Superstar CEOS and Corporate Law

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Assaf Hamdani
Tel Aviv University and ECGI

Kobi Kastiel
Tel Aviv University, Harvard Law School and ECGI

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We would like to thank Jonathan Bukshpan, Alona Gueta, Omer Muttai, Noam Norkin, Yuval Szamet and Maya Shamir for their excellent research assistance. We also benefited from suggestions and comments by Michal Barzuza, Lucian Bebchuk, Jesse Fried, Zohar Goshen, Sharon Hannes, Scott Hirst, Ehud Kamar, Louis Kaplow, Yaron Nili, Elizabeth Pollman, Ed Rock, Roy Shapira, Holger Spamann, Eric Talley and participants in the Law and Economics Seminar at Hamburg University, the Law and Economics Workshop at Harvard Law School, the 2022 ALEA Annual Meeting and the Corporate Law Academic Webinar Series (CLAWS). The Fischer Center on Corporate Governance at Tel Aviv University provided financial support.

Abstract

Larger-than-life corporate leaders, who can move fast and disrupt entrenched players are often perceived as having the vision, superior leadership, or other exceptional qualities that make them uniquely valuable to their corporation. While the business press, management experts, and financial economists have long studied these "superstar" CEOs, the legal literature has largely overlooked this phenomenon. In this Article we develop a framework to explore the challenges that superstar CEOs pose for corporate law doctrine and scholarship. We show that, even in the present era of increasingly powerful shareholders, superstar CEOs have significant power over boards of directors. The power of superstar CEOs arises not from their formal influence over director nomination, shareholders' rational apathy, or other sources of directors' agency costs. Rather, it is based on the widespread belief that a CEO, and only this individual CEO, has what it takes to produce superior returns for shareholders. Consequently, superstar CEOs' power is limited in both duration and scope: it is likely to vanish when markets lose faith in their star qualities, and it cannot be abused if its harm to the company exceeds the value of the CEO's unique contribution. This framework, we show, explains Elon Musk's continuous entanglement with Delaware courts, board failure at Uber and WeWork, the puzzling jurisprudence regarding management buyouts and the failure of governance reforms to contain CEO misconduct. It also cautions against reliance on existing governance arrangements to induce companies to advance stakeholder interests.

Keywords: Corporate governance, corporate law, superstar CEOs, agency costs, institutional investors, accountability, mergers & acquisitions, executive compensation, related-party transactions, judicial review

JEL Classifications: D21, G32, G34, G38, K22

Assaf Hamdani*
Professor of Law
Tel Aviv University, The Buchmann Faculty of Law
Dr George Wise St
Tel Aviv 6997801, Israel
e-mail: ahamdani@tauex.tau.ac.il

Kobi Kastiel
Associate Professor of Law
Tel Aviv University
Ramat Aviv
Tel Aviv 6997801, Israel
e-mail: kastiel@tauex.tau.ac.il

*Corresponding Author

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ABSTRACT

Larger-than-life corporate leaders, who can move fast and disrupt entrenched players are often perceived as having the vision, superior leadership, or other exceptional qualities that make them uniquely valuable to their corporation. While the business press, management experts, and financial economists have long studied these "superstar" CEOs, the legal literature has largely overlooked this phenomenon. In this Article we develop a framework to explore the challenges that superstar CEOs pose for corporate law doctrine and scholarship.

We show that, even in the present era of increasingly powerful shareholders, superstar CEOs have significant power over boards of directors. The power of superstar CEOs arises not from their formal influence over director nomination, shareholders' rational apathy, or other sources of directors' agency costs. Rather, it is based on the widespread belief that a CEO, and only this individual CEO, has what it takes to produce superior returns for shareholders. Consequently, superstar CEOs' power is limited in both duration and scope: it is likely to vanish when markets lose faith in their star qualities, and it cannot be abused if its harm to the company exceeds the value of the CEO's unique contribution. This framework, we show, explains Elon Musk's continuous entanglement with Delaware courts, board failure at Uber and WeWork, the puzzling jurisprudence regarding management buyouts and the failure of governance reforms to contain CEO misconduct. It also cautions against reliance on existing governance arrangements to induce companies to advance stakeholder interests.

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[*] Professor of Law, Tel Aviv University; Research Member, the European Corporate Governance Institute (ECGI).

[**] Professor of Law, Tel Aviv University Faculty of Law; Senior Research Fellow at the Program on Corporate Governance and Lecturer on Law, Harvard Law School; Research Member, ECGI; Affiliated Fellow, Stigler Center, Chicago Business School.

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SUPERSTAR CEOS AND CORPORATE LAW

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INTRODUCTION

Elon Musk is often described as a visionary, leading Tesla in its disruption of the car industry to become the world's most valuable car manufacturer.[1] He has

[1] Eva Matthews, *Factbox: Tesla Market Cap Eclipses that of Top 5 Rival Carmakers Combined,* REUTERS (Oct. 26, 2021, 3:25 PM), https://www.reuters.com/business/autos-transportation/tesla-market-cap-eclipses-that-top-5-rival-carmakers-combined-2021-10-26/

also repeatedly pushed the boundaries of corporate law. Musk is currently the direct target of two derivative lawsuits and the subject of a third one. One lawsuit attacks Tesla's 2016 acquisition of SolarCity—a public company in which Musk and his brother were the largest shareholders.[2] Another challenges Musk's unprecedented pay arrangement which, according to some estimates, could provide him with up to $56 billion.[3] The third lawsuit accuses Tesla's directors of abdicating their responsibility to monitor Musk's use of his Twitter account, which prompted the SEC to intervene.[4]

Musk's entanglement with Delaware courts presents corporate law scholars with two puzzles. First, his status as a visionary whose leadership is critical for Tesla's success[5] has been used by courts *against* Musk. Whereas Delaware courts normally dismiss lawsuits challenging executive pay and other business decisions,[6] the Chancery Court declined to dismiss the two lawsuits against Musk. Tesla's dependence on Musk's vision led the court to hold that Musk *controls* Tesla, thereby subjecting his transactions with the company to close judicial scrutiny under the entire fairness standard.[7]

The second puzzle concerns the failure of Tesla's board to supervise Musk's Twitter use. In the past, public company directors were commonly perceived as structurally weak and lacking incentives to resist powerful CEOs. Today, in contrast, shareholders empowered by legal reforms and market developments often discipline directors who are perceived as too deferential to management.[8] In fact, this rise of shareholder power and its effect on directors' accountability has led some scholars to argue that corporate law is dead.[9]

These puzzles, we argue, are typical of a phenomenon long recognized by management experts and financial economists, but largely overlooked by corporate law scholars[10]—the "Superstar CEO." Some CEOs have—or investors believe they have—the vision, charisma, superior leadership, or other exceptional

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[https://perma.cc/VJC9-MGBR].

[2] The Chancery Court has ruled in favor of Musk. *See In re* Tesla Motors, Inc., No. 12711-VCS, 2022 WL 1267229, at *1 (Del. Ch. Apr. 27, 2022). A motion to appeal has been filed. *See* I*n re* Tesla Motors, Inc. Stockholder Litigation, 2022 WL 2871317.

[3] *See* Tom Hals, *Musk's pay trial asks if Tesla's growth justifies $56 bln compensation,* REUTERS (Nov. 19, 2022), https://www.reuters.com/business/musks-pay-trial-asks-if-teslas-growth-justifies-56-bln-compensation-2022-11-18.

[4] *See infra* notes 162 –165, and accompanying text.

[5] Musk's genius reputation, however, has unraveled recently due to the significant decline in the Tesla share price following Musk's acquisition of Twitter, and the criticism over his decision to devote most of his attention to Twitter. *See* discussion in *infra* Section III.A.2.

[6] *See* Lawrence A. Hamermesh & Michael L. Wachter, *The Importance of Being Dismissive: The Efficiency Role of Pleading Stage Evaluation of Shareholder Litigation*, 42 J. CORP. L. 597 (2017).

[7] Another reason was Musk's ownership of a significant fraction of Tesla shares. *See* discussion *infra* Section III.A.

[8] *See infra* Part I.

[9] Zohar Goshen & Sharon Hannes, *The Death of Corporate Law*, 94 N.Y.U. L. REV. 263, 269 (2019) (claiming that "the more competent shareholders become, the less important corporate law will be").

[10] For a notable exception *see* Guhan Subramanian, *Deal Process Design in Management Buyouts*, 130 HARV. L. REV. 590, 619–23 (2016) (discussing the impact of valuable management). We discuss his analysis *infra* Section IV.B.1.

qualities that make then uniquely valuable to their corporations. Elon Musk is perhaps the most famous example today. Other well-known names include Jeff Bezos (Amazon), Jamie Dimon (J.P. Morgan), and Reed Hastings (Netflix).[11] In this Article, we develop the first account of the superstar CEO phenomenon and its implications for corporate law and governance.

We argue that, even in the era of increasingly powerful shareholders, superstar CEOs' unique contribution to company value accords them significant power over boards of directors. Even directors who are faithful agents of shareholders might struggle to fulfil their oversight duties when the CEO is believed to have star qualities. How effective can directors be in questioning the CEO's proposed strategy when all believe that the CEO's singular vision is what makes the company succeed? And how likely are directors to take harsh measures in response to the misconduct of a CEO who is commonly viewed as critical to the company's success?

Moreover, regardless of their sophistication or power, shareholders themselves might defer to superstar CEOs. As long as the CEO is viewed as critical to the company's success, shareholders may tolerate self-dealing, problematic governance and other practices that would normally be met with their resistance.[12] This could explain, for example, how Netflix has managed to disregard for a long while its shareholders' call for governance changes,[13] and why WeWork's savvy investors permitted its CEO to engage in questionable self-dealing transactions.[14]

In the present era of active and engaged shareholders, superstar CEOs' power is unlikely to arise from their influence over director nomination, shareholders' rational apathy, or directors' agency costs. Rather, a superstar CEO derives her power from shareholders' widespread belief that this CEO, and only this CEO, has what it takes to produce superior returns. Superstar CEOs' power is therefore limited in duration and magnitude. First, it is likely to vanish when markets lose faith in the CEO's ability to outperform. Second, boards and investors are likely to prevent superstar CEOs from abusing their power if the expected harm exceeds the value of the CEO's singular contribution to company value.

Our account offers several insights into the corporate governance of firms with superstar CEOs. First, board failure to control managers is not necessarily the result of directors' incentives not being aligned with those of shareholders. Even nominally independent directors—those who have no business or other ties to a/the CEO and who are genuinely committed to shareholders—might be limited in their ability to stand up to superstar CEOs. Indeed, our account explains why even sophisticated investors at VC-backed startups such as Uber and WeWork failed to contain self-dealing and other forms of managerial misconduct.[15] Thus,

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[11] *See infra* Sections II.A.2 and IIIA.3.

[12] *See infra* Section II.A.2.

[13] *See infra* notes 170-76, and accompanying text.

[14] *See infra* notes 220-226, and accompanying text.

[15] Other scholars have explained governance failures at startups. *See* Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155 (2019) ; Donald C. Langevoort & Hillary A. Sale, *Corporate Adolescence: Why Did "We" Not Work?*, 99 TEX. L. REV. 1347, 1367-70 (2021).

conventional governance remedies, such as enhancing director independence, might not improve board oversight of superstar CEOs.

Second, we shed new light on the link between superstar founders and the controversial use of dual-class structures.[16] Under our framework, superstar founders manage to go public with super-voting shares not because investors find this structure desirable to protect from capital market pressure to focus on short term results. Rather, founders perceived by investors as critical to the company's success use their power to bargain for super-voting shares at the IPO stage. This could explain why the number of dual-class IPOs have increased with the rise of winner-take-all markets.[17]

Our account also cautions against the reliance on existing governance arrangements to protect *stakeholder* interests. There is growing optimism that increasingly powerful shareholders will push companies toward incorporating environmental and other social considerations into their policies. Our analysis, however, shows that even powerful shareholders might be disinclined to confront a superstar CEO who is not promoting stakeholder interests.

Superstar CEOs pose at least two questions for corporate law. First, should corporate law contain superstar CEOs' power? Specifically, should courts play an active role in ensuring that superstar CEOs do not abuse the power arising from the common belief in their singular contribution to company value? Second, assuming that a CEO does make a unique contribution to company value, should corporate law allocate the extra value created by that CEO to shareholders or to the CEO? These questions inform several pieces of corporate law doctrine: courts' expansion of the definition of controlling shareholders, their treatment of management buyouts, and directors' duty of oversight.

In the *Tesla* decision, the court treated Elon Musk as Tesla's controlling shareholder given his "singularly important role in sustaining Tesla in hard times and providing the vision for the Company's success."[18] Our analysis explains, but does not necessarily justify, this legal development. At first sight, superstar CEOs' power calls for legal intervention to protect investors. The power of superstar CEOs, however, is constrained by the expected magnitude of their unique contribution. The benefits from legal intervention, therefore, are likely to be limited as well. We further identify institutional concerns that complicate the case for legal intervention to protect *shareholders* from CEOs who are powerful only because the market believes in their star qualities. Most notably, a rule targeting only superstar CEOs would be costly given the lack of a clear test for identifying these CEOs.

The question whether superstar CEOs—and not shareholders—are entitled to their singular contribution to firm value underlies the legal treatment of management buyouts (MBOs). Specifically, it sheds new light on the choice between two legal approaches for ensuring investors' right to the fair value of their shares under the appraisal remedy. The first approach relies on judicial valuation

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We explain the differences between our account and their explanation in Part III.B.2, *infra.*

[16] *See, e.g.*, Lucian A. Bebchuk & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 GEO. L.J. 1453 (2019).

[17] For an elaborated discussion see *infra* Section III.B.3.

[18] *In re* Tesla Motors, Inc., No. 127711, 2018 WL 1560293, at *16 (Del. Ch. Mar. 28 , 2018).

of the company, often using the Discounted Cash Flow (DCF) method. The second approach relies on the transaction price achieved after an effective sale process.[19] We show that the DCF approach awards *shareholders* the value created by a superstar CEO, while the transaction price approach, in contrast, allocates this value to the *CEO*.

Finally, we offer a new understanding of the *Caremark* doctrine. We show that shareholders, who benefit from the continued leadership of a superstar CEO, are likely to tolerate misconduct despite its effects on third parties (as long as it does not significantly diminish company value). Thus, without the threat of liability under the *Caremark* doctrine, boards might opt to overlook managerial misconduct.

We note that all CEOs are expected to be talented leaders who will increase company value, and it is difficult to draw a clear line between a CEO who simply does a good job and a "superstar." Indeed, the difficulty of identifying superstar CEO is perhaps one reason why legal scholars have largely ignored this phenomenon. Moreover, the belief that one individual significantly affects company value could be wrong as a matter of principle or in specific cases. For our purposes, what matters is only that such a belief does exist.

The Article proceeds in the following order. Part I describes the shift from powerful CEOs to powerful shareholders. Part II describes the rise of superstar CEOs and analyzes their unique characteristics. Part III discusses the ways in which the star qualities of some CEOs provide them with power vis-à-vis boards and shareholders. It also highlights the limits of such power and considers the implications of our analysis for recent corporate governance developments, including corporate scandals in start-up companies, the rise of dual-class shares, and stakeholder governance. Part IV highlights the implications of our analysis for corporate law. Part V concludes.

I. From Powerful CEOs to Powerful Shareholders

This Part describes the transition from powerful CEOs to powerful shareholders. Section A describes the traditional view under which the main goal of corporate law was to protect shareholders from powerful CEOs.[20] Section B reviews the market and legal developments that have tilted the balance of power in favor of shareholders. Section C reviews two responses to the rise of powerful shareholders. One response argues that the rise in shareholder power has significantly reduced the role of corporate law in inducing boards to protect investors. The other response argues that the balance has tilted too far, leading founders to insist on dual-class shares that would allow them to resist shareholder

[19] *See infra* Section IV.B.

[20] CEO power is a complex concept that has received significant attention in the academic literature. Marcel Kahan and Ed Rock define three essential elements of "CEO power": decision making (the ability of the CEO to decide key issues facing the firm), second-guessing (the ability of other actors to second-guess and penalize the CEO for a decision), and scope (the type of decisions that a CEO has the power to make). *See* Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 992–95 (2010).

pressures to produce short-term results.

A. The Traditional View: Powerful Managers

Corporate law and scholarship distinguish between controlled and widely held companies.[21] In controlled companies, a single shareholder (or a group of affiliated shareholders) holds a majority of the voting rights, and therefore has the power to appoint board members.[22] Controlling shareholders' large equity stake provides them with powerful incentives to supervise management.[23] However, controllers might abuse their dominant position through related party transactions or in other ways.[24] Therefore, in controlled companies, corporate law should protect minority investors from exploitation by controlling shareholders.

In widely held companies, no single shareholder owns an equity stake large enough to dictate vote outcomes or elect all the board members. With dispersed shareholders, management might choose to promote its interests at the expense of investors.[25] Therefore, an important goal of corporate law with respect to widely held companies is addressing the agency problem that arises from the disparity between shareholder and management interests.[26]

Shareholders of widely held companies have always held the formal power to elect board members, who in turn have the power to appoint the CEO. Therefore, in theory, public company CEOs could keep their positions only as

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[21] *See, e.g.*, Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Global Governance Standards*, 157 U. PA. L. REV. 1263 (2009) [hereinafter Bebchuk & Hamdani, *The Elusive Quest*]; Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641 (2006).

[22] *See, e.g.,* Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors and Controlling Shareholders*, 165 U. PA. L. REV. 1271, 1274 (2017) [hereinafter Bebchuk & Hamdani, *Independent Directors*]. As the authors explain, "the existing arrangements for electing directors" provide them with decisive power to appoint directors, including independent ones.

[23] *See, e.g.,* Bebchuk & Kastiel, , *supra* note16, at 1459; Zohar Goshen & Assaf Hamdani, *Corporate Control, Dual Class, and the Limits of Judicial Review*, 120 COLUM. L. REV. 941, 963-64 (2020) [hereinafter Goshen & Hamdani, *Dual Class*]. These incentives mitigate the concerns that might arise because controllers are generally insulated from the pressure of activist hedge funds. *See, e.g.*, *Kobi Kastiel, Against All Odds: Hedge Fund Activism in Controlled Companies*, 2016 COLUM. BUS. L. REV. 60, 126 (2016).

[24] *See*, *e.g.*, Simeon Djankov, Rafael La Porta, Florencio Lozpez-de-Silanes & Andrei Shleifer, *The Law and Economics of Self-Dealing,* 88 J. FIN. ECON. 430, 430 (2008) (noting, "… those who control a corporation, whether they are managers, controlling shareholders, or both, can use their power to divert corporate wealth to themselves rather than sharing it with the other investors. Various forms of such self-dealing include executive perquisites, excessive compensation, transfer pricing, appropriation of corporate opportunities, self-serving financial transactions such as directed equity issuance or personal loans to insiders, and outright theft of corporate assets"). For a review of the analysis of the relative efficiency of rules regulating self-dealing and related studies, see Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 571-75 (2016) [hereinafter Goshen & Hamdani, *Idiosyncratic Vision*].

[25] *See*, *e.g.*, Bebchuk & Hamdani, *The Elusive Quest*, *supra* note 21, at 1281.

