“CAPTURED BOARDS”: THE RISE OF “SUPER DIRECTORS” AND THE CASE FOR A BOARD SUITE

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Boards of public corporations in the United States are becoming increasingly independent due to an effort to ensure that shareholders’ interests in the company are protected. Yet, little attention has been given to the way that board members obtain and digest the information necessary for their independent decision-making. In this Article, we highlight how “independent” boards remain extremely dependent on management for the information they need to accomplish their role—what we classify as the “informational capture” of the board. We further describe how activist hedge funds identified this capture and are using what is commonly termed as “super directors” to mitigate it. Contrary to many who cast the rise of activist super directors in a negative light, we assert that super directors are not a new phenomenon, that they are not limited to activist nominees, and that they perform an important role in mitigating the board’s informational capture. We further show that this positive role carries several important doctrinal implications for the way Delaware law treats these nominees. However, while activist super directors serve an important role in mitigating this capture, they are far from a perfect solution. Therefore, we propose a more systematic approach to mitigating the board’s capture. Specifically, we call for the creation of a “Board Suite”—a dedicated office within the board that would be in charge of independent data collection and dissemination, therefore minimizing the dependence of the board on management for its information.

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We wish to thank Lucian Bebchuk, Charles Elson, Jesse Fried, Jeffery Gordon, Assaf Hamdani, Michelle Harner, Roy Shapira, Brian L. Schorr, and the participants at the National Business Law Schools conference and at the John L. Weinberg Center for Corporate Governance 2017 Corporate Governance Symposium for their helpful comments. Eric Martin provided valuable research assistance.

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INTRODUCTION

United Airlines is a household name and one of the three major air carriers in the United States. The company has, however, been outperformed by its major competitors over the last few years. Consequently, in March 2016, two activist hedge funds, PAR Capital Management and Altimeter Capital Management, which together owned 7.1 percent of United, launched a campaign against the company's current board calling for the appointment of six new directors.[1] The activists highlighted the board's perceived lack of experience in the airline industry and termed the board "underqualified, ineffective, complacent, . . . entrenched,"[2] and "lack[ing] . . . leadership"[3] that is "too stale to effectively represent stockholders."[4] Furthermore, despite the fact that ten out of thirteen United directors were independent at the time of the engagement,[5] the activists raised serious concerns with regard to the company's succession planning, the compensation

1. Altimeter Capital Mgmt. & PAR Capital Mgmt., *United Shareholders Altimeter Capital and PAR Capital Express Disappointment in the United Board for Misleading United Stakeholders*, PR NEWSWIRE (Mar. 22, 2016, 4:15 PM), http://www.prnewswire.com/news-releases/united-stockholders-altimeter-capital-and-par-capital-express-disappointment-in-the-united-board-for-misleading-united-stakeholders-300239902.html [https://perma.cc/EJM6-J3K3].

2. UNITED CONTINENTAL HOLDINGS, INC., AIRLINE INDUSTRY VETERAN GORDON BETHUNE LEADS STOCKHOLDER-NOMINATED SLATE FOR ELECTION TO THE UNITED CONTINENTAL HOLDINGS, INC. BOARD OF DIRECTORS (FORM EX-99.2) 2 (2016).

3. *Id.* at 3.

4. *Id.*

5. UNITED CONTINENTAL HOLDINGS, INC., PROXY STATEMENT (FORM DEF 14A) 21 (2015).

structure of the CEO, and insufficient disclosures by the board about the health status of the company, CEO, and a recent investigation into the airline's dealings with the Port Authority of New York and New Jersey, which led to resignation of the former CEO.[6] The activists also highlighted the fact that the current chairman of the board lacked any relevant airline operating expertise.[7]

The activists' pressure proved effective. First, in the course of the engagement with the activists, United announced that its board had appointed three new independent directors with deep industry experience.[8] Second, in a settlement between the parties that was reached in April 2016, United agreed to add two activist nominees to its board: Barney Harford, former chief executive of Orbitz, and Edward Shapiro, a partner at PAR Capital Management,[9] as well as an additional, mutually agreed independent director.

The United example is indicative of a larger trend in the United States corporate landscape. Shareholders are becoming increasingly active and often challenge management and boards to achieve what they consider much needed changes.[10] Indeed, directors nominated by activist hedge funds[11] increasingly gain board seats across corporate America.[12] And while the presence of activist directors in boardrooms is far from a new occurrence, the academic and public discourse around this important phenomenon has focused mainly around its impact on the

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6. Jeffrey Dastin & Alwyn Scott, *Activist Investors Question United Airlines CEO's Board Role*, REUTERS (Mar. 14, 2016, 7:13 AM), http://www.reuters.com/article/us-ual-board-idUSKCN0WF0EA [https://perma.cc/Y52E-LCPD]. *See also* Josh Beckerman & Doug Cameron, *One of United Continental's Largest Shareholders Declares Activist Position*, WALL ST. J. (Jan. 26, 2016, 7:44 PM), http://www.wsj.com/articles/two-united-investors-report-activist-stakes-1453847880 [https://perma.cc/N2CQ-KWYX] (noting that the "airline's surprise Jan. 6 announcement that Mr. Munoz underwent a heart transplant raised questions about how and when the airline disclosed information about his health status").

7. Altimeter Capital Mgmt. & PAR Capital Mgmt., *supra* note 1.

8. UNITED CONTINENTAL HOLDINGS, INC., PROXY STATEMENT (FORM DEFA 14A) 2 (2016).

9. Jeffrey Dastin & Michael Flaherty, *United Airlines Bows to Activists, Adds Directors*, REUTERS (Apr. 20, 2016, 6:36 PM), http://www.reuters.com/article/us-unitedcontinental-board-idUSKCN0XH06Q [https://perma.cc/Q26E-UHPU].

10. *See, e.g.*, *infra* note 64.

11. Hedge funds may act as activist investors by accumulating large, but non-controlling, stakes in target companies in order to bring about change in the company's strategic, operational, or financial activity, often while threatening to nominate their representatives to the board. For a detailed definition, see Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1734–36 (2008).

12. *See, e.g.*, *infra* note 65.

short- and long-term performance of the company.[13] We argue that shareholder activism in the context of the board function has an additional and important benefit that has received little attention so far; activist appointed directors play an important role in improving and bridging the informational asymmetries that the current monitoring structure of the United States board room suffers from.

Over the last few decades the composition of United States public firms' boards of directors has seen a dramatic shift.[14] Board rooms controlled by company executives have been replaced with board rooms that are independent, which in many cases consist of the CEO as the lone executive in the room.[15] This ongoing shift, which was aimed to ensure that shareholders' interests in the corporation are properly represented and protected, has accelerated during the last decade.[16] Academic discourse, the trend towards the shareholder franchise approach, and corporate scandals that brought about regulatory reforms have all led to this push toward more independent boards.[17]

But, the move towards independent boards is not without costs. Indeed, academic literature and public discourse have focused on the negative impact director independence may have on the board's *advisory* role and company performance.[18] Yet, little attention has been given to the impact of the current independent board structure on the

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13. *See infra* note 76.

14. *See* Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1473 (2007); *see also* Yaron Nili, *The "New Insiders": Rethinking Independent Directors' Tenure*, 67 HASTINGS L.J. 97, 99–100 (2016).

15. SPENCER STUART, SPENCER STUART BOARD INDEX 2014, at 8 (2014), http://www.spencerstuart.com/research/articles/1621/ [https://perma.cc/5LTB-L575] (noting that in fifty-nine percent of the S&P 500 companies the CEO is the only company employee in the boardroom).

16. *See* Gordon, *supra* note 14, at 1540.

17. *Id.* at 1472–76.

18. *See* Nili, *supra* note 14, at 99–103. The board of directors

> has been entrusted with several different important roles in the governance of the corporation. First, while most of the operational decision making can be, and is, delegated to management, the board is still required to be an active participant in some of the more important managerial business decisions, such as mergers, stock issuance and change of company governance documents. Second, the board is a resource for management to utilize, providing insight and advice as well as networking benefits, and facilitating the firm's access to various resources [which is often termed as the board's advising role]. Third, the board is charged with a monitoring role, making sure that shareholder interests are fully served, in an effort to constrain the agency costs associated with a managerial centric corporation model. While each board serves all of these functions, the primary role and purpose of the board in the governance of the corporation has changed significantly over the years.

Id. at 105 (citations omitted).

board's ability to effectively carry its *monitoring* role—the main goal for which director independence was sought after. We seek to address this gap by highlighting how board independence may have actually diminished the board's ability to effectively monitor management.

Independent board members suffer from what we term as "informational capture."[19] As part-time employees who often sit on multiple boards, outside directors lack the time, adequate resources, and the industry-specific knowledge to properly obtain, digest, and analyze the extensive and complex information that modern boards are tasked with evaluating. Consequently, independent directors are too dependent on the information management chooses to provide or conceal, as well as on the manner management presents it to the board. These institutional constrains have led to the following paradox: shareholders, courts, and regulators expect the board to be independent—to ensure its ability to monitor management. But at the same time, the current composition of the board room, dominated by "outside" independent directors, severely limits the ability of the board to independently obtain complete and unfiltered information regarding the company, a *prerequisite* to the board's ability to properly perform its monitoring role.

Therefore, the board often monitors management's actions while wearing "filtered glasses" that are provided by the same executives the board is tasked to monitor. Considering these structural hurdles, it is not surprising the activists in the aforementioned engagement with United Airlines claimed that the board was "underqualified, ineffective, complacent, and entrenched"[20] and "lacks sufficient leadership, expertise, and experience to challenge management."[21]

Activist hedge funds, we further argue, identified this informational gap, and have filled this vacuum through what is commonly termed as "super directors": directors who, due to the backing and resources of the activist fund that appointed them, can transcend the limitations that "ordinary" directors have been suffering from due to their part-time role at the company and their limited access to information.[22] Activist super directors, who enjoy the full resources of the hedge fund that appointed them, have the ability to collect, process, and edit voluminous information in a timely fashion, independently of management. The activists' working product is then provided to the entire board, through its director nominee, allowing

19. For additional discussion on the informational capture of the board, see Ann C. Mulé & Charles M. Elson, *A New Kind of Captured Board*, DIRECTOR EVALUATION, First Quarter 2014, at 27, 27-29.

20. *See* UNITED CONTINENTAL HOLDINGS, INC., *supra* note 2.

21. *Id.*

22. *See infra* Section II.A.

other independent board members to base their decision-making on a more balanced and complete picture. Contrary to many who cast the rise of activist super directors in a negative light,[23] we show that super directors are not a new phenomenon, are not limited to activist nominees, and most importantly, serve as a key channel for mitigating boards' informational capture.

But our argument extends deeper. First, we show that this positive informational role performed by the activist super directors carries an important doctrinal implication for the way courts should treat information sharing between board members and the activist investors that nominated them. Second, while the recent rise of activist super directors indeed underscores the importance of addressing boards' informational capture, we argue that the current model of activist directors provides only a partial remedy to such a fundamental, structural problem. Activist nominees are self-made—almost Band-Aid-like—solutions that fall short of addressing the core issue. Activist interventions are limited to a small number of companies, last a limited time, and do not promote the creation of institutional knowledge within the boardroom. Therefore, as a structural matter, a board that is comprised of part-time outside directors is doomed to suffer from these information deficiencies.

Addressing the issue at its core, thus, requires a rethinking of the current board structure and how this structure correlates with the board's role as a monitor. Since the independence of directors has become a key governance demand, and as boards have shifted into a monitoring role, the board as an institution must provide independent directors with tools to monitor and examine management. To achieve that goal, we call for the creation of a new institution within the board: the "Board Suite." Such suite is a dedicated office within the board, consisting of a full-time special counsel to the board (and supporting staff) that would serve as information facilitators: requesting information and collecting outside sources, receiving the information requested, editing it, and providing it in a simple, clear, and efficient way to the board with a critical eye on management's actions. This office would become the institutional knowledge base of the board—unmoved by the personal changes the board room experiences—and is likely to alleviate the information capture that boards currently suffer from.

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23. *See, e.g.*, Martin Lipton, *Bite the Apple; Poison the Apple; Paralyze the Company; Wreck the Economy*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Feb. 26, 2013), http://corpgov.law.harvard.edu/2013/02/26/bite-the-apple-poison-the-apple-paralyze-the-company-wreck-the-economy/ [https://perma.cc/8RKN-BG6E]; Ira M. Millstein, *Re-examining Board Priorities in an Era of Activism*, N.Y. TIMES (Mar. 8, 2013, 3:52 PM), https://dealbook.nytimes.com/2013/03/08/re-examining-board-priorities-in-an-era-of-activism/ [https://perma.cc/PQE5-W4DK].

We also address potential objections to our proposed solution and highlight its doctrinal implications on Delaware case law. For instance, acknowledging board informational capture could potentially lead Delaware courts to conclude that a board, which refrains from independently gathering the needed information and blindly relies on management, may not be afforded the protections from personal monetary liability provided by Sections 141(e) and 102(b)(7) of the Delaware Code.[24]

The rest of this Article is organized as follows: Part I describes the information dependency of independent directors. Part II discusses the rise of activist super directors as a means to mitigate this dependency while also highlighting how super directors are already in existence in many other similar cases. Part III explains why activist super directors are not an adequate solution to the informational capture concerns. Part IV introduces our proposed solution to the concern of board capture: the establishment of a Board Suite. Part V addresses potential concerns and objections to the establishment of a Board Suite. Part VI details the doctrinal implications of our proposed solution. We then provide a brief conclusion.

I. "CAPTURED BOARDS"

Over the last few decades, the composition of United States public firms' boards of directors has undergone a major shift.[25] Independent directors began holding an increasingly larger portion of corporate board seats, replacing company employees, commonly referred to as "insiders."[26] The movement toward "independent" boards, which was mainly market driven until the early 2000s,[27] has been further intensified by the corporate scandals that took place in the past decades and the regulatory reforms following it, including the Sarbanes-Oxley Act[28] (SOX) and the Dodd-Frank Act.[29] Motivated by the belief that

24. *See infra* Section VI.B.

25. *See* Gordon, *supra note* 14, at 1473–75.

26. "Insiders" will be used in this Article to mean company executives and employees.

27. State law has developed to require the approval of self-dealing transactions by disinterested directors, often independent directors. This requirement along with the need for special independent committees pushed companies to include more independent directors in their board room. *See* Gordon *supra* note 14, at 1473 (showing a decrease in the percentage of inside directors from 49% in 1950 to 21% in 1995 and to 16% in 2000 well before the SOX requirements were put in place).

