors and managers make them especially prone to ingroup bias.[67] Directors tend to approach their task "with a deep personal understanding of, and respect for, the burdens of management."[68] An executive or former executive, for example, is likely to have formed a belief that management should have the ability to implement their business ideas in the manner that they see fit—that it is even counterproductive for management to spend a great deal of time responding to issues raised by shareholders or the board. As a director, then, the executive or former executive will tend to defer to management even when she has a different view.

Second, it is often in a director's self-interest to play by the rule "there but for the grace of God go I."[69] Directors may show favoritism to other directors because this type of behavior benefits directors indirectly as a class.[70] This self-interest extends to decisions that favor corporate officers as well.[71] Executives serving as directors have an incentive to favor management in order to encourage similar treatment on their own boards. Consider, for example, decisions about executive compensation. By approving generous pay arrangements for other corporate officers, executives contribute to a business environment that is conducive to better pay for themselves.

Finally, bias might result from what Warren Buffett calls the "boardroom atmosphere."[72] Except perhaps in times of crisis, directors are expected to be "team players" who "get along" with each other and with the firm's executives.[73] In the boardroom, some things are just not done. Buffett offers this example: it is "almost impossible," he explains, for a director "to question a proposed acquisition that has been endorsed by the CEO, particularly when his inside staff and outside advisors are present and unanimously support his decision. (They wouldn't be in the room if they didn't.)."[74] In this form, bias exists because unspoken social norms, which prize collegiality and consent over conflict, dictate the actual course of behavior in board meetings.

4. Risk to Reputation

Finally, reputation plays an important role in directors' incentive calculus. Corporate

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https://ig.ft.com/sites/us-board-diversity (finding that U.S. boards are "maler, staler and frailer" than European boards); Joann S. Lublin, *This Is Why Corporate Boards Aren't More Diverse*, WALL STREET J. (Apr. 15, 2014), https://blogs.wsj.com/atwork/2014/04/15/this-is-why-corporate-boards-arent-more-diverse (reporting that around 67% of male directors, 65% of white directors, 54% of minority directors, and 45% of female directors have experience as CEOs or chief financial officers).

67. Cox & Munsinger, *supra* note 62, at 105–07.

68. *Id.* at 106.

69. *See* Zapata Corp. v. Maldonado, 430 A.2d 779, 787 (Del. 1981).

70. *See* Velasco, *supra* note 62, at 856–57 (describing one paradigm of structural bias as an "implicit conspiracy" that causes independent directors to show favoritism for management and other directors because they will indirectly benefit from promoting those groups' interests).

71. *See id.*

72. Letter from Warren Buffett, Chairman, Berkshire Hathaway Inc., to Shareholders 16 (Feb. 21, 2003), http://www.berkshirehathaway.com/letters/2002pdf.pdf.

73. JONATHAN R. MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 61–62 (2008); *accord* Cox & Munsinger, *supra* note 62, at 91 (noting that boardroom norms disfavor "[i]ndividuals who are quarrelsome, disagreeable, or rigid").

74. Letter from Warren Buffett, *supra* note 72, at 17.

directors have been described as the "most reputationally sensitive people in the world."[75] On the traditional account, reputational concerns enhance independence in fact. As Eugene Fama and Michael Jensen have argued, independent directors' desire to join other boards should make them tougher monitors of management in order to "develop reputations as experts in decision control."[76] A reputation for director talent, the argument goes, will translate into more directorship opportunities. Association with a corporate scandal can also be embarrassing to directors and disrupt other aspects of their careers, including their full-time jobs.[77] Presumably most directors would not be willing to sacrifice the value of their human capital in order to appease a controlling shareholder.[78]

Bebchuk and Jesse Fried have suggested an alternative account. They contend that reputational concerns only deter independent directors from severe malfeasance or actions that starkly empower the management at the expense of other shareholders, such as an egregious pay arrangement.[79] In the more common situation involving underperformance, which is often the result of a complicated set of events, there is little or no reputational penalty.[80] In addition, although board members vote individually on corporate decisions, their actions are recorded as a group, making it hard for public shareholders to reward or discipline a particular director for her contributions.[81] Consistent with this observation,

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75. David A. Skeel, Jr., *Shaming in Corporate Law*, 149 U. PA. L. REV. 1811, 1812 (2001) (quoting corporate governance expert Nell Minow).

76. Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 315 (1983).

77. For example, following the Enron scandal, several of Enron's former directors resigned from their directorships at other corporations. *See* Brooke A. Masters, *Enron's Quiet Outages Uncharged in the Fraud, Directors Settled, Resigned, Lay Low*, WASH. POST (June 2, 2006), https://www.washingtonpost.com/archive/business/2006/06/02/enrons-quiet-outages-span-classbankheaduncharged-in-the-fraud-directors-settled-resigned-lay-lowspan/a3b9fc3f-5e6b-4833-be82-c85b7d66cc81/?noredirect=on&utm_term=.08a6d0d099a6; MACEY, *supra* note 73, at 208 (noting that the careers of Enron's former directors "virtually ended when their weak oversight of Enron was revealed"). But other commentators have argued that directors rarely suffer labor market consequences, even when they fail to prevent egregious conduct. For instance, Steven Davidoff Solomon has observed that "many of the directors of Lehman and Bear Stearns continue to serve on other boards, and one Lehman director, Jerry A. Grundhofer, has apparently been so chastened about the liability issue surrounding large banks that he is serving on the Citigroup board." Steven Davidoff Solomon, *Despite Worries, Serving at the Top Carries Little Risk*, N.Y. TIMES: DEALBOOK (June 7, 2011), https://dealbook.nytimes.com/2011/06/07/despite-worries-serving-at-the-top-carries-little-risk.

78. *See* Dooley & Veasey, *supra* note 62, at 534–35 (expressing skepticism that "outside directors generally are more willing to risk reputation and future income than they are to risk the social embarrassment of calling a colleague to account"); *In re* MFW S'holders Litig., 67 A.3d 496, 528–29 (Del. Ch. 2013) (describing the Delaware Supreme Court's belief that "directors have a more self-protective interest in retaining their reputations as faithful, diligent fiduciaries") (citing Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart, 845 A.2d 1040, 1052 (Del. 2004)).

79. BEBCHUK & FRIED, *supra* note 52, at 35–36.

80. *See id.* Ronald Gilson and Reinier Kraakman have also expressed this skepticism, calling the idea that the market will punish underperforming directors a "myth" akin to "directorial noblesse." Ronald Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 875 (1991).

81. *See* Lucian Arye Bebchuk et al., *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 771 (2002) (arguing that "the signal provided by independent directorships is likely to be quite noisy"). A recent study by Reena Aggarwal and her co-authors found that directors who receive low shareholder support in elections—which can be seen as a director-specific assessment—do suffer negative consequences, including a reduction in directorships at other firms. *See generally* Reena Aggarwal et al.,

studies have found that proxy advisory firms frequently issue conflicting recommendations for a director who is up for election in multiple firms: proxy advisors would recommend that shareholders of firm A withhold their votes for the director because of poor performance but simultaneously recommend that shareholders in firm B vote for the director.[82]

Bebchuk and Fried also question whether a reputation for tough monitoring helps or hurts a director's prospects of securing directorships in other companies.[83] They argue that because CEOs heavily influence—and controlling shareholders control outright—director selection, a reputation as a director who does not rock the boat will likely be more useful in obtaining additional board seats.[84] While this view has some intuitive appeal, the empirical evidence is decidedly mixed.[85] On the one hand, there is evidence that outside directors who take shareholder-friendly actions are rewarded. Studies have found, for example, that independent directors who opted out of state anti-takeover laws—laws that entrench management—observe an increase in the number of future board opportunities;[86] directors who fail to implement shareholder proposals are more likely to lose board seats at other firms;[87] and outside directors at highly-performing firms are more likely to gain additional directorships, at least under certain empirical models.[88] On the other hand, several papers have concluded that directors suffer only trivial labor market penalties for poor monitoring, even when a crisis erupts under their watch. Researchers have observed, for instance, that outside directors of firms that engaged in option backdating or that substantially underperformed their peers were no less successful than other directors at gaining future board seats.[89]

The Power of Shareholder Votes: Evidence from Uncontested Director Elections, J. FIN. ECON. (forthcoming).

82. *See* Yonca Ertimur et al., *Reputation Penalties for Poor Monitoring of Executive Pay: Evidence from Option Backdating*, 104 J. FIN. ECON. 118, 136 & n.30 (2012) [hereinafter Ertimur et al., *Reputation Penalties*] (finding no instances where the proxy adviser Institutional Shareholder Services (ISS) recommended withholding votes from a director at one firm because of the director's association with a different firm that was involved in option backdating, and reporting that ISS does not automatically carry over negative recommendations to a director's other boards except in the most egregious cases); Stephen Choi et al., *Director Elections and the Role of Proxy Advisors*, 82 S. CAL. L. REV. 649, 686–87(2009) (finding no evidence that proxy advisers considered a director's performance on one board in issuing a recommendation for a different board).

83. *See* BEBCHUK & FRIED, *supra* note 52, at 36 (discussing how "a reputation for challenging CEO compensation is likely to be viewed as a minus, not as a plus, by other firms' nominating committees").

84. *See id.*

85. For a summary of the empirical evidence, see Steven M. Davidoff et al., *Do Outside Directors Face Labor Market Consequences? A Natural Experiment from the Financial Crisis*, 4 HARV. BUS. L. REV. 53, 61–63 (2014).

86. *See* Jeffrey L. Coles & Chun-Keung Hoi, *New Evidence on the Market for Directors: Board Membership and Pennsylvania Senate Bill 1310*, 58 J. FIN. 197, 229 (2003).

87. *See* Yonca Ertimur et al., *Board of Directors' Responsiveness to Shareholders: Evidence from Shareholder Proposals*, 16 J. CORP. FIN. 53, 67 (2010).

88. *See, e.g.*, David Yermack, *Remuneration, Retention, and Reputation Incentives for Outside Directors*, 59 J. FIN. 2281, 2302 (2004) (finding statistically significant results only when using a lagged performance variable and stock returns).

89. *See, e.g.*, Davidoff et al., *supra* note 85, at 72 (finding no significant correlation between the performance of one firm associated with the outside director and the director's ability to obtain other board seats); Ertimur et al., *Reputation Penalties*, *supra* note 82, at 137 (finding that association with a firm involved with option backdating did not significantly affect other directorship opportunities); Christopher S. Armstrong, *Inelastic Labor Markets and Directors' Reputational Incentives*, HARV. L. SCH. F. ON CORP. GOVERNANCE &

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In this Part, I showed that "independence" in the standard Delawarean parlance reduces roughly to a lack of substantial past or ongoing connections to the controlling shareholder. The inquiry recognizes and responds to the concern that negative incentives may lead directors to favor controllers: the worry is that directors with lucrative ties to the controlling shareholder might be influenced by the fact that the controller can cut off those ties. Yet it all but ignores the fact that positive incentives—the prospect of future patronage from the controlling shareholder—can provide the same spur to appease. Attempts by corporate governance reformers to refine the markers of independence are similarly lopsided, identifying mostly sticks (the *loss* of a directorship, the risk of *harm* to reputation) but no carrots.