[26] *See, e.g.,* ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 139–40 (1932) (observing that managers "while in office, have almost complete discretion in management"); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308, 315 (1976) (noting that "there is good reason to believe that the agent will not always act in the best interests of the principal").

long as investors were satisfied with their performance. Until at least two decades ago, however, CEOs were nonetheless considered quite powerful.[27] As Kahan and Rock explain, this power was manifested in several dimensions, including the ability of the CEO to act imperiously, impose her will and decide key issues facing the firm, as well as the limited extent to which directors and shareholders second guess or voice opposition to decisions made by CEOs.[28]

CEO power was the result of several factors. First, while they had the formal power to nominate directors, dispersed investors lacked incentives to do so and tended to follow a passive approach.[29] Electoral challenges were rare, and shareholders often voted for the directors nominated by management.[30] Shareholder passivity was reinforced by legal rules governing director elections. For example, under plurality voting, once the prevailing method for director elections, the directors who receive the most votes are elected.[31] This means that when the directors nominated by management are the only candidates for election, even directors lacking shareholder support would be elected.[32]

Second, CEOs were often involved in board appointments, including the nomination of independent directors.[33] It was therefore quite difficult to get elected to the board if the CEO objected to a potential candidate's nomination.[34]

Third, Delaware courts adopted a permissive approach to the use of anti-

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[27] *See, e.g.,* LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 23–33 (2006) ; Kahan & Rock, *supra* note 20, at 1038.

[28] *See* Kahan & Rock, *supra* note20 .

[29] *See, e.g.,* Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 584–91 (1990) (discussing rational apathy, and shareholder's lack of incentives to become informed). *See also* Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 261 (1962) ("It is commonplace to observe that the modern shareholder . . . does not think of himself as or act like an 'owner.'").

[30] *See, e.g.,* Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 683 (2007) (providing empirical evidence on the small number of electoral challenges). *See also* Kobi Kastiel & Yaron Nili, *Competing for Votes*, 10 HARV. BUS. L. REV. 287, 290 (2020) (explaining how in the past, shareholder voting was largely inconsequential, and shareholders often sided with management).

[31] CLAUDIA H. ALLEN, STUDY OF MAJORITY VOTING IN DIRECTOR ELECTIONS ii (2007), https://katten.com/Files/45102_FINAL%20%20MAJORITY%20VOTE%20SURVEY.pdf [https://perma.cc/P8FB-FZWD] (explaining that "[u]ntil recently, virtually all directors of U.S. public companies were elected under a 'plurality' vote standard"); Kahan & Rock,, *supra* note 20, at 1010 ("Of S&P 100 companies, only ten deviated from plurality voting in 2003.").

[32] *See* ALLEN, *supra* note31, at ii ("A nominee in an election to be decided by a plurality could theoretically be elected with as little as one vote, thereby ensuring that, in an uncontested election, nominees slated by a board will be elected and that board seats will not be left vacant").

[33] *See*, *e.g.*, Anil Shivdasani & David Yermack, *CEO Involvement in the Selection of New Board Members: An Empirical Analysis,* 54 J. FIN. 1829, 1830 (1999) (CEO is involved in nominating directors when the CEO is a member of the nominating committee); BEBCHUK & FRIED, *supra* note27, at 23–33.

[34] *See* Jay Lorsch & Jack Young, *Pawns or Potentates: The Reality of America's Corporate Boards*, 4 EXECUTIVE 85, 85–86 (1990) ("It is no exaggeration to say that many directors are beholden to the CEO for their position, when they are in fact supposed to be monitoring the CEO's performance/position").

takeover defenses, such as the poison pill.[35] The then-common combination of a poison pill and a staggered board, for example, has proven to be a serious impediment to hostile takeovers.[36]

Consequently, until at least two decades ago, academics believed that legal reforms were required to limit CEO power and contain management agency costs. The principal recommendation was to make corporate boards more accountable to shareholders and less dependent on the CEO.[37]

B. The Rise of Powerful Shareholders

Today, a combination of governance, legal, and market changes have made shareholders more powerful.[38] Some of these changes are a result of federal intervention or changes to corporate law; others can be attributed to shareholder demands or market developments.[39] We review some of these changes below.

The first change is the movement toward board independence.[40] Initially driven by market demand, this change accelerated with the enactment of the Sarbanes-Oxley Act[41] (SOX) and the stock exchange requirements demanding greater board independence.[42] As Jeff Gordon showed, the independence of board members increased from 20 percent in 1950 to around 75 percent in 2005, with the CEO often being the sole insider in the boardroom.[43] And the trend toward board independence is continuing.[44]

The second change is the declassification of the boards of America's largest corporations. Classified boards discourage hostile takeovers because a potential

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[35] *See, e.g.*, Moran v. Household Int'l, Inc., 500 A.2d 1346, 1357 (Del. 1985) (applying the business judgment rule to the board's adoption of a poison pill because it was adopted "in the good faith belief that it was necessary to protect" the corporation); Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 57 (Del. Ch. 2011) (approving the board's continued use of a poison pill even after losing one electoral challenge).

[36] Lucian Arye Bebchuk, John C. Coates IV, & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 910, 913–14 (2002) (stating that, to the authors' knowledge, there has not been a hostile acquisition of a firm with an effective staggered board where the firm kept its pill in place).

[37] Bebchuk & Hamdani, *The Elusive Quest*, *supra* note21, at 1296–97 (discussing the provisions that make directors more accountable to shareholders and how they are perceived positively).

[38] Edward B. Rock, *Adapting to the New Shareholder-Centric Reality,* 161 U. PA. L. REV. 1907, 1922 (2013) ("the old story of dispersed ownership, passive shareholders, and directors under the thumb of an imperial CEO is no longer accurate").

[39] *See, e.g.*, Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563, 2575-79 (2021) .

[40] 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) .

[41] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

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[42] N.Y. STOCK EXCH., N.Y.S.E. LISTED COMPANY MANUAL §§ 303A.01, .04, .05, .06 (2021); NASDAQ, NASDAQ STOCK MARKET LLC RULES § 5605(b)(1), (c)(2), (d)(2), (e) (2021).

[43] Gordon, *supra* note40, at 1473-75.

[44] Kobi Kastiel & Yaron Nili, *The Corporate Governance Gap*, 131 YALE L.J. 782, 834-35 (2022).

acquirer cannot simply replace an entire board at once.[45] When combined with a poison pill, this protection becomes extremely effective.[46] While the academic debate on the merits of classified boards remains lively,[47] shareholders have already made up their minds.[48] Their efforts to de-stagger corporate America have been remarkably successful,[49] with a decrease from 60% of S&P 500 firms having classified boards in 2000 to only 10% twenty years later.[50] Moreover, directors hesitate to adopt poison pills, fearing that such a move would cause proxy advisors to recommend, and institutional investors to vote, against reappointing them to the board.[51]

The third change is the rise of majority voting for directors. As noted earlier, under the traditional plurality voting regime, directors need not earn the support of a majority of shareholders to be elected in uncontested elections.[52] Under majority voting however, a director is elected to the board only upon obtaining a majority of votes.[53] Shareholder campaigns on this subject have had a tremendous impact; today, majority voting is the standard in large companies.[54] With board declassification and majority voting, elections are held more frequently and directors that lose favor with shareholders face an increased risk of losing their position.[55]

Perhaps the most important changes are the growing power of large institutional investors and the rise of activist hedge funds. Institutional investors

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[45] Bebchuk et al., *supra* note36 , at 893-94.

[46] *Id.* at 912–13; *see also* Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 48 (Del. Ch. 2011) (allowing the board to keep the poison pill even after the bidder won one round of director elections).

[47] For a review of the empirical evidence in support of annual elections, see Lucian Bebchuk, Scott Hirst, & June Rhee, *Towards the Declassification of S&P 500 Boards*, HARV. BUS. L. REV. 157, 165 (2013). For a different view, *see* K.J. Martijn Cremers, Lubomir P. Litov & Simone M. Sepe, *Staggered Boards and Long-Term Firm Value, Revisited*, 126 J. FIN. ECON. 422, 422–23 (2017) (finding a positive association between staggered boards and long-term firm value). *See also* Yakov Amihud, Markus Schmid & Steven Davidoff Solomon, *Settling the Staggered Board Debate*, 166 U. PA. L. REV. 1475 (2018).

[48] Kahan & Rock, *supra* note20 , at 1008.

[49] The Shareholder Rights Project at Harvard Law School assisted institutional investors in using shareholder proposals to precipitate the declassification of staggered boards at roughly 100 S&P 500 and Fortune 500 companies. *See* Bebchuk et al., *supra* note47 .

[50] Kastiel & Nili, *supra* note44, at 827.

[51] Goshen & Hannes, *supra* note 9, at 279-80; INSTITUTIONAL S'HOLDER SERVS., UNITED STATES PROXY VOTING GUIDELINES: 2016 BENCHMARK POLICY RECOMMENDATIONS 13 (2016) (explaining that poison pills, by definition, diminish some shareholders' rights and "adversely impact" some shareholders).

[52] Stephen J. Choi, Jill E. Fisch, Marcel Kahan & Edward B. Rock, *Does Majority Voting Improve Board Accountability?*, 83 U. CHI. L. REV. 1119 (2016).

[53] *Id.*

[54] *Id.*; *see also* DAVID WEBBER, THE RISE OF THE WORKING-CLASS SHAREHOLDER: LABOR'S LAST BEST WEAPON 75 (2018) (discussing how the United Brotherhood of Carpenters Fund utilized shareholder proposals to successfully influence many target companies to adopt majority voting); Kastiel & Nili, *The Corporate Governance Gap*, *supra* note44 , at 828–-29 (showing that 88% of companies that make up the S&P 500 required a majority vote for board elections in 2020, and above 60% and 55% of the S&P 400 and S&P 600, respectively, require majority voting).

[55] Kahan & Rock, *supra* note 20, at 1042.

today collectively own the majority of the shares of U.S. public companies.[56] These holdings are increasingly concentrated in the hands of a few large asset managers.[57] Institutional investors have increasingly used their power to engage with portfolio companies—favoring changes to executive compensation, supporting proposals that empower shareholders, and withholding votes from directors who systematically ignore shareholder demands or proposals enjoying broad support.[58]

Increased institutional ownership has facilitated the rise of activist hedge funds.[59] These investors take a significant equity position in target companies and use various tools, from behind-the-scenes communication with management to proxy fights, to bring about change in the target companies' business strategy or governance.[60] They sometime manage to make director appointments that lead to the departure of CEOs whose performance is deemed unsatisfactory.[61] Successful activist campaigns often require support by institutional investors.[62]

The combined effect of these changes has been to empower shareholders at the expense of CEOs.[63] One of the primary indications of the change in the balance of power between shareholders and management is the shortening of CEO tenure. Steven Kaplan and Bernadette Minton provide evidence that CEO tenure in large U.S. companies was shorter between 1998 and 2005 than it was in the 1970s to the 1990s.[64] Marcel Kahan and Edward Rock show that between 2000

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[56] *See, e.g.,* Edward B. Rock, *Institutional Investors in Corporate Governance*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 363, 365 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018); Assaf Hamdani & Sharon Hannes, *The Future of Shareholder Activism*, 99 B.U. L. REV. 971, 973 (2019).

[57] *See, e.g.*, Lucian Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 732–40 (2019) [hereinafter Bebchuk & Hirst, *The Specter*] (documenting that the "Big Three" collectively vote about 25% of the shares in all S&P 500 companies); John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve* (Harvard Pub. L. Working Paper, Paper No. 19-07, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3247337 [https://perma.cc/EN69-QKQL].

[58] Kastiel & Nili, *Competing for Votes*, *supra* note 30, at 310, 312–14, 319–21 (providing evidence that "investors do not always stick in the pocket of management," in connection with votes on proxy fights, shareholder proposals, say-on-pay votes and uncontested director elections).

[59] Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 874-75 (2013).

[60] Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1734-36 (2008) (describing the main characteristics of activist hedge funds); Lucian A. Bebchuk, Alon Brav, Wei Jiang & Thomas Keusch, *Dancing with Activists*, 137 J. FIN. ECON. 1, 6-34 (2020) (providing a comprehensive analysis of the drivers, nature, and consequences of activists' engagements and settlements with companies).

[61] Kahan & Rock, *supra* note 20, at 1029–32, 1061–62.

[62] Kastiel & Nili, *Competing for Votes*, *supra* note30, at 90.

[63] *See, e.g.*, Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767 (2017); Kahan & Rock, *supra* note 20; Lund & Pollman, *supra* note 39 . *See also* Kastiel & Nili, *The Corporate Governance Gap*, *supra* note 44, at 797.

[64] Steven N. Kaplan & Bernadette A. Minton, *How Has CEO Turnover Changed? Increasingly Performance Sensitive Boards and Increasingly Uneasy CEOs* 1, 1-2 (Nat'l Bureau of Econ. Rsch., Working Paper No. 12465, 2006),

and 2007, in a significant portion of S&P 500 companies, the tenure of outside directors was longer than that of the CEO's.[65]

To summarize, the persistent trend toward shareholder empowerment and the rise of activist hedge funds mean that CEOs of widely held companies are less powerful today than they were two decades ago. CEOs have lost their formal influence over director nomination, and contested elections are more prevalent. We should stress that we do not argue that managerial agency costs have become extinct. It is fair to say, however, that underperforming CEOs face a meaningful risk of removal by disgruntled investors.

C. Is Corporate Law Dead?

The dramatic rise of shareholder power has generated two lines of responses. First, some argue that corporate law has lost its importance in protecting investors from managerial agency costs. In a market environment in which shareholders are sufficiently sophisticated, powerful and active, there is less need for legal intervention to protect their rights.

Edward Rock, for example, has claimed that "since the early 1980s, the U.S system has shifted from a manager-centric system to a shareholder-centric system."[66] As a result, he argues, managers today tend to think like shareholders.[67] Zohar Goshen and Sharon Hannes have argued that, with shareholders becoming more powerful, corporate law has lost its role in of protecting investors from managers. In their words, the "transformation of American equity markets from retail to institutional ownership has relocated control over corporations from courts to markets and has led to the death of corporate law."[68]

The second response argues that the balance of power has tilted too far in favor of shareholders, who push corporate leaders to favor short-term gains over long-term value creation.[69] Critics further link the rise of shareholder power to the recent increase in dual-class initial public offerings (IPOs), which ensure that founder-CEOs retain control over their corporation.[70] Almost 30 percent of IPOs

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https://www.nber.org/system/files/working_papers/w12465/w12465.pdf. [https://perma.cc/3EJ3-JN7Q].

[65] Kahan & Rock, *Embattled CEOs*, *supra* note 27, at 1032.

[66] *See* Rock, *Shareholder-Centric Reality*, *supra* note 38, at 1910.

[67] *Id*. ("With respect to the most important decisions—such as changes in control—there is substantial reason to believe that managers and directors today largely 'think like shareholders.'")

[68] Goshen & Hannes, *supra* note 9, at 265 (footnote omitted).

[69] *See, e.g.* , Zohar Goshen & Reilly Steel, Raiders, Activists, and the Risk of Mistargeting 4–5 (Eur. Corp. Governance Inst., Law Working Paper No. 613/2021, 2021),https://ecgi.global/sites/default/files/working_papers/documents/goshensteelfinal.pdf [https://perma.cc/SJ3J-78P5]. . For reviews of the pervasive argument that activist shareholders cause executives to focus on short-term results, see Lucian A. Bebchuk, *The Myth That Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637 (2013); Mark J. Roe & Roy Shapira, *The Power of the Narrative in Corporate Lawmaking* 11 HARV. BUS. L. REV. 233 (2021).

[70] *See, e.g.*, Dorothy S. Lund, *Nonvoting Shares and Efficient Corporate Governance*, 71 STAN. L. REV. 687, 715–16 (2019) (explaining that proponents of dual-class structures contend that they allow management to pursue its long-term objectives); David J. Berger, Steven Davidoff Solomon & Aaron J. Benjamin, *Tenure Voting and the U.S. Public Company*, 72 BUS. LAW. 295, 298 (2017)

between 2017 and 2019 had dual-class structures.[71] These structures are especially prevalent among high-tech companies, with 46.6 percent of the tech IPOs in 2021 adopting them.[72]

Against this background, the *Tesla* case seems quite puzzling. If powerful shareholders are effective in disciplining boards, how can one explain their reluctance to held Tesla's board accountable for its failure to control Musk's use of Twitter, for example? Moreover, as the examples that we discuss in the next Part demonstrate, some CEOs stay at the helm for many years, even when they repeatedly ignore shareholder opposition to their companies' governance arrangements.[73]

II. SUPERSTAR CEOS

Our core claim is that some CEOs—we call them "superstar CEOs"—can be quite powerful even when shareholders are not reticent and boards are accountable to shareholders. The power of these CEOs stems not from their control over director elections or other formal channels, but from the market's belief that through their vision or other exceptional qualities, they make a singular contribution to company value.

In this Part, we outline the features that might make a CEO uniquely valuable. Section A focuses on the perception that an individual CEO is uniquely valuable. Section B considers other factors that often, but not always, bolster the power of superstar CEOs: founder status and a significant equity stake.

A. Unique Contribution to Company Value

There is no precise definition of a superstar or uniquely valuable CEO. All CEOs are expected to be talented leaders who will serve their companies well and increase their value,[74] and it is difficult to draw a clear line between a CEO who simply does a good job and a "superstar" or visionary CEO. Indeed, the difficulty of identifying superstar CEO in real time (and not in hindsight) is perhaps one reason why legal scholars have largely ignored this phenomenon.

Our analysis will therefore proceed in three steps. We begin by describing our notion of superstar CEOs and the characteristics that might lead investors to believe that an individual CEO is uniquely valuable. We then provide some illustrative examples of larger-than-life CEOs. Finally, we review some of the rich body of research by business experts and financial economists on the unique contribution that certain individual CEOs can make to company value.

(tying the rise of dual-class shares to the "deretailization" of stock ownership).

[71] *See* Dhruv Aggarwal, Ofer Eldar, Yael V. Hochberg & Lubomir P. Litov, *The Rise of Dual-Class Stock IPOs,* 144 J. FIN. ECON. 122, 123 (2022).

[72] Jay R. Ritter, *Initial Public Offerings: Updated Statistics*, WARRINGTON COLL. OF BUS., 68 https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf. [https://perma.cc/WM6J-2WU8] (Jan. 4, 2023).

[73] *See supra* note 58; *infra* notes 155-56.

[74] *See, e.g.*, Alex Edmans & Xavier Gabaix, *Executive Compensation: A Modern Primer*, 54 J. ECON. LITERATURE 1232, 1233 (2016) (noting that "CEOs have a very large effect on firm value compared to rank-and-file employees. Thus, in a competitive labor market, it may be optimal to pay high wages to attract talented CEOs . . . .").

1. The Qualities of Superstar CEOs

We view superstar CEOs as individuals who directors, investors, and markets believe they make a unique contribution to company value. What makes investors believe that a CEOs is critical to the company's success? There is no one answer. Markets may believe, for example, that only the CEO possesses the idiosyncratic vision that is essential to make the company outperform the competition. Or that only she possesses exceptional skills or other rare qualities that are crucial for implementing the company's strategy. Another explanation is that the CEO possesses the charisma and ability to sell their vision that is crucial for attracting investors, employees or other constituencies.[75] Max Weber, for example, views charismatic leaders as those who have specifically extraordinary, or even supernatural, skills that set them apart from ordinary people.[76] And in our context, these are CEOs who directors, investors, and markets *believe* they have *charismatic power* or other *extraordinary qualities* that set them apart from other ordinary CEOs.

Moreover, CEOs might act strategically to make themselves uniquely valuable to a specific company. They might make firm-specific investments that enable them to generate unique value only in the specific company under their leadership or making the firm invest in assets that have a higher value under them than under the best alternative manager.[77]

For our present purposes, the precise factors that could make certain individuals uniquely valuable are less important.[78] Moreover, the perception that a CEO is uniquely valuable could be wrong as a matter of principle or in the case of certain individuals. For our purposes, what matters is only that such a *belief* does exist.

The media, management experts, and financial economists have long studied the superstar CEO phenomenon due to its importance. Before discussing the academic literature, however, we would like to provide some recent examples of such larger-than-life CEOs.

2. Examples

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[75] For a thoughtful analysis linking CEOs' power to their charisma, see Rock and Kahan, *supra* note 20 .

