Boards of Directors as Mediating Hierarchs

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I. INTRODUCTION

In June of 2014, the board of directors of Demoulas Supermarkets, Inc.—better known as Market Basket, a mid-sized chain of grocery stores in New England—decided to oust the man who had been CEO for the previous six years, Arthur T. Demoulas.[1] Most likely, the board of directors did not anticipate what happened next: Thousands of employees, customers, and fans of Market Basket boycotted the stores and staged noisy public protests asking the board to reinstate "Arthur T."[2] The reaction by employees and customers made what had been a simmering, nasty, intrafamily feud within the closely held Market Basket chain into national news. In this era of overpaid and aloof CEOs, who expects employees and customers to go to bat for the CEO?

The Demoulas clan feud provides useful context for thinking about the institutional mechanism for resolving disputes at the heart of corpo-

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1. *See* Kristen Cloud, *Market Basket Board Ousts Arthur T. Demoulas, Two Veteran Store Leaders*, THE SHELBY REPORT (June 24, 2014), http://www.theshelbyreport.com/2014/06/24/market-basket-board-ousts-arthur-t-demoulas-two-veteran-store-leaders/; Jane Kasperkevic, *A Timeline of the Market Basket Supermarket Family Feud*, THE GUARDIAN (Aug. 14, 2014), http://www.theguardian.com/money/us-money-blog/2014/aug/14/timeline-market-basket-supermarket-arthur-family-feud; *The Market Basket Timeline: From Ousted to Today,* MYDEMOULAS.NET, http://www.mydemoulas.net/timeline/ (last visited Aug. 28, 2014).

2. He is known as "Arthur T." so as not to be confused with his cousin—and nemesis—Arthur S. Demoulas. *See* Kasperkevic, *supra* note 1; *The Market Basket Timeline*, *supra* note 1; Casey Ross, *Market Basket Deal Ends Bitter Feud*, BOSTON GLOBE (Aug. 28, 2014), http://www.bostonglobe.com/2014/08/27/deal-sell-market-basket-arthur-demoulas-has-been-signed/w9cj3I5GjanMthHzXGk11K/story.html.

rate law: the granting of decisionmaking authority to a board of directors. Most, if not all, long-term relationships do not go smoothly all the time. When people make a decision to live together, work together, own property together, or build something together, they should anticipate that disagreements will arise, sometimes major disagreements. This is as true in a business endeavor as it is in other aspects of life. For this reason, institutional arrangements that are successful at supporting collaborative activities over time are likely to have some sort of dispute resolution mechanism, or decision rule about resolving disputes, imbedded in them. In this Essay, I highlight and explore the dispute resolution function of the corporate law requirement that corporations have boards of directors with "all corporate powers."[3]

It is easy to overlook the dispute resolution function of corporate boards. When this institution is working well, most potential disputes do not have to be decided by the board,[4] and those disputes that do come up to the board are generally resolved before they become public. Therefore, the role boards play in this regard is mostly invisible. Moreover, the corporate form is used for many other purposes in the twenty-first century, in addition to providing a framework for the self-governance of productive activity.[5] Historically, the use of the corporate form for business activity developed first as a mechanism to enable groups of people to combine, invest, and preserve capital to provide a needed product or service to a community—be it churches, colleges, bridges, canals, etc.—and to provide a governance structure for that committed capital. Corporations were also formed to either establish, defend, and control trading routes,

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3. DEL. CODE ANN. tit. 8, § 141(a) (2014) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . ."); MODEL BUS. CORP. ACT § 8.01(b) (2010) ("All corporate powers shall be exercised by or under the authority of the board of directors of the corporation . . . .").

4. *See infra* Parts II and IV discussing how delegating decisions to an independent third party encourages participants in a potential dispute to moderate their demands.

5. *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 250 n.7 (1999) ("Once this internal governance structure is in place, courts give it wide discretion and resist becoming involved in disputes over how the hierarchy uses its inputs and allocates its outputs."); Margaret M. Blair, *The Four Functions of Corporate Personhood*, *in* HANDBOOK OF ECONOMIC ORGANIZATION: INTEGRATING ECONOMIC AND ORGANIZATION THEORY 440, 442 (Anna Grandori ed., 2013) (lists self-governance as one of the four key functions of corporate personhood). Corporations and similar legal entities (such as LLCs) are created often for what Henry Hansmann and Reinier Kraakman have called "asset-partitioning" purposes, however. *See* Henry Hansmann & Reinier Kraakman, *The Essential Role of Organization Law*, 110 YALE L.J. 387, 390 (2000) ("[W]e argue that the essential role of all forms of organizational law is to provide for the creation of a pattern of creditors' rights—a form of 'asset partitioning'—that could not practicably be established otherwise.").

or to colonize trading partners.[6] In all of these types of activity, some sort of governance mechanism was required. Although research on origins of board governance is thin,[7] it seems clear that the earliest corporations almost universally had boards of directors or some similar governing body. Why were boards needed then, and why does the law today require corporations to be governed by boards?[8] In recent decades, the dominant answer to that question among legal scholars has been that boards of directors are "agents" of shareholders, whose job is to monitor management for shareholders.

However, team production theory of corporate law, which this symposium explores, argues that boards of directors serve a different function.[9] Because boards have "all corporate powers," but do not themselves own the assets being deployed in a corporation, they can serve as a mechanism for resolving potential disputes among the other participants in the corporate enterprise over the strategic direction of the firm, the use of corporate assets, and the allocation of the economic surplus created by the enterprise.[10] The assignment of authority by law to the board serves to keep most potential disputes out of the courts, which is where many of them would probably end up if the underlying relationships were purely contractual.[11] Moreover, the fact that the board of directors has the final

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6. *See* RON HARRIS, INDUSTRIALIZING ENGLISH LAW: ENTREPRENEURSHIP AND BUSINESS ORGANIZATION 1720–1844 (2000); Margaret M. Blair, *Corporate Personhood and the Corporate Persona*, 2013 U. ILL. L. REV. 785, 785–820 (2013); Margaret M. Blair & Elizabeth Pollman, *The Supreme Court's View of Corporate Rights: Two Centuries of Evolution and Controversy*, 56 WM. & MARY L. REV. (forthcoming 2014).

7. *See* Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 HOFSTRA L. REV. 89, 126–29 (2004); Henry Hansmann & Mariana Pargendler, *The Evolution of Shareholder Voting Rights: Separation of Ownership and Consumption*, 123 YALE L.J. 948 (2014); Howard Bodenhorn, *Large Block Shareholders, Institutional Investors, Boards of Directors and Bank Value in the Nineteenth Century* (Nat'l Bureau of Econ. Research, Working Paper No. w18955, Apr. 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2250264.

8. For very closely held corporations, corporate law in most states permit organizers to opt into an alternative governance arrangement that looks more like partnership governance, without a board of directors, or with a board whose power is severely limited. *See* DEL. CODE ANN., tit. 8, §§ 141–146 (2014); MODEL BUS. CORP. ACT § 7.32.

9. *See* Blair & Stout, *supra* note 5, at 247–328.

10. *See infra* Part II.

11. To be sure, some corporate disputes wind up in court anyway, as the history of the Demoulas clan in Massachusetts illustrates. In 1990, the heirs of George A. Demoulas initiated two actions (one was a derivative action and the other a stock transfer action) against the heirs of Telemachus Demoulas and the entities held by Demoulas Super Markets. These actions were litigated for over a decade at all levels of appeal in Massachusetts state courts. *See* Demoulas v. Demoulas, 784 N.E.2d 1122, 1124 (Mass. App. Ct. 2003). *See also, e.g.*, Demoulas v. Demoulas, 677 N.E.2d 159 (Mass. 1997); Demoulas v. Demoulas Super Mkts., Inc., 600 N.E.2d 613 (Mass. App. Ct. 1992). Since the close of those actions, litigation amongst the Demoulas family has continued, most recently in an action directly between Arthur T. and Arthur S. in *Demoulas v. Demoulas*, No. CIV.A.

say in internal disputes among corporate participants encourages corporate participants to work out their disagreements among themselves to the extent possible.[12] On a day-to-day basis, most corporate participants do not want to have a decision "kicked upstairs." Therefore, it can be argued that the provision that "all corporate powers" are possessed by boards prevents many disputes from arising in the first place.

In Part II, I briefly review the theory of team production in the economic literature, and walk through the argument laid out by Blair and Stout that the institution of boards of directors in corporations fits the description in the economics literature of an important solution to a "team production" problem.[13] In Part III, I discuss how the legal structure and duties of boards of directors ensures that most of the potentially highly contentious decisions that must be made in the management and governance of corporations will be resolved internally, without recourse to a court. If they cannot be resolved at a lower level, they will go to the board of directors and be resolved there, which means that a major task of boards is mediation and dispute resolution. Because the law requires that certain decisions must be made by the board, and that most decisions, once made by the board, cannot be challenged in court, board governance helps minimize the number of disputes that might otherwise boil over and require court adjudication. I argue that corporate law has traditionally supported this interpretation of what boards are supposed to be doing better than it supports the idea that boards are supposed to be agents of shareholders. In Part IV, I review new theoretical work on corporate law that explores this idea, and in Part V, I review empirical find-

2013-3171A, 2013 WL 5754104 (Mass. Super. Sept. 25, 2013). But unless a potential claimant has a clear contract right at stake, the "business judgment rule" ensures that the judgment of the board cannot be challenged in court unless there is evidence of fraud, illegality, or conflict of interest. *See* Shlensky v. Wrigley, 237 N.E.2d 776 (Ill. App. Ct. 1968). It is a very interesting question as to what makes a dispute an "internal" one that must be decided by the board, rather than a dispute between the corporation and some "external" party, which might get a hearing in court. Oliver Williamson has defined the boundary of a firm as the line between cases a court will hear (e.g., a dispute between a senior vice president who was demoted and the corporation over terms of the employment contract), and cases it will not hear (e.g., a dispute between two senior vice presidents over the allocation of a bonus pool). *See* Oliver E. Williamson, *Comparative Economic Organization: The Analysis of Discrete Structural Alternatives*, 36 ADMIN. SCI. Q. 269, 274 (1991) (noting that "courts routinely grant standing to firms [suing other firms] should there be disputes over prices, the damages to be ascribed to delays, failures of quality, and the like, [but] . . . refuse to hear disputes between one internal division and another over identical technical issues"); Oliver E. Williamson, *Visible and Invisible Governance*, 84 AM. ECON. REV. 2, 325 (1994) ("[T]he (implicit) contract law of hierarchy is that of forbearance, according to which the internal organization becomes its own court of ultimate appeal.").

12. *See infra* Part IV.

13. Blair & Stout, *supra* note 5, at 247–328.

ings on boards of directors that provide support for this interpretation. In Part VI, I review several developments in the Delaware courts that may inhibit the ability of boards to carry out this function. In conclusion, I comment on the effect that these developments may have on how corporate boards carry out their duties.

I. THE TEAM PRODUCTION PROBLEM

Early work by economists on the "theory of the firm" focused on the question of why people organize themselves into firms to carry out production activities.[14] Ronald Coase posed this question in 1937 and hypothesized that business people would organize themselves into firms, in which control and decisionmaking is delegated to a managerial hierarchy, when the transactions costs of organizing through markets was higher than the transactions costs associated with production in a firm.[15] In his words, in markets, "coordination is the work of the price mechanism," while within firms, coordination is the work of the "entrepreneur."[16] But Coase did not offer any explanation in his article for when or why transactions costs would be higher in the market than they would be within a firm. In 1972, Armen Alchian and Harold Demsetz explored one set of circumstances in which costs would likely be high when transacting in markets but potentially lower when decisionmaking is delegated to an entrepreneur or boss.[17] This is the case, they said, in the context of "team production," which they defined as "production in which 1) several types of resources are used . . . 2) the product is not a sum of separable outputs of each cooperating resource. . . . [and] 3) not all resources used in team production belong to one person."[18]

In the context of team production, it is extremely difficult to write contracts that simultaneously provide appropriate incentives for team members to cooperate and contribute what they are expected to contribute, and that allocate all of the output in a way that discourages team members from dissipating all of the gains in squabbling over the distribu-

14. The explanation of the team production problem in this section condenses, but follows closely the discussion in Part II.B of the original Blair and Stout article. *See* Blair & Stout, *supra* note 5, at 265–76.

