

Fixing MFW: Fairness and Vision in Controller Self-Dealing

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Zohar Goshen

Columbia University and ECGI

Assaf Hamdani

Tel Aviv University and ECGI

Dorothy S. Lund

Columbia University and ECGI

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The authors have benefitted from insightful comments and discussions with Ryan Bubb, Stephen Fraidin, Kobi Kastiel, Ann Lipton, Ted Mirvis, John Reed, and Eric Talley and the participants in the Columbia Law School Faculty workshop. Thanks to Ilay Atias, Kyle Mary Oefelein, and Ashley Pennington for superb research assistance.

Abstract

The legal regime governing controlling shareholders relies on the court's ability to police conflicted transactions under the stringent "entire fairness" standard of review. This review involves both implicit valuation—evaluating the transaction process, and explicit valuation—assessing the fairness of the transaction's financial terms. Our research reveals a critical flaw in this regime: courts cannot reliably engage in valuation when the transaction involves an entrepreneur's idiosyncratic vision for the company. As a result, there is a gaping hole in Delaware's framework for policing the fairness of controller transactions. Delaware courts have developed guardrails to avoid judicial valuation by rewarding controllers that implement procedural protections for minority shareholders with more favorable review. Nonetheless, we describe how these guardrails have been failing more and more often, forcing judicial valuation to the forefront of trials and negating the informed input of shareholders. To address this shortcoming, we propose reforms to the doctrinal framework that would enable courts to avoid valuation when the interested parties have endorsed the transaction and its price. We also offer guidance for judicial review of controller self-dealing transactions where necessary that respects the competency of courts. Our modified framework represents an important advancement in the legal treatment of controlling shareholder transactions. It would safeguard minority shareholders from expropriation by controllers while simultaneously encouraging visionary entrepreneurs to engage in value-creating activities, thereby promoting both fairness and innovation in Delaware corporate law.

Keywords: Delaware Law, MFW, cleansing, entire fairness review, controlling shareholders, Elon Musk, *Tornetta v. Musk*, entrepreneurs, vision

Zohar Goshen

Jerome L. Green Professor of Transactional Law
Columbia University
435 West 116th Street
New York, NY 10027, United States
phone: +1 212 854 9760
e-mail: zohar.goshen@law.columbia.edu

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

Dorothy S. Lund*

Professor of Law
Columbia University
435 W 116th St
New York, NY 10027, United States
phone: +1 847 334 2262
e-mail: dorothy.lund@columbia.edu

*Corresponding Author

FIXING *MFW*: FAIRNESS AND VISION IN CONTROLLER SELF-DEALING

Zohar Goshen,^{*} Assaf Hamdani,^{*} and Dorothy Lund^{*}

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The legal regime governing controlling shareholders relies on the court's ability to police conflicted transactions under the stringent "entire fairness" standard of review. This review involves both implicit valuation—evaluating the transaction process, and explicit valuation—assessing the fairness of the transaction's financial terms. Our research reveals a critical flaw in this regime: courts cannot reliably engage in valuation when the transaction involves an entrepreneur's idiosyncratic vision for the company. As a result, there is a gaping hole in Delaware's framework for policing the fairness of controller transactions.

Delaware courts have developed guardrails to avoid judicial valuation by rewarding controllers that implement procedural protections for minority shareholders with more favorable review. Nonetheless, we describe how these guardrails have been failing more and more often, forcing judicial valuation to the forefront of trials and negating the informed input of shareholders. To address this shortcoming, we propose reforms to the doctrinal framework that would enable courts to avoid valuation when the interested parties have endorsed the transaction and its price. We also offer guidance for judicial review of controller self-dealing transactions where necessary that respects the competency of courts. Our modified framework represents an important advancement in the legal treatment of controlling shareholder transactions. It would safeguard minority shareholders from expropriation by controllers while simultaneously encouraging visionary entrepreneurs to engage in value-creating activities, thereby promoting both fairness and innovation in Delaware corporate law.

^{*} Jerome L. Greene Professor of Transactional Law, Columbia Law School; ECGI.

^{*} Professor of Law, Tel Aviv University; ECGI.

^{*} 1982 Alumna Professor of Law, Columbia Law School; Co-Director of the Millstein Center for Global Markets and Corporate Ownership; ECGI. The authors have benefitted from insightful comments and discussions with Ryan Bubb, Stephen Fraidin, Kobi Kastiel, Ann Lipton, Ted Mirvis, John Reed, and Eric Talley and the participants in the Columbia Law School Faculty workshop. Thanks to Ilay Atias, Kyle Mary Oefelein, and Ashley Pennington for superb research assistance.

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I. INTRODUCTION

In January 2024, the Delaware Chancery Court rescinded Tesla’s \$55.8 billion dollar stock-option grant to Elon Musk—the largest executive pay package in history.¹ Of course, this was a staggering amount of money, dwarfing typical CEO pay packages and even exceeding the annual GDP of many small countries.² But when Tesla first announced Musk’s compensation plan on January 23, 2018,³ many considered it extremely unlikely Musk would earn this payday.⁴

Under the compensation plan, Musk’s receipt of a series of 1% stock grants was contingent on Tesla achieving certain performance milestones over the next ten years⁵—milestones that were deemed “laughably impossible” by Tesla’s detractors.⁶ To earn the maximum payout under the plan, Musk would have to take Tesla from about a \$59 billion dollar market value to \$650 billion within 10 years—a “jaw-dropping”⁷ goal that some called a publicity stunt.⁸

When Tesla designed the compensation plan, its outlook was grim. It had recently reported record losses and struggled to meet production targets for its new Model 3 car.⁹ By October 2018, several months after Tesla announced Musk’s compensation plan, Tesla’s share price plummeted to below \$17, prompting hedge fund manager David Einhorn to alert his investors that Tesla bore a grim resemblance to Lehman Brothers before its 2008 bankruptcy (a collapse that Einhorn had foreseen months before it occurred).¹⁰ By June 2019, Tesla’s shares had plunged further, dropping below \$12—a 48% decrease from the date of the plan’s announcement. It was not until December 2019 that the stock price finally rebounded to its initial level of \$23.51, where it had stood two years earlier when the plan was introduced. Musk himself described this period as “incredibly

¹ *Tornetta v. Musk*, 310 A.3d 430, 445 (Del. Ch. 2024).

² *Id.*

³ *Press Release: Tesla Announces New Long-Term Performance Award for Elon Musk*, TESLA INVESTOR RELATIONS (Jan. 23, 2018), <https://ir.tesla.com/press-release/tesla-announces-new-long-term-performance-award-elon-musk#:~:text=PALO%20ALTO%2C%20Calif.%2C%20Jan,valuable%20companies%20in%20the%20world>.

⁴ Andrew Ross Sorkin, *Tesla’s Elon Musk May Have the Boldest Pay Plan in Corporate History*, N.Y. TIMES (Jan. 23, 2018). For a comprehensive analysis of Musk’s compensation package, see Jeffrey L. Coles, Naveen Daniel & Lalitha Naveen, *Musk’s \$56 billion: Pay, Incentives, or Rewards?*, ECGI Working Paper N° 1010/2024 <https://ssrn.com/abstract=4942066>.

⁵ *Tornetta*, 310 A.3d at 445.

⁶ Andrew Ross Sorkin, *Tesla’s Elon Musk May Have the Boldest Pay Plan in Corporate History*, N.Y. TIMES (Jan. 23, 2018).

⁷ *Id.*

⁸ See Aaron Mak, *Elon Musk Will Not Get Paid Unless Tesla Meets Ambitious Goals*, SLATE (Jan. 23, 2018).

⁹ *Tesla Posts Record \$710m Net Loss as it Struggles to Produce Model 3 Cars*, GUARDIAN (May 2, 2018), <https://www.theguardian.com/technology/2018/may/02/tesla-loss-model-3-elon-musk>.

¹⁰ Tae Kim, *Einhorn on Tesla: ‘Like Lehman, We Think the Deception Is About to Catch Up’*, CNBC (Oct. 5, 2018, 12:26 PM EDT), <https://www.cnbc.com/2018/10/05/einhorn-on-tesla-like-lehman-we-think-the-deception-is-about-to-catch-up-to-tsla.html> [<https://perma.cc/AM9N-3NGD>].

difficult and painful” to the point where he was “sleeping on the floor of the factory” as he tried to solve the production delays.¹¹ During this time, Musk received no guaranteed compensation of any kind.

Amid this period of turmoil, Tesla stockholder Richard Tornetta filed a lawsuit on June 5, 2018, claiming that Tesla’s directors breached their fiduciary duties by awarding Musk excessive compensation.¹² Under Delaware corporate law, shareholders can challenge controller transactions and secure judicial review of the transaction’s fairness.¹³ Accordingly, the *Tornetta* court had to evaluate whether Tesla paid a fair price when it compensated Musk in January 2018. But how can a court determine the fair value of Elon Musk’s leadership at Tesla?¹⁴

Musk is a controversial figure, and we make no judgment about his personal and leadership qualities. In this Article, however, we use *Tornetta* to identify major flaws in Delaware’s regulation of controller self-dealing transactions. These flaws, we argue, undermine the regulation of self-dealing transactions that require courts to determine the value of a controller’s entrepreneurial vision for the company. We demonstrate that there is no reliable way to value an entrepreneur’s vision or their contribution to the company; moreover, we show that the absence of reliable valuation methods undermines judicial review of controlling shareholder transactions.

Two of us have described an entrepreneur’s unique idea or method of execution as their *idiosyncratic vision*.¹⁵ A key aspect of idiosyncratic vision is that outsiders are often unable to observe or verify it.¹⁶ Even with all relevant information, parties might reach different conclusions about the viability and value of the entrepreneur’s vision.¹⁷

¹¹ Catherine Clifford, *Elon Musk Is Stressed, Says He’s Sleeping on Tesla Factory Floor and Has No Time to Go Home and Shower*, CNBC (Apr. 11, 2018), <https://www.cnbc.com/2018/04/11/elon-musk-says-he-is-sleeping-on-tesla-factory-floor-to-save-time.html>.