[76] CHRISTOPHER ADAIR-TOTEFF, *Max Weber's Charisma*, *in* MAX WEBER'S SOCIOLOGY OF RELIGION 29, 36 (Mohr Siebeck 2016). Yet, as Weber makes clear, charismatic power "is only effective insofar as it is seen to be." Steven Lukes, *The Big Picture: Trump's Charisma*, PUB. BOOKS (Oct. 25, 2017), https://www.publicbooks.org/big-picture-trumps-charisma/ [https://perma.cc/7DCE-ZD43]

[77] Andrei Shleifer & Robert W. Vishny, *Management Entrenchment: The Case of Manager-Specific Investments, 25* J. FIN. ECON. 123, 123–124 (1989).

[78] Whether the CEO's superstar status is firm-specific or could be transferred will become relevant when we discuss the bargaining power of the parties and its implications for corporate law and governance in Parts III and IV.

The superstar CEO phenomenon is not new, but our era of rapid technological changes and the rise of a "winner takes all" market provides well-known examples of superstar CEOs: Elon Musk of Tesla, Reed Hastings of Netflix, and Jeff Bezos of Amazon. Note that we do not argue that these individuals do have a singular contribution to company value. Rather, we aim at demonstrating the common belief—by markets and even courts—that these individuals are uniquely valuable for their companies. Our examples here include CEOs of public companies. In the next Part, we present some private company examples.

Tesla. Under Elon Musk's leadership, Tesla's share price increased over 23,000% in a little more than a decade since its 2010 IPO, making Tesla the world's most valuable automaker.[79] *Forbes* magazine recently named Elon Musk today's most successful business mind (along with Jeff Bezos), noting that he "works to revolutionize transportation both on Earth and in space."[80] Musk is often viewed as the "face of Tesla."[81] The CEO of Panasonic recently suggested Musk is "a genius who defies common sense."[82] And as another prominent expert in the auto industry put it: "Elon is Tesla, Tesla is Elon."[83]

As we noted above, the notion that Musk is uniquely valuable to Tesla was acknowledged by the Delaware Chancery court.[84] The court found that Tesla board was "well aware of Musk's singularly important role in sustaining Tesla in hard times and providing the vision for the Company's success." [85]His master plans, the court explained, "provide the architecture by which the Company has been and will be operated . . . . "[86] And as the company itself acknowledged in its public filings, Tesla is "highly dependent" on the services of Elon Musk, and if it were to lose his services, that loss "would . . . negatively impact [its] business, prospects, and operating results as well as cause [its] stock price to decline."[87]

Recent events reinforce this view, showing that once Musk is no longer focused on Tesla, Tesla is in trouble.[88] Since Musk announced his plans to acquire

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[79] Stock Data of Tesla, Inc. (TSLA), YAHOO! FIN., https://yhoo.it/3E58pvW (last visited Feb. 8, 2022).

[80] America's Most Innovative Leaders, FORBES, https://www.forbes.com/lists/innovative-leaders/#3610349f26aa [https://perma.cc/4Y7A-9QN4] (last visited Jan. 20, 2022).

[81] *In re* Tesla Motors Stockholder Litig., No. 12711-VCS, 2018 ,, 2020 WL 553902 (Del. Ch. Mar. 28, 2018).

[82] *See Panasonic CEO Says Tesla's Elon Musk a 'Genius Who Can Be Overly 'Optimistic*,*'* REUTERS , https://www.reuters.com/article/us-panasonic-tesla-idUSKBN2482BF [https://perma.cc/J4TX-CE37] (last updated July 7, 2020, 12:00 PM)..

[83] New York Law Journal, Tesla's Stock Option Grant to Elon Musk: Part 2, MCCARTER & ENGLISH (June 22, 2018), https://www.mccarter.com/insights/teslas-stock-option-grant-to-elon-musk-part-2-new-york-law-journal/[https://perma.cc/T9CL-BM7H] (quoting Ed Kim, vice president of industry analysis at AutoPacific, and noting that "Mr. Musk is a visionary leader of Tesla and Tesla very much depends on his outstanding talents in the design, production and marketing of Tesla vehicles").

[84] In re Tesla Motors Stockholder Litig., 2018 WL 1560293, at *15-16 (Del. Ch. Mar. 28, 2018).

[85] *Id,* at **16.*

[86] *Id.* at *16.

[87] *Id.* at *2 (alterations in original).

[88] Peter Hoskins, *Elon Musk Sells $3.6bn of Shares in Electric Car Maker Tesla,* BBC NEWS (Dec. 15, 2022), https://www.bbc.com/news/business-63981767 [https://perma.cc/ZD9P-ZZXZ]. ("Mr [sic] Musk completed the takeover of Twitter in October and since then has focused a

Twitter, Tesla share price has declined significantly, more than any other competitor,[89] falling to its lowest price in more than two years.[90] Some experts and investors are of the opinion that Musk's increased attention to Twitter is to blame,[91] especially after completing its acquisition in October 2022[92] and becoming the owner and CEO.[93] The latest events have even raised the question – was ever Tesla "worth that much", or was it just that Musk was perceived as a "brilliant, cool innovator"?[94]

Netflix. In 1997, Reed Hastings co-founded Netflix, the first online DVD rental store.[95] In 1998, he took over the CEO position.[96] Under his leadership, Netflix has become the largest entertainment-media company by market capitalization, with over 230 million subscribers worldwide.[97] Netflix's changed its core business over the years from a DVD rental service to a streaming service.[98]

Netflix's success is attributed to its unique culture, which encourages competitiveness, critical thinking, invention, and transparency.[99] Reed Hastings is

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significant amount of his time on the business".)

[89] Lora Kolodny, *Elon Musk Tries to Explain Why Tesla Shares Are Tanking,* CNBC (Dec. 20, 2022, 5:55 PM), https://www.cnbc.com/2022/12/20/elon-musk-tries-to-explain-why-tesla-shares-are-tanking.html [https://perma.cc/RF3V-3WJ8].

[90] Kari Paul, *Tesla Stock Marks Lowest Close in Years as Investors Worry About Musk's Focus*, GUARDIAN (Dec. 27, 2022, 6:48 PM), https://www.theguardian.com/technology/2022/dec/27/tesla-stock-drops-lowest-close-years-elon-musk [https://perma.cc/69PJ-HMHB] .

[91] Faiz Siddiqui, *Twitter Brings Elon Musk's Genius Reputation Crashing down to Earth,* WASH. POST (Dec. 24, 2022, 6:00 AM), https://www.washingtonpost.com/technology/2022/12/24/elon-musk-twitter-meltdown-tesla [https://perma.cc/DX5U-NRRG]. ("[S]ome investors in Tesla, by far the biggest source of his wealth, have begun to see him as a liability").

[92] Kate Conger & Lauren Hirsch, *Elon Musk Completes $44 Billion Deal to Own Twitter,* N.Y. TIMES (Oct. 27, 2022), https://www.nytimes.com/2022/10/27/technology/elon-musk-twitter-deal-complete.html .

[93] Paul, *supra* note 91.

[94] Paul Krugman, *Did the Tesla Story Ever Make Sense?*, N.Y. TIMES (Dec. 27, 2022). https://www.nytimes.com/2022/12/27/opinion/tesla-stock-elon-musk.html [https://perma.cc/3NLV-HX93].

[95] Nicole Sperling, *Long Before 'Netflix and Chill,' He Was the Netflix C.E.O.*, N.Y TIMES (Sep. 18, 2019), https://www.nytimes.com/2019/09/15/business/media/netflix-chief-executive-reed-hastings-marc-randolph.html [https://perma.cc/89XW-QCJD]

[96] Reed Hastings, LINKEDIN, https://www.linkedin.com/in/reedhastings/ (last visited Feb. 15, 2023).

[97] Julia Stoll, *Quarterly Netflix Subscribers Count Worldwide 2013-2022*, STATISTA (Jan. 20 , 2023), https://www.statista.com/statistics/250934/quarterly-number-of-netflix-streaming-subscribers-worldwide/[https://perma.cc/G8LF-F2GP].

[98] *See, e.g.*, Rani Molla & Peter Kafka, *How One of Netflix's Biggest Mistakes Helped Build its Culture,* VOX (June 23, 2020, 9:12 AM), https://www.vox.com/recode/2020/6/23/21287050/netflix-effect-qwikster-culture-podcast-vox-recode-land-of-the-giants-reed-hastings [https://perma.cc/4MMF-YJJ9].

[99] For example, when an employee is fired, the reasons for his dismissal are emailed to the whole staff. Todd Spangler, *Reed Hastings on New Book, Netflix's Future and One of His Toughest 'Keeper Tests',* VARIETY (Sept. 7, 2020, 7:00 AM), https://variety.com/2020/digital/news/reed-hastings-book-netflix-cfo-keeper-test-1234755643/)[https://perma.cc/7256-E6G8].

the public face of this culture, which he named "No Rules Rules."[100] A presentation outlining Hastings's radical management philosophy has been viewed over 20 million times since he posted it online. Sheryl Sandberg, the chief operating officer of Facebook, described it as "the most important document ever to emerge from Silicon Valley."[101] Hastings's book about his management philosophy is a bestseller,[102] and he has drawn praise for being a "genius,"[103] and one of the greatest success stories in the technology business.[104]

Interestingly, Hastings holds only a tiny fraction—1.2%—of Netflix's voting rights. He therefore depends on the company's shareholders for his continued service. Yet, despite the fact that Netflix has systematically ignored shareholder demands concerning its corporate governance, he has continued to serve as the company's chair and CEO.[105]

Amazon. Jeff Bezos, who founded Amazon in his garage in Seattle in 1994, served as CEO for 27 years.[106] He is credited with having the strategic vision that led the company to its phenomenal success, transitioning it from a modest online bookseller into one of the world's largest corporations.[107] Under his leadership, Amazon's share price has increased 198,989% (!) since its IPO in 1997, making Amazon the fifth largest company by market cap as of the end of 2021.[108] The media viewed Bezos as a unique leader, describing him as a "once-in-a-generation-type-CEO."[109]

Not surprisingly, investors seemed to believe that Bezos was essential to the

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[100] Reed Hastings & Erin Meyer, NO RULES RULES: NETFLIX AND THE CULTURE OF REINVENTION (Penguin, 2020). .

[101] *The Hastings doctrine: Can Reed Hastings preserve Netflix's culture of innovation as it grows?* ECONOMIST (12.09.2020), https://www.economist.com/business/2020/09/12/can-reed-hastings-preserve-netflixs-culture-of-innovation-as-it-grows.

[102] Hastings & Meyer, *supra* note 100.

[103] Kinsey Grant, *Why Netflix CEO Reed Hastings Is a Genius,* STREET (Nov. 3, 2017, 9:26 A.M.), https://www.thestreet.com/investing/stocks/why-netflix-ceo-reed-hastings-is-a-genius-14368670 [https://perma.cc/8AZW-LCSB].

[104] Nathan McAlone, *Netflix CEO Reed Hastings Asked His Board to Fire Him Twice Early in His Career—and They Refused,* BUSINESS INSIDER (Sept. 20, 2015, 8:01 AM), https://www.businessinsider.com/netflix-ceo-reed-hastings-asked-his-board-to-fire-him-twice-early-in-his-career-they-refused-2015-9[https://perma.cc/5YZL-KGG5].

[105] *See infra* notes 175–177, and accompanying text.

[106] Terry Collins, *Jeff Bezos Steps Down as Amazon CEO Today. Here Are Some of His Biggest Moments as He Becomes Executive Chair,* USA TODAY (July 6, 2021, 9:13 AM), https://www.usatoday.com/story/tech/2021/07/05/amazon-ceo-jeff-bezos-leaving-andy-jassy/7847643002/[https://perma.cc/KQP9-GPR5].

[107] *See Jeff Bezos Leaves Enduring Legacy as He Steps Away as Amazon CEO,* NDTV (July 4, 2021, 8:44 AM), https://www.ndtv.com/world-news/jeff-bezos-leaves-enduring-legacy-as-he-steps-away-as-amazon-ceo-2478759 [https://perma.cc/HYZ2-F2RP] [hereinafter *Bezos Leaves Enduring Legacy*].

[108] *Amazon.com, Inc. (AMZN) Stock Price News, Quote & History*, YAHOO! FIN., https://finance.yahoo.com/quote/AMZN/ (last visited December 9, 2021); *see also Largest Companies by Market Cap*, COS. MKT. CAP, https://companiesmarketcap.com/[https://perma.cc/J99V-UMBG].

[109] Brian Sozzi, *Why Amazon CEO Jeff Bezos' Departure Would Be Bad News for Investors*, YAHOO! (May 30, 2019), https://www.yahoo.com/video/why-amazon-ceo-jeff-bezos-departure-would-be-bad-news-for-investors-181555666.html [https://perma.cc/8PS6-TLEF].

company's meteoric growth.[110] He was praised for his ability to make big, important decisions without offering his shareholders any financial or strategic rationale.[111] Jeff Bezos holds 14% of the company's voting rights,[112] but as one commentator noted, "his influence would be the same if he had 51 percent shares outstanding or 1 percent."[113] And while Bezos recently handed over the CEO position, he still retains a key role as Executive Chair of the company.[114]

3. Academic Literature and Evidence

Although the notion that certain CEOs have a singular contribution to company value has occasionally been recognized by courts,[115] the legal literature has largely overlooked the superstar CEO phenomenon.[116] Management scholars and financial economists, in contrast, have developed a rich body of literature on the link between individual CEOs and firm value. This subsection reviews several lines of this research. Our goal is to show that the notion that firm value could be tied to specific individuals is quite pervasive outside legal scholarship.

The business press portrays some CEOs as "larger-than-life" and celebrates their magic touch.[117] It also discusses the problems that arise when companies are too dependent on their charismatic leaders.[118] Management experts analyze the positive or negative effects of charismatic CEOs on firms' decision-making,[119] and the difficulty of filling the position of a visionary CEO.[120] Economists have argued that CEOs might take strategic measures to make themselves indispensable, for example, by making the firm invest in assets that have a higher

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[110] *Id.*

[111] James Mackintosh*, Where Bezos Leads, Amazon Shareholders Blindly Follow,* WALL ST. J. (June 22, 2017, 8:16 PM), https://www.wsj.com/articles/where-bezos-leads-amazon-shareholders-blindly-follow-1498147966 [https://perma.cc/GH7N-3CAY] (discussing Bezos' ability to launch the takeover of Whole Foods without offering any rationale).

[112] Amazon.com, Inc., Definitive Proxy Statement (Form DEF14A) 61–62 (May 26, 2021).

[113] *See* Mackintosh*, supra* note112 .

[114] *Bezos Leaves Enduring Legacy, supra* note 108.

[115] See *infra* Section III.A.1.

[116] For a notable exception, see Subramanian, *supra* note10.

[117] *See,* Chester Dawson, *Sergio Marchionne, Who Melded Chrysler and Fiat, Dies at Age 66,* WALL ST. J. (July 25, 2018), https://www.wsj.com/articles/sergio-marchionne-who-melded-chrysler-and-fiat-dies-at-age-66-1532512001; Patrick Jenkins, *Can Jamie Dimon's Magic Touch Weather the Bad Times Ahead?*, FIN. TIMES (Sept. 15, 2019), https://www.ft.com/content/c65b32d8-d648-11e9-a0bd-ab8ec6435630 [https://perma.cc/B64K-CW2S].

[118] *Key-Person Risk Is Alive and Kicking in Global Business*, ECONOMIST (Nov. 22, 2018), https://www.economist.com/business/2018/11/22/key-person-risk-is-alive-and-kicking-in-global-business ("Key-person risk occurs when an individual's presence, absence or behaviour disproportionately affects a firm's value") [https://perma.cc/CN7G-Z94J]..

[119] *See* Rakesh Khurana, *The Curse of the Superstar CEO*, 80 HARV. BUS. REV. 60 (2002) (arguing that "charismatic leaders can destabilize organizations in dangerous ways").

[120] Steve Blank, *Why Visionary CEOs Never Have Visionary Successors*, HARV. BUS. REV. (Oct. 20, 2016), https://hbr.org/2016/10/why-visionary-ceos-never-have-visionary-successors [https://perma.cc/RK62-YXK3].

value under them than under the best alternative manager.[121] Studies also look at the connection between superstar CEOs and winner-take-it-all markets.[122]

The most intuitive setting in which corporate value is closely linked to individual managers is startup companies. For a company in its very early stages and without a predictable stream of income, the quality of the entrepreneurs-founders is a crucial determinant of value. Studies have shown that entrepreneurs' qualities are a major factor in the decisions of venture capital (VC) funds to finance startups.[123] Startups led by experienced entrepreneurs, for example, often receive higher valuations by VCs.[124]

Other studies focus on public companies. Researchers have tried to identify the CEO qualities that affect firm performance or valuation.[125] Evidence shows, for example, founder-CEOs tend to increase firm value or operating performance compared to other CEOs.[126] This 'founder premium' is prevalent in the early stages of the company life cycle, but disappears as the firm matures and expands.[127]

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[121] Andrei Shleifer & Robert W. Vishny, *Management Entrenchment: The Case of Manager-Specific Investments*, *25* J. FIN. ECON. 123, 124 (1989).

[122] *See* Anton Korinek & Ding Xuan Ng, *Digitization and the Macro-Economics of Superstars*, (Dec. 2018) (unpublished manuscript) (describing a model that treats the "superstar entrepreneur" as a factor of production who implements superstar technology); *see also* John Gapper, *Superstar Chief Executives Can Self Destruct*, FIN. TIMES (Aug. 29, 2018), https://www.ft.com/content/f5d07308-ab78-11e8-89a1-e5de165fa619 [https://perma.cc/2V6Y-BS7M].

[123] *See, e.g.,* Shai Bernstein, Arthur Korteweg & Kevin Laws, *Attracting Early-stage Investors: Evidence from a Randomized Field Experiment*, 72 J. FIN. 509 (2017) ((finding that the quality of the entrepreneur determines funding decisions by early-stage investors); Francesco Ferrati & Moreno Muffatto, *Reviewing Equity Investors' Funding Criteria: A Comprehensive Classification and Research Agenda*, 23 VENTURE CAP. 157 (2021) (a literature review finding that in many studies (25) the key element in valuation is the characteristics of the entrepreneurial team).

[124] *See, e.g.,* David H. Hsu, *Experienced Entrepreneurial Founders, Organizational Capital, and Venture Capital Funding*, 36 RSCH. POL"Y 722 (2007) (finding that prior founding experience increases the likelihood of early-stage VC funding); Tarek Miloud, Arild Aspelund & Mathieu Cabrol, *Startup Valuation by Venture Capitalists: An Empirical Study*, 14 VENTURE CAP. 151 (2012).

[125] *See*, *e.g.*, Morten Bennedsen, Francisco Pérez-González & Daniel Wolfenzon, *Do CEOs Matter? Evidence from Hospitalization Events*, 75 J. FIN. 1877, 1879 (2020) (discussing the growing body of research in economics and finance that stresses the unique contribution of managers to firm outcomes).

[126] Renée Adams, Heitor Almeia & Daniel Ferreira , *Understanding the Relationship Between Founder-CEOs and Firm Performance,* 16 J. EMPIRICAL FIN. 136, 136–137 (2009) (finding evidence consistent with a positive causal effect of founder–CEOs on firm performance); Rüdiger Fahlenbrach, *Founder-CEOs, Investment Decisions, and Stock Market Performance,* 44 J. FIN. & QUANTITATIVE ANALYSIS 439 (2009). Related studies have shown that family ownership increases firm value only if founders serve as CEO or chair the board. *See also* Belen Villalonga & Raphael Amit, *How Do Family Ownership, Control and Management Affect Firm Value?*, 80 J. FIN. ECON. 385 (2006).