28. SOX directly regulated several aspects of the audit committee of the board, essentially requiring listing agencies, such as the NYSE and NASDAQ, to amend their listing standards so that a board have an audit committee, and that the audit committee be comprised entirely of independent directors. *See* SEC. & EXCH. COMM'N, STANDARDS RELATING TO LISTED COMPANY AUDIT COMMITTEES,

inside directors encounter greater difficulties to effectively monitor corporate officers—and that independent directors are better equipped to detect fraud, protect shareholders' interests, and monitor managerial abuse of authority—regulatory reforms forced United States exchanges to enhance their director independence requirements.[30] These subsequent amendments to listing standards require public firms to populate their boards and committees with independent directors.[31] Nowadays, the NYSE and NASDAQ listing standards mandate that a majority of the board members of public companies be independent of management and that the audit, compensation, and nominating committees be composed entirely of independent directors.[32]

Indeed, while in the 1950s, forty-nine percent of board members were company insiders; however, by 2005, only approximately twenty-five percent remained insiders.[33] Today, in the majority of the S&P 500

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https://www.sec.gov/rules/final/33-8220.htm [https://perma.cc/97W7-EX7B] (last visited Feb. 6, 2017). Additionally, following SOX, listing agencies, such as the NYSE and NASDAQ, require a majority of the members of the board of directors of listed companies be independent of management and each member of the nominating committee be independent. *See id.*

29. Section 952 of the Dodd-Frank Act and Rule 10C-1 of the Securities Exchange Act of 1934 direct the national securities exchanges to adopt new listing standards applicable to compensation committees. *See* 17 C.F.R. § 240.10C-1 (2016). In particular, the SEC rules and the proposed listing requirements of the stock exchanges require boards to take into consideration the following when assessing the independence of compensation committee members: (1) the source of compensation of the director, including any consulting, advisory, or other compensatory fee paid by the issuer to the director; and (2) whether the director is affiliated with the issuer, its subsidiaries or their affiliates. *Id.*

30. *See* Gordon, *supra* note 14, at 1538–40; *see also* William W. Bratton & Michael L. Wachter, *Tracking Berle's Footsteps: The Trail of the Modern Corporation's Last Chapter*, 33 SEATTLE U. L. REV. 849, 866 (2010).

31. *See* Melissa Maleske, *8 Ways SOX Changed Corporate Governance*, INSIDECOUNSEL MAG. (Jan. 1, 2012), http://www.insidecounsel.com/2012/01/01/8-ways-sox-changed-corporate-governance [https://perma.cc/W7YH-QFXJ]. For example, SOX mandated the creation of an "audit committee of the board that has greater powers and many more responsibilities than ever before, such as working with external auditors of internal controls." *Id.*

32. N.Y. STOCK EXCH., NYSE LISTED COMPANY MANUAL, §§ 303A.01, 303A.04-06, http://nysemanual.nyse.com/LCM/Sections/ [https://perma.cc/8JGM-3LMN] (last visited Feb. 21, 2017); NASDAQ, NASDAQ MARKETPLACE RULES, §§ 5605(b)(1), 5605(c)(2), 5605(d)(2), and 5605(e), http://nasdaq.cchwallstreet.com [https://perma.cc/Y2SG-E4TD] (last visited Feb. 21, 2017); *see also Developments in the Law—Corporations and Society*, 117 HARV. L. REV. 2169, 2194–95 (2004) ("[T]he revised listing standards of both the NYSE [New York Stock Exchange] and NASDAQ . . . require (with few exceptions) that listed-company boards have a majority of independent directors.").

33. *See* Gordon, *supra* note 14, at 1473 n.9; Urska Velikonja, *The Political Economy of Board Independence*, 92 N.C.L. REV. 855, 865 (2014).

companies, the CEO is the lone company insider in the boardroom.[34] Moreover, while only a majority of the board is required to be independent in order to comply with the regulatory requirements, independent directors, as currently defined, now make up eighty-four percent of all board members, the highest share ever.[35] This percentage reflects an ongoing increase in the ratio of independent directors to non-independent directors from 3.6:1 a decade ago to 5.4:1 today.[36]

This transition from an insider-dominated board to an "independent" board, and consequently from an advisory-focused role to a monitoring-oriented role, created an informational problem that stands at the heart of our project. In particular, the move toward board independence generated severe informational asymmetries between top executives and outside directors that limit the ability of the board to closely monitor such executives and to properly perform their role.[37] This informational capture manifests itself in several ways.

First, directors usually lack direct access to company information. As outsiders who do not engage in the daily affairs of the corporation, independent directors rely heavily on company insiders, and, in particular, on the CEO, as the source of information.[38] As a survey from 2007 demonstrates, only ten percent of directors were able to access the corporation's information independently, through an online board portal.[39] Therefore, the ability of an independent board to effectively monitor management and discharge their oversight responsibilities is based almost exclusively on the information obtained, screened, and then shared by management.[40] However, since

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34. *See* STUART, *supra* note 15, at 8 (noting that in fifty-nine percent of the S&P 500 companies the CEO is the only company employee in the boardroom).

35. *Id.* Data used in this part was collated from several reports. *See, e.g.*, KORN/FERRY INTERNATIONAL, 33RD ANNUAL BOARD OF DIRECTORS STUDY (2006), http://www.kornferry.com/institute/231-33rd-annual-board-of-directors-study [https://perma.cc/3ZH5-UC65]; RAJEEV KUMAR, GEORGESON, 2014 ANNUAL CORPORATE GOVERNANCE REVIEW (2014), http://www.georgeson.com/us/resource/Pages/acgr.aspx [https://perma.cc/Y37P-FRS5]; PRICEWATERHOUSECOOPERS LLP, INSIGHTS FROM THE BOARDROOM 2012: PWC'S ANNUAL CORPORATION DIRECTORS SURVEY (2012), http://www.pwc.com/us/en/financial-services/events/assets/pwc-annual-corporate-directors-survey.pdf [https://perma.cc/M9ED-NWM7]; SHEARMAN & STERLING LLP, 10TH ANNUAL SURVEY: CORPORATE GOVERNANCE OF THE LARGEST US PUBLIC COMPANIES (2012), http://corpgov.shearman.com/about-the-survey [https://perma.cc/3LKW-A39L].

36. STUART, *supra* note 15, at 8.

37. Robert J. Thomas et al., *How Boards Can Be Better—a Manifesto*, 50 MASS. INST. TECH. SLOAN MGMT. REV. 69, 72 (2009).

38. *Id.*

39. *Id.*

40. Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127, 161–67 (2010) (describing directors' information and knowledge

management decides what information to include in the board package, this information may be influenced, even unintentionally, by the outcome it desires to achieve. When screening the information for the board, company insiders may focus on information that supports their position and ignore information that undermines it.[41] Insiders could also intentionally provide outside directors with limited information, or even manipulate the data presented to the board.[42] The absolute reliance on management as the information provider also makes it difficult for independent directors to verify the accuracy of the information.[43]

Second, outside directors suffer from information overload and they often lack the appropriate resources to properly process and analyze the voluminous information they are often presented within a timely manner. Independent directors are part-time employees who often sit on other boards or have other professional commitments, and thus cannot devote more than a few hours per month to their role as directors.[44] The board meets only a handful times a year[45] and they need to cover an extensive set of materials before their meetings, which is often submitted to them at the last minute.[46] Under such circumstances, and without any external assistance, they are simply unlikely to have the time to properly digest and assimilate all the information they are given.[47]

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limitations); *see generally* Nicola Faith Sharpe, *The Cosmetic Independence of Corporate Boards*, 34 SEATTLE U. L. REV. 1435, 1453–54 (2011).

41. RICHARD M. CYERT & JAMES G. MARCH, A BEHAVIORAL THEORY OF THE FIRM 169, 171 (2d ed. 1992). This tendency to identify information that confirms our expectations and disregards information that does not is known as confirmation bias. Kristin N. Johnson, *Addressing Gaps in the Dodd-Frank Act: Directors' Risk Management Oversight Obligations*, 45 U. MICH. J.L. REFORM 55, 103–04 (2011).

42. In a survey "independent directors were found to be less satisfied with the financial, operational and strategic information they received than their nonindependent counterparts." *See* Thomas et al., *supra* note 37, at 72.

43. *See id.*

44. PRICEWATERHOUSECOOPERS LLP, TRENDS SHAPING GOVERNANCE AND THE BOARD OF THE FUTURE: PWC'S 2015 ANNUAL CORPORATE DIRECTORS SURVEY (2014), http://www.pwc.com/us/en/corporate-governance/annual-corporate-directors-survey/assets/annual-corporate-directors-survey-full-report-pwc.pdf [https://perma.cc/747C-7NF5] (noting that the average time commitment of public company directors was 219 hours in 2013; that is 18 hours per month) [hereinafter PwC].

45. Sharpe, *supra* note 40, at 1453.

46. *Id.* at 1453–55.

47. *See, e.g.*, Nicola Fiaith Sharpe, *Informational Autonomy in the Boardroom*, 2013 U. ILL. L. REV. 1089, 1119 ("The 2001 Tyco board is an excellent example of failure to assimilate information. The board knew of the executive loan program that resulted in public scandal, yet it did not investigate the loan terms or look into whether then-CEO Dennis Kozlowski had repaid the loans. The result was a board that blindly trusted its CEO and that failed to investigate or process the information it had been given.").

Third, while many outside directors—who are not former employees of the companies (or of other companies that operate in the same industry)—may have general business skills, most of them lack the relevant firm or industry-specific knowledge.[48] These directors are likely to encounter obstacles to properly analyze the industry-specific information presented to them.[49] Gaining sufficient knowledge about the different activities of a company takes time and energy. Independent directors, who devote about half an hour per day to the company's affairs, are limited in their ability to overcome this knowledge deficit fast.[50] This informational problem becomes worse considering the increasing complexities involved with many of today's businesses and the fast-evolving business technologies in which many firms operate.[51] The knowledge deficit also increases the likelihood that independent directors may feel uncomfortable challenging managerial decisions that they do not understand, and will further prompt deference to management and undermine directors' ability to be effective monitors.[52]

Finally, the informational problem of outside directors could also aggravate other behavioral biases, such as group thinking, from which board members suffer. It has been well recognized that structural biases and group thinking could prevent board members from expressing independent views.[53] According to this view, "the likelihood that [an

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48. Fairfax, *supra* note 40, at 164–65 ("Except in the audit committee, no reform focuses on the affirmative skills or knowledge directors need in order to properly perform their responsibilities. . . . [W]hile many directors have knowledge about general business matters, few have knowledge regarding the particular industry on whose board they sit, and even fewer have knowledge about the specific company on whose board they sit."). *See* Sarbanes-Oxley Act of 2002 § 407, 15 U.S.C. § 7265 (2012).

49. *See* THE KORN/FERRY INST., 34TH ANNUAL BOARD OF DIRECTORS STUDY 10 (2007). The Korn/Ferry survey found that directors spent an average of sixteen hours a month on board business. *Id.* at 4–5. The sixteen hours include "the time taken reviewing and preparing, attending meetings and traveling." *Id.* at 10.

50. *Id.* at 10, 27. Board members spend more time at their duties, averaging eighteen hours per month. PwC, *supra* note 44.

51. *See* James P. Holdcroft & Jonathan R. Macey, *Flexibility in Determining the Role of the Board of Directors in the Age of Information*, 19 CARDOZO L. REV. 291, 294–95 (1997).

52. Fairfax, *supra* note 40 ("Such scholars maintain that a monitoring system that relies on people without sufficient knowledge is not only inefficient, but potentially damaging."); *see also* Erica Gorga & Michael Halberstam, *Knowledge Inputs, Legal Institutions and Firm Structure: Towards a Knowledge-Based Theory of the Firm*, 101 NW. U. L. REV. 1123, 1125 (2007).

53. For a discussion of structural bias, see Fairfax, *supra* note 40, at 152–53; *see also* Claire A. Hill & Brett H. McDonnell, *Disney, Good Faith, and Structural Bias*, 32 J. CORP. L. 833 (2007); Antony Page, *Unconscious Bias and the Limits of Director Independence*, 2009 U. ILL. L. REV. 237; Julian Velasco, *Structural Bias and the Need for Substantive Review*, 82 WASH. U. L.Q. 821 (2004). For a discussion of

independent director] will be willing to criticize the CEO . . . is limited because her decision making is influenced by boardroom norms" and "the desire for unanimity."[54] Building on that view, we further argue that the heavy reliance of outside directors on top management as a source of information, and their limited ability to properly digest and analyze large amounts of information, may further exacerbated those cognitive biases and further reduce the chances that an outside director will express an independent view.

Indeed, our claim regarding the board's information capture is further supported by a 2015 survey that covers 783 public company directors, seventy-four percent of whom serve on boards of companies with more than $1 billion in annual revenue.[55] The survey reveals that when it comes to the quality of information that directors receive from management, as well as the format and timing of board materials, "[t]here is a lot of room for improvement."[56] For instance, "[m]ore than two-thirds of directors 'somewhat' or 'very much' wish their materials better highlighted risks related to the issue being discussed."[57] "[T]he format and timing of board materials could also be improved; more than half of directors at least 'somewhat' wish the materials were shorter and more summarized and forty-six percent at least 'somewhat' wish they were provided with more lead time."[58] Many directors also criticized management domination over boardroom discussions.[59] "Nearly half of the polled directors at least 'somewhat' wish the dialogue with management was less scripted or controlled."[60] Management's control over information also allows it to limit the scope of issues being discussed, as well as the time devoted to consideration.[61] As a result, two-thirds of the surveyed directors want at least "some"

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groupthink, see Marleen A. O'Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CIN. L. REV. 1233 (2003).

54. Nicola Faith Sharpe, *Process Over Structure: An Organizational Behavior Approach to Improving Corporate Boards*, 85 S. CAL. L. REV. 261, 287 (2012).

55. PRICEWATERHOUSECOOPERS LLP, GOVERNING FOR THE LONG TERM: PWC'S 2015 ANNUAL CORPORATE DIRECTORS SURVEY (2015), http://progresomicrofinanzas.org/wp-content/uploads/2016/02/pwc-2015-annual-corporate-directors-survey.pdf [https://perma.cc/KL7U-GPMA] (also noting that the "board tenure of participants was dispersed relatively evenly" and that "[w]hile participants came from nearly two dozen industries, with the leading sectors represented are industrial products, energy, insurance, and banking").

56. *Id.* at 22.

57. *Id.*

58. *Id.*

59. *Id.* at 23.