¹² *Tornetta*, 310 A.3d at 496.

¹³ See *In re Match Grp., Inc. Derivative Litig.*, 315 A.3d 446, 451 (Del. 2024). The entire fairness standard applies to self-dealing transactions with controlling shareholders. The court treated Musk as the controller of Tesla. See *Tornetta* at 446. In this paper, we do not discuss the question whether Musk controls Tesla. For an analysis of the definition of “control” under Delaware law, see generally Ann M. Lipton, *The Three Faces of Control*, 77 BUS. LAW. 801 (2022).

¹⁴ Two former Delaware Supreme Court judges and a corporate law scholar made a similar argument. See Lawrence Hamermesh, Jack Jacobs, & Leo Strine Jr., *Optimizing the World’s Leading Corporate Law: A 20-Year Retrospective and Look Ahead*, 77 BUS. L. ___, manuscript at 32 n.102. (2021) (“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.”)

¹⁵ Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 577 (2016).

¹⁶ *Id.* at 567.

¹⁷ Zohar Goshen & Assaf Hamdani, *Corporate Control, Dual Class, and the Limits of Judicial Review*, 120 COLUM. L. REV. 941, 968 (2020).

Unfortunately for entrepreneurs and investors (and courts asked to value vision), there is no methodology to separate business ideas doomed to fail from successful, even revolutionary, ideas. Some of the past century's most transformative founders were dismissed before their ideas gained traction. For example, Fred Smith first conceived the idea to start FedEx in 1965 and while a student wrote a paper laying out his vision to transform the shipping industry. Smith's professor, however, did not share his vision and gave the paper a C.¹⁸ Howard Schultz's idea to bring Italian-style coffee houses to the United States was rejected by over 217 investors before he was able to raise enough money to start the business which became Starbucks.¹⁹ Steve Wozniak offered his then-employer Hewlett Packard the Apple I PC.²⁰ The company rejected the idea again and again until Wozniak struck out on his own to make the now best-selling computer.²¹ Sarah Blakely spent two years developing a new style of hosiery after selling fax machines through hot Florida summers in traditional pantyhose. She cold called hosiery mills for weeks only to be sent away by every representative. She eventually convinced one mill manager to give her a shot developing "Spanx," a company that is now worth over a billion dollars.²²

Stories like this are as common as they are unsurprising: Not everyone will immediately see value in an entrepreneur's vision. And as these examples suggest, the inability to accurately value transformative ideas can reduce social welfare, as pricing failures can hamper the idea's execution, leading to the loss of value and social wealth.²³

Our Article shows how this insight—that idiosyncratic vision cannot be reliably valued—throws a wrench into the mechanics of one of corporate law's core standards of review—entire fairness.²⁴ When a controlling shareholder transacts with the company, that transaction may be subject to entire fairness review because of the pronounced conflict of interest that the transaction

¹⁸ See, *Fred Smith: An Overnight Success*, ENTREPRENEUR (Oct. 9, 2008), <https://www.entrepreneur.com/growing-a-business/fred-smith/197542>.

¹⁹ See HOWARD SCHULTZ & DORI JONES YANG, *POUR YOUR HEART INTO IT: HOW STARBUCKS BUILT A COMPANY ONE CUP AT A TIME*, (1997).

²⁰ WALTER ISAACSON, *STEVE JOBS* 93 (2011).

²¹ *Id.* at 118

²² <https://www.forbes.com/global/2012/0326/billionaires-12-feature-united-states-spanx-sara-blakely-american-booty.html>

²³ Zohar Goshen & Reilly S. Steel, *Barbarians Inside the Gates: Raiders, Activists, and the Risk of Mistargeting*, 132 YALE L.J. 447-48 (2022).

²⁴ In this way, the entire fairness standard of review may no longer be "functional" because as we show, the standard is not a useful tool that aids the court in deciding the duty at issue in a way that provides the right incentives for directors and stockholders, but also defers "to outcomes reached through effective intra-corporate dispute resolution mechanisms." William T. Allen, Jack B. Jacobs and Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287 (2001).

presents. A core goal of corporate law is ensuring that controlling shareholders do not expropriate value from the minority shareholders when they transact with the company.²⁵ Thus, Delaware courts entitle minority shareholders to seek judicial review of the controller's self-dealing transaction, which places the burden on the controller to demonstrate the fairness of the transaction's price, as well as the process that led to it.²⁶ In theory, entire fairness review allows courts to distinguish between fair transactions that benefit the company and those that are the product of value-reducing self-dealing.

Entire fairness review is fundamentally reliant upon the competence of courts to determine the disputed transaction's fairness. As part of the fair price analysis, Delaware courts are tasked with evaluating the price paid for entire companies, business divisions, specific assets, and so on, in order to determine whether the transaction was fair to the minority shareholders.²⁷ To do so, courts rely on valuation models developed by economists for the pricing of assets.²⁸ Applying valuation models is challenging for most courts, as it requires at least some understanding of financial theory.²⁹ Although Delaware courts are uniquely sophisticated when it comes to cutting-edge valuation techniques,³⁰ non-trivial challenges remain when courts conduct their own independent valuation.³¹

²⁵ See Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 786 (2003); Zohar Goshen, *The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality*, 91 CALIF. L. REV. 393 (2003); Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1650 (2006); Assaf Hamdani & Lucian A. Bebchuk, *The Elusive Quest for Global Governance Standards*, 157 U. PA. L. REV. 1263, 1283-1285 (2009).

²⁶ *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983) ("The concept of fairness has two basic aspects: fair dealing and fair price."); *In re Match*, 315 A.3d at 459.

²⁷ See R. Scott Widen, *Delaware Law, Financial Theory and Investment Banking Valuation Practice*, 4 N.Y.U. J.L. & BUS. 579, 579 (2008) ("Delaware courts have developed a surprisingly large body of law regarding the proper analytics for valuing businesses. Most of this law has been developed in the context of adjudicating appraisal rights of dissenting shareholders in corporate M&A or going-private transactions."); *Weinberger*, 457 A.2d at 711 (Fair price "relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock.").

²⁸ See *Weinberger*, 457 A.2d at 712-13.

²⁹ See, e.g., *Merion Cap. L.P. v. Lender Processing Servs., Inc.*, No. CV 9320-VCL, 2016 WL 7324170, at *15 (Del. Ch. Dec. 16, 2016), judgment entered, (Del. Ch. 2016) ("it is difficult for the Chancellor and Vice Chancellors to assess wildly divergent expert opinions regarding value").

³⁰ See, e.g., William A. Groll & David Leinwand, *Judge and Banker—Valuation Analyses in the Delaware Courts*, 116 PA. ST. L. REV. 957, 959 (2012) ("[T]he Delaware courts have become quite sophisticated in reviewing valuation analyses and are thoroughly conversant in the related, highly technical financial arcana."); Widen, *supra* note 53, at 581 ("Delaware courts have become increasingly sophisticated in their understanding of business valuation techniques.").

³¹ Andrew Baker, Jonah Gelbach, & Eric Talley, *Validating Valuation: How Statistical Learning Can Cabin Expert Discretion in Valuation Disputes*, (April 30, 2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4849281; see also *Union Illinois 1995 Inv. Ltd. P'ship v. Union Fin. Grp., Ltd.*, 847 A.2d 340, 359 (Del. Ch. 2004)

These valuation challenges become especially unwieldy when idiosyncratic vision is at stake. While relying on accepted valuation methodologies works for transactions involving assets that can be objectively valued, there is no acceptable methodology for valuing an entrepreneur's idiosyncratic vision and there likely never will be.³² And without a reliable way to assess the value contributed by visionary individuals to a specific firm, courts would naturally tend to focus on tangible guideposts, such as the compensation of an “average” CEO at a “comparable”³³ company.³⁴ But these benchmarks fail to account for outliers or extreme probabilities, leading courts to treat even exceptional corporate leaders as “average” CEOs.³⁵ As an example, the *Tornetta* court noted that Musk's maximum payout under the compensation plan was “250 times larger than the contemporaneous median peer compensation plan and 33 times larger than the plan's closest comparison.”³⁶ This approach, however, is also inherently at odds with the rationale underlying Musk's compensation package: the board argued that Musk—and only Musk—could enable Tesla to achieve its ambitious milestones. In light of the wide range in leadership performance and the inability to sort top performers *ex ante*, the effectiveness of judicial review under the entire fairness standard is substantially lessened.³⁷

The inability to value vision also matters when courts examine the process leading to the transaction, because valuation plays an important role in the bargaining process. When contemplating a transaction with a controlling shareholder, the board typically appoints a special

(“For me (as a law-trained judge) to second-guess the price that resulted from that process involves an exercise in hubris and, at best, reasoned guess-work.”); see also *In re Appraisal of Dole Food Co., Inc.*, 114 A.3d 541, 555 (Del. Ch. 2014) (“[T]he past and current members of this court are law-trained judges, not valuation experts.”)

³² Goshen & Hamdani, *supra* note 17, at 969; see also John Coates IV, “Fair Value” As an Avoidable Rule of Corporate Law: Minority Discounts in Conflict Transactions, 147 U. PA.L. REV. 1251 (1999) (“Valuing minority shares is at the heart of every conflict transaction.”).

³³ *Tornetta*, 310 A.3d at 538.

³⁴ Although this example focuses on compensation for controller-executives, other transactions, such as the purchase of a company from the controller, also depend on the controller's vision, complicating valuation.

³⁵ This valuation issue also arises when courts evaluate other types of conflicted controller transactions. Consider, for example, the 2016 merger between Tesla and Solar City, which Tesla shareholders challenged under the theory that Tesla overpaid due to Musk's influence over both companies. As part of its analysis, the court was forced to determine whether Tesla paid a fair price for Solar City. But without an objective valuation methodology to guide it, the court was forced to rely on little more than hindsight. Part X describes this case in greater detail.