Is the prospect of future patronage substantial enough to bear on the average independent director's ability to be impartial? To put the point more bluntly, is this conflict more than a mere theoretical danger? The answer turns in large part on another empirical question: do controlling shareholders reward cooperative directors? I now turn to this question.

III. INDEPENDENT DIRECTOR REALITIES

This Part presents my empirical results. After describing the data sources and methodology in Part III.A, I show in Part III.B that controlling shareholders re-appoint nominally independent directors to executive positions and directorships at other firms that they control. (In what follows, I will refer to these ties simply as "professional" ties). My results suggest that many nominally independent directors received opportunities from the controlling shareholder after acting to favor the controlling shareholder's interests.

In Part III.C, I argue that the monolithic conception of controlling shareholders that pervades the jurisprudence and literature is too coarse to capture the complex ways in which controlling shareholders can undermine director independence. Building off of my empirical results, I offer a more nuanced taxonomy that theorizes how much and what kind of pressure a controlling shareholder can exert. The taxonomy divides controllers along two dimensions: the base of controlled entities and the concentration of decision-making authority. A given controller's power to incentivize director behavior depends on its mix of these attributes.

A. Data Sources and Methodology

I constructed a new database of nominally independent directors who vetted recent freezeouts of Delaware targets. I searched the Thomson Reuters Corporation's SDC Platinum database for all completed transactions that were coded as "acquisitions of remaining interest" or "going private"; were announced between January 1, 2000, and December 31, 2014; and in which the target was a Delaware corporation and the acquirer (or the ultimate parent of the acquirer) was a U.S. entity. I eliminated transactions where the acquirer held less than 35% of the target's voting shares when the transaction was

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FIN. REG. (July 13, 2017), https://corpgov.law.harvard.edu/2017/07/13/inelastic-labor-markets-and-directors-reputational-incentives (finding that directors with poor stock returns over their tenure are more likely to lose their board seat, but they are also more likely to gain a seat on another, and often better, board).

announced (Delaware courts have deemed a shareholder with as little as a 35% holding to be a controlling shareholder[90]), as well as transactions that were actually one step of a two-step acquisition by an outside third-party (because whether such transactions are "true" freezeouts is a gray area[91]). I also excluded transactions where the acquirer held 90% or more of the outstanding shares because such transactions can be executed as short-form mergers, which are treated differently by Delaware law.[92] Finally, I eliminated transactions where the target did not establish a special committee of independent directors to assess the offer. The final data includes 88 transactions.

For each deal, I examined SEC filings to collect information on the special committee formed to review and negotiate the terms. The resulting data includes 222 nominally independent directors. I gathered information about board directorships and employment history for each director from the BoardEx database, news reports, and SEC filings of companies associated with the director. Using this information, I hand coded relational links among directors and controlling shareholders. With one exception, I identified instances where the nominally independent director either served on the board of another company controlled or dominated by the controlling shareholder or as an executive of such a company. The exception is Ronald Joseph, who was a director of Great American Financial Resources and whose son served as a director of another company controlled by Great American's controlling shareholder. I classified Joseph as having a professional tie to the controlling shareholder, but the major findings reported in this section remain unchanged if I exclude him from the analysis.

To be clear, I looked at connections to the ultimate controlling person or entity, which is not necessarily the acquirer.[93] While my data includes 88 deals, it includes only 77 unique ultimate controlling shareholders because several freezeouts were executed by the same controlling entity. (For example, the Cox family completed a freezeout of both Cox Communications and Cox Radio during the sample time period). In four cases, I classified a person or entity as the ultimate controlling shareholder even though it held less than 35% of the acquirer's voting shares at the time of the freezeout, because the acquirer or Delaware courts treated it as the ultimate controlling shareholder: Leslie Wexner (The Limited's

90. *See, e.g.*, *In re* Cysive, Inc. S'holders Litig., 836 A.2d 531, 535, 551–53 (Del. Ch. 2003). In fact, the Delaware Chancery Court recently found it reasonably conceivable that Elon Musk, a 22.1% stockholder of Tesla Motors, Inc., was a controlling shareholder in light of "his domination of the Board . . . against the backdrop of his extraordinary influence within the Company generally, the Board level conflicts that diminished the Board's resistance to Musk's influence, and the Company's and Musk's own acknowledgements of his outsized influence." *See In re* Tesla Motors, Inc. Stockholder Litig., C.A. No. 12711–VCS, 2018 WL 1560293, at *2, *19 (Del. Ch. Mar. 28, 2018).

91. *See* Victor Brudney & Marvin A. Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354, 1360 (1978) (explaining that "[a]lthough the tag-end merger appears to be an example of self-dealing by the majority stockholders, it is only superficially of that class").

92. *See* DEL. CODE ANN. tit. 8, § 253 (2001); *see generally* Glassman v. Unocal Expl. Corp., 777 A.2d 242 (Del. 2001).

93. Both Delaware courts and the United States Supreme Court have looked beyond the formal corporate entities behind the transaction to the persons or entities "who wield . . . control in substance." *In re* Ezcorp Inc. Consulting Agreement Derivative Litig., C.A. No. 9962–VCL, 2016 WL 301245, at *9, *18–21 (Del. Ch. Jan. 25, 2016) (holding that a person could owe fiduciary duties to minority shareholders when he controlled a corporation through intervening entities); *accord* S. Pac. Co. v. Bogert, 250 U.S. 483, 491–92 (1919) (holding that a firm that exercised control through a subsidiary entity could owe fiduciary duties to the controlled company's minority shareholders).

freezeout of Intimate Brands);[94] John Malone (Liberty Media International's freezeout of UnitedGlobalCom);[95] Bennett LeBow (Vector Group's freezeout of New Valley);[96] and the Lindner family (American Financial Group's freezeout of Great American Financial Resources).[97]

Finally, using SEC filings, I classified ultimate controlling shareholders along two dimensions. First, I categorized each controlling shareholder as either an individual person, a family group, an investment manager,[98] or a widely-held corporation. Second, among controlling shareholders that are persons or family groups, I identified those that have controlled more than one publicly-traded company between 1993 and 2017. I excluded controlling shareholders that are investment managers from this classification because investment managers typically acquire attributes of control through large but non-controlling stakes (the hedge fund model) or by taking companies private (the private equity model).[99] The purpose of this second classification is to identify controlling shareholders who maintain operational control of a portfolio of companies, and it is well known that private equity firms often function as repeat players in the market for operational control in this way.[100] I also excluded controlling shareholders that are widely-

94. *See In re* The Limited, Inc. S'holders Litig., No. CIV.A. 17148–NC, 2002 WL 537692, at *1, *5 & n.33 (Del. Ch. Mar. 27, 2002) (suggesting that Leslie Wexner controlled The Limited's board because of his 25% holding coupled with "his position, as chairman, chief executive officer, and director"). At the time of The Limited's freezeout of Intimate Brands, Wexner and the entities subject to his fiduciary duties as trustee held approximately 24% of The Limited's outstanding shares. *See* The Limited, Inc., Amendment No. 26 (Schedule 13D/A), at 12–13 (Nov. 3, 2004).

95. *See* Liberty Media Int'l, Inc., Information Statement (Exhibit 99.1 to Form 10-12G/A) (May 28, 2004) ("By virtue of Mr. Malone's [29%] voting power in our company as well as his positions as our Chairman of the Board, President and Chief Executive Officer, Mr. Malone may be deemed to control our operations."). At the time of Liberty Media International's freezeout of UnitedGlobalCom, John Malone controlled approximately 33% of Liberty Media International's voting power. Liberty Media Int'l, Inc., Amendment No. 2 (Schedule 13D/A), at 6 (Jan. 19, 2005).

96. *See* Vector Grp. Ltd., Definitive Proxy Statement Relating to Merger or Acquisition (Schedule 14A), at 6 (Nov. 7, 2005) (describing Bennett LeBow's "controlling interest in Vector"). At the time of Vector Group's freezeout of New Valley, LeBow held approximately 33.4% of Vector Group's outstanding shares. *Id.* at 4.

97. *See* Am. Fin. Grp., Annual Report (Form 10-K), at 19 (Mar. 1, 2007) ("[C]ertain members of the Lindner family have the ability to exercise significant influence over AFG's management, including over matters requiring shareholder approval."). At the time of American Financial Group's freezeout of Great American Financial Resources, the Lindner family members held approximately 32.6% of Vector Group's outstanding shares. *See id.*

98. I drew on John Morley's work for my definition of investment managers. In his article, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, Morley argues that investment funds are characterized by the separation of funds and managers. *See* John Morley, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, 123 YALE L.J. 1228, 1238–40 (2014). As a practical matter, investment managers can overlap with the other three categories because investment management companies can be controlled by a single person, controlled by a family, or widely held (for instance, the hedge fund ESL Investments, Inc. is controlled by a single person, Edward Lampert). For present purposes, I coded controllers that manage investment funds as investment managers even if they fall under one of the other categories as well to focus on those controllers' status as repeat players in the market for corporate control or influence.

99. *See* Brian R. Cheffins & John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. CORP. L. 51, 58–60 (2011) (comparing the business models of hedge funds and private equity firms).

100. *See, e.g.*, Ronald W. Masulis & Randall S. Thomas, *Does Private Equity Create Wealth? The Effects of Private Equity and Derivatives on Corporate Governance*, 76 U. CHI. L. REV. 219, 222–23 (2009) (explaining

held companies from this second classification because they are, by definition, a part of a family of public companies (at a minimum, the family consists of the widely-held controller and the public subsidiary it froze out).

There are important limitations to my data, particularly as related to my focus on freezeouts and certain types of relationships. I limited the study to directors who were tasked with reviewing and negotiating freezeout transactions. The freezeout data offers a conservative picture of independence—that is, a vantage point on who is labelled an "independent" director when the stakes are high and litigation is nearly inevitable. So any evidence that directors who are appointed to negotiate freezeouts have other relationships with the controlling shareholders would be particularly suggestive.

Additionally, out of an abundance of caution, I chose to focus exclusively on connections routinely reported in public databases and filings: directorships and senior executive positions in, for the most part, public companies. Controlling shareholders can benefit directors in a myriad of other, less visible ways, including appointing them to senior positions at privately-held companies.[101] I tried to mitigate this concern by studying each director's biography in SEC filings, which sometimes provide information on a director's employment at private firms. However, given these unavoidable data constraints, the full list of controller-independent director business dealings is almost certainly much longer.