60. *Id.*

61. *Id.* at 20.

additional boardroom time and focus on strategy, and one-in-five want much more time and focus.[62]

In sum, independent board members face significant informational challenges, which are inherent to their role as outside directors and negatively affect their ability to effectively monitor management. This problem is traced to the significant reliance of outside directors on management as the source of information, to their lack of time and adequate resources to properly digest and analyze large amounts of information, and their lack of knowledge regarding the particular industry or specific characteristics of the firm on whose board they sit. Outside board members are also likely to encounter difficulties to look for information and explanations that extend beyond that which such insiders provide them.

This complete dependence on management for information gathering and processing severely limits the board's ability to monitor the company's insiders, to engage in optimal decision making, and to comply with their duty of care requirements.[63] Instead of being beholden to the information received from the company CEO, directors need to gain direct access to complete and accurate information as well as the adequate resources to analyze such information independently. The rise of super directors nominated by hedge funds, as described in the next Section, has brought with it the promise to mitigate (at least partially) this information asymmetry problem, and to facilitate better management monitoring.

II. THE RISE OF THE SUPER DIRECTOR

The recent rise of shareholder activism,[64] and the increase in directors appointed by activist investors to board rooms of major public companies in the United States,[65] has supplied public shareholders with

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62. *Id.*

63. Gordon, *supra* note 14, at 1541 ("Uninformed independence has limited value."); Sharpe, *supra* note 40, at 1112 (noting that board's "information gathering and processing is crucial for good monitoring").

64. *See* Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 688–89 (2007) (discussing impediments to replacing boards even when shareholder dissatisfaction is high); Lucian A. Bebchuk et al., *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1087 (2015) (highlighting the recent increase in shareholder activism and creating a debate as to whether such activism is more beneficial or harmful); Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1024 (2007) (noting how hedge fund have become critical players in corporate governance and control).

65. *See, e.g.*, KAREN KANE, KORN/FERRY INST., ACTIVIST INVESTORS TAKE ON THE BOARD (2015), http://www.kornferry.com/institute/activist-investors-take-board [https://perma.cc/4FGV-BNDW]; Ian D. Gow et al., *Activist Directors: Determinants*

what we term as a "super director." This is a director that has been able to transcend the limitations that "regular" directors have been suffering from due to their part-time role, their limited access to information, and, in some cases, lack of sufficient industry-specific knowledge. Indeed, activist shareholders that recognize the informational capture of independent board members seek to promote their proposed reforms by placing their nominees on the target's board or by issuing informational "white papers"[66] that are aimed to mitigate the board informational gaps.

While activist directors have drawn heated criticism, often referred to as "shadow management,"[67] we argue that their presence is mostly a good thing—as these directors reduce the "informational capture" of the board, and in any event the presence of "super directors" in boardrooms is far from a new occurrence. Below we will discuss the function that super directors fill within companies' boards, the benefits such directors provide, and offer a more detailed taxonomy of super directors—showing that activist directors are far from the only manifestation of it.

A. The "Activist" Super Director

Activist investors, led by several prominent hedge funds, have achieved an increasingly important and active role in corporate America. Their participation, alongside other changes to the corporate

and Consequences 1 (Harv. Bus. Sch., Working Paper No. 14-120, 2014); Barbara L. Becker & Eduardo Gallardo, *2015 Year-End Activism Update*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Feb. 5, 2016), https://corpgov.law.harvard.edu/2016/02/05/2015-year-end-activism-update [https://perma.cc/2YPS-XQA8]; Liz Hoffman and David Benoit, *Activist Investors Ramp Up, and Boardroom Rifts Ensue*, WALL ST. J. (April 16, 2015, 2:43 PM), http://www.wsj.com/articles/activists-ramp-up-and-boardroom-rifts-ensue-1429209792 [https://perma.cc/4E8Q-SAWH].

66. "White papers" are detailed analyses produced by major activist hedge funds that discuss "a target's management, operations, capital structure and strategy designed to show that the changes they propose would quickly boost shareholder values." Martin Lipton et al., *Dealing with Activist Hedge Funds*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (June 2, 2015), https://corpgov.law.harvard.edu/2015/06/02/dealing-with-activist-hedge-funds-4/ [https://perma.cc/KWT9-QTBY].

67. Target companies use the term "shadow management" when referring to hedge fund activists looking to get one of its principals on the target's board of directors to gain "access to internal data" and "overcome the 'information advantage' enjoyed by incumbent management teams." Jack Kaskey, *DuPont Heads for Rare Showdown With Activist at Meeting*, BLOOMBERG (May 12, 2015), https://www.bloomberg.com/news/articles/2015-05-12/dupont-heads-for-rare-showdown-with-activist-at-meeting [https://perma.cc/XEA4-UFPR].

landscape,[68] has created a surge in the activism movement in the United States.[69] Most often, these funds get involved after a public call for change, a request for board representation, the threat of a proxy fight to their portfolio companies, and sometimes launching a proxy fight.[70] The increasing involvement of activist hedge funds and the emergence of proxy advisory firms have also stimulated the activism conducted by traditional institutions, leading to an overall increase in the number of shareholders willing to take on an active role in the governance of the corporation.[71]

This surge in activism, coupled with the attention it merits, has propelled activism from a localized occurrence into a matter that dominates both the business arena and corporate governance scholarly discourse. Indeed, activist investors have been lauding this new landscape, with Carl Icahn, one of the most prominent and long-tenured activist investors, stating that "there has never been a better time for activist investing."[72] This golden age of activism is reflected not only in the amount and success rates of activist campaigns[73] but also in the

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68. Among the recent changes are the SEC proxy reform, the establishment of the say-on-pay as part of the Dodd-Frank Act, and the regulation of some private funds. For a review of these changes, see, for example, Lucian A. Bebchuk & Michael S. Weisbach, *The State of Corporate Governance Research*, 23 REV. FIN. STUD. 939 (2010); Aviv Pichhadze, *Is the SEC a Learning Regulator? Lessons from Proxy Access, Regulation & Governance*, 10 REG. & GOVERNANCE 384 (2016); Randle B. Pollard & Tod Perry, *"Grade Incomplete": Examining the Securities and Exchange Commission's Attempt to Implement Credit Rating and Certain Corporate Governance Reforms of Dodd-Frank*, 47 IND. L. REV. 147, 147–48 (2014).

69. *See* Bebchuk, *supra* note 64, at 688–89; Bebchuk et al., *supra* note 64, at 1086–90; Kahan & Rock, *supra* note 64, at 1024, 1072–87.

70. *See generally* Brian R. Cheffins & John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. CORP. L. 51, 69–70 (2011).

71. *See* Stephen J. Choi & Jill E. Fisch, *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance*, 61 VAND. L. REV. 315, 316–19 (2008) (documenting the developing role of public pension funds); David Gelles & Michael J. de la Merced, *New Alliances in Battle for Corporate Control*, N.Y. TIMES (Mar. 18, 2014, 9:40 PM) http://dealbook.nytimes.com/2014/03/18/new-alliances-in-battle-for-corporate-control/?_php=true&_type=blogs&_r=0 [https://perma.cc/LV8Q-CCB9]; Matteo Tonello, *Global Trends in Board-Shareholder Engagement*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Dec. 26, 2014), http://blogs.law.harvard.edu/corpgov/2013/10/25/global-trends-in-board-shareholder-engagement/ [https://perma.cc/V7Q2-E9SG].

72. Sam Forgione, *Carl Icahn Says No Better Time to be an Activist Investor*, REUTERS (Nov. 4, 2013), http://www.reuters.com/article/2013/11/04/us-icahnenterprises-results-idUSBRE9A312F20131104 [https://perma.cc/LL9H-62GG].

73. See *infra* notes 78–84 and accompanying text regarding the rise in success rates of proxy fights; *see also* John J. Madden, *The Evolving Direction and Increasing Influence of Shareholder Activism*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Dec. 23, 2013), http://blogs.law.harvard.edu/corpgov/2013/12/23/the-evolving-direction-and-increasing-influence-of-

sentiment of activist investors themselves. Regulators and academics alike have acknowledged it, too. Former SEC chair, Marry Jo White, has touted the benefits of shareholder activism[74] joining a vast literature that has been supporting the "shareholder franchise" and calling for more shareholder involvement in corporate life.[75]

While academic and public discourse around shareholder activism has focused mainly on the return to shareholders,[76] and the question regarding whether or not shareholder activism is detrimental to the long term value of the company,[77] shareholder activism in the context of the board function has an additional and important benefit. Activist-appointed directors can improve and bridge the informational asymmetries the current monitoring structure of the board suffers from, to the benefit of all shareholders.

One of the key channels through which activist hedge funds attempt to affect changes in their target companies is through board representation.[78] A large number of activist engagements with companies includes a request for the insertion of activist director-nominees to the board room,[79] with the number of campaigns including

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shareholder-activism/ [https://perma.cc/9Y87-TA53] ("[T]he resurgence of contested board elections, which began in 2012, continued into the 2013 proxy season. Proxy contests to replace some or all incumbent directors went from 9 in the first half of 2009 to 19 in the first half of 2012 and 24 in the first half of 2013. And the dissident win rate has increased significantly, from 43% in 2012 to 70% in 2013.") ("Data from Sharkrepellent for 2013 through mid-September shows similar dissident success. For that period, Sharkrepellent reports 37 contests filed and 23 going to a shareholder vote; with a dissident win rate of 65%.").

74. *See* Sarah N. Lynch, *SEC Chair White Touts Benefits of Shareholder Activism*, REUTERS (Dec. 26, 2014), http://www.reuters.com/article/us-sec-shareholder-activism-idUSBRE9B20TC20131203 [https://perma.cc/77KG-QPT2].

75. The main proponent of this movement is Professor Bebchuk. *See* Lucian A. Bebchuk, *Letting Shareholders Set the Rules*, 119 HARV. L. REV. 1784, 1784–85 (2006); Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 883, 886 (2005).

76. For a recent survey of sixty-seven studies that examine the impact of shareholder activism on firm value, see Matthew Denes et al., *Thirty Years of Shareholder Activism: A Survey of Empirical Research*, J. CORP. FIN. (forthcoming). *See also* Kobi Kastiel, *Against All Odds: Hedge Fund Activism in Controlled Companies*, 16 COLUM. BUS. L. REV. 60, 70–71 (2016).

77. Kastiel, *supra* note 76, at 71.

78. *See* Lipton et al., *supra* note 66; Matteo Tonello, *The Activism of Carl Icahn and Bill Ackman*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 29, 2014), https://corpgov.law.harvard.edu/2014/05/29/the-activism-of-carl-icahn-and-bill-ackman/ [https://perma.cc/GY88-AZNM].

79. ACTIVISM MONTHLY, 2015: THE FIRST HALF IN NUMBERS (2015); *see generally* Michael Flaherty & Anjali Athavaley, *U.S. Companies Quicker to Give Board Seats to Activists,* REUTERS (Sept. 25, 2015), http://www.reuters.com/article/us-hedgefunds-activists-insight-idUSKCN0RP0D020150925 [https://perma.cc/TEE6-ST69] ("[D]ata reviewed by Reuters shows that corporate management teams are reaching agreements with activists at the fastest pace since the financial crisis . . . .

such request peaking at 514 in 2014.[80] In many cases, such representation is achieved either through a negotiated settlement or through a proxy fight.[81] Indeed, the last few years have seen a dramatic increase in the success rate of activist campaigns that went to a vote.[82] Voting statistics compiled by FactSet show that since 2001 management has won 222 campaigns for board seats that went all the way to a vote, compared to 143 that were won by activists and 31 campaigns that were split (meaning that only some of the activist nominees were elected).[83] However, in 2013–2014, those numbers have changed dramatically, as only 21 contests for board seats have been won by management, while 31 have been won by activists, and 3 have ended with a split.[84]

When activists obtain a seat on the board, they often elect to place one of their own general partners on the boards,[85] but in many cases they may also have independent directors of their choosing fill the allocated seats.[86] These activist-appointed directors are the most recent,

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Boards have become quick on the trigger to grant seats to activist investors just to avoid a proxy fight."); *Top 10 Topics for Directors in 2016: Shareholder Activism*, AG DEAL DIARY (Feb. 10 2017, 1:54 PM), https://www.akingump.com/en/experience/practices/corporate/ag-deal-diary/top-10-topics-for-directors-in-2016-shareholder-activism.html [https://perma.cc/8NTY-6FJ3].

80. According to a recent report, in 2014, the number of campaigns in which activists sought to have their nominees on the targets board reached 514, the highest since the 2008 financial crisis. *See* David A. Katz, *Engagement and Activism in the 2015 Proxy Season*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Feb. 6, 2015), https://corpgov.law.harvard.edu/2015/02/06/engagement-and-activism-in-the-2015-proxy-season/ [https://perma.cc/3GA7-L6UE].

81. David Benoit, *Activists Are on a Roll, With More to Come*, WALL ST. J., (Jan. 1, 2015, 5:08 PM); *see also* Madden, *supra* note 73.

82. *See* FTI CONSULTING, 2015 SHAREHOLDER ACTIVIST LANDSCAPE: AN INSTITUTIONAL INVESTOR PERSPECTIVE (2015), http://www.fticonsulting.com/~/media/Files/us-files/insights/reports/shareholder-activism-2015.pdf [https://perma.cc/HJ7W-E3ZG].

83. *Id.* at 1.

84. *Id.*

85. Numerous cases demonstrate that this is the standard approach of the activist. *See* Steve Schaefer, *Bill Ackman Says J.C. Penney Board Is 'Flying Blind,' Chairman Needs To Go*, FORBES (Aug. 9, 2013), http://www.forbes.com/sites/steveschaefer/2013/08/09/ackman-j-c-penney-board-is-flying-blind-chairman-needs-to-go/#59f8673b455b [https://perma.cc/4YTU-6KQK] (Pershing Square appointed Bill Ackam to the board of JCPenny); Phil Wahba, *Activist Investor Jana's Biggest Get Yet: 2 Walgreens Board Seats,* FORTUNE (Sep. 8, 2014), http://fortune.com/tag/jana-partners/ [https://perma.cc/5GWJ-T7LE] (Jana Partners founder and managing partner Barry Rosenstein appointed to the board of Walgreens); Richard Waters, *Microsoft Cedes Board Seat to ValueAct*, FIN. TIMES (Aug. 30, 2013), https://www.ft.com/content/d4b2cafa-11c1-11e3-a14c-00144feabdc0 [https://perma.cc/3BBN-GE4C] (Value Act appointed one of its partners to the board of Microsoft).