15. R. H. COASE, THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT 18 (Oliver E. Williamson & Sidney G. Winter eds., 1991).

16. *Id.* at 20.

17. *See* Arman A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972).

18. *Id.* at 779.

tion.[19] If the parties attempt to agree up front to a decision rule about allocating the output from a team—such as every member of the team will receive an equal share of the total output—the team members will then have incentives to shirk, since their share of the output is fixed no matter how much they contribute. On the other hand, if they wait until the output has been generated to divide up the surplus created, they will have incentives to squabble over that output, possibly destroying much of the wealth in the process.

The Demoulas family history illustrates the problems that can arise out of team production. George Demoulas and Telemachus Demoulas, sons of the founder of the firm, ran the business together in the 1950s and 1960s,[20] and apparently had an implicit agreement that the wealth generated by the firm would be split evenly between George's family and Telemachus's family.[21] However, George died at a young age and none of his offspring joined the family business. Telemachus, on the other hand, ran the business and expanded it significantly during the decades after George had died.[22] According to court findings in lawsuits between the two branches of the family, Telemachus began siphoning off some of the wealth being generated by the business into related firms that were owned only by the Telemachus branch of the family.[23] Arthur T., the son of Telemachus, also joined the business and has been a key member of the management team since Telemachus died.[24] Arthur T. was made

19. The original Alchian and Demsetz article did not consider the question of the allocation of the output from the team production process, except to say that the surplus should go to the "monitor" (see discussion below), but this part of the problem was introduced and modeled a few years later in Bengt Holmstrom, *Moral Hazard in Teams*, 13 BELL J. ECON. 324 (1982). Holmstrom referred to this part of the problem as the "budget constraint." See discussion below.

20. *See* Kenneth J. Mickiewicz & C. Forbes Sargent, III, *Demoulas v. Demoulas Super Markets, Inc.: Directors' and Shareholders' Duty of Loyalty in Self-Dealing Transactions Involving Corporate Opportunity*, 42 BOSTON B.J., no. 1, 1998, at 16, 16; *History of Market Basket*, MYDEMOULAS.NET, http://www.mydemoulas.net/history/ (last visited August 28, 2014).

21. *See* Meghan S. Laska & Wendy L. Pfaffenbach, *Demoulas: An Inside Look at the Twists and Turns of a Legal Blood Feud*, 28 MASS. LAW. WKLY. 2897 (2000), *available at* http://www.lawyersweekly.com/reprints/davismalm2.htm. *See also* Michael S. Frisch, *Zealousness Run Amok*, 20 GEO. J. LEGAL ETHICS 1035, 1037 (2007).

22. *See* Demoulas v. Demoulas Super Mkts., Inc., No. CIV.A. 2013-3171A, 1995 WL 476772, at *5, *56, *64–65 (Mass. Super. Sept. 25, 2013); Mickiewicz & Sargent, *supra* note 20, at 16.

23. *See* Demoulas v. Demoulas Super Mkts., Inc., 677 N.E.2d 159, 179–87 (Mass. 1997); *Demoulas*, 1995 WL 476772, at *1–2; Grant Welker, *How One Woman Set off the Latest Chapter in the Market Basket Tale*, SENTINEL & ENTERPRISE (July 27, 2014), http://www.sentinelandenterprise.com/news/ci_26225290/how-one-woman-set-off-latest-chapter-market.

24. *See* Casey Ross, *Market Basket CEO Faces Revolt Led by His Cousin,* BOSTON GLOBE (July 12, 2013), http://www.bostonglobe.com/business/2013/07/11/latest-market-basket-battle-ceo-faces-revolt-led-his-cousin/GGvTeDG067xE5LKmFjWMRM/story.html ("Market Basket has

CEO in 2008, and by the summer of 2014 had worked in the business in one capacity or another for more than 40 years.[25]

The tensions between the two branches of the family are, undoubtedly, about a lot of things, but without having access to nonpublic information, one likely source of tension seems obvious: Arthur S. and his siblings (George's offspring) think they deserve half of the value of the Market Basket business because their father was an equal partner in the business (the *ex ante* sharing rule was fixed at 50/50), while Arthur T. and his siblings think they deserve more than half of the value of the business because their father, and Arthur T. himself, worked for years in the business without any help from the other side of the family. The Telemachus side, it seems, has contributed substantial human capital as well as financial wealth.[26] This case also illustrates that *ex post* squabbling can be extremely destructive—some observers of the grocery industry have estimated that the dispute cost the Demoulas family as much as $10 million per day while the stores remained closed or disrupted.[27]

Alchian and Demsetz, in their classic article, used a much more prosaic example of a team production problem than that presented by the Demoulas family feud—the effort by two movers to load cargo into a truck. In their example, neither member of the team can do the job by himself, but it is very hard to specify in advance precisely what each mover is supposed to do, and very difficult to measure, even as they are carrying out the task, which person is contributing what.[28] "With team production it is difficult, solely by observing total output, to either define or determine each individual's contribution to this output of the cooperating inputs. The output . . . is not a sum of separable outputs of each of its members," they explained.[29] Alchian and Demsetz suggested that the

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grown and prospered during his five-year tenure as boss: opening 12 stores and renovating another 11 . . . .").

25. *See id.*

26. *See* Mickiewicz & Sargent, *supra* note 20, at 16 ("At all relevant times after George's death, the boards of directors of DSM and Valley were controlled by members of Telemachus' family or directors who had a business or financial relationship with Telemachus or stood to personally benefit from the transactions voted upon by the boards.").

27. *See* Casey Ross & Jack Newsham, *Pressure Mounts on Market Basket Board of Directors*, BOSTON GLOBE (July 28, 2014), http://www.bostonglobe.com/business/2014/07/28/the-state-market-basket/dDBOJigFgrmrNhsDcwJ94M/story.html ("Industry specialists have estimated the crisis is costing the company more than $10 million a day in lost business and inventory."). The two sides reached an agreement on August 27, 2014, after which thousands of Market Basket employees returned to work to get the stores stocked and opened again. Casey Ross, *Market Basket Deal Ends Bitter Feud*, BOSTON GLOBE (Aug. 28, 2014), http://www.bostonglobe.com/2014/08/27/deal-sell-market-basket-arthur-demoulas-has-been-signed/w9cj3I5GjanMthHzXGk11K/story.html.

28. Alchian & Demsetz, *supra* note 17, at 779.

29. *Id.*

solution to such a team production problem is for someone to specialize as a "monitor" and, to make sure that the monitor doesn't shirk, the monitor should be awarded the net revenue of the team, over and above the cost of paying the other team members according to their opportunity cost.[30] Alchian and Demsetz's solution, therefore, may explain why business people form individual proprietorships, in which one person owns the assets used in production, hires other labor inputs, and monitors the activity of those inputs. But Alchian and Demsetz did not consider how their solution would be affected if team members have to make some sort of team-specific investment in the enterprise, and they asserted that there is no role or purpose in their model for long-term relationships among team members.[31] The Alchian and Demsetz model is a helpful start in thinking about a more general theory of the firm, but it does not provide an explanation of large, publicly traded corporations, in which share ownership is separated from control, and the employer–employment relationship is generally quite long-term.

Using a different approach, Bengt Holmstrom, writing in 1982, revisited the problem of team production.[32] Holmstrom asked: what happens if the activities of the team member are difficult to measure, even for a full-time monitor? And what if the productivity of individual team members is interactive, in the sense that each team member's actions affect not only her own productivity, but that of her other team members as well? Would it be possible for an entrepreneur to solve this problem with contracts? Could the entrepreneur write an employment contract with each team member that would provide appropriate incentives for each team member to work hard, cooperate, and not shirk, while also satisfying a "budget constraint?"[33] In particular, the budget constraint requires that all of the joint output, and no more, is distributed to the team members. Holmstrom developed a mathematical model of this problem and concluded that it is mathematically impossible to write a contract that provides the right incentives to all members of the team, while distributing all of the surplus—no more and no less—to the team members.[34] To solve the problem, someone must play the role of a

30. *Id.* at 781–82. If team members are paid their opportunity cost out of the revenue generated by the business, the net revenue would be equal to the total new value created by the efforts of the team.

31. *Id.* at 783 ("The employee can terminate the contract as readily as can the employer, and long term contracts, therefore, are not an essential attribute of the firm.").

32. *See* Holmstrom, *supra* note 19.

33. *Id.*

34. *Id.* at 326. To provide the "right incentives"—incentives that lead to the most efficient choices of effort and output by each team member—each team member would need to be paid his or

"budget breaker."[35] Like a monitor, a budget breaker is an outsider to the team production process, but the role of the budget breaker is to passively pay out surpluses to team members when the surplus is high, but absorb the surpluses when total surplus is lower than the optimal level.[36] Team members would then be paid according to the following scheme: If the team as a whole achieves some target level of output—a level that can only be reached if no one shirks—then the surplus generated by team production will be divided equally among all the active team members, not including the budget breaker.[37] If the team fails to achieve the target level, this implies that at least one member of the team shirked. In such a case, all of the team members would be punished, and paid only their marginal opportunity cost, without sharing in the surplus. This is the only way to be sure that each team member bears the full cost of her own shirking. In this case, whatever surplus was created (which is less than the target amount), must then *not* be distributed to the team, but should go to the budget breaker.[38]

One problem with this solution, however, is that a purely passive budget breaker would have a significant incentive not to stay passive, but rather would try to bribe a member of the team to shirk just a little, so that output falls just short of the target level of output, and the budget breaker would then capture the surplus that is created.[39]

Gary Miller has argued that Holmstrom's insight that a budget breaker is needed, combined with the Eswaran and Kotwal critique about the incentives of the budget breaker, imply that, for Holmstrom's solu-

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her individual marginal product. But in a team production situation, the marginal product is a team product, not just an individual product. It is not mathematically possible to pay every team member the marginal team product of his or her individual input. This conclusion has sometimes been called "Holmstrom's impossibility result." *See, e.g.*, Gary Miller, *Why Is Trust Necessary in Organizations? The Moral Hazard of Profit Maximization*, *in* TRUST IN SOCIETY 314 (Karen Cook ed., 2001). Miller states the "result" as simply "that *there is no way to allocate the earnings of the team that is simultaneously budget-balancing, Pareto-optimal, and a Nash equilibrium*. . . . [B]udget balancing makes every team production problem an N-person prisoners' dilemma game." *Id* (emphasis in original).

35. Holmstrom, *supra* note 19, at 325 ("Thus, the principal's primary role is to break the budget-balancing constraint.").

36. *Id.* at 327–28 ("The enforcement problem can be overcome only by bringing in a principal (or a party) who will assume the residual of the nonbudget balancing sharing rules."); Miller, *supra* note 34, at 311 (refers to the budget breaker as a "sponge").

37. The division does not have to be equal, but it simplifies the discussion to tell the story this way.

38. Holmstrom, *supra* note 19, at 327.

39. *Id.* Holmstrom acknowledges this problem in passing but does not explore it. *Id.* Eswaran and Kotwal were the first to fully discuss this troubling implication of the Holmstrom solution to the team production problem. Mukesh Eswaran & Ashok Kotwal, *The Moral Hazard of Budget-Breaking*, 15 RAND J. ECON. 578, 578–81 (1984).

tion to work, the budget breaker must be completely passive.[40] If the budget breaker can play any kind of active role, then team members will have to take into account the incentives that the budget breaker has to bribe one of the team members to prevent the optimal output from being achieved. I will return to this point below.