B. Controller-Independent Director Ties

Table 1 shows the incidence of nominally independent directors who have multiple professional connections to the controlling shareholder. At the highest level, Table 1 shows that 20.3% of all directors in the data (45 of 222) have served as a director or a senior executive in at least one other company controlled or dominated by the controlling shareholder, and 2.3% (5 of 222) have ties to at least three other companies. This basic finding calls into question the familiar trope that directors who are labelled "independent" have *no* relationship to the controlling shareholder other than their service on the board.[102]

The special committee that approved the 2011 M&F Worldwide deal typifies the kinds of connections in the sample. M&F Worldwide formed a special committee of four nominally independent directors to negotiate and review the offer from MacAndrews & Forbes and its controlling shareholder, Ronald Perelman. Just three months after the deal closed, the chairman of the special committee, Paul Meister, was invited to be an independent director of Scientific Games, which at the time was 34.2% owned by Perelman. Meister also subsequently became the president of MacAndrews & Forbes in 2014 and joined the boards of two other Perelman-controlled companies, vTv Therapeutics

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that private equity firms typically control their portfolio companies' operations through control of their boards of directors); *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 54 (Del. Ch. 2013) (describing venture capital firms as repeat players).

101. Other scholars have discussed the limited available data on private firms. *See, e.g.*, Robert J. Jackson, Jr., *Private Equity and Executive Compensation*, 60 UCLA L. REV. 638, 647 (2013); Robert Anderson IV, *The Delaware Trap: An Empirical Analysis of Incorporation Decisions*, 91 S. CAL. L. REV. 657, 661 (2018).

102. *See* Bebchuk & Hamdani, *Independent Directors*, *supra* note 6, at 1274 (defining independent directors as "directors who have no ties to the controller or the company other than their service on the board"); Marcel Kahan & Edward Rock, *When the Government is the Controlling Shareholder: Implications for Delaware*, 89 DEL. J. CORP. L. 409, 414 (2010) (describing directors who "work for the controlling shareholder or have other business relationships with the controlling shareholder" as non-independent).

and Revlon, Inc.[103] Meister's path is not unique: as I mentioned earlier, Viet Dinh, another special committee member, became an independent director of Revlon in June 2012, less than a year after the freezeout. In 2017, Dinh left Revlon to join the Scientific Games board. A third special committee member, Carl Webb, previously served as the president, chief operating officer and director of several Perelman-controlled entities (notably entities associated with First Nationwide Bank) between 1988 and 2002.[104]

103. Because of his role as president of MacAndrews & Forbes, Meister was not deemed an independent director of vTv Therapeutics or Revlon. *See* vTv Therapeutics Inc., Definitive Proxy Statement (Schedule 14A), at 11 (Mar. 24, 2016); Revlon, Inc., Definitive Proxy Statement (Schedule 14A), at S-ii (Apr. 29, 2016).

104. In the ensuing litigation over the MFW freezeout, minority shareholders challenged the special committee's independence, citing Dinh's and Webb's relationships to Perelman. *In re* MFW S'holders Litig., 67 A.3d 496, 512–14 (Del. Ch. 2013), *aff'd sub nom.* Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014). The Delaware Chancery Court ruled that the ties were insufficient to call into question the special committee's independence, *id.*, and the Delaware Supreme Court affirmed. *Kahn*, 88 A.3d at 647–48. The plaintiffs did not challenge Meister's independence perhaps because Meister's connections to other Perelman-affiliated entities were only formed after the MFW freezeout closed. *In re MFW S'holders Litig.*, 67 A.3d at 509.

Table 1. Incidence of independent (special committee) directors with professional ties

	n	At least one other professional tie	At least 3 other professional ties
All special committee directors	222	45 (20.3%)	5 (2.3%)
Directors by controlling shareholder characteristics[1]:			
Single natural person	85	23 (27.1%)	4 (4.7%)
Widely-held company	66	14 (21.2%)	1 (1.5%)
Family group	41	4 (9.8%)	0
Investment manager	32	4 (12.5%)	0
Controlling shareholder controlled multiple public companies and is a[2]:			
Single natural person	50	22 (44.0%)	4 (8.0%)
Family group	14	4 (28.6%)	0

1. Two directors, Charles Crocco Jr. and Viet Dinh, served as special committee members for two freezeouts in the sample. Crocco Jr. was a member of the special committee that negotiated First Banks's freezeout of First Banks America and Anthony Gumbiner's freezeout of the Hallwood Group. Dinh was a member of the special committee that negotiated JDS Capital Management's freezeout of Orchard Enterprises and Ronald Perelman's freezeout of M&F Worldwide. Because these deals involve controlling shareholders with different attributes, Crocco and Dinh are counted twice.
2. For the reasons discussed in Part III.A, widely-held companies and investment manager controllers were not categorized by the number of public companies under their control.

With respect to controlling shareholder type, Table 1 shows that independent directors on boards controlled by a single natural person are most likely to have professional ties to other companies controlled or dominated by the controlling shareholder. Twenty-three of 85 directors in that subset, or 27.1%, have repeat relationships of this sort. Among independent directors on boards controlled by a widely-held corporation, 21.2% (14 of 66) have professional ties with at least one other controlled company. This result reflects the reality that directors of subsidiaries sometimes join the boards of the widely-held parent corporations once the subsidiary is taken private. Among the 32 independent directors on boards controlled by an investment manager, only four have professional ties to at least one other controlled company. This figure is likely an underestimate, however, because some investment managers invest mostly in private companies, and little is known about whom they hire as directors or executives.[105] Only four directors (9.8%) serving on boards

105. *See supra* note 101.

controlled by a family group have professional ties to another controlled company.

The lower half of Table 1 focuses on the subset of controlling shareholders that have controlled multiple public companies, which for convenience I will call "portfolio" controllers. In this subsample, the incidence of independent directors with professional ties to at least one other controlled company is notably higher than in the full sample—and quite high in absolute terms as well. Among independent directors on boards controlled by portfolio controllers who are individual persons in particular, 44% have repeat relationships. These results suggest that reappointment behavior may be a function of the controlling shareholder's power. Not all controlling shareholders can hire a director for a position at another entity; a controller who controls only one firm cannot offer a director a job at another firm. As I will explain in Part III.C, a controlling shareholder is likely to be more able to engage in reappointment behavior as the size of its portfolio increases.

It is possible that these director-level results are skewed by the actions of just a few controlling shareholders, and the vast majority of controllers do not have other ties to the directors they label as independent. To explore this, I break down the controlling shareholders in the sample by reappointment behavior. The results are presented in Table 2. I find that 36.4% of controlling shareholders (28 of 77) have repeat relationships with at least one nominally independent director on their board, and 26% (20 of 77) have repeat relationships with at least half of the special committee members who negotiated the freezeout. This result confirms that the director-level outcomes are not driven by outliers. Moreover, like Table 1, Table 2 shows that reappointment behavior is more common among portfolio controllers. Strikingly, among portfolio controllers that are individual persons, 73.3% (11 of 15) have repeat relationships with at least half of the special committee that negotiated the deal.

Table 2. Controlling shareholders by reappointment behavior

		Repeat relationships with:	
	n	At least one director	Half or more of SC[1]
All controlling shareholders	77	28 (36.4%)	20 (26.0%)
Controlling shareholder characteristics:			
Single natural person	29	14 (48.3%)	12 (41.4%)
Widely-held company	23	7 (30.4%)	5 (21.7%)
Family group	12	3 (25.0%)	1 (8.3%)
Investment manager	13	4 (30.8%)	2 (15.4%)
Controlling shareholder controlled multiple public companies and is a[2]:			
Single natural person	15	13 (86.7%)	11 (73.3%)
Family group	4	3 (75.0%)	1 (25.0%)

1. Five controlling shareholders (Thermo Electron, the Cox family, Barry Diller, John Malone, and Carl Icahn) executed multiple freezeouts in the sample. These controllers were coded as having repeat relationships with half or more of the special committee if they had such ties with at least one of the special committees they negotiated with.
2. For the reasons discussed in Part III.A, widely-held companies and investment manager controllers were not categorized by the number of public companies under their control.

If controlling shareholders reward cooperative directors with future patronage, then we should observe new relationships between directors and controlling shareholders after the freezeout closed. While professional ties from before the freezeout was announced are evidence of repeat relationships and reappointment behavior, it would be surprising if no director joined another company that the controller controlled after the freezeout. Figure 1 focuses on the 45 independent directors that have multiple professional ties to the controlling shareholder, broken down by when the connections were formed. Consistent with the rewards thesis, I find that 44.4% of these directors only have past or ongoing ties with the controller from before the freezeout was announced, and conversely, 55.6% formed new post-freezeout connections. Curiously, past ties to the controlling shareholder appear to be a poor predictor of future ties: only 16% of independent directors who joined another controlled company after the freezeout (4 of 25) had a pre-freezeout relationship with the controller as well. A potential explanation for this finding is that courts are currently willing to believe that directors who have worked with the controller once before can be independent, but they are more skeptical when two or more past connections exist. As a result, most controlling shareholders may be less inclined to select an individual for an independent directorship if they have worked together at two or more prior companies.

Finally, to render this discussion more concrete and to identify interesting cases for further investigation, Table 3 describes the five independent director-controlling shareholder pairings that share the largest number of professional ties. These vignettes illustrate how some directors have, over time, developed a mutually-beneficial network of relationships with the controlling shareholder. Consider, for example, J. David Wargo, who was a member of the special committee that blessed media mogul John Malone's 2003 offer to freeze out the minority shareholders of On Command Corporation. Between 1998 and 2003, while he was a director at On Command, Wargo simultaneously served on the boards of two other Malone-affiliated entities, Liberty Digital and OpenTV. Since the freezeout, Wargo has joined the boards of four more of Malone's companies: Liberty Global (and its predecessors), Discovery Communications (and its predecessor), Liberty Broadband, and Fun Technologies. Wargo has served on the board of seven of Malone's companies since 1999, making the Wargo-Malone link the most extensive in the dataset. Indeed, a shareholder activist group recently called Wargo one of "Malone's go-to directors over the years."[106]