³⁶ *Tornetta*, 310 A.3d at 445.

³⁷ For a different critique of entire fairness review and in particular, the fair price analysis, see Amir Licht, *Farewell to Fairness: Toward Retiring Delaware's Entire Fairness Review*, 44 Del. J. Corp. L. 1 (2020) (arguing that entire fairness review allows controllers to get away with misconduct so long as it priced fairly); J. Travis Laster, *The Distinctive Fiduciary Duties That Stockholder Controllers Owe*, 20 N.Y.U J. L. & BUS. 461, 491-492 (arguing that the compensatory approach underlying the fair-price prong of entire fairness review is arguably less effective in preventing overreaching by controlling shareholders).

committee composed of independent and disinterested directors to negotiate with the controller. Ideally, the special committee will first assess the value of the proposed transaction and then negotiate with that price in mind.³⁸ Yet, because the value of idiosyncratic vision is inherently nonverifiable, the special committee ultimately bargains in the face of a profound unknown: the true value of a person’s vision to the company and its shareholders. Without an objective measure of this value, it is challenging for courts to review the process after the fact, raising concerns of hindsight bias³⁹ and leading courts to rely on indirect measures of fairness, such as whether the negotiation was sufficiently “adversarial.”

And yet, entire fairness review is not inevitable. A decade ago, Delaware courts provided a means for transactional planners to contract around entire fairness review in *Khan v. M&F Worldwide Corp.* (“*MFW*”).⁴⁰ Under *MFW*, Delaware courts will apply the deferential business judgment standard of review if controlling shareholders voluntarily condition the execution of a self-dealing transaction on the approval of a special committee and an affirmative vote of a majority of properly informed minority shareholders (or the “majority of minority” condition).⁴¹ We refer to these two cleansing mechanisms as the “*MFW* conditions.”

At first blush, this regime ostensibly sidesteps the problems inherent in judicial valuation. Independent directors negotiate with the controller, minority shareholders vote on the deal, and courts ensure the approval process was objective, uncoerced, and informed.⁴² However, when even one of the *MFW* conditions fail, courts must revert to valuing the transaction. Specifically, if only one cleansing mechanisms is used, the transaction is still subject to the entire fairness review, but the burden shifts to the plaintiff to show the unfairness of the transaction. And as we explain in Part II, since the *MFW* decision, a significant fraction of companies that have attempted to adopt

³⁸ *Reservation Price*, HARVARD LAW SCHOOL, <https://www.pon.harvard.edu/tag/reservation-price/>.

³⁹ As an example, consider how the Delaware court scheduled trial in *Tornetta* for August 2022, several months after the final milestone was achieved. In other words, the case was litigated *after* Tesla became the world’s most valuable carmaker and reached all the milestones, not when the grants were in serious doubt. See Steven Loveday, *Tesla Becomes Most Valuable Automotive Brand in the World*, INSIDE EVS (Apr. 10, 2023), <https://insideevs.com/news/661555/tesla-most-valuable-automotive-brand-in-world/>. As such, the court’s decision about the process and price was colored by the ultimate outcome—the fact that Musk met the milestones and earned the payday.

⁴⁰ *In re MFW S’holders Litig.*, 67 A.3d 496, 502 (Del. Ch. 2013), *aff’d sub nom. Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

⁴¹ *Id.*

⁴² See Edward B. Rock, *Majority of the Minority Approval in a World of Active Shareholders*, in *The Law and Finance of Related Party Transactions*, CAMBRIDGE UNIVERSITY PRESS 105, 115 (Luca Enriques & Tobias Tröger eds., 2019).

the *MFW* framework failed to secure its benefits.⁴³ Specifically, plaintiff’s lawyers have increasingly challenged the disclosure of the special committee process, which has led courts to disregard both the committee’s approval and the shareholder vote. Consider how the *Tornetta* court invalidated the first shareholder vote approving Musk’s pay package because the proxy statement failed to disclose that certain special committee members were conflicted.⁴⁴ This outcome, we believe, deviates from the regime Delaware envisioned when it embraced cleansing and puts complex valuation disputes back at the center of litigation more often than it should.

We propose reforms to the *MFW* framework that would limit judicial valuation of controller transactions—including those that do not involve idiosyncratic vision⁴⁵—to the scenarios where it is most warranted.⁴⁶ First, we argue that disclosure deficiencies regarding the special committee process should not invalidate an otherwise informed shareholder vote.⁴⁷ In controller transactions, the inherent conflict is already obvious—the corporation is dealing with its controlling shareholder. After all, the power of controlling shareholder over independent directors is the rationale underlying the courts’ unwillingness to grant full cleansing power to these directors’ approval of controller transactions. Therefore, shareholders’ understanding of the financial terms

⁴³ See Nathaniel J. Stuhlmiller and Brian T.M. Mammarella, *'MFW' Just Turned 10, but Is It Worth the Candle?*, DEL. BUS. CT. INSIDER (July 4, 2024) (between mid-2019 to mid-2024, *MFW* defenses succeeded in only four of 15 cases for a success rate of 26.7%); see also Fernan Restrepo & Guhan Subramanian, *Missing MOMs: Freezeouts in the New Doctrinal Regime and the MOOM Alternative*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4965438 (showing that deal planners are using the majority of the minority voting condition less often).

⁴⁴ *Tornetta*, supra note X. The court also disregarded a second vote that was taken to ratify the compensation package after it was invalidated, among other reasons, because the legal consequences of the vote on the validity of the deal were not properly represented. See *Tornetta* II, <https://courts.delaware.gov/Opinions/Download.aspx?id=372420>. It is one thing to ask shareholders to approve a self-dealing transaction represented as being subject to a subsequent judicial review when no such review is expected (this could be misleading because the availability of judicial review could have affected a shareholder’s choice of whether to approve or not), and another to ask shareholders to approve a transaction that will not be subject to judicial review when such review is, in fact, expected (this is not misleading because shareholders willing to support a transaction without judicial review would presumably also support it with the extra protection added).

⁴⁵ Our proposals encompass all controller transactions for two reasons. First, although self-dealing transactions that involve a controller’s vision raise an insurmountable valuation challenge, the flaws we identify in the *MFW* framework apply to all self-dealing transactions. Specifically, our modifications are consistent with Delaware jurisprudence that has treated the two *MFW* conditions as separate, and preserve the signal conveyed by an informed shareholder vote concerning the fairness of the transaction’s financial term. Second, our proposals have practical appeal because they limit stringent review and valuation (which is a complex task even when idiosyncratic vision is not at stake) to the circumstances most needed.

⁴⁶ As we discuss in Part X, our discussion of idiosyncratic vision reveals a crucial valuation issue that complicates entire fairness review of controller transactions when vision is at stake. But our proposal extends beyond those transactions because the deficiencies in the *MFW* framework affect all transactions—not just those involving vision. For another proposal to modify the entire fairness framework, see Jill E. Fisch & Steven Davidoff Solomon, *Control and Its Discontents* U. PA. L. REV. (forthcoming 2025).

⁴⁷ See *Tornetta*, Def. Opening Br., 2018 WL 4362284 31-33 (Del.Ch.).

of the transaction should be the key question. This is particularly true when the fairness of the transaction that is submitted to a shareholder vote is closely related to the value of the controller's vision. Shareholders are best positioned to assess the value of the controller's vision, even when it is idiosyncratic. Although shareholders may err in this valuation, the voting process aggregates their subjective valuations of the transaction and its price and thus serves as a referendum on the value of the controller's vision. Accordingly, if shareholders are given full information about the financial terms of the transaction, their approval should be respected by the court, and the quality of the special committee process should be addressed separately by *MFW*'s other cleansing mechanism (and potentially the court's substantive review of the transaction as well).

We recognize, however, that information concerning the special committee and its process serves valuable purposes, including aiding shareholder litigation.⁴⁸ Because our emphasis on financial disclosure could encourage companies to withhold information about the special committee, we offer a second proposal: if the company fully and accurately describes the special committee process (including any flaws) to shareholders and secures a vote approving the transaction, this vote should immunize the transaction from post-closing challenges to the special committee *MFW* condition. Adopting this *Corwin*-style rule would incentivize companies to disclose comprehensive information about the bargaining process and any committee conflicts before the shareholder vote.⁴⁹ However, the failure to make such disclosures would not invalidate the vote; instead, it would allow litigants to challenge the special committee process and seek entire fairness review (with the burden shift that accompanies transactions that have been cleansed by a single mechanism). Additionally, this rule would permit investors to seek an injunction before the vote has taken place if they believe that the disclosures are inadequate or that the special committee members have breached their duties to the company and its shareholders. All in all, these dual modifications would not just restore *MFW* cleansing to its intended purpose, they would also dramatically reduce the need for courts to engage in the impossible task of valuing a controller's idiosyncratic vision.

⁴⁸ As we explain below, the SEC disclosure requirements concerning the process leading to freezeout transactions are more expansive than the requirements concerning other self-dealing transactions. *See supra* text accompanying notes 233-236. We believe that the SEC should expand the disclosure requirements that apply to self-dealing transactions.

⁴⁹ This mirrors the approach Delaware courts take for *Revlon* claims involving the board's duty to maximize the price of the company when there is a sale of control. *See Revlon, Inc. v. MacAndrews & Forbes Holdings*, 506 A.2d 173 (Del. 1986). After a deal closes, however, *Revlon* claims are eliminated by an informed, uncoerced shareholder vote approving the transaction—a rule established in *Corwin*. Shareholders must bring *Revlon* claims before closing, so that the court can correct the process if needed. *See Corwin v. KKR Fin. Hldgs. LLC*, 125 A.3d 304 (Del. 2015).