Oliver Hart, together with various coauthors, has also studied the team production problem, although he does not use that phrase to describe the problem he models.[41] Hart, together with Grossman, considers the organizational problems that arise when two or more parties must all make highly specific investments, say in specialized skills required to use a unique type of equipment or software program.[42] Hart points out that (as in team production) it is difficult or impossible to write complete contracts to govern the participants in such a project.[43] Consequently, he argues, there is a role for property rights in this situation, noting that property rights give the "owner" of an asset the right to make decisions about the uses of the asset other than those decisions and activities that have been contracted away.[44] This solves the incomplete contracting problem because it allows the parties who are participating in a joint production activity to commit to what they can in a contract, while giving the "owner" of the specific assets used in production the right to make the "residual" decisions about the use of the assets in any contingency that has not been provided for in the contract.[45] The "owner" thus has a bargaining advantage in dividing up any surplus from the team production activity, which ensures the owner that investments she makes in specialized human capital cannot be expropriated by the other team mem-

40. Eswaran & Kotwal, *supra* note 39, at 579 ("A crucial assumption that is implicit in Holmstrom's proposal is that the principal cannot make covert side contracts with one of the agents. Since the principal's payoff is discretely greater when the team output falls marginally short of the Pareto optimal level than when it does not, he actually *prefers* the agents to shirk." (emphasis in original)); Miller, *supra* note 34, at 311 ("Someone with *no active role in the team's production efforts* must absorb residual costs and benefits." (emphasis in original)).

41. Hart emphasizes the incompleteness of contracts, and does not limit his work to contracting problems that arise because of team production. But most of the scenarios he lays out can be analyzed as team production problems. *See, e.g.*, Oliver D. Hart, *Incomplete Contracts and the Theory of the Firm*, 4 J.L. ECON. & ORG. 119 (1988).

42. Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691, 692 (1986) (noting that the difficulty of writing complete contracts arises "when either the buyer or seller must make investments that have a smaller value in a use outside their own relationship than within the relationship (i.e., there exist 'asset specificities')").

43. *Id.*

44. *See, e.g.*, *id.*; Oliver Hart, *An Economist's Perspective on the Theory of the Firm*, 89 COLUM. L. REV. 1757 (1989); Oliver Hart & John Moore, *Property Rights and the Nature of the Firm*, 98 J. POL. ECON. 1119 (1990).

45. Property rights thus serve as a dispute resolution—or dispute prevention—mechanism.

bers. Therefore, Hart's solution to the team production problem is to grant property rights over the specific assets used in production to the team member whose investments in specialized human capital are most important to the project. Hart then defines a "firm" as the set of assets under common ownership.[46]

Hart's solution provides substantial insight into the role of property rights in firms, but it only allows for one owner. If more than one member of the team must make specific investments for the team to achieve its efficient level of productivity, this solution may not work. More importantly for our consideration of corporate law, this solution cannot explain the modern business corporation, in which "ownership" of the assets used in production is separated from control over the use of those assets.

Raghuram Rajan and Luigi Zingales build on Hart's model.[47] They first observe that Hart's model assumes that there will be a single team member whose investment in team-specific assets is most important to the team. But unless specific investments of all other team members are not important, assigning property rights to one team member does not solve the problem of providing appropriate incentives to the other team members. Rajan and Zingales also note that asset "ownership" normally includes the right to sell (or "redeploy") the asset, as well as the right to make the residual decisions about its use.[48] When the right to sell is taken into account, they observe that there might be situations in which an owner can make more money by selling the asset, thereby capturing some of the value of specific investments made by other team members, than she can make by investing in her own specialized human capital.[49] The solution they arrive at is similar to Holmstrom's solution, which is to give control rights (but, they argue, *not* the right to possess or sell) over the specialized assets in the business to an outsider to the team.[50] The outsider would have hiring and firing authority, thereby controlling who is on the team, and his job would be to allow teams to compete with each

46. Grossman & Hart, *supra* note 42, at 693 (defining a firm as "those assets that it owns or over which it has control").

47. Raghuram G. Rajan & Luigi Zingales, *Power in a Theory of the Firm*, 113 Q. J. ECON. 387 (1998).

48. *Id.* at 408 ("The owner can extract a greater share of the surplus *ex post* . . . by wielding the out-of-equilibrium threat of leaving the relationship and taking the assets with him.").

49. *Id.*

50. *Id.* at 422 ("[I]f all parties involved in production (i.e., including the entrepreneur) have to make substantial specific investments over time, it may be optimal for a completely unrelated third party to own the assets. . . . [T]he third party holds power so that the agents critical to production do not use the power of ownership against each other.").

other for the right to use the specialized asset, and to grant that right to the team that is able to deliver the highest total output from the project.[51] The outsider could be compensated by granting him a tiny fraction of the output, which gives him a reason to choose the most productive team.

Holmstrom, Miller, and Rajan and Zingales all suggest that their models of the team production problem help explain key features of publicly traded corporations. In particular, they suggest that the role of the outside budget breaker in Holmstrom's and Miller's work, or the role of the outside decider in Rajan and Zingales's work, in their models helps explain why we see absent and largely passive shareholders in modern corporations.[52] Holmstrom argues that a passive "owner" (who does not also "control" the firm), can provide the right incentives to active team members by retaining the surplus in low performance years and paying out the surplus as bonuses in high performance years.[53] Rajan and Zingales claim that having a player whose job is to decide which team to hire, but who does not have the other rights and duties of ownership, helps explain the role of outside, largely passive shareholders.[54] Miller asserts that passive shareholders fulfill the role of budget breaker by "passively absorbing residual profits or losses."[55]

Blair and Stout pick up where Rajan and Zingales leave off. They note first that the role for an outsider described by Rajan and Zingales does not look like the role of outside shareholders in real corporations.[56] Outside shareholders in a publicly traded corporation are not typically involved—at least not directly—in choosing the members of the active team.[57] Nor do they play a role in real corporations that remotely resembles the role of either Holmstrom's budget breaker or Miller's "residual owner." Whereas the budget breaker in the Holmstrom model captures the surplus when productivity is low, not when it is high, the reverse is more typically the case for shareholders—dividends are high when a corporation is especially productive and low when productivity is low.

51. *Id.*

52. *See* Holmstrom, *supra* note 19, at 325; Miller, *supra* note 34, at 314; Rajan & Zingales, *supra* note 47, at 423.

53. Holmstrom, *supra* note 19, at 325.

54. *See* Rajan & Zingales, *supra* note 47, at 422–23.

55. Miller, *supra* note 34, at 312–13.

56. Blair & Stout, *supra* note 5, at 274 n.57 ("Rajan and Zingales interpret their story as providing a rationale for the separation of share ownership in a corporation from labor inputs. . . . This seems like an odd interpretation, however, because the third party 'owner' in the Rajan and Zingales model is not a residual claimant.").

57. Rajan & Zingales, *supra* note 47, at 422 (noting that the "third party" decider in their model has the power of "hiring, firing, and controlling the sale of assets").

Blair and Stout observe that the participants in actual corporations whose role conforms most closely to the outside decider in these models is the board of directors, especially the "outside" or "independent" directors.[58] Directors, when acting as a body, have almost complete control over the assets used in production, plus hiring and firing rights, but they do not themselves own the assets of the firm. They are not part of the regular "team" in that they do not typically get involved in day-to-day activities and decisions.[59] They also typically do not personally make much in the way of human capital investments that are specific to the corporation. Thus, directors can play a role that is similar to the role of the outside decider in the Rajan and Zingales model.

Directors do not play the role of the outside budget breaker described in Holmstrom's and Miller's articles, however. They do not absorb the surplus production when output falls short of the most efficient level of production, nor do they pay the surplus to team members when productivity is high enough. But there is a party that does play this role in the publicly traded corporation. It is the corporation itself, the separate legal entity that, because it is an artificial person and not a flesh-and-blood person, can be the completely passive holder of surpluses created by the team, at least until the surplus is high enough that the board of directors can decide to pay some of it out in the form of higher dividends and higher salaries to the active team members.[60] Building on Holmstrom and Miller, Blair and Stout suggest that the corporation itself is the purely passive counterparty to all transactions in which surpluses generated by the team are either paid out to team members, or withheld and retained in the corporate coffers.[61] And building on Rajan and Zingales, the board of directors is the party that has the right (and the responsibility) to decide the allocation of duties and benefits among competing interests within the corporation. The latter role is what we have called the role of "mediating hierarch."

58. Blair & Stout, *supra* note 5, at 277.

59. With the exception, of course, that CEOs, who also serve on boards, are actively involved and responsible for the day-to-day activities of the firm.

60. Roland Kirstein and Robert D. Cooter explore in detail the idea that the firm itself can play the role of "External Anti-Sharer," which is almost identical to the role played by Holmstrom's "Budget Breaker." *See* Roland Kirstein & Robert D. Cooter, *Anti-Sharing as a Theory of Partnerships and Firms* (Berkeley Program in Law & Econ., Working Paper No. 294, 2006).

61. Blair & Stout, *supra* note 5, at 269 ("[W]e argue that shareholders, executives, and employees are *all* team members, and that the budget breaker is *the corporation itself*—the fictional entity that, under the law, holds title to the firm's assets and serves as the repository for all its residual returns until they are paid out to shareholders or other stakeholders." (emphasis in original)).

II. HOW CORPORATE LAW ASSIGNS DIRECTORS TO THE ROLE OF MEDIATING HIERARCHS

One of the major benefits of organizing production through a corporation is that the corporation itself has standing as a separate legal entity that is allowed to own property—separate from management, from shareholders, and from board members or other participants. Assets used jointly by all of the team members can thus be held by the corporation—the separate entity. In this way, none of the active team members own the assets, so they cannot unilaterally pull assets out of the enterprise or otherwise compel the corporation to buy out their interests. For this reason, they cannot use a threat to withdraw assets to extract a higher share of the economic rents generated in the business from the other team members.

In related work, I have discussed the economic benefits that come from the fact that capital invested in corporations is essentially "locked in," at least until the board of directors decides to pay some of it out.[62] The ability to lock in the assets invested in a corporation makes it possible for the corporation to undertake production activities that require large amounts of highly specific and long-lived assets, such as railroad tracks. However, it also means that investors in equity shares, if they decide they want to get out of that investment, cannot just compel the corporation to buy them out. This is another painful lesson of the story of the Demoulas family and Market Basket grocery stores. If Arthur T. and Arthur S. were partners in a common law partnership, rather than shareholders in a corporation, Arthur S. could get out of the business if he were unhappy simply by announcing that he wants to disassociate. This would compel Arthur T. to either to buy out Arthur S.'s share of the value of the business, or liquidate the business in order to distribute Arthur S.'s share of the business to him. Since they may not be able to get out of an investment in a corporation that easily (especially if there is no market for the shares of the corporation), participants in corporations need mechanisms for resolving disputes. The team production theory of corporate law hypothesizes that the institutional arrangement provided by law for settling many of the disputes that arise in the course of carrying out a business activity through a corporation is governance by a board of directors. If the parties directly involved in any internal dispute cannot reach a resolution themselves, directors are authorized to decide the issue, and for the most part, their decisions cannot be challenged in court.

62. *See* Margaret M. Blair, *Locking In Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. REV. 387, 387–455 (2003).

In this way, directors play a role that is similar to the role of the outside decider in the Rajan and Zingales model.

A number of important features of corporate law support the idea that directors are expected to be the final decisionmakers with respect to decisions that are inherently likely to be highly conflictual. These issues include (1) the hiring or firing of a CEO;[63] (2) compensation of the CEO;[64] (3) compensation of the board itself;[65] (4) succession planning;[66] (5) declaring and paying dividends;[67] (6) developing a plan for a merger or acquisition,[68] or for a sale of all or substantially all of the assets of a corporation;[69] (7) dissolution of the company;[70] (8) issuing new stock;[71] (9) reviewing and approving any transaction in which the CEO or a board member has a conflict of interest;[72] (10) responding to a derivative action initiated by a shareholder;[73] and (11) selecting an auditor and approving the audit.[74]

In all of these matters, key constituencies in the corporation will likely have interests that conflict with each other. Shareholders and creditors may not agree, for example, about how large a dividend the corporation can safely pay out and still have plenty of cash to pay debt obligations. A dissident shareholder may have a very different idea about who should be the next CEO than that of the internal management team. There may be disputes within the internal management team over succession, or over compensation packages and bonuses. Common shareholders may have very different views about whether a corporation should issue new shares, and what the characteristics of those shares should be, than the founders have.[75] In the world of venture capital firms, it is well

63. MODEL BUS. CORP. ACT § 8.40(b) (2002).

64. *Id.* § 8.01(c)(iii).