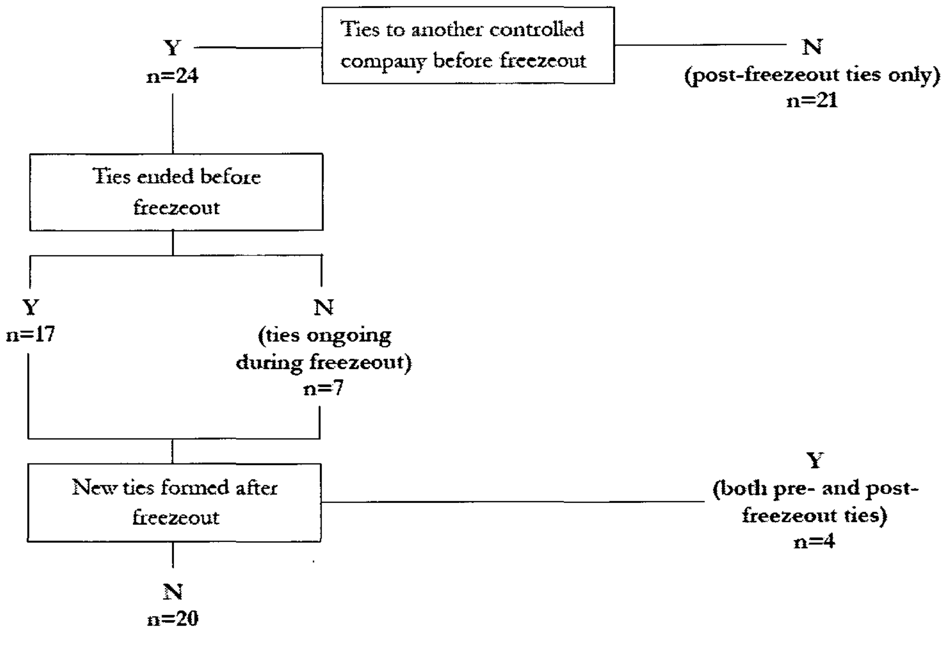

Figure 1. Breakdown of independent directors with multiple professional ties

As another illustration, consider Paul Gould, who was a member of the special committee that negotiated Malone's 2005 offer to freeze out the remaining shareholders of

106. Letter from Dieter Waizenegger, Exec. Director, CtW Inv. Grp., to shareholders of Discovery Comm., Inc. 4 (Apr. 1, 2016), http://ctwinvestmentgroup.com/2016/04/ctw-letter-discovery-communications-shareholders/ (click on the link to read the letter).

UnitedGlobalCom. According to the proxy statement, the fact that Gould had previously served on the boards of at least two of Malone's companies and was contemporaneously serving on a Malone-affiliated board was insufficient to disqualify his independence:

> The Special Committee noted that Mr. Gould's service on the boards of directors of various entities affiliated with Mr. Malone or in which Mr. Malone, directly or indirectly, was a substantial investor consisted in each case of service as an independent director. The Special Committee deemed Mr. Gould's receipt of fees with respect to this service as a director to be *insufficiently material to undermine his independence*, given Mr. Gould's personal finances.[107]

Ultimately, the most striking point that emerges from Table 3 is that, contrary to the practice assumed by most academics, controlling shareholders and controlled companies do not always treat business dealings—even extensive connections like the Wargo-Malone or Gould-Malone networks—as antithetical to independence. For instance, Gould was called an independent director in at least five of Malone's companies, and Wargo was an independent director at six. This odd reality is almost certainly a result of Delaware's indeterminacy toward director independence, which invites controlling shareholders to push the envelope.[108]

107. Liberty Media Int'l, Inc., Definitive Proxy Statement Relating to Merger or Acquisition (Schedule 14A), at 21–22 (May 3, 2005) (emphasis added).

108. For a similar point in the deal protection setting, see Fernán Restrepo & Guhan Subramanian, *The New Look of Deal Protection*, 69 STAN. L. REV. 1013, 1015, 1024 (2017).

Table 3. The Five Most-Entangled Controller-Independent Director Pairings

Controlling Shareholder	Director	Professional Ties #	 Description
John Malone	J. David Wargo	7	• Independent Director, Liberty Digital (1999 to 2002) • Independent Director, Special Committee Member, On Command (1998 to 2003) • Independent Director, OpenTV[1] (2002 to 2007) • Director, Fun Technologies[1] (2007 to 2008) • Independent Director, Liberty Global[1] (2004 to Present) • Independent Director, Discovery Communications[1] (2005 to Present) • Independent Director, Liberty Broadband (2015 to Present)
John Malone	Paul Gould	5	• Independent Director, Special Committee Member, Tele-Communications Inc.[1] (1996 to 1999) • Independent Director, Liberty Interactive[1] (1999 to 2009) • Independent Director, DirectTV[1] (2009 to 2010) • Independent Director, Special Committee Member, Liberty Global[1] (2004 to Present) • Independent Director, Discovery Communications[1] (2005 to Present)
Ronald Perelman	Paul Meister	5	• Independent Director, Special Committee Member, MFW (1995 to 2011) • Independent Director, Scientific Games[1] (2012 to Present) • President, MacAndrews & Forbes (2014 to 2018) • Director, vTv Therapeutics (2015 to 2018) • Director, Revlon (2016 to Present)
Barry Diller	Alan Spoon	4	• Independent Director, Special Committee Member, Ticketmaster (1997 to 2002) • Director, The HealthCentral Network[2] (2005 to 2011) • Independent Director, IAC/InterActiveCorp (2003 to Present) • Independent Director, Match Group (2015 to Present)
Thermo Electron Corp.	Polyvios Vintiadis	4	• Independent Director, Special Committee Member, Thermo TerraTech (1992 to 2000) • Independent Director, Special Committee Member, Thermo Instrument Systems (1993 to 2000) • Independent Director, Special Committee Member, Spectra Physics (1999 to 2001) • Director, Randers Killam Group (1997 to 1999)

1. Denotes companies in which the controlling shareholder held a large but less than 35% voting stake at the time of appointment.
2. Alan Spoon became a director of HealthCentral in 2005 as a representative of venture capital firm Polaris Partners. Barry Diller, through IAC/InterActiveCorp, acquired a significant minority stake in HealthCentral in 2008. This type of connection where the controlling shareholder invests in a company that the independent director is already affiliated with is not typical of the ties in the sample.

Thus far in this Part, I have offered evidence that controlling shareholders will re-appoint friendly nominally independent directors to senior positions and directorships at other firms under their control. As a result, directors can use their directorships as a portal of entry by which to form additional connections with and gain future benefits from controlling shareholders. From the perspective of the directors, other lucrative posts may be obtainable—if the directors remain on good terms with the controllers. Controlling shareholders' power to grant or withhold these benefits then has the potential to shape the directors' allegiances. I turn to that power next.

C. Creating a Taxonomy of Controlling Shareholders

The extent of controllers' ability to influence directors is not uniform. This distinction rarely appears in existing scholarship or jurisprudence about controlling shareholders. Controllers are instead portrayed with the attributes of a single person with plenary control: an "800-pound gorilla"[109] that can always get its way or a "king"[110] or queen who likes the ego boost from her tremendous clout.[111] In reality, however, controlling shareholders come in many forms, such as families, widely-held corporations, investment companies, or as the recent financial crisis demonstrates, the U.S. government. The power of decision-making actors within these various controlling entity types can be arrayed on a spectrum, with decision-making authority concentrated solely in one person's hands at one end and divided authority where decisions are reached by consensus at the other. Moreover, some controllers have influence over a vast portfolio of companies; others have far fewer holdings. Controlling shareholders also exhibit different attitudes toward director independence and the qualities they look for in their boards. For example, Dole's controlling shareholder David Murdock has said that, at his companies, he is "the boss" and "[t]he boss does what he wants to do."[112] By contrast, Warren Buffett, who controls Berkshire Hathaway, has said he prefers directors who not only "think and speak independently" but are also "shareholder-oriented";[113] Buffett in fact handpicked some of Berkshire's outside directors from shareholders whose families own substantial Berkshire holdings to ensure that the directors' interests are aligned with those of Berkshire's minority shareholders.[114]

These attributes are not meant to be exhaustive or to create sharp lines; they simply illustrate that controlling shareholders are not uniform. The stark dichotomy between

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109. Strine, *The Inescapably Empirical Foundation*, *supra* note 6, at 509.

110. Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 571 (2016).

111. For notable exceptions, see Gilson, *supra* note 24, at 1649 (recognizing that "controlling shareholders come in different forms—for example, families as opposed to widely held corporations"); Kobi Kastiel, *Executive Compensation in Controlled Companies*, 90 IND. L.J. 1131, 1161 (2015) (collecting data on the "significant heterogeneity" across U.S. controlling shareholders and arguing that some types of controllers may be unwilling or unable to effectively monitor managerial pay). Some scholars have observed that different controlling shareholders establish control through different devices and argued that controllers who hold control through mechanisms that separate voting rights from equity ownership, such as dual class stock, are more likely to engage in self-dealing. *See, e.g.*, Bebchuk et al., *Stock Pyramids*, *supra* note 1, at 301–05 (finding high agency costs in firms with dual-class shares). These works, however, focus on controlling shareholders' incentives to extract private benefits, not their ability to do so.

112. *In re* Dole Food Co., Inc. Stockholder Litig., C.A. No. 8703–VCL, 2015 WL 5052214, at *1, *5 (Del. Ch. Aug. 27, 2015).

113. Letter from Warren Buffett, *supra* note 72, at 17.

114. *Id.* at 19.

controlling and non-controlling shareholders that pervades the jurisprudence obscures the complex ways in which controllers can undermine director independence. Assessing how much and what type of pressure a controller can exert requires a more nuanced taxonomy. Drawing from the corporate governance and political science literature on power,[115] I offer an important first cut at such a framework by distinguishing controlling shareholders along two dimensions: the base of controlled entities and the concentration of decision-making authority. I discuss each factor in turn, with illustrations from the freezeouts in my data and other cases as appropriate.

1. Base

Base refers to the size of the network of businesses over which a controlling shareholder has authority. Empire builders—heads of conglomerates like Alphabet (formerly Google) and Berkshire Hathaway—are clear examples of controllers with a wide base of control. Companies that routinely retain control blocks in a portfolio of firms, such as venture capital and private equity funds, fall into this category as well.

Just as increased firm size tends to mean more CEO power,[116] a wider base tends to mean more controlling shareholder power. In particular, base size does not affect the controller's power to remove directors from the board, but it does increase the controller's ability to reward for the simple reason that those who control more resources have more ways to dole out benefits. Most obviously, a controlling shareholder who controls a portfolio of companies can cause controlled firm A to enter into transactions that benefit a director on the board of controlled firm B. Two nominally independent directors on MFW's board, for instance, received fees for legal and consulting services from another Perelman company, Scientific Games.[117] Deborah Norville, a nominally independent director of Sumner Redstone's Viacom, is an anchor of "Inside Edition," which is produced by another Redstone-controlled company, CBS.[118]

Increased base size also translates into more opportunities to make appointments for high-level posts. Controlling shareholders with control over a large portfolio of companies can reward a director who has served loyally on the board of one firm by asking her to join the board of another firm, and then another, and another. My empirical observations are

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115. There is a massive literature on "power" in public law, political science, and the social sciences. *See, e.g.*, MAX WEBER, ECONOMY AND SOCIETY 53 (Guenther Roth & Claus Wittich eds., 1978) (defining power as "the probability that one actor within a social relationship will be in a position to carry out his own will despite resistance"); Daryl J. Levinson, *The Supreme Court, 2015 Term—Foreword: Looking for Power in Public Law*, 130 HARV. L. REV. 31, 39 (2016) (defining power in public law as "the ability of political actors to control the outcomes of contested decisionmaking processes and secure their preferred policies"); *see generally* Robert A. Dahl, *The Concept of Power*, 2 BEHAV. SCI. 201 (1957). For a discussion of power in corporate governance, see Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 992–95 (2010) [hereinafter Kahan & Rock, *Embattled CEOs*], which measures CEO power along three dimensions: decision making, second-guessing, and scope.