86. *See* Yaron Nili, *Servants of Two Masters? The Feigned Hysteria Over Activist-Paid Directors*, 18 U. PA. J. CORP. L. 509, 521–22 (2016).

and prominent, manifestation of the super director. The activist super directors are appointed by a fund that has researched the target company extensively prior to engaging with it. Its general partners are well versed with the company's background and are savvy businessmen who often serve on other boards. In many instances, the activist fund has had long discussions with the board and management prior to getting a seat and thus has intimate knowledge of the company and the personas in the board room.

More importantly, the activist is truly independent of the current board and management. They are free agents of sorts, who do not need the good will of their fellow directors or management to retain their seats.[87] As such, they can more easily speak their mind, request information, and confront management and other directors, asserting a position of power within the board room quickly.[88] In addition, and similarly to other instances of super directors discussed below, activists enjoy the full resources of their fund, can process and verify the information that is provided to the board by management quickly, and are often presenting the board with their own analysis of the company's underlying data.

And while management often controls the boardroom, as most activist engagements seek for only a minority representation on the board,[89] the advantages that these minority directors bring is invaluable. They reduce the dependency of other directors on managements' input by bringing a different perspective to the board, therefore sparking an informative and more complete discussion on the matter at hand, and they have the ability to digest and process data quickly, availing this capacity to the rest of the board.

B. Trian Case Study

The important role activist funds play in enriching the board informational access is exemplified through an examination of major engagements of one of the most notable American activist funds in the United States with over $10 billion in managed assets—Trian Fund

87. *Id.* at 548–49.

88. *See* Kastiel, *supra* note 76, at 90–91 (discussing the implications of the presence of activist director on the board room).

89. PRICEWATERHOUSECOOPERS LLP, SHAREHOLDER ACTIVISM WHO, WHAT, WHEN, AND HOW? (2015), https://www.pwc.com/us/en/corporate-governance/publications/assets/pwc-shareholder-activism-full-report.pdf [https://perma.cc/JR7S-RY3R]; Howard B. Dicker, *2016 Proxy Season: Engagement, Transparency, Proxy Access*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Feb. 4, 2016), https://corpgov.law.harvard.edu/2016/02/04/2016-proxy-season-engagement-transparency-proxy-access/ [https://perma.cc/2QSH-FS3L].

Management LP.[90] In 2006, Trian, led by Nelson Peltz, disclosed that it had built up a 5.5% stake in H.J. Heinz Co., the famous ketchup maker.[91] Soon thereafter, the activist declared its intention to nominate five candidates for election to the board.[92] In nominating their candidates, Trian cited the company's disappointing record since April 1998 and management's failure to increase shareholder value and improve financial results despite numerous restructuring plans.[93] The proxy fight resulted in success for Trian: Nelson Peltz and another director nominated by the fund were appointed to the Heinz board.[94]

When the activist investor, Nelson Peltz, first demanded board seats, the company's management was indignant and expressed concern over the possibility that Nelson Peltz and Trian nominees would win the elections to the board.[95] According to the company's chief financial officer at the time, company insiders simply thought they "don't need outside help."[96] After winning the proxy battle, Trian received direct access to company information: boxes of old board minutes, financial statements, and operational reports. Trian's analysts were after what they called "perfect information" about Heinz—"the insider knowledge they wanted to help advance their ideas."[97] "We eliminate the management information advantage," said Trian co-founder and Chief Investment Officer Ed Garden. "We influence the agenda in the boardroom so that everyone is focused on what's gone wrong, so a lot of smart people around a table can have an honest discussion about it."[98]

Trian's ability to mitigate the board's informational capture helped focus the company on cutting certain costs and improving profitability. "[Peltz] had a little more analytical strength behind him than the rest of us," said Thomas Usher, the former chief executive of U.S. Steel

90. David Benoit, *Trian's Nelson Peltz: What Happens When Activist Comes on Board*, 4-TRADERS (May 7, 2015, 5:45 AM), http://www.4-traders.com/business-leaders/Nelson-Peltz-81/news/Trian-s-Nelson-Peltz-What-Happens-When-Activist-Comes-on-Board--20332552/ [https://perma.cc/Y6VQ-WNPB].

91. Miles Weiss, *Peltz Helped Spur Heinz Turnaround Setting Stage for Bid*, BLOOMBERG (Feb. 14, 2013, 5:13 PM), https://www.bloomberg.com/news/articles/2013-02-14/peltz-helped-spur-heinz-turnaround-setting-stage-for-bid [https://perma.cc/K4YJ-ZS6P].

92. *Id.*

93. *Id.*

94. *Id.*

95. David Benoit, *Activism's Long Road from Corporate Raiding to Banner Year*, WALL ST. J. (Dec. 26, 2015, 12:01 AM), http://www.wsj.com/articles/activisms-long-road-from-corporate-raiding-to-banner-year-1451070910 [https://perma.cc/VSA6-BZXJ].

96. *Id.*

97. Benoit, *supra* note 90.

98. *Id.*

Corp. and Heinz's lead independent director.[99] Along the same lines, Dennis Reilley, then an independent director at Heinz (and now an advisory partner at Trian), stated that despite being a minority board member, Mr. Peltz's advice was compelling and influenced other members of the board because "[t]he best board members are the ones who do their homework, come up with good ideas, and hope they can compel the others to do it . . . . That's what Nelson did."[100] These continuing efforts to improve Heinz' profitability were not fruitless. In 2013, Heinz was sold to Brazilian private equity firm 3G Capital Partners LP and Warren Buffett's Berkshire Hathaway Inc. for $23 billion, a nineteen percent premium to the stock's all-time high.[101]

In June 2015, Trian got an entirely different reception after purchasing a seven percent stake in Pentair PLC, a maker of pumps and valves.[102] The target CEO spoke several times with Trian about corporate strategies and promptly agreed to add Trian's representative to its board.[103] Trian also gained board seats, without a fight, at a few additional companies ranging from fast-food chain Wendy's Co. to Bank of New York Mellon Corp. "They aren't on a search-and-destroy mission," says Wesley von Schack, the lead director of Bank of New York Mellon, "[t]hey come in and speak to the right issues."[104]

General Electric's CEO, Jeffrey Immelt, has gone even further to invite Trian to get involved in his company. When GE announced in 2015 its plan to divest its financial arm, Mr. Peltz, who wasn't an investor at the time, called to congratulate Mr. Immelt. "I'd love to have you in the stock," Mr. Immelt told Mr. Peltz.[105] Trian then invested $2.5 billion in GE.[106] As Trian did due diligence, it urged GE to pursue with the divestiture of its financial arm, and to initiate additional buybacks. GE's management emphatically endorsed these recommendations. A month after the disclosure of Trian's investment in GE, the company stock crossed $30 a share for the first time since the financial crisis.[107]

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99. *Id.*

100. *Id.*

101. *Berkshire Hathaway, 3G Buying Heinz for $23.3 Billion*, CNBC (Feb. 14, 2013), http://www.cnbc.com/id/100442835 [https://perma.cc/RY8U-MCLU].

102. David Benoit, *Trian Builds 7.24% Stake in Pump Maker Pentair*, MARKETWATCH (June 30, 2015, 8:30 AM), http://www.marketwatch.com/story/trian-builds-724-stake-in-pump-maker-pentair-2015-06-30 [https://perma.cc/B2DQ-RHJW].

103. Benoit, *supra* note 95 ("[y]ou never know what you don't know," explained one of the board members regarding his willingness to listen to the activists).

104. Benoit, *supra* note 95.

105. *Id.*

106. *Id.*

107. *Id.*

The Trian example clearly shows that sophisticated activists play an important role in bridging the board's informational capture by independently collecting and analyzing information about the company. The activists' informational advantages, their dedicated research capacity, and the recruiting of former executives with experience in the relevant industries to work alongside them on campaigns, allow them to come up with proposals to improve operations at target companies.

Indeed, even long-term critics of hedge fund activism, such as Martin Lipton, the founding partner of Wachtell, Lipton, Rosen & Katz, are unable to disregard activists' informational advantages and their ability to produce detailed analyses.[108] As Mr. Lipton noted, "[t]he major activist hedge funds are very experienced and sophisticated with professional analysts, traders, bankers and senior partners that rival the leading investment banks," which allow them to "produce detailed analyses ("white papers") of a target's management, operations, capital structure and strategy designed . . . ."[109]

C. Re-contextualizing "Super Directors"

The rise of activists directors in recent years has drawn heated criticism. Many have termed these directors as "shadow management" and have expressed concern regarding the ability of the board to work effectively and collegially in their presence.[110] However, as we detail below, the presence of super directors is far from a new development in corporate America and there are many existing examples of directors who fit the basic attributes of "super director." By providing a more detailed taxonomy of the different super directors already in existence, we hope to shift public discourse from the perception that activist nominees are destabilizing the board as an institution, to the recognition that activist directors are following the footsteps of other constituency groups while also serving an important role in mitigating board's informational gap.

1. THE CHAIRMAN/CEO

As discussed in the previous Part, the last decade has seen major transformations in the board of directors' structure.[111] This transition from an insiders' board to an "independent" board—and consequently from an advisory-focused role to a monitoring-oriented role[112]—also

108. Lipton et al., *supra* note 66.
109. *Id.*
110. *See* Kaskey, *supra* note 67.
111. *Supra* Part II.A.
112. *See* Nili, *supra* note 14, at 4–8.

facilitated the creation of an original form of "super directors," that is the Chairman/CEO often consisting as the lone, true insider in the boardroom.[113]

The Chairman/CEO has formal control on many board actions as the chairman of the board. She, wearing the hat of the CEO, controls many items on the board's agenda as well as the type and way information is presented to the rest of the board. As CEO, she enjoys an army of employees and the entire corporate resource base, helping her in managing and processing the information that is to be discussed at every board meeting.[114] In such a board, lack of parity between the Chairman/CEO and other directors regarding access to information, their formal and informal power in the boardroom, and ability to process the information that is available, is evident. The Chairman/CEO is, therefore, the strongest manifestation of a super director.

Importantly, even when the CEO does not serve as the chairman of the board—a trend that has gained steam in recent years[115]—she still

113. *Id.* at 114–15.

114. LUIS L. GOLDBERG & JUSTINE LEE, BOARD LEADERSHIP STRUCTURE (2013), https://www.conference-board.org/retrievefile.cfm?filename=DN-011-10.pdf&type=subsite [https://perma.cc/6WK7-KHJ3] ("[T]he chairman would have such responsibilities as: presiding at board meetings; having ultimate approval over board agendas, length of discussion time for agenda items, and information flow to the board; and working with the corporate governance committee to coordinate CEO and board assessments."); *see also* Z. Jill Barclift, *Governance in the Public Corporation of the Future: The Battle for Control of Corporate Governance*, 15 CHAP. L. REV. 1, 12–13 (2011) ("The SEC has designed rules, which give investors information on the inherent or the structural design of board membership, so that share-holders will know whether a dominant CEO or leader has exerted undue influence on board decision-making."); Megan Wischmeier Shaner, *Restoring the Balance of Power in Corporate Management: Enforcing an Officer's Duty of Obedience*, 66 BUS. LAW. 27, 53 (2010); Sharpe*, supra* note 47.

115. In 2014, 47% of S&P 500 boards had separate CEO and chair roles, up from 23% in 2000, and 28% of chairs were independent, versus just 9% in 2005. STUART, *supra* note 15. Section 972 of the Dodd-Frank Act increased disclosure requirements for companies that maintain CEO/Chairperson duality, making the issue more visible to shareholders. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act § 972. For a move comprehensive review, see Sharpe, *supra* note 47, at 1102 ("The number of U.S. corporations that have an individual other than the CEO serving as chairperson of the board is increasing. As of 2008, estimates suggest that thirty-nine percent of the Standard & Poor's 500-stock index (S&P 500) have separated the position of CEO and board chairperson as compared to sixteen percent a decade earlier."). *See also* MICHELLE TAN, CORP. SEC'Y, SEPARATE CEO AND CHAIRMAN ROLES: A BOARD OPPORTUNITY (2015), http://www.corporatesecretary.com/articles/boardrooms/12970/separate-ceo-and-chairman-roles-board-opportunity/ [https://perma.cc/6FJV-AB2H]; Michael Corkery, *Bank of America's Fight to Keep Brian Moynihan's Dual Roles*, N.Y. TIMES (Sep. 16, 2015), https://www.nytimes.com/2015/09/17/business/dealbook/17db-bank.html [https://perma.cc/F8TP-D637].

holds the key to many board functions, is still the most informed person in the room regarding the ins and outs of the company, and has the ability to use the corporate's arsenal of resources at her discretion.

2. THE "CONSTITUENCY" SUPER DIRECTOR

While CEOs may be the strongest, and original, form of super directors, they are not the only ones. In several other contexts, investors and boards have found ways to empower their directors, thus creating other forms of super directors. "Constituency" directors, i.e., directors who have ties to a major shareholder, investor, or other interested party, are prevalent in many of the major corporations in the United States.[116] Below we will review some of the prominent forms of constituency super directors.

a. The Private Equity Nominated Director

Private equity buyout firms[117] are a good example of investors that often utilize the "super director" proposition. Private equity firms are known for empowering management of public firms,[118] often

116. *See* Brian Broughman & Jesse Fried, *Renegotiation of Cash Flow Rights in the Sale of VC-backed Firms*, 95 J. FIN. ECON. 384, 386 (2010) (showing the strong venture capital representation in private companies' boards); Martin Gelter & Geneviève Helleringer, *Lift not the Painted Veil! To Whom are Directors' Duties Really Owed?*, U. ILL. L. REV (2015); Nili, *supra* note 86, at 555; E. Norman Veasey & Christine T. Di Guglielmo, *How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors*, BUS. LAW. 761 (2008); Joseph Hinsey, *The Constituency Directo*r, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 14, 2008), https://corpgov.law.harvard.edu/2008/01/14/the-constituency-director/#more-374/ [https://perma.cc/X73A-HXDK]..

117. For a discussion of private equity funds, see generally JOSH LERNER ET AL., VENTURE CAPITAL AND PRIVATE EQUITY: A CASEBOOK (3d ed. 2005); Brian Cheffins & John Armour, *The Eclipse of Private Equity* (Eur. Corp. Governance Inst. Law Working Paper No. 82, 2007), http://ssrn.com/abstract=982114 [https://perma.cc/E96M-VVUF]; William Clayton, *Preferential Treatment and Rise of Individualized Investing in Private Equity*, (Yale L. Sch.: John M. Olin Cent. for Studies in L., Econ., and Pub. Pol'y, Research Paper No. 532, 2017), https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2746725 [https://perma.cc/499P-UJVL].