[127] *See*, *e.g.*, Bradley E. Hendricks & Travis Howell, *The Founder Premium Revisited* (Dec. 6, , 2021) (unpublished manuscript) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3977112). For an analysis of the negative impact of the time dimension on the costs of dual-class shares, *see* Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585 (2017) [hereinafter Bebchuk & Kastiel, *Dual-Class Stock*]. For an empirical study confirming this

Another line of studies measures the effect of individual CEOs on firm value by studying market reaction when CEOs suddenly die or experience another unexpected event, such as hospitalization. Researchers found, for example, that such events tend to have a stronger negative impact when (i) the CEO is relatively young and short-tenured, (ii) in growing, family-controlled firms, or (iii) in human-capital-intensive industries.[128] In contrast, the sudden departure of older, long-tenured, entrenched CEOs is associated, on average, with large value *gains* to shareholders.[129]

Researchers have also focused on the link between certain managerial "styles" or CEO characteristics, such as overconfidence, and firm performance.[130] Studies show, for example, that narcissist CEOs could lead the company to either "big wins or big losses,"[131] and that founder CEOs tend to be overconfident and thus invest more in innovation.[132] Others argue that retaining targets' founder CEOs is essential for successful acquisitions,[133] especially of technology-driven young firms.[134]

Finally, due to the inevitable difficulty of identifying superstar CEOs, researchers have devised proxies to identify CEOs who are perceived as uniquely valuable to their companies. One proxy is the receipt of business awards from a prestigious national magazine or newspaper.[135] Earlier studies looked at factors that could make CEOs more powerful, such as being the company founder, the number of positions they hold (including serving as both chair of the board and

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analysis, see Bebchuk & Kastiel, , *supra* note 16, at 1458.

[128] *See*, *e.g.*, Bennedsen et al., *supra* note 126; Dirk Jenter, Egor Matveyev, & Lukas Roth, *Good and Bad CEOs* (Sept. 2018) (unpublished manuscript) (available at https://matveyev.mit.edu/sites/default/files/images/JMR%2C%20for%20the%20web.pdf),)

[129] *See* Jenter et al., *supra* note129 ; John R. Graham Hyunseob Kim & Mark Leary,*CEO-Board Dynamics*, 137 J. FIN. ECON. 612, 615 (2020).

[130] Marianne Bertrand & Antoinette Schoar, *Managing with Style: The Effect of Managers on Firm Policies*, 118 Q. J. ECON. 1169 (2003) (finding evidence consistent with managerial "style" affecting corporate policies and performance); Kenny Phua, T. Mandy Tham & Chishen Wei, *Are Overconfident CEOs Better Leaders? Evidence from Stakeholder Commitments*, 127 J. FIN. ECON. 519 (2018)

[131] Arijit Chatterjee & Donald C. Hambrick, *It's All About Me: Narcissistic Chief Executive Officers and Their Effects on Company Strategy and Performance*, 52 ADMIN SCI. Q. 351 (2007).

[132] Joon Mahn Lee, Byoung-Hyoun Hwang & Hailiang Chen, *Are Founder CEOs More Overconfident than Professional CEOs? Evidence from S&P 1500 Companies*, 38 STRATEGIC MGMT. J. 751, 752-54 (2017).

[133] *See, e.g.*, M. V. Shyam Kumar, Nandu J. Nagarajan & Frederik P. Schlingemann, *The Performance of Acquisitions of Founder CEO Firms: The Effect of Founder Firm Premium*, 15 STRATEGIC MGMT. SOC'Y 619 (2020).

[134] Keivan Aghasi, Massimo G. Colombo & Cristina Rossi-Lamastra, *Post-Acquisition Retention of Target Founder-CEOs: Looking Beneath the Surface*, 59 J. MGMT. STUD. 958 (2022) (showing that "[w]hen the target firms are mature . . . the fact that the target CEO is one of the firm's founders does not influence post- acquisition retention.").

[135] *See* Ulrike Malmendier & Geoffrey Tate, *Superstar CEOs*, 124 Q.J. ECON. 1593 (2009); Manuel Ammann, Philipp Horsch & David Oesch, *Competing with Superstars,* 62 MGMT. SCI. 2842 (2016); Thomas David, Alberta Di Giuli & Arthur Petit-Romec, *CEO Reputation and Corporate Voting* (Mar. 26, 2021) (unpublished manuscript) (available at, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3551223) .

president), and whether the CEO is the only insider on the board.[136] These factors do not, by themselves, make the CEO a superstar, but they can be highly correlated with superstar CEO status.

Recall that we do not take a position on whether individual CEOs indeed have a singular effect on firm value. The sources above, however, demonstrate the extent to which business experts and economists have studied the unique contribution that certain individuals can make to company value, and how this notion is pervasive outside legal scholarship.

B. Equity Stake and Founder Status

Superstar status is sometimes accompanied by additional factors that bolster CEO power. We consider these attributes in this Section.

1. Significant Equity Stake

Superstar CEOs are often, but not always, owners of a significant equity stake. For example, Elon Musk of Tesla, now holds 14% of the company's shares;[137] Jeff Bezos holds 14% of the company's shares;[138] and Larry Ellison, the co-founder of Oracle, held about 25% of Oracle's shares when he was the CEO.[139] This is not a coincidence. As shown in the previous Section, superstar CEOs are often founders. And CEO-founders tend to hold a significant equity stake even after the company goes public.[140]

Our framework excludes CEOs with majority control, usually through the use of a dual-class share structure. Mark Zuckerberg, for example, holds about 60% of Facebook's voting rights, which clearly makes him a controlling shareholder.[141] By virtue of their control of the majority of the votes, these CEOs are powerful regardless of their contribution to the firm's value. Therefore, we focus only on companies where, at least in theory, public investors could outvote the CEO. For example, Larry Ellison's equity stake, although significant, was not enough for him to control the vote at Oracle in 2015, when a majority of the shareholders voted not to approve his executive compensation.[142]

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[136] *See*, *e.g.*, Sydney Finkelstein, *Power in Top Management Teams: Dimensions, Measurement, and Validation*, 35 ACAD. MGMT. J. 505, 509 –12 (1992); Renée B. Adams, Heitor Almeida & Daniel Ferreira, *Powerful CEOs and Their Impact on Corporate Performance*, 18 REV. FIN. STUD. 1403, 1404-1409 (2005).

[137] In the past, Musk's equity stake in Tesla amounted to 22% and was one of the reasons underlying the court's holding that Musk controlled Tesla. *See infra* notes 256-57 and accompanying text. Later on, while making an effort to fund the Twitter purchase, Musk sold a large fraction of his shares in Tesla. He is still Tesla's biggest shareholder, with a 13.4% stake. *See* Hoskins, *supra* note 89.

[138] *See supra* note 113.

[139] For information on Ellison equity stake, during the last year he served as Oracle's CEO, *see* Oracle Corp., Definitive Proxy Statement (Form DEF14A) 26 (Sept. 23, 2014) .

[140] There is also a link between founder statues and dual-class shares that enable founder to retain control for a long period of time. *See* Aggarwal et al., *supra* note71.

[141] Facebook Inc., Definitive Proxy Statement (Form DEF14A) 61–62 (Apr. 9, 2021).

[142] *See supra* note 140.

We should stress, however, that significant share ownership is not a necessary condition of superstar status. Reed Hastings, the CEO (and founder) of Netflix, holds only 1.2% of the company's shares, and Steve Jobs of Apple held less than 1% of the firm's outstanding shares.[143]

2. Founder Status

As we noted above, many superstar CEOs are founders. As the ones who had the original vision to invent new markets or disrupt existing ones, founders often become instrumental to their companies.[144] Not all founders, however, are superstar CEOs. And markets might lose faith in founders that were perceived as essential to the company's success, as seen in Apple's decision to fire Steve Jobs in the 1980s.[145]

Moreover, not all superstar CEOs are founders. CEOs who were hired long after the company went public could become recognized by investors as singularly instrumental to their companies. Jamie Dimon, the CEO of J.P. Morgan, is a prominent example of a non-founder CEO who is perceived to be essential to his company's success. He was featured on *Time* magazine's list of the world's 100 most influential people four times, and was several times named the most admired CEO or the top CEO of the year among colleagues.[146]

Another example is Carlos Ghosn, the Brazilian-born executive who led the Renault-Nissan alliance for two decades and, according to experts, "saved Nissan."[147] Ghosn achieved celebrity status throughout the business world.[148] *Fortune* identified him as one of the ten most powerful people in business outside the United States,[149] and surveys jointly published by the *Financial Times* and

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[143] Apple Inc., Definitive Proxy Statement (Form DEF14A) 18 (Feb. 23, 2011).

[144] For empirical evidence on the impact of talented founder on firm value, *see, e.g.*, Adams et al., *supra* note 136; *see also supra* notes 126-35.

[145] WALTER ISAACSON, STEVE JOBS 186 –206 (2011); Randall Lane, *John Sculley Just Gave His Most Detailed Account Ever of How Steve Jobs Got Fired from Apple*, FORBES (Sept. 9, 2013, 11:32 AM), http://www.forbes.com/sites/randalllane/2013/09/09/john-sculley-just-gave-his-most-detailed-account-ever-of-how-steve-jobs-got-fired-from-apple [https://perma.cc/DJG6-8JMS].

[146] *See, e.g.*, Jack Hough, *Barron's Top CEOs 2020: JPMorgan Chase's Jamie Dimon*, BARRON'S (June 26, 2020, 8:39 PM), https://www.barrons.com/articles/barrons-top-ceos-2020-jpmorgan-chases-jamie-dimon-51593218399 [https://perma.cc/SP3D-M3XC]; Alan Murray & David Meyer, *The Most Admired Fortune 500 CEO Is...,* FORTUNE (May 15, 2020, 5:00 AM), https://fortune.com/2020/05/15/most-admired-fortune-500-jamie-dimon-ceo-daily/ [https://perma.cc/HW6W-SQSY]; *One of a Kind*, CEO N. AM., https://ceo-na.com/executive-interviews/one-of-a-kind/ [https://perma.cc/4FUA-V5FF].

[147] Paul A, Eisenstein, *Can the Renault-Nissan Alliance Survive Without Carlos Ghosn?*, NBC NEWS (Jan. 22, 2020, 10:44 AM), https://www.nbcnews.com/business/autos/can-renault-nissan-alliance-survive-without-carlos-ghosn-n1120166 [https://perma.cc/MLN5-4TM6].

[148] James Mackintosh, *A Superstar Leader in an Industry of Icons*, FIN. TIMES (Dec. 16, 2004, 2:00 AM), https://archive.today/20140921044518/http://www.ft.com/cms/s/0/159a679c-4f09-11d9-9488-00000e2511c8.html%23ixzz3CVnCpyJ4. [https://perma.cc/7XMN-WHAD].

[149] Carol J. Loomis, The 25 Most Powerful People in Business, FORTUNE (Nov. 21, 2012, 10:28 AM), https://fortune.com/2012/11/21/the-25-most-powerful-people-in-business/ [https://perma.cc/K7AH-YYAB].

PricewaterhouseCoopers named him one of the world's most respected business leaders.[150] Ghosn was eventually arrested for alleged corruption at the end of 2018. The market reaction in the period that followed his arrest shows his immense impact, as shares in both Nissan and Renault plummeted by one-third.[151]

III. CORPORATE GOVERNANCE

We argue that the common belief that superstar CEOs have a singular contribution to company value provides them with significant leverage over boards and shareholders. This power, however, does not arise from insufficient shareholder power or directors' failure to represent shareholder interests.

In Section A, we discuss the ways in which the star qualities of some CEOs provide them with power vis-à-vis boards and shareholders, even in our era of powerful shareholders and independent boards. We then discuss the limits of this CEO power. In Section B, we put forward a theory of superstar CEOs and consider the implications of our analysis for corporate governance. Specifically, we expand our analysis by considering the case of powerful CEOs in private companies, the increasing use of dual class shares by powerful CEOs, and the potential impact of powerful CEOs on stakeholder protection.

A. CEO Power

In this Section, we analyze how the presence of a superstar CEO affects the balance of power between this CEO, boards and shareholders. In particular, we argue that, even in the era of increasingly powerful shareholders and boards with independent directors, superstar CEOs' unique contribution to company value accords them significant power. How effective can directors be in second-guessing her proposed strategy when investors believe that the CEO's singular vision is what makes the company succeed? How likely are shareholders to discipline directors who are deferential to a superstar CEO?

Our analysis does not suggest that directors or shareholders are powerless to influence corporate decisions. Rather, it shows that they are less likely to use the full measure of their power in the presence of superstar CEOs.[152] More importantly, this type of CEO power is not without limits, and is likely to vanish when markets lose faith in the star qualities of the CEO.

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[150] *The World's Most Respected Leaders: Do You Agree?*, FAST CO. (Nov. 23, 2004), https://www.fastcompany.com/667431/worlds-most-respected-leaders-do-you-agree [https://perma.cc/FEJ9-LJF8]; James Macintosh, *Carlos Ghosn: Superstar Car Executive*, FIN. TIMES (Nov. 19, 2004), https://www.ft.com/intl/cms/s/1/24ad542e-395b-11d9-b822-00000e2511c8.html [https://perma.cc/XGQ5-VMF5]; James Brooke, *Nissan Chief Staying Put*, N.Y TIMES (Nov. 20, 2005), https://www.nytimes.com/2005/11/20/business/worldbusiness/nissan-chief-staying-put.html [https://perma.cc/J7XP-DSZW].

[151] Eisenstein, *supra* note 148.

[152] Our analysis does not focus on the formal allocation of power between CEOs and directors and shareholders. Rather, it focuses on the other dimensions identified by Kahan and Rock, namely, the extent to which directors and shareholders will second guess or voice opposition to decisions made by CEOs. *See* Kahan & Rock, *supra* note27 , at 992–95.

1. Boards

Boards of directors do not run companies. Rather, they appoint CEOs and monitor their performance.[153] Boards, for example, approve major transactions and set the CEO pay. As we explained in Part I.A, the conventional view holds that, to ensure the effective performance of their oversight function, boards should become sufficiently independent from management and accountable to shareholders.[154]

But what happens if directors who are fully committed to shareholders believe that the CEO has exceptional skills that make her crucial to the company's success? This belief might undermine their ability to effectively monitor the CEO.[155] Directors know that letting the CEO go would be harmful to the company, and that alienating the CEO might have a similar effect. They might also doubt their own judgment and hesitate to question the decisions of their superstar CEO. After all, investors (who elected them to the board) believe that it is the CEO's vision, charisma or other unique qualities that drive the company's success. It is that perception, which is shared by boards, investors, and the market alike, that gives a CEO power vis-à-vis the board of directors.

Consider, for example, a board's decision to approve a strategic transaction proposed by the CEO. The directors might defer to the CEO not because their fear of retaliation, but because they genuinely believe that the CEO has the unique vision to assess the transaction's contribution the company's success.

Now consider members of the board's nominating committee tasked with recommending new members to the board. They find one candidate very promising, but the CEO strongly disapproves of that person. The directors might defer to the CEO not only because of their fear of retaliation,[156] but because they also believe that the CEO knows better than they which candidates would be best for the company and improving its performance. Or they might believe that the costs of having a disgruntled CEO outweigh the benefits of having this otherwise ideal candidate join the board. The same logic applies to other board decisions, such as approving self-dealing transactions or disciplining the CEO for engaging in improper behavior.

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[153] *See, e.g.,* Gordon, *The Rise of Independent Directors*, *supra* note 40, at 1502–05, 1530–33.

[154] *See supra* notes 40-44, and accompanying text.

[155] The notion that successful CEOs gain leverage over boards was noted by Hermalin and Weisbach. They use this insight to explain why CEOs might have a say on director appointment. *See* Benjamin E. Hermalin & Michael S. Weisbach, *Endogenously Chosen Boards of Directors and Their Monitoring of the CEO*, 88 AM. ECON. REV. 96, 97 (1998) ("If a CEO keeps his job, then retaining him must be worth more to the directors than replacing him. This means that this CEO is, to some extent, a rare commodity, which gives him bargaining power vis-a-vis the directors.").

[156] Although the fear of retaliation could also have its own impact. Superstar CEOs are often well connected to other powerful market players, including members of the company they lead. Directors who are perceived as troublemakers risk losing future benefits and opportunities associated with having good ties with superstar CEOs. *See* Da Lin, *Beyond Beholden*, 44 J. CORP. L. 515, 530 (2019).

Finally, some superstar CEOs own a significant equity stake.[157] This in turn bolsters their power (regardless of the market's perception of their star qualities). Blockholders can exert considerable influence through voting in director elections. Directors might not want to be in a position where a large shareholder objects to their reelection to the board, even if it is mathematically possible that they could be elected despite that objection.[158] It is also more difficult (though not impossible) to oust a CEO who has a significant equity stake.[159] At the same time, a significant equity stake also provides CEOs with incentives to enhance firm value, as they bear a significant portion of the costs of their actions and receive a significant portion of the benefits.[160]

Let us return to the Tesla example. Tesla's dependence on Elon Musk might explain why its directors fail to control his use of Twitter in connection with company matters. Musk tweets have resulted in National Labor Relations Board violations,[161] and a $20 million settlement with the SEC.[162] The board's apparent failure to intervene has itself resulted in a derivative shareholder lawsuit.[163] In fact, Tesla's dependence on Musk' unique contribution perhaps explains why the SEC itself did not bar him from serving as a Tesla officer.[164] He was forced to step

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[157] See *supra* Section II.B.1.

[158] A large shareholder who holds, say, 20% of the votes does not have the formal right to veto the election of a board member. However, if such shareholder threatens to vote against a director, it could significantly reduce the chances of that director to be elected if the company has adopted a majority voting standard. Such standard requires any board candidate in an uncontested election to obtain a majority of the votes before being seated. *See,* Choi et al., *supra* note 52, at 1124-25. Obtaining such required majority could be challenging when a large shareholder opposes the director election.

[159] *See infra* the example of the founder of Papa John's discussed in Subsection II.A.3.

[160] Insiders' ownership of a significant equity stake tends to have a positive effect on corporate value. S*ee, e.g.*, Paul A. Gompers, Joy Ishii & Andrew Metrick, *Extreme Governance: An Analysis of Dual-Class Firms in the United States*, 23 REV. FIN. STUD. 1051, 1052–55, 1084 (2010) (providing evidence in the case of dual class companies).

[161]Noam Scheiber, *Tesla Employee's Firing and Elon Musk Tweet on Union Were Illegal Labor Board Rules*, N.Y. TIMES (Mar. 25, 2021), https://www.nytimes.com/2021/03/25/business/musk-labor-board.html/ [https://perma.cc/9RHU-9ZTZ].

[162] In August 2018, Musk posted a tweet that Tesla would be taken private with shares priced at $420 and that he had secured funding. The SEC claimed that the tweet had no factual basis; eventually Musk and Tesla settled with the SEC. brought by Some Tesla investors also filed a class action against Musk. However, the jury recently found him not liable for securities fraud.. *See Tesla's Elon Musk Says His Tweet That Led to a $20 Million Fine Was 'Worth It'*, CNBC (Oct. 29, 2018), https://www.cnbc.com/2018/10/29/teslas-elon-musk-says-his-tweet-that-led-to-a-20-million-fine-was-worth-it.html [https://perma.cc/2QC9-2EBV]; David Meyer, *Elon Musk's SEC Settlement Is Sending Tesla Shares Through the Roof*, FORTUNE (Oct. 1, 2018, 6:35 AM), http://fortune.com/2018/10/01/tesla-shares-soar-musk-sec-settlement/ [https://perma.cc/4VXQ-QBXQ]; Kalley Huang & Peter Eavis, *Jury Rules for Elon Musk and Tesla in Investor Lawsuit Over Tweets*, N.Y. TIMES (Feb. 3, 2023), https://www.nytimes.com/2023/02/03/business/elon-musk-tesla-investor-trial.html

[163] Wagner v. Tesla Inc., 2022 WL 1406536, No. 2021-1090-JTL (Del. Ch. May 3, 2022) ; Mike Leonard, *Tesla Hit with Investor Lawsuit Over Musk's Market-Moving Tweets*, BLOOMBERG L. (Dec. 16, 2021, 3:11 PM), https://news.bloomberglaw.com/esg/tesla-hit-with-investor-lawsuit-over-musks-market-moving-tweets/ [https://perma.cc/UHJ6-8D3P].