Our third proposal, however, is directed at courts that must determine fair value when the *MFW* conditions are not met, which can be an impossible task. And yet, *MFW* provides the roadmap for this review. First, where *MFW* does not apply, the court lacks assurance that an independent decisionmaker has accepted the entrepreneur's vision or its price. In such cases, the burden should be on the defendant to show that the price was appropriate relative to the *average value* of the asset or the transaction in question. In other words, courts should be reluctant to accept a controller's claim that their vision justifies a price that is beyond the range of comparable market transactions when that controller failed to obtain informed approval from the minority shareholders and disinterested directors.

By contrast, when only one cleansing mechanism is used, entire fairness remains the standard of review, but the burden shifts to the plaintiffs to show unfairness.⁵⁰ Whereas the existing regime gives equal weight to each cleansing device (and the failure to apply it), we believe that the choice of cleansing device should guide the entire fairness analysis. For instance, if a majority of disinterested shareholders vote in favor of the transaction, without coercion and with full disclosure of the transaction's economic terms, this approval strongly indicates that disinterested parties have accepted the controller's vision and its price.⁵¹ Therefore, little evidentiary weight should be given to plaintiffs' evidence of market practices, competitive benchmarks, or other parameters comparing the price paid by the company to the asset or individual's average value.

On the other hand, if a special committee negotiates a transaction that is not approved by disinterested shareholders, the court's inquiry should differ. Delaware caselaw generally doubts a special committee's ability to negotiate effectively against a controller, given the controller's influence over the company and board.⁵² Because of the controller's outsized influence, lingering doubts remain about whether the outcome represents a genuine endorsement of the controller's vision. Without a vote of the disinterested shareholders, therefore, courts should consider plaintiffs' evidence of average prices and process deficiencies in the review process, as they do now.

⁵⁰ *Id.*

⁵¹ *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134, 1143 (Del. Ch. 1994) ("Cinerama I"), *aff'd*, 663 A.2d 1156 (Del. 1995) ("Cinerama II") (directors must establish that valuation fell within a "range of fairness," which is one "that a reasonable seller, under all of the circumstances, would regard as within a range of fair value; one that such a seller could reasonably accept.").

⁵² *In re Match*, 315 A.3d at 473; *see also Kahn v. Lynch Commc'n Sys.*, 669 A.2d 79 (Del. 1995). For a critique of the inherent coercion doctrine, *see Hamermesh*, *supra* note 18.

Consider how judicial review of Musk’s compensation would fare under our modified framework. The compensation package was negotiated by conflicted directors, but it was also approved by disinterested shareholders who were aware of Musk’s conflict and the financial terms of the transaction.⁵³ Under our framework, the failure to disclose the special committee’s conflicts would not invalidate the shareholder vote; instead, the shareholder approval would entitle defendants to a burden shift, obligating the plaintiffs to establish the transaction’s unfairness. Moreover, in light of the disinterested shareholder approval of Musk’s vision, the court would give little evidentiary weight to information about average CEO compensation. Our framework would therefore have substantially eased the burden on courts asked to address an impossible question—did the company pay the right amount for the services of a visionary entrepreneur?

Beyond this advantage, our modified framework is grounded in fundamental precepts of Delaware corporate law. It respects the core goal of protecting minority investors from overreaching by controlling shareholders by preserving a way for shareholders to secure stringent review of a transaction’s fairness where such review is most needed. But it also responds to the limits of judicial competence in valuation and the comparative advantage of the shareholder voting process, which aggregates each shareholder’s subjective judgment of vision and price. For these reasons, our framework should apply to all controlling shareholder transactions, not just those involving idiosyncratic vision.⁵⁴

Balancing these aspects is crucial for Delaware, and more importantly, for economic growth. Ensuring that controlled corporations protect minority shareholders is critically important for value creation,⁵⁵ but so is refraining from subjecting entrepreneurs and the companies that they build to undue judicial second-guessing. Entrepreneurs face many challenges, and an unfriendly

⁵³For simplicity, the text assumes that Tesla shareholders were informed about the financial terms underlying Musk’s pay arrangement. The Chancery Court, however, found that the proxy statement did not disclose that, under the company’s projections for accounting purposes, Tesla would achieve some of the milestones by 2020. *Tornetta*, 310 A.3d at 488. See also our discussion in footnote 191 *infra*.

⁵⁴Recent empirical work demonstrates that the disinterested shareholder voting condition is not often used because it subjects the company to shareholder holdouts. See Subramanian and Restrepo, *supra* n. X. Our analysis reveals another reason why the majority of minority shareholder vote has become less appealing: it is very easy for plaintiffs’ lawyers to identify disclosure failures that invalidate it. See, e.g., *Tornetta*, 310 A. 3d. 430 (2024); *Tornetta II*, Therefore, by limiting the scope of those disclosure failures, our proposal would encourage deal planners to continue to use this valuable protection for shareholders.

⁵⁵ See, e.g., Rafael LaPorta, Florencio Lopez-de-Silanes, Andrei Shleifer, Robert Vishny, *Investor Protection and Corporate Governance*, 58 J. Fin. Econ. 3 (2000).

legal environment will only further hamper the execution of their ideas.⁵⁶ Delaware needs to get the balance right not just to support the execution of transformative products and services but also to maintain its dominance in corporate law.⁵⁷

Our Article proceeds as follows. Part II provides an overview of Delaware’s legal regime for controller self-dealing transactions. Part III demonstrates the impossibility of accurately valuing an entrepreneur’s idiosyncratic vision and shows how these difficulties impact judicial valuation, as well as special committee functioning and the shareholder vote. Part IV describes our proposed framework for procedural cleansing and judicial valuation.

II. EXISTING REGULATION OF CONFLICTED CONTROLLER TRANSACTIONS

An important goal of corporate law is to protect minority investors in controlled companies from opportunistic self-dealing by a controlling shareholder.⁵⁸ While an entrepreneur-controller may use their control in order to pursue their idiosyncratic vision, they might also engage in self-dealing, extracting private benefits at the expense of the minority shareholders.⁵⁹ In this Part, we review the existing legal regime governing controller transactions in Delaware. Specifically, Delaware relies on its expert courts to police self-dealing, and these courts have developed a sophisticated doctrinal framework for that purpose.⁶⁰ The Sections that follow describe this framework and preview some of its limitations.

⁵⁶ Although this Article explores this issue through the lens of Musk and the *Tornetta* case, entrepreneurs are increasingly women and people of color. <https://www.weforum.org/agenda/2022/07/women-entrepreneurs-gusto-gender/>. As such, this issue matters not just for Musk, but for innovative entrepreneurs who seek to execute transformative ideas across the country.

⁵⁷ Delaware competes with not only other states, but also the federal government, for regulatory authority over most corporations. Mark J. Roe, *Delaware’s Competition*, 117 Harv. L. Rev. 588 (2003). In 2024, scholars and media commentators began to argue that Delaware’s superiority was now in question—due in part to decisions like that of *Tornetta*. https://www.ecgi.global/sites/default/files/working_papers/documents/nevadadelaware.pdf, Michal Barzuza, *Nevada v. Delaware: The New Market for Corporate Law*, ECGI Working Paper (March 2024), https://www.ecgi.global/sites/default/files/working_papers/documents/nevadadelaware.pdf; Sujeet Indep & Myles McCormick, *Can Elon Musk Derail Delaware?*, Fin. T. (Feb. 4, 2024), <https://www.ft.com/content/2dff823d-6821-4519-8ca2-05bda288c574>.

⁵⁸ See Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Law and Economics of Self-Dealing*, 88 J. FIN. ECON. 430, 430–31 (2008) (describing the increasing emphasis of academics on corporate self-dealing over the last twenty years); Ronald J. Gilson & Alan Schwartz, *Constraints on Private Benefits of Control: Ex Ante Control Mechanisms Versus Ex Post Transaction Review*, 169 J. INSTITUTIONAL & THEORETICAL ECON. 160, 180–81 (2013) (arguing that ex post judicial review of transactions with controlling shareholders or their affiliates is superior to ex ante limits on dual-class and other leveraged control structures).

⁵⁹ Goshen, *supra* note 19, at 576.

⁶⁰ For a critique of the proposed European regime on self-dealing transactions, see Luca Enriques, *Related Party Transactions: Policy Options and Real-World Challenges (with a Critique of the European Commission Proposal)*, 16 EUR. BUS. ORG. L. REV. 1, 25–31 (2015).

A. Entire Fairness Review and Valuation

In Delaware, the standard of review for self-dealing transactions—by controllers and other fiduciaries alike—is entire fairness,⁶¹ the most searching standard of review under Delaware law.⁶² Entire fairness review places the burden on the controller to prove that the disputed transaction was “entirely fair.”⁶³ To meet their burden, the conflicted controller must establish that the transaction was negotiated via a fair process (“fair dealing”) and that the company received a “fair price,” which is a price resembling that which one would get in an arms-length transaction.⁶⁴ Effectively, this means that the controller can force a self-dealing transaction against the objection of the minority shareholders,⁶⁵ who could then file a lawsuit and ask the court to evaluate the transaction’s fairness.⁶⁶

The courts’ willingness and ability to determine the fairness of a disputed transaction’s process and price is thus a central component to entire fairness review.⁶⁷ To assess fair price, judges must evaluate whether the price paid in a transaction for the company or its assets was fair to minority shareholders.⁶⁸ Courts often turn to asset-pricing models to aid their analysis,⁶⁹ but using

⁶¹ See *Weinberger*, 457 A2d at 703, 711 (describing how transaction involving potential self-dealing concerns invoke the entire fairness standard); see also Ann Lipton, *the Three Faces of Control*, 77 Bus. Law. 801 (2022) (discussing how controller conflict transactions differ from director conflict transactions, but that both warrant “entire fairness” review if not cleansed).