118. *See* Steven N. Kaplan & Per Strömberg, *Leveraged Buyouts and Private Equity* (Nat'l Bureau of Econ. Res., Working Paper No. 14207, 2008); *see also* NICOLAUS LOOS, VALUE CREATION IN LEVERAGED BUYOUTS: ANALYSIS OF FACTORS DRIVING PRIVATE EQUITY INVESTMENT PERFORMANCE 30 (2006) ("Furthermore, the change in status, from manager to co-owner could increase financial performance because it gives managers a positive incentive to look for efficiency gains and smart strategic moves . . ."); Clayton, *supra* note 117; Douglas Cumming et al., *Private Equity, Leveraged Buyouts and Governance*, 12.4 J. CORP. FIN. 439, 441–42 (2007).

cooperating with management initiatives to take a company private.[119] On the other hand, private equity firms are also known for placing a strong system of oversight over management, starting with compensation arrangements that are tailored to maximizing value and through a strong board room that often includes the general partners of the private equity firm.[120]

Even when the private equity firm does not hold complete ownership, for instance in cases where the company has gone back public[121] or where the fund is conducting a Private Investment in Public Entity (PIPE),[122] private equity firms often have their general partners sit on the board,[123] bringing the same "super director" attributes to the public company setting. These general partners have intimate knowledge of the company, obtained before acquiring their equity stake. They also enjoy the resources of the private equity firms' analysts and business network. In this context, a director who is empowered by the private equity firm to monitor managements' work and has the tools, resources, and power to affect changes through the effective control the private equity exercises over the company, represents a different manifestation of a super director.

b. The Venture Capital Nominated Director

Venture capital firms[124] employ a similar model to the one used by private equity firms, but at a different time in the company life cycle—its early stages. Venture capital firms often have their partners sit on boards of public companies that they have backed through the IPO

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119. *See* KAPLAN & MICHAEL P. KELLY, CORPORATE BOARD, PRIVATE EQUITY AND CORPORATE GOVERNANCE 6 (2007); John J. Moon, *Public vs. Private Equity*, 18(3) J. APPLIED CORP. FIN. 76 (2006); Robert C. Pozen, *If Private Equity Sized Up Your Business*, HARV. BUS. REV., NOV. 2007, at 78.

120. Moon, *supra* note 119; *see also* LOOS, *supra* note 118.

121. Mario Levis, *The Performance of Private Equity-backed IPOs*, 40 FIN. MGMT. 253–77 (2011).

122. For a review of PIPEs, see ANNA T. PINEDO & JAMES R. TANENBAUM, MORRISON & FOERSTER, FREQUENTLY ASKED QUESTIONS ABOUT PIPES (2016), http://media.mofo.com/files/Uploads/Images/FAQsPIPEs.pdf [https://perma.cc/4P5C-A2JE].

123. *See* Dan Primack, *Private Equity IPOs are Rarely 'Quick Exits,'* FORTUNE (Jan. 25, 2011), http://fortune.com/2011/01/25/private-equity-ipos-are-rarely-quick-exits/ [https://perma.cc/7326-NJCS].

124. For a general discussion of venture capital funds, see Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, STAN. L. REV. 1067 (2003); William A. Sahlman, *The Structure and Governance of Venture-capital Organizations*, 27 J. FIN. ECON. 473 (1990).

process,[125] while they still hold an equity portion (at times very significant) in the corporation. These appointed directors are in many cases partners in the venture capital firms themselves. For instance, Castlight Health, which went public in March 2013 and has a market cap of $1.26 billion, has five venture capital partners on its board.[126] Twitter has a partner of a venture capital firm which holds 5.35% of its shares on its board. Similar venture capital representation can be found in many of the recent large venture capital-backed IPOs, such as Zulily, Yelp, A10 Networks, Tableau Software, and FireEye Inc.[127]

These directors could also qualify for the super director designation. These directors are often well versed in the industry in which the startup company is competing, are very involved with the direction of the company, and have the full resources of the venture capital firm at their disposal. In fact, this is what makes the venture capital model so attractive to startup companies.[128]

c. The Dominant Shareholder Nominated Director

A similar, and more general, appearance of a super director can be found in companies with a dominant and influential shareholder that receives a board seat. This is particularly relevant in cases where the dominant shareholder is itself a business entity or holding company. For instance, Berkshire Hathaway, who is a major shareholder in Coca-Cola Company, has Howard G. Buffett, Warren Buffet's son, as an independent director on Coca-Cola's board.[129] Directors appointed by dominant shareholders, such as Berkshire Hathaway, have the outside resources to evaluate management performance and the ability to act on this information. This, in turn, effectively counterbalances the power of the CEO.

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125. *See* Brian Broughman & Jesse Fried, *Renegotiation of Cash Flow Rights in the Sale of VC-Backed Firms*, 95 J. FIN. ECON 384 (2010) (showing that similar representation can be found in private companies with venture capital directors).

126. Doctor Bryan E. Roberts (Chairman) and Doctor Robert Kocher from Venrock (twenty-percent shareholder); Ann Huntress Lamont from Oak Investment Partners LP (twelve-percent shareholder); Christopher P. Michel from Nautilus Ventures LLC; and David B. Singer from Maverick Capital Ltd. *Company Overview of Castlight Health, Inc.*, BLOOMBERG (Mar. 5, 2017, 5:35 PM), http://www.bloomberg.com/research/stocks/private/board.asp?privcapId=62702188 [https://perma.cc/NH26-6EEK].

127. Data on the ownership structure of these companies is on file with the Authors.

128. *See* Gilson, *supra* note 124, at 1069–70.

129. *Board of Directors: Howard G. Buffett*, COCA-COLA, http://www.coca-colacompany.com/our-company/board-of-directors-howard-g-buffett [https://perma.cc/3F3A-JUB9] (last visited Feb. 23, 2017).

d. The Founder Director

The founder director, who is no longer the CEO and does not have a controlling stake in the company, presents another interesting manifestation of a super director. While the founder director may lack the outside resources private equity or venture capital directors may enjoy, she does have the clout and deep understanding of the company, which she established, to gain augmented power on the board.[130] Having served as the CEO of the company in the past, as is often the case, may also allow the founder to better challenge management. In addition, the founder may still have access to the raw information that management is using through her connections to mid-level and high-level employees—many of whom she may have personally hired.

In sum, we have shown that this presence of "super directors" in boardrooms is far from a new occurrence. Dominant investors, such as private equity, venture capital funds or former founders, often nominate directors who fit the basic attributes of "super directors" to the board. By providing a more detailed taxonomy of the different manifestations of super directors already in existence, we hope to shift public discourse from the perception that activist nominees are destabilizing the board as an institution, to the recognition that activist directors are following the footsteps of other constituency groups and are also serving an important role in mitigating the board's informational capture. As discussed in the next Section, this important role of super directors as information facilitators also has implications on the way Delaware courts should approach information sharing between the activist director and the funds that nominates them.

3. FACILITATING INFORMATION SHARING

Shareholders, directors, companies, and courts have long grappled with the question of information sharing between the company, board members, and certain shareholders. There is an inherent tension between the right of board members to request information from the company and the privilege to share such information with a certain shareholder. While this question is not new, the increased presence of activist nominees on companies' boards has made this tension omnipresent and relevant more than ever. In this Section, we argue that this doctrinal question has yet to account for the positive impact super directors provide in mitigating the board's informational capture. The recognition of this important positive externality that activist directors provide to the board as an institution provide, therefore, additional

130. For a general review, see Ronald C. Anderson et al., *Founders, Heirs, and Corporate Opacity in the United States*, 92 J. FIN. ECON. 205, 205–22 (2009).

support to Delaware courts' decision to view information sharing between board members and certain shareholders favorably.

Delaware law has emphasized the unfettered right of a director to obtain all the information about the corporation she serves, which is necessary to discharge directors' fiduciary duties.[131] Such a right is provided to any director, regardless of whether she was designated by a specific stockholder, such as a hedge fund.[132] Less clear, however, is the extent to which a designee director can share this information with the stockholder she represents.[133]

On one hand, constituent directors, who sit on public company boards, are often perceived "as representatives of those shareholders that nominated them and are considered likely to share details of board deliberations with their sponsors."[134] Such constituent directors may be chosen for board seats by their sponsoring entities under the explicit understanding that they will share inside information for investment evaluation purposes. On the other hand, such information sharing with the shareholder that appoints the constituent directors raises serious concerns that sensitive board information will be leaked to the media or to other members of the investment community.[135] At the end of the day, once information has been passed outside of the board, it becomes more complicated to control the flow of information from the sponsoring shareholder's employees to others in the investment community.

Absent contractual provisions to the contrary, Delaware law permits constituent directors to disclose information to their sponsors so long as they do so in a manner that is consistent with their fiduciary duties. A series of Delaware cases establish the rule permitting such information sharing.[136] For instance, in a recent case, the Delaware

131. *See, e.g.*, *Kalisman v. Friedman*, C.A. No. 8447-VCL, 2013 WL 1668205, at *3 (Del. Ch. Apr. 17, 2013) ("A director's right to information is essentially unfettered in nature."); *Schoon v. Troy Corp.*, No. Civ.A. 1677-N, 2006 WL 1851481, at *1 n.8 (Del. Ch. Jun. 27, 2006); *Henshaw v. Am. Cement Corp.*, 252 A.2d 125, 128 (Del. Ch. 1969) ("[I]n order to meet his obligation[s] . . . [a director] must have access to books and records; indeed he often has a duty to consult them.").

132. *See, e.g.*, *Hall v. Search Capital Grp.*, Civ. A. No. 15264, 1996 WL 696921, at *2 (Del. Ch. Nov. 15, 1996) ("Absent a governance agreement to the contrary, each director is entitled to receive the same information furnished to his or her fellow board members.").

133. J. Travis Laster & John Mark Zeberkiewicz, *The Rights and Duties of Blockholder Directors*, 70 BUS. LAW. 33, 41 (2015).

134. *See* David A. Katz, *Boardroom Confidentiality Under Focus*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (July 23, 2014), https://corpgov.law.harvard.edu/2014/01/23/boardroom-confidentiality-under-focus/ [https://perma.cc/S5RJ-XAS2].

135. *Id.*

136. *See, e.g.*, *Kalisman*, 2013 WL 1668205, at *6 (discussing the question of whether sharing was permitted when the parties had failed to address the matter,

Chancery Court expressed the view that "[w]hen a director serves as the designee of a stockholder on the board, and when it is understood that the director acts as the stockholder's representative, then the stockholder is generally entitled to the same information as the director."[137] Along the same lines, in another case it was noted that "a fiduciary sharing of information with an affiliated stockholder and its advisors, standing alone, is not inherently a breach of duty," and that "[t]he use and sharing of information is rather another context-dependent inquiry."[138]

Such rules enabling information sharing reflect the practical reality that director representatives routinely share confidential corporate information with colleagues at their affiliated investment funds. Moreover, in many cases, the director representatives are managers or employees of the fund that purchased the minority stake in the company and fiduciaries of the limited partners or other investors in the fund. A bright-line rule against information sharing would put those director representatives in a problematic situation: they would either have to avoid sharing information with the fund that nominated them, or refrain from receiving any confidential information from the company they serve. Such a rule is counterproductive and unlikely to be followed.[139]

The approach, which Delaware has adopted, is therefore to permit information sharing and allow corporations to address potential risks that the information will be leaked by contracting with the fund that nominates the director[140] and by enforcing the directors' fiduciary duties. If the corporation was harmed by the disclosures, or if the director or the sponsor would use the information disclosed to the detriment of the corporation and its stockholders or to benefit themselves improperly, the director would likely be found to have breached his or her duty of loyalty.[141]

Our analysis shows that Delaware case law that enables information sharing is not only justified by practical reasons—given the understanding that it is impossible to block the information flow from

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holding that "When a director serves as the designee of a stockholder on the board, and when it is understood that the director acts as the stockholder's representative, then the stockholder is generally entitled to the same information as the director"); *see also Moore Business Forms, Inc. v. Cordant Holdings Corp.*, 21 DEL. J. CORP. L. 279 (1996); *AOC Limited Partnership v. Horsham Corp.*, 18 DEL. J. CORP. L. 582 (1993).

137. *Kalisman*, 2013 WL 1668205, at *6.

138. *In re Dole Food Co.*, No. 9079-VCL, 2015 WL 5052214, at *43 (Del. Ch. Aug. 27, 2015).

139. *Id.* at *145 ("our law does not appear to me to have adopted a bright-line position" against information sharing).

140. Certain activists routinely enter into confidentiality agreements with companies on whose boards they participate, and these agreements are aimed to protect both the company and the activist. Katz, *supra* note 134.

141. *Id.*

the representative director to the stockholder that place her on the board—but is also an important factor in facilitating the operation of the activist super director and her ability to monitor the management team. If a constituent director is unable to share information with the fund that places her on the board, that director will not be able to utilize the fund's vast sources to process and analyze data received from the board or enhance the monitoring of the management team. Put differently, the entire operation of the "super director" model depends on the ability of a constituency director to convey information to the stockholder that placed him on the board.

III. THE LIMITS OF THE ACTIVIST SUPER DIRECTOR

In the previous Part, we discussed the rise of activist super directors, and the important role that director plays in mitigating board informational capture. This super director model, however, has several limitations, which we discuss below.

First, while hedge fund activism has been increasing in recent years, reaching 514 engagements in 2014, the highest since the 2008 financial crisis,[142] there are still many companies that are not subject to activism. Therefore, directors of the vast majority of American companies do not have access to hedge funds' resources, market information, and knowledge. These directors in non-targeted companies will continue to suffer from the informational problems described in Part II, which negatively affects their ability to monitor management.

Importantly, while the potential threat of activist intervention, in itself, could encourage management of non-targeted companies to engage in value maximizing activities before they become targets,[143] it does not mitigate the issue. The positive externalities on non-targeted companies, due to the perceived threat of activism, are still likely to be limited in their scope. Recently, there has been an increase in the use of dual-class structures, which allows issuers to retain majority control over long periods of time and other governance.[144] Companies with

142. Katz, *supra* note 80. The importance of activist funds is also reflected by the dramatic increase in their activity over the past fifteen years. Assets managed by activist hedge funds were worth twenty-three billion dollars in 2002, grew to $100 billion in 2006, and then to approximately $200 billion by the beginning of 2015. *See* Kastiel, *supra* note 76, at 72.