[164] *See* Dave Michaels & Rebecca Elliott, *SEC Has Limited Options to Regulate Elon Musk*, Wall St. J. (June 2, 2021, 5:54 PM), https://www.wsj.com/articles/sec-is-running-out-of-options-

down as the company's chair and to add additional independent directors to the board, but the SEC allowed him to remain CEO.[165]

Musk's unique contribution to Tesla performance could also explain why the Delaware court found the Tesla-SolarCity related-party transaction that Musk initiated to be entirely fair after trial, despite acknowledging that the process led to it was "far from perfect". In reasoning its decision for satisfying entire fairness in that case, the court stated that "while the synergistic effects of the Acquisition are still unfolding, the astronomic rise in Tesla's stock price post-Acquisition is noteworthy" and that "hindsight suggests that Elon is right when he asserts that, once valued as a car company, Tesla is now valued as "a first-of-its-kind, vertically integrated clean energy company."[166]

Recent events provide additional evidence to Tesla's board lack of ability to rein in Musk. Following Twitter acquisition and as layoffs and resignations have decreased Twitter's engineering ranks significantly, Musk has borrowed Tesla employees, mostly engineers and advisors, to assist him at Twitter. While one Tesla board member said they would be deployed briefly, these employees have continued to work for Twitter.[167] Musk has not provided any information regarding how their schedules will split between the companies.[168] Musk has also been regularly posting incendiary tweets, aimed at people who according to him have a "woke mind virus." Considering Tesla's recent troubles and the significant decline in the company share price, some shareholders have begun to wonder – why is the board doing nothing to constrain him?[169]

2. *Shareholders*

The key mechanism for ensuring board accountability is having shareholders elect directors or vote on specific corporate actions.[170] As we explained in Part I, shareholders today are increasingly using their voting power. But when a company is led by a superstar CEO, even shareholders might be limited in their ability to discipline the CEO.

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to-rein-in-elon-musk-11622670845 [https://perma.cc/A8X3-NWD7] (quoting experts suggesting that the SEC does not bar Musk from serving as an office because such action would harm the company and its shareholders).

[165] *Id.*

[166] In re Tesla Motors, Inc. S'holder Litig., No. 12711-VCS, 2022 WL 1237185, at *47 (Del. Ch. Apr. 27, 2022).

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[167] Ryan Mac & Kate Conger, *Elon Musk Says He Will Resign as Twitter C.E.O. When He Finds Successor,* N.Y. TIMES (Dec. 20, 2022), https://www.nytimes.com/2022/12/20/technology/elon-musk-twitter-resign.html [https://perma.cc/P5FY-MFG5].

[168] Lora Kolodny, *Tesla Stock Has Dropped More than 35% since Elon Musk First Said He'd Buy Twitter*, CNBC (Nov. 4, 2022), https://www.cnbc.com/2022/11/04/tesla-down-35percent-since-elon-musk-first-said-hed-buy-twitter.html[https://perma.cc/J72E-3GZL].

[169] Lora Kolodny, *Tesla Shares Have Fallen 28% since Elon Musk Took over Twitter, Lagging Other Carmakers*, CNBC (Dec. 13, 2022), https://www.cnbc.com/2022/12/13/tesla-stock-down-28percent-since-elon-musk-took-over-twitter.html [https://perma.cc/H74S-DBDX] ("Kristin Hull, Nia Impact Capital founder and a Tesla shareholder, wrote on Twitter following that: 'So many issues with the Tesla brand, when the board can't rein in the CEO'").

[170] *See*, *e.g.*, Bebchuk et al., *Declassification of S&P 500 Boards*, *supra* note 47, at 162–63.

To begin, even when the CEO takes actions that they find undesirable, shareholders are unlikely to initiate or support measures to remove a CEO who is perceived as crucial to the company's success. They would not want to throw the baby out with the bathwater. Shareholders also might be more cautious before using their votes against directors merely for deferring to a superstar CEOs. The examples of Tesla, Netflix, and Oracle nicely illustrate this point.

Netflix. Under Delaware law, shareholders lack the power to make governance changes without the cooperation of the board. The conventional wisdom today, however, is that directors cater to shareholder governance preferences out of the fear of losing their board seats. The Netflix example shows that shareholders dissatisfied with the company's governance might not discipline a superstar CEO.

In 2013, Netflix shareholders submitted a nonbinding proposal to split the CEO and chair roles. At the company's annual meeting, 73% of the shareholders voted in favor of this non-binding proposal. More broadly, data we collected from the ISS Voting Analytics database show that 26 governance-related proposals submitted to Netflix between 2013 and 2020 received majority shareholder support.[171]

That seems like a huge win for shareholders, but Netflix has consistently disregarded these results. Usually, when companies systematically ignore shareholder concerns, their directors are subject to withhold campaigns that are embarrassing at the least,[172] and which can result in their defeat or resignation.[173] Indeed, in three separate elections (2014, 2017, and 2020), ISS recommended that shareholders withhold their support from Hastings.[174] Hastings, however, received significantly more supporting than negative votes.[175]

Recall that Hastings owns only a tiny fraction of the Netflix votes. As one

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[171] ISS, Voting Analytics Data Set, ISS Database, https://www.issgovernance.com/solutions/iss-analytics/voting-analytics/ [hereinafter ISS Database] . These proposals were related to matters such as declassifying staggered boards, adopting majority voting, adopting proxy access, reducing supermajority requirements.

[172] *See, e.g.,* Yonca Ertimur, Fabrizio Ferri & Stephen R. Stubben, *Board of Directors Responsiveness to Shareholders: Evidence from Shareholder Proposals*, 16 J. CORP. FIN. 53, 54 (2010) (the implementation of a proposal that receives majority support is associated with a one-fifth reduction in the probability of both director turnover and losing other directorships); Yonca Ertimur, Fabrizio Ferri & David Oesch, *Understanding Uncontested Director Elections,* 64 MGMT. SCI. 3400, 3402–06, 3417 (2018) (examining shareholder withhold votes and finding that 419 cases out of 580 (72.2%) relate to lack of responsiveness to majority-vote shareholder proposals).

[173] *See* Reena Aggarwal, Sandeep Dahiya & Nagpurnanand R. Prabhala, *The Power of Shareholder Votes: Evidence from Uncontested Director Election*s, 133 J. FIN. ECON. 134, 135 (2019) (examining director elections held between 2003 and 2014, and finding that 7.14% of directors who receive a majority dissent depart within a year of the election); William C. Johnson, Jonathan M. Karpoff & Michael D. Wittry, *The Consequences for Directors of Deploying Poison Pills* (Charles A. Dice Ctr., Working Paper No. 2019-23, , 2021), https://ssrn.com/abstract=3460201 [https://perma.cc/HR8F-SXE2] (noting directors are subject to higher rates of protest votes and increased termination rates across all of their directorships following the board's adoption of a poison pill).

[174] We collected the data on the results of the votes and ISS recommendation from the ISS Voting Analytics Dataset. *See supra* note 185.

[175] *Id.*

investor pointed out, the fact that Netflix shareholders remain mostly powerless is "even more egregious" because the company does not have a dual-class stock structure providing the company founder with majority control.[176] This outcome, however, is hardly surprising under our theory. Shareholders are unlikely to discipline CEOs when the market believes in their star qualities. As one commentator explained, "given that Netflix shares soared nearly 300 percent in 2013: investors were not inclined to penalize Hastings after such an accomplishment."[177]

The Netflix case suggests, however, that shareholders might direct some of their dissatisfaction at directors. While Netflix shareholders were unwilling to unseat Hastings, they did, at some point, escalate their action against some of Netflix's directors. Six of them received less than majority support in at least one corporate election (mostly in 2019).[178] Since the company (still) has a plurality voting system, these directors continued to serve on the board. Moreover, these withheld votes did lead the company to change its governance.

Interestingly, only after the company experienced a sharp decline in its share price, in early 2022, did Netflix agree to adopt a "more standard large-cap governance structure."[179] In other words, while investors had been pressing for a change for almost a decade, the board decided to accept shareholder demands only when the market started to lose faith in the star qualities of the company's CEO.

Oracle. Larry Ellison is the founder of Oracle and one of the highest-paid executives in corporate America. In 2012, shareholders started to express concerns about his lucrative pay. For six years in a row, a majority of the company shareholders voted against Ellison's pay package in non-binding say-on-pay votes.[180] Since Ellison held about 25% of the company's outstanding shares, this outcome means that the overwhelming majority of public investors opposed his compensation package during a long period of time.

Yet, at the same six annual meetings, the very same shareholders voted in favor of his reelection to the board by wide margins.[181] How can one explain this split in voting patterns? Why did shareholders vote against Ellison's executive pay package while at the same time overwhelmingly supporting his reelection to the board? A plausible explanation is that given their belief in Ellison's

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[176] Levi Sumagaysay, *Netflix Investors 'Losing Patience,' Say Company Ignores Them on Governance*, MARKETWATCH (Jun. 9, 2021) https://www.marketwatch.com/story/28etflix-investors-losing-patience-say-company-ignores-them-on-governance-11623257126 [https://perma.cc/XB5S-PGZM]..

[177] Paul Bond, *Netflix Shareholders Reject Plan to Split CEO and Board Chairman Roles*, HOLLYWOOD REP. (June 9, 2014), https://www.hollywoodreporter.com/business/business-news/netflix-shareholders-reject-plan-split-710445/[https://perma.cc/9GBV-UK6Z].

[178] We collected the data from the ISS Voting Analytics Dataset. *See supra* note172.

[179] Jennifer Elias, *Netflix to Eliminate Supermajority Requirement for Board Changes Following Investor Demand*, CNBC (Jan. 21, 2022)

https://www.cnbc.com/2022/01/20/28etflix-eliminates-supermajority-requirement-for-board-changes.html [https://perma.cc/9UJ8-68V5].

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[180] We collected the data from the ISS Voting Analytics Dataset. *See supra* note172 .

[181] *Id.*

contribution to the company, shareholders preferred not to "rock the boat" and oust Ellison from the board even though they were dissatisfied with the size of his pay package.[182]

Oracle shareholders did, however, express their disapproval of independent directors who served on the company's compensation committee. In 2013 and 2016 for example, a majority of non-Ellison votes withheld support for those directors due to their failure to address shareholder concerns about executive compensation. These directors were able to continue serving on Oracle's board only with Ellison's support.[183] Eventually, Oracle made some changes to its long-term equity grants to executives to address shareholder concerns,[184] but it took it six proxy seasons to do so, and that was well after Ellison had handed over the CEO role.

Tesla. As noted in Section II.A.1, Elon Musk has been involved in a series of high-profile scandals. Moreover, several derivative lawsuits are pending against Musk, including one blaming him of abusing his power to force Tesla to acquire SolarCity. But judging by their ballots, Tesla investors are very content with Musk. He has been up for reelection to the board twice since Tesla went public (in 2017 and 2020). In both cases his reelection was approved by extremely high margins: over 95% of the votes cast supported his reelection.[185] As this example clearly illustrates, when a CEO is perceived as a superstar and the company performs extraordinarily, shareholders are willing to ignore any behavior that might be unacceptable for other CEOs.[186]

Elon Musk has also received the largest stock option package ever granted by a public company. It was valued at $2.6 billion at the date of the award, and the amount Musk can ultimately realize was estimated at $56 billion.[187] As we explained above, this unprecedented compensation package led to another lawsuit against Musk. Yet, this pay package was approved by 73% of Tesla shareholders who are unaffiliated with company management.[188] The Twitter acquisition,

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[182] *Cf.* Jill E. Fisch, Darius Palia, & Steven Davidoff Solomon, *Is Say on Pay All About Pay? The Impact of Firm Performance*, 8 HARV. BUS. L. REV. 101 (2018) (finding that shareholder say-on-pay votes are determined by the company's performance).

[183] *Id.*; *see also In re* Oracle Corp. Derivative Litig., No. 2017-0337-SG, 2018 WL 1381331, at *16 (Del. Ch. Mar. 19, 2018).

[184] Robin Ferracone, *Oracle's Road to Moving the Needle on 'Say On Pay' Votes*, FORBES (Feb. 26, 2018), https://www.forbes.com/sites/robinferracone/2018/02/26/oracles-road-to-moving-the-needle-on-say-on-pay-votes/?sh=420f8ee1348a [https://perma.cc/38E4-TWJ7].

[185] The ISS Voting Analytics database provides data about the items on the ballot at the annual meetings of Russell 3000 companies starting in 2003. See ISS Database, *supra* note 172. All data obtained from the ISS Voting Analytics database are on file with authors.

[186] Data we collected from the ISS Voting Analytics show that a few governance-related proposals that Tesla shareholders submitted to a vote between 2016 and 2020 received a significant support of shareholders unaffiliated with the company management. *See* ISS Database, *supra* note 172. However, as in Netflix example, the fact that the company refused to implement these proposals did not prevent Tesla shareholders from overwhelmingly supporting the election of Musk to the board.

[187] Alexandria Sage & Ross Kerber, *Tesla shareholders approve CEO Musk's $2.6 billion compensation plan*, REUTERS (Mar. 21, 2018), https://www.reuters.com/article/us-tesla-ceo-idUSKBN1GX0C0.

[188] *Id*. It may also be the case that Tesla shareholders believed that providing Musk with high-powered monetary incentives was beneficial to Tesla (*see, e.g.,* Tom Hals, *Musk's pay trial asks if*

however, has put the relationship between Musk and Tesla's shareholders to test. Following the significant decline in the company share price and criticism over Musk's decision to devote most of his attention lately to Twitter, his genius reputation is unraveling and some investors have even begun to see him as a liability.[189]

To summarize, when CEOs are perceived as essential to the company's success, shareholders might tolerate practices they would otherwise consider unacceptable. A recent empirical study provides systemic evidence that goes beyond these three examples to support the theory we present in this Article. The study finds that shareholders in general, and mutual funds in particular, are more likely to vote with management (i.e., against shareholder proposals) when the CEO is a superstar (as measured by winning prestigious business awards).[190] To be clear, this evidence does not suggest that shareholders are powerless to influence corporate decisions. Rather, it shows that shareholders are less likely to use the full measure of their power to discipline superstar CEOs. In the last Part, we discuss the implications for providing shareholders with additional say on corporate affairs.

3. *The Limits of Superstar Power*

In the past, CEO power was mostly the outcome of CEOs' influence on director nominations and shareholder passivity. In the present era of powerful shareholders, however, CEO power arises from the widespread perception that the CEO is vital to the company's success. This power of superstar CEOs is therefore limited in both duration and scope.

Duration. Investors might lose faith in the CEO's vision or star qualities.[191] For startups, this can happen when the firm matures and requires different leadership skills. For other companies, it can happen when market conditions

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Tesla's growth justifies $56 bln compensation, REUTERS (Nov. 19, 2022), https://www.reuters.com/business/musks-pay-trial-asks-if-teslas-growth-justifies-56-bln-compensation-2022-11-18.), as well as approving the self-dealing transaction with SolarCity (*see, e.g.,* James B. Stewart, *Everyone Despises SolarCity Deal, Except Tesla Shareholders*, N.Y. TIMES (Aug. 4, 2016), https://www.nytimes.com/2016/08/05/business/everyone-despises-solarcity-deal-except-tesla-shareholders.html). This alternative explanation shows the difficulty in anticipating shareholder reaction to superstar CEOs.

[189] Lora Kolodny, *Elon Musk Tries to Explain Why Tesla Shares Are Tanking,* CNBC (Dec. 20, 2022), https://www.cnbc.com/2022/12/20/elon-musk-tries-to-explain-why-tesla-shares-are-tanking.html [https://perma.cc/5QTB-QGTE]; Faiz Siddiqui, *Twitter Brings Elon Musk's Genius Reputation Crashing Down to Earth*, WASH. POST (Dec. 24, 2022), https://www.washingtonpost.com/technology/2022/12/24/elon-musk-twitter-meltdown-tesla [https://perma.cc/DX5U-NRRG]. ("Musk has built his reputation on having a Midas touch with the companies he runs… [b]ut that image is unraveling. [S]ome investors in Tesla, by far the biggest source of his wealth, have begun to see him as a liability.")

[190] David et al., *supra* note136.

[191] *Cf.* Lukes, *supra* note 76 (noting Max Weber believes the charismatic leader "depends on his followers for recognition" and "[o]nce the followers cease to believe in the leader, the leader's charismatic power disappears.").

change or when the company is underperforming. As a result, directors may act in response to institutional investors' pressure (even before the company becomes the target of an activist attack).

Scope. The power of superstar CEOs is also limited by the extent of their unique contribution to company value. Assume, for example, that a CEO is believed to be responsible for generating 5% of the company's value. Such a CEO will be immune from the board or investor pressure as long as her misconduct is not expected to decrease value by more than 5%. Once a CEO takes steps that reduce company value by more than 5%, shareholders and boards are likely to become less tolerant.

This can happen when a superstar CEO becomes a liability for reasons not directly related to the company's performance, such as misconduct that significantly undermines the company's reputation. Consider Papa John's example. John Schnatter started selling pizzas in 1984 in the back of his father's Indiana Tavern. He founded Papa John's in 1985 and led the company to become one of the top-selling pizza delivery companies in the United States, with 5,000 stores and $1.7 billion in revenue.[192] In addition to being the CEO and owner of almost 30% of company shares, Schnatter was the face of the company. He starred in the company's commercials and delivered its signature line, "Better ingredients, better pizza."[193]

But in November 2017, he criticized the NFL's handling of national anthem protests, calling the affair a "debacle." Papa John's shares immediately crashed by 11% and kept falling. Schnatter lost his CEO title and franchise sales dropped by more than 5%.[194] Still, little changed in the company's day-to-day management according to a *Forbes*' investigation.[195] Then in July 2018, *Forbes* learned that Schnatter made inappropriate remarks on a conference call, and was involved in other types of misconduct.[196] Company shares then fell nearly 5%, bringing the stock's decline to about 30% over a nine-month period.[197] On the day that news broke, Schnatter resigned as chair[198] and the share price rebounded, closing 11% higher.[199]

For our purposes, what matters is that the board then turned against Schnatter. To protect the company against a takeover attempt by Schnatter, the board adopted a poison pill that effectively prevented Schnatter and affiliates from raising their

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[192] Noah Kirsch, *The Inside Story of Papa John's Toxic Culture*, FORBES (July 19, 2018) https://www.forbes.com/sites/forbesdigitalcovers/2018/07/19/the-inside-story-of-papa-johns-toxic-culture [https://perma.cc/52ND-DLSL] [hereinafter Kirsch].

[193] .*Cf*.Tiffany Hsu, *Racial Slur Leads to Papa John's Founder Quitting Chairman Post,* N.Y. TIMES (July 11, 2018), https://www.nytimes.com/2018/07/11/business/papa-johns-racial-slur.html [https://perma.cc/G2MK-H24R] [hereinafter Tiffany Hsu, *Racial Slur*].

[194] Kirsch, *supra* note 192; Matthew Haag*, Papa John's Chief Executive to Step Down, Weeks After Blaming N.F.L. for Sales Slump*, N.Y. TIMES (Dec. 21, 2017), https://www.nytimes.com/2017/12/21/business/papa-johns-john-schnatter.html [https://perma.cc/62AU-CELD].

[195] Kirsch, *supra* note 194 .

[196] *Id.*

[197] Tiffany Hsu, *Racial Slur*, *supra* note195.

[198] Kirsch, *supra* note194.

[199] Tiffany Hsu, *Racial Slur*, *supra* note195.

combined stake to 31%.[200] Papa John's also removed his picture from marketing materials, evicted him from subleased office space at the corporate headquarters, and asked him not to speak to the media.[201] Schnatter's unusual example shows that even a founder that enjoys a superstar statue with a significant equity stake is not immune to being ousted.