⁶² *Frederick Hsu Living Tr. v. ODN Holding Corp.*, No. 121108-VCL, 2017 WL 1437308, at *26 (Del. Ch. Apr. 24, 2017) (describing entire fairness as an “onerous standard of review”).

⁶³ *Id.*

⁶⁴ See, e.g., *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 937 (Del. 1983) (describing how transactions involving potential self-dealing concerns invoke the entire fairness standard).

⁶⁵ This Article disregards the potential role of the board when its approval is required for self-dealing transactions. The extent to which boards—even without the judicial review—can truly be relied upon to resist powerful controllers is beyond the scope of this Article. For analysis of the challenges facing the oversight role of independent directors and potential reforms, see generally Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors and Controlling Shareholders*, 165 U. PA. L. REV. 1271 (2017).

⁶⁶ See Zohar Goshen, *The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality*, 91 CALIF. L. REV. 393, 426 (2003).

⁶⁷ Lawrence A. Hamermesh & Leo E. Strine, Jr., *Fiduciary Principles and Delaware Corporation Law: Searching for the Optimal Balance by Understanding that the World is Not*, in THE OXFORD HANDBOOK OF FIDUCIARY LAW 871, 872 (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff eds., 2019).

⁶⁸ See R. Scott Widen, *Delaware Law, Financial Theory and Investment Banking Valuation Practice*, 4 N.Y.U. J.L. & BUS. 579, 579 (2008) (“Delaware courts have developed a surprisingly large body of law regarding the proper analytics for valuing businesses. Most of this law has been developed in the context of adjudicating appraisal rights of dissenting shareholders in corporate M&A or going-private transactions.”); *Weinberger*, 457 A2d at 711 (Fair price “relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company’s stock.”).

⁶⁹ See *Weinberger*, 457 A.2d at 712–13.

these models effectively requires at least some understanding of financial theory.⁷⁰ Delaware courts typically have the expertise necessary to understand valuation techniques,⁷¹ but even they encounter challenges when conducting their own independent valuation.⁷²

To ameliorate these issues, Delaware courts will generally limit their analysis to reviewing the valuation methods offered by the parties or the inputs that were used. Typically, in such cases, the court will examine the reports prepared by third-party valuation experts (who often disagree quite substantially⁷³) and by the independent directors charged with negotiating the transaction at issue.⁷⁴ As part of its review, the court will consider arguments from each side about the value of the assets via different methodologies chosen by the parties. Under one of the most commonly used methods, the Discounted Cash Flow (“DCF”) analysis, the court will consider whether projections of future cash-flows and the estimates of the business risk associated with generating those cash-flows favor the plaintiffs or the defendants.⁷⁵ Similarly, under a comparable companies analysis, the court will consider arguments about the company’s value relative to its peers, comparing relative multiples such as the company’s price/earnings ratio as estimates of value.⁷⁶ These methodologies allow ample room for argument about the value of assets over time

⁷⁰ See, e.g., *Merion Cap. L.P. v. Lender Processing Servs., Inc.*, No. CV 9320-VCL, 2016 WL 7324170, at *15 (Del. Ch. Dec. 16, 2016), judgment entered, (Del. Ch. 2016) (“it is difficult for the Chancellor and Vice Chancellors to assess wildly divergent expert opinions regarding value”).

⁷¹ See, e.g., William A. Groll & David Leinwand, *Judge and Banker—Valuation Analyses in the Delaware Courts*, 116 PA. ST. L. REV. 957, 959 (2012) (“[T]he Delaware courts have become quite sophisticated in reviewing valuation analyses and are thoroughly conversant in the related, highly technical financial arcana.”); *Widen*, *supra* note 53, at 581 (“Delaware courts have become increasingly sophisticated in their understanding of business valuation techniques.”).

⁷² Andrew Baker, et al, *supra* note 31; see also *Union Illinois 1995 Inv. Ltd. P’ship v. Union Fin. Grp., Ltd.*, 847 A.2d 340, 359 (Del. Ch. 2004) (“For me (as a law-trained judge) to second-guess the price that resulted from that process involves an exercise in hubris and, at best, reasoned guess-work.”); see also *In re Appraisal of Dole Food Co., Inc.*, 114 A.3d 541, 555 (Del. Ch. 2014) (“[T]he past and current members of this court are law-trained judges, not valuation experts.”).

⁷³ *Id.*; see also *Paramount Commc’ns Inc. v. Time Inc.*, No. CIVIL ACTION 10670, 1989 WL 79880, at *13 (Del. Ch. July 14, 1989) (describing a range of \$208-402 per share).;

⁷⁴ See, e.g., *In re Nine Sys. Corp. S’holders Litig.*, No. CV 3940-VCN, 2013 WL 4013306, at *5 (Del. Ch. July 31, 2013).

⁷⁵ See, e.g., *In re Sears Hometown & Outlet Stores, Inc. S’holder Litig.*, 309 A.3d 474 (Del. Ch. 2024); *In re Trados Inc. S’holder Litig.*, 73 A.3d 17 (Del. Ch. 2013); see also Timothy A. Luehrman, *What’s It Worth?: A General Manager’s Guide to Valuation*, HARV. BUS. REV. (May–June 1997), <https://hbr.org/1997/05/whats-it-worth-a-general-managersguide-to-valuation> [<https://perma.cc/7Q3N-97BH>] (recounting the development of the DCF model “as best practice for valuing corporate assets” and discussing the different ways companies use the model).

⁷⁶ See *In re Trados*, 73 A.3d 17 at *71; see also *LongPath Capital, LLC v. Ramtron Int’l Corp.*, No. CV 8094-VCP, 2015 WL 4540443, at *9 (Del. Ch. June 30, 2015) (“Much has been said on litigation-driven valuations, none of it favorable.”).

(including the appropriate growth rate and discount rate), the types of companies that should constitute peers, the proper choice of trading multiples, and so on.

Although the process of checking the work of others is perhaps more feasible for a law-trained judge, it is still challenging, especially when dueling experts offer vastly different analyses and conclusions.⁷⁷ Consider the expert valuations submitted to Vice Chancellor Laster as part of his review of a conflicted merger's fairness in *In Re Trados*: "With the high end coming in more than eight times the low, the resulting dispersion was four times what Chancellor Allen famously described as a range that 'a Texan might feel at home on.'"⁷⁸

Judicial valuation also plays a role in the fair process analysis. To evaluate fair dealing, the court looks at "how the purchase was initiated, negotiated, structured and the manner in which director approval was obtained."⁷⁹ The gold standard is negotiation by independent directors at arm's length, although "a finding of perfection is not sine qua non in an entire fairness analysis."⁸⁰ As such, courts evaluating imperfect facts must consider whether the bargaining process yielded a fair price.

How does bargaining over value typically proceed? Sometimes the transaction will be initiated by the company that has determined that a deal with the controller is in its interest.⁸¹ In other circumstances, the controller will approach the board, which must then evaluate the terms of the deal. Preferably, in either case, a special committee will determine whether the transaction and its terms are beneficial for the company and negotiate with the controller to secure the best terms for the company and its minority shareholders. While the transaction at issue in *Tornetta* concerned controller compensation, the special committee may also be tasked with evaluating a sale of the minority shares to the controller (also known as a "freezeout" transaction) or another type of self-dealing transaction. In each scenario, however, the committee begins with an estimate of value. For example, when the controller seeks to buy out the minority shareholders, the special committee starts by determining the fair market value of the company's shares and then bargains with the

⁷⁷ See Licht, *supra* note 37 at 38-39 (describing the difficulties courts face in conducting valuation as part of judicial review).

⁷⁸ *Id.* at *56 (quoting *Weinberger*, 457 A.2d at 711).

⁷⁹ *Kahn v. Tremont Corp.*, 694 A.2d 422, 430 (Del. 1997).

⁸⁰ *In re Tesla Motors, Inc. S'holder Litig.*, 298 A.3d 667, 700 (Del. 2023)

⁸¹ Regarding Musk's compensation, the transaction was initiated by the board who sought to retain Musk through a difficult period. *Tornetta*, 310 A.3d at 460-61.

controller over the surplus.⁸² In the context of a compensation arrangement, the special committee must estimate the controller's value to the company and negotiate with that value in mind.

Simply put, valuation is an important component of bargaining and is an essential aspect of the court's review of the fair dealing.⁸³ Therefore, when the court applies the entire fairness standard of review, the issue of valuation becomes central to the trial. In its review of both the transaction's price and process, the court explicitly and implicitly relies on an assessment of the transaction's value.

B. Cleansing under MFW

And yet, entire fairness review is not inevitable. Over time, the framework for judicial review has evolved to embrace two cleansing mechanisms that allow courts to avoid searching review of the transaction's terms and the process that led to it.⁸⁴

The relevant line of cases begins with *Khan v. Lynch*, in which the Delaware Supreme Court held that if a controller secured the approval of *either* a special committee *or* a majority of minority shareholders, the burden of persuasion would shift to the plaintiff, who would be required to show the transaction was unfair.⁸⁵ Entire fairness, however, remained the standard of review, entailing a full-blown trial and all the discovery that comes with it. The only benefit to the controller from adopting one of the cleansing mechanisms was an improved probability of winning: If, at the end of the trial, the evidence of fairness is even, the plaintiff will lose because the burden of proof rests with them.

Ultimately, this regime was criticized because it did not allow transactional planners a way to avoid entire fairness review; likewise, controllers had no reason to adopt more than one

⁸² See *supra* note 35; Jeffrey Chapman & Benjamin W. James, *The Use of Special Committees in Mergers and Acquisitions*, 42 Tex. J. Bus. L. 315 (2008); see also David A. Lax & James K. Sebenius, *Negotiating Through an Agent*, 35 J. of Conf. Res. 474 (1991).