116. *See* Kahan & Rock, *Embattled CEOs*, *supra* note 115, at 993 (explaining that "[g]iven the CEO's power within a firm, a CEO of a larger firm is more powerful than a CEO of a smaller firm"); *cf.* DAVID A. BALDWIN, POWER AND INTERNATIONAL RELATIONS: A CONCEPTUAL APPROACH 77 (2016) (recognizing that, while power is not simply a function of resources, resources can be a convenient way of measuring power).

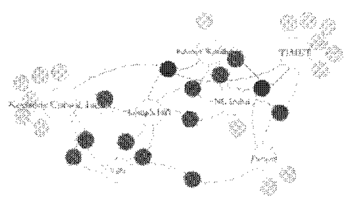
117. *See In re* MFW S'holders Litig., 67 A.3d 496, 510–13 (Del. Ch. 2013).

118. *See* Leslie Picker, *Viacom in Cross Hairs of Activist Investor*, N.Y. TIMES: DEALBOOK (Jan. 19, 2016), https://www.nytimes.com/2016/01/20/business/dealbook/viacom-in-cross-hairs-of-activist-investor.html.

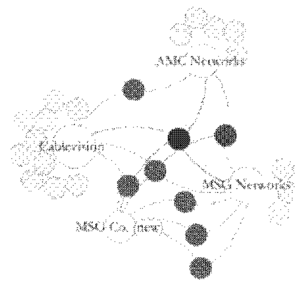
Figure 2. Examples of "independent" director networks

The white nodes represent controlled or dominated firms. The gray nodes represent nominally independent directors, with darker gray nodes representing directors with more connections to controlled or dominated companies. The networks include only nominally independent directors of publicly-traded controlled or dominated companies. In addition, the networks cover different time periods based on the availability of data on nominally independent directors.

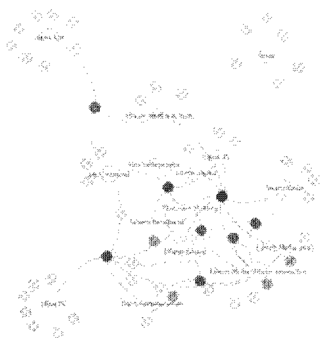
a. Harold Simmons (2000 to 2013)



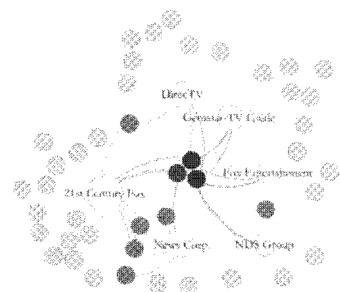
b. The Dolan family (2000 to 2016)



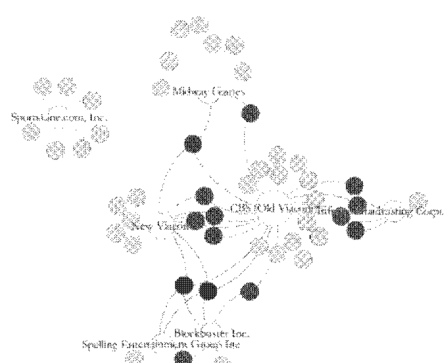
c. John Malone (1998 to 2016)



d. Rupert Murdoch (2000 to 2016)



e. Sumner Redstone (1995 to 2016)



consistent with this intuition. A majority of the controlling shareholders in the data that have controlled multiple public companies—meaning that they have controlled multiple boards—have formed repeat relationships with at least one "independent" director on their board. Conversely, among controlling shareholders with only one public firm in their portfolio, only one has formed repeat ties with a nominally independent director.[119]

For a real-world illustration of how a wide base enables a system of patronage, consider the boardrooms controlled by the late Harold Simmons. Between 2000 and his death in 2013, Simmons controlled seven public companies: Keystone Consolidated Industries, Valhi, NL Industries, Kronos Worldwide, CompX International, Titanium Metals, and Tremont Corporation. Figure 2a depicts the network of individuals who were designated as independent directors of Simmons' companies during this time.[120] The white nodes represent controlled or dominated firms. The gray nodes represent nominally independent directors, with the shade of gray varying by the number of connections between the director and controlled companies. The darker the gray, the more connections that director has. As the visualization of Simmons' network reveals, Simmons regularly recruited directors of one controlled company to the board of another. Overall, of the 29 nominally independent directors in Simmons' companies, 45% served on at least two Simmons-controlled boards.

Also consider Figures 2b–2e, which shows the independent director networks for four other controlling shareholders with large bases: the Dolan family, John Malone, Rupert Murdoch, and Sumner Redstone. These four controlling shareholders controlled at least two firms within the S&P 1500 in 2015.[121] In each network, there are highly connected "independent" directors—including special committee members in most cases—who have served on the boards of multiple controlled or dominated companies. These are the controlling shareholders' "go-to" directors, and the directors whose relationship with the controller are most likely to be characterized by mutual indebtedness and reliance. As expected, controllers that control a very large base of subsidiary boards, like Malone, have many go-to "independent" directors.

The idea that a controller's power to influence increases with the size of its base has particular relevance for venture capital and private equity firms. When a venture capital firm makes an investment, it normally obtains significant control rights in the portfolio company, including the right to one or more board seats.[122] As a result, venture capital firms can appoint individuals to a large number of boards over time. In *In re Trados Inc. Shareholder Litigation*, for example, Trados outside director Joseph Prang initially

119. The controlling shareholder is Richard Hokin, who owns privately-held Intermountain Industries, Inc. A.J. Schwartz was an independent director at one of Intermountain's subsidiaries, Petroglyph Energy Inc., from 1997 to its acquisition in 2000, *see* Petroglyph Energy, Inc., Proxy Statement (Schedule 14A), at 6 (Apr. 27, 2000), and then became a director of Intermountain. *See* INTERMOUNTAIN INDUSTRIES, INC., https://web.archive.org/web/20170930090332/http://www.intermountainindustries.com/industries.php.

120. Data from BoardEx (on file with author).

121. KAMONJOH, *supra* note 20, at 84–90. I excluded the Scripps family, which also held control over two S&P 1500 firms, because neither company is incorporated in Delaware and thus the concept of independence in Delaware law does not govern.

122. *See* Jesse M. Fried & Mira Ganor, *Agency Costs of Venture Capitalist Control in Startups*, 81 N.Y.U. L. REV. 967, 987 (2006); Jackson, *supra* note 101, at 644.

developed a relationship with venture capital firm Sequoia Capital after Sequoia invested in a company where Prang was president.[123] Based on the success of that relationship, Sequoia designated Prang as a director of several other Sequoia-backed firms, including Trados.[124] Private equity firms similarly obtain control over the boards of their portfolio companies, and are thus able to appoint individuals to many boards.[125] Because venture capital and private equity firms are long-term repeat players, directors like Prang have substantial incentive to favor their interests.[126] However, Delaware courts rarely consider a controlling shareholder's repeat-player status in assessing independence, and they have not recognized venture capital or private equity firms' enhanced influence over directors.[127] As I argue in the next Part, the courts should adopt a more granular approach, one that pays more attention to controlling shareholder characteristics.

2. Concentration

Concentration relates to the number of decision-making entities that share the power to control within the controlling shareholder. Concentration, in turn, has two related facets: decisional allocation and spheres of influence.

a. Decisional Allocation

Controlling shareholders vary with respect to whether decision-making power is concentrated in the hands of a single actor or diffused across multiple actors with potentially different preferences and interests. Most of the controlling shareholders discussed in this Article, such as Perelman, Malone, and Simmons, are examples of the former; founding families, widely-held corporations, and partnerships are common examples of the latter.[128]

All else equal, when the authority to control is highly centralized in a single person, she has more power because she can secure her preferred outcomes.[129] She stands at the apex of a neatly hierarchical chain of command and can always get her way because she alone calls the shots. By contrast, when decision-making authority is divided among

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123. *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 54–55 (Del. Ch. 2013).

124. *Id.*

125. *See* William Magnuson, *The Public Cost of Private Equity*, 102 MINN. L. REV. 1847, 1861 (2018) ("Since private equity firms control the boards of their portfolio companies, they can easily add directors to fill specific gaps in expertise, and they can compensate these board members highly").

126. *See* Fried & Ganor, *supra* note 122, at 989 (arguing that directors of portfolio companies are often not truly independent because they "have—or can expect to have—long-term professional and business ties" with the funds).

127. *See infra* notes 162–64 and accompanying text.

128. *Cf. Family Firms: Business in the Blood*, THE ECONOMIST (Nov. 1, 2014), https://www.economist.com/news/business/21629385-companies-controlled-founding-families-remain-surprisingly-important-and-look-set-stay (reporting that family-controlled firms comprise 19% of Fortune Global 500 companies).