65. *Id.* § 8.11.

66. BUSINESS ROUNDTABLE, PRINCIPLES OF CORPORATE GOVERNANCE 2012, at 28 (2012), *available at* http://businessroundtable.org/sites/default/files/BRT_Principles_of_Corporate_Governance_-2012_Formatted_Final.pdf.

67. MODEL BUS. CORP. ACT § 6.40 (2002).

68. *Id.* § 11.40(a).

69. *Id.* § 12.02(b).

70. *Id.* § 14.02(b).

71. *Id.* § 6.21(b).

72. *Id.* § 8.61(b); and §8.62.

73. *Id.* § 7.44.

74. 17 C.F.R. § 240.10A-3 (2014).

75. For example, when Google underwent a stock split in April 2014, each share of Class A Stock (Google's publically traded common stock) was split into two shares: one share of Class A stock and one share of Class C stock, a newly created category of nonvoting stock. The founders of Google structured this split in order to avoid dilution of their control of the company, a move that was criticized by proponents of shareholder primacy. Moreover, some large shareholders filed class-action lawsuits seeking to block the split, which resulted in Google making several concessions. *See,*

known that there are likely to be disagreements between holders of common shares and holders of preferred shares about when the firm should sell itself and merge with another firm.[76] And, as the Market Basket brouhaha illustrates, employees and customers may even have preferences about who should be CEO that are different from what some dominant faction of shareholders would prefer.

To be sure, some constituencies—the CEO, or top management team, or prominent activist shareholders—may well have significant input into the conversation or debate among board members about a key decision. But in *every* case, the board of directors, acting as a body, must ultimately make the call. The fiduciary duties of directors address the question of how the board must go about arriving at a decision[77] and, for some types of questions, the law has outlined in very general terms what factors the board should consider in making the decision.[78] But irrespective of how directors proceed, the decision is theirs to make. Corporate law in the United States requires that decisions such as these are the responsibility of the board. And if board members (or an independent sub-

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e.g., Michael Liedtke, *An Explanation of Google's Confusing Stock Split*, SAN JOSE MERCURY NEWS (Apr. 1, 2014), http://www.mercurynews.com/business/ci_25468991/an-explanation-googles-confusing-stock-split; Steven Davidoff Solomon, *New Share Class Gives Google Founders Tighter Control*, N.Y. TIMES (Apr. 13, 2014), http://dealbook.nytimes.com/2012/04/13/new-share-class-gives-google-founders-tighter-control/. As of August 28, 2014, the Class A shares were trading at a 2% premium above the Class C nonvoting shares.

76. This was the issue behind the recent decision of the Delaware Chancery Court in *In re* Trados Inc. S'holder Litig. (*Trados II*), 17 A.3d 17, 36–38 (Del. Ch. 2013). See *infra* Part IV for discussion of this problem.

77. *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (holding that in order for directors to satisfy their duty of care, directors must "inform[] themselves prior to making a business decision, of all material information reasonably available to them" (internal quotations omitted)); *see also In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 60–62 (Del. 2006) (holding that directors were "fully informed of all material facts" when hiring a new CEO by knowing the key terms of the employment agreement, understanding the CEO's experience and skills, and asking pertinent questions during the hiring process); *cf. In re* Nat'l Auto Credit, Inc. S'holders Litig., No. Civ. A. 19028, 2003 WL 139768, at *12 (Del Ch. Jan. 10, 2003) (explaining that the decisionmaking process of directors is actionable only if "grossly negligent").

78. *See, e.g.*, Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1376–77 (Del. 1995) (explaining that in the context of a hostile tender offer, directors must balance the long-term business valuation of the company against potential immediate monetary gains to shareholders); *see also* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (holding that after the board has decided to sell the company, the directors' duties change from preserving the "corporate entity to the maximization of the company's value . . . for the stockholders' benefit"); Unocal Corp. v. Mesa Petroleum Co. 493 A.2d 946 (Del. 1985) (stating that the board should consider "the nature of the takeover bid and its effect on the corporate enterprise. . . . [including the] inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)"); Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) (stating that directors owe shareholders an "uncompromising duty of loyalty" during their decisionmaking process).

set of them, or a formal committee) make the decision in good faith, with the best interests of the corporation in mind, courts will very rarely overturn the decision that the board made.[79] In fact, once these decisions have been made by the board, any attempt to challenge them in a court will probably not get past a motion to dismiss, unless the plaintiffs can show evidence of "fraud, illegality, or conflict of interest" on the part of the board.[80]

The dominant paradigm in corporate law and corporate governance in recent decades asserts that directors are supposed to act as agents for shareholders, so that, when making decisions in any of the situations identified above, they are supposed to choose the path that maximizes share value. But very few issues present themselves as a clear choice between path A, which maximizes share value, and path B, which does not. In a complex business environment, directors must inevitably consider the various competing ideas and interests at stake, and make judgment calls and tradeoffs. The business judgment rule ensures that directors' decisions in these matters, even if they turn out badly, will not be overturned by courts, absent some sort of self-dealing, misconduct, or bad faith by the board.[81] The decision by the board of directors of Market Basket to force Arthur T. out of the CEO job, for example, was probably not a decision that could be challenged in court, unless Arthur T. could

79. Davis v. Louisville Gas & Electric Co., 142 A. 654 (Del. Ch. 1928) ("The response which courts make to such applications is that it is not their function to resolve for corporations questions of policy and business management. The directors are chosen to pass upon such questions and their judgment *unless shown to be tainted with fraud* is accepted as final." (emphasis in original)); Gries Sports Enters. v. Cleveland Browns Football Co., 496 N.E.2d 959, 963–64 (Ohio 1986) ("[The business judgment rule is] a rebuttable presumption that directors are better equipped than the courts to make business judgments and that the directors acted without self-dealing or personal interest and exercised reasonable diligence and acted with good faith."); In *Trados*, the Delaware Chancery Court made it abundantly clear that it believes that the best interest of the corporation means the best interest of common shareholders. *In re* Trados Inc. S'holder Litig. (*Trados II*), 17 A.3d 17, 36–38 (Del. Ch. 2013); *see also infra* Part V and related discussion. But unless the decision by the board blatantly disregards the interests of the common shareholder, as was the case in *Trados* where the board was controlled by preferred shareholders, it is highly unlikely that a plaintiff will be able to make a case that the directors breached their fiduciary duties in making a decision in which there was no fraud, illegality, or conflict of interest.

80. Schlensky v. Wrigley, 237 N.E.2d 776 (Ill. App. Ct. 1968). In *Trados*, the court found that the six of the seven directors had conflicts of interest, so it applied the entire fairness standard, rather than the business judgment rule. *Trados II*, 73 A.3d 17, at 45. The Delaware Chancery Court in *eBay Domestic Holdings, Inc. v. Newmark* appears to have established a somewhat different decision rule for whether a board's decision will be given deference under the business judgment rule. eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010). The requirement in this case was that the plaintiff show that a "majority of the directors who approved the action (1) had a personal interest in the subject matter of the action, (2) were not fully informed in approving the action, or (3) did not act in good faith in approving the action." *Id.* at 36.

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

show that board members committed fraud or had inappropriate motives, such as that a majority of the board was so controlled by, and accountable to, Arthur S. that their ability to act in the best interest of the corporation was compromised.[82]

If Market Basket were a publicly traded corporation, dissatisfied family shareholders on one side or the other of the Demoulas family battle would probably have simply sold their shares and gotten out of the business some time ago. In a closely held business, however, shareholders can be locked in because there is no market in which to sell their shares. In this context, it is worth noting that, if a board comes to be totally controlled by a faction that owns a majority of the shares of the corporation (thus making it impossible for a dissatisfied minority shareholder to replace the board, or have their interests taken into account), and the board causes the corporation to take actions that defeat the reasonable expectations of the minority to share in the benefits of the corporation, courts do provide another remedy—a suit for equitable relief on the grounds of shareholder oppression.[83]

Because the law requires that certain decisions must be made by the board, and that most decisions, once made by the board, cannot be challenged in court, board governance helps minimize the number of disputes that might otherwise boil over and require court adjudication. The structure of corporate law thus supports the idea that boards must be "mediat-

82. *See* Holman W. Jenkins, Jr., *Clean-Up Still Needed on Aisle Five: Massachusetts Gov. Deval Patrick Offers Sage Advice to Protesting Workers, Which of Course Is Promptly Rejected*, WALL ST. J. (Aug. 15, 2014), http://online.wsj.com/articles/holman-jenkins-clean-up-still-needed-on-aisle-five-1408140579?KEYWORDS=demoulas; Ross*, supra* note 2. If a board is controlled by one party in an internal dispute, it is unlikely that the other party will trust the board to make a fair decision. I will come back to this point later.

83. Litle v. Waters, Civ. A. No. 12155, 1992 WL 25758 (Del. Ch. Feb. 11, 1992) (defining minority shareholder oppression as a "violation of the reasonable expectations of the minority" (internal quotations omitted)); Gimpel v. Bolstein, 477 N.Y.S.2d 1014 (N.Y. Sup. Ct. 1984) (defining oppressive conduct). *See generally* Edward B. Rock & Michael L. Wachter, *Waiting for the Omelet to Set: Match-Specific Assets and Minority Oppression in Close Corporations*, 24 J. CORP. L. 913, 923 (1999) (explaining that the "core protection against majority oppression is the prohibition on non pro rata distributions [to shareholders] and the related prohibitions on self-dealing"); Robert B. Thompson, *The Shareholder's Cause of Action for Oppression*, 48 BUS. LAW. 699 (1993) (explaining circumstances in which oppression remedy is available). Technically, Delaware does not recognize minority oppression as grounds for equitable relief, but it does offer relief to minority shareholders under other causes of action by applying other legal principles. In fact, Delaware cases that have consistently stated that directors must run corporations for the benefit of shareholders, and not for the benefit of other corporate constituents, have stated this rule in the context of situations in which a minority shareholder is being deprived much of the benefit of being a shareholder by actions of majority shareholders. *See* D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 279 (1998) ("The shareholder primacy norm was first used by courts to resolve disputes among majority and minority shareholders in closely held corporations.").

ing hierarchs" better than it supports that boards are supposed to be "agents" of shareholders, who focus exclusively on maximizing share value. Moreover, the lessons of Holmstrom, Miller, Rajan and Zingales, and Blair and Stout, suggest that, for this mechanism to work well, the board should not be so controlled by any of the team members that the other important team members cannot trust that the decisions made by the board will be in the best interest of the corporation as a whole.

III. NEW THEORETICAL WORK THAT SUPPORTS THE IDEA THAT DIRECTORS SHOULD BE MEDIATING HIERARCHS

There is a certain irony in the way that scholarship and doctrine about the duties of boards of directors has evolved. Throughout the middle of the twentieth century through at least the 1970s, most scholars of corporate law, as well as legal and business practitioners, accepted and were comfortable with the idea that boards of directors have to play a balancing role.[84] Corporations were recognized as having substantial impact on many constituencies in the economy and in society, and pronouncements about the duties of corporate managers and directors reflected the idea that the leaders of large business corporations had an obligation to take these broad social impacts into account. For example, as late as 1981, Business Roundtable, under the leadership of Clifton C. Garvin, CEO of Exxon from 1975 to 1986, published a "Statement on Corporate Responsibility" that said corporate executives must balance the interests of various constituents:

> Carefully weighing the impacts of decisions and balancing different constituent interests—in the context of both near-term and long-term effects—must be an integral part of the corporation's decision-making and management process. Resolving the differences involves compromises and trade-offs. It is important that all sides be heard but impossible to assure that all will be satisfied because competing claims may be mutually exclusive.[85]

Similarly, a United States Department of Commerce report published in 1980 quoted Reginald Jones, former chairman and chief executive officer of General Electric, as expressing a similar sentiment: "[P]ublic policy and social issues are no longer adjuncts to business planning and management, they are in the mainstream of it. The concern

84. *See generally* Harwell Wells, *"Corporation Law Is Dead": Heroic Managerialism, Legal Change, and the Puzzle of Corporation Law at the Height of the American Century*, 15 U. PA. J. BUS. L. 305 (2013) (pages 326–31 provide an extended discussion of this point).