143. *See, e.g.*, Frank Partnoy & Randall Thomas, *Gap Filling, Hedge Funds, and Financial Innovation*, *in* NEW FINANCIAL INSTRUMENTS AND INSTITUTIONS: OPPORTUNITIES AND POLICY CHALLENGES 101 (Yasuyuki Fuchita & Robert E. Litan eds., 2007) (discussing the potential disciplinary effect of hedge fund activism on non-targeted companies).

144. Maureen Farrell, *In Snap IPO, New Investors to Get Zero Votes, While Founders Keep Control*, WALL ST. J. (Jan. 16, 2017), http://www.wsj.com/articles/in-snap-ipo-new-investors-to-get-zero-votes-while-founders-keep-control-1484568034

dual-class stock, or other governance arrangements that insulate insiders from external pressures, are substantially less likely to be subject to an activist intervention.[145] The rise of hedge fund activists has also led issuers and their advisors to exercise significant efforts to limit the role, rights, and involvement of activist shareholders. These efforts, if successful, could reduce the effect of hedge fund activism not only on targeted but also non-targeted companies.[146] Most significantly, while the potential threat of activism could have positive spill-over effects on the performance of certain non-targeted companies, directors in these companies are still likely to suffer from knowledge capture in the absence of an actual activist involvement.

Second, even when activist hedge funds appoint their nominees to companies' boards, such nominees usually stay on the board for a limited period of time, which does not exceed two to three years.[147] After the activists liquidate their position and end the intervention with a target company, the activists' nominees usually leave the board.[148] When this happens, other outside board members of a target company no longer have access to the resources of the hedge funds, and they will continue to encounter the same informational gaps they had before the activist intervention took place. Moreover, the solution that super directors provide to the informational problems of the board of directors is not only temporary in its nature, but it also lacks an organizational long-term view point. Once the activist's nominees exit the board, they leave no organizational knowledge or resources to the other directors who continue to serve on the board. The super director model is, therefore, a patch, not a long-term, systemic solution to the informational problem of the board.

Relatedly, activist hedge funds, and their nominees, may incur high information costs and encounter certain difficulties in gaining access to company-specific information. For instance, activist directors may not receive full cooperation from management regarding information, or rely on outside, more costly methods, of obtaining information that already exists within the company.

[https://perma.cc/B3VZ-NNVS] (presenting evidence on the increasing incidence of dual-class structures in the United States).

145. Kastiel, *supra* note 76, at 149–54 (showing that when activism is conducted against majority controlled companies, when the activists have no ability to elect minority directors, the likelihood of activism reduces dramatically).

146. For an analysis of the various policy reforms aimed at limiting the power activist hedge funds, see Bebchuk et al., *supra* note 64, 1148–154.

147. Gow et al., *supra* note 65, at 13 ("Affiliated (unaffiliated) directors who have left their respective boards, did so after being on the board for 695 (752) days on average.").

148. *Id.* at 12–13 (providing data on the length of an average intervention).

Third, activist directors may be prevented from accessing certain information, or prohibited from sharing it with their team due to conflict of interests and/or desire to avoid any restriction on the fund trading flexibility.[149] As a general matter, when a fund receives information from the director it nominates to the target board, such fund is likely to be treated as "a constructive insider for the purpose of the common law limitations on insider trading."[150] Such restriction on trading, in its turn, will limit the ability of the fund to liquidate its position, and will increase its financing costs. The target corporation could also have a cause of action against the fund for any further disclosure of confidential information that inflicted harm on the corporation, which, in turn, increases its exposure to litigation. These cumulative costs associated with information sharing could cause the fund to establish a "Chinese Wall" between the fund and the directors they place on the corporation board, and to avoid the sharing of information, even in cases when doing so will produce certain efficiency gains to the benefits of all other shareholders.

Finally, there is a common concern among certain practitioners and academics, which we do not share, regarding the director's motives when nominated by activist hedge funds. The critics of hedge fund activism often claim that activist interventions are value-decreasing in the long term, and that activists tend to use their board representatives to force management to disgorge cash in lieu of investing in long-term growth.[151] At least according to this view (that so far lacks strong empirical support),[152] activist hedge funds, and the directors nominated by them, may pursue other interests which do not necessarily align with the interests of other long term shareholders.[153] Therefore, any

149. Laster & Zeberkiewicz, *supra* note 133, at 56–57.

150. *Id.*

151. *See, e.g.*, Lipton, *supra* note 23; Millstein, *supra* note 23.

152. For studies invoked by critics of hedge fund activism, see Martin Lipton, *Is 2015, Like 1985, an Inflection Year?*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Dec. 8, 2015), http://corpgov.law.harvard.edu/2015/12/08/is-2015-like-1985-an-inflection-year/ [https://perma.cc/9UN3-T7U6]. For a critical analysis of the evidence raised by hedge fund opponents, see Bebchuk et al., *supra* note 64; Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637, 1642–44 (2013).

153. One of the main concerns is about the use of activism for short-term self-interest over the long-term efficiency of the firm. This is balanced against the risk of potentially leading to over-activism that will distort daily life at the firm and harm the board and management's ability to steer the corporation effectively. *See, e.g.*, LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC 63–73 (2012); Stephen M. Bainbridge, *Response, Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1744–51 (2006); William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment,* 158 U. PA. L. REV. 653, 653–54, 657–59 (2010); Justin

informational benefits provided by activist nominees to the rest of the board members could be offset by the long-term costs that these funds may generate. Even if the activist does not intend to damage the long-term value of the company, the board's view of the activist nominee as an outsider, who is focusing on short-term gains at the expense of long-term planning, may impact the rest of the directors' willingness to fully rely or use the information benefits that an activist director can provide. Due to the contentious nature of activist engagements, outside directors may find themselves choosing sides, aligning themselves with the CEO or the activist and thus opting to use only one channel of information instead of both.

All of the above suggest that regulators and investors cannot rely on occasional, short-term interventions by activist hedge funds to solve the board's informational capture. Activist interventions are limited to a small number of companies, last only several years, do not promote the creation of institutional knowledge within the boardroom, and there is always a concern that the data screened and digested by the activist nominees will be biased to reflect the activists' short-term interests in the firm (to the extent such activists are indeed short-term oriented).

Therefore, investors and regulators who are interested in finding a systematic, long-term solution to the board information asymmetries should push toward certain institutional changes that will empower board members and equip them with independent access to company-specific data, institutional knowledge, as well as better resources to analyze the information that is collected by them. This solution could be based on a model used by activist hedge funds, but without its limitations. Such proposal for an institutional change is aimed at empowering board members and providing them with better tools to monitor management. This proposal will be discussed in greater detail in the next Part.

IV. MITIGATING BOARDS' INFORMATIONAL CAPTURE

So far we have reviewed the significant hurdles that independent directors face when acting as agents of shareholders. They are outsiders

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Fox & Jay W. Lorsch, *What Good Are Shareholders?*, HARV. BUS. REV., July-Aug. 2012, at 49, 51 (discussing problems created by increase in shareholder power and rise of short-term investors). Similar concerns were raised regarding hedge funds' use of derivatives to manipulate other shareholders. *See* KJ MARTIJN CREMERS ET AL., HEDGE FUND ACTIVISM AND LONG-TERM FIRM VALUE (2015) (suggesting that hedge fund activism decreases, rather than increases, a firm's long-term value, relative to non-targeted control firms that have similar characteristics as the targeted firms); Henry T. C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811, 821, 824 (2006); Kahan & Rock, *supra* note 64.

to the company's culture, history, and inner workings, are part-time employees who often hold many other positions, and they lack the infrastructure to request, process, and challenge the information that is imperative to their work.

As a structural matter, a board that is comprised of part-time outside directors who are required to be independent of management is doomed to suffer from these information deficiencies and to over-rely on whoever is willing to "lay a hand"—most often the CEO, but at times other constituency directors. In either case, such reliance on the CEO (or other super directors) is far from a long-term cohesive solution to the "catch-22" dilemma the board faces. On the one hand, shareholders, courts, and regulators expect the board to be an outsider—independent of the company—to ensure its ability to monitor management. At the same time, such distance from the company and the independence of the board becomes a clear hurdle in the ability of the board to independently obtain and accumulate the information that is needed for such a role.

Addressing the issue at its core, therefore, requires a rethinking of current board structure and how this structure correlates with the board's role as a monitor. Since director's independence has become a key governance demand, and as boards have shifted into a monitoring role, the board as an institution must provide independent directors with tools to monitor and examine management. The current state of affairs forces these directors to wear a set of "filtered glasses,"—glasses that are shaded and filtered through the views of management, who often control the data the board relies on—when making decisions regarding strategy, and equally important when monitoring management actions.

Treating the board as an independent institution—as regulators,[154] courts,[155] and shareholders[156] expect it to be—must therefore go hand in hand with supplying the board with independent and effective tools to carry on its duties. As such, the corporation, particularly large and complex ones, must provide its board with the resources to consistently and effectively obtain, digest, and review pertaining information from within and outside the company. Relatedly, the proposed design should strive to create a permanent organizational knowledge base—one that

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154. *See supra* notes 28–29.

155. *Beam v. Stewart*, 845 A.2d 1040 (Del. 2004); *see also* MAUREEN S. BRUNDAGE & OLIVER C. BRAHMST, GLOBAL CORPORATE GOVERNANCE GUIDE, DIRECTOR INDEPENDENCE: ALIVE AND WELL UNDER DELAWARE LAW (2004); Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447 (2008).

156. *See* Theo Francis & Joann S. Lublin, *Boards Get More Independent, but Ties Endure*, WALL ST. J. (Jan. 19, 2016, 3:16 PM), http://www.wsj.com/articles/boards-get-more-independent-but-ties-endure-1453234607 [https://perma.cc/8GMY-4RLP].

does not fluctuate, or is overly dependent, based on the composition of the board or any specific member of it.

Naturally, the chairman of the board or the lead independent director (in case the CEO is also the chair), is the obvious existing institution within the board that could be expected to provide this permanent "super director" function. Indeed, many companies have separated their CEO and chairman roles,[157] or created the position of a "lead independent director," in order to increase the independence of the boardroom and reduce the excessive power of CEOs within the board.

But how, and in what ways, should companies empower the independent chair or the lead director? The answer is not a simple one and requires a careful consideration of the costs and benefits of any proposed solution. As further detailed below, we believe that institutionalizing data independence for the board should be at the core of any proposed solution, and that an introduction of a dedicated special counsel to the board, as part of a larger "board suit" that would be entrusted with data gathering and processing for the board and would present the optimal infrastructure to mitigate the "captured board" concern.

A. The Board's Suite

In this Part we propose an efficient and institutionalized way of addressing the board's informational gap. Specifically, we call for the creation of a "board suite." In essence, a board suite entails the establishment of an office of the board and the appointment of a special counsel to the board—a full time employee that is hired by the board and is independent of the company (except that her salary is paid for by the company). The office, that may also include dedicated secretarial services, would be responsible to request, summarize, and prepare information from management, as well as assess the completeness of the information, and, if need be, hire outside consultants to produce complementary information. This suite would become the institutional knowledge base of the board, unmoved by the personal changes the board room experiences. The special counsel and her staff (if needed depending on the size of the company) will in essence serve as information facilitators: requesting information and collecting outside sources, receiving the information requested, editing it and providing it in a simple, clear, and efficient way to the board with a critical eye on the board's responsibilities. The board suite, therefore, is likely to

157. *Id.*

decrease the "processing costs" for directors, and to alleviate the informational capture that boards currently suffer from.

Notably, this concept of a board suite already exists elsewhere. The United Kingdom Financial Reporting Council has issued guidance on board effectiveness in 2011,[158] stressing that:

> Well-informed and high-quality decision making is a critical requirement for a board to be effective and does not happen by accident . . . . Many of the factors which lead to poor decision making are predictable and preventable. Boards can minimize the risk of poor decisions by investing time in the design of their decision-making policies and processes . . .[159]

The United Kingdom has chosen the company secretary to carry out a similar role to the one we envision the special counsel to the lead director to perform.[160] Essentially tasking her with the responsibility to "ensure the presentation of high-quality information to the board and its committees . . . ."[161]

Clearly, the United States presents a different governance structure,[162] although one that is often referred to as very close to the United Kingdom.[163] Thus, any concrete reform would have to delineate much more carefully to the specific authority, roles, and duties of the special counsel and the board suite, more generally. In designing these functions, shareholders or regulators would have to decide how independent they would like the board suite to be. Particularly, the officers of the board may be hired directly by the board, but paid by the company. Similarly, allowing shareholders to have a say regarding the compensation and appointment of the special counsel could achieve the same goal.

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158. FIN. REPORTING COUNCIL, THE GUIDANCE ON BOARD EFFECTIVENESS 7 (2011), https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Board-Effectiveness.pdf [https://perma.cc/DBB5-5HGZ].

159. *Id.* at 8.

160. *See* David A. Katz, *The Changing Dynamics of Governance and Engagement*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (July 23, 2015), https://corpgov.law.harvard.edu/2016/02/04/2016-proxy-season-engagement-transparency-proxy-access/ [https://perma.cc/2CZU-CEH5].

161. FIN. REPORTING COUNCIL, *supra* note 158, at 7.

162. *See* REINIER KRAAKMAN, THE ANAATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH (2d ed. 2009); Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999); Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737 (1997). However, recent empirical work casts doubt as to the validity of these empirical findings. *See* Holger Spamann, *The "Antidirector Rights Index" Revisited*, 23 REV. FIN. STUD. 467 (2010).

163. *See* KRAAKMAN, *supra* note 162; La Porta et al., *supra* note 162; Shleifer & Vishny, *supra* note 162.

While the idea that directors could use personal advisors, and, in particular, bring them into the boardroom, is understandably unlikely to be warmly received by management, there is no legal ground for ruling out our proposal as long as the director remains the responsible fiduciary and that the advisors' main role is to facilitate the director's fiduciary decision-making function. Directors generally should be permitted to use their own advisors to assist the directors in understanding the information being presented for the purpose of discharging her fiduciary duties.[164] For instance, "if management was making a presentation about a highly technical issues and the director wanted the assistance of a technical expert who could question management," then Delaware law is unlikely to restrict barring the advisor from participating in the meeting.[165]

To be clear, even under the current Delaware law, boards can, and at times do, use the help of outside advisors. For instance, when a special independent committee of the board negotiates a sale of a company or a conflicted transaction with a controlling shareholder, such committee has the ability to hire its own independent council or investment banker. The logic behind this process is similar to the one that motivates our proposed solution: the board committee cannot rely on the information provided by management as a basis for its recommendation. In order to form an independent opinion, the committee uses the services of independent "intermediaries" that assist the committee to analyze the different aspects of management proposed transactions. However, this practice of hiring outside "data-providers" has been extremely limited in scope and frequency so far, and is most common in material end game decisions where management is often forced to refrain from participation (independent committees negotiating going private transactions of hostile bid). We propose applying it in a systematic way, during the lifespan of the company and not just before a potential sale of the company.