129. *See* Michael J. Gerhardt, *Constitutional Arrogance*, 164 U. PA. L. REV. 1649, 1651 (2016) (arguing that one factor contributing to the growth in presidential power is the "[t]he executive's unique design, with a single official at its apex, [which] positions Presidents perfectly to take positive independent action and invests them with the capacity to do so"). The Founding Fathers in fact emphatically rejected the idea of a plurality in the executive, observing that the difficulties of cooperation among a group of people may "tincture the exercise of the executive authority with a spirit of habitual feebleness and dilatoriness." THE FEDERALIST NO. 70 (Alexander Hamilton).

several actors, no single actor can independently impose her will. Instead of giving commands, each must bargain, cajole, appeal, reason, or litigate against others to influence decision outcomes.[130] These actors, put simply, only have the "power to persuade."[131] My findings corroborate this conclusion. Controlling shareholders who are single natural persons re-appoint nominally independent directors with far greater frequency than those that are family groups or widely-held firms, suggesting that single persons are able to act—and reward—without the inefficiency and conflict that can hinder decision-making in collective entities.[132]

For a recent illustration of how diffuse power structures constrain decisional power, consider the ousting of Ferdinand Piëch, the former chairman of the German automaker Volkswagen. The Porsche-Piëch family, which also controls the automaker Porsche, gained 50.8% of the Volkswagen Group in 2008.[133] The family's holdings are organized through a holding company, Porsche Automobil Holding, in which family members separately own voting rights.[134] For many years, Ferdinand Piëch owned a hefty 13% of the holding company, sat on its board, and as Volkswagen's CEO and later chairman, was considered the ruling patriarch of the Porsche-Piëch family.[135]

In 2015, Piëch publicly undermined Volkswagen's then-CEO, Martin Winterkorn, saying "I am at a distance to Winterkorn."[136] Piëch soon discovered, however, that he had neither his family's support nor enough votes from other stakeholders on the Volkswagen board. Members of the family bluntly disagreed with Piëch's remarks, commenting that Piëch's "private" opinion about Winterkorn was not the opinion of the family.[137] Volkswagen's worker representatives, who also sit on its board, backed Winterkorn as "one of the most successful car industry managers."[138] Two weeks after he moved to oust

130. *See* Levinson, *supra* note 115, at 39 n.38 (suggesting that when decision-making authority is shared among multiple actors, each actor can only exert "influence"); Kevin M. Stack, *The President's Statutory Powers to Administer the Laws*, 106 COLUM. L. REV. 263, 319–20 (2006) (arguing that the President faces a lower transaction cost in asserting power because the President can take unilateral actions); Terry M. Moe & William G. Howell, *Unilateral Action and Presidential Power: A Theory*, 29 PRESIDENTIAL STUD. Q. 850, 862–63 (1999) (arguing that Congress is "poorly equipped to take almost any kind of coherent, forceful action" because of its collective action problem).

131. RICHARD E. NEUSTADT, PRESIDENTIAL POWER AND THE MODERN PRESIDENTS: THE POLITICS OF LEADERSHIP FROM ROOSEVELT TO REAGAN 11 (Free Press rev. ed. 1990) (1964).

132. *See, e.g.*, William T. Allen & William R. Berkley, *In Defense of the CEO Chair*, 81 HARV. BUS. REV. 24, 25 (2003) (arguing that multiple "centers of authority" in a business, such as separate CEO and board chairman roles, "would create the potential for organizational tension and instability").

133. *See* Dietmar Hawranek, *The VW Debt Trap: Has Porsche Bitten Off More than it Can Chew?*, SPIEGEL ONLINE (Apr. 20, 2009), http://www.spiegel.de/international/business/the-vw-debt-trap-has-porsche-bitten-off-more-than-it-can-chew-a-620020.html.

134. *See* Dietmar Hawranek & Dirk Kurbjuweit, *Blood Feud: Behind the Scenes of Volkswagen's Dynastic Battle*, SPIEGEL ONLINE (May 6, 2015), http://www.spiegel.de/international/business/the-families-at-the-center-of-the-power-struggle-at-volkswagen-a-1032210.html.

135. *See id.*; Dalia Fahmy, *With Piech in the Exit Lane, Porsche Family Feud Draws to Close*, BLOOMBERG (Mar. 17, 2017), https://www.bloomberg.com/news/articles/2017-03-17/ferdinand-piech-in-talks-to-sell-shares-in-volkswagen-s-owner (describing Piëch as "the family's undisputed patriarch").

136. *See* Chris Bryant, *Volkswagen Power Struggle Deepens as Porsche Weighs In*, FIN. TIMES (Apr. 12, 2015), https://www.ft.com/content/71d27596-e0f2-11e4-9b30-00144feab7de [subscription required].

137. *See id.*

138. *See* Chris Bryant, *VW Chairman Hints at Tension with CEO*, FIN. TIMES (Apr. 10, 2015), https://www.ft.com/content/be7f1b4c-df8a-11e4-b6da-00144feab7de.

Winterkorn, Piëch was himself forced to resign from Volkswagen's board.[139] Just before his departure, Piëch was at the head of his family, which in turn controlled Volkswagen's voting shares, but his power rested on his family members' confidence and support. As German magazine Der Spiegel summarized, Piëch's inability to get his way resulted from the fact that, this time, he couldn't "succeed in persuading [his family] that his position was the right one."[140]

The boundaries between concentrated and diffuse power structures can appear porous. Michael Eisner, the longtime CEO and Chairman of Disney (though not a controlling shareholder), was able to "enthrone[] himself as the omnipotent and infallible monarch of his personal Magic Kingdom" and bypass his board, which ostensibly had veto authority over his decisions, when he hired his good friend as Disney's president.[141] While Eisner formally shared power with his board, he gained such a substantial bargaining advantage from his status and prestige that he could essentially rely on commands to get what he wanted.[142]

But the fact that status yields bargaining advantages should not be allowed to conceal a basic difference between leadership and unilateralism: when power is diffused, decisions are always the product of give-and-take. No matter her leverage, each actor's ability to influence the outcome is ultimately dependent on the consent of the other actors, and this power reduces to nothingness if consent is withdrawn. Peter Strauss has recognized this, arguing that a meaningful difference exists between "ordinary respect" and deference and "[c]ompelled obedience."[143] Eisner, like Piëch, was ultimately forced to resign from Disney when he lost the support of two directors, who successfully rallied Disney's shareholders to oppose Eisner's re-election to Disney's board.[144]

b. Spheres of Influence

Acting in concert with decisional allocation, "sphere of influence" refers to the types of decisions over which an actor has control.[145] In some controlling entities, power can be somewhat specialized; that is, a decision-maker who can determine the outcome of one type of decision cannot determine the outcome of another type. For example, when the U.S. government was the controlling shareholder of the American International Group (AIG), the Treasury Department appointed a special master for executive compensation, popularly known as the "pay czar," who had final authority over compensation decisions

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139. *See* Hawranek & Kurbjuweit, *supra* note 134.

140. *Id.*

141. *See In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 763 (Del. Ch. 2005).

142. *Cf.* Dahl, *supra* note 115, at 203 (describing the source of presidential power as including "his influence with the national electorate, his charisma, his charm, and the like").

143. Peter L. Strauss, *Foreword: Overseer, or "The Decider"? The President in Administrative Law*, 75 GEO. WASH. L. REV. 696, 704 (2007).

144. *See* David Teather, *Disney Shareholders Force Eisner out of Chairman's Role*, THE GUARDIAN (Mar. 4, 2004), https://www.theguardian.com/business/2004/mar/04/usnews.citynews; Laura M. Holson, *A Quiet Departure for Eisner at Disney*, N.Y. TIMES (Sept. 26, 2005), https://www.nytimes.com/2005/09/26/business/media/a-quiet-departure-for-eisner-at-disney.html.

145. Robert Dahl refers to this concept as the "scope" of an actor's power. "Scope" measures the types of responses A can evoke from B. *See* Dahl, *supra* note 115, at 203.

for AIG's senior executives.[146] Meanwhile, the Treasury Department and the Federal Reserve created a separate entity, the AIG Credit Facility Trust, which had the sole power to vote the government's AIG shares.[147] Among the trustees' main responsibilities was recruiting and appointing new directors to ensure that AIG had "an effective, independent and capable board."[148] Still other divisions in the government had broad influence over AIG's restructuring plans and risk management policies.[149]

Dispersing qualitatively different aspects of the power to control to different spheres, governed by different personnel, further limits each actor's ability to reward or retaliate.[150] AIG's Credit Facility trustees, for instance, could appoint directors to or remove directors from AIG's board, but they could not direct AIG's business toward cooperative directors because the trustees were barred from interfering with AIG's operational decisions.[151] For the same reason, the trustees could not punish directors who displeased them by cutting off an existing service contract.

De jure barriers are of course not de facto barriers. In many cases, there is a pronounced gap between an actor's limited de jure sphere of influence and the extent of the decisions over which she has power in practice. From a strictly de jure vantage, CEOs of most widely-held corporations have no authority to elect members of the board. Post-Enron rules require that nominating committees consisting entirely of "independent" directors control the director selection process.[152] Commentators have noticed, however, that formal barriers to CEO involvement are not sufficient to actually insulate nomination decisions from CEO influence.[153] Some nominating committees "receiv[e] names from the CEO."[154] Moreover, nominating committees are often "unlikely to nominate a director

146. Deborah Solomon, *Pay Czar Gets Broad Authority Over Executive Compensation*, WALL STREET J. (June 11, 2009), https://www.wsj.com/articles/SB124464909136002467.

147. *AIG: Where is the Taxpayers' Money Going?: Hearing Before the H. Comm. On Oversight & Gov't Reform*, 111th Cong. 1 (2009) (statement of the Trustees of the AIG Credit Facility Trust), https://oversight.house.gov/sites/democrats.oversight.house.gov/files/migrated/20090512165555.pdf [hereinafter AIG Credit Facility Trustees Statement].

148. *Id.* at 6–8.

149. *See id.*

150. *See* Kahan & Rock, *Embattled CEOs*, *supra* note 115, at 993 (explaining that "[t]he more comprehensive the type of decisions [over which the CEO has authority], the more powerful is the CEO").

151. *See* AIG Credit Facility Trustees Statement, *supra* note 147, at 5.

152. *See* Michael E. Murphy, *The Nominating Process for Corporate Boards of Directors: A Decision-Making Analysis*, 5 BERKELEY BUS. L.J. 131, 148 (2008) (explaining that "NYSE rules . . . require the nominating committee to be composed entirely of independent directors"); *see also* Gordon, *supra* note 17, at 1498–99 (describing SEC disclosure requirements that are intended to shield nominating committees from CEO influence).

153. *See, e.g.*, BEBCHUK & FRIED, *supra* note 52, at 25–27 (arguing that "[e]ven CEOs not formally serving on the nominating committee have had a significant influence on the nomination process"); Murphy, *supra* note 152, at 148–49 (arguing that "it is clear that CEO's [sic] may have the dominant voice in the nominating process even if not included in the membership of a nominating committees [sic] composed of independent directors"); *cf.* Nadia Damouni et al., *Dimon Wields Large Influence Over Who Serves on JPMorgan Board*, HUFFPOST (July 16, 2013), https://www.huffingtonpost.com/2013/05/16/dimon-jpmorgan-board_n_3283683.html (explaining that "JPMorgan board's governance committee, responsible for hiring new members, relies almost entirely on referrals from management to find director nominees").

154. ROBERT A.G. MONKS & NELL MINOW, CORPORATE GOVERNANCE 246 (4th ed. 2008). A CEO told Robert Monks and Nell Minow, "My nominating committee is very independent. Sometimes they turn down the names I send them." *Id*; *see also* JAY W. LORSCH & ELIZABETH MACIVER, PAWNS OR POTENTATES: THE REALITY OF AMERICA'S CORPORATE BOARDS 20 (1989) (finding that 55% of directors reported that "the CEO was the

clearly opposed by the CEO," so at a minimum, CEOs have the power to block nominations.[155] These informal practices enable CEOs to dominate the selection process despite barriers that exist on paper.

