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## The Value of Insider Control

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## THE VALUE OF INSIDER CONTROL

BENJAMIN MEANS\*

### ABSTRACT

*According to conventional wisdom, insider control of businesses is detrimental to the interests of noncontrolling investors. Family-run businesses, in particular, are seen as nepotistic and inefficient. Yet, commentators have overestimated the dangers of insider control and overlooked its potential benefits for all stakeholders. Controlling owners have a personal stake that gives them reason to identify with their business and to adopt responsible business practices capable of creating lasting value. A stewardship model of insider control helps explain the continuing vitality of family businesses as well as the success of recent public offerings by Facebook, Google, and Snapchat involving low-vote or no-vote stock. Consequently, this Article criticizes efforts to limit insider control categorically—for example, recent moves by stock exchanges to block companies that issue stock with unequal voting rights. To the extent controlling shareholders are tempted to abuse their control in particular cases, this Article contends that the fiduciary duties of care and loyalty provide an appropriate basis for judicial monitoring.*

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## INTRODUCTION

Insider control has emerged as one of the hottest topics in corporate governance in the wake of public offerings by prominent technology companies such as Google, Facebook, and Snapchat involving low-vote or no-vote stock.<sup>1</sup> Dual-stock classification distinguishes founder stock from common stock and thereby enables founders to raise money from the capital markets without surrendering the perquisites of control.<sup>2</sup>

Critics charge that dual-stock classification should be restricted or disallowed because it shackles controlled companies to the vision of their founders even when there is no longer good reason to defer to that vision.<sup>3</sup> For example, Sumner Redstone remained in control of Viacom and CBS long after it had become apparent that he lacked the capacity to make business decisions.<sup>4</sup> The fact that family businesses pioneered the use of dual-class stock in order to

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1. See, e.g., Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585 (2017); Bernard S. Sharfman, *A Private Ordering Defense of a Company's Right to Use Dual Class Share Structures in IPOs*, 63 VILL. L. REV. 1 (2018); Kirby Smith, *The Agency Costs of Equal Treatment Clauses*, 127 YALE L.J. F. 543 (2017); Tian Wen, Comment, *You Can't Sell Your Firm and Own It Too: Disallowing Dual-Class Stock Companies from Listing on the Securities Exchanges*, 162 U. PA. L. REV. 1495 (2014); Andrea Tan & Benjamin Robertson, *Dual-Class Shares Are Coming Under Fire—Again*, BLOOMBERG MKTS. MAG. (Sept. 27, 2017, 8:22 PM), <https://www.bloomberg.com/news/articles/2017-09-27/can-democracy-stage-a-comeback-at-stock-exchanges> [<https://perma.cc/T2HJ-HPFF>].

2. See Ronald W. Masulis et al., *Agency Problems at Dual-Class Companies*, 64 J. FIN. 1697, 1722 (2009); Joel Seligman, *Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy*, 54 GEO. WASH. L. REV. 687, 687 (1986). Companies with dual-class stock “play an important role in the U.S. economy.... and ha[d] an aggregate market capitalization exceeding \$3 trillion as of July 2016.” Bebchuk & Kastiel, *supra* note 1, at 594.

3. See, e.g., Bebchuk & Kastiel, *supra* note 1, at 590 (“Going forward, the debate should be limited to the choice between (1) precluding dual-class structures altogether and (2) permitting dual-class structures that sunset after a fixed period of time (such as ten or fifteen years) unless their extension is approved by shareholders unaffiliated with the controller.”).

4. See *id.* at 587-88 (“[P]ublic investors, who own approximately 90 [percent] of Viacom’s equity capital, remained powerless and without influence over the company or the battle for its control.”). As a practical matter, the family’s decision-making is now in the hands of Sumner Redstone’s daughter, Sheri Redstone. See Jessica Toonkel, *Sumner Redstone Removes Viacom CEO and Board Member From Trust*, REUTERS (May 20, 2016, 10:22 PM), <https://www.reuters.com/article/us-redstone-trust/sumner-redstone-removes-viacom-ceo-and-board-member-from-trust-idUSKCN0YC02K> [<https://perma.cc/BN8S-XWXQ>].

perpetuate family control only exacerbates the critique of controlled companies.<sup>5</sup>

This Article contends, to the contrary, that family businesses illustrate why controlled companies can be attractive to investors and other stakeholders. In particular, family values can motivate responsible business practices. For example, acting as stewards for future generations, family owners often prioritize sustainability over more immediate payouts.<sup>6</sup> A focus on long-term viability benefits nonfamily groups as well, including value investors, employees, customers, and communities.<sup>7</sup>

Although reconciling family and business interests can be challenging,<sup>8</sup> “[f]amily businesses are ubiquitous in the United States and are often described as ‘the backbone’ of the American economy.”<sup>9</sup> In fact, studies suggest that family businesses may outperform nonfamily businesses in the marketplace.<sup>10</sup> Notably,

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5. See Bebchuk & Kastiel, *supra* note 1, at 605 (citing “the problem of the ‘idiot heir’”). According to Bebchuk and Kastiel, “A structure that provides the founder’s family with a perpetual lock on control forgoes the benefits of optimal succession of leadership upon the founder’s departure.” *Id.* Currently, “[f]ounders or their descendants control nearly 89% of dual class firms.” Ronald Anderson et al., *The Dual Class Premium: A Family Affair* (Fox Sch. Bus. Res. Paper No. 17-021, 2017), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3006669](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3006669) [<https://perma.cc/MA8K-AJJD>].

6. See CREDIT SUISSE RESEARCH INST., FAMILY BUSINESSES: SUSTAINING PERFORMANCE 3 (2012), [https://research-doc.credit-suisse.com/docView?language=ENG&format=PDF&source=em&document\\_id=999615271&serialid=ar%2BmiufackjVY15u5tKdzgvcLatsFZZZ05m%2BATD8dI8%3D](https://research-doc.credit-suisse.com/docView?language=ENG&format=PDF&source=em&document_id=999615271&serialid=ar%2BmiufackjVY15u5tKdzgvcLatsFZZZ05m%2BATD8dI8%3D) [<https://perma.cc/7FXT-BKNW>] (reporting survey results of 280 family businesses: “At least three quarters of respondents see a long-term perspective as key to success; most have a long-term payback approach to investment and focus on an internal rather than external financing model to fund future growth”).

7. See generally William Mullins & Antoinette Schoar, *How Do CEOs See Their Roles? Management Philosophies and Styles in Family and Non-Family Firms*, 119 J. FIN. ECON. 24 (2016) (reporting survey results of more than 800 CEOs). The authors also included nonfamily businesses in their study and found that “[f]ounders and CEOs related to the firm’s founder are more likely to embrace a stakeholder view of management and feel less responsibility towards their shareholders, instead prioritizing employees and creditors.” *Id.* at 25.

8. See Benjamin Means, *Nonmarket Values in Family Businesses*, 54 WM. & MARY L. REV. 1185, 1189 (2013) (“In a family business ... the values associated with family life must coexist with the values of the marketplace.” (footnote omitted)).

9. Allison Anna Tait, *Corporate Family Law*, 112 NW. U. L. REV. 1, 5 (2017) (citing ANDREA COLLI, *THE HISTORY OF FAMILY BUSINESS, 1850-2000*, at 8 (2003)). Family businesses are also a dominant force globally. See Belén Villalonga & Raphael Amit, *Family Control of Firms and Industries*, 39 FIN. MGMT. 863, 863 (2010) (“Family-controlled firms dominate the corporate landscape around the world.”).

10. The empirical data is inconclusive but suggests that founder-led businesses have a

many of the most successful U.S. businesses are family controlled—for example, Ford Motor Company,<sup>11</sup> Wal-Mart Stores, Incorporated,<sup>12</sup> Mars, Incorporated,<sup>13</sup> Cargill, Incorporated,<sup>14</sup> and Hobby Lobby Stores, Incorporated.<sup>15</sup> According to one estimate, about a third of Fortune 500 companies are family controlled.<sup>16</sup> In sum, far from serving as a cautionary tale regarding the dangers of insider control, family businesses offer a useful model.

The Article proceeds as follows. Part I contends that the perpetuation of insider control should not be equated with the nepotistic hiring and promotion of unqualified individuals.<sup>17</sup> More commonly, the next generation of owners are carefully groomed for managerial responsibilities and must demonstrate their capacity to lead.<sup>18</sup>

Parts II and III respond to a different type of concern: that controlling owners will abuse their position to expropriate value without sharing it with minority investors. Part II argues that stewardship provides a plausible alternative explanation for insider-favoring models of control. Part III contends that the fiduciary

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competitive advantage, at least until succession to the next generation of family ownership. See Ronald C. Anderson & David M. Reeb, *Founding-Family Ownership and Firm Performance: Evidence from the S&P 500*, 58 J. FIN. 1301, 1316-17 (2003); Belen Villalonga & Raphael Amit, *How Do Family Ownership, Control and Management Affect Firm Value?*, 80 J. FIN. ECON. 385, 402-03 (2006).

11. See Anderson & Reeb, *supra* note 10, at 1306.

12. See Benjamin Means, *Wealth Inequality and Family Businesses*, 65 EMORY L.J. 937, 939 n.11 (2016) (citing Nick Kirkpatrick & Justin Moyer, *Meet America's Richest Families, Courtesy of Forbes*, WASH. POST (July 11, 2014), <http://www.washingtonpost.com/news/morning-mix/wp/2014/07/11/meet-americas-richest-families/>).

13. See *id.*

14. See *id.*

15. See Tait, *supra* note 9, at 6.

16. See *id.* (quoting *Family Business Facts*, CONWAY CTR. FOR FAM. BUS., <http://www.familybusinesscenter.com/resources/family-business-facts>); see also Anderson & Reeb, *supra* note 10, at 1301.

17. Thus, to use “nepotism” as a synonym for “kinship preferences” is to assume an impropriety that must be demonstrated. See Joan G. Wexler, *Husbands and Wives: The Uneasy Case for Antinepotism Rules*, 62 B.U. L. REV. 75, 75 (1982) (“The term nepotism is a pejorative which connotes favoritism, undeserved rewards, or unfair discrimination in granting employment or other advantages to relatives.”).

18. From a broader perspective, one might still object that preferential access creates inequality, a problem that is conceptually distinct from considerations of individual merit. See Means, *supra* note 12, at 940-41 (acknowledging the problem but arguing that “family businesses can increase the distribution of wealth by providing needed investments in human capital” and by providing “a source of opportunity, not just for family members, but also for employees and the communities in which family businesses operate”).

duties of care and loyalty suffice to protect the minority from mistreatment. The Article concludes that legislative or regulatory restrictions—for example, mandatory time limits on insider control—could have the unintended consequence of deterring stewardship. The benefits of family ownership and other forms of insider control need not be taken on faith, but neither should they be rejected as a matter of principle.

### I. NEPOTISM, INC.?

If insider control is to continue past a company's founding stage, there must be a strategy to perpetuate it.<sup>19</sup> Notably, most family businesses use kinship as an important criterion for the selection of key personnel.<sup>20</sup> “Family heirs benefit not only from inherited wealth but also from access to employment opportunities reserved for them.”<sup>21</sup> The inheritance of managerial responsibilities may seem to fit the classic definition of nepotism: unfair preferences based on kinship.<sup>22</sup> This Part argues, however, that insider-favoring models of control need not conflict with appropriate standards of merit.

#### A. *The Merit Paradigm*

If we are to avoid the *reductio ad absurdum* of concluding that all kinship preferences are nepotism, even the care and affection that parents provide for children within the family, we must find some means of distinguishing nepotistic and non-nepotistic kinship preferences. Nepotism refers not just to the existence of a kinship

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19. See *id.* at 977 (quoting Danny Miller, Isabelle Le Brenton-Miller & Barry Scholnick, *Stewardship v. Stagnation: An Empirical Comparison of Small Family and Non-Family Businesses*, 45 J. MGMT. STUD. 51, 52 (2008)).

20. See *id.* at 939.

21. *Id.* at 985.

22. See Wexler, *supra* note 17, at 75; see also STEPHEN J. McNAMEE, THE MERITOCRACY MYTH 43 (4th ed. 2018) (“[M]eritocracy applies strictly only to the poorest of the poor; everyone else has at least some advantage of inheritance over others that places them ahead at the start of the race.”). When favoritism turns on personal connections other than kinship, it is called “cronyism.” See Michela Ponzo & Vincenzo Scoppa, *A Simple Model of Nepotism* 1 (Università Della Calabria, Working Paper No. 17-2010), [http://www.ecostat.unical.it/RePEc/WorkingPapers/WP17\\_2010.pdf](http://www.ecostat.unical.it/RePEc/WorkingPapers/WP17_2010.pdf) [<https://perma.cc/F42D-YB8J>].

preference, but to the context in which it arises.<sup>23</sup> Some social goods are properly assigned using kinship as a criterion; others are not.<sup>24</sup>

The philosopher Michael Walzer has argued that “there has never been a single criterion ... for all distributions.”<sup>25</sup> Instead, each kind of social good should be handled according to the procedures appropriate for it.<sup>26</sup> Intimate relationships, political choices, and impersonal market transactions take place in separate spheres and are governed by different rules.<sup>27</sup> For instance, because some goods involve matters of intimacy, people are not supposed to exchange them for money.<sup>28</sup> In other circumstances, where market conventions apply, money is all that is expected to matter.<sup>29</sup> When we seek to ascertain whether a kinship preference should be considered nepotism, the particular context is crucial.<sup>30</sup> We must ask, specifically, whether kinship preferences are permissible in that sphere.<sup>31</sup>

Yet, Walzer’s proposed mode of analysis does not tell us whether kinship preferences in family-owned business are improper because the spheres of family and business overlap.<sup>32</sup> An intention to pass

23. See ADAM BELLOW, IN PRAISE OF NEPOTISM: A HISTORY OF FAMILY ENTERPRISE FROM KING DAVID TO GEORGE W. BUSH 23-24 (First Anchor Books 2004) (2003).