B. Implications

Our analysis suggests that superstar CEOs can be quite powerful. The source of their power is not the misalignment of interests between directors and shareholders, shareholder passivity, or the formal power that CEOs exercise in director elections. It is the market's belief that the CEO has such a unique vision or leadership skills that the company's success depends on that CEO's continued leadership.

This Section reviews the implications of superstar CEOs for corporate governance. We start with an overview of the main lessons for the governance of companies with superstar CEOs. We then explore the more specific implications for private companies, dual-class shares and the stakeholder debate.

1. *Synopsis: Governance with Superstar CEOs*

For many years, corporate governance reforms focused on empowering shareholders, making directors more independent and strengthening their accountability to shareholders.[202] The goal of these reforms was ensuring that boards would be well positioned to monitor CEOs and that their interests align with those of shareholders. Against this background, our framework offers several lessons about the nature of superstar CEO power and the extent to which boards and shareholders can contain it.

First, boards may have only limited ability to exercise oversight over CEOs who are perceived as uniquely valuable. Superstar CEOs can undermine directors' effectiveness in reviewing corporate strategy, approving major transactions or even preventing CEOs from engaging in improper behavior. Board failure to contain superstar CEOs is not necessarily the result of directors' misaligned incentives and their limited accountability to shareholders in public companies. As we show below, even directors of private companies who are appointed by powerful and sophisticated investors, as in the cases of Uber and WeWork, might fail to prevent CEO misconduct.[203]

Second, the conventional prescriptions for addressing perceived board failures might be of limited usefulness. Making directors more independent or increasing shareholder power to elect directors might not improve boards'

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[200] Tiffany Hsu, *Papa John's Adopts 'Poison Pill' Defense Against John Schnatter*, N.Y. TIMES (July 24, 2018), https://www.nytimes.com/2018/07/23/business/papa-johns-john-schnatter-poison-pill.html. [https://perma.cc/3T45-RGXN].

[201] *Id*.

[202] *See supra* Section I.B.

[203] *See supra* Section III.B.2.

oversight of superstar CEOs. In fact, it is boards' belief that the CEO has a singular contribution to shareholder value that undermines their effectiveness. And as long as the CEO is perceived as a star and the company depends on her vision and leadership, even nominally independent directors—those who have no business or other ties to the CEOs and who are genuinely committed to shareholders— are less likely to challenge the CEO, and may tolerate problematic practices that would normally be met with their resistance.

Third, our analysis highlights the limits of shareholder power in the presence of a superstar CEO. As the Tesla and Netflix examples suggest, even if shareholders are dissatisfied with some corporate practices, they are less likely to use their disciplinary power in the presence of a superstar CEO. They might use their voting power to send a *non-binding* signal of dissatisfaction to the powerful CEO (and the board), but they are unlikely to take any concrete action against such CEOs who ignore their signal.[204] After all, a change in company leadership may prove very costly.

Finally, the power of these CEOs can vanish when the market loses faith in their exceptional qualifications. Once the perception of star qualities fades away, a CEO who underperforms or misbehaves can, and often will, be replaced.[205]

2. *Private Companies*

Recent cases of board failure to contain CEO misconduct at private companies, such as Uber and WeWork, have puzzled corporate law scholars. After all, unlike public companies characterized by the separation of ownership from control, private firms are less likely to suffer agency costs. Moreover, these cases took place at startups backed by venture capital funds, who insist on board representation and specialize in monitoring founders.[206] Our analysis, however, suggests that board failure can arise even with loyal directors and powerful, sophisticated investors.[207]

Our first example concerns Uber's CEO and co-founder, Travis Kalanick. Kalanick was a visionary founder who led Uber to become one of most valuable private companies around the world. He was also responsible for a toxic culture and questionable practices that at eventually led to a crisis.

Under Kalanick's leadership, Uber made the headlines, but not necessarily in a positive way. Uber CEO was involved in a "never-ending string of missteps" that received negative public attention.[208] He was accused of tolerating a culture

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[204] *See supra* Section III.A.2.

[205] *See infra* Section III.A.3.

[206] Josh Lerner, *Venture Capitalists and the Oversight of Private Firms*, 50 J. FIN. 301 (1995); Thomas Hellmann, *The Allocation of Control Rights in Venture Capital Contracts*, 29 RAND J. ECON. 57, 57 – 58 (1998).

[207] Moreover, as we explain below, our analysis does not depend on the governance features of VC-backed startups. *Cf.* Pollman, *Startup Governance, supra* note15.

[208] For a review, *see* Kerry Flynn, *From 'Boober' to #DeleteUber, the 12 Times Uber Disgusted All of Us*, MASHABLE (Feb. 21, 2017), https://mashable.com/article/uber-disgusting-examples [https://perma.cc/39CY-MLYZ]; Sam Levin, *Uber's Scandals, Blunders and PR Disasters: The Full List*, GUARDIAN (June 28, 2017), https://www.theguardian.com/technology/2017/jun/18/uber-travis-kalanick-scandal-pr-disaster-timeline [https://perma.cc/EDL4-NGJJ]. For example, in 2014, Kalanick made several sexist

of sexual harassment that required the company to hire the former U.S attorney general to investigate 215 claims sexual harassment claims.[209] Uber also had its name linked with privacy controversies.[210] Among other things, it used technology to track down drivers that simultaneously worked for Lyft, its main competitor.[211] Another scandal includes a lawsuit by Waymo, Alphabet's self-driving car company, accusing Uber of technology theft.[212]

One might rightfully wonder: Where were Uber's major investors? How did their representatives on the board react to the company's ongoing involvement in these scandals? They seemed to have confidence in Kalanick's leadership.[213] Although concerns about misconduct started in 2014,[214] only in 2017 did Uber investors seriously question Kalanick's ability to lead the company.[215] Some investors wrote a letter to Kalanick expressing their disappointment in his failure to change the firm's "toxic patterns".[216] Other investors still showed faith in Kalanick.[217] Only three years after concerns about Kalanick misconduct started,

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remarks in an interview and was caught visiting an escort bar in Seoul with a group of senior employees.

[209] Maya Kosoff, *Uber C.E.O. Orders* "*Urgent Investigation" Into Sexual Harassment Allegations,* VANITY FAIR (Feb. 20, 2017), https://www.vanityfair.com/news/2017/02/uber-ceo-orders-urgent-investigation-into-sexual-harassment-allegation [https://perma.cc/YC48-C5YP]; Maya Kosoff, *Mass Firing at Uber as Sexual Harassment Scandal Grows*, VANITY FAIR (June 6, 2017), https://www.vanityfair.com/news/2017/06/uber-fires-20-employees-harassment-investigation [https://perma.cc/L64R-ET45].

[210] *See, e.g.,* Brian Fung, *Uber's Secret 'Greyball' Program Shows Just How Far Uber Will Go to Get its Way*, L.A. TIMES (March 3, 2017, 3:10 PM), https://www.latimes.com/business/technology/la-fi-tn-uber-greyball-20170303-story.html [https://perma.cc/PPL2-NEEL].

[211] Michelle Starr, *Uber Reportedly Used 'Hell' Program to Stalk Lyft Drivers*, CBS NEWS (Apr. 13, 2017, 7:11 PM), https://www.cbsnews.com/news/uber-reportedly-used-hell-program-to-stalk-lyft-drivers/ [https://perma.cc/64GH-XPV3].

[212] *See* Levin, *supra* note 210.

[213] Todd Bishop, *How Uber's Travis Kalanick is Like Amazon's Jeff Bezos, According to Investor Bill Gurley*, GEEKWIRE (Dec. 11, 2014, 3:21 PM), https://www.geekwire.com/2014/ubers-travis-kalanick-like-amazons-jeff-bezos-according-investor-bill-gurley/ [https://perma.cc/RF5U-U9GE].

[214] Laurie Segall, *Peter Thiel: Uber is 'most ethically challenged company in Silicon Valley'*, CNNMONEY (Nov. 18, 2014), https://money.cnn.com/2014/11/18/technology/uber-unethical-peter-thiel/.

[215] Mike Isaac, *Inside Travis Kalanick's Resignation as Uber's C.E.O.*, CNBC (June 22, 2017, 12:44 AM), https://www.cnbc.com/2017/06/21/inside-travis-kalanick-resignation-as-ubers-c-e-o.html?&qsearchterm=kalanick%20investor [https://perma.cc/F75L-KWPM]; Mike Isaac, *Uber Board Stands by Travis Kalanick as It Reveals Plans to Repair Its Image*, N.Y. TIMES (Mar. 21, 2017), https://www.nytimes.com/2017/03/21/technology/uber-board-stands-by-travis-kalanick.html.

[216] Mitch & Freada Kapor, *An Open Letter to The Uber Board and Investors*, MEDIUM (Feb. 23, 2017), https://blog.kaporcenter.org/an-open-letter-to-the-uber-board-and-investors-2dc0c48c3a7.

[217] Harriet Taylor, *Travis Kalanick Will be 'Legendary' Like Bill Gates, Say Uber Investor'*, CNBC (March 1, 2017, 11:53 AM), https://www.cnbc.com/2017/03/01/uber-ceo-travis-kalanick-needs-to-stop-self-inflicted-wounds-jason-calacanis.html?&qsearchterm=kalanick%20investor [https://perma.cc/4YR2-6UAS]; Anita Balakrishnan, *Uber Investor: Travis Kalanick Should Stay at Uber, Even if Not as CEO*, CNBC (June 13, 2017, 12:20 PM),

and after some major investors filed a lawsuit against him, he resigned from his role as Uber's CEO.[218]

Another example concerns Adam Neumann, the co-founder of the office sharing company WeWork. Executives who surrounded Neumann testified about his intoxicating charisma.[219] Under his leadership, WeWork grew into a 12,500-employee company with 500,000 users in 111 cities across 29 countries.[220] With the board permission, Neumann regularly engaged in self-dealing: he owned stakes in buildings that WeWork leased and borrowed money from it. Neumann's spouse held a senior position in the company.[221] Neumann insisted on throwing lavish company-sponsored "summer camp" retreats for employees, even as the company was losing great sums of money,[222] and he had a widely reported reputation for reckless use of alcohol and marijuana at work events.[223]

Nevertheless, WeWork's board and investors did not take action to discipline their CEO. They not only allowed him to engage in self-dealing, but also approved his request to recapitalize the company and provide him with more control.[224] When these practices were disclosed, the company had to shelve its plan to go public,[225] and investors forced Neumann out of the company.[226]

Governance scholars have tried to explain these board failures by focusing on agency costs or startups' unique governance structure. Elizabeth Pollman, for example, claims that the complex capital structure of late-stage startups and the conflicts of interests among venture capitalists who want to maintain their founder-friendly reputation can explain these failures.[227] Donald Langevoort and Hilary Sale explain that public markets, with their enhanced disclosure and mandatory governance requirements, provide important mechanisms for

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https://www.cnbc.com/2017/06/13/uber-investor-travis-kalanick-should-stay-at-uber-even-if-not-as-ceo.html?&qsearchterm=kalanick%20investor [https://perma.cc/8EQA-WLUP?type=image].

[218] Mike Isaac, *Uber Founder Travis Kalanick Resigns as C.E.O.*, N.Y. TIMES (June 21, 2017), https://www.nytimes.com/2017/06/21/technology/uber-ceo-travis-kalanick.html?smid=url-share [https://perma.cc/ZN6U-H7GP].

[219] Gabriel Sherman, *"You Don't Bring Bad News to the Cult Leader": Inside the Fall of WeWork*, VANITYFAIR (Nov. 21, 2019), https://www.vanityfair.com/news/2019/11/inside-the-fall-of-wework [https://perma.cc/VB2H-7ZMU].

[220] *Id.*

[221] *See* Langevoort & Sale, *supra* note 15, at 1367 –70.

[222] Eliot Brown, *How Adam Neumann's Over-the-Top Style Built WeWork. 'This Is Not the Way Everybody Behaves.'*, WALL ST. J. (Sept. 18, 2019),; https://www.wsj.com/articles/this-is-not-the-way-everybody-behaves-how-adam-neumanns-over-the-top-style-built-wework-11568823827/ [https://perma.cc/75PZ-84T8]; Sherman, *supra* note 20

[223] *Id.*

[224] Langevoort & Sale, *supra* note15, at 1369.

[225] Mary Meisenzahl, *WeWork's Had a Terrible 2 Months, and Now SoftBank is Reportedly Taking Control of the Company in a Bailout Deal — Here's Everything that Has Happened Since the Embattled Company Tried to Go Public*, INSIDER (Oct. 22, 2019), https://www.businessinsider.com/wework-ipo-timeline-delayed-ceo-adam-neumann-scandals-explained-2019-9 [https://perma.cc/5QJL-6FN9].

[226] *Id*.

[227] Pollman, *Startup Governance*, *supra* note 15, at 203-06. Pollman offers another explanation that is more in line with our view. She argues that startup directors may fail to exercise oversight because they emphasize growth and profits over compliance. *Id.* at 202. Under our analysis, in contrast, monitoring failure can arise even at companies that do not need to demonstrate growth to raise more funding.

overseeing CEOs that do not exist in the context of private companies.[228]

We offer another explanation. The belief in the founder's unique ability to produce superior returns puts even powerful and sophisticated investors at a structural disadvantage, as this belief might undermine their ability to effectively monitor the CEO. This dynamic is not necessarily the outcome of the unique characteristics of VC-backed startups or private companies more generally.[229] As long as the CEO is perceived as a star and the company depends on her vision and leadership, investors are less likely to challenge the CEO. Regardless of their financial savvy, investors might even approve self-dealing and other value-reducing transactions. They will not rush to discipline CEOs with star qualities even when they engage in misconduct. They will challenge the CEO only when they believe that he has lost his magic touch or that the harm from his misconduct exceeds his singular contribution to company value.

3. *Dual-Class Shares*

Supporters of dual-class structures find this structure desirable because it allows CEOs to implement their long-term strategy in the face of investor pressure to produce short-term returns.[230] Under this view, investors would agree—perhaps even support—granting super-voting shares to superstar founders. Opponents, on the other hand, show that the costs of these structures tend to increase over time, and thus call for the adoption of time-based sunset clauses.[231] Others view super-voting shares as the outcome of bargaining: founders value these shares because they allow them to pursue their vision even against investors' objections, while investors view them as costly given their concerns about agency costs.[232]

Our analysis offers two contributions concerning the link between superstar founders and dual-class shares. First, it casts doubt on the view that *investors* value the dual-class structure because it allows superstar founders to focus on the long term. Founders commonly viewed as essential to their companies' success

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[228] Langevoort & Sale, note15, at 1367 –70.

[229] Pollman convincingly explains that certain governance features of VC-backed startups make it more likely that boards fail to monitor CEOs. *See* Pollman, , *supra* note15. Our analysis, in contrast, applies to all companies with superstar CEOs.

[230] For early work supporting this claim, *see* Daniel R. Fischel, *Organized Exchanges and the Regulation of Dual Class Common Stock*, 54 U. CHI. L. REV. 119, 137–38 (1987). For recent work, *see* Vijay Govindarajan, Shivaram Rajgopal, Anup Srivastava & Luminita Enache, *Should Dual-Class Shares Be Banned?*, HARV. BUS. REV. (Dec. 3, 2018), https://hbr.org/2018/12/should-dual-class-shares-be-banned [https://perma.cc/V6SD-GA97] (A dual-class structure "could be optimal if it enables founder-managers to ignore pressures from the capital markets and avoid myopic actions such as cutting research and development and delaying corporate restructuring"); Berger, *supra* note70 ; Bernard S. Sharfman, *The Undesirability of Mandatory Time-Based Sunsets in Dual Class Share Structures: A Reply to Bebchuk and Kastiel*, 93 S. CAL. L. REV. Postscript 1 (2019).

[231] Bebchuk & Kastiel, *Dual-Class Stock*, *supra* note 127. S*ee also* Robert J. Jackson Jr., Comm'r, U.S. Sec. & Exch. Comm'n, Perpetual Dual-Class Stock: The Case Against Corporate Royalty (Feb. 15, 2018), https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty [https://perma.cc/VHK9-WZ3Y] (calling national securities exchanges to consider proposed listing standards that would address the use of perpetual dual-class stock).

[232] *See* Goshen & Hamdani, *Idiosyncratic Vision*, *supra* note 24, at 566-67.

can stay at the helm for long periods. Shareholders might even allow such founders to maintain pay and other governance arrangements that they generally disfavor. Superstar founders, therefore, might not require super-voting shares to be able to focus on the long term. Rather, they need this governance structure for the time when, rightly or wrongly, the market no longer considers them essential to their company's success, and investors might take action to change the company's leadership. This might explain why some founders still insist on taking dual-class companies public without time-based sunset clauses.[233] While there is a marked increase in the popularity of these clauses in recent years,[234] about half of dual-class IPOs (at least for now) do not adopt them.

Second, under our framework, superstar founders are likely to go public with a dual-class structure not because investors believe that those founders will *always* have the vision would produce superior returns. Rather, superstar CEOs have more bargaining power at the IPO stage.[235] Ideally, investors might want to retain the power to displace CEOs when they lose faith in their abilities. Yet, founders perceived as uniquely valuable in the company's early days can use their considerable bargaining power to insist on having a lock on control through the use of super-voting shares that would be most valuable to them at some point in the future, precisely when this lock on control is most likely to be less desirable for investors (that is, when investors no longer consider the founders as essential to their company's success, and might want to replace them).[236]

This sheds a new light on the link between technological developments and dual-class shares. The rise of "winner take all" markets increases the demand for CEOs who can move fast and disrupt markets.[237] These CEOs, in turn, leverage their bargaining position to require more control rights. Investors give them these control rights not because they believe the founders will always know how to lead the company better than the markets do, but because these founders are perceived as indispensable at the IPO stage or earlier.

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[233] For a comprehensive analysis showing that the costs of dual-class structures rise, and their benefits decline, the longer they extend past the IPO, *see* Bebchuk & Kastiel, *Dual-Class Stock*, *supra* note128 . For a review of subsequent empirical studies confirming this theory, *see* Bebchuk & Kastiel, *The Perils of Small-Minority Controllers*, *supra* note16, at 1458-59.

[234] For example, 26% of the dual-class IPOs had time-based sunsets in 2017. This number increased to 32-33% in the two subsequent years, and to 47% in 2020. *See* COUNCIL OF INSTITUTIONAL INVESTORS, DUAL-CLASS IPO SNAPSHOT: 2017-2020 STATISTICS (2020), https://www.cii.org/files/2020%20IPO%20Update%20Graphs%20.pdf [https://perma.cc/2RD9-DEHF], at 1, 4, 7 & 8; *See also* Aggarwal et al., *supra* note 71 (the increasing popularity of dual-class structures is driven by founder-controlled firms, and founders' enhanced bargaining power is associated with a lower likelihood of sunset provisions).

[235] *See* Aggarwal et al., *supra* note71. According to them, founders may have greater bargaining power at the IPO stage in two related circumstances: when there is more private capital available to be deployed, and when the founders need relatively less capital to operate their business. Our analysis focuses on a different dimension that increases founders' bargaining power: their perceived skills and star aura at the IPO stage.

[236] *See* Bebchuk & Kastiel, *Dual-Class Stock*, *supra* note128, at 602 –17.

[237] *See, e.g.,* Anton Korinek & Ding Xuan Ng, *Digitization and the Macro-Economics of Superstars* (Working Paper 2018)**,** https://www.korinek.com/research [https://perma.cc/W2VZ-XBRY]; Goshen & Hamdani, *Idiosyncratic Vision*, *supra* note 24, at 565 –66, 577 –79 (describing the entrepreneur's "idiosyncratic vision"); Polman, *Startup Governance, supra* note 216 (explaining that investors appreciate founders' ability to create an innovative culture").