To summarize, controlling shareholders are weaker when the power to control is diffused or functionally separated because of the difficulties of cooperation among a group of actors. As a result, they are less able to pressure directors effectively.

* * *

This Part provides the first empirical evidence on professional connections between directors who are nominally independent and the controlling shareholders they are supposed to be independent from. The revelation that some "independent" directors share repeat relationships with a controlling shareholder—and in particular, some directors obtain new ties to a controlling shareholder after concurring with that controller's views—offers powerful support for my theory that controlling shareholders will reward cooperative directors. By extension, these findings suggest that nominally independent directors can be biased by the prospect of those future benefits.

Recognizing reward's role in the director's incentive calculus is important because patronage triggers no special scrutiny and little disclosure, and thus can work better than threats. The firing of an independent director receives intense media attention,[156] and even the threat of firing or other retribution can trigger a higher level of judicial scrutiny.[157] In contrast, a controlling shareholder can discuss a future benefit at any time without public notice. When a director actually joins another board under the controlling shareholder's control, she is not required to disclose information about their past relationship.[158] Controlling shareholders thus have every incentive to prefer seducing directors with the prospect of future rewards over using threats.

Of course, not all controlling shareholders are created equal or are equally able to dole out benefits (or punishment). The two factors that I have identified in this Part provide an analytic framework for assessing which controlling shareholders have greater potential to offer future patronage, and by extension, create conflicts of interest. As the next Part argues, courts can move toward a more nuanced doctrine for constraining private benefits of control by disaggregating controllers in this way.

major source of ideas for new candidates").

155. BEBCHUK & FRIED, *supra* note 52, at 26–27.

156. *See* Sallie Hofmeister, *Cablevision Power Play Alarms Wall Street, Governance Experts*, L.A. TIMES (Mar. 4, 2005), http://articles.latimes.com/2005/mar/04/business/fi-dolan4 (describing how Charles Dolan fired four Cablevision directors who voted to end his pet project); Emily Steel, *Redstone Moves to Replace Five Viacom Directors, Escalating Battle*, N.Y. TIMES (June 16, 2016), https://www.nytimes.com/2016/06/17/business/media/five-viacom-directors-are-replaced-in-escalation-of-redstone-battle.html (describing how Sumner and Shari Redstone fired five of Viacom's independent directors who did not show sufficient loyalty).

157. *See supra* note 58 and accompanying text.

158. *Cf.* Yaron Nili, *Out of Sight, Out of Mind: The Case for Improving Director Independence Disclosure*, 43 J. CORP. L. 35, 58–60 (2017) (arguing that important information is often omitted in a company's disclosures about director independence in part because companies are only required to report relationships that they consider "material"). My review of SEC filings for the controlled companies in this Article is consistent with Nili's argument.

IV. DOCTRINAL AND THEORETICAL IMPLICATIONS

In this Part, I discuss three doctrinal and theoretical implications of my empirical findings. First, Delaware courts should depart from the operative assumption that all controlling shareholders hold equal sway over the directors who serve on their boards. Rather, courts should tailor the level of deference afforded to independent directors' decisions by the controlling shareholder's ability to influence director behavior. Second, Delaware courts should not assume that, absent signs of a bribe, post-transaction relationships contain no information relevant to a director's independence at the time of the deal. Again, courts should examine controlling shareholder attributes to identify cues about a director's expectations at the time she approved the transaction. And third, Delaware courts and scholars should understand freezeout transactions as presenting an asymmetric final period problem, meaning that nominally independent directors may be influenced by the fact that their relationship with minority shareholders will end once the freezeout closes but their relationship with the controlling shareholder can still continue. This insight contributes a new perspective on freezeout doctrine and recent proposals to improve it. I discuss each of these implications in turn.

A. Enhanced Scrutiny for Powerful Controllers

The findings presented in this Article should change the contours of the ongoing debate over structural pressures. As mentioned above, scholars like Bebchuk and Hamdani have argued that nominally independent directors will inevitably be influenced by structural realities, such as the fact that the controlling shareholder has the power to remove them from the board.[159] On the other hand, recent Delaware cases have retreated from the view that independent directors cannot be truly independent from a controlling shareholder.[160] By their account, structural incentives will not prevent most nominally independent directors from pushing back and performing their monitoring duties "with fidelity."[161]

This debate is misdirected if controlling shareholders are not monolithic and if

159. *See, e.g.*, Bebchuk & Hamdani, *Independent Directors*, *supra* note 6 (arguing that the controlling shareholders' decisive power to appoint and fire directors prevent directors from being truly independent); María Gutiérrez & Maribel Sáez, *supra* note 26 (arguing that nominally independent directors lack incentives to effectively monitor controllers for a variety of structural reasons).

160. Early Delaware cases appeared open to the possibility that a director can be truly independent of the controlling shareholder that appointed her to the board and can remove her from the board. *See, e.g.*, Aronson v. Lewis, 473 A.2d 805, 816 (Del. 1984) ("It is the care, attention and sense of individual responsibility to the performance of one's duties, not the method of election, that generally touches on independence."). But by the 1990s, the Delaware court "implicitly endorse[d] the view that independent directors cannot be truly independent from the controlling shareholder, and that courts still need to scrutinize freezeout transactions for entire fairness because of the inability to replicate an arms-length process between the controlling shareholder and the [special committee]." Subramanian, *supra* note 2, at 15 (describing Kahn v. Lynch Commc'n Sys., 638 A.2d 1110, 1118 (Del. 1994)). In contrast, more recent cases seem to have abandoned the court's prior skepticism. *See In re* MFW S'holders Litig., 67 A.3d 496, 528 (Del. Ch. 2013) ("Although it is possible that there are independent directors who have little regard for their duties or for being perceived by their company's stockholders (and the larger network of institutional investors) as being effective at protecting public stockholders, the court thinks they are likely to be exceptional . . . .").

161. *In re MFW S'holders Litig.*, 67 A.3d at 528.

variation exists in how much pressure they can exert over the directors who serve on their boards. Structural pressures may pose a very serious risk to directors' independence vis-à-vis some controlling shareholders but not others. A more useful question then is how to distinguish controllers who tend to hold more sway from those who tend to hold less. The two factors presented in Part III give courts an analytic framework for thinking about this problem. For example, courts should be particularly wary when the controlling shareholder is an individual person who controls a vast conglomerate and can single-handedly determine the outcomes of important company decisions. Courts should also pay more attention to reward-oriented structural incentives if the potential for repeat relationships is high, for example, if the controlling shareholder is an investment firm that regularly appoints directors to the boards of its portfolio companies.

Delaware courts have never considered these or any other controlling shareholder characteristics in its independence inquiry. In the *In re Trados Inc. Shareholders Litigation* decision, however, the Delaware Chancery Court noted that the venture capital "ecosystem" may provide incentives for nominally independent directors to favor venture capital firms over other shareholders when their interests diverge: "Many of these [supposedly independent] directors have—or can expect to have—long-term professional and business ties with the VCs, who are more likely to be repeat players than are most of the common shareholders. Cooperative outside directors can expect to be recommended for other board seats or even invited to join the VC fund as a 'venture partner.'"[162]

However, the court then said that "general characterizations" of this ecosystem cannot carry the plaintiff's burden of proving non-independence at trial.[163] Because the plaintiff also introduced evidence of the director's "long history" with the venture capital fund, the court agreed that the director's independence was compromised.[164]

While the court in *Trados* explicitly disavowed placing weight on broad structural influences, the fact that venture capital firms can secure coveted jobs for friendly directors in the future was unmistakably on the court's mind. Subsequent Delaware doctrine should incorporate this attention to controlling shareholders' ability to exert pressure.

To be clear, I am not suggesting that controlling shareholder characteristics should be determinative of director independence. My point, rather, is that courts should be aware of the fact that some controllers have more means to influence directors and thus pose a greater risk to independence. And while it may not be possible for courts to neatly separate the wheat from the chaff, there are some simple cues that courts should factor in when assessing whether to defer to nominally independent directors' judgements. One straightforward way to incorporate the insights here into doctrine is to change the operative assumption that a special committee of nominally independent directors should either receive full credit as a "cleansing" device for a conflicted transaction or none at all. This approach is hardly novel; in many other contexts, Delaware courts already use intermediate standards of review for "specific, recurring, and readily identifiable situations" where the "realities of the decision-making context can subtly undermine the decisions of even

162. *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 54 (Del. Ch. 2013) (quoting Fried & Ganor, *supra* note 122, at 989).

163. *Id.*

164. *Id.* at 54–55.

independent and disinterested directors."[165] When the context warrants intermediate scrutiny, courts have given nominally independent directors a form of partial deference by reviewing the reasonableness of their actions.[166]

B. A Harder Look at Post-Transaction Relationships

In *In re MFW Shareholders Litigation*, the Delaware Chancery Court explained that Viet Dinh's subsequent directorship at another Perelman-controlled firm would only be relevant to Dinh's independence if the evidence also showed that Dinh "was offered the directorship *before* the special committee approved the deal, or that it had at least been discussed with him before th[at] time."[167] Finding no such evidence in the record, the court deemed Dinh to be sufficiently independent of Perelman.[168]

MFW and similar cases demonstrate judges' reluctance to see a conflict of interest absent a smoking gun: an outright bribe. But this narrow fixation depends on a judgment that otherwise independent directors are unlikely to have *tacit* expectations of future patronage. My findings challenge this assumption. Among the nominally independent directors who served on boards dominated by Perelman-type controlling shareholders—individual persons who control a large conglomerate—almost half were re-appointed by the controller to a directorship or an executive position at another controlled company. When faced with these odds, most sophisticated directors would recognize that it is in their self-interest to cultivate their relationship with the controlling shareholder, even if no discussion about a future appointment has taken place.

The court in *MFW* also missed a second contextual cue that relates to Dinh's expectations about Perelman. Like Dinh, the chairman of M&F Worldwide's special committee also joined the board of a Perelman-dominated company three months after the freezeout closed.[169] And a third member of the special committee had a long history of working at Perelman-controlled entities before joining M&F Worldwide's board.[170] In cases involving threats of retaliation, Delaware courts have held that when the controlling shareholder *actually* removes an uncooperative director, "[t]hat action convey[s] more strongly than words the type of retributive threat that [the controlling shareholder is] willing to carry out" against the remaining directors.[171] By the same token, it seems appropriate to infer that Perelman's demonstrated willingness to re-appoint other familiar (and presumably friendly) directors would have increased Dinh's expectations of a similar

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165. *Id.* at 43.

166. As every student of corporate law knows, where a board adopts anti-takeover defensive measures, Delaware courts will examine whether the measure was reasonable in response to the threat. *See* Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946, 955 (Del. 1985); Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1367 (Del. 1995). Further, where a company is in *Revlon* mode (when a sale or break-up of the company is inevitable), Delaware courts will examine whether the board proceeded "reasonably" in its role as auctioneer. Equity-Linked Inv'rs, L.P. v. Adams, 705 A.2d 1040, 1055 (Del. Ch. 1997).