24. See *id.* (“I am very far from wanting to suggest that what we call nepotism is simply the operation of a normal and natural preference for kin. Nepotism is properly defined as ‘undue preference for a relative’ where fair and open competition should prevail.”).

25. MICHAEL WALZER, SPHERES OF JUSTICE 4 (1983) (“Desert, qualification, birth and blood, friendship, need, free exchange, political loyalty, democratic decision: each has had its place, along with many others, uneasily coexisting, invoked by competing groups, confused with one another.”); see also ELIZABETH ANDERSON, VALUE IN ETHICS AND ECONOMICS (1993); MARGARET JANE RADIN, CONTESTED COMMODITIES (1996); Bernard Williams, *The Idea of Equality*, in PHILOSOPHY, POLITICS AND SOCIETY 110 (Peter Laslett & W. G. Runciman eds., 2d ser. 1962).

26. WALZER, *supra* note 25, at 10 (“Every social good or set of goods constitutes, as it were, a distributive sphere within which only certain criteria and arrangements are appropriate.”).

27. See *id.*

28. See *id.* at 9 (“[T]he words *prostitution* and *bribery* ... describe the sale and purchase of goods that, given certain understandings of their meaning, ought never to be sold or purchased.”).

29. See *id.* at 10 (“Whatever can rightly be sold ought to be sold to pious men and women and also to profane, heretical, and sinful men and women.”).

30. See BELLOW, *supra* note 23, at 23-24.

31. In arguing for distinctive spheres, Walzer recognizes that “[w]hat happens in one distributive sphere affects what happens in the others; we can look, at most, for relative autonomy.” WALZER, *supra* note 25, at 10.

32. See Means, *supra* note 8, at 1189 (“In a family business, ... the values associated with family life must coexist with the values of the marketplace.” (footnote omitted) (citing MANFRED F.R. KETS DE VRIES ET AL., FAMILY BUSINESS ON THE COUCH 9 (2007))).



control from generation to generation is a constitutive element of family businesses.<sup>33</sup> The appropriateness of kinship preferences is, therefore, inseparable from broader questions about the role of family businesses in society.<sup>34</sup>

Perhaps family ownership does not make a difference and kinship preferences should be considered improper in any business context. Even if participants have preexisting relationships that affect their goals and their mutual expectations,<sup>35</sup> they are still joined in a for-profit venture. Further, by selecting a corporate, limited liability company, or partnership form, a family business could be said to have accepted the market principles applicable to that form of business.<sup>36</sup> There is no separate, family-business entity form available.<sup>37</sup> Across all forms of business associations, merit is the accepted principle for the distribution of opportunities in the workplace.<sup>38</sup>

Kinship preferences in family businesses may be problematic because they appear to violate the principle of distribution according to merit. That is, family businesses involve the preferential transmission of direct economic advantage to insiders as to employment matters—such as hiring and promotion—that would ordinarily depend on formally neutral criteria.<sup>39</sup> The fact that a family owns a business does not prove that kinship preferences in the workplace are inevitable or appropriate. If the family wished to do so, it could hire professional managers to run the business.

On the other hand, we might ask who has grounds to complain about kinship preferences.<sup>40</sup> If a business does not sell its stock to the general public but the stock is instead held by a single family,

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33. See Means, *supra* note 12, at 939.

34. See *id.* at 939-41.

35. See Means, *supra* note 8, at 1209 (“An employer-employee relationship may also be a parent-child relationship.”).

36. See LARRY E. RIBSTEIN, *THE RISE OF THE UNCORPORATION* 26 (2010).

37. See Means, *supra* note 8, at 1193.

38. Opportunities in this context should be broadly understood to include not only hiring and promotion, but also performance evaluation. See Bridgette K. Mulder, *A Model of Organizational Nepotism*, in *NEPOTISM IN ORGANIZATIONS* 219, 220 (Robert G. Jones ed., 2012). Failure to discipline or fire an employee because of kinship might also qualify as nepotism. See *id.*

39. See BELLOW, *supra* note 23, at 11 (The practice of nepotism “violates our basic sense of fairness and elicits strong reactions of revulsion and distaste.”).

40. See *infra* Part III (examining the fiduciary duties that protect the interests of noncontrolling owners).

the business is, effectively, the family's property.<sup>41</sup> In this regard, one scholar suggests that public affirmative action policies elicit greater concern because they involve the allocation of resources that are open to all members of society, whereas, "in the case of a family-owned business in which nepotistic hiring is a stage in a process that will end with intergenerational transfer of the business itself, we see nepotism as completely legitimate."<sup>42</sup> Why, after all, should a family have an obligation to distribute its assets to strangers?

Perhaps employment in a family business is no less a family asset than any other kind of wealth.<sup>43</sup> Consider three approaches to transferring wealth across generations:

Version One. An entrepreneur builds a successful business. Rather than giving the business to her children, she sells it before her death and leaves her children the proceeds of the sale in equal shares.

Version Two. An entrepreneur builds a successful business. She leaves control of the business to her children in equal shares. The children sell the business and split the proceeds.

Version Three. An entrepreneur builds a successful business. She employs her children in the business, and, ultimately, transfers control of the business to them. They continue to operate the business.

In each case, setting aside any tax considerations that might pertain, the parent bequeaths substantially identical economic resources to her children. The children benefit from the morally arbitrary fact that they have a wealthy parent, whether or not they receive the money directly or access it through the business organization. If the financial consequences are identical, and if there is no public policy reason to prefer that the parent use one form of

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41. By contrast, the managers of a publicly traded corporation take on a fiduciary responsibility to widely dispersed investors who have entrusted their capital to the enterprise without any direct ability to control its use. *See generally* D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399 (2002).

42. Deborah C. Malamud, *Values, Symbols, and Facts in the Affirmative Action Debate*, 95 MICH. L. REV. 1668, 1699 (1997) (reviewing several books on affirmative action).

43. *See Means, supra* note 12, at 985.

estate plan instead of another, then it is unclear what purpose is served by drawing normative distinctions.<sup>44</sup>

As long as families are permitted to raise children, it is unrealistic to insist that families will convey certain benefits while withholding others. Indeed, family members are expected, and in some respects legally obligated, to care for one another.<sup>45</sup> One commentator argues that “[w]e have a *duty* to be nepotistic, and if we fail to put our families first we may destroy the very sources of altruism on which society depends.”<sup>46</sup> Thus, if nepotism denotes an “unfair preference to a relative”<sup>47</sup> over other qualified persons, kinship-based preferences in family businesses may not qualify.<sup>48</sup>

Moreover, concerns about kinship preferences may be misplaced when kinship ties are marital in nature. In such cases, it is debatable whether there has been a distribution, let alone a preference.<sup>49</sup> Within a marriage, business assets are hard to distinguish “from the broader economic life of a household.”<sup>50</sup> That is, each spouse would likely be entitled to half the value of the family’s business investment regardless of the formal ownership records because the business assets are treated as part of the economic partnership of marriage.<sup>51</sup> A spouse’s involvement in a business may

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44. A broader issue of opportunity inequality is implicated regardless of the form of inheritance. *See id.* at 942.

45. *See* BELLOW, *supra* note 23, at 476 (“[M]any Americans agree with Robert Frost in defining home as the place where, when you have nowhere else to go, ‘they have to take you in.’”); Martha Albertson Fineman, *The Vulnerable Subject and the Responsive State*, 60 EMORY L.J. 251, 263 (2010) (“The family is the mechanism by which we privatize ... dependency and its implications.”).

46. BELLOW, *supra* note 23, at 476.

47. *Nepotism*, OXFORD ENGLISH DICTIONARY, <http://www.oed.com/view/Entry/126151?redirectFrom=nepotism#eid> [<https://perma.cc/W9XK-ZV3L>].

48. In businesses that are family controlled but involve other owners, the situation is more complex, as nonfamily investors might reasonably view family preferences as self-dealing. *See, e.g.*, *Donahue v. Rodd Electrottype Co. of New Eng.*, 328 N.E.2d 505, 510-11 (Mass. 1975) (children caused the corporation to repurchase shares from a retiring parent, who had been the controlling shareholder, but refused to provide similar liquidity for an unrelated minority investor).

49. *See infra* note 52 and accompanying text.

50. Benjamin Means, *The Contractual Foundation of Family-Business Law*, 75 OHIO ST. L.J. 675, 693 (2014). Note that “[i]n its pristine form, coverture treated husband and wife as indistinguishable legal actors from the perspective of the outside world.” VIVIANA A. ZELIZER, *THE PURCHASE OF INTIMACY* 67 (2005).

51. *See* Tait, *supra* note 9, at 30.

be seen as a feature of the marriage rather than an example of nepotism.<sup>52</sup>

To summarize, even if business and family constitute separate spheres as a matter of conceptual logic, invoking those spheres does not guide the use of kinship preferences in family businesses. Neither sphere controls the outcome because family businesses (and families, more generally) involve an intermingling of economics and intimacy. Indeed, the conspicuous lack of an answer in this setting suggests that Walzer's spheres are unlikely to provide clear guidance regarding the distribution of resources in most disputed cases.<sup>53</sup> Rather than seeking categorical answers, perhaps it would be more fruitful for us to inquire whether particular insider-favoring decisions are well supported or represent a departure from minimum standards. The next section argues that the continuation of insider control can reflect merit-based judgments. In this regard, while kinship preferences in family businesses may be motivated in part by other considerations, family owners are likely to take steps to ensure that heirs are properly qualified and to insist upon the satisfaction of objective criteria.

### *B. Kinship as Qualification*

Insider preferences cannot stand alone as the basis for decision-making in controlled companies. Perhaps most objectionably, a powerful benefactor might confer business opportunities—office, title, salary—regardless of qualifications. To ignore merit and to prefer fellow insiders in all circumstances is cronyism in its most

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52. A spouse's involvement looks more like nepotism when the spouse takes on a role in the business that would ordinarily have an independent merit qualification—as when the director Roman Polanski cast his wife, Emmanuelle Seigner, as a colead in the movie *Venus in Fur*. See Amy Taubin, *Venus in Fur*, 50 *FILM COMMENT* 69, 69 (2014). Favorable reviews, including observations that the plot may resemble the Polanski marriage in certain respects, *see id.*, indicate that the casting decision may nonetheless have been well-considered. Cf. *Bayer v. Beran*, 49 N.Y.S.2d 2, 10 (Sup. Ct. 1944) (opera singer hired to promote company was wife of the chair of the board of directors but had appropriate qualifications).

53. See ZELIZER, *supra* note 50, at 33 (“In any particular social setting—not only households, but also workplaces, schools, churches, and clubs—multiple ties of different kinds coexist and often extend across the setting's boundary into other settings.”); Frances E. Olsen, *The Family and the Market: A Study of Ideology and Legal Reform*, 96 *HARV. L. REV.* 1497, 1497 (1983); *supra* notes 25-31 and accompanying text.

barefaced incarnation.<sup>54</sup> Yet, rarely will the case be so clear. In a family business, a child might spend summers working for the business and, over time, develop the competence to run it. These types of opportunities are not available to outsiders. As one commentator observed, “[g]rowing up around a business or vocation—learning how it works, getting to know the people in it—creates a powerful advantage that is tantamount to nepotism.”<sup>55</sup> Such indirect advantages elude easy categorization.<sup>56</sup>

### 1. *The Boss’s Nephew*

The term nepotism was first used to describe the improper practice of Renaissance-era popes who appointed nephews (perhaps actually illegitimate sons)<sup>57</sup> to important ecclesiastical positions, thereby cementing family power and prestige, a danger the Church had seemingly hoped to forestall by forbidding clergy from marriage: “Since it was one of the purposes of clerical celibacy to cut the church loose from the feudal system and to ensure a succession of qualified individuals, the practice was identified as sinful early on.”<sup>58</sup>

Nepotism continues to conjure an unpleasant image of patronage and of incompetent or lazy heirs trading on their family connections, eclipsing the career prospects of more qualified but less connected peers.<sup>59</sup> We might call this the problem of the meritorious outsider.<sup>60</sup> As one commentator puts it, “from the workingman’s perspective nepotism means hiring or promoting the boss’s son-in-law, nephew, or girlfriend over the heads of more qualified candidates.”<sup>61</sup>

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54. See *supra* note 22.

55. BELLOW, *supra* note 23, at 10.

56. See Harvey S. James, Jr., *What Can the Family Contribute to Business? Examining Contractual Relationships*, 12 FAM. BUS. REV. 61, 61 (1999) (“To the extent that family processes contribute to the efficient and effective functioning of the company, family businesses will survive and thrive.”).

57. BELLOW, *supra* note 23, at 11 (“The term *nepotismo* was coined sometime in the fourteenth or fifteenth century to describe the corrupt practice of appointing papal relatives to office—usually illegitimate sons described as ‘nephews.’”).

58. WALZER, *supra* note 25, at 147; see also BELLOW, *supra* note 23, at 191 (“The Renaissance papacy is one of the greatest monuments to nepotism in Western history.”).