⁸³ For example, in *Southern Peru*, the Chancery court examined the valuation methodologies used by the special committee, as well as its financial advisor to determine, that the *process* was unfair. See *In re S. Peru Copper Corp. S'holder Derivative Litig.*, 52 A.3d 761, 791 (Del. Ch. 2011), *aff'd sub nom. Americas Mining Corp. v. Theriault*, 51 A.3d 1213 (Del. 2012) ("The actions of the Special Committee and Goldman undermine the defendants' argument that the process leading up to the Merger was fair and lend credence to the plaintiff's contention that the process leading up to the Merger was an exercise in rationalization").

⁸⁴ Courts have encouraged the use of these cleansing mechanisms in part because of the belief that when disinterested parties have signed off on a transaction, it makes little sense to subject it to judicial valuation. See *In re MFW*, 67 A.3d at 533-534 (discussing how the *MFW* procedures have the benefit of insulating the transaction from litigation when the disinterested shareholders have embraced it after disinterested director negotiation).

⁸⁵ See *Kahn v. Lynch*, 638 A.2d at 1117 ("[A]n approval of the transaction by an independent committee of directors or an informed majority of minority shareholders shifts the burden of proof on the issue of fairness from the controlling or dominating shareholder to the challenging shareholder plaintiff."). See also *Kahn v. Tremont*, 694 A.2d (applying the burden shift evaluation to a non-squeeze-out transaction).

cleansing mechanism. Under *Lynch*, controllers that utilized both cleansing mechanisms would receive no special credit and so they generally chose just one: negotiating against a special committee but *not* subjecting the transaction to approval by majority of minority shareholders.⁸⁶

In 2014, Delaware upended the standard of review for controller transactions with the *MFW* decision. In that case, Ronald Perelman, the controlling shareholder of MacAndrews & Forbes, conditioned his buyout of the MFW minority shareholders on the approval of *both* a special committee and majority of minority shareholders.⁸⁷ In the ensuing litigation, the defendants argued that the imposition of these two procedural protections converted the transaction into an arms-length merger, and as such, the transaction was entitled to the business judgment rule.⁸⁸ The business judgment rule is highly deferential to management, allowing courts to interfere only if a decision has no rational basis.⁸⁹ Importantly, under the business judgment rule, the defendant can file a motion to dismiss the claim, thereby avoiding discovery and trial. The Delaware Chancery and Supreme Court accepted the defendant’s arguments that the dual procedural protections caused the transaction to resemble an arm’s-length merger, obviating the need for judicial review.⁹⁰

Delaware law has therefore given controlling shareholders that engage in self-dealing a choice: They can either accept a judicial evaluation of the transaction’s fairness or avoid such judicial review by voluntarily agreeing to a set of procedural conditions. Depending on the controller’s decision, Delaware courts will apply one of three alternative frameworks to cases of self-dealing:⁹¹ (1) entire fairness review with the burden on the defendants to prove fairness when no cleansing mechanisms are used, (2) review under the business judgment rule if both cleansing

⁸⁶ *Kahn v. Lynch*, 638 A.2d at 1117.

⁸⁷ *In re MFW*, 67 A.3d at 500.

⁸⁸ *Id.*

⁸⁹ *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 74 (Del. 2006) (explaining that “where the business judgment presumptions are applicable, the board’s decision will be upheld unless it cannot be attributed to any rational business purpose”).

⁹⁰ *See, e.g., In re MFW*, 67 A.3d. More recently, in 2024, the Delaware Supreme Court clarified that the *MFW* framework applied to all conflicted controller transactions—not just squeeze-outs. *In re Match*, 315 A.3d at 463.

⁹¹ A third alternative in which the entire fairness review applies but with a shift in the burden of proof is also possible. *See Kahn v. Lynch*, 638 A.2d at 1117 (“[A]n approval of the transaction by an independent committee of directors or an informed majority of minority shareholders shifts the burden of proof on the issue of fairness from the controlling or dominating shareholder to the challenging shareholder plaintiff.”). This Article does not discuss this alternative because it does not add any insight to the analysis.

mechanisms are used,⁹² or (3) entire fairness review with a shift of the burden of persuasion to the plaintiff if only one cleansing mechanism is present.⁹³

This regime appeared to let controllers (and courts) bypass judicial valuation whenever minority shareholders approved the transaction after a special committee had negotiated its terms. Moreover, *MFW* made it difficult for plaintiffs to challenge the special committee condition. The test for assessing special committee effectiveness under the *MFW* analysis is “whether the committee was sufficiently informed and exercised reasonable care,”⁹⁴ and the standard for breaching this duty is gross negligence⁹⁵—a significant departure from the conduct expected of the same committee under the entire fairness standard—which sets a high bar for plaintiffs to overcome.⁹⁶

However, plaintiffs’ lawyers eventually identified litigation strategies that got around *MFW*, even when the transaction was subject to a majority-of-minority shareholder vote and a special committee.⁹⁷ Specifically, plaintiffs’ lawyers began challenging the shareholder vote used to cleanse the transaction and argued that it would not be informed if there were disclosure deficiencies about the special committee process.⁹⁸ In other words, these lawyers argued that

⁹² See *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635, 644 (Del. 2014) (introducing the *MFW* conditions).

⁹³ See *In re Tesla Motors, Inc. S’holder Litig.*, 2022 WL 1237185, at *32 (Del. Ch. Apr. 27, 2022), *aff’d sub nom. In re Tesla Motors, Inc. S’holder Litig.*, 298 A.3d 667 (Del. 2023) (“when a transaction is subject to entire fairness review, the burden of persuasion typically rests with the defendant, but the burden can shift to the stockholder challenging the transaction if the defendant show[s] that the transaction was approved either by an independent board majority (or in the alternative, a special committee of independent directors) or, assuming certain conditions, by an informed vote of the majority of the minority shareholders.”)

⁹⁴ See *Flood v. Synutra Int’l, Inc.*, 195 A.3d 754, 756–57 (Del. 2018) (explaining that the *MFW* framework requires courts to examine whether the special committee “employed qualified legal and financial advisors and indisputably engaged in a deliberative process that cannot rationally be characterized as grossly negligent.”)

⁹⁵ *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985) (“The standard of care applicable to a director’s duty of care ... [is] the concept of gross negligence”).

⁹⁶ Before *MFW*, courts tended to engage in fact-intensive review of the substance of the special committee process to determine whether this cleansing device merits a burden shift. See, for example, *In re S. Peru Copper Corp. S’holder Derivative Litig.*, *supra* note 83, at 791 (“there is no way to decide whether the defendant is entitled to a burden shift without taking into consideration the substantive decisions of the special committee, a fact-intensive exercise that overlaps with the examination of fairness itself.”); *Clements v. Rogers*, 790 A.2d 1222, 1242 (Del.Ch. 2001) (holding that “the effective functioning of the Special Committee as an informed and aggressive negotiating force is of obvious importance to the public stockholders.”). In the *MFW* decision, Delaware essentially modified this requirement to make it easier for courts to apply the business judgment rule at a preliminary stage, without the need to conduct a trial. See *In re MFW*, 67 A.3d 518, 530 (“[A]lthough prior cases can potentially be read as requiring an assessment of whether a special committee was effective in the sense of being substantively good at its appointed task, such a precondition is fundamentally inconsistent with the application of the business judgment rule standard of review.”)

⁹⁷ See *supra* note 38.

⁹⁸ See, e.g., Edward B. Micheletti, *Corwin, MFW, and Beyond: Developing Trends in Delaware Disclosure Law*, Skadden Insight (Nov. 19, 2019), <https://www.skadden.com/insights/publications/2019/11/insights-the-delaware-edition/corwin-mfw-and-beyond> (“[The] Court of Chancery continues to opine on stockholder plaintiffs’ long-favored disclosure topics ... but now does so through the lens ... *MFW*....”).

shareholders must be informed not only about the economic terms of the transaction but also about the special committee's negotiating process⁹⁹ and the independence of the directors and their advisors in order to have the shareholder vote count as a procedural cleansing mechanism.¹⁰⁰

Relying on pre-*MFW* principles,¹⁰¹ courts have accepted these arguments,¹⁰² leading to an undesirable outcome where incomplete disclosure about the special committee or its advisors might cause the failure of *both* cleansing mechanisms—not just the special committee approval but also the shareholder vote.¹⁰³ This latter outcome marks a significant shift from the doctrinal evolution described above. Before *MFW*, if a controlling owner used just one cleansing mechanism—either a special committee or a majority of minority vote—the burden of proof shifted to the plaintiff under entire fairness.¹⁰⁴ These mechanisms were not interconnected.¹⁰⁵ A controller could seek majority of minority shareholder approval without any special committee negotiation, provided the economic terms of the transaction were disclosed.

When *MFW* required both mechanisms to cleanse a transaction, the court's treatment of the disclosure requirements and the implications of incomplete disclosure did not adapt to the new regime. Delaware courts have long held that information about the special committee process—including director independence, the bargaining process, and potential conflicts of the committee's

⁹⁹ See, e.g., Tornetta Pl.'s Post-Trial Opening Br. at 68–81 (arguing that Tesla failed to disclose that members of the compensation committee were conflicted, as well as process flaws, in the proxy statement).

¹⁰⁰ See, e.g., *City of Sarasota Firefighters' Pension Fund v. Inovalon Holdings, Inc.*, No. 305, 2023, 2024 WL 1896096 (Del. May 1, 2024).

¹⁰¹ See note 96 *supra*.

¹⁰² *City of Sarasota Firefighters' Pension Fund v. Inovalon Holdings, Inc.*, No. 305, 2023, 2024 WL 1896096 (Del. May 1, 2024) (embracing plaintiffs' arguments that *MFW* was not satisfied where advisors to the special committee were conflicted and this fact was not disclosed to the shareholders); *City of Dearborn Police & Fire Revised Ret. Sys. v. Brookfield Asset Mgmt. Inc.*, 314 A.3d 1108 (Del. 2024) (same); *Allen v. Harvey*, No. 2022-0248-MTZ, 2023 Del. Ch. LEXIS 463 (Del. Ch. Oct. 30, 2023) (holding that a special committee member's ties to the company rendered the proxy statement stating that all special committee members were independent misleading, thereby holding that the shareholder vote *MFW* condition was not satisfied).