85. BUSINESS ROUNDTABLE, STATEMENT ON CORPORATE RESPONSIBILITY 8 (1981).

must be pervasive in companies today, from boardroom to factory floor. Management must be measured for performance in noneconomic and economic areas alike."[86]

In the 1980s, however, corporate law scholarship began to reflect a finance perspective on the role of corporate officers and directors in the form of principal–agent analysis. Legal scholars borrowed themes from Milton Friedman,[87] Jensen and Meckling,[88] and other finance theorists[89] to embrace the idea that the fundamental problem in the governance of corporations is the separation of ownership from control. This separation supposedly creates significant difficulties for the ability of the "owners" (shareholders) to be sure that the managers are faithfully carrying out their duties. Scholars reasoned that, if this is the central problem, then the function of corporate law must be to provide a solution to that problem; thus scholars began analyzing corporate law issues within a framework of principal–agent theory.[90] Part of the solution, some theorists argued, must be that directors and managers of corporations have a legal duty to try to maximize the value of corporations for their "owners," the com-

86. U.S. DEP'T. OF COMMERCE, BUSINESS AND SOCIETY: STRATEGIES FOR THE 1980S, at 75 (1980).

87. Friedman wrote that "there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it . . . engages in open and free competition without deception or fraud." Milton Friedman, *The Social Responsibility of Business is to Increase its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, *available at* http://www.umich.edu/~thecore/doc/Friedman.pdf (quoting MILTON FRIEDMAN, CAPITALISM AND FREEDOM (1962)).

88. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

89. *See, e.g.*, Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980); Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J. L. & ECON. 301 (1983); Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965). The concern about the separation of ownership and control dates back at least to ADOLPH BERLE & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

90. *See, e.g.*, FRANK H. EASTERBROOK & DANIEL FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991); FOUNDATIONS OF CORPORATE LAW (Roberta Romano ed., 1993); Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403 (1985); Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of A Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863 (1991).

mon shareholders,[91] and that shareholders should have significant legal tools to make sure that directors and managers do this.[92]

Now, thirty-five years after the language of share value maximization began to dominate discussions of corporate governance, corporate law—in the form of decisions from the Delaware courts—appears to be evolving in the direction suggested by finance theorists in the 1970s and 1980s, by requiring boards of directors to focus on maximizing value for common shareholders, at least in certain contexts.[93] Now, however, finance theorists are increasingly rejecting the idea that maximizing the value for holders of common shares necessarily produces the socially optimal outcome.

There are a variety of situations explored in finance literature that are beginning to be studied by law and finance scholars, wherein a simple rule—that boards of directors should choose actions to maximize share value—would not lead to the most efficient or socially optimal long-term outcome. These include: First, situations of substantial information asymmetry, in which shareholders or other investors do not have full information about the sources of long-term value in the firm. As a result, they may prefer that the firm take actions such as a merger or share repurchase that seem to offer a higher value to shareholders in the short run, but may weaken or destroy the ability of the firm to deliver long-term value.[94] Widespread concerns about whether corporate manag-

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91. Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J. L. & ECON. 395, 395 (1983); Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23, 23 (1991).

92. Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005). *See also* Easterbrook & Fischel, *The Proper Role of A Target's Management in Responding to a Tender Offer*, *supra* note 90.

93. See discussion *infra* of *eBay* and *Trados* in Part V. *See also* Gantler v. Stephens, 965 A.2d 695, 706 (Del. 2009) (holding that "enhancing the corporation's long term share value" is a "distinctively corporate concern"). For most of the last thirty years or so, it has been credible to argue that corporate law in Delaware paid lip-service to the idea that managers and boards should run corporations in the interest of common shareholders, but the business judgment rule provided almost complete protection to directors who chose actions that protected and advanced the interests of other corporate constituencies, if directors asserted that those actions would create value for shareholders in the long run. See, for example, Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 733–869 (2005), who makes a powerful case that neither Delaware law, nor the corporate law of any other state, require that corporate boards must maximize share value. Recent decisions out of the Delaware Court, however, suggest that directors who take into account the impact of corporate decisions on other stakeholders, including preferred shareholders, run some risk of being found in breach of their fiduciary duties unless they can show that their decisions were in the best long-run interest of the common shareholders. See discussion *infra*.

94. *See, e.g.*, COLIN MAYER, FIRM COMMITMENT: WHY THE CORPORATION IS FAILING US AND HOW TO RESTORE TRUST IN IT (2013); LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW

ers are pressured—by powerful stock-based incentive compensation packages, shareholder activism, concerns about legal liability, or all three—to sacrifice long-term value creation in order to push share prices up in the short run are responses to the problem of information asymmetry.[95] Second, situations in which share value can be enhanced by actions that have the effect of expropriating value from other corporate participants by breaching implicit contracts.[96] And third, situations in which the interests of various investor groups conflict which each other. For example, holders of one class of stock can benefit from risky strategies that destroy or reduce the value of other classes of stock or debt.[97]

Theorists and practitioners who have studied these situations frequently look to boards of directors as one of the institutional arrangements that can mitigate the conflicts that such situations present. For example, Wall Street lawyer and inventor of the "poison pill" defense against hostile takeovers, Martin Lipton, has long argued that managers and boards of directors need to be protected from shareholder activism in order to manage corporations for the long term.[98] Harvard law professor Lucian Bebchuk, on the other hand, has made it a signature argument of

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PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC (2012); Stewart C. Myers & Nicholas S. Majluf, *Corporate Financing and Investment Decisions When Firms Have Information that Investors Do Not Have*, 13 J. FIN. ECON. 187 (1984); Jeremy C. Stein, *Efficient Capital Markets, Inefficient Firms: A Model of Myopic Corporate Behavior*, 104 Q. J. ECON. 655 (1989).

95. *See* MAYER, *supra* note 94; William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653 (2010) (arguing that actions taken by firms to benefit short-term shareholders can have value-reducing effects).

96. Andrei Shleifer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers*, *in* CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 33–65 (Alan J. Auerback ed., 1988) (arguing that the gains to target shareholders in corporate takeovers may arise from the fact that the takeover facilitates shareholder expropriation of firm-specific investments made by other corporate participants, especially employees); MARGARET M. BLAIR, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY (1995) (arguing that employee investments in firm-specific assets are at risk in corporate enterprises along with financial capital). Blair and Stout's work on team production theory fits most comfortably in this category, in that it argues that if boards are required to focus on share value maximization, this could inhibit the ability of the firm to elicit team-specific investments by team members. But the concept of the team production problem is general enough to encompass the problem of asymmetric information, and the problem of the incentives for excess risk-taking.

97. *See* Douglas Baird & M. Todd Henderson, *Other People's Money*, 60 STAN. L. REV. 1309 (2008); Simone Sepe, *Corporate Agency Problems and Dequity Contracts*, 36 J. CORP. LAW 113 (2010). Brian Broughman, *The Role of Independent Directors in Startup Firms*, 2010 UTAH L. REV. 461, 471–80 (2010), models the situation in which one party to an investment benefits by pursuing a risky strategy, and the other benefits from pursuing a more conservative strategy.

98. *See, e.g.*, Martin Lipton & Steven A. Rosenblum, *Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come*, 59 BUS. LAW. 67 (2003) (arguing that short-term shareholders pressure companies to take actions that destroy economic value); Martin Lipton, *The Many Myths of Lucian Bebchuk*, 93 VA. L. REV. 733, 733–58 (2007).

his career that shareholders need more power to prevent corporate managers from using their power in ways that destroy shareholder value.[99]

In recent years, however, law and finance scholars have been pursuing both theoretical and empirical work examining the implication of these kinds of problems for corporate law. Some of this new work points to solutions that are remarkably similar to the solution suggested by Blair and Stout in their conception of a mediating hierarchy role for boards of directors. In this Part, I review some of this new empirical work, and in Part V, I highlight some interesting empirical findings that seem to support the mediating hierarchy solution.

In an example of new scholarship on team production problems, or similar problems in corporate law, Robert Bartlett has written about what he calls the "horizontal" agency problem in corporations.[100] The standard description of the agency problem thought to be at the core of corporate law refers to the problem that shareholders have in ensuring that managers act in their interests. Bartlett calls this familiar problem the "vertical" agency problem.[101] In an important 2006 paper, however, Bartlett also observes that, in many firms, problems and conflicts can arise between different classes of investors, problems that he refers to as horizontal agency problems.[102] These problems arise in firms financed with venture capital, for example, because venture capital financing typically occurs

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99. *See, e.g.*, Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005); Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 J. FIN. ECON. 409 (2005); Lucian A. Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence and Policy* (Nat'l Bureau of Econ. Research, Working Paper No. 8974, 2002); Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675 (2007). Prof. Bebchuk and Mr. Lipton have also engaged in a lively debate on the Harvard Law School Forum on Corporate Governance and Financial Regulation, about whether boards of directors need more, or less protection from activist shareholders. *See Lucian Bebchuk & Martin Lipton to Debate Blockholder Regulation*, HARVARD L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Nov. 6, 2012), http://blogs.law.harvard.edu/corpgov/2012/11/06/lucian-bebchuk-and-martin-lipton-to-debate-blockholder-regulation/.

100. *See* Robert P. Bartlett III, *Venture Capital, Agency Costs, and the False Dichotomy of the Corporation*, 54 UCLA L. REV. 37, 42 (2006).

101. *Id.*

102. *See generally id.* Bartlett notes that other scholars have discussed the potential for conflict among shareholders, citing Lucian Bebchuk, Reinier Kraakman & George Triantis, *Stock Pyramids, Cross-Ownership, and the Dual Class Equity*, *in* CONCENTRATED CORPORATE OWNERSHIP 295 (R. Morck ed., 2000); Jesse M. Fried & Mira Ganor, *Agency Costs of Venture Capitalist Control in Startups*, 81 N.Y.U. L. REV. 967 (2006); Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785 (2003); and Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641 (2006), among others. *Id.* Although he doesn't use the language of "team production," Bartlett's analysis of the conflicts between different groups of investors in venture capital firms—his horizontal agency problem—provides a vivid example of the kinds of problems that Blair and Stout had in mind in their 1999 article.

in stages, with venture capitalists (VCs) purchasing preferred shares in the initial round of venture capital financing, and subsequent investors purchasing different classes of preferred shares, often with preference in liquidation over some or all of the earlier classes, in later rounds of financing.[103] As finance theorists are well aware, there will always be a potential for conflict between the interests of different classes of securities holders if the various securities are all backed by the same cash flows of a firm, but they have different priorities in receiving dividends, or in liquidation, or different control rights.[104] This means that, in many firms, there may be various classes of investors that each have different interests in the performance of the firm. As Bartlett points out, however, until very recently the legal and economic literature on venture capital firms ignored this problem and focused only on the vertical agency problem between venture capital investors and the founders or managers of the portfolio firm.[105]

In his study of the horizontal agency problem, Bartlett works through examples of several firms in which the conflicts among different classes of investors came to a head during the years after the dot.com bubble collapsed in 2000 and 2001.[106] The recurring problem in these incidents was that late round investors often received substantial control rights and preferences, especially if the firm was struggling somewhat or not yet making a profit at the time of the later financing. The rights and preferences of the newcomer could then be used in ways that harm early-round investors if the firm gets into serious financial difficulty. Another common problem is that investors who have higher priority in liquidation are often eager to accept merger offers or refinancing transactions that protect their interests, but offer little or nothing to lower priority investors.[107]

Bartlett seems to believe that these potential conflicts could be anticipated and addressed effectively through terms in the corporate charter that specify rights and claims of various classes of securities that the firm

103. Steven N. Kaplan & Per Stromberg, *Financial Contracting Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, 70 REV. ECON. STUDS. 281, 313 (2003) (reporting that 94% of venture capital financings from 1987 through 1999 were done with preferred stock).