59. See BELLOW, *supra* note 23, at 11; *supra* notes 3-5 and accompanying text.

60. My thanks to Professor Kenneth Rosen who proposed the terminology.

61. BELLOW, *supra* note 23, at 11.

A satirical newspaper captured the perceived injustice of nepotism in a made-up news blurb reporting a hiring decision:

WHITEHOUSE STATION, NJ—The hiring of Adam Dwyer by Merck Pharmaceutical was described Monday by CEO James Dwyer as “tremendously synergistic.” “With his impressive range of experiences, including one and a half years of bartending and four years of heavy pharmaceutical use at the University of Delaware, Adam brings a lot to the table,” Dwyer said of his nephew. “We, in turn, can help Adam earn \$220,000 a year as vice-president of corporate communications for the Mid-Atlantic region.”<sup>62</sup>

The intended humor is in the unembarrassed, matter-of-fact disclosure of motivations that would not be acknowledged, let alone trumpeted in a press release. And yet, sarcasm aside, some version of “nepotism is often the rule in family businesses, and it is usually accepted as ‘the way things are’ by everyone involved.”<sup>63</sup> Successful family businesses seem to rise above accusations of nepotism, perhaps because the heirs are not often so dismally qualified.<sup>64</sup>

In family businesses, merit remains an important factor in hiring and promotion.<sup>65</sup> Therefore, the concept of nepotism is potentially misleading because it obscures the manner in which kinship preferences normally function. Although the formal definition of nepotism—favoritism based on kinship<sup>66</sup>—does not specify any central or less-central examples, it is a feature of human reasoning that we organize concepts according to prototypes.<sup>67</sup> For example,

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62. *Nepotism Passed Off as Synergy*, ONION (June 20, 2001, 3:00 PM), <https://www.theonion.com/nepotism-passed-off-as-synergy-1819566082> [<https://perma.cc/R6Q4-DNRQ>]; see also *CEO Worked Way Up from Son of CEO*, ONION (Oct. 24, 2013, 2:00 PM), <https://local.theonion.com/ceo-worked-way-up-from-son-of-ceo-1819575776> [<https://perma.cc/FB98-CSRL>]; Jaden Smith, *Perhaps the Gimmick of My Father and Me Starring in a Movie is Actually More Annoying than Appealing*, ONION (May 31, 2013, 3:20 PM), <https://entertainment.theonion.com/perhaps-the-gimmick-of-my-father-and-me-starring-in-a-m-1819584865> [<https://perma.cc/482S-VV7E>].

63. BELLOW, *supra* note 23, at 11.

64. See, e.g., *infra* notes 82-90 and accompanying text.

65. See *infra* Part III (describing market and legal constraints on kinship preferences).

66. See *supra* note 47 and accompanying text.

67. Nepotism’s definition establishes a category, and all examples that meet the definition fall within the category. See Steven L. Winter, *The Metaphor of Standing and the Problem of Self-Governance*, 40 STAN. L. REV. 1371, 1385 (1988) (“In the classical theory of categorization,

strawberries are more central to our understanding of the concept “fruit” than tomatoes, bell peppers, or olives.<sup>68</sup> Prototype “categories are structured by means of *idealized cognitive models*—culturally shared ‘theories’ of how to organize some portion of our experience.”<sup>69</sup> When the concept is nepotism, we are likely to picture the polo player, feckless heir, rather than a well-qualified understudy who receives special opportunities but makes the most of them.<sup>70</sup>

Consequently, hiring decisions involving relatives with outstanding credentials look like outliers and may be difficult to reconcile with our basic understanding of nepotism. That is, “[b]ecause ‘prototypes act as *cognitive reference points* of various sorts and form the basis for inferences,’ they tend to play an important role in reasoning about categories.”<sup>71</sup> We might paint with too broad a brush and treat kinship preferences as an affront to meritocratic principles, even those kinship preferences that do not involve the preservation of unearned privileges or the elevation of the incompetent.<sup>72</sup> For this reason, the position of the heir can carry with it a stigma, which “arises from the belief that nepotism is not just favoring a relative, but also favoring someone who is unqualified or incompetent compared to other applicants.”<sup>73</sup> Customers and colleagues alike may be too quick to conclude that the heir is lacking.<sup>74</sup>

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all objects having the same relevant criteria are classed together. In this view, no category member is any more ‘representative’ of a category than another.”).

68. See GEORGE LAKOFF & MARK JOHNSON, *METAPHORS WE LIVE BY* 123 (1980).

69. Winter, *supra* note 67, at 1385.

70. Admittedly, polo-playing heirs are not entirely mythical creatures. See *The Checkered Past of August Busch IV*, CBS NEWS (Dec. 28, 2010, 8:37 AM), <https://www.cbsnews.com/news/the-checkered-past-of-august-busch-iv/> [<https://perma.cc/UW8G-4EYL>] (reporting legal travails of August Busch IV, also known as the Fourth, “heir to his family’s beer fortune” and CEO of the company before it was sold). For detailed reporting concerning the mismanagement that led to the company’s forced sale to an international conglomerate, see JULIE MACINTOSH, *DETHRONING THE KING: THE HOSTILE TAKEOVER OF ANHEUSER-BUSCH, AN AMERICAN ICON* (2011).

71. Winter, *supra* note 67, at 1386 (footnote and internal citations omitted).

72. See *id.* (“Sometimes, we may not distinguish the variants from the prototype of the idealized cognitive model. An extreme example is when a child thinks that the teacher or daycare worker is the mother of the other children. In that case, we have a *radical prototype effect* in which the prototype overshadows the rest of the category.”).

73. Mulder, *supra* note 38, at 224. Similar perceptions regarding unfairness can stigmatize the beneficiaries of affirmative action policies, even though the basis and justification for such preferences may be quite different. See *id.*

74. See, e.g., MARK RUSS FEDERMAN, *RUSS & DAUGHTERS: REFLECTIONS AND RECIPES FROM THE HOUSE THAT HERRING BUILT* 5 (2013) (“I am Mr. Russ.’ I expected my pronouncement to

Equally important, the distorting influence of the “nepotism” prototype can leave us without a language to talk about family-business hiring and promotion practices in which the beneficiaries of kinship preferences are qualified and capable of handling the responsibility entrusted to them.<sup>75</sup> The next Section explores a variety of real-world situations involving kinship preferences.

## 2. Access and Apprenticeship

The advantages of insider connections are inescapable in almost any field of endeavor. At the 2013 MTV awards show, for instance, Robin Thicke sang his hit song, “Blurred Lines,” while another well-known singer and actress, Miley Cyrus, danced with him.<sup>76</sup> Robin Thicke’s father, Alan, was an actor best known for his role as the genial patriarch on a television sitcom.<sup>77</sup> Miley Cyrus’s father, Billy Ray, is a country singer famous for one chart-topping hit.<sup>78</sup> Nor are these kinds of connections unusual; the entertainment industry is legendary for its incestuousness.<sup>79</sup>

Such connections, however helpful, are at most an indirect form of nepotism.<sup>80</sup> Neither Alan Thicke nor Billy Ray Cyrus could hand

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end any further challenges. It took less than a second for her response. ‘I know you. You’re not Mistar Russ. Your grandfather was Mistar Russ.’”)

75. See Winter, *supra* note 67, at 1386 (“One consequence of these extreme prototype effects is that the variants may be left unexpressed by the linguistic conventions of the culture. Because they have no name, these variants become suppressed aspects of our social consciousness.” (footnote omitted)). In this vein, one commentator asserts that “[t]he reason we have tied ourselves in knots around this question [of the meaning of nepotism] is really quite simple: there is a missing distinction in our lexicon between *good* nepotism and *bad*.” BELLOW, *supra* note 23, at 15.

76. Jon Caramanica, *Stubborn Persistence of Pop*, N.Y. TIMES (Aug. 26, 2013), <https://www.nytimes.com/2013/08/27/arts/music/mtv-video-music-awards-review.html> [<https://perma.cc/D2E9-9DB7>].

77. See ‘*Show Me That Smile Again ...*’; *Nick at Nite Launches Hit Family Comedy; Growing Pains Beginning Monday, February 12*, PR NEWSWIRE, Jan. 29, 2007.

78. See Faye Brookman, *Hannah Montana Enters Hair Care Segment*, WOMEN’S WEAR DAILY, Feb. 15, 2008.

79. See BELLOW, *supra* note 23, at 499 (“The multiple couplings, marriages, and remarriages within this privileged class, resulting in a web of children, stepchildren, half siblings, uncles and aunts, nieces, nephews, and cousins, have made the Hollywood community increasingly resemble an inbred occupational caste.”).

80. See *id.* at 10 (“No one can pick up the phone these days and get their kid a high-paying job, a record deal, or a spot on the national ticket.”). Yet, “[w]hile not nepotism in the classic sense, it is rightly called nepotism because it involves exploiting the family name, connections,



down hit singles like a family heirloom. Their children had to choose a career path and work for their own success. On the other hand, it would be naïve to overlook the value of industry connections, access to voice lessons, the right acting coaches, and the like. Whatever the talent of Robin Thicke or Miley Cyrus, native or as nurtured, they enjoyed opportunities not equally available to meritorious outsiders—that is, the talented children of less well-connected parents.<sup>81</sup>

In family businesses, kinship affords access to a reservoir of information about a business and associated relationships. Nevertheless, as is true in other professional contexts, the entry of a younger generation into a family business does not necessarily signify that kinship has taken precedence over merit. Rather, it may be the case that the younger generation has developed a sincere interest in the business, learned the ropes, and, by the time control passes, qualified for the opportunity.

For example, Arthur Gregg Sulzberger appears well suited for the role of publisher of the *New York Times*, which he assumed on January 1, 2018, when his father stepped down after a quarter-century in the position.<sup>82</sup> Mr. Sulzberger is the sixth member of the Ochs-Sulzberger family to serve as publisher since the Ochs-Sulzberger family acquired the paper in 1896.<sup>83</sup> The Ochs-Sulzberger family continues to own approximately 91 percent of the paper's stock and controls the board.<sup>84</sup> However, his appointment was not a foregone conclusion; Mr. Sulzberger was one of several candidates in contention, and the *Times* established an independent committee to make the decision.<sup>85</sup>

Although Mr. Sulzberger stated in an interview that he “wasn't someone who grew up aspiring to become publisher of [t]he *New*

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or wealth. The method may be different, but the result is much the same.” *Id.* at 14-15.

81. In the fashion industry, the advantages of famous parentage may be even more powerful. See Vanessa Friedman, *Fashion's Latest Obsession: Chips Off the Celebrity Block*, N.Y. TIMES (Feb. 2, 2017), <https://www.nytimes.com/2017/02/02/fashion/iris-law-evan-ross-celebrity-children-fashion.html> [<https://perma.cc/MXG4-TMMR>] (“Never before have so many children of famous parents been so celebrated and rewarded for their lineage, and so willing to publicly embrace it.”).

82. See Sydney Ember, *A.G. Sulzberger, 37, to Take Over as New York Times Publisher*, N.Y. TIMES (Dec. 14, 2017), <https://www.nytimes.com/2017/12/14/business/media/a-g-sulzberger-new-york-times-publisher.html> [<https://perma.cc/LTU5-H385>].

83. *Id.*

84. *Id.*

85. *Id.*

*York Times*,”<sup>86</sup> it is clear that he had been groomed for the role. He worked as a journalist beginning in 2003 and became a reporter for the *Times* in 2009, moving up to bureau chief and then deputy publisher.<sup>87</sup> Perhaps most notably, Mr. Sulzberger took on important responsibility “heading the team that produced [t]he *Times*’s ‘innovation report’ in 2014.”<sup>88</sup> The innovation report recommended far-reaching changes to the paper’s digital offerings.<sup>89</sup> As evidenced by Mr. Sulzberger’s leadership in reviewing the *Times*’s digital strategy, when changes are needed, family members may have the ability to force difficult conversations that outsiders might avoid.<sup>90</sup> To this extent, Mr. Sulzberger’s family status may enhance his qualifications for the role.

The advantages of upbringing do not always bespeak favoritism. An older generation may not even intend for younger family members to join the business.<sup>91</sup> In this regard, the third-generation owner of the Russ & Daughters delicatessen in New York recalls that his early education in the business may have been intended in some ways to *discourage* his eventual participation:

Shouting and cursing were the accepted forms of communication, and there was no attempt to tone it down at all, even in the presence of a ten-year-old boy. Looking back now, I suspect that part of the show was for my benefit, with the underlying message being, “Look, kid, every day is a battle. We enjoy our battles; it’s all we know. But you don’t need to do this for a living. You’ll get a good education and won’t have to sell fish.”<sup>92</sup>

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86. *Id.* (emphasis added).

87. *Id.*

88. *Id.*

89. *See id.*

90. For another example, see Jeffrey Sonnenfeld, *Trump’s White House Is a Family Business. That’s Not a Bad Thing.*, POLITICO MAG. (Apr. 8, 2017), <https://www.politico.com/magazine/story/2017/04/trump-white-house-family-business-215002> [<https://perma.cc/24VH-TXE3>] (“By virtue of their close relationship with the president, Jared and Ivanka are able to speak truth to power without fear of suspect motives. This is a major advantage of family enterprises.”).

91. *See* BELLOW, *supra* note 23, at 10 (noting that the modern version of nepotism is “not so much a matter of parents hiring or getting jobs for children as of children choosing to follow in their parents’ footsteps”).

92. FEDERMAN, *supra* note 74, at 61-62.

Whether or not they are encouraged to do so, of course, children may still gravitate towards the family business.