Additionally, in the past few years, companies are increasingly using the services of investment bankers or other outside consultants to prepare for a "rainy" day and in order to preempt a potential activist event. These outside advisers provide the board with external, independent proposals for changes in the company's financial or organizational structure. Here, once again, by hiring these advisors, boards recognized that they suffer from certain informational capture and may need an external support in processing and analyzing

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164. *See Holdgreiwe v. Nostalgia Network, Inc.*, Civ. A. No. 12914, 1993 WL 144604, at *7 (Del. Ch. Apr. 29, 1993) (refusing to permit a director to inspect books and records using conflicted professionals, such as "accountants, lawyers or other advisors," thereby implying that he could use other, non-conflicted advisors).

165. Laster & Zeberkiewicz, *supra* note 133, at 48.

information in order to facilitate their decision-making. However, such process is often dominated by the management of the company and thus is not fully independent, and it is often done ad-hoc, as preventive measure, in light of a risk that the company will be subject to an activist intervention that could cause certain members of the company's management to lose their seats. Thus, again, this development is unlikely to provide a systemic solution to the board informational capture.

Finally, our proposed solution could have a positive impact on engagement with shareholders, which has become a key issue for many public corporations.[166] While companies and boards show great effort to meet the demand of shareholders, boards often lack enough resources for effective shareholder engagement. A board suite could take over some of the engagement tasks, particularly those who are data/information driven. In addition, having a long-time fixture in the board suite could help in establishing long-term relationships with key shareholders and could prevent miscommunications. The presence of a board suite would not only help in the engagements themselves, it also has the potential to reduce the volume of engagement requests that are focused at providing information to the board. Investors that are concerned with uninformed boards, or boards receiving overly biased information, could now be more confident that such concerns are reduced, and would have a clear avenue to provide any information they see as relevant to the board suite.

B. Back to the Insider Director Model?

Another prominent way to overcome board informational capture is to empower the lead director (or other independent directors) by increasing her compensation as well as her time commitment to the company, or in short, making her an insider.[167] One can envision a full-time lead director that serves only in that role during her tenure. This will in turn create a new type of "super director," and will facilitate a way to preserve the institutional knowledge of the board over the company. Such solution, in our view, carries a high price tag. Forcing the lead directors, or any other outside director, to refrain from having any additional board positions and expecting a time commitment that is closer to that of an executive, will chill certain candidates from joining the board. This is particularly relevant to extremely valued board members that are likely to be wanted in other boards.

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166. Tonello, *supra* note 71.

167. *See* Fairfax, *supra* note 40 (making the case for increasing the number of inside directors on the board).

In addition, a full appointment with a reflective salary could be inefficient as it may create waste. It also raises difficult questions: would paying the lead director as an executive provide the best return on investment to shareholders (especially if that could also lead to a relative increase in the payment of other directors)? Would the new responsibilities allocated to the lead directors require a full-time job?

Finally, and most importantly, the essence of the "independent board" is the separation between the directors and the company, so that the board will have an outside look that would enable it to monitor management appropriately. Making an outside director, in this case the lead director, an "insider" by paying her a full-time salary and increasing her dependence on the company[168] may solve the informational gap but it would also bring us back to square one: having insiders, whether they are executives or directors that are paid as executives, controlling the boardroom.

Another possible way to mitigate a board's informational capture is by prolonging the time directors serve on the board. As one of us discussed elsewhere,[169] the rising tenure of directors in United States companies could reflect an attempt to bridge the information gap that outside directors face when joining a company board. A longer tenure provides directors with more time to acquire industry, and firm-specific knowledge, and allows them to develop better working relationships with management. Presumably for the same reasons, boards have begun to meet more often[170] and public companies have been increasingly willing to limit the ability of their directors to serve on multiple boards[171] as a mean to ensure that each director has sufficient time to their directorship. Rising director compensation (to compensate for these additional time commitments)[172] and heightened prerequisites for audit and compensation committee members[173] further support this goal.

Although rising tenure and limitations on other directorships may improve director's time availability and her knowledge of the idiosyncratic attributes of company, they are not without costs. In particular, there is concern that long tenured directors might also erode the true independence of the board that the regulatory changes were

168. Since it will be her only job so both human capital and equity will be tied to the company.

169. Nili, *supra* note 14.

170. *See* STUART, *supra* note 15, at 28.

171. According to the Spencer Stuart survey, such limitations include a cap—which ranges from two to five other positions—on the number of additional boards for all directors or only for directors employed by public companies or a request that directors notify the chairman in advance of accepting an invitation to join another company board. *Id.* at 16.

172. *Id.* at 35.

173. Nili, *supra* note 14.

intended to ensure.[174] Additionally, long tenured directors who do not have their own office and employees that could assist them in analyzing the data received from the company would still heavily rely on management's input and wishes.

Our proposal to establish a board suite could balance this inherent tension between long tenure and independence.[175] For instance, one of the concerns often raised with the calls for limitations on director tenure is that such limitations would increase the information problem of directors—as higher turnover means less institutional knowledge in the board room. However, a board suite that has stable long term employees, and records, could alleviate this concern and in turn could facilitate a higher ratio of board refreshment when needed.

V. POTENTIAL OBJECTIONS

This Part considers and responds to a wide range of possible objections to our suggested proposal to empower independent directors. We show that the objections presented in this Part do not provide a good basis for rejecting our proposed solution.

A. Private Ordering

If the organizational proposal we raise in this Article is indeed value enhancing, then supporters of the market view could rightfully ask why public companies do not already follow this course of action and establish a board suite through private ordering. This enabling view, however, overlooks the limited incentives and ability of managers and directors to promote such proposal, as well as the inability of shareholders to quantify the magnitude and implication of board's informational capture.

Managers. Although Delaware law (or any other state law we are aware of) does not restrict our proposed solution, board members who are willing to hire their own advisors (on a constant basis) and to create their own suite will likely want the cooperation of management. However, a CEO, who is the most powerful person on the board and who benefits from her exclusive control over the company information has little incentive, if at all, to cooperate with demands to establish a board suite that would decrease, or even fully eliminate, the dependency of board members on the CEO. Moreover, a board that lacks resources and an ability to analyze and digest information quickly

174. *Id.*

175. *See* INSTITUTIONAL SHAREHOLDER SERVS., DIRECTOR TENURE (US AND CANADA) (2014), http://www.issgovernance.com/files/Directortenure-USandCanada.pdf [https://perma.cc/5ZPB-74FR].

is more likely to accept a managerial proposed plan of action as is, without questioning it. Therefore, a CEO has no incentive to provide board members with tools and resources that would better enable them to closely monitor the CEO's activities and decision making or challenge it at boardroom discussions.

To be clear, CEOs also have an incentive to facilitate the work of the board in order to improve the company value. They are also required to keep the board members well informed so that these board members could discharge their fiduciary duties. All we argue is that CEOs, as rational players, would prefer to have more power than less, and control over information is an important source of power they will not voluntarily relinquish. They would also prefer being subject to relaxed, rather than strict, board monitoring and to ensure that their preferred course of action will not be second guessed.

Directors. Even the directors, who could eventually benefit from our proposed institutional change, have limited incentives to promote it. First, managing their own board suite and supervising the work of the board's advisors requires additional time and effort, at least in the early stages. As long as director compensation remains substantially the same, they may be reluctant to undertake additional responsibilities without being adequately compensated. Moreover, under current Delaware regime, outside directors of public companies are generally protected from any out-of-pocket liability risks by directors' and officers' liability insurance, as long as they rely in good faith on information provided to them by management.[176] Therefore, such directors almost never face financial sanctions for relying on information provided to them by management,[177] and have little incentives to seek independent access to information.

Second, as discussed previously, managers are likely to oppose the creation of an office of the board in order to ensure that their preferred course of action will not be second guessed. Since managers of widely-held firms often exercise significant influence over the nomination and election of independent board members, directors who will insist on advancing the creation of an office of the board against the will of management may face a significant risk of not being re-elected.[178]

Third, certain directors, as any other individuals, are prone to suffer from cognitive biases, which make it difficult for them to admit that they currently suffer from informational capture, or that they are not performing their monitoring role properly. Admitting that such

176. DEL. CODE ANN. tit. 8, § 141(e) (2017).

177. Bernard S. Black et al., *Outside Director Liability*, 58 STAN. L. REV. 1055 (2006).

178. *See, e.g.*, Lucian Bebchuk et al., *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 785 (2002).

informational capture exists at a given boardroom could raise question marks regarding an outside director's ability to monitor management and could even expose them to litigation risk.

These explanations do not necessarily mean that directors will not benefit from the proposed change; they just explain why directors may initially be reluctant to push for such structural changes. At the end of the day, both board members and shareholders will benefit from having more engaged directors, who are equipped with better access to company-specific information, and who have advisors that could digest the information and follow market trends for the board. Board members could also be compensated for the additional supervisory work they will have to undertake.

Shareholders. Shareholders could also press management to accept our proposed solution, either though submitting a 14a-8 shareholder proposal or having informal engagements with issuers. However, shareholder initiatives with respect to the board of directors tend to focus on external parameters that are observable to outside shareholders, such as the composition of the board, diversity issues, representation of minorities, and board refreshment and tenure. The informational problem of board members is not observable to outsiders, as board discussions are confidential and board decision making, as well as their interaction with the CEO, are kept behind the scenes. Thus, shareholders have no ability to quantify the real magnitude and implication of board's informational capture, and may underestimate its severity. Also, even if demands to establish a board suite were raised during informal conversation with issuers, they are likely to be blocked by managements for the reasons discussed above.

B. Disrupting Management?

Critics of this proposed solution could also argue that it may disrupt the work of management and undermine board collegiality and cohesiveness.[179] According to this argument, managers will encounter greater difficulties to run the company's affairs and would be reluctant to take risks, knowing that any decision they make will be second guessed and challenged by the board, which, in turn, could lead to stagnation and discourage growth. Relatedly, it could be argued that a board's ability to second guess managerial decisions could bring hostility and fragmentation to the boardroom, create unconstructive environments and undermine the mutual trust between insiders who sit

179. Nili, *supra* note 86, at 521–22.

on the board, and, in particular, the company CEO, and outside board members.[180]

To be clear, the proposed solution does not aim at paralyzing management activity, but rather to provide board members with efficient tools to perform their monitoring role and bring new perspectives to board discussions. Providing boards with better tools to supervise management does not automatically have to come at the expense of efficient risk taking activities. To the contrary, directors have an interest in management continuing to take appropriate risks as long as such activity could increase firm value. The proposed solution merely ensures that directors will have the appropriate tools to monitor excessive risk taking or other managerial activities that are to the determinant of public shareholders.

Moreover, despite the importance of board cohesiveness, it should not be a goal by itself. Boards that are too "cohesive" could avoid taking the hard steps necessary to monitor the CEO and improve firm performance.[181] Indeed, studies have shown that lack of cohesiveness might actually contribute to company and board performance.[182]

1. DIRECTORS WILL REMAIN CAPTURED

It could also be argued that the proposed solution is unlikely to solve the fundamental incentive problem from which corporate boards suffer. Since management—even those of widely held firms—still

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180. A close knit board could be beneficial by increasing trust and openness between board members. *See* John F. Olson & Michael T. Adams, *Composing a Balanced and Effective Board to Meet New Governance Mandates*, 59 BUS. LAW. 421, 445–46 (2004) (suggesting that shared interests promote honest dialogue and constructive criticism within a group); *see also* James D. Westpahl & Edward J. Zajac, *Defections from the Inner Circle: Social Exchange, Reciprocity and the Diffusion of Board Independence in U.S. Corporations*, 42 ADMIN. SCI. Q. 161, 163–64 (1997) (citing social psychological research that demonstrates high levels of group cohesion facilitate cooperative behavior among group members).

181. *See* Jerry Goodstein & Warren Boeker, *Turbulence at the Top: A New Perspective on Governance Structure Changes and Strategic Change*, 34 ACAD. MGMT. J. 306, 313 (1991) (suggesting that the longer the members of a board of directors have worked together, the more likely they are to resist change); O'Connor, *supra* note 53, at 1256–57 (suggesting that groups create a shared perception, which may not be accurate, simply because some members in the group possesses a particular view).

182. *See* Khaled Elsayed, *Board Size and Corporate Performance: The Missing Role of Board Leadership Structure*, 15 J. MGMT. & GOVERNANCE 415, 423 (2011) (discussing the impact CEO-Chairman duality has on board effectiveness and how cohesiveness can cause independent directors to exit the game of monitoring altogether); Daniel P. Forbes & Frances J. Milliken, *Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-making Groups*, 24 ACAD. MGMT. REV. 489, 496 (1999) (suggesting that very high levels of cohesiveness are likely to prove detrimental to the quality of the board's decision making).

exercise significant influence over the election of board members by being involved in the preparation of the list of directors who stand for election (or re-election),[183] and since board members and CEOs often come from the same milieu,[184] board members are likely to remain captured and incentivized to keep treating the CEOs with "silk gloves" due to the special formal and business ties they develop along the years.

The proposed solution, however, does not aim at eliminating all potential agency concerns in United States public companies. As long as CEOs exercise certain indirect influence over the election (or re-election) of some board members, the latter will be dependent (at least up to certain extent) on the former. All we argue is that our proposed solution is likely to bridge the informational gaps from which the board suffers by facilitating board's ability to collect and process information independently. These additional resources provided to the board, in their turn, will reduce board reliance on the CEO as its sole source of information, and will increase the relative bargaining power of the board and its ability to be proactive.

Lastly, one could raise the concern that the proposed solution will replace one agency problem with another. Instead of relying on the company CEO for the provision of information and its analysis, board members will develop dependency on their outside advisors, who will become the new power players in the boardroom. Such concern, in our view, is also not well founded. The advisors, consultants or other members of the board suite will be directly subordinated to the board, some of them could be low-level employees, and the board could terminate their employment at the company at any time and for any reason. A board's relation with such employees will not be similar in any way to their relation with the CEO, and their role will be limited to assist the board with collecting and analyzing information, assessing management proposals, and performing the board's monitoring role.