¹⁰³ Note that, given the relatively lax standard that *MFW* applied to the special committee condition, deficient disclosure might invalidate the shareholder vote condition without affecting the special committee condition. In cases involving advisors' potential conflicts, for example, courts held that the special committee did not breach its duty of care by hiring advisors with ties to the controller. Yet the court held that *MFW* did not apply because these ties should have been disclosed to shareholders. See, e.g., *Inovalon*, 2024 Del. WL 1896096 at *15; *Brookfield*, 314 A.3d. 1108, at 1134.

¹⁰⁴ *In re Ezc Corp. Inc. Consulting Agreement Derivative Litig.*, No. CV 9962-VCL, 2016 WL 301245, at *11 (Del. Ch. Jan. 25, 2016) ("If a controller agrees to use only one of the protections... then the ... controller can achieve [] a shift in the burden of proof such that the plaintiff challenging the transaction must prove unfairness").

¹⁰⁵ Even after *MFW*, using only one cleansing device—majority-of-minority vote or a special committee—entitles the controller to shift the burden to demonstrate unfairness to the plaintiff. See *In re Match*, 315 A.3d. 474.

advisors—counted as “material information” required to be disclosed to shareholders.¹⁰⁶ In the post-*MFW* era, the absence of such disclosure concerning the special committee led courts to invalidate the shareholder vote prong of the *MFW* conditions.¹⁰⁷ Simply put, issues with the special committee process, if not disclosed to shareholders, also tainted the shareholder vote, potentially resulting in the failure of both cleansing mechanisms and subjecting the transaction to entire fairness review.¹⁰⁸ This result undermined *MFW*’s chief benefit—avoiding the need for courts to engage in valuations when the parties in interest had embraced the transaction.¹⁰⁹

Not only that, this disclosure failure meant that the controller would not receive any burden shift that they could have obtained by avoiding the special committee altogether and relying solely on a majority of minority shareholder vote. Thus, attempting to secure both *MFW* conditions and failing at one could become more detrimental than pursuing just one mechanism from the outset.

As an illustration of this development in the law, recall the *Tornetta* case, which challenged an outsized compensation package awarded to Elon Musk that was approved by a majority of minority shareholders.¹¹⁰ The court found that the board compensation committee that awarded the package consisted of conflicted directors who were beholden to Musk.¹¹¹ Because the disclosure to shareholders omitted these facts, the court disregarded not just the special committee vote, but also the majority of the minority shareholder approval.¹¹² With the failure of both cleansing mechanisms, the fairness of the deal and judicial valuation of Musk’s compensation became central to the trial, without a favorable burden shift for the defendants.¹¹³

¹⁰⁶ See *Clements*, 790 A.2d at 1242 ([I]n a transaction where the outcome is foreordained by the majority stockholder’s voting power and where that voting power precludes the Special Committee from finding other purchasers, the effective functioning of the Special Committee as an informed and aggressive negotiating force is of obvious importance to the public stockholders.”); *In re Emerging Commc’ns, Inc. S’holders Litig.*, No. CIV.A. 16415, 2004 WL 1305745, at *37 (Del. Ch. May 3, 2004).

¹⁰⁷ See sources cited *supra*, note 102.

¹⁰⁸ See *supra* note 103.

¹⁰⁹ This very result occurred in *Tornetta*, where details about the non-independence of directors were not disclosed to the shareholders, which caused the court to rule that not only was the disclosure flawed, but also the shareholder approval. *Tornetta*, 310 A.3d at 523. Not only that, this committee failure also colored the entire fairness analysis.

¹¹⁰ *Id.*

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ Courts can give weight to shareholder vote as evidence of fairness even when none of the *MFW* conditions applies. After all, an informed shareholder vote approving the proposed transaction with the controller can provide an important indication that the price is fair. See *In re Tesla*, 298 A.3d at 727–28 (an informed shareholder vote can weigh in favor of fairness); see also *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1176 (Del. 1995) (absent disclosure violations, the support of an “overwhelming majority” of stockholders constitutes “substantial evidence of fairness.”). In *Tornetta*, however, the court held that the lack of disclosure concerning the compensation committee precluded it from giving weight to the stockholders’ vote as evidence of fairness. See *Tornetta*, 310 A.3d at 543–44.

In sum, the *MFW* regime that was designed to provide controllers with a process that would avoid a searching entire fairness review has become more demanding, and therefore, more likely to fail. When failure occurs, the court is left with the unenviable task of determining whether the price and process that led to the transaction were fair, both of which require valuation. In the next Part, we argue that it is impossible for the court to soundly perform this task when a controller's idiosyncratic vision is at stake.

III. THE IMPOSSIBILITY OF VALUING IDIOSYNCRATIC VISION

As the introduction highlighted and this Part discusses in detail, the core question underlying the *Tornetta* case was the value of Musk's vision for Tesla. This Part defines idiosyncratic vision and then explains why it is impossible for courts to value it. It then demonstrates how this valuation problem results in potent challenges to judicial review under entire fairness, relying on two key cases: *Tornetta v. Musk*, in which the Delaware Court of Chancery rescinded a record-breaking pay package for Tesla's controlling shareholder,¹¹⁴ Elon Musk;¹¹⁵ and *In re Tesla*, in which the Court of Chancery considered whether Tesla paid an adequate price for SolarCity, another company that Musk controlled.¹¹⁶

A. Valuing an Entrepreneur's Idiosyncratic Vision

In this Section, we first define idiosyncratic vision. We show how vision can create immense value, but its value is not ascertainable *ex ante*. We next describe the leading valuation methods used by experts, litigants, and courts, and describe why they are not able to reliably estimate an entrepreneur's idiosyncratic vision.

i. Idiosyncratic Vision

Entrepreneurs differ from other individuals.¹¹⁷ Most participants in our modern economy take relatively risk-free, salaried jobs. But entrepreneurs instead make the difficult choice to strike out on their own to implement some idea or vision. A rational actor will choose to commit time, energy, and resources to execute their vision—to the exclusion of other pursuits—if they believe it will

¹¹⁴ For purposes of this Article, we assume that Musk constituted a controlling shareholder, although this conclusion is subject to debate. *See, e.g.*, Hamermesh, *supra* note 18 at 37 (“The [] finding [] that Musk was so talented and visionary that the company could not succeed without him [] does not rationally imply that someone is a controlling stockholder.”); Ann Lipton, *After Corwin: Down the Controlling Shareholder Rabbit Hole*, 72 Vand. L. Rev. 1977 (2019) (discussing the complexity of determining who is a controlling shareholder in the modern market environment).

¹¹⁵ *Tornetta*, 310 A.3d. 443

¹¹⁶ *In re Tesla*, 298 A.3d 726.

¹¹⁷ For simplicity, we use the example of entrepreneurs. But even CEOs of established companies can have idiosyncratic vision that would allow them to produce above market returns for investors.

produce an above-market rate of return on the resources invested.¹¹⁸ Two of us have referred to an entrepreneur's belief in their unique idea, or their unique ability to execute an idea, as *idiosyncratic vision*.¹¹⁹

While idiosyncratic vision is often an invention or new innovation,¹²⁰ it need not be. The idea can be identifying a new market or an emerging market niche,¹²¹ developing a new method of marketing a product,¹²² or creating a more efficient production¹²³ or delivery system.¹²⁴ As long as the entrepreneur subjectively believes the idea will result in above-market returns, it is an idiosyncratic vision.

Importantly for this Article, an entrepreneur's idiosyncratic vision represents part of the entrepreneur's business idea that even expert outsiders may be unable to observe or verify. An essential feature of idiosyncratic vision is that its viability is not testable at the outset, and thus, the idea's probability of success cannot be known with certainty except in hindsight. Indeed, although most entrepreneurs genuinely believe that their idiosyncratic vision will produce above-market returns, experience reveals that only a few actually have such vision.

Predictably, this feature can result in differences of opinion between investors and the founder-entrepreneur. To raise funding for the implementation of their idea, the entrepreneur must persuade investors that their business plan will produce superior returns without clear evidentiary support. Another important feature of idiosyncratic vision is that it is the part of the business plan which, if successfully implemented, will drive the business's above-market returns. Put another way, idiosyncratic vision is the feature of the business that sets it apart from all other ordinary businesses—the reason to invest in the first place.

¹¹⁸ See Goshen, *supra* note 19, at 577. This concept has been referred to by other names: the entrepreneurial vision or idea, the business plan, the subjective value, or the hidden value. See, e.g., Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521, 521-22 (2002) (expressing the concept as "hidden value" to describe Delaware's deference to the incumbent board in hostile takeover cases).

¹¹⁹ Goshen, *supra* note 19, at 577.

¹²⁰ See ISAACSON, *supra* note 24, at 59-79 (describing the founding of Apple and the invention of the Apple I and II computer).

¹²¹ See Steve Olenski, *The Evolution of Ecommerce*, FORBES (describing Jeff Bezos' first online book sale and the subsequent boom in the ecommerce industry).

¹²² See THOMAS K. MCCRAW, *AMERICAN BUSINESS, 1920-2000: HOW IT WORKED* (2000) (describing how Procter and Gamble's development of brand management and a new kind of market research changed the way consumer marketing decisions are made).

¹²³ M. Todd Henderson, *The Story of Dodge v. Ford Motor Company: Everything Old Is New Again*, CORPORATE LAW STORIES, 37, 40 (J. Mark Ramseyer ed., 2009).

¹²⁴ Sue Landau, *Spotlight: FedEx Chief Looks at Next Destination*, N.Y. TIMES (Feb. 5, 2005) (recounting FedEx founder Fred Smith's "revolutioniz[ing] the air transport business").