So far, this Article has argued that kinship preferences in family businesses do not necessarily signify nepotism. The next Part broadens the Article's focus and considers the reasons why a business, family owned or not, might adopt an insider-favoring model of governance—and, equally important, why noninsider investors might accept such an arrangement. Although belief in the entrepreneurial prowess of business founders could account for initial investment decisions by outsiders, that explanation has a built-in expiration date no later than the death or incapacity of the founders. By contrast, a belief that founders and their appointed heirs will be faithful stewards provides a more permanent explanation that may encompass generations of insider control.

## II. THE CONTROLLED-COMPANY PUZZLE

The continued success of controlled companies requires an explanation because it contradicts conventional models of corporate governance. Controlled companies have been characterized as outmoded “relics of an earlier era.”<sup>93</sup> According to this view, which has been prevalent since the middle of the twentieth century, evolution toward “widely held distribution of stock ownership and control” is “inevitable.”<sup>94</sup> And yet global practices remain stubbornly resistant to expert forecasts.<sup>95</sup>

For example, borrowing a strategy pioneered by family businesses, Google, Facebook, and Snapchat have all offered low-vote or no-vote stock to the general public while reserving effective voting control to company founders.<sup>96</sup> These maneuvers are legal under

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93. Alex Stewart & Michael A. Hitt, *Why Can't a Family Business Be More Like a Nonfamily Business? Modes of Professionalization in Family Firms*, 25 *FAM. BUS. REV.* 58, 58 (2012) (citing ALFRED D. CHANDLER, JR., *SCALE AND SCOPE: THE DYNAMICS OF INDUSTRIAL CAPITALISM* (1990)). See generally David S. Landes, *French Entrepreneurship and Industrial Growth in the Nineteenth Century*, 9 *J. ECON. HIST.* 45 (1949).

94. Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 *HARV. L. REV.* 1641, 1647 (2006) (characterizing the argument as “teleological”); Rafael La Porta et al., *Corporate Ownership Around the World*, 54 *J. FIN.* 471, 471 (1999) (discussing scholarship on widely held corporations in the last century).

95. See Gilson, *supra* note 94, at 1643; La Porta et al., *supra* note 94, at 471.

96. See Smith, *supra* note 1, at 544-45.

state corporate law codes that do not require each share to have a single vote,<sup>97</sup> and they have been embraced by investors who are eager to acquire equity and are apparently undeterred by the lack of voting influence.<sup>98</sup> Thus, unless regulators or stock indices change the rules to preclude stock-classification, the trend seems likely to continue.<sup>99</sup>

Why has insider control proved so durable?<sup>100</sup> According to most law and finance scholars, the answer is plain: controlling owners enjoy private benefits of control.<sup>101</sup> For example, controlling owners may devise stratagems to expropriate economic resources.<sup>102</sup> Alternatively, if the law stands in the way of self-dealing, controlling owners might still find intrinsic value in the enhanced social status and political access that ownership brings.<sup>103</sup> Either type of private benefit can be said to compensate controlling owners for the risk of an undiversified investment and the cost of monitoring it.<sup>104</sup> Therefore, even if a widely dispersed ownership structure would be more efficient, controlling owners might prefer the status quo.<sup>105</sup>

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97. See Marco Becht & J. Bradford DeLong, *Why Has There Been So Little Block Holding in America?*, in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS 613, 653 (Randall K. Morck ed., 2007).

98. See Steven Davidoff Solomon, *Shareholders Vote with Their Dollars to Have Less of a Say*, N.Y. TIMES (Nov. 4, 2015), <https://www.nytimes.com/2015/11/05/business/dealbook/shareholders-vote-with-their-dollars-to-have-less-of-a-say.html> [<https://perma.cc/783C-MJCB>]. However, increasing pressure from institutional investors could limit the use of dual stock. For example, the Investor Stewardship Group, which represents several prominent institutional investors, has announced new governance principles requiring corporations to “establish mechanisms to end or phase out controlling structures at the appropriate time.” *Corporate Governance Principles for US Listed Companies*, INV. STEWARDSHIP GROUP, <https://isgframework.org/corporate-governance-principles/> [<https://perma.cc/ZH7Z-Y4B9>].

99. The absence of public regulation may depend, in part, on whether lawyers who draft governance provisions are able to address investor concerns by tailoring dual-stock structures to facilitate idiosyncratic entrepreneurial strategies without ignoring legitimate concerns regarding self-dealing. See generally Andrew William Winden, *Sunrise, Sunset: An Empirical and Theoretical Assessment of Dual-Stock Structures*, 3 COLUM. BUS. L. REV. 852 (2018).

100. In a controlled structure, “a large blockholder owns a majority or large plurality of a company’s shares.” 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, 295 (Randall K. Morck ed., 2000).

101. See, e.g., Gilson, *supra* note 94, at 1651-52.

102. See *id.*

103. See *id.* at 1666-67.

104. See *id.* at 1651-52.

105. See Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate*

In a recent *Yale Law Journal* article, Professors Zohar Goshen and Assaf Hamdani questioned the prevailing view and offered a competing explanation that does not depend on private benefits of control.<sup>106</sup> They argue that founders might instead seek to safeguard an “idiosyncratic vision[.]”<sup>107</sup> By maintaining control, founders avoid the risk of being overruled by impatient or skeptical public investors.<sup>108</sup> However, the value of the controlling owners’ entrepreneurial strategy affects all shareholders equally—that is, minority investors receive a pro rata share of any value added as a consequence of the controlling owners’ idiosyncratic vision.<sup>109</sup>

The various rationales law and finance scholars offer for controlled ownership are not mutually exclusive—any or all of them could be true—but they lack a broader explanatory framework.<sup>110</sup> A complete account of corporate control must include consideration of the identity of the controlling owners.<sup>111</sup> In this regard, for the vast majority of controlled companies that are family owned, the family

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*Ownership and Governance*, 52 STAN. L. REV. 127, 130 (1999) (“[P]arties who participate in corporate control under an existing structure might have the incentive and power to impede changes that would reduce their private benefits of control even if the change would be efficient.”). On the other hand, investors might prefer the level of self-dealing associated with controlling owners to the agency costs inherent in managerial control. See Sharfman, *supra* note 1, at 7 (“[T]he use of the dual class share structure in IPOs is a value-enhancing result of the bargaining that takes place in the private ordering of corporate governance arrangements.”) (citing Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 767 (2017)).

106. See Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 564-65 (2016).

107. *Id.* at 617 (“Instead of assuming that controlling owners are expropriators who are motivated by a desire to consume private benefits at the expense of minority shareholders, we assert that many controlling owners are instead motivated primarily by a desire to pursue their idiosyncratic visions that they believe will increase the value of their firms to the benefit of all shareholders.”).

108. See *id.* at 565.

109. See *id.* at 567. If the strategy fails, the loss in business value likewise diminishes the worth of each shareholder’s investment. *Cf. id.* However, as long as minority investors hold a diversified portfolio, the downside risk may be less serious for them than for the controlling shareholders. See *id.* at 564.

110. As Ronald Gilson observes, “a more complete explanation for the distribution of shareholdings must incorporate politics, law, and efficiency, together with the serendipity of each country’s initial condition.” Gilson, *supra* note 94, at 1645.

111. Although the identity of controlling owners was not the focus of Gilson’s article, he cited empirical findings regarding the relative performance of family-controlled businesses. *Id.* at 1661. Gilson indicated a need for further research into “the micro-level dynamics” of controlled structures. *Id.* at 1678-79.

business literature supplies a plausible framework for analysis. In particular, the concept of family stewardship illuminates the ways in which private economic benefits, noneconomic benefits, and an entrepreneurial vision might coalesce.

#### A. *The Law and Finance of Control*

To the extent control rights are commensurate with financial commitment, those who have control are, in effect, putting all of their eggs in one basket.<sup>112</sup> Their investment is hostage to the uncertain fortunes of a single enterprise.<sup>113</sup> Moreover, the controlling owners must share earnings on a pro rata basis with minority shareholders who do not bear the same burden and may know little about a company other than its stock price.<sup>114</sup> So why is control appealing? The dominant explanation that law and finance offers for the persistence of controlled business structures is that they enable controlling owners to extract private benefits at the expense of other investors.<sup>115</sup>

Empirical studies confirm that controlled companies are most common in legal systems that fail to offer minority investors meaningful protections against expropriation of wealth by controlling owners.<sup>116</sup> For example, controlling owners might cause a controlled

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112. See Goshen & Hamdani, *supra* note 106, at 564. The size of the bet depends on the strategy for maintaining control. For example, the use of dual classes of stock separates voting rights from cash-flow rights, allowing founders to maintain control even if outside investors contribute a majority of the equity capital. See Bebchuk et al., *supra* note 100, at 297. Although beyond the scope of this Article, it is worth noting that dual-voting structures are potentially more problematic than outright majority ownership as a means of securing control because dual stock creates a divergence of voting rights and cash-flow rights. See Goshen & Hamdani, *supra* note 106, at 592-93 (“In the dispersed-ownership and the dual-class structures, those with de facto control do not necessarily hold a majority of cash-flow rights.”). Those who control the company through special, high-voting stock rather than equity have less skin in the game. See *id.* Still, controlling owners typically have a far greater economic stake than would be appropriate for a fully diversified investment strategy. See *id.* at 564.

113. Most individual investors seek to acquire a diversified portfolio so that they are less exposed to company-specific or industry-specific risks. See BURTON G. MALKIEL, A RANDOM WALK DOWN WALL STREET 235-40 (6th ed. 1996) (describing the “modern portfolio theory”).

114. See Goshen & Hamdani, *supra* note 106, at 567.

115. See Vladimir Atanasov et al., *Law and Tunneling*, 37 J. CORP. L. 1, 8-9 (2011) (citation omitted); Goshen & Hamdani, *supra* note 106, at 571.

116. See, e.g., Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113, 1145-51 (1998) (studying forty-nine countries and finding that “[t]he results support the idea that heavily concentrated ownership results from ... weak protection of investors”).

company to engage in transactions with other entities wholly owned by the controlling owners on terms favorable to the wholly owned entities.<sup>117</sup> Such maneuvers siphon wealth from minority owners who stand on the losing side of each transaction.<sup>118</sup>

Yet, an explanation for controlled structures premised on expropriation by the controlling owners accounts for only half of the puzzle—we still need to ask why outside investors would contribute capital without adequate safeguards against self-dealing. Unless outside investors are systematically uninformed, irrational, or bereft of other options, every increase in the prospects for controlling-owner expropriation should drive down the market price for controlled-company stock.<sup>119</sup> Private benefits of control are illusory if they are offset by a higher cost of capital. That is, if self-dealing behavior has already been “priced in,” controlling owners who operate in reasonably efficient capital markets should end up more or less where they started.<sup>120</sup> As a matter of logic, then, expropriation does not seem to offer a convincing explanation for the prevalence of controlled business structures.<sup>121</sup>

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117. In the United States, such transactions would be considered self-dealing and subject to heightened judicial scrutiny. *See, e.g.,* *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

118. *See id.* at 720-21.

119. Indeed, even if most investors are uninformed—so-called “noise” traders—an appropriate discount for the risk of self-dealing should be applied so long as the market includes investors with access to fundamental information.

120. Selling company stock at a discount in order to preserve the ability to misbehave is self-defeating from an economic standpoint, much like paying to stock a pond with fish to increase the chance of catching a fish. In the latter circumstance, at least the enjoyment of a day spent fishing might be worth the cost.

121. Also, setting aside the controlling owners’ motivation in any particular case, an increased cost of capital for controlled businesses would seem to put those corporations at a significant disadvantage to noncontrolled businesses. *See* WILLIAM A. KLEIN ET AL., *BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES* 373-74 (11th ed. 2010) (explaining why someone solicited to invest in a restaurant business controlled by two owner-managers “might exact a high price for the investment, by demanding a larger portion of the total equity than would be appropriate in the absence of the possibility of opportunistic behavior by the owner-managers”). Over time, one might expect those increased costs to motivate an evolutionary shift toward public corporations with widely dispersed ownership. *See* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 *GEO. L.J.* 439, 460 (2001) (“If, as the developing consensus view holds, the standard shareholder-oriented governance model maximizes corporate value, controlling shareholders who are motivated chiefly by economic considerations may not wish to retain control of their firms.”).

Some law and finance scholars contend that controlled structures are not necessarily detrimental to the interests of outside investors, even if there is self-dealing by controlling owners.<sup>122</sup> Rather, the desirability of a controlled business-entity structure depends upon a “tradeoff.”<sup>123</sup> With more capital at risk, controlling owners have a strong incentive to monitor the performance of management, thereby reducing managerial agency costs to the benefit of all shareholders.<sup>124</sup> The tradeoff is that “[b]ecause controlling shareholders must bear the direct costs of monitoring, liquidity, and nondiversification from holding a concentrated position, some private benefits of control likely are necessary to induce a party to play that role.”<sup>125</sup> Thus, the value of the tradeoff depends on the importance of shareholder monitoring and the amount of implicit compensation demanded by the controlling owners.<sup>126</sup>

Finally, it is worth observing that private benefits of control are not always financial.<sup>127</sup> The availability of nonpecuniary benefits may explain why concentrated ownership is common even in jurisdictions that prohibit many forms of economic opportunism.<sup>128</sup> Controlling owners might value enhanced community status, political influence, or other perquisites.<sup>129</sup> According to one commentator, it

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122. See Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 790-92 (2003).

123. *Id.* at 785.