104. *See, e.g.*, Brian Broughman & Jesse Fried, *Renegotiation of Cash Flow Rights in the Sale of VC-Backed Firms*, 95 J. FIN. ECON. 384 (2010) (studying the conflict between investors in common stock and investors in preferred stock).

105. Bartlett, *supra* note 100, at 40, 41 n.9.

106. *Id.* at 81–95. When cash flows are high and growing, it is relatively easy to reconcile the potential conflicts among different investors, but when a firm suffers a setback, and cash flow is lower than expected, the potential conflicts often become serious actual conflicts.

107. This was the issue in *In re Trados Inc. S'holder Litig. (Trados II)*, 73 A.3d 17 (Del. Ch. 2013).

can issue, or in the preferred share financing documents. He believes that for this to work, the courts must recognize the provisions in those documents as contractual in nature, and use contract interpretation rules in resolving subsequent disputes.[108] While that might address the specific problems that arose in one case that he looked at, he recognizes that there is a larger issue here. "First," he says, "the presence of both investor–manager and interinvestor agency problems in VC investment suggests the need to reassess traditional analytical frameworks" that emphasize only the vertical agency problems.[109] Second, "in addition to emphasizing the need to consider multidimensional agency problems in firms, VC finance also highlights the dynamic manner in which these problems can develop."[110] Bartlett is concerned with dynamic issues arising from the fact that contractual and institutional arrangements put in place at one stage in a corporation's development, perhaps to mitigate and control vertical agency problems, can exacerbate the various conflicts among investors at a later time, especially when some investors come into the project later and on different terms. This implies, he says, that "[t]he existence within a single firm of both interstakeholder and intrastakeholder conflicts places renewed emphasis on the need for governance structures to resolve these conflicts as they arise."[111]

Another situation in which there is likely to be "horizontal" conflict among investors arises when a corporation gets into financial trouble. Again, investors that have higher priority in liquidation, such as creditors, are likely to favor conservative actions that move quickly to liquidate assets and pay off debts, even if this would leave little or nothing left in the firm to distribute to investors with lower priority, such as common shareholders. If shareholders control firms, however, or if corporate managers and directors are required to maximize share value, the firm may be more likely to take risky actions that can destroy value for high priority claimants, but make shareholders better off by giving them a shot at a higher return. Knowing this, creditors often negotiate for con-

108. Bartlett is especially critical of the Delaware Court's decision in *Benchmark Capital Partners IV, L.P., v. Vague*, No. Civ. A. 19719, 2002 WL 1732423 (Del. Ch. July 15, 2002), *aff'd sub nom.* Benchmark Capital Partners IV, L.P. v. Juniper Fin. Corp., 822 A.2d 396 (Del. 2003) because the court applied common law rules of corporate law, rather than contract law, to resolve the dispute, having the effect of wiping out some of the protections that Benchmark Capital thought it had bargained for. Bartlett, *supra* note 100, at 101 ("A primary failure of the Benchmark opinion—and of Delaware corporate jurisprudence in general—is the refusal to apply ordinary contract principles in interpreting the terms of preferred stock rights.").

109. *Id.* at 108.

110. *Id.* at 111.

111. *Id.* at 47.

trol rights to protect their interests. Douglas Baird and Robert Rasmussen have written extensively about the fact that these arrangements often mean that creditors play a significant role in corporate governance, one that, in the past, tended to be overlooked by corporate law scholars.[112] Michelle Harner has similarly explored how activist distressed debt investors often take positions in the debt securities of a firm in financial difficulty with the intention of using the control rights they obtain through their debt claims to influence or control the restructuring process.[113] In this way, they are sometimes able to acquire a position as a creditor for pennies on the dollar, and then parlay their holdings into a position as a major shareholder in the restructured company. The conflicts that must be resolved along the way are more likely to be horizontal conflicts, among various classes of investors, rather than the more thoroughly studied conflicts between investors and managers.[114]

When a corporation is in financial trouble, or even if it just has a high level of debt relative to its total assets, there will inevitably be conflicts between what is in the interest of creditors, and what is in the interest of employees, trade creditors, or shareholders. Bartlett might call these situations "horizontal agency problems," but they could also be described as team production problems—each group of participants has made some contribution to the wealth generating capacity of the corporation. A valuation may or may not have been put on these prior contributions at the time they were made, but those valuations may be irrelevant or only marginally relevant when considering what participants should get in a liquidation or restructuring. If the corporation is restructured and will continue in business, however, the organizers of the restructured firm will need to work out some arrangement by which the key players stay on board and work together going forward. Even if the firm is going

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112. *See* Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751 (2002) (proposing private ordering solutions to the intra-investor disputes that arise in bankruptcy); *See also* Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209 (2006) (discussing the covenants and other strategies used by creditors or corporations that give them a large role in the affairs of the corporation, including, when the firm is in financial trouble, the ability to replace managers); Frederick Tung, *Leverage in the Board Room: The Unsung Influence of Private Lenders in Corporate Governances*, 57 UCLA L. REV. 115, 123–40 (2009).

113. *See* Michelle M. Harner, *The Corporate Governance and Public Policy Implications of Activist Distressed Debt Investing*, 77 FORDHAM L. REV. 703 (2008) ("An investor can purchase the debt of a financially troubled company and then try to influence corporate matters by exercising or threatening to exercise its contractual and statutory rights as a debtholder.").

114. *Id.* at 709 (the investment goals of distressed debt investors "may or may not align with the goals of the company, the company's other stakeholders, and the underlying bankruptcy regime").

to be liquidated and wound up, the parties may still be better off if they can find a way to resolve the conflicts among the various claimants outside of bankruptcy court.

Simone Sepe has suggested that these problems could be modeled as "common agency" problems, using the framework developed by Douglas Bernheim and Michael Whinston for thinking about problems in which an agent is responsible to multiple principals.[115] "A common agency problem arises when a single agent performs tasks on behalf of several independent principals who have divergent preferences," Sepe explains.[116] Examples include a sales agent representing a number of clients and selling a variety of products, some of which may compete with each other, or a government agency that is supposed to pursue multiple objectives. This model, Sepe asserts, "can be applied to describe managers as common agents of several types of investors (e.g., principals), including both controlling and non-controlling shareholders, and creditors."[117]

Sepe offers two reasons why we should think of corporate managers as common agents: "First, investors of all types rely on managers . . . for fulfilment of their investment expectations"; and second, the common agency model "captures the complexity of corporate agency problems, allowing for consideration of both the vertical and horizontal dimensions of such problems."[118]

Although Bartlett, Baird and Rasmussen, and Harner have explored such issues primarily in the context of firm financial distress, Sepe observes that the problem of the vulnerability of noncommon equity investors (NCE investors) to corporate actions designed to maximize share value is not limited to firms in financial distress.[119] The problem exists, he says, for all firms that have a low net worth, asset volatility, severe asymmetric information problems, and a high degree of specificity of investment[120]—a description that applies to most venture capital firms as well as to firms in financial distress.

Sepe has argued that one solution to the problem that is becoming more commonly deployed, is the appointment of directors to corporate boards who are explicitly supposed to represent the interests of NCE in-

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115. Sepe, *supra* note 97, at 113; B. Douglas Bernheim & Michael D. Whinston, *Common Agency*, 54 ECONOMETRICA 923, 923–42 (1986).

116. Sepe, *supra* note 97, at 116.

117. *Id.*

118. *Id.*

119. *See* Simone E. Sepe, *Intruders in the Boardroom: The Case of Constituency Directors*, 91 WASH. U. L. REV. 309 (2013).

120. *Id.* at 332.

vestors whose investments are at risk in the enterprise.[121] He cites as examples the common practice on boards of firms funded by venture capital of having some directors who explicitly represent the interest of the venture capitalists, who frequently hold preferred shares rather than common shares.[122] Other examples he offers include the appointment of directors representing workers or unions when workers agree to wage and benefit cuts during financial restructuring, and the appointment of directors representing the United States Treasury onto boards of companies that received bailout money from the Troubled Asset Relief Program, more commonly known as TARP.[123]

A major problem with this solution, however, is that recent decisions of the Delaware courts seem to say that such directors owe fiduciary duties only to common shareholders, regardless of whether they were selected to represent some other interest.[124] Sepe suggests that having directors on boards to explicitly represent competing interests is an effort, on the part of the corporate participants, to try to anticipate horizontal agency/team production issues, and to develop their own contracts or other "private ordering" solutions to them.[125] But if so, it is important that courts respect the solutions they devise, even when that means that the individuals on boards of directors must be able to advocate for the party they represent and weigh competing interests in making decisions. This solution sounds very similar to the mediating hierarchy solution described by Blair and Stout.

Brian Broughman also studies startup firms and venture capital firms, and considers the arrangements that such firms often make to deal with the fact that both the entrepreneurs/managers of the firm and the venture capitalist investors have investments at risk, and all need a governance tool that can allow them to balance and protect both sets of interests.[126] Broughman models the relationship between two parties involved together in a single firm, an entrepreneur and a VC, in which the entrepreneur holds common stock and the VC holds preferred stock. Because the parties have different cash flow rights in the firm, they are likely to have different preferences over certain strategic decisions, such as whether to undertake a new risky project, or sell the firm, or seek a new round of financing that will dilute the interest of one or both parties and

121. *Id.*
122. *Id.* at 336.
123. *Id.* at 337–39.
124. *Id.* at 344–45 & nn.140–42.
125. *Id.* at 336–39.
126. Broughman, *supra* note 97, at 510.

have priority over the preferred stock owner. In Broughman's model, the VC consistently prefers the more conservative choices that protect its fixed claim, whereas the entrepreneur tends to prefer riskier strategies that have a chance at creating substantial new value for the common stock, even if the strategies reduce the value of fixed or high priority claims by making them more risky.[127] In his model, Broughman assumes that the choice of strategy is determined by whether the entrepreneur controls the board, in which case the risky strategy will be chosen, or the VC controls the board, in which case the conservative strategy will be chosen.[128] Prior research on these sorts of problems has tended to assume that there are only two choices of strategies, with no possibility of compromise in which both parties get some benefits, even if it is not their ideal outcome.[129] Additionally, research has assumed that the decision must be controlled by one of the two parties.[130] Given these assumptions, the parties may be unable to reach the most efficient outcome—the one that maximizes the total value created by the firm—even though the parties could both be made better off if they could maximize total value and then share the gains.[131]

Broughman shows, however, that the parties *can* achieve the socially optimal outcome if the decision can be assigned to a board consisting of three people: one representing the entrepreneur, one representing the VC, and an independent director who is explicitly recruited to the board to be a neutral player who casts the deciding vote in the case of any disagreements.[132] Broughman calls this player the "ID-arbitrator."[133] The reason this system works is not because the ID-arbitrator is assumed to be smarter or a better bargainer. It is because choices of actions proposed by the entrepreneur and the VC will have a tendency to converge to the so-

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127. *Id.* at 471–72.

128. *Id.* at 472–73.

129. Brian Broughman, *Independent Directors and Shared Board Control in Venture Finance* 10 (Indiana Univ. Maurer Sch. of Law, Working Paper, 2008) (on file with the author), notes that his model of the relationship between an entrepreneur and a venture capitalist follows the modeling strategies in S. Grossman & Oliver Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691 (1986), and P. Aghion & P. Bolton, *An Incomplete Contracts Approach to Financial Contracting*, 59 REV. ECON. STUD. 473 (1992), both of which assume there are only two choices in the strategy space. Broughman's model provides for the possibility of a continuum of intermediate possibilities. In Broughman, *supra* note 97, at 471–80, his model provides for one intermediate strategic option.

130. Broughman, *supra* note 97, at 472.

131. *Id.* at 474–75.

132. *Id.* at 480–84.