4. *Stakeholder Protection*

In recent years there has been growing interest in the role corporate law and governance play in protecting the interests of stakeholders other than shareholders.[238] Optimists believe that increasingly powerful shareholders would push companies to incorporate environmental, social and governance (ESG) considerations into their policies.[239] Under this view, shareholders may be willing to forgo some financial gains for social purposes.[240] Shareholders increasingly submit ESG-related proposals,[241] institutional investors are taking part in initiatives to protect stakeholder interests, and even activist hedge funds have started to include ESG issues on their agenda.[242]

Our analysis, however, cautions against over-reliance on shareholders to force firms take stakeholder interests into consideration. Even shareholders who care about stakeholders may be too deferential to iconic CEOs. As we have shown, shareholders are unlikely to deploy the full measures in their arsenal when such a CEO ignores shareholders' views on governance issues. This dynamic will likely apply to shareholders' pressure on CEOs to promote stakeholder interests.[243]

Our view is supported by empirical evidence showing that companies that outperform or that have superstar CEOs are less likely to be subject to ESG activism. For example, a recent study finds that shareholder proposals are significantly more likely to fail when the CEO is viewed as a superstar.[244]

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[238] For a review, see Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91 (2020).

[239] *See* Wolf-Georg Ringe, *Investor-led Sustainability in Corporate Governance* (Eur. Corp. Governance Inst. Working Paper Series in Law, Paper No. 615/2021, 2022), . https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3958960 [https://perma.cc/DX73-NK5X]; Roberto Tallarita, *Stockholder Politics*, 73 HASTINGS L.J. (forthcoming, 2022), https://ssrn.com/abstract=3798101; Cathy Hwang & Yaron Nili, *Shareholder-Driven Stakeholderism* 2020 U. CHI. L. REV. ONLINE 1 (2020).

[240] *See, e.g.*, Adi Libson, *Taking Shareholders' Social Preferences Seriously: Confronting a New Agency Problem*, 9 U.C. IRVINE L. REV. 699, 707 (2019) (discussing agency problems regarding managers and shareholders with respect to social preferences).

[241] Tallarita, *supra* note 240; ; Hwang & Nili, *, supra* note 241; *see also* Mark J. Roe, *Corporate Purpose and Corporate Competition* (Eur. Corp. Ints. Working Paper Series in Law, Paper No. 601/2021, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3817788 [https://perma.cc/QR4G-4FL2**]** (tying these developments to the rising concentration of the US economy).

[242] *See, e.g.,* Michal Barzuza, Quinn Curtis, & David H. Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243 (2020); Kai H.E. Liekefett, Holly J. Gregory, & Leonard Wood, *Shareholder Activism and ESG: What Comes Next, and How to Prepare,* HARV. L. SCH. F. ON CORP. GOVERNANCE. (May. 29, 2021), https://corpgov.law.harvard.edu/2021/05/29/shareholder-activism-and-esg-what-comes-next-and-how-to-prepare/ [https://perma.cc/Q76L-3X25].

[243] For the difficulty to oppose powerful leaders *see, e.g.,* Michal Barzuza, Quinn Curtis, & David H. Webber, *The Millennial Corporation: Strong Stakeholders, Weak Managers* (Working Paper, 2021). Our analysis is consistent with Lund and Pollman view, which explains that "while some … institutional investors have begun to highlight the importance of stakeholder interests, there is no sign that they have abandoned the pursuit of long-term shareholder value." *See* Lund & Pollman,, *supra* note39.

[244] *See* David et al., *supra* note 136, and accompanying text.

Commenters also note that even the poster child of climate activism, the campaign launched by Engine No. 1 against Exxon Mobil, was mostly motivated by Exxon's severe underperformance.[245]

IV. CORPORATE LAW

Superstar CEOs raise two normative questions for corporate law. First, can corporate law contain superstar CEOs' power, and should it do so? Specifically, should courts play an active role in ensuring that superstar CEOs do not abuse the power arising from the common belief in their singular contribution to company value? Second, assuming a CEO's contribution to company value is indeed unique, should corporate law allocate the extra value created by that CEO to shareholders or to the CEO?

In this part, we show how these two questions inform several pieces of corporate law doctrine: the expansion of the definition of controlling shareholders, courts' treatment of management buyouts, and directors' duty of oversight.

A. Definition of "Control"

Under Delaware law, the legal treatment of related-party transactions depends on the company's ownership structure, i.e., whether the company has a controlling shareholder.[246] Consider, for example, a public company that acquires a business owned by that company's CEO. If a majority of the company's directors are disinterested and independent, and if the CEO is not a controlling shareholder, courts will apply the *business judgment rule* and defer to the board.[247] However, if the CEO is the company's controlling shareholder, the courts will scrutinize the transaction under the *entire fairness* standard.[248] To avoid a fairness review, controllers are encouraged to have the transaction approved by a special committee of independent directors and a majority of disinterested shareholders.[249]

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[245] Alex Kimani, *Forget Activism: Chronic Underperformance Is Big Oil's Biggest Problem,* OILPRICE.COM(June 6, 2021),https://oilprice.com/Energy/Energy-General/Forget-Activism-Chronic-Underperformance-Is-Big-Oils-Biggest-Problem.html [https://perma.cc/4YKK-TGKN].

[246] Ann Lipton, *The Three Faces of Control*, 77 BUS LAW. 801, 803 (2022) ("[U]nder Delaware doctrine, a single label – controlling shareholder – carries an enormous amount of legal weight.")

[247] *Id.*, at 809 –10.

[248] Lipton,, *supra* note248 , at 81 ("when the transaction concerns a controlling shareholder, business judgment review cannot be restored by the approval of the disinterested and independent directors or the disinterested (minority) shareholders."). The law on the application of the entire fairness standard to transactions other than freezout mergers is unclear. For the view that virtually all controller self-dealing transactions are subject to entire fairness, *see In re* EZCORP Inc. Consulting Agreement Derivative Litig., No. CV 9962-VCL, 2016 WL 301245, at *12-15 (Del. Ch. Jan. 25, 2016) Berteau v. Glazek, No. 2020-873-PAF, 2021 Del. Ch. LEXIS 141 (Del. Ch. June 30, 2021). For criticism, see Lawrence A. Hamermesh, Jack B. Jacobs & Leo E. Strine, Jr., *Optimizing the World's Leading Corporate Law: A 20-Year Retrospective and Look Ahead* 27–28, 34–37 (U. Penn. Working Paper, 2021)("We never understood that entire fairness review would be universally required in these common situations.").

[249] *In re* MFW S'holders Litig., 67 A.3d 496, 499 (Del. Ch. 2013), *aff'd sub nom*; Kahn v.

Shareholders holding 50 percent or more of the voting rights are clearly controlling shareholders.[250] However, plaintiffs wishing to challenge related-party transactions seek to trigger entire fairness review by arguing that certain minority blockholders (with less than 50 percent of the votes) also should be treated as controlling shareholders.[251] While in some borderline cases courts have relied on the shareholders' influence as *managers* to classify them as controllers,[252] the test for control has traditionally focused on shareholders' voting power.[253] Shareholders with *significantly* less than 50 percent of the votes have generally not been treated as controllers.[254]

The *Tesla* decision marked a substantial departure from this approach.[255] Although Musk held only 20 percent of Tesla's voting rights, the court found him to be Tesla's controlling shareholder with respect to the acquisition of SolarCity.[256] Notably, one of the reasons for this determination was Musk's

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M&F Worldwide Corp., 88 A.3d 635 (Del. 2014); *see also* Lipton, *supra* note 248, at 811–12 (noting that so far the Delaware Supreme Court has only approved the use of MFW procedures for cleansing transformative transactions, such as freezeouts, but chancery courts have used it to cleanse additional types of conflicted transactions, involving a controlling shareholder).

[250] *See*, *e.g.*, In re PNB Holding Co. S'holders Litig., No. Civ.A. 28-N., 2006 WL 2403999, at *9 (Del. Ch. Aug. 18, 2006) ("Under our law, a controlling stockholder exists when a stockholder… owns more than 50% of the voting power of a corporation"); Williamson v. Cox Communs., Inc., No. Civ.A. 1663-N , 2006 WL 1586375, at *4 (Del. Ch. June 5, 2006) ("A shareholder is a 'controlling' one if she owns more than 50% of the voting power in a corporation").

[251] Hamermesh, Jacobs & Strine, *supra* note 250, at 40-41 (discussing "pressures by plaintiffs to characterize defendants as controlling stockholders when they possess far less than majority ownership" in order to subject the conflicted transaction to the entire fairness test).

[252] Most notably, one decision found a 35% shareholder (or 40% after counting options) qualified as a controller. That shareholder also served as Chairman and CEO, and was found "by admission, involved in all aspects of the company's business, was the company's creator, and has been its inspirational force." *See* In re Cysive, Inc. S'holder Litig., 836 A.2d 531, 552 (Del. Ch. 2003).

[253] *See* Hamermesh, Jacobs & Strine, *supra* note 250 , at 35–36 (explaining that even in the Cysive case, the control group held approximately 40% of the votes (after counting options), and that the court's reasoning remained deeply tied to voting, not managerial power).

[254] *Id.* at 35–37 (noting that "[u]nder Delaware law, it was historically difficult to establish that a stockholder having less than majority ownership was a controlling stockholder" and that "courts have focused on voting rather than managerial power"). To be clear, court rulings have recognized in the past that a shareholder who owns less than 50% of the voting power of the corporation but "exercises control over the business affairs of the corporation" could be found a controller under Delaware law (*see, e.g.,* Kahn v. Lynch Commc'ns Sys., Inc., 638 A.2d 1110, 1113-14 (Del. 1994)). However, as Hammermesh, Jacobs and Strine explain, Delaware judges "have been cautious in determining that a minority holder with a significant role in the company was a controller."

[255] Hamermesh, Jacobs & Strine, Jr., *supra* note 250, at 37 (noting that "[a]lthough that finding [in the Tesla case] may have been appropriate, we are concerned that the court's reasoning in applying controlling stockholder doctrine sweeps too broadly."). For a different view and comprehensive analysis of the definition of control, *see* Ann M. Lipton, *After Corwin: Down the Controlling Shareholder Rabbit Hole*, 72 VAND. L. REV. 1977, 1987-2005 (2019).

[256] *In re* Tesla Motors, Inc. S'holder Litig., No. 12711-VCS, 2018 WL 1560293, at *2, 19 (Del. Ch. Mar, 28, 2018) ("[T]he Complaint pleads sufficient facts to support a reasonable inference that Musk exercised his influence as a controlling stockholder with respect to the Acquisition.").

unique contribution as the company's visionary. The court explained, "the Board was well aware of Musk's singularly important role in sustaining Tesla in hard times and providing the vision for the Company's success."[257]

This decision has triggered criticism. For example, two former justices from Delaware's Supreme Court and a leading expert on Delaware corporate law argue that even if "Musk was so talented and visionary that the company could not succeed without him [,this]—does not rationally imply that someone is a controlling stockholder."[258] Still, it appears that courts are continuing to take this factor of unique contribution into account,[259] and this approach finds support in academic research.[260]

Our analysis explains, but does not necessarily justify, this legal development. Superstar CEOs do share some features with controlling shareholders. Subjecting transactions with superstar CEOs to judicial review, however, raises significant institutional concerns.

Delaware's long-standing approach "[has] been cautious in determining that a minority holder with a significant role in the company was a controller."[261] In the absence of extreme circumstances, and as long as the control is *contestable* and other shareholders had a realistic ability to outvote blockholders, they were generally not treated as controllers.[262] Should this outcome change when the blockholder happens to be a superstar CEO?

The main justification for tasking courts with reviewing transactions with controlling shareholders is controllers' power over director election.[263] Shareholders with a majority of voting rights hold the power to elect directors even against the will of all other investors. Even nominally independent directors—those who have no business or other ties to controlling shareholders—depend on these shareholders for their election and reelection to the board. The concern is that these directors might fail to prevent opportunistic self-dealing by

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[257] *Id.* at *48-49 (Del. Ch. Mar. 28, 2018). Other factors court mentioned by the court were: Musk's ownership of twenty-two percent of the company's shares and the fact that Tesla's bylaws contain several supermajority voting requirements with respect to certain mergers, acquisitions, or changes to the Board's compensation and composition, which allows Musk to exercise effective control over these corporate matters. *Id.*, at *15 .

[258] Hamermesh, Jacobs & Strine, *supra* note 250, at 37.

[259] *See*, *e.g.*, Basho Techs. Holdco B, LLC v. Georgetown Basho Invs., LLC, No. CV 11802-VCL, 2018 WL 3326693, at *27 (Del. Ch. July 6, 2018) (noting that "the ability to exercise outsized influence in the board room, such as through high-status roles like CEO, Chairman, or founder" is one of the indicia of control), *aff'd sub nom*. Davenport v. Basho Techs. Holdco B, LLC, 221 A.3d 100 (Del. 2019); FrontFour Cap. Grp. LLC v. Taube, No. CV 2019-0100-KSJM, 2019 WL 1313408, at *24 (Del. Ch. Mar. 11, 2019) (listing status as founder among indicia of control).

[260] *See* Lipton, *supra* note248 , at 813–17.

[261] *See* Hamermesh, Jacobs & Strine, *supra* note 250, at 36.

[262] *See*, *e.g.*, OTK Associates, LLC v. Friedman, 85 A.3d 696 (Del. Ch. 2014) ; *In re* Loral Space & Commc'ns Inc., 2008 WL 4293781, at *21 (Del. Ch. Sept. 19, 2008) ("With 36% of the votes, MHR hardly feared a proxy fight, and although it did not have the power to unilaterally vote in charter changes or effect a merger, it had substantial blocking power."); *see* also Hamermesh, Jacobs & Strine, *supra* note250 , at 35–36.

[263] Another explanation is the threat of retribution by controlling shareholders. *See*, *Id*, at 12. For a review and criticism of this rationale see Hammermesh, Jacobs & Strine, *supra* note250 , at 15–22.

controlling shareholders.[264] In contrast, independent directors of a widely held firm presumably have both the power and the incentives to prevent opportunistic related-party transaction, especially in today's era of powerful shareholders.[265]

Our analysis lends some support to *Tesla's* treatment of superstar CEOs as controlling shareholders. Under our framework, the power of superstar CEOs might undermine the board's effectiveness in preventing opportunistic self-dealing by superstar CEOs.[266] It is therefore tempting to treat superstar CEOs as controlling shareholders. If directors are unable to oppose them, why not use courts to protect public investors from opportunistic related-party transactions?

Superstar CEOs' power, however, differs from that of majority shareholders. As we explained above, superstar CEOs' power is limited in scope and duration. The board is more likely to challenge such CEOs if she loses her star aura or if the expected harm from self-dealing exceeds the surplus generated by their unique contribution to company value. As shown in Section III.A above, this constraint also applies to CEOs who hold a significant percentage of the company shares.

This constraint, however, does not apply to shareholders with a majority of the votes. These shareholders' power is based not on their contribution to company value, but on their uncontestable ability to elect whomever they want to the board regardless of other shareholders' views.[267] Whereas both majority shareholders and superstar CEOs can use related-party transactions to divert value from the company, only superstar CEOs are constrained by the fact that they cannot extract more than what their unique contribution is deemed to be worth.

The last point underscores the normative question underlying the *Tesla* approach: Let us assume that boards might permit superstar CEOs to engage in harmful self-dealing, but only to the extent that the cost to the company from such transactions does not exceed the value of CEO's singular contribution to the company. Treating powerful CEOs as controlling shareholders can be justified under the view that corporate law should prevent superstar CEOs from using related-party transactions to capture some of their unique contribution to company value.[268] Powerful investors presumably can protect a company from CEOs whose

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[264] *See* Bebchuk & Hamdani, *Independent Directors*, *supra* note22 , at 1284–-85; J. Travis Laster, *The Effect of Stockholder Approval on Enhanced Scrutiny*, 40 WM. MITCHELL L. REV. 1443, 1460 (2014) ("The controller's influence also undercuts the independence of otherwise independent and disinterested directors, because the controller has the power to determine whether those individuals will remain directors").

[265] Kastiel & Nili, *Competing for Votes*, *supra* note30, at 312–314, 319–312 (providing evidence of the willingness of shareholders to vote against directors and reviewing related literature).

[266] Lipton, *Three Faces of Control*, *supra* note248 , at 813 ("[C]ourts might also consider whether certain founders or CEOs are so closely identified with the company that it would be nearly unthinkable to oust them").

[267] For the concern about directors' dependence on the controller, *see, e.g.,* Bebchuk & Hamdani, *Independent Directors*, *supra* note22, at 1274. Hamermesh, Jacobs & Strine, Jr., however, argue that directors at controlled companies may be motivated to constrain controlling shareholders by their desire to maintain their reputation and get shareholder support in their nomination in other companies. *See* Hammermesh, Jacobs & Strine, *supra* note250 , at 34.

[268] Another concern is inefficiency. Superstar CEOs might use value-reducing transactions simply because they provide them with a channel to divert value. *See, e.g.* Randall Morck, Andrei

actions, through mismanagement or self-dealing, reduce its value. But shareholders' power--especially their power to vote directors out of office--is likely less effective in preventing CEOs with unique contribution to company value from diverting some of that extra value to their own pockets. Treating powerful CEOs as controlling shareholders can be justified under the view that corporate law should prevent superstar CEOs from using their power to capture their unique contribution to company value.

We do not take a stance on the *normative* question of whether superstar CEO should be permitted to use related-party transactions to capture their unique contribution to company value.[269] Rather, we would like to highlight the *institutional* reasons that could explain Delaware's traditional reluctance, until *Tesla*, to expand the definition of controlling shareholders to include visionary CEOs. First, while superstar CEOs might use their power for opportunistic related-party transactions, their ability to do is limited by the magnitude of their unique contribution. Accordingly, the benefits from extending judicial review are limited as well.

Second, turning the elusive notion of a superstar CEO into a legal test for control will be costly. Recall that there is no simple way to distinguish between a 'superstar' CEO and a 'good' CEO. Protecting investors only from superstar CEOs will require courts to develop inevitably vague standards that will create uncertainty and encourage litigation. As we have shown, some superstar CEOs can hold as little as two percent of the voting rights and still significantly influence decision-making. If a visionary CEO can influence the firm's decision-making even with a tiny equity stake, where should courts draw the line? In contrast, a 'control' test based on voting power and its contestability increases certainty. While disagreement may arise over the percentage ownership at which control becomes contestable, such a test would provide a clear metric that would enable market players to anticipate the level of judicial review to which a related-party transaction will be subject.

Third, in some cases, subjecting transactions with superstar CEOs to substantive fairness review might require the court to assess the CEO's contribution to the firm.[270] In the case of Elon Musk's compensation, for example, what would be an "unfair" pay package? [271] Are the courts in a position to estimate the value to shareholders of Musk's vision and unique skills?[272] If shareholders

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Shleifer & Robert W. Vishy, *Do Managerial Objectives Drive Bad Acquisitions?*, 45 J. FIN. 31, 32 (1990) ("When an investment provides a manager with particularly large personal benefits, he is willing to sacrifice the market value of the firm to pursue that investment"). Inefficient transactions might also take place if investors approve value-reducing transactions by superstar CEOs.

[269] In our view, this question requires an answer to the question of why superstar CEOs cannot simply use compensation arrangements or other contracts to determine their share of the surplus produced by their singular contribution. As a matter of theory, such an arrangement would be superior to self-dealing transactions as a mechanism for compensating superstar CEOs.

[270] *See* Goshen & Hamdani, *Dual Class*, *supra* note23, at 961–74.

[271] *See supra* notes 188-89 and accompanying text.

[272] *See also* Hamermesh, Jacobs & Strine, Jr., *supra* note 248, at 32n.102 ("Appraising a company sold in a conflicted merger with no market test is difficult enough; judicial pricing of compensation packages plans is unmoored in standards that would make any exercise of discretion reviewable in any coherent and consistent way.").

are willing to pay Musk an unprecedented amount once he meets certain extremely ambitious thresholds, thereby delivering incomparable returns, should the courts intervene?