124. See Goshen & Hamdani, *supra* note 106, at 592-93.

125. Gilson, *supra* note 94, at 1652.

126. The need for shareholder monitoring will depend on a number of factors, including the nature and volatility of the business and the existence of other sources of monitoring, such as “institutional lenders or government regulators.” See Edward B. Rock, *Shareholder Eugenics in the Public Corporation*, 97 CORNELL L. REV. 849, 856 (2012) (citing Edward M. Iacobucci & George G. Triantis, *Economic and Legal Boundaries of Firms*, 93 VA. L. REV. 515, 552-57 (2007)); see also Harold Demsetz & Kenneth Lehn, *The Structure of Corporate Ownership: Causes and Consequences*, 93 J. POL. ECON. 1155, 1159 (1985) (“The noisier a firm’s environment, the greater the payoff to owners in maintaining tighter control.”).

127. See Goshen & Hamdani, *supra* note 106, at 571.

128. See Hans Sjögren, *Families Breaking the Business Logic: The Entrepreneurial Spirit in the Evolution of Swedish Family Dynasties*, in *THE ENDURANCE OF FAMILY BUSINESSES* 111, 113 (Paloma Fernández Pérez & Andrea Colli eds., 2013) (“[T]he Swedish case clearly shows that family business groups are not just products of emerging market imperfections: they are also able to start and survive in well-governed and highly industrialized countries such as Sweden.”).

129. Goshen & Hamdani, *supra* note 106, at 571; see also Demsetz & Lehn, *supra* note 126, at 1162 (observing that certain firms have a higher “amenity potential” than others: “Winning the World Series or believing that one is systematically influencing public opinion plausibly



follows “[a]lmost tautologically” that “nonpecuniary benefits must play a prominent role in regimes in which functionally good law keeps pecuniary private benefits low.”<sup>130</sup> Whatever the form of compensation, in dollars or social status, the prevailing law and finance explanation assumes that controlling shareholders must be paid for the risks they bear and the excess value of the monitoring they provide.<sup>131</sup>

### *B. Entrepreneurial Vision*

An alternative explanation for the persistence of controlled companies does not assume that controlling owners expropriate private benefits.<sup>132</sup> Goshen and Hamdani argue that founders who refuse to surrender control may have in mind an entrepreneurial strategy that, if successful, will benefit both majority and minority investors.<sup>133</sup> By accepting the burden of control, those with confidence in their own strategy for increasing the value of a business earn the right to follow that strategy without deviation.<sup>134</sup>

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provides utility to some owners even if profit is reduced from levels otherwise achievable”). Investors might still worry about the implications of nonmonetary motivations. For example, three scholars contend that the recent scandal involving Volkswagen’s fraudulent evasion of vehicle emissions standards may be explained in part by controlling owners’ empire-building ambitions. See Charles M. Elson et al., *The Bug at Volkswagen: Lessons in Co-Determination, Ownership, and Board Structure*, 27 J. APPLIED CORP. FIN., Fall 2015, at 36, 38.

130. Gilson, *supra* note 94, at 1664.

131. See, e.g., Goshen & Hamdani, *supra* note 106, at 564-65.

132. See *id.* at 565.

133. *Id.* at 617 (“Instead of assuming that controlling owners are expropriators who are motivated by a desire to consume private benefits at the expense of minority shareholders, we assert that many controlling owners are instead motivated primarily by a desire to pursue their idiosyncratic visions that they believe will increase the value of their firms to the benefit of all shareholders.”). Professors Goshen and Hamdani define entrepreneurship broadly to include not only inventing new products, but also “an innovative method of marketing an existing product, capitalizing on a new market niche, motivating employees, creating an optimal capital structure, or utilizing new sources of capital.” *Id.* at 577 (citing Raghuram G. Rajan, *Presidential Address: The Corporation in Finance*, 67 J. FIN. 1173, 1179 (2012)). For a similarly broad definition, see Darian M. Ibrahim & D. Gordon Smith, *Entrepreneurs on Horseback: Reflections on the Organization of Law*, 50 ARIZ. L. REV. 71, 84 (2008).

134. See Goshen & Hamdani, *supra* note 106, at 565, 595. Although controlling owners would prefer to capture all of the economic returns from their labor, the presence of outside investors may be unavoidable if the founders lack sufficient capital and cannot accomplish their entrepreneurial vision without taking on additional equity owners. See *id.* at 578-79.

For example, in 1903, Henry Ford insisted upon sole control of the Ford Motor Company, his third entrepreneurial venture.<sup>135</sup> He had learned the hard way that his financial backers could otherwise thwart his entrepreneurial vision in favor of a safer return on investment.<sup>136</sup> In two previous ventures, coinvestors refused to defer to Ford's judgment and insisted that he move from development into production before he was ready to do so.<sup>137</sup> By establishing uncontested control of the Ford Motor Company, Ford was able to take the time necessary to develop a revolutionary assembly line process and the design for the Model T automobile.<sup>138</sup> His vision paid off handsomely, and the Ford Motor Company became one the world's most successful companies.<sup>139</sup>

More recently, when Google offered shares to the public, it used a dual-voting structure to preserve the control of its founders, Sergey Brin and Larry Page, as well as its chairman, Eric Schmidt.<sup>140</sup> In a disclosure required by securities law, Google explained that control was necessary to protect the entrepreneurial vision of its founders:

We are creating a corporate structure that is designed for stability over long time horizons. By investing in Google, you are placing an unusual long-term bet on the team ... and on our innovative approach.

We want Google to become an important and significant institution. That takes time, stability and independence. We bridge the media and technology industries, both of which have experienced considerable consolidation and attempted hostile takeovers.

In the transition to public ownership, we have set up a corporate structure that will make it harder for outside parties to take over or influence Google. This structure will also make it easier for our management team to follow [a] long term, innovative approach ....

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135. See M. Todd Henderson, *The Story of Dodge v. Ford Motor Company: Everything Old Is New Again*, in CORPORATE LAW STORIES 37, 47-49 (J. Mark Ramseyer ed., 2009).

136. See *id.* at 46.

137. See *id.* at 43-44.

138. See *id.* at 42, 48-49.

139. See *id.* at 39.

140. Google Inc., Registration Statement (Form S-1), at iii, 21 (Apr. 29, 2004).

The main effect of this structure is likely to leave our team ... with significant control over the company's decisions and fate, as Google shares change hands. New investors will fully share in Google's long term growth but will have less influence over its strategic decisions than they would at most public companies.<sup>141</sup>

Professors Goshen and Hamdani do not purport to demonstrate that private benefits are irrelevant to the question of control.<sup>142</sup> Rather, they argue that there is a strong, alternative explanation—"control allows entrepreneurs to pursue business strategies that they believe will produce above-market returns by securing the ability to implement their vision in the manner they see fit."<sup>143</sup>

Perhaps the most significant limitation of Goshen and Hamdani's theory is that it provides a useful explanation for control only so long as the controlling owners can be said to have a distinctive entrepreneurial vision. Yet, most controlled businesses have no mechanism for transitioning toward a widely dispersed model.<sup>144</sup> An investor who accepted Google's justification regarding the value of controlled ownership might still be concerned about Google's lack of concrete plans for an eventual succession of control.<sup>145</sup>

For this reason, some commentators have argued that insider control achieved via dual-stock classification should be subject to time limits of no more than ten or fifteen years, unless reapproved

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141. *Id.* at iii (emphasis omitted).

142. Goshen & Hamdani, *supra* note 106, at 576 ("We do not argue that control offers no private benefits .... Nor do we rule out the possibility that ... private benefits will motivate some controllers to hold a control block.").

143. *Id.* at 565.

144. See Steven Davidoff Solomon, *Lessons from the Viacom Dispute*, N.Y. TIMES (Aug. 22, 2016), <https://www.nytimes.com/2016/08/23/business/dealbook/lessons-from-the-viacom-dispute.html> [<https://perma.cc/LAZ6-HM4R>] ("A public corporation is not necessarily a family business to be run forever by that founder and his family. And putting an expiration date on dual-class stock to the extent it is used may be prudent. Other companies should consider such a mechanism, and prospective shareholders should consider demanding it before they invest.").

145. A company's fundamental value can be described as its future cash flow reduced to present value. Sylvain Marsat & Benjamin Williams, *Does Price Influence Assessment of Fundamental Value? Experimental Evidence*, 14 J. BEHAV. FIN. 268, 268 (2013). Thus, storm clouds on the horizon—even the far-distant horizon—would seem to be relevant to the pricing of the company's stock. See *id.* Perhaps, though, concerns about succession of control in a high-tech company such as Google are too far away to affect stock price, given the volatility in an industry in which there is rarely, if ever, a comfortable distance between the cutting edge and obsolescence.

by independent directors.<sup>146</sup> Consistent with this argument, at least one company has adopted a sunset provision premised on the diminishing value of insider control once the distinctive entrepreneurial vision of the founder is no longer a factor.<sup>147</sup> Facebook recently adjusted its corporate structure to provide for a transition to widely dispersed ownership once Facebook's founder, Mark Zuckerberg, no longer plays an active role in management:

[T]he new automatic conversion triggers ... provide for the unwinding of the multi-class stock structure and the relinquishment of Mr. Zuckerberg's majority voting control of us in certain circumstances .... The Special Committee and the board of directors believe that without these new terms (*i.e.*, if Mr. Zuckerberg or his descendants could maintain majority voting control indefinitely after he is no longer in a leadership role at the company, which is currently the case), it could be exceedingly difficult to attract and retain a high-quality replacement for Mr. Zuckerberg. These new terms thus ensure that we will not remain a founder-controlled company after we cease to be a founder-led company.<sup>148</sup>

While Facebook values Zuckerberg's leadership, just as Google relies upon its founders,<sup>149</sup> Facebook's structure guarantees that Zuckerberg cannot transition control to a family heir.<sup>150</sup> Facebook's time-limited approach to control is appropriate assuming that the justification for control depends on the founder's idiosyncratic entrepreneurial vision.<sup>151</sup> Investors are invited to surrender voting protections ordinarily applicable to a publicly traded corporation in order to gain the alleged benefits of the founder's entrepreneurial vision.<sup>152</sup> In doing so, however, they are not asked to accept the vicissitudes of permanent family ownership.<sup>153</sup>

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146. *See, e.g.*, Bebchuk & Kastiel, *supra* note 1, at 590.

147. *See infra* note 148 and accompanying text.

148. Facebook, Inc., Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Form DEF 14A), at 62 (June 2, 2016) (Mitigating Succession Risk).

149. *See supra* notes 140-41 and accompanying text.

150. *See supra* note 148 and accompanying text.

151. *See* Goshen & Hamdani, *supra* note 106, at 617.

152. *See supra* notes 106-09 and accompanying text.

153. *See* Bebchuk & Kastiel, *supra* note 1, at 590 (“[A]s time passes, the potential costs of a dual-class structure tend to increase while the potential benefits tend to erode.”).

### C. Stewardship

So far, this Part has canvassed several law and finance explanations for control: expropriation of private financial benefits, access to the perquisites of control, and idiosyncratic entrepreneurial vision. This Section argues that financial explanations do not fully account for the motivations of controlling owners, especially in family businesses. What is missing is stewardship—the sense that control comes with obligations to the business, to one’s own family, to employees, and to community.

Financial explanations of behavior presume that self-interest alone is what counts—hence the widely accepted view that the greater costs and risks borne by controlling owners must be compensated with private benefits.<sup>154</sup> Even Professors Goshen and Hamdani accept that founders pursue an entrepreneurial vision because they believe, rightly or wrongly, that they will be able to maximize the value of the business.<sup>155</sup> But when individuals are part of institutions they have reason to care about, they do not necessarily make choices based solely on self-interest.<sup>156</sup> Indeed, there is evidence that family owners sometimes engage in “propping” behavior—devoting their own resources to sustain the viability of a business in a downturn, although the benefit of that investment will be shared with public investors.<sup>157</sup>

The expectation of stewardship may explain the appeal of controlled companies to outside investors, notwithstanding the concerns raised by law and finance scholars. As one commentator explained:

If you buy *New York Times* stock, you are buying into the notion that you’ll let the family run the show, as it has done for more

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154. See Gilson, *supra* note 94, at 1652.

155. See Goshen & Hamdani, *supra* note 106, at 617.

156. See, e.g., Joe Nocera, *How Punch Protected the Times*, N.Y. TIMES (Oct. 1, 2012), <https://www.nytimes.com/2012/10/02/opinion/nocera-how-punch-protected-the-times.html> [<https://perma.cc/M577-TL3G>] (“As many other well-known newspaper families have abandoned the business—most recently, the Bancrofts of Dow Jones and [t]he *Wall Street Journal*—the Sulzbergers have remained steadfast in their belief that they were put on this earth to preserve and protect [t]he *New York Times*.”).

157. See Villalonga & Amit, *supra* note 9, at 865 (“[C]ontrolling shareholders, such as families, may use their private funds to ‘prop up’ (i.e., provide temporary support) to financially troubled firms, thereby benefiting minority shareholders in those companies.”).

than a century. And the Sulzbergers will put [t]he *Times's* journalism ahead of all else, because that is what is in the family's DNA.<sup>158</sup>

Notably, stewardship implies a long-term relationship. Unlike Facebook,<sup>159</sup> most controlled companies do plan for a succession of control from generation to generation.<sup>160</sup> For this reason, the owners typically see themselves as stewards of the business enterprise.<sup>161</sup> According to one recent study, public corporations run by their founders or by family owners reflect the values of their controlling owners.<sup>162</sup> The study suggests that founders and family owners are more inclined to give weight to the interests of all stakeholders.<sup>163</sup>

Stewardship can affect business strategy in several important respects. First, because family business owners tend to take a longer-term view, they often find it more important to avoid the risk of “busts” than to optimize the profitability of “booms.”<sup>164</sup> Thus, family owners “exhibit much care about continuity, community and connection: specifically, about the long term preservation and nurturing of their business and its markets.”<sup>165</sup> Other types of

158. Nocera, *supra* note 156.

159. *See supra* note 148 and accompanying text.