167. *In re* MFW S'holders Litig., 67 A.3d 496, 513 n.65 (Del. Ch. 2013), *aff'd sub nom.* Kahn v. M & F Worldwide Corp., 88 A.3d 635, 648 (Del. 2014); *see supra* note 49–50 and accompanying text.

168. *In re MFW S'holders Litig.*, 67 A.3d at 513.

169. Data from BoardEx (on file with author).

170. *In re MFW S'holders Litig.*, 67 A.3d at 513 (describing Perelman's ties to Carl Webb).

171. *In re* Ezcorp Inc. Consulting Agreement Derivative Litig., C.A. No. 9962–VCL, 2016 WL 301245, at *41 (Del. Ch. Jan. 25, 2016).

reward.

Viewed in this light, Dinh's subsequent directorship is probably evidence that Dinh's independence was tainted at the time that the special committee approved the transaction. At the very least, it reveals the question of Dinh's independence to be far closer than the Chancery Court allowed. My general point is that Delaware courts should not presume that post-transaction ties contain no relevant information absent signs of a bribe.

It bears emphasis that post-transaction ties are subject to the same critiques that many have leveled at using past and ongoing connections as proxies for independence.[172] Most fundamentally, directors do not become genuinely independent just because they have no ties to the controlling shareholder, and conversely, directors do not automatically become supine just because they do.[173] Eliminating pre- or post-transaction ties, moreover, may not be costless. For one thing, it shrinks the overall pool of qualified candidates for independent director positions and may promote directors "who lack any real desire to take their monitoring role seriously" as independent.[174] This second concern can be somewhat blunted if courts keep in mind that not all relationships are equally probative of a director's motivations or expectations. An economic connection to a controlling shareholder who is a repeat player and has shown a willingness to reward pliable directors in the past is very different from a social connection to a controller with a small base of influence and no history of repeat relationships.

What giving attention to post-transaction ties will do, however, is promote doctrinal consistency. A central claim of this Article is that, just as a feeling of beholdenness toward the controlling shareholder can compromise a director's impartiality, the prospect of future reward from the controlling shareholder can also impact director behavior. Delaware courts scrutinize directors' past or ongoing relationships to the controlling shareholder because, so the argument goes, these ties can signal that a director is beholden to the controller at the time of the deal negotiations.[175] Post-transaction relationships are informative for the exact same reason: they can be cues about a director's expectations at the time the director approved the transaction. Judges and scholars do not seem to be making this connection across relationships formed at different times, and in particular they only take a hard look at past or ongoing relationships, not post-transaction relationships, without any acknowledgement of or justification for the distinction.

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172. *See infra* note 173 and accompanying text.

173. *See, e.g.*, MONKS & MINOW, *supra* note 154, at 286 ("Directors do not become independent just because they have no economic ties to the company beyond their job as a director"); Letter from Warren Buffett, Chairman, Berkshire Hathaway Inc., to Shareholders 18 (Feb. 28, 2007), http://www.berkshirehathaway.com/letters/2006ltr.pdf ("[M]any directors who are now deemed independent by various authorities and observers are far from that."); Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797, 798–99 (2001) (noting the same).

174. Langevoort, *supra* note 173, at 798–99; *accord* Kenneth B. Davis, Jr., *Structural Bias, Special Litigation Committees, and the Vagaries of Director Independence*, 90 IOWA L. REV. 1305, 1341 (2005) (arguing that the prevailing requirements for independence does not produce "the combination of traits that the corporation would have prioritized had its sole objective been to assemble the best possible board team").

175. *See supra* Part II.B.1.

C. Understanding Freezeouts as Presenting an Asymmetric Final Period Problem

One of the basic tenets of game theory is that two rational actors who expect to engage in future dealings have an incentive to cooperate.[176] The risk that one party will self-deal or cheat is constrained by the threat of retribution from the other party in subsequent interactions.[177] This accountability breaks down, however, when participants know that a transaction is the last in the series.[178] In the final period, participants are more likely to put their own interests over those of the other party because the penalty for doing so has disappeared.[179]

It is well understood that third-party acquisitions present a final period problem because the target's shareholders will be bought out by the acquirer.[180] As a result, the efficacy of shareholders as a constraint on directors self-dealing loses traction.[181] Less familiar is the idea that freezeouts can present an *asymmetric* final period problem if the controlling shareholder has the ability to provide future patronage. On the one hand, a director's relationship with minority shareholders will normally end after a freezeout because outside directors typically leave the target board once the company goes private. On the other hand, a director's relationship with the controlling shareholder can still continue, as the numerous examples of post-freezeout ties that I have already offered illustrate.

Recognition of this asymmetric final period dynamic advances on at least two debates in the literature about freezeout doctrine. Most directly, it confounds the theoretical assumption that nominally independent directors might block some freezeouts that are actually fair to public shareholders to advance their personal self-interest. Guhan Subramanian, for example, has argued that special committee directors might resist against a freezeout offer in order to entrench themselves in office.[182] Subramanian thus concluded that freezeout doctrines that provide the special committee with veto power over the deal will discourage some value-increasing freezeouts.[183] But the exact opposite is true in the asymmetric final period model: if the controlling shareholder has the power to act as a repeat benefactor, then self-interest would more likely propel special committee directors to go along with the controlling shareholder's proposal. A director who votes to reject a freezeout offer will likely be unseated by the controlling shareholder at the next election,

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176. *See generally* ROBERT AXELROD, THE EVOLUTION OF COOPERATION 174–75 (rev. ed. 2006) (1984) (describing "conditions for the evolution of cooperation").

177. *See* RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 720 (2d ed. 1995).

178. *See id.*

179. *See id.*

180. *See, e.g.*, J. Travis Laster, *Omnicare's Silver Lining*, 38 J. CORP. L. 795, 809 (2013) (describing a "negotiated corporate acquisition [as] a paradigmatic example of a final period problem"); Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521, 536 (2002) (describing acquisitions as a scenario in which "the target's managers and board will likely lose their positions" and thus "are in a final period where reputation and fear of future discipline lose their force as constraints on self-interested behavior."). *See generally* Sean J. Griffith, *Deal Protection Provisions in the Last Period of Play*, 71 FORDHAM L. REV. 1899, 1941–47 (2003).

181. *See* Griffith, *supra* note 180, at 1945; Laster, *supra* note 180, at 809–10.

182. *See* Subramanian, *supra* note 2, at 39–40 (describing the "obvious concern" that independent directors "might reject some freezeout offers out of self-interest rather than the interest of minority shareholders").

183. *See id.*

if not earlier, so any benefits of resistance will be fleeting. Accommodation is the far better strategy for reaping long-term benefits. From this perspective, there is no conceptual reason to believe that giving the special committee veto power will deter some socially efficient freezeouts.

Second, some scholars have suggested that nominally independent directors would be more effective in overseeing controlling shareholders if minority shareholders can hold directors accountable at the ballot box.[184] In a recent article, Bebchuk and Hamdani proposed empowering minority shareholders over certain director appointment, reelection, and removal decisions—for instance, by giving minority shareholders veto rights over those outcomes.[185] Bebchuk and Hamdani argued that these "enhanced-independence directors" should play a dominant role in negotiating self-dealing transactions, such as freezeouts, because they are properly motivated to safeguard minority investors' interests.[186]

I agree with the core intuition that nominally independent directors would be better guardians in ordinary conflict situations if they had incentives to be accountable to minority shareholders. But the same result does not necessarily follow for freezeouts. Nominally independent directors will typically be less responsive to minority shareholder discipline during freezeout negotiations because the director-shareholder relationship will soon end.[187] At the same time, those directors will be motivated to stay on good terms with controlling shareholders that remain a source of potential benefits. The key point is this: merely increasing the degree to which minority investors can influence director elections, without reducing controlling shareholders' ability to reward directors after the deal, cannot effectively induce nominally independent directors to have robust freezeout negotiations with controlling shareholders.

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184. *See, e.g.*, Bebchuk & Hamdani, *Independent Directors*, *supra* note 6; *cf.* George W. Dent, Jr., *Toward Unifying Ownership and Control in the Public Corporation*, 1989 WIS. L. REV. 881, 907–08 (proposing giving a firm's ten or twenty largest shareholders control over the director election process).

185. *See* Bebchuk & Hamdani, *Independent Directors*, *supra* note 6, at 1293–1304.

186. *Id.* at 1306–07.

187. Of course, if the minority shareholders also can appoint directors to new board seats post freezeout or provide other benefits, then the directors might be more motivated to resist controller opportunism. While the fact that institutional shareholders now own approximately 80% of outstanding shares in S&P 500 companies might suggest that they have leverage over independent directors as repeat players, *see* Neil Stewart, *Retail Shareholders: Looking Out for the Little Guy*, IR MAG. (May 15, 2012), https://www.irmagazine.com/shareholder-targeting-id/retail-shareholders-looking-out-little-guy, these shareholders have proven reluctant to interfere in their portfolio companies. *See* Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 886–88 (2013) (discussing the evidence showing that institutional investors have not played an active steward role in their portfolio firms); Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1048 (2007) (citing regulatory constraints, incentives, and conflicts of interest as factors that prevent mutual funds from acting as effective monitors); Lucian A. Bebchuk et al., *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSPECTIVES 89, 90 (2017) (demonstrating that "index funds have especially poor incentives to engage in stewardship activities that could improve governance and increase value"); *cf. also* Giovanni Strampelli, *How to Enhance Directors' Independence at Controlled Companies*, 44 J. CORP. L. 103, 127, 133–36 (2018) (arguing, for a reason different from my own, that institutional investor passivity "may significantly impair the effectiveness of the Bebchuk and Hamdani proposal" and suggesting the need for an entity to coordinate institutional investor voting).

V. CONCLUSION

This Article establishes the prospect of reward, or patronage, from the controlling shareholder as an important factor in the incentive calculus of nominally independent directors. Judges and scholars miss half the story when they view independence solely through the lens of beholdenness and retribution. I show that controlling shareholders can and do form repeat relationships with the nominally independent directors who serve on their boards, and the prospect of this patronage can compromise those directors' ability to prevent controlling shareholder opportunism.

By orienting the independence inquiry toward reward, this Article also exposes the value of a more granular account of controlling shareholders—one that contends with the heterogeneity among the people and entities within that broad category. When jurists and scholars invoke the term "controlling shareholders," they are in fact pointing to a plurality of actors, governance techniques, and bargaining dynamics. Efficient regulation of companies with controllers requires a better understanding of this heterogeneity than we now have. I have offered a framework that disaggregates controlling shareholders to allow more precise analysis of their ability to influence director behavior, and I hope this Article will encourage more work in a similar vein.

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