133. *Id.* at 474.

cially optimal level if they both know that the ID-arbitrator will choose from the actions proposed by the two parties. Broughman explains:

> Under ID-arbitration, the entrepreneur and VC anticipate how the independent director is likely to vote if a conflict should arise. This knowledge affects the strategies that the entrepreneur and the VC will propose ex ante. There is no point in proposing a strategy that will be rejected by the independent director, as this would effectively let the other party select the firm's course of action. Instead the parties have an incentive to offer a strategic compromise—a proposal that is likely to be endorsed by the independent director and yet is still acceptable to the proposing party.[134]

The solution to Broughman's model is based on solutions worked out for models of "final-offer arbitration"[135] and models of candidates for election who must appeal to the median voter.[136] Broughman discusses empirical evidence showing that, in the context of startup firms and venture capital financed firms, the most common pattern of the composition of the boards of directors is that neither representatives of the VCs nor representatives of the entrepreneurs/managers control the board of directors of the firm by having a majority of board seats. Instead, each side will hold less than half the seats, and one or two individuals, chosen jointly by the parties *explicitly to be neutral decisionmakers*, will hold the deciding vote on the board.[137]

Broughman distinguishes his theory of independent directors on corporate boards from the team production theory laid out by Blair and Stout in 1999 because, he notes, Blair and Stout explicitly asserted that their theory applied to the boards of publicly traded corporations, and not to closely held corporations.[138] Nonetheless, Broughman's model and his theory capture exactly the same intuition that Blair and Stout were trying to express—the participants in an enterprise where there are team production, or horizontal agency, problems need "a mechanism that allows both parties to commit to nonopportunistic behavior."[139] The requirement in corporate law that corporations have boards of directors can be such a

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134. *Id.* at 482.

135. *Id.* at 482 (citing Vincent P. Crawford, *On Compulsory-Arbitration Schemes*, 87 J. POL. ECON. 131, 131–32 (1979)); Daniel R. Marburger, *Arbitrator Compromise in Final Offer Arbitration: Evidence from Major League Baseball*, 42 ECON. INQUIRY 60, 60–62 (2004).

136. Broughman, *supra* note 97, at 482 (citing Anthony Downs, *An Economic Theory of Political Action in a Democracy*, 65 J. POL. ECON. 135 (1957)); ROBERT COOTER, THE STRATEGIC CONSTITUTION 25–27 (2000).

137. Broughman, *supra* note 97, at 489–91.

138. *Id.* at 501.

139. *Id.* at 480.

mechanism, especially if directors are chosen for their general thoughtfulness and independence, not only from management, but from any of the powerful interests at stake in the firm.

IV. EMPIRICAL EVIDENCE

At the time that Blair and Stout were writing their "team production" article, they focused on publicly traded corporations. The primary evidence they brought to bear on the theory that one job of boards of directors is to be mediating hierarchs was court cases that give boards wide discretion to consider many competing interests.[140] In a 2001 article, however, Blair and Stout suggested that a good place to look for direct evidence was in venture capital firms as they go public.[141] At the time, there was a smattering of scholarly evidence that, in fact, when venture capital firms go public, they often have a board structure in which neither the entrepreneur/managers, nor the VCs, have control:

> Academic studies of firms planning an initial public offering show that even though outside investors (e.g., venture capital firms) may often hold majority blocks of stock, at the time the firm goes public the board is structured so that neither the block investors nor the firm's founders make up a majority of the seats on the board. "Independent" directors who are neither part of management, nor representatives of the venture capitalists, typically hold enough votes to determine the outcome of any dispute between the entrepreneur and the venture capitalist. In a recent working paper, Stephen Choi argues that this structure is designed to reassure the firm's entrepreneurs and employees on the one hand, and its contributors of financial capital on the other, that neither side can readily manage the firm in a fashion detrimental to the other.[142]

Research by Julia Liebeskind had found a similar phenomenon in a sample of seventy-nine biotechnology startup firms in California, founded between 1974 and 1995.[143] Since then, a much larger body of evidence has been developed that expands on this point. A 2003 article by

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140. Blair & Stout, *supra* note 5, at 290–305.

141. Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L.Q. 403 (2001).

142. *Id.* at 422 (footnotes omitted, but citing to Stephen Choi, *What Determines Board Composition? CEOs and Firm-Specific Investments in Human Capital* (Working Paper, 2000) (on file with the author), and to Julia Porter Liebeskind, *Ownership, Incentives, and Control in New Biotechnology Firms*, *in* THE NEW RELATIONSHIP: HUMAN CAPITAL IN THE AMERICAN CORPORATION (Margaret M. Blair & Thomas A. Kochan eds., 2000).

143. Liebeskind, *supra* note 142, at 323.

Steven Kaplan and Per Stromberg,[144] in which the authors study 213 venture capital investments in 119 portfolio companies,[145] found that in 60.7% of the observations in their data,[146] neither the founder/entrepreneur, nor the VC controlled a majority of seats on the board. Over the whole sample, VCs controlled 41.4% of the board seats, the founder controlled 35.4% of the board seats, and outsiders, whom the authors say were "mutually agreed upon by the VCs and the founders/entrepreneurs," held the remaining 23.2% of seats.[147] In practice, this meant that neither founders nor VCs could unilaterally make important strategic decisions. For any decision that required a vote of a majority of the directors, if they could not get the support of the other party, they would have to at least get the support of the outsider.

Broughman cites the Kaplan and Stromberg findings in support of his theory and, in addition, examines data on fifty-four VC-backed firms in Silicon Valley that had a total of 154 rounds of funding, and that were sold to an acquirer in 2003 or 2004.[148] He finds that "a startup board has an average of 5.5 directors (the first round board is slightly smaller). . . . VCs hold on average 43.9% of the board seats, entrepreneurs hold 33%, and the remaining board seats, 23.1% of the total, are held by independent directors."[149] Broughman also categorizes the boards in his sample by whether they are controlled by the VC, controlled by the entrepreneur, deadlocked (each party holds 50% of the seats), or what he calls "arbitration" boards with independent directors holding the deciding vote in any dispute between the VC and the entrepreneur.[150] He finds that in 64.3% of his observations (financing rounds), the boards appear to be structured for an arbitration approach to decisionmaking.[151] Broughman also finds evidence that the right to select directors to particular positions on the board is a right that is bargained for when the terms of the financing agreement are being worked out, but that the independent directors must be approved by both parties.[152] Interviews that Broughman conducted

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144. Kaplan & Strömberg, *supra* note 103.

145. *Id.* at 281.

146. *Id.* at 287–88. Observations were funding rounds. Some of the firms in their sample had multiple funding rounds.

147. *Id.* at 288.

148. Broughman, *supra* note 97, at 488.

149. *Id.* at 489.

150. *Id.* at 490–91.

151. *Id.* at 491.

152. *Id.* at 492.

confirmed that "the parties consulted each other and made sure everyone approved the directors selected."[153]

Elizabeth Pollman has also researched the questions of what boards of directors of venture capital-funded corporations look like and how they function.[154] She finds data that show that

> In the early stages of the corporation, the board is often composed of three to five directors total, representing one to two management seats, one to three VC seats, and zero to two independent seats. Through the later stages of the startup corporation, the board typically increases to between five to seven directors, representing one to two management seats, two to three VC seats, and two to three independent seats.[155]

She also finds that, in the professional literature discussing board composition and addressing the startup and venture capital community, there is widespread discussion to the effect that it is useful to have independent directors on boards and of the idea that neither the VC nor the founder/entrepreneur should control the board.[156] In particular, there is extensive discussion of the independent directors doing what one practitioner calls "constructive mediation."[157]

Another body of empirical evidence may provide a kind of "dog that didn't bark" support for the idea that boards of directors serve a mediating function. This is the curious fact that, in hundreds of empirical studies of the impact that various configurations and characteristics of boards of directors have on the performance of corporations, almost no consistent patterns have emerged.[158] Board composition and structure does not seem to affect the financial performance of corporations, except in one very limited respect: the presence of independent directors on boards, especially if they serve on audit committees, is associated with reduced incidence of financial or accounting misbehavior.[159] Outside of

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153. *Id.* at 493.

154. *See* Elizabeth Pollman, *Team Production Theory and Private Company Boards*, 38 SEATTLE U. L. REV 619 (2015).

155. *Id.* at 629.

156. *Id.* at 639–46.

157. *Id.* at 644, (citing Philip Black, *The Value of an Independent Director on a Board*, EXECREPS, http://www.execrepsinsights.com/the-value-of-an-independent-director-on-a-board/ (last visited Nov. 15, 2014)).

158. *See* Margaret M. Blair, *Boards of Directors and Corporate Performance Under a Team Production Model*, *in* HANDBOOK OF SHAREHOLDER POWER (Randall S. Thomas & Jennifer Hill eds., forthcoming) (draft on file with the author).

159. *Id.* at 25.

that, the evidence is very mixed about the impact that board independence or other characteristics have on performance.[160]

Why might this be? If an important function of boards of directors is to serve a mediating function, we would expect that, if they are doing this job well, their impact will be mostly invisible. The reason is twofold. First, as Broughman argues, when mediating, members of a board are going to make the call between two factions, and both factions have strong incentives to moderate their demands.[161] They are generally both better off if they can reach a strategic compromise. Thus, it may appear to all concerned that there is no conflict. The second reason is that mediating directors will only be called upon to actually make the decision in cases that involve an exceptionally high level of conflict that can't be resolved at a lower level.[162] In such cases, the issue that the mediating directors must decide likely involves making complex and difficult tradeoffs, the outcome of which is uncertain as it is unclear what actions or choices will maximize share value, or achieve any other corporate goal. The issues are "close calls." As a result, the actions or policies chosen by the mediating directors will probably deviate more or less randomly from some hypothetical set of optimal choices. In other words, the decisions that mediating directors make will not be a random sample of all decisions—they will be only the hardest cases. In those situations, if the mediator is unbiased and not aligned with one side or the other with respect to the issue under consideration, those decisions will not systematically favor one side or the other. Following the logic of Priest and Klein in their analysis of the selection of disputes for litigation,[163] the result might be that we cannot expect to find a correlation between the presence of a mediating board, and various measures of corporate performance.[164]

IV. DELAWARE MAY BE REJECTING THE MEDIATING BOARD

Delaware courts have always insisted that directors must act "in the best interest of the corporation," and sometimes "in the best interests of the corporation and its shareholders." In decisions going back decades,

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160. *Id.*

161. Broughman, *supra* note 97, at 482 ("Under ID-arbitration . . . . [t]here is no point in proposing a strategy that will be rejected by the independent director, as this would effectively let the other party select the firm's course of action. Instead, the parties have an incentive to offer a strategic compromise—a proposal that is likely to be endorsed by the independent director, and yet is still acceptable to the proposing party.").

162. Blair, *supra* note 158, at 23.

163. George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1 (1984).

164. *Id.* at 25.

however, they have historically granted wide discretion for boards of directors who make choices for their corporations that are designed to balance competing interests. In recent years, however, the Delaware courts have handed down a number of decisions that seem to tie directors' hands more tightly to the task of acting for the sole benefit of common shareholders. Sepe dates the apparent shift in Delaware doctrine to the 2009 decision of the Chancery Court in *In re Trados, Inc. Shareholder Litigation* (*Trados I*), a decision which Sepe called "pathbreaking."[165] In its decision, the Chancery Court denied a motion to dismiss sought by directors of a VC-financed corporation, Trados, Inc.[166] Directors had made a decision to sell the company in a merger transaction for a price that provided a payout to preferred shares and almost covered their liquidation preferences, but provided nothing for the common shareholders.[167] A holder of common shares sued.[168] Five of the seven directors of Trados, Inc. that had made the decision were representatives of venture capital firms that held preferred shares in the company.[169] They sought to have the case dismissed on various grounds and even argued that they believed that they were acting in the best interest of the corporation.[170] In denying the motion, the Chancery Court said:

> [G]enerally it will be the duty of the board, where discretionary judgment is to be exercised, to prefer the interests of common stock—as the good faith judgment of the board sees them to be—to the interests created by the special rights, preferences, *etc.,* of preferred stock, where there is a conflict.[171]

Similarly, in *eBay Domestic Holding, Inc. v. Newmark*, the Delaware Chancery Court said that directors are required to seek "to promote the value of the corporation for the benefit of its stockholders."[172] In this case, eBay was a minority shareholder in craigslist, Inc., a very closely held corporation in which Craig Newmark and James Buckmaster, the founders and top executives in craigslist, were the only other sharehold-

165. *In re* Trados, Inc. S'holder Litig. (*Trados I*), No. 1512-CC, 2009 Del. Ch. LEXIS 128 (Del. Ch. July 24, 2009). *See also* Sepe, supra note 119, at 345.