160. *See* Marianne Bertrand & Antoinette Schoar, *The Role of Family in Family Firms*, 20 J. ECON. PERSP. 73, 74 (2006) (“Family firms are characterized by a concentration of ownership, control and often key management positions among family members, even after the retirement of the firms’ founders.”); Means, *supra* note 12, at 939 (“Typically, owners seek to increase family wealth, to provide employment for family members, and, ultimately, to transfer control to a new generation of family owners.”).

161. Danny Miller et al., *Stewardship vs. Stagnation: An Empirical Comparison of Small Family and Non-Family Businesses*, 45 J. MGMT. STUD. 51, 51-52 (2008) (In addition to economic dependence, “scholars have argued that there can be significant socio-emotional attachments of family managers to their business, which comes to satisfy their needs both for security, as well as for social contribution, sharing, belonging, and even standing within the family.”).

162. *See* Mullins & Schoar, *supra* note 7, at 24-25 (reporting survey results of more than 800 CEOs). The authors also included nonfamily businesses in their study and found that: “Founders and CEOs related to the firm’s founder are more likely to embrace a stakeholder view of management and feel less responsibility towards their shareholders, instead prioritizing employees and creditors.” *Id.* at 25.

163. *See id.* at 26.

164. *See* Nocera, *supra* note 156 (“As a red-blooded capitalist, I understand why dual classes of stock are frowned upon.... It is likely that *Times* Company stock is lower than it would be if shareholders knew they could ‘put it in play,’ as they say on Wall Street.”).

165. Miller et al., *supra* note 161, at 73; *see also* Danny Miller et al., *Family Ownership and Acquisition Behavior in Publicly-Traded Companies*, 31 STRATEGIC MGMT. J. 201, 202 (2010)

entrepreneurs are more likely to adopt “strategies of rapid growth through quick expansion rather than more gradual means such as substantive innovation, social contribution or reputation building.”<sup>166</sup>

Second, family-business owners often seek “to ‘enlarge’ the family concept sufficiently” to encompass workers and other important stakeholders.<sup>167</sup> The desire to include others within the family’s ambit may reflect a perceived ethical obligation, but it also can strengthen the business. For example, family-business owners engender loyalty by protecting workers even when it would be economically rational to engage in layoffs and outsourcing to reduce labor costs.<sup>168</sup> In the short term, these commitments may come at the expense of profitability.<sup>169</sup> However, while corporate generosity might reduce revenue, the good will engendered gives family-controlled businesses better odds of weathering unforeseen challenges.<sup>170</sup> The decision by family owners “[t]o share some benefits

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(“[F]amily owners, preoccupied with corporate longevity, are said to pursue strategies of ‘continuity’ that avoid potentially destabilizing acquisitions and build enduring relationships with stakeholders inside and outside the firm to sustain the business and reduce risk.”).

166. Miller et al., *supra* note 161, at 54.

167. Andrea Colli, *Risk, Uncertainty, and Family Ownership*, in *THE ENDURANCE OF FAMILY BUSINESSES*, *supra* note 128, at 85, 104. Although it involved intrafamily conflict, the recent boycott by employees and customers of the Market Basket grocery store chain in favor of their deposed CEO, Arthur T. Demoulas, showed how strong the ties of loyalty can be—employees were willing to risk their jobs in support of a CEO who, in their view, treated them like family. Jana Kasperkevic, *Market Basket’s Popular CEO Arthur T Goes Rogue and Wins—Now What?*, *GUARDIAN* (Aug. 28, 2014, 5:26 PM), <https://www.theguardian.com/money/us-money-blog/2014/aug/28/market-basket-ceo-rogue-now-what> [<https://perma.cc/YJW2-2KJ5>]; Alana Semuels, *Power to the Workers: How Grocery Chain Employees Saved Beloved CEO*, *L.A. TIMES* (Aug. 28, 2014, 4:20 PM), <http://www.latimes.com/nation/nationnow/la-na-nn-market-basket-ceo-arthur-t-demoulas-20140828-story.html#> [<https://perma.cc/K2QJ-K5BY>].

168. See Timothy G. Habbershon & Mary L. Williams, *A Resource-Based Framework for Assessing the Strategic Advantages of Family Firms*, 12 *FAM. BUS. REV.* 1, 4 (1999) (“Family firms have been described as having a unique working environment that fosters a family-oriented workplace and inspires greater employee care and loyalty.”). For a case study, see BETH MACY, *FACTORY MAN* (2014).

169. See Pascual Berrone et al., *Family-Controlled Firms and Stakeholder Management: A Socioemotional Wealth Preservation Perspective*, in *THE SAGE HANDBOOK OF FAMILY BUSINESS* 179, 191 (Leif Melin et al. eds., 2014).

170. See *id.*; Colli, *supra* note 167, at 103. To this end, family leaders may also “nurture employees who contribute to corporate health by creating a *community* culture populated by motivated, well-trained and loyal staff” and “create strong *connections* with outside stakeholders, especially customers who can sustain the business in times of trouble.” Miller et al., *supra* note 161, at 52.

[is] thus a way of safeguarding the survival of the company, as well as of enhancing the standing of the family within the community.”<sup>171</sup>

Third, because of their identification with the business, family owners may be more willing than nonfamily owners to accept personal financial risk: “[T]he owners and managers of family businesses have an unusual amount at stake because of the deep connections between the family and the business.”<sup>172</sup> In this respect, stewardship theory suggests that the family owners’ commitment to the business may be stronger than economic analysis would otherwise predict.<sup>173</sup>

An example may help clarify the distinction between stewardship and other explanations for insider control. While the early years of the Ford Motor Company illustrate the potential virtues of idiosyncratic, entrepreneurial vision,<sup>174</sup> the company today better represents the value of stewardship. That is, Goshen and Hamdani’s theory illuminates Henry Ford’s reasons for seeking control more than a century ago,<sup>175</sup> but it falters as an explanation for the Ford family’s continuing control of the Ford Motor Company.<sup>176</sup> Outside investors are unlikely to credit the Ford family with having inherited superior judgment relevant to corporate entrepreneurship, “the processes by which an established organization creates new organizations, initiates strategic renewal, and innovates within the organization.”<sup>177</sup>

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171. Colli, *supra* note 167, at 103. Efforts by family firms to integrate themselves into the community “are abundant almost everywhere in Europe and in the industrialized world in general.” *Id.*

172. Miller et al., *supra* note 161, at 51. *See generally* James H. Davis et al., *Toward a Stewardship Theory of Management*, 22 *ACAD. MGMT. REV.* 20 (1997) (distinguishing stewardship from other theories of managerial behavior).

173. Colli, *supra* note 167, at 95 (“[Family owners] are often not acting on the basis of personal self-interest, but for the benefit of the organization and of its stakeholders.”).

174. *See supra* notes 135-39 and accompanying text.

175. *See* Goshen & Hamdani, *supra* note 106, at 617.

176. *See supra* note 11 and accompanying text.

177. Alexander McKelvie et al., *Corporate Entrepreneurship in Family Businesses: Past Contributions and Future Opportunities*, in *THE SAGE HANDBOOK OF FAMILY BUSINESS*, *supra* note 169, at 340, 340. To be clear, I do not mean to question the competence of the current generation of Ford leadership or its commitment to entrepreneurship. *See, e.g.*, Neal E. Boudette, *Ford Motor Plans Ride-Hailing Service with Fleet of Driverless Cars by 2021*, *N.Y. TIMES*, Aug. 17, 2016, at B2; Will Oremus, *Ford Wants to Be the Ford of Driverless Cars*, *SLATE* (Aug. 16, 2016, 2:28 PM), <https://slate.com/technology/2016/08/ford-says-it-will-mass-produce-a-driverless-car-by-2021.html> [<https://perma.cc/WAF4-SLHG>] (“Ford’s goal is to



Nevertheless, outside investors might value the family's evident sense of mission and long-term perspective. During the financial crisis of 2008, Ford was the only U.S. car company to turn down a bailout—its executive chairman at the time was the great-grandson of Henry Ford, and the company had taken a more conservative strategy than its rivals to amass financial resources in case of an unexpected downturn.<sup>178</sup> Also, the family was willing to put its own capital on the line to help the corporation pull through the crisis and emerge in a stronger competitive position.<sup>179</sup> From the standpoint of outside investors, the sincere commitment of controlling owners to the long-term success of the company may be more important than the content of their entrepreneurial vision. Longstanding, visible family ownership is one way of signaling that commitment.<sup>180</sup>

The concept of stewardship is most applicable to family businesses but may also explain other forms of controlling ownership. When controlling owners have reason to identify with the long-term interests of the business, the benefits of stewardship can be disaggregated from the specific characteristics of family ownership.

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reprise its role in the original automotive revolution: It doesn't want to be the company that invents driverless cars, but the one that brings them to the masses.”).

178. Erik Cassano, *How Bill Ford Jr. Led Ford Motor Co. Through the Recession*, SMART BUS. MAG. (Mar. 1, 2011, 7:56 PM), <http://www.sbnonline.com/article/bill-ford-jr-on-the-future-of-his-brand-the-business/> [<https://perma.cc/S4TJ-RTZ8>].

179. *See id.* (“The patience of the Ford family is being rewarded. Not only did the company emerge from the financial crisis without the need for federal money, but Ford says the company's debt is being paid off much faster than either the company's leaders or industry analysts anticipated.”). *See generally* MATTHIAS HOLWEG & NICK OLIVER, CRISIS, RESILIENCE AND SURVIVAL: LESSONS FROM THE GLOBAL AUTO INDUSTRY 278 (2016) (“[Ford] use[s] closely held shares as a proxy for a long-term commitment to the firm, likely to be manifested as a propensity to provide support in the face of financial and other adversity.”).

180. *See, e.g.*, Nocera, *supra* note 156:

The bet Punch Sulzberger made his whole career is that people wanted—and would pay for—great journalism. Today, despite an uncertain future, his heirs [at the *New York Times*] are making the same bet. The protection afforded them by the dual-class structure has allowed the current chairman, Arthur Sulzberger Jr., and the rest of the family to take the long view without worrying about corporate raiders or hedge fund managers.

Empirical studies focused on economic metrics indicate that family firms outperform non-family firms but that “the performance of family firms is only better in firms in which the family is still active, either on the executive or the supervisory board.” Christian Andres, *Large Shareholders and Firm Performance—An Empirical Examination of Founding-Family Ownership*, 14 J. CORP. FIN. 431, 432 (2008).

The viability of stewardship as an explanation for nonfamily control has important implications for corporate governance debates regarding dual-stock classification. In recent years, well-known technology companies have made the case that their founding owners should retain control in order to safeguard the business mission.<sup>181</sup> To accomplish this objective, these companies have used the dual-stock strategies developed by family businesses such as the *New York Times*.<sup>182</sup>

Although technology company founders base the appeal for continuing control on their proven entrepreneurial skills and instincts rather than the *noblesse oblige* of family ownership,<sup>183</sup> investors may conclude (for better or worse) that the founders will identify deeply with the companies they have worked so hard to build. It does not require a large stretch of the imagination to understand why business owners, whose public prominence is bound up in the technologies they have created, might care about how those technologies are used and whether they serve the public interest.<sup>184</sup>

On the other hand, regulators might be skeptical of the value of stewardship, especially when nonfamily owners take measures to preserve their control. These concerns are likely to be heightened when the companies at issue are significant to the economy and to everyday life for millions of people. Google, Facebook, and Snapchat all belong in that category of significance. If insider control reduces value because insiders expropriate private benefits for themselves,

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181. See *supra* notes 140-41 and accompanying text.

182. See Nocera, *supra* note 156:

Since the 1950s, the company had given stock to favored employees and others, stock that could be bought and sold but had no voting rights. The solution was to give that stock—Class A shares, they were called—some voting rights, but not enough to threaten the family's control. The Class B shares, held largely in a family trust, still gave the Sulzbergers the power to elect around 70 percent of the board.

183. See, e.g., *supra* notes 140-41 and accompanying text.

184. It is, of course, possible for business owners to seek to achieve public benefit and family recognition using the wealth generated by a family business, even if the business itself operates without concern for the harms it creates. For a stark recent example of the divergence between business practices and philanthropic ambitions, see Patrick Radden Keefe, *Empire of Pain*, *NEW YORKER*, Oct. 30, 2017, at 34 (uncovering the relationship between the Sackler family's wealth, which was largely generated from the unscrupulous marketing of OxyContin, and the family's lavish support of the arts).

then dual-stock classification is undesirable because it enables founders to offer stock to the public markets without relinquishing control.<sup>185</sup> Accordingly, concerned investor advocates, regulators, and lawmakers have sought to apply financial penalties to deter these types of governance structures.<sup>186</sup>

For example, Senator Elizabeth Warren has asked the “NYSE and NASDAQ to declare companies ineligible for an initial listing if they have unequal voting rights, and to prohibit already listed companies from issuing additional classes of common stock with unequal voting rights.”<sup>187</sup> The lobbying efforts against controlled companies have begun to bear fruit: notably, Snapchat’s 2017 initial public offering did not provide public investors with voting rights, and, in response, “S&P excluded it from its ubiquitous S&P 500 Index.”<sup>188</sup>

### III. FIDUCIARY OBLIGATIONS OF CONTROLLING OWNERS

Concerns about abuses of insider control are legitimate, but regulations that restrict insider control also diminish the prospects for stewardship. This Part argues that the fiduciary obligations owed by controlling owners provide a more balanced basis for regulation than across-the-board regulatory restrictions of the sort favored by Professors Bebchuk and Kastiel, Senator Warren, and other concerned critics.<sup>189</sup> To the extent well-informed investors are willing to invest in controlled companies because they believe the benefits outweigh the costs, the government and stock exchange should respect those investment decisions.<sup>190</sup> Moreover, regulations

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185. See *supra* note 2 and accompanying text.