2. Increased Administrative Costs

A final concern is that the proposed solution will increase the company's administrative costs. In particular, it could be argued that the company will have to hire a few full-time employees or advisors that will be subordinated to the board, and such advisors will perform a role that overlaps with that of certain legal or financial officers of the company. At the end of day, the company shareholders are the ones who will have to bear these extra administrative costs.

While the proposed solution is indeed likely to increase company expenses, it is important to remember that shareholders will also benefit

183. *See* Bebchuk et al., *supra* note 178, at 785.

184. *Id.*

from having a board that is more independent and is equipped with better tools to monitor and criticize management while reducing their reliance on the CEO. Therefore, any additional costs produced by the proposed solution should be offset by the benefits it generates to all shareholders. Moreover, the additional costs of hiring a couple of full-time employees or advisors that will be directly subordinated to the board are not expected to be very significant, especially for mid- or large-cap publicly traded companies, and could be subject to a cap.

VI. THE DOCTRINAL IMPLICATIONS

Our proposed solution to create an office of the board in order to mitigate boards' informational gaps has significant doctrinal implications on the way Delaware law should address the board's informational requirement as well as the legal implications that will be further discussed in this Part.

A. Board's Informational Requirements

First, mitigating the informational gap boards suffer from—through the presence of activist super directors—would increase the probability of boards' decisions being more fully informed and therefore reduce the level of scrutiny Delaware courts apply when decisions are contested.

Delaware law has long incentivized effective decision-making processes by making it and the information that underlies it a prerequisite for director protection under the business judgment rule.[185] Delaware courts have recognized that information is critical to a director's ability to fulfill her obligations under the fiduciary duty of care.[186] Furthermore, Delaware courts have been explicit that as part of this duty of care, boards must utilize an adequate process in making decisions.[187]

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185. Sharpe, *supra* note 54, at 279; Sharpe, *supra* note 47, at 1120.

186. *Smith v. Van Gorkom*, 488 A.2d 858, 874, 878, 893 (Del. 1985) (holding that the Trans Union board had breached their duty of care when they agreed to the sell the company to Marmon Group based in part on their failure to "inform themselves of all information reasonably available to them"), *overruled by Gantler v. Stephens*, 965 A.2d 695 (Del. 2009); *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000); *see also In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 122 (Del. Ch. 2009) (stating that to receive the protection of the business judgment rule, directors must have informed themselves of "all material information reasonably available to them").

187. *See, e.g.*, *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 367 (Del. 1993) ("Directors 'have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them. Having become so informed, they must then act with requisite care in the discharge of their duties.'")

Since the famous *Smith v. Van Gorkom* case,[188] a series of cases have made it clear that inherent in the duty of care is an assumption that boards must follow an adequate process in making their decision. Most notable is the *In re Caremark International Inc. Derivative Litigation*[189] decision, where the Delaware Court of Chancery noted that "relevant and timely information is an essential predicate for satisfaction of the board's supervisory and monitoring role under Section 141 of the Delaware General Corporation Law."[190] More importantly, the court noted that evaluating whether a board's decision complied with the fiduciary duty of care must be done in the context of the process the board employs. *In re Caremark* arguably sets forth an affirmative monitoring obligation for directors, and is considered the basis for the board's good faith obligation to monitor the corporation.

Our proposal to establish a board suite and institutionalize the data availability to directors—not only in specific circumstances, where a super director is present, but rather on an ongoing basis—will lead Delaware courts to look differently on the board's process when contested by shareholders, reducing the ex-post litigation costs to companies and ensuring more informed decisions by the board ex ante.

B. Section 141(e) and the Exculpatory Clause

Delaware law protects directors who are compelled to rely on expert advice to perform their directorial duties. Section 141(e) of the General Corporation Law states that:

> A member of the board of directors, or a member of any committee designated by the board of directors, shall, in the performance of such member's duties, be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person's

(quoting *Aronson*, 473 A.2d at 812); *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967, 970 (Del. Ch. 1996) ("[R]elevant and timely information is an essential predicate for satisfaction of the board's supervisory and monitoring role.").

188. 488 A.2d 858, 893 (Del. 1985) (finding that directors may be personally liable if their decision to approve a merger was too hasty or unsupported).

189. 698 A.2d 959 (Del. Ch. 1996).

190. *See id.* at 970.

> professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation.[191]

This allows directors to invoke a "reliance" protection in cases where there is an alleged breach of their duties to the corporation, and where their "good faith" reliance on expert advice or on information provided to them by the company, therefore, leading the court to dismiss a claim of duty of care breach.[192] In the words of the court, "[t]here can be no personal liability of a director for losses arising from 'illegal' transactions if a director was financially disinterested, acted in good faith, and relied on advice of counsel reasonably selected in authorizing a transaction."[193]

Similarly, Section 102(b)(7) allows companies to include in their charter a provision limiting directors' personal liability for monetary damages for any breach of the duty of care. Specifically, Section 102(b)(7) authorizes shareholders to include a clause in a corporation's charter eliminating a director's personal liability to shareholders for monetary damages in a breach of fiduciary duty, provided that such clause does not eliminate liability (1) for "any breach of the director's duty of loyalty," (2) "for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law," and (3) "for any transaction from which the director derived an improper personal benefit."[194]

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191. DEL. CODE ANN. tit. 8, § 141(e) (2016).

192. *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134, 1146 (Del. Ch. 1994). For a detailed analysis, see PETER ALLAN ATKINS, SKADDEN, ARPS, SLATE, MAEGHER & FLOM LLP, RELIANCE BY DIRECTORS: WHAT'S A CONSCIENTIOUS DIRECTOR TO DO? 3 (2014), https://www.skadden.com/insights/reliance-directors-whats-conscientious-director-do-0 [https://perma.cc/38TJ-BN63]; Richard B. Kapnick & Courtney A. Rosen, *The Exculpatory Clause Defense to Shareholder Derivative Claims*, 17 BUS. TORTS LITIG. J. 2, 2 (2010); Thomas A. Uebler, *Reinterpreting Section 141(e) of Delaware's General Corporation Law: Why Interested Directors Should Be "Fully Protected" in Relying on Expert Advice*, 65 BUS. LAW. 1023 (2010).

193. *Gagliardi v. TriFoods Int'l, Inc.*, 683 A.2d 1049, 1051 n.2 (Del. Ch. 1996); *see also Crescent/Mach I Partners v. Turner*, 846 A.2d 963, 985 (Del. Ch. 2000) ("Section 141(e) of Delaware's corporation law provides that directors are protected from a breach of the duty of care when the directors reasonably believe the information upon which they rely has been presented by an expert selected with reasonable care and is within that person's professional or expert competence.") (internal quotation omitted); *Perlegos v. Atmel Corp.*, Nos. 2320-N & 2321-N, 2007 WL 475453, at *20 n.149 (Del. Ch. Feb. 8, 2007) ("The principle that directors should be protected when they act with due care in reasonably relying upon the competent advice of an expert is expressed in Section 141(e) of the DGCL . . . .").

194. DEL CODE ANN. tit. 8, § 102(b)(7) (2016). For recent case law review, see Jason M. Halper, *Delaware Supreme Court Clarifies that Section 102(b)(7) Charter Provisions May be Basis for Dismissal at the Pleading Stage in Controlling Stockholder Transactions*, ORRICK, HERRINGTON & SUTCLIFFE, (Mar. 20, 2015), http://blogs.orrick.com/securities-litigation/2015/05/20/delaware-supreme-court-

While Delaware law seeks to limit the financial exposure disinterested directors may face in a breach of duty of care, it looks unfavorably upon the same reliance argument in cases where a director is an interested party and thus may be breaching her duty of loyalty[195] or in cases where the director does not rely on the information in "good faith."

For instance, Delaware courts have indicated that in order to prevail on a motion to dismiss, a plaintiff must show one of the following:

> (a) the directors did not in fact rely on the expert; (b) their reliance was not in good faith; (c) they did not reasonably believe that the expert's advice was within the expert's professional competence; (d) the expert was not selected with reasonable care by or on behalf of the corporation, and the faulty selection process was attributable to the directors; (e) the subject matter . . . that was material and reasonably available was so obvious that the board's failure to consider it was grossly negligent regardless of the expert's advice or lack of advice; or (f) that the decision of the Board was so unconscionable as to constitute waste or fraud.[196]

Importantly, in a recent case, *In re Rural Metro Corporation Stockholders Litigation*,[197] the Delaware court also noted that although Section 141(e) may provide a defense to a director, such defense may be limited to the financial liability and not to a general finding that the director breached their duty of care.[198]

In sum, Delaware law strives to protect the ability of directors to rely on the information given to them in order to prevent a chilling effect. But, such protection is not obsolete. Directors may still face monetary or reputational liability in cases where they were an interested

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clarifies-that-section-102b7-charter-provisions-may-be-basis-for-dismissal-at-the-pleading-stage-in-controlling-stockholder-transactions/ [https://perma.cc/2QTW-NTEJ].

195. *See Valeant Pharms. Int'l v. Jerney*, 921 A.2d 732, 736, 745 (Del. Ch. 2007); *see also Boyer v. Wilmington Materials, Inc.*, 754 A.2d 881, 906 (Del. Ch. 1999).

196. *Brehm v. Eisner*, 746 A.2d 244, 262 (Del. 2000).

197. C.A. No. 6350-VCL 64–65 (Del. Ch. March 7, 2014). In *In re Rural Metro*, the Court found that Rural Metro's directors (who had settled before trial and were no longer in the case) breached their fiduciary duty because their conduct in selling control of the company fell outside the range of reasonableness required by the enhanced scrutiny standard applied under *Revlon*, and that their financial advisor (the only remaining defendant) knowingly aided and abetted that breach. *Id.* (To find an aiding and abetting violation, the Court necessarily needed to find a breach of duty by the directors.)

198. ATKINS, *supra* note 192.

party, relied on information not in good faith, or where the information they relied upon was not "selected with reasonable care."[199] These "reasonableness" (objective) and "good faith" (subjective) standards allow courts to override the defenses directors may have through Sections 141 and 102(b)(7).

Understanding the informational capture that boards suffer from and the board suite's role in mitigating it, has several important implications to the proper application of Sections 141(e) and 102(b)(7) in specific cases. Specifically, we believe that boards are not only potentially at risk of breach of their duty of care when not investing the time to inform their selves based on the *Van Gorkom* line of cases. Boards may also, and should, face risk of a breach of duty of care when solely relying on management for their information as part of a breach of the "reasonableness" and "good faith" standards. As noted above, captured boards may not serve the best interests of shareholders, and therefore directors that refrain from actively obtaining objective and complete information may be breaching their duties to their shareholders.

We believe that current Delaware law already enables this view point. In our view, there is a question regarding whether boards that rely solely on information given to them by management and on experts' advice where such advice is arranged for by management could argue that they have acted in good faith and chose the information in a reasonable manner, and are thus entitled to the protection of these sections. In other words, management's blind reliance does not reflect a process according to which the information was "selected with reasonable care by or on behalf of the corporation"[200] and is especially problematic in cases where interested parties are trying to engage the board with supplemental information. According to the objective reasonableness standard, if a transaction is deemed unfair, the directors must prove that they considered all material information reasonably available about the issue presented,[201] and a "captured" director may not be able to meet that burden. Similarly, boards may not be able to meet the subjective "good faith" protection in cases where management has a vested interest in the transaction and the board refrains from independently gathering the needed information.[202]

199. DEL. CODE ANN. tit. 8, § 141(e) (2016).

200. *Id.*

201. Uebler, *supra* note 192, at 1042–43.

202. *See Sample v. Morgan*, 914 A.2d 647, 669 (Del. Ch. 2007) ("The Committee's generosity, if it could be called that, might be thought to have arisen as much from the rapid action of a poorly informed committee relying upon conflicted advice from a lawyer subservient to management rather than from a good faith exercise of business judgment."); *In re Tele-Communications, Inc. S'holders Litig.*, No. 16470, 2005 WL 3642727, at *10 (Del. Ch. Dec. 21, 2005) (stating that special committee's

Finally, activist super directors may themselves be subject to heightened exposure to personal liability in cases where a transaction approved by the board involves their own interest. As discussed, breach of duty of loyalty cases are not protected through Section 141(e) or 102(b)(7), and thus activist super directors may be found personally liable if a transaction that they have an interest in is challenged in court and is found unfair. This heightened exposure, in turn, may serve as a good check on activist directors intentionally "feeding" the board with inaccurate information.

CONCLUSION

Over the last few decades the composition of United States boardrooms has undergone a major shift: the move towards board independence. Motivated by the belief that independent directors are better equipped to detect fraud, protect shareholders' interests, and monitor managerial abuses of authority, regulatory reforms forced public firms to populate their boards and committees with independent directors.

Yet, little attention has been directed to the way board members obtain, digest and analyze the information necessary for their decision making. In this Article, we highlight how board members who are independent according to the exchanges' rules, still remain extremely dependent on management for the information they need to accomplish their role, and suffer from severe "informational capture."

We further highlight how activist hedge funds identified this capture and are using what is commonly termed as "super directors" to mitigate it. Contrary to many who cast the rise of activist super directors in a negative light,[203] we show that super directors are not a new phenomenon, are not limited to activist nominees, and perform an

use of experts who were already advising the corporation and its management "alone raises questions regarding the quality and independence of the counsel and advice received"); *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1283–84 (Del. 1988) ("Under Del. Code Ann. tit. 8, § 141(e), when corporate directors rely in good faith upon opinions or reports of officers and other experts selected with reasonable care, they necessarily do so on the presumption that the information provided is both accurate and complete. Normally, decisions of a board based upon such data will not be disturbed when made in the proper exercise of business judgment. However, when a board is deceived by those who will gain from such misconduct, the protections girding the decision itself vanish.") (internal quotation omitted); *see also* STEPHEN A. RADIN, THE BUSINESS JUDGMENT RULE 627 (6th ed. 2009) ("Courts are reluctant to defer to reliance by directors on the advice of financial advisors where the compensation to be paid to the financial advisor creates a conflict of interest. The most common example of such a conflict occurs where the advisor will receive a substantial contingent fee if a transaction succeeds . . . and the contingent fee is not linked to shareholder value.").

203. *See* Lipton, *supra* note 23; Millstein, *supra* note 23.

important positive role in mitigating the informational capture of the board. Activists' interventions, however, are limited in their number and duration. Therefore, despite the important role they play as information facilitators, they cannot offer a systematic solution to board's informational capture.

We, therefore, call for the creation of a board suite—a dedicated office within the board that would be in charge of independent data collection and dissemination, therefore minimizing the dependence of the board on management for its information.