Finally, the Delaware's approach to judicial review under the entire fairness standard might not work in the case of superstar CEOs. Under the MFW standard,[273] courts encourage controlling shareholders to submit conflicted transactions for an approval by both a special committee of independent directors and a majority-of-the-minority vote. They do so by subjecting transactions that meet these two conditions to the business judgment rule and avoiding a substantive fairness analysis of the transaction. The rationale underlying this approach is that shareholders are better positioned than courts to determine whether a proposed transaction is desirable.

Our analysis, however, questions the effectiveness of shareholder votes in containing opportunistic behavior by superstar CEOs. On the one hand, as the WeWork example demonstrates, even sophisticated investors might support a suboptimal related-party transaction if they believe that its harm does not exceed the value of the CEO's unique contribution. In *Tesla*, for example, both the SolarCity transaction and Musk's executive compensation package were approved by the overwhelming majority of disinterested shareholders.[274]

On the other hand, our analysis also suggests that, even when they are displeased with some of superstar CEOs' actions, shareholders are unlikely to use votes on director elections to retaliate against superstar CEOs. Without a separate vote on related-party transactions, shareholders might feel compelled to "pay the price" of a value-reducing related-party transaction. In contrast, if they had the opportunity to vote on specific transactions (and not just on director elections), shareholders could reject value reducing transaction while keeping the CEO (and the board). A separate vote on related-party transactions could therefore allow shareholders to capture a larger share of the surplus generated by a superstar CEO.

To summarize, under Delaware law, treating superstar CEOs as controlling shareholders would encourage companies to submit self-dealing transaction to a shareholder vote.[275] From an institutional standpoint, expanding the definition of control to include superstar CEOs would improve investor protection only when shareholders—unlike directors—will prove effective in using their votes to

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[273] *Supra* note 250.

[274] For example, Musk's compensation package was approved by 73% of shareholders of Tesla, who were unaffiliated with the company management (see *supra* note 188–89, and accompanying text), and about 60% of the holders of Tesla outstanding shares voted in favor of the SolarCity acquisition. *See In re* Tesla Motors, Inc. S'holder Litig., No. 12711-VC 2018 WL 1560293, at *10 (Del. Ch. Mar. 28, 2018). Plaintiffs contended that certain mutual funds who held equity positions in both Tesla and SolarCity should have been excluded from the vote tally, as they are allegedly not "disinterested" *Id.* at *10 n.183.

[275] Under the MFW standard, courts encourage controlling shareholders to submit conflicted transactions for a shareholder vote because an approval by a majority of shareholders unaffiliated with the controller in addition to an approval by a special committee of independent directors would subject the conflicted transaction to the deferential business judgment rule and avoid a substantive fairness analysis of the transaction. See *supra* note251. Even if the two MFW conditions are not met, a vote by unaffiliated shareholders still shifts the burden of proof to the plaintiff under the entire fairness standard. *See* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

prevent these CEOs from pursuing opportunistic transactions.

B. Management Buyouts

The law governing corporate acquisitions aims to ensure that managers' potential conflicts of interest do not undermine investors' rights to receive the fair value of their shares. This desirable goal, however, becomes more difficult to attain when management is uniquely valuable, that is, when the value of the company depends on the identity of its CEO. We focus on management buyouts to illustrate this difficulty.

In a management buyout the CEO, usually in cooperation with a private equity fund or another financial sponsor, acquires a public company from its public investors. In 2013, for example, Michael Dell, who owned approximately sixteen percent of Dell, Inc. and served as its CEO and chair, partnered with Silver Lake Partners to acquire Dell's remaining shares and take the company private.[276]

MBOs inevitably create conflicts of interest between shareholders and the CEO, who would like to buy the company from its shareholders at the lowest price possible. The conventional view identifies two primary concerns arising from these conflicts. First, CEOs know the company better than the shareholders and independent directors do and can use their informational advantage to buy the company at an unfairly low price.[277] Second, CEOs might use their power to sway the decision to sell in their favor, undermining the bidding process by reducing the likelihood that competing bids will be made or accepted.[278]

These concerns have led commentators to call for more extensive judicial review of MBOs.[279] More recently, the question of the legal treatment of MBOs has focused on the appraisal remedy. In appraisal cases, shareholders who object to the terms of an MBO ask the court to determine the fair value of their shares.[280] The courts often rely on experts, who usually use the discounted cash flow (DCF) analysis to estimate the company's fair value.[281] A question that has recently occupied courts and scholars is whether an effective sale process can eliminate the need for appraisal. Under one approach, a court may forgo the complicated task of determining a company's fair value if the share purchase price results from an auction or other competitive bidding process.[282] Another approach would

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[276] *See* Dell Inc., Definitive Proxy Statement (Schedule 14A), 9, 63 (Sept. 24, 2013); Poornima Gupta, Nadia Damouni & Greg Roumeliotis, *Dell to go private in landmark $24.4 billion deal,* REAUTERS (Feb. 6, 2013), https://www.reuters.com/article/us-dell-buyout-idUSBRE9140NF20130206.

[277] *See* Matthew D. Cain & Steven M. Davidoff, *Form Over Substance? The Value of Corporate Process and Management Buy-Outs*, 36 DEL. J. CORP. L. 849 (2011); Iman Anabtawi, *Predatory Management Buyouts*, 49 U.C. DAVIS L. REV. 1285, 1305 (2016) ("In contrast to their inside counterparts, outside directors are not full-time employees of the target and thus must rely primarily on management for information").

[278]*See* Anabtawi, supra note 278, at 1301.

[279] Cain & Davidoff, *supra* note278 , at 895–900.

[280] DEL. CODE ANN. tit. 8, § 262(a) (West 2022)

[281] Albert H. Choi & Eric Talley, *Appraising the "Merger Price" Appraisal Rule,* 34 J. L. ECON. & ORG. 543, 546 n.4 (2018).

[282] *See* Union Ill. 1995 Inv. Ltd. P'shipv. UnionFin. Grp., Ltd., 847 A.2d 340, 358 (Del. Ch. 2004) (merger price is indicative of fair value when it "resulted from a competitive and fair

require courts to independently value companies regardless of the process leading to the MBO.[283]

Following the Dell MBO, for example, shareholders filed an appraisal action in the Delaware Court of Chancery. The defendants argued that since the sale process provided other potential buyers with a meaningful opportunity to submit competing bids, the purchase price was the best evidence of the company's fair value.[284] Finding that the bidding process had several flaws, the Chancery Court used the DCF method to value the company.[285] The Delaware Supreme Court reversed,.[286] relying on the fact that other prospective buyers had been given the opportunity to submit higher bids.[287]

Interestingly, *Dell* was the first case in which the Court of Chancery expressly addressed the issue of "valuable CEOs," indicating that: "[a] competing bidder that did not have Mr. Dell as part of its buyout group would be bidding for a company without that asset and would end up with a less valuable company" and that "Mr. Dell's unique value and his affiliation with the Buyout Group were negative factors that inhibited the effectiveness of the go-shop process."[288] However, the Delaware Supreme Court ruled there was no factual basis for that finding.[289]

In an insightful article, Guhan Subramanian explains that a market check is not a useful price discovery mechanism when management is valuable to the company and declines to work with third-party bidders.[290] Our analysis offers a different take on the tension underlying MBOs, at least for companies with superstar CEOs. Corporate law grants the target's shareholders the right to receive the fair value of their shares, that is, their pro rata share of the value of the company as a going concern, without the synergy gains that the acquisition will produce.[291] But what happens when the company's value depends on the identity of its CEO? In this case, the 'fair value' determination raises the following question: who is entitled to the value created by the CEO's unique contribution to

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auction, which followed a more-than adequate sales process and involved the broad dissemination of confidential information to a large number of prospective buyers.")

[283] *See id.*at 359.

[284] *See In re* Appraisal of Dell Inc., No. 9322-VCL, 2016 WL 3186538, at *22 (Del. Ch. May 31, 2016), *aff'd in part, rev'd in part sub nom*. Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1 (Del. 2017).

[285] *Id*., at *1, *51.

[286] *Dell, Inc.*, 177 A.3d at 6; *see* Charles Korsmo & Minor Myers*, The Flawed Corporate Finance of Dell and DFC Global,* 68 EMORY L.J. 221, 251 (2018) ("[A]t the end of the day, the Supreme Court simply saw nothing wrong with the sales process.").

[287] The Supreme Court remanded the case (*Dell, Inc.*, 177 A.3d), and the parties settled thereafter. *In re* Appraisal of Dell Inc., No. 9322-VCL, 2018 WL 2939448, at *1 (Del.Ch. June 11, 2018).

[288] *In re* Appraisal of Dell Inc., 2016 WL 3186538, at *43-44 (Del. Ch. May 31, 2016).

[289] *Dell, Inc*., 177 A.3d at 33, 34 .

[290] Subramanian, *supra* note10, at 621. He also outlines proposals for boards to follow to level the playing field and increase the role of auctions in price discovery. *Id.* at 631–47.

[291] *See, e.g.,* DFC Glob. Corp. v. Muirfield Value Partners, L.P., 172 A.3d 346 (Del. 2017) ; Lawrence A. Hamermesh & Michael L. Wachter, *Finding the Right Balance in Appraisal Litigation: Deal Price*, *Deal* Process, and Synergies, 73 BUS. L. 961 (2018).

the firm?

Assume that a CEO acquires the company from its public investors. Assume further that the value of that company under the leadership of the current CEO exceeds its value under any other CEO. What should be the 'fair value' of the company under these assumptions? Should shareholders be entitled to the (lower) value of the company without the CEO or its (higher) value with the CEO?

On the one hand, until the CEO decided to take the company private, the extra value that the CEO produced seemed to belong to the shareholders: the CEO was entitled to a compensation package and the shareholders were entitled to all the company's residual cash flows. On the other hand, shareholders depend on the CEO to produce this extra value, and they cannot force the CEO to continue providing services to the company.[292]

We do not take a stand on this normative question. Rather, we make two points. First, asymmetric information and the threat of opportunistic behavior by CEOs are not the only concerns raised by MBOs. When the CEO is uniquely valuable, MBOs can be difficult to regulate even when boards are powerful, independent, and genuinely accountable to the shareholders.

Second, the choice between appraisal and deal price as a measure of firm value reflects one's view on the desirable allocation of the CEO's unique contribution to company value. Reliance on the deal price as a measure of fair value is consistent with the view that public shareholders are entitled only to the value of the company without the CEO unique contribution. The appraisal remedy, in contrast, is consistent with the opposite view.

To see why, consider the prevailing method for valuing companies: the DCF method. Although it does not formally incorporate the CEO's identity into the model, the DCF method takes into account past cash flows and management projections for future cash flows.[293] Management projections inevitably will include the vision and value of its existing leadership. The appraisal remedy, to the extent it relies on the DCF method, therefore captures the unique value superstar CEOs would produce were they to stay with the company. Other bidders, in contrast, assume that the existing CEO would not stay with the company if they were to acquire it. Thus, they will price their bid based on their assessment of the expected value of the company without its superstar CEO. The more uniquely valuable the CEO, the larger will be the difference in value assigned to the target under the DCF method and its value under an auction (the deal price method).

To illustrate, assume that the CEO decides that she would like to bid for the

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[292] Another complicating factor is related to whether the CEO's threat to leave the company is a credible one and whether it can produce this value at another venture. The CEO who founded a company may be reluctant to leave it just before an exit, and if she does so and the value of the company would decrease, this does not mean that the CEO would enjoy this lost value elsewhere. *See* Oliver Hart & John Moore, *Property Rights and the Nature of the Firm* 98 J. POL. ECON. 1119 (1990). However, a charismatic CEO with transferable skills could become a superstar at other companies and thus may enjoy a greater bargaining power.

[293] *See, e.g.*, Jay W. Eisenhofer & John L. Reed, *Valuation Litigation*, 22 DEL. J. CORP. L. 37, 112–13 (1997) (describing DCF methodology and its use in calculating cash flows: "[u]nder the DCF approach, future cash flows over a specified period are first estimated… The cash flow projections generally cover a five-year period and the accuracy of the projections is critical to the acceptance of the valuation by the courts.")

company. Assume further that the value of the company is $20 billion without the CEO, and $21 billion with the CEO. The highest price that outside bidders would be willing to pay is $20 billion. The management group could offer a slightly higher price, say $20.1 billion, and win the auction. Under the appraisal method, in contrast, the fair value of the shares would be $21 billion (the value of the company under its existing management).[294]

Thus, if one holds the view that shareholders are not entitled to the extra value the CEO produces, relying on the deal price is preferable to judicial valuation because the appraisal remedy tends to provide public investors with a share of the extra value attributable to the CEO's leadership.[295] Moreover, reliance on the deal price does not require courts to determine whether a CEO is uniquely valuable. In our discussion above whether courts should treat superstar CEOs as controlling shareholders, we explained that a legal rule that distinguishes between superstar and 'regular' CEOs would likely fail given the difficulty of distinguishing between the two types of CEOs. The deal price method of appraisal, however, would allow superstar CEOs to capture their unique contribution without requiring courts to identify superstar CEOs. In other words, the market will treat the two types of CEOs differently. If outside bidders believe the CEO is not uniquely valuable, their bid will not be adversely affected by their expectation that the management team would not join them, Thus, there will be little difference between the value determined using the appraisal and deal price methods.[296]

Note that our analysis differs from Subramanian's view. He recognizes the problem of "valuable CEOs" and focuses on the obstacle superstar CEOs might create for bidders.[297] In his view, these obstacles imply that auctions, in their current formulation, cannot ensure that deal price reflect fair value. He therefore proposes several measures to improve the sale process, the most important one being ensuring that "valuable" managers work with other bidders.[298]

Our analysis, in contrast, explains that the legal treatment of MBOs depends on the question of whether superstar CEOs alone—and not shareholders—are entitled to the extra value they produce. For those who take the view that CEOs are entitled to their unique contribution to company value, an effective auction is a sufficient requirement for ensuring that shareholders receive the fair value of

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[294] For simplicity, this example assumes there are no gains from taking the company private.

[295] *See* Choi & Talley, supra note 282,; Jonathan Macey & Joshua Mitts, *Asking the Right Question: The Statutory Right of Appraisal and Efficient Markets*, 74 BUS. LAW. 1015 (2019).

[296] We do not ignore the other concerns raised by MBOs. *See infra* notes 277-279 and accompanying text. We assume these concerns will be incorporated into courts' review of the deal process.

[297] Subramanian, *supra* note 10, at 620-21 ("Management does not have an obligation to work with third-party bidders, but when management chooses not to do so (either implicitly or explicitly), and when management is valuable, a market canvass process is no longer a useful mechanism for price discovery.")

[298] *Id.* at 639 ("In order to mitigate the information-asymmetry problem and the valuable-management problem, boards should insist on cooperation agreements from management as a condition for considering an MBO.") Yet, the board cannot force managers to cooperate with all potential buyers. *See* Guhan Subramanian & Annie Zhao, *Go-Shops Revisited*, 133 HARV. L. REV. 1215, 1242 (2020) ("[I]f the CEO is important to the ongoing value of the enterprise, no go-shop bidder would want to partner with a reluctant CEO.").

their shares.

C. Board Oversight and Managerial Misconduct

Our analysis sheds a new light on the so-called oversight duties of directors.[299] For purposes of our analysis, it will be useful to distinguish between two types of managerial misconduct. The first is directly related to the company's business. It will increase profits if undetected, but will result in corporate liability and penalties otherwise. When managerial misconduct leads to penalties, plaintiffs often file *Caremark*-type derivative lawsuits alleging that the board failed to fulfill its oversight duties.[300] Delaware courts seem to have become more receptive to such lawsuits in recent years.[301]

The second type of managerial misconduct is *not* directly related to company business and might be costly for the company and shareholders. Examples include the allegations of reckless workplace drug use by the founder of WeWork, sexual harassment claims against corporate executives,[302] and Elon Musk's use of Twitter.

Why do boards fail to prevent CEO misconduct? Current views focus on CEO power and board agency costs. For example, it has been argued that board members are rewarded with equity-based compensation, which leads them to prefer short-term profits over long-term performance.[303] But this view fails to explain managerial misconduct that is not directly related to company business. Why would directors turn a blind eye to a CEO's unlawful conduct that is not likely to benefit the corporation? Agency costs also cannot fully explain why sophisticated investors who sit on the board of startups, such as Uber and WeWork, tolerate misconduct.[304]

Our framework explains board failure to monitor superstar CEOs. Directors might hesitate to confront superstar CEOs because they fear the consequences losing such a CEO (including by uncovering information about misconduct) will have on the company. Consider, for example, a CEO who engages in unlawful conduct that might be harmful to the company, such as reckless public use of drugs at work events, or discriminatory employment practices. If the CEO is commonly perceived as critical for the company's success, the board might be reluctant to dismiss her or, more realistically, might find it preferable to remain ignorant of the CEO's misconduct. The board might also defer to the CEO with respect to

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[299] Our discussion does not include cases where the board knowingly decides to violate the law. Genworth Fin., Inc. Consol. Derivative Litig., No. 11901-VCS , 2021 WL 4452338, at *14-15 (Del. Ch. Sept. 29, 2021) (explaining the distinction between failure of oversight and causing the company to violate the law).

[300] *In re* Caremark Int'l Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996).

[301] *See, e.g.,* Stephen M. Bainbridge, *Don't Compound the Caremark Mistake by Extending It to ESG Oversight* (Oct 12, 2021); Roy Shapira, *A New Caremark Era: Causes and Consequences* 98 WASH. U. L. REV 1857 (2021).

[302] *See, e.g.,* Daniel Hemel & Dorothy S. Lund, *Sexual Harassment and Corporate Law*, 118 COLUM. L. REV. 1583 (2018); Amelia Miazad, *Sex, Power, and Corporate Governance*, 54 U.C. DAVIS L. REV. 1913, 1959–69 (2021).

[303] John Armour, Jeffrey Gordon & Geeyoung Min, *Taking Compliance Seriously*, 37 YALE J. ON REGUL. 1, 3-5 (2020).

[304] See *supra* Section III.B.2.

legal risks and compliance strategy.

This explanation could justify the undertheorized *Caremark* doctrine. Why is a special doctrine needed to force boards to monitor compliance? Our analysis shows that without the motivation such a doctrine provides, boards might opt to remain ignorant of misconduct because they would rather not confront a superstar CEO, or are simply be too deferential. Shareholders may benefit from the continued leadership of a powerful CEO and are likely to tolerate misbehavior despite its effects on third parties (as long as it does not significantly diminish company value). This account provides additional support for the view that the *Caremark* doctrine is not really about protecting shareholder interests, but about advancing the interests of stakeholders and other societal interests.[305]

CONCLUSION

Recent technological advances and increasing winner-take-all competition in markets has led to the rise of "larger-than-life" CEOs. While the business press, management experts, and financial economists have long been preoccupied with researching this fascinating phenomena and its financial implications, the legal literature has largely overlooked it. This Article is the first to fill this gap by providing a comprehensive, and novel theory of superstar CEOs.

Superstar CEOs challenge the traditional dichotomy in corporate law between companies that have controlling shareholders and those that are widely held. The Article analyzes the nature of superstar CEO power and its limits, and explores its important implications for recent high-profile corporate governance debates on managerial misconduct, the use of dual-class shares, and the role of corporate law in protecting constituencies other than shareholders. In addition, the Article sheds new light on three recent corporate law developments: the expansion of the definition of controlling shareholders; courts' treatment of management buyouts; and directors' duty of oversight. The analysis provided in the Article represents an important first step in addressing the complex issues raised by the rise of superstar CEOs, and may potentially prompt a new line of inquiry regarding the role of corporate law in regulating their activities.

[305] *See* Elizabeth Pollman, *Corporate Oversight and Disobedience,* 72 VAND. L. REV. 2013, 2025–31 (2019).

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