186. See, e.g., Bebchuk & Kastiel, *supra* note 1, at 626.

187. Press Release, Elizabeth Warren, Senator Elizabeth Warren Urges NYSE, NASDAQ to Propose Rules Requiring “One Share, One Vote” Structures (June 5, 2013) (reporting contents of letter sent to the NYSE and NASDAQ). According to Senator Warren, “[l]ong-term investors will have limited recourse in holding management and the board accountable if the company heads in a wrong direction.” *Id.*

188. Smith, *supra* note 1, at 543-44.

189. See *supra* notes 186-87 and accompanying text.

190. In this regard, Bernard Sharfman argues that “it is an overreach for academics and shareholder activists to dictate to sophisticated capital market participants—the ones who actually take the financial risk of investing in IPOs (including those with dual class share structures)—how to structure corporate governance arrangements.” Sharfman, *supra* note 1, at 32.

that make it harder for businesses to select and adhere to idiosyncratic strategies are unlikely to serve the broader goals of progressive critics.<sup>191</sup> The stewardship that insider control fosters, however imperfectly, can serve as a hedge against a monolithic corporate system of profit maximization that neglects other kinds of social value.

### *A. The Availability of Judicial Oversight*

Ordinarily, shareholders owe no fiduciary duties to other shareholders or to the corporation, and are free to act in their own self-interest, regardless of the possible consequences for other constituencies.<sup>192</sup> In controlled companies, the situation is different for two reasons. First, to the extent controlling owners hold board positions or senior managerial roles, the controlling owners owe the same fiduciary duties as any other board member or manager when acting in that capacity.<sup>193</sup> Second, even if controlling owners act indirectly by appointing board members to implement their plans, the law imposes fiduciary duties commensurate with their effective control of corporate decision making.<sup>194</sup>

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191. A similar dynamic is at play in the nascent law of social enterprise; the business structures that create managerial flexibility also leave room for managers to depart from the mission without full accountability. For an assessment of social enterprise's promise and challenges, see *THE CAMBRIDGE HANDBOOK OF SOCIAL ENTERPRISE LAW* (Benjamin Means & Joseph W. Yockey eds., 2018), [https://papers.ssrn.com/so13/papers.cfm?abstract\\_id=3280370](https://papers.ssrn.com/so13/papers.cfm?abstract_id=3280370) [<https://perma.cc/AW4Y-TMNX>].

192. See, e.g., *In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 65 (Del. Ch. 2013) ("Stockholders in Delaware corporations have a right to control and vote their shares in their own interest." (quoting *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, 845 (Del. 1987))).

193. See *Zahn v. Transamerica Corp.*, 162 F.2d 36, 45 (3d Cir. 1947) ("[T]here is a radical difference when a stockholder is voting strictly as a stockholder and when voting as a director; that when voting ... as a director he represents all the stockholders in the capacity of a trustee for them and cannot use his office as a director for his personal benefit at the expense of the stockholders." (citing *Haldeman v. Haldeman*, 197 S.W. 376 (Ky. 1917))).

194. See *Ivanhoe Partners v. Newmont Mining Corp. (In re Newmont Mining Corp. S'holders Litig.)*, 535 A.2d 1334, 1344 (Del. 1987) ("[A] shareholder owes a fiduciary duty only if it owns a majority interest in or exercises control over the business affairs of the corporation." (citing *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 958 (Del. 1985))); *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 719-20 (Del. 1971) (applying fiduciary duties to a parent corporation that held 97 percent of the stock of its subsidiary and appointed its board); STEPHEN M. BAINBRIDGE, *CORPORATION LAW AND ECONOMICS* 336 (2002) (arguing that controlling shareholder liability is premised on agency principles because the controlling shareholder has the power to elect the board and is therefore responsible for it).

Accordingly, across all forms of business association, the fiduciary duties of care and loyalty are available to regulate insider control.<sup>195</sup> In closely held businesses, the doctrine of minority shareholder oppression may provide further protection for noncontrolling owners.<sup>196</sup> Unlike regulations that might, for example, limit insider control by imposing sunset provisions<sup>197</sup> or by preventing companies with unequal classes of stock from listing on stock exchanges or indices,<sup>198</sup> the availability of judicial monitoring should not impede owners from serving as stewards. Unless noncontrolling shareholders can specifically allege breaches of the duty of care or loyalty, the board has “virtually unconstrained freedom to exercise business judgment.”<sup>199</sup> As discussed below, fiduciary duties require a well-informed decision-making process and prevent controlling owners from expropriating the value of a business for their own benefit, but leave ample room for discretionary choices that can serve the interests of multiple corporate constituencies.<sup>200</sup>

### *B. The Duty of Care*

The fiduciary duty of care matters because insider control is no guarantor of competent management, and noncontrolling shareholders lack the voting power to make necessary changes. For example, according to a common, three-generation schema of family businesses, entrepreneurial ambition is too often confined to the first generation of ownership.<sup>201</sup> As one commentator assessed the

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195. The strength of the respective fiduciary duties varies depending on the form of business association and state law, and may be more or less subject to private ordering. For simplicity's sake, this Article focuses largely on Delaware. Delaware is by far the most important jurisdiction for corporate law. *See, e.g.*, Kent Greenfield, *Democracy and the Dominance of Delaware in Corporate Law*, 67 *LAW & CONTEMP. PROBS.* 135, 136 (2004) (“Delaware’s dominance is staggering. Over 300,000 companies are incorporated there, including nearly three hundred of the Fortune 500.”).

196. *See* Benjamin Means, *A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation*, 97 *GEO. L.J.* 1207, 1220 (2009) (describing and critiquing current judicial approaches to resolving problems of shareholder oppression).

197. *See* Bebchuk & Kastiel, *supra* note 1, at 626.

198. *See, e.g.*, Press Release, Warren, *supra* note 187.

199. BAINBRIDGE, *supra* note 194, at 251.

200. For a detailed analysis of the business judgment rule and the tradeoff between managerial discretion and equity, see Bernard S. Sharfman, *The Importance of the Business Judgment Rule*, 14 *N.Y.U. J.L. & BUS.* 27 (2017).

201. *See, e.g.*, Sjögren, *supra* note 128, at 111-12 (“The founder builds up his enterprise,

problem, “[c]onservatism prevails, and growth ambitions and opportunities are curtailed.”<sup>202</sup> According to this “stagnation perspective,” “resource shortages, family conflicts and succession difficulties aggravate the situation, compromising the very longevity of the firm.”<sup>203</sup> When they overstay their welcome, controlling owners can sabotage a business notwithstanding the strength of their personal attachments.<sup>204</sup>

In many family businesses, the transition of control across generations poses the greatest risk to stability and growth.<sup>205</sup> First, there is the question whether the next generation of family owners will have the talent and motivation to build on what earlier generations established.<sup>206</sup> Second, an orderly, timely transition of power requires advance planning—yet, founders too often defer the unpleasant consideration of their own mortality and resist surrendering control when, in their view, that means a loss of individual identity and a diminishment of status within the family.<sup>207</sup>

Properly understood, the duty of care addresses these concerns by requiring managers and, by extension, controlling owners to act with reasonable care.<sup>208</sup> For example, business succession is a high

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often on the basis of a clever innovation; the second generation administers the firm without further innovations; and the third generation concentrates on interests other than those of the founder, including cutting corners, self-indulgent luxurious living, and the fortune is thus dissipated.”). Although this life cycle may reduce economic inequality in society by limiting the temporal scope of family fortunes, a predictable decline in managerial competence would surely be of concern to outside investors. *See Means, supra* note 12, at 955, 958-59 (“When a family falters, the markets will wrest control away, one way or another.”).

202. Miller et al., *supra* note 161, at 52 (describing this view as the “stagnation perspective”).

203. *Id.*

204. The continued existence of family-controlled companies does not rebut the argument. *See id.* After all, new ventures will arise to replace those that fail. *See generally* Sjögren, *supra* note 128, at 112 (including a discussion of “emerging dynasties”). As a consequence, family-controlled companies could represent a significant percentage of the overall economy whether or not individual companies survive multiple generations of ownership. *See Means, supra* note 12, at 939-40.

205. *See Means, supra* note 8, at 1189.

206. *See supra* note 201.

207. *See Means, supra* note 8, at 1215.

208. In Delaware, directors must “use that amount of care which ordinarily careful and prudent men would use in similar circumstances.” *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963). The Model Business Corporation Act similarly states that directors should act “with the care that a person in a like position would reasonably believe appropriate under similar circumstances.” MODEL BUS. CORP. ACT § 8.30(b) (2016).

priority for any business dependent on key managerial employees.<sup>209</sup> Failure to establish a succession plan should be a per se violation of the duty of care.<sup>210</sup> Nor does nepotism satisfy the duty of care; although kinship preferences are part and parcel of family ownership, those in control of a business must make reasonable inquiry into the qualifications of designated successors.<sup>211</sup> To the extent family members participate in management, therefore, a succession plan should establish criteria to ensure that only well-qualified family members will be eligible for high-level managerial positions. For these reasons, invocation of the duty of care could help minority investors insist that controlled companies engage in proper succession planning and, if necessary, would provide grounds for obtaining injunctive relief.<sup>212</sup>

Although some commentators might object that the duty of care is toothless in controlled companies because boards lack independence, the presence of fiduciary obligations can still shape behavior. As an initial matter, one cannot presume that directors will violate their fiduciary obligations in order to seek reappointment in the future, or out of misplaced loyalty to those who appoint them.<sup>213</sup>

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209. For example, at a recent shareholders meeting, Apple's CEO explained "that one of his most important roles as CEO is properly 'passing the baton' to a new leader" and that "[e]very Apple board meeting in recent years has had succession planning on the agenda for all key executive roles." Mark Gurman, *Apple CEO Sees Dividend Hikes, Calls Succession a Priority*, BLOOMBERG TECH. (Feb. 13, 2018, 3:02 PM), <https://www.bloomberg.com/news/articles/2018-02-13/apple-ceo-sees-dividend-hikes-calls-succession-a-priority> [<https://perma.cc/WQX5-XAFW>].

210. See generally Means, *supra* note 8, at 1231 ("Effective planning can reduce the likelihood of conflict in a family business and provide nondestructive solutions for conflicts that do arise. However, family businesses often fail to consider issues of succession and other potential flash points.... Consequently, courts have an important role to play in resolving disputes that cannot be settled amicably by the parties.").

211. Compare *supra* note 201, with *supra* note 209.

212. See *Malpiede v. Townson*, 780 A.2d 1075, 1095 (Del. 2001). Litigation costs could pose a practical barrier to maintaining duty of care lawsuits. Ordinarily, shareholders would not be entitled to monetary damages. See *Emerald Partners v. Berlin*, 787 A.2d 85, 91-92 (Del. 2001). Although the affirmative standard requires due care, directors are only liable for gross negligence. See *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985). Moreover, most jurisdictions permit corporations to exculpate directors from monetary damages for breaches of the duty of care. See, e.g., *Emerald Partners*, 787 A.2d at 90.

213. For example, in a bitter takeover battle between Air Products and Chemicals, Inc. ("Air Products") and Airgas, Inc. ("Airgas"), nominees to the Airgas board appointed by Air Products ultimately endorsed the defensive measures put in place by the Airgas management team. See *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 122 (Del. Ch. 2011).

Equally important, if the board lacks independence because of a controlling shareholder, then the board can enforce the fiduciary duties against the shareholder if there is self-dealing.<sup>214</sup>

It may be that courts should apply closer scrutiny to ensure that the duty of care has been met in cases involving insider control. If all parties saw judicial relief as a realistic option, controlled companies would have reason to adopt succession plans. When necessary, shareholders could use the prospect of litigation to force corporations to engage in meaningful succession planning or to adjust outdated plans that might already exist.<sup>215</sup>

Courts may not be well-positioned to judge the merits of a particular succession plan, but they can evaluate the adequacy of the underlying process.<sup>216</sup> Poorly designed succession plans can put a business at risk.<sup>217</sup> For example, a dual-class stock scheme adopted in 1990 allowed Sumner Redstone to retain complete control of Viacom, even a quarter century after serious questions regarding his mental competence arose.<sup>218</sup> This arrangement should have been subject to a fiduciary challenge, either by Viacom's board or by minority shareholders.<sup>219</sup> Although Redstone built Viacom "into a \$40 billion entertainment empire that encompasses the Paramount movie studio and the CBS, MTV, and Showtime television networks,"<sup>220</sup> his faculties as of 2016 were so diminished that it was not clear whether he was still capable of basic cognitive functioning.<sup>221</sup> Nevertheless, one commentator concluded that the family's effective control was so absolute that board resistance to the family's directives was likely an exercise in futility without any clear legal basis.<sup>222</sup> It may well be true that Redstone and his family had total

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214. See BAINBRIDGE, *supra* note 194, at 336.