166. *Trados I*, at *3.

167. *Id.* at *1.

168. *Id.*

169. *Id.* at *3–4.

170. *In re* Trados Inc. S'holder Litig. (*Trados II*), 73 A.3d 17, 63 n.37 (Del. Ch. 2013) (quoting defendant director David Scanlon saying "I viewed the operation as a whole in its best interests and all of its stakeholders and all of its shareholders as my duties").

171. *Trados I*, at *27–28 (emphasis in original) (citing Equity-Linked Investors, LP v. Adams, 705 A.2d 1040, 1042 (Del. Ch. 1997)).

172. eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010).

ers and the only members of the board of directors. When eBay initiated its classified ads website, Kijiji, which competed with craigslist, Newmark and Buckmaster took several actions on the part of craigslist designed to prevent eBay from being able to either elect a director to the board, or acquire more shares of craigslist, or even sell its holdings to another investor.[173] In its decision, the court observed that craigslist, "[t]hough a for-profit concern . . . largely operates its business as a community service."[174] While the court found that Newmark and Buckmaster had a legitimate competitive concern about eBay being able to elect a director, they could not use the corporate machinery to prevent eBay from being able to enjoy other benefits of its ownership interest. The court explained:

> As an abstract matter, there is nothing inappropriate about an organization seeking to aid local, national, and global communities by providing a website for online classifieds . . . . The corporate form in which craigslist operates, however, is not an appropriate vehicle for purely philanthropic ends, at least not when there are other stockholders interested in realizing a return on their investment. . . . [Newmark and Buckmaster] opted to form craigslist, Inc. as a *for-profit Delaware corporation* and voluntarily accepted millions of dollars from eBay as part of a transaction whereby eBay became a stockholder. Having chosen a for-profit corporate form, the craigslist directors are bound by the fiduciary duties and standards that accompany that form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders.[175]

In *North American Catholic Education Programming Foundation, Inc. v. Gheewalla*,[176] decided in 2007, the Delaware Supreme Court settled an issue that scholars had been debating for a number of years: whether directors owe fiduciary duties to creditors when a corporation is "in the zone of insolvency."[177] This issue rose to prominence after former Chancellor William Allen raised the possibility in *Credit Lyonnaise Bank Nederland N.V. v. Pathe Communications Corp*.[178] In *Gheewalla*, the court found that when a corporation is insolvent, creditors may have standing to pursue a derivative action against the board of directors for

173. *Id.* at 6.
174. *Id.* at 8.
175. *Id.* at 34 (emphasis in original).
176. N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92 (Del. 2007).
177. *Id.* at 99. See *id.* at n.28 for an extensive list of the literature discussing this question.
178. Credit Lyonnaise Bank Nederland N.V. v. Pathe Communications Corp., Civ. A. No. 12150, 1991 WL 277613, at *34 n.55 (Del. Ch. Dec. 30, 1991).

breach of their fiduciary duties, but they still would not have a direct cause of action:

> When a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners.[179]

Most recently, in the summer of 2013, the Delaware Chancery Court published its decision in *In re Trados, Inc., Shareholder Litigation* (*Trados II*),[180] in which the court reiterated the point it made in its decision on the motion to dismiss in this same case, discussed above, about the duty of the board to prefer the interest of the common shareholders to the interest of other security holders.[181] As if to pound the point home, Vice Chancellor Laster specifically engaged the scholarly literature on whether corporate directors should focus on "enterprise value" rather than just shareholder value,[182] and repeated his point in five separate places in the opinion.[183] In the most extended statement of the point, he says:

> [T]he standard of conduct for directors requires that they strive in good faith and on an informed basis to maximize the value of the corporation for the benefit of its residual claimants, the ultimate beneficiaries of the firm's value, not for the benefit of its contractu-

179. *Gheewala*, 930 A.2d 92, at 101.

180. *In re* Trados, Inc., S'holder Litig. (*Trados II*), 73 A.3d 17 (Del. Ch. 2013).

181. *Id.* at 63–64.

182. *Id.* at note 16 (citing Jesse M. Fried & Mira Ganor, *Agency Costs of Venture Capitalist Control in Startups*, 81 N.Y.U. L. REV. 967 (2006)); Baird & Henderson, *supra* note 97; William W. Bratton & Michael L. Wachter, *A Theory of Preferred Stock*, 161 U. PA. L. REV. 1815 (2013).

183. *Trados II*, 73 A.3d at 20 ("Directors of a Delaware corporation owe fiduciary duties to the corporation and its stockholders which require that they strive prudently and in good faith to maximize the value of the corporation for the benefit of its residual claimants."); *id.* at 46–47 ("When exercising their statutory responsibility, the standard of conduct requires that directors seek 'to promote the value of the corporation for the benefit if its stockholders.'") (footnote omitted, but citing *eBay*, and *Gheewala*, among others); *id.* at 48 (citing other prior cases which the court says "capture . . . the foundational relationship in which directors owe duties to the corporation for the ultimate benefit of the entity's residual claimants. Nevertheless, 'stockholders' best interest must always, within legal limits, be the end. Other constituencies may be considered only instrumentally to advance that end."); *id.* at 49 ("Equity capital, by default, is permanent capital. In terms of the standard of conduct, the duty of loyalty therefore mandates that directors maximize the value of the corporation over the long-term for the benefit of the providers of equity capital, as warranted for an entity with perpetual life in which the residual claimants have locked in their investment. When deciding whether to pursue a strategic alternative that would end or fundamentally alter the stockholders' ongoing investment in the corporation, the loyalty-based standard of conduct requires that the alternative yield value exceeding what the corporation otherwise would generate for stockholders over the long-term.") (footnotes omitted); *id.* at 63–64 (as cited in text *infra*).

> al claimants. In light of this obligation, it is the duty of directors to pursue the best interests of the corporation and its common shareholders, if that can be done faithfully with the contractual promises owed to the preferred. . . . This principle is not unique to preferred stock; it applies equally to other holders of contract rights against the corporation. Consequently . . . in circumstances where the interests of common stockholders diverge from those of the preferred stockholders, it is possible that a director could breach her duty by improperly favoring the interests of the preferred stockholders over those of the common stockholders.[184]

One can quibble about the extent to which the decisions in these cases are limited to the special facts—in both *Trados* and *eBay*, the facts involved closely held corporations in which controlling shareholders were accused, in effect, of squeezing out the noncontrolling shareholders and depriving them of the benefits of ownership of their shares.[185] This is the same context in which most of the clear statements of courts about the importance of maximizing value for shareholders is stressed.[186] Leo Strine, however, is now the Chief Justice and in his scholarly writings he has increasingly adopted a view that is consistent with the pronouncements by Vice Chancellor Laster about the importance of focusing on the benefit to common shareholders.[187] One effect of these decisions, Sepe worries, is that Delaware courts are more strictly enforcing the duty of undivided loyalty, "virtually depriving constituency directors of any effective role."[188] The courts may also make it more difficult in the future for boards to play a mediating role that might otherwise be an important private ordering solution to the team production problem in their firms.

IV. CONCLUSIONS

Scholarship on the idea of a mediating function for boards of directors of corporations has, in recent years, suggested that participants in corporations may prefer to choose an arrangement in which decisionmaking is delegated to an independent and unbiased board as a

184. *Id.* at 63–64.

185. It is notable that neither of these cases were appealed, so the Delaware Supreme Court has not affirmed that these opinions properly state Delaware law.

186. Smith, *supra* note 83.

187. *See, e.g.*, Leo E. Strine, Jr., *Our Continuing Struggle with the Idea That For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135 (2012). *See also* Leo E. Strine, Jr. et al., *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L.J. 629, 634 (2010) ("[I]t is essential that directors take their responsibilities seriously by actually trying to manage the corporation in a manner advantageous to the stockholders.").

188. Sepe, *supra* note 119, at 345.

private ordering solution to problems that have the characteristics of team production problems. Such characteristics include productive activity that requires complex, difficult to measure, and difficult to contract inputs; inputs that must come from a number of participants; and an output of the productive activity that is "nonseparable," in that it is not possible to determine *ex post* what portion of the output was produced by each participant. These characteristics make it difficult or impossible to write contracts with team members, which provide incentives for them to fully contribute, while also adequately protecting the team-specific investments they make in pursuing the enterprise. The delegation of key decision rights to a "mediating hierarchy" is one solution to this problem. Blair and Stout, in 1999, argued that the laws governing decisionmaking by boards of directors in publicly traded corporations are more consistent with a mediating function than with a requirement that directors must maximize share value. Since then, a growing body of evidence suggests that in many private corporations, board structures are being chosen explicitly so that independent directors can carry out a mediating function.

The Demoulas Supermarkets board, at one point, was apparently structured in this way, with two representatives of each side of the family on the board, as well as three individuals chosen by majority vote of all shareholders, three who, in theory, were supposed to be unaligned.[189] Such arrangements can be fragile, however, if the "independent" directors are not truly unaligned. Until recently, the Arthur T. side of the family controlled the selection of the three independent members, because one member of the Arthur S. side who controlled 5.5% of the shares voted with the Arthur T. side, thereby tipping the balance slightly in favor of Arthur T.[190] All was not peace and light under that arrangement, as transcripts from board meetings obtained by the Boston Globe reveal.[191] Arthur S. and the board member appointees from his side of the family continually challenged Arthur T.'s authority to enter into sizeable real estate transactions without approval from the board, and were generally fearful and distrustful that the Arthur S. side of the family was being taken advantage of. Nonetheless, as one observer noted, the stores stayed open, the employees went to work, and the customers came.[192] In the summer

189. Adam Vaccaro, *Get to Know Market Basket's Shareholders and Board of Directors*, BOSTON.COM (July 30, 2014), http://www.boston.com/business/news/2014/07/30/get-know-market-basket-shareholders-and-board-directors/dCJhLBCsjlU3JQQfFq71qO/story.html.

190. *See* Welker, *supra* note 23.

191. *See* Casey Ross, *Market Basket Board Meetings the Stage for Family Strife*, BOSTON GLOBE (Aug. 15, 2014), http://www.bostonglobe.com/business/2014/08/14/behind-closed-doors-demoulas-cousins-feud-raged/0dc9gC2d7tNlk9oTH4QIuK/story.html.

192. *Id.*

of 2013, the shareholder from the Arthur S. side who had been voting with the Arthur T. side switched sides.[193] The result was that, within a year, according to news accounts about the family feud, there was "a shake-up on the board of directors . . . which led to a controversial $300 million special payout to family shareholders, and ultimately, the ouster . . . of popular CEO and 40-year employee Arthur T. Demoulas."[194] There was so much bad blood between the two branches of the clan that the stalemate threatened to completely destroy the firm, causing the governors of Massachusetts and New Hampshire to jointly engage with both sides to try to get them to come to an agreement.[195] The governors openly appealed to both sides to end the dispute so that employees could get back to work and customers could return to shop at the store they apparently loved. The story has not yet come out about what exactly the two governors did, but the theory of mediating boards examined in this Article suggests that they would not have had to do much—the mere fact that they were unaligned may have been what was needed to get each of the sides to moderate their demands. On August 27, 2014, the parties reached an agreement, by which the Arthur T. side will buy out the Arthur S. side in late 2014 or early 2015, and Arthur T. returned to work as CEO of the company.[196]

There is no doubt that the Market Basket story is unusual in many respects, but the basic scenario of joint participants in a corporate enterprise—team members—contending with each other over how the wealth created by the corporation will be divided up is not. In these situations, decisionmaking by trusted intermediaries can help keep the team functioning together.

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193. *See* Welker, *supra* note 23.

194. *Id.* at 1.

195. *See* Philip Marcelo, *Governors Say Deal May Come Soon in Market Basket Feud*, PATRIOT LEDGER (Aug. 23, 2014), http://www.patriotledger.com/article/20140823/News/140828281.

196. *See* Ross, *supra* note 2.