215. See *supra* notes 210, 212 and accompanying text.

216. See, e.g., *Emerald Partners*, 787 A.2d at 90-91 (discussing deference for business decisions and the opportunity for court assessment of fairness).

217. See Miller et al., *supra* note 161, at 52.

218. Bebchuk & Kastiel, *supra* note 1, at 587-88, 587 n.1 ("Sumner Redstone indirectly controls Viacom through National Amusements, Inc. ... while holding only 8 [percent] of Viacom's equity capital." (citing Viacom Inc., Proxy Statement pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Form DEF 14A), at 22 (Dec. 16, 2016))).

219. See *generally id.* (noting the powerlessness of investors).

220. *Id.* at 587.

221. Sydney Ember, "He Can't Speak," *Lawyer Says as Redstone Word War Rages*, N.Y. TIMES, July 1, 2016, at B3.

222. See Steven Davidoff Solomon, *Viacom Has Few Options for Fighting National*



control over Viacom, but, regardless of whether they voted directly or through other controlled companies or trusts, the Redstones' exercise of that power was subject to fiduciary constraints that appear to have been ignored.<sup>223</sup>

The duty of care does not preclude family-business succession or other similar exercises of insider prerogative; it simply requires an appropriate process before decisions are made.<sup>224</sup> Consider in this regard the way the *New York Times* selected its most recent publisher.<sup>225</sup> Even though there was a strong presumption in favor of the Ochs-Sulzberger family, the succession decision was delegated to an independent committee.<sup>226</sup> The newspaper is publicly held and proceeded in apparent recognition of the fact that there were non-family equity investors with financial interests at stake.<sup>227</sup> Moreover, the *New York Times* has long served nationally and perhaps internationally as the paper of record.<sup>228</sup> As the controlling family surely understood, an improperly handled transition could damage the paper's ability to fulfill this vital role to the detriment of its shareholders, the journalists who work for it, and the general public who rely on its integrity.<sup>229</sup> Indeed, abiding by the duty of care is part of what it means to be a steward. The applicable fiduciary standard reflects and reinforces benign explanations for insider control.

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*Amusements*, N.Y. TIMES (June 9, 2016), <https://www.nytimes.com/2016/06/10/business/dealbook/viacom-has-few-options-for-fighting-national-amusements.html> [https://perma.cc/AG92-DGXA] (noting Viacom directors' "shrill" response to Sumner Redstone's daughter asserting control of the company, and the CEO's "seeming incapability of letting go").

223. See *id.*; see also *supra* note 218 and accompanying text (discussing the voting structure of Viacom).

224. See *supra* note 208.

225. See *supra* notes 82-90 and accompanying text.

226. See Ember, *supra* note 82.

227. See *id.*

228. See *id.*

229. See *id.* Similar concerns were raised when the Bancroft family sold its stake in the *Wall Street Journal* to Rupert Murdoch. See Richard Pérez-Peña & Andrew Ross Sorkin, *Dow Jones Deal Gives Murdoch a Coveted Prize*, N.Y. TIMES (Aug. 1, 2007), <https://www.nytimes.com/2007/08/01/business/media/01dow.html?mtrref=search.yahoo.com> [https://perma.cc/3F5F-GVZP]. Although many of Murdoch's own businesses are family controlled, and so it could be said that the *Wall Street Journal* remains in family hands, see *Lachlan Murdoch to Claim Family Empire*, BBC NEWS (May 17, 2018), <https://www.bbc.com/news/business-44149076> [https://perma.cc/B8N5-LMMG], it is now arguably harnessed to a media empire in which journalism plays only a part alongside entertainment properties and apparent political ambitions.

### C. *The Duty of Loyalty*

The duty of loyalty offers further protection against abuses of control. As a general matter, managerial decisions are protected from substantive judicial review by what is known as the “business judgment rule.”<sup>230</sup> However, courts apply heightened scrutiny to challenged transactions if plaintiffs can properly allege that controlling shareholders or directors have a conflict of interest that calls their loyalty into question.<sup>231</sup> Such conflicts include “transactions with close relatives of managers or with companies owned by their families.”<sup>232</sup>

For example, in one famous case, the corporation hired the spouse of a board member to sing as part of the corporation’s new advertising campaign.<sup>233</sup> Shareholders challenged the use of corporate funds as an improper transfer in violation of the duty of loyalty.<sup>234</sup> The court approved the hiring decision, but only after closely scrutinizing it to ensure that the substantive terms were entirely fair to the corporation.<sup>235</sup>

The duty of loyalty supplements the duty of care and provides another mechanism for regulating controlling shareholders in conflict-of-interest transactions.<sup>236</sup> Thus, regardless of the voting power of a controlling owner, business succession should not receive business judgment rule deference when controlling owners rely upon kinship preferences. Although family succession may survive enhanced scrutiny, the perpetuation of family ownership must be justified.<sup>237</sup> To avoid the prospect of judicial scrutiny after the fact, controlling owners may choose to disclose the existence of the conflict and seek ratification by independent board members or shareholders.

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230. See ERIC W. ORTS, *BUSINESS PERSONS: A LEGAL THEORY OF THE FIRM* 41 (2013) (“In the United States, the ‘business judgment rule’ bestows significant discretion to corporate managers and directors to exercise independent decision-making authority on a wide range of decisions under ordinary circumstances.”).

231. See, e.g., *Kahn v. Lynch Commc’n Sys., Inc.*, 638 A.2d 1110, 1116 (Del. 1994).

232. REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW* 153 (2d ed. 2009).

233. *Bayer v. Beran*, 49 N.Y.S.2d 2, 7 (Sup. Ct. 1944).

234. *Id.* at 4.

235. See *id.* at 9-10.

236. See, e.g., *Malpiede v. Townson*, 780 A.2d 1075, 1079, 1082 (Del. 2001) (recognizing separate claims for breach of the duty of loyalty and breach of the duty of care).

237. See, e.g., *supra* notes 82-90 and accompanying text.

The safeguard provided by the duty of loyalty is important because there is always the risk that controlling owners will take advantage of their position to achieve private benefits of control.<sup>238</sup> In the context of family ownership, family members who are employed by a family business sometimes earn salaries greater than they could expect elsewhere, dividends can be issued to meet the needs of family members, and business ownership may come with meaningful nonpecuniary benefits for the controlling family.<sup>239</sup>

Accordingly,

To the extent that the controlling shareholder or her heirs wish to go on directly managing the company, there may be a powerful inclination to overinvest in the company's existing businesses—those with which the family manager is more comfortable—even though other opportunities that require different managerial skills may offer higher returns.<sup>240</sup>

The duty of loyalty comes into play when a controlling owner's choices benefit insiders at the expense of other constituencies.<sup>241</sup>

However, the duty of loyalty should constrain managerial discretion principally when those in control stand on both sides of a transaction. Taken too far, the duty of loyalty could be used to blanch stewardship of its ameliorative powers and to enshrine profit-maximization at the expense of other corporate objectives.<sup>242</sup> Applied in this fashion, the duty of loyalty would undermine the business judgment rule and prevent controlling owners from

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238. See Means, *supra* note 12, at 959. To be clear, the existence of self-interested motivation does not mean that family owners will adopt entrepreneurial strategies that fail to produce value for other investors. See *supra* notes 155-61 and accompanying text. Nor should successful stewardship require family owners to act with total selflessness. See, e.g., *supra* notes 100-09 and accompanying text. Notwithstanding the potential for misalignment, some scholars conclude that "family ownership, instead of exacerbating the agency costs with minority-equity claimants, appears to reduce conflicts of interest." Ronald C. Anderson & David M. Reeb, *Founding-Family Ownership, Corporate Diversification, and Firm Leverage*, 46 J.L. & ECON. 653, 655-56 (2003).

239. See, e.g., *supra* notes 127-31 and accompanying text.

240. Gilson, *supra* note 94, at 1667.

241. See, e.g., *Malpiede*, 780 A.2d at 1083-85 (rejecting the duty of loyalty claim because "the facts alleged in the complaint [did] not state a cognizable claim that the directors acted in their own personal interests rather than in the best interests of the stockholders").

242. See *id.* ("[T]he board must perform its fiduciary duties in the service of a specific objective: maximizing the sale price of the enterprise.").

exercising their discretion to define business objectives and to formulate a strategy to achieve them.<sup>243</sup>

A recent case involving craigslist, Incorporated, a company controlled by its founders, James Buckmaster and Craig Newmark, illustrates the danger of an overly broad interpretation of the duty of loyalty.<sup>244</sup> The court rejected as improper craigslist's commitment to serving as a community resource for online classified advertisements.<sup>245</sup> Per longstanding practice, craigslist earned money from "online job postings in certain cities and apartment listings in New York City" and otherwise made its website available for free.<sup>246</sup> The court acknowledged that craigslist's founders were "committed to this community-service approach to doing business."<sup>247</sup> Further, the court noted that, however "mysterious" the result might be, craigslist was the dominant provider of classified listings and earned significant revenues from its operations.<sup>248</sup>

Nevertheless, the court concluded that craigslist could not assert stewardship as a rationale for refusing to monetize the full spectrum of its classified advertisements.<sup>249</sup> According to the court, the problem was that craigslist's controlling owners, James Buckmaster and Craig Newmark, owed a fiduciary duty of loyalty to a minority investor, eBay Domestic Holdings, Inc. (eBay).<sup>250</sup> The narrow dispute involved defensive measures taken by craigslist's board to limit eBay's ability to acquire a greater ownership stake in the future.<sup>251</sup> Behind those corporate machinations was the fundamental question of corporate purpose.<sup>252</sup> Buckmaster and Newmark objected that eBay's eventual acquisition of craigslist "would fundamentally alter craigslist's values, culture and business model,

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243. Cf. Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 775 (2005) ("[S]ome discretion to sacrifice profits is an inevitable byproduct of the business judgment rule.").

244. See *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 6-7 (Del. Ch. 2010).

245. See *id.* at 33.

246. *Id.* at 8.

247. *Id.*

248. *Id.* ("[C]raigslist's unique business strategy continues to be successful, even if it does run counter to the strategies used by the titans of online commerce.").

249. See *id.* at 33.

250. *Id.* at 25-26.

251. See *id.* at 32.

252. See *id.*

including departing from [craigslist's] public-service mission in favor of increased monetization of craigslist."<sup>253</sup>

Rejecting that argument, the court held that craigslist's justification for its actions could not rest on "culture" and had to, at the end of the day, maximize shareholder profits: "Jim and Craig did not make any serious attempt to prove that the craigslist culture, which rejects any attempt to further monetize its services, translates into increased profitability for stockholders."<sup>254</sup> Giving away services could perhaps be justified as a business strategy, but "[p]romoting, protecting, or pursuing nonstockholder considerations must lead at some point to value for stockholders."<sup>255</sup>

Importantly, the court's holding did not turn on its interpretation of the contract between eBay and the craigslist founders, pursuant to which eBay had agreed to take a minority stake in craigslist.<sup>256</sup> Indeed, the court noted that eBay had elected not to pursue contract-based arguments.<sup>257</sup> Instead, eBay asserted a claim premised on breaches of fiduciary duty<sup>258</sup>—and prevailed, notwithstanding craigslist's well-known commitment to a culture of stewardship.<sup>259</sup>

By using the concept of fiduciary duty to force controlling owners to prioritize shareholder profits, the court reduced the business judgment rule to a question of means rather than ends and refused to credit the viability of craigslist's distinctive business strategy.<sup>260</sup> To identify profits as the sole legitimate objective of the corporate form is to endorse an impoverished view of what corporations can accomplish. When the controlling owners are not seeking to enrich themselves or their families, and merely wish to serve as responsible business stewards for the benefit of all stakeholders, the obligation of loyalty should not be used to coerce compliance with a shareholder-maximization model of corporate governance.

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253. *Id.* (quoting Defendants' Post-Trial Answering Brief at 54, eBay Domestizing Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010) (No. 3705-CC)).

254. *Id.* at 33.

255. *Id.*

256. *Id.* at 27.

257. *Id.*

258. *Id.* at 7.

259. *See id.* at 32-33, 35.

260. *See id.* at 33.

## CONCLUSION

According to conventional wisdom, insider control of businesses is detrimental to the interests of noncontrolling investors.<sup>261</sup> Family-run businesses, in particular, are seen as nepotistic and inefficient.<sup>262</sup> Although commentators identify potential downsides of insider control,<sup>263</sup> they overlook the significant benefits that controlled companies can offer.

This Article argues that controlled companies can soften the harder edges of capitalism by bringing the values of controlling owners into the marketplace. Unlike the managers of public corporations with widely dispersed shareholders, controlling owners have a personal stake that gives them reason to identify with their business and to care about its long-term success. A stewardship model signals commitment to other investors while also potentially benefiting employees, customers, and communities.

Among other implications, this Article's analysis suggests that regulatory pressure to prohibit dual-stock offerings or insist that they "sunset" after a limited period of time is misguided. The argument is not that controlling owners will always engage in stewardship, or that the risk of self-dealing by controlling owners should be ignored. However, rather than impose a one-size-fits-all model of corporate governance to forestall the possibility of opportunism, this Article concludes that courts should address abuses of control by applying the fiduciary duties of care and loyalty already owed by controlling owners.

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261. *See supra* note 3 and accompanying text.

262. *See supra* note 5 and accompanying text.

263. *See, e.g., supra* note 3 and accompanying text.