The founding of Vanguard, an investment management company with over \$7 trillion in assets under management, provides an example of idiosyncratic vision in action. Vanguard's founder, John C. Bogle, formed an idea while an undergraduate at Princeton that he memorialized as his senior thesis.¹²⁵ Titled "The Economic Role of the Investment Company," Bogle argued that investment companies should work to minimize all fees charged to investors.¹²⁶ This idea was in direct contrast to prevailing norms at the time. Active mutual funds ruled the investing industry and imposed high up-front and annual fees to manage investor's money.¹²⁷ These funds premised their high costs on their ability to outpace the market and deliver superior returns.¹²⁸ But Bogle had personally documented the consistent failure of active mutual funds to beat the market over the immediately preceding three decades.¹²⁹ Given that active management of investment funds was seemingly doing little for investors, Bogle determined he would launch the index fund, which took the manager out of the picture. Such funds eschew active management for simple passive investment by replicating the performance of the market. As a result, index funds require no investment advisory services and therefore charge only minimal fees.¹³⁰

This now obvious idea was viewed with extreme skepticism from Vanguard's board.¹³¹ But nevertheless, in 1974, Bogle convinced them to green-light the launch of Vanguard's S&P 500 index mutual fund—the first of its kind.¹³² The fund was initially scorned by industry leaders, and the fund's first public offering in 1976 was a flop, raising a mere \$11 million (instead of the projected \$150 million). Edward C. Johnson III, chairman of the leading investment fund Fidelity, told the press he could not believe investors would "be satisfied with just receiving average returns" when "the name of the game is to be the best."¹³³ One brokerage firm went as far as to call index funds "un-American."¹³⁴ Forbes ridiculed Bogle in an article titled, "A Plague on Both

¹²⁵ Steven Goldberg, *John Bogle: The Defiant Patron Saint of Index Investing*, KIPLINGER (Jan. 17, 2019), <https://www.kiplinger.com/article/investing/t030-c007-s001-john-bogle-patron-saint-index-investing-dies-89.html>

¹²⁶ John C. Bogle, *The Economic Role of the Investment Company*, PRINCETON UNIV. UNDERGRADUATE SENIOR THESIS (1951).

¹²⁷ Goldberg, *supra* note 104.

¹²⁸ KNUT A. ROSTAD, *THE MAN IN THE ARENA: VANGUARD FOUNDER JOHN C. BOGLE AND HIS LIFELONG BATTLE TO SERVE INVESTORS FIRST* (2013), 138.

¹²⁹ *Id.*

¹³⁰ *Id.*

¹³¹ *Id.* at 139.

¹³² *Id.* at 138.

¹³³ *Id.*

¹³⁴ *Id.*

Houses,” characterizing Bogle as a scourge on both his former employer, Wellington, and his new company, Vanguard.¹³⁵

While the early days were difficult, in the long-run, the idea was a massive success. By charging extremely low fees, Vanguard’s index funds began to overtake rival’s actively managed funds. With more investment dollars coming in, Vanguard was able to cut its prices further, continuing the cycle.¹³⁶ This innovation transformed the investing industry. Warren Buffett once asserted that Jack Bogle was “the person who has done the most for American investors . . . hands-down.”¹³⁷ Passive funds have firmly taken hold, surpassing actively managed funds in terms of assets under management in January 2023.¹³⁸ The asset managers that specialize in passively managed mutual funds are the largest in the world, with Vanguard holding the number two spot with over \$7 trillion in assets under management.¹³⁹

The passive investment vision did not have any sophisticated secrets or advanced intellectual property. Bogle and the market knew the same facts, but only Bogle believed in his vision. Bogle could not offer proof to other Vanguard stakeholders that his idea would necessarily succeed when all direct market competitors operated differently. But he was able to convince the board to let him try, which resulted in the transformation of investing worldwide.

The entrepreneur might, of course, be proven wrong about their idea. But what matters for the analysis is that the entrepreneur has conceived of an idea that they believe will generate above-average returns. While such ideas sometimes fail, they do occasionally succeed—generating significant wealth both for the entrepreneurs and their investors as well as for society.¹⁴⁰

ii. The Failure of Acceptable Valuation Methods

As the Vanguard example suggests, accepted valuation methods are fundamentally at odds with the task of valuing an entrepreneur’s vision. The two valuation methods often used by Delaware courts (as well as the experts who provide valuation analysis in litigation) are a

¹³⁵ *A Plague on Both Houses?*, FORBES (May 1975).

¹³⁶ Goldberg, *supra* note 104.

¹³⁷ Goldberg, *supra* note 104.

¹³⁸ Jeff Cox, *Passive Investing Rules Wall Street Now, Topping Actively Managed Assets in Stock, Bond and Other Funds*, CNBC, <https://www.cnbc.com/2024/01/18/passive-investing-rules-wall-street-now-topping-actively-managed-assets-in-stock-bond-and-other-funds.html>.

¹³⁹ Dorothy S. Lund & Adrianna Robertson, *Giant Asset Managers, the Big Three, and Index Investing*, USC GOULD CENTER FOR LAW AND SOCIAL SCIENCE (2023); Alon Brav, Dorothy S. Lund & Lin Zhao, *Flows, Financing Decisions, and Institutional Ownership of the U.S. Equity Market*, EUROPEAN CORP. GOV. INST. WORKING PAPER SERIES IN LAW (2024).

¹⁴⁰ See Goshen, *supra* note 19.

comparable companies and DCF analysis.¹⁴¹ These methodologies seek to value the company's assets independently of the individuals that control those assets.¹⁴² The goal of these valuations is to predict the value at which the assets would trade hands in the market.¹⁴³ Thus, projections that model a firm's future cash-flows, like the DCF methodology, are based on the most likely performance of that set of assets in existing market conditions, ignoring the manager's identity.¹⁴⁴ Likewise, the comparable companies analysis finds examples of analogous assets that have recently been sold in arm's length transactions and uses those prices to attempt to estimate what the asset in question is worth, without considering the value that the particular entrepreneur could bring to the table.¹⁴⁵

Given the extreme differences in company performance that can be driven by company leadership, the failure of accepted valuation techniques to account for outliers is a crucial flaw that undermines the court's ability to value vision. Again, DCF projections are based on the asset's most likely performance given available objective information like a firm's exposure to systemic risk, debt-to-equity ratios, expected revenue, and other metrics, all of which are divorced from the performance of the firm's managers.¹⁴⁶ Moreover, basing the transaction's value on benchmarking or a comparable companies analysis relies on expected returns for a group of assets under an average manager—a method which fails to account for outsize value that can be generated by a leader's idiosyncratic vision.

These valuation difficulties lead to many undesirable outcomes when applied to visionary entrepreneurs: entrepreneurs that fail to convince investors about the value of their ideas may never see them realized, investors that fail to separate the great ideas from the bad will suffer poor returns, and overall, the failure to match investors with visionary entrepreneurs will cause social welfare to suffer. More relevant for this Article, judges who are asked to determine the “fair value” of an entrepreneur's idiosyncratic vision may not necessarily get the answer right.

¹⁴¹ Baker, et al, *supra* note 31, at 7 (“As it is currently practiced in business law courtrooms and boardrooms, modern valuation practice is dominated by three alternative methodologies: Comparable companies (CC), comparable transactions (CT), and discounted cash flow (DCF) analyses.”).

¹⁴² 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 cashflows).

¹⁴³ J.B. Heaton, *The DCF Valuation methodology Is Untestable*, HARV. L. SCH. F. CORP. GOV. (Apr. 20, 2022).

¹⁴⁴ Note that valuing a company under the DCF methodology might be indirectly related to the company's existing management to the extent that this management and its business plan affect projections of future cashflows. See Assaf Hamdani & Kobi Kastiel, *Superstar CEOs and Corporate Law*, 100 WASH. U. L. REV. 1353, 1402-1407 (2023).

¹⁴⁵ Baker, et al, *supra* note 31.

¹⁴⁶ Goshen, *supra* note 21, at 967.

As we explained, a distinctive feature of an entrepreneur's idiosyncratic vision is that it reflects the parts of the entrepreneur's business idea that outsiders may be unable to observe or verify.¹⁴⁷ And herein lies the challenges from an objective valuation perspective. When an entrepreneur's vision for the company is shaped by her experience, knowledge, character, and intuition, another individual with the same goals may reach different conclusions regarding the viability and value of the idiosyncratic vision. Indeed, investors who did not believe in Musk's vision and sold their Tesla shares at the low price of \$12 in June 2019 lost out, while those who believed in his vision and bought at that time saw their investment increase thirty-three-fold by November 2021.

In sum, these limitations plague valuations by outside experts, directors, individual shareholders, and courts. Even when the firm is publicly traded and investors are using stock prices as a proxy for the firm's performance, there is still the risk that the parties will end up with different views on the value of the entrepreneur's business idea. Markets do not have any clear advantage in refereeing differences of opinion regarding the best strategy for a firm. And this makes sense, as idiosyncratic vision is one person's subjective view of the best path forward that often runs counter to market consensus. These features make the value of a specific entrepreneur's idiosyncratic vision difficult to ascertain even at publicly traded companies.¹⁴⁸

To be sure, not all controller transactions will involve idiosyncratic vision. For instance, freezeout transactions—the area in which entire fairness and *MFW* cleansing emerged—or the sale of the company to a third party are transactions that do not require an assessment of the controller's vision. In a freezeout, the controller is proposing to buy the shares held by minority shareholders. Since the freezeout ends the 'partnership' with the minority, the value of the transaction to minority shareholders does not depend on their assessment of the non-verifiable *future* value of the controller's idiosyncratic vision.¹⁴⁹ Similarly, when the company is sold to a third party, its value is determined by market participants through auctions, acceptable valuation methods, or average premiums paid for similar firms. From the perspective of minority shareholders, the value of the proposed transaction can be determined based on the acceptable methods for determining the value

¹⁴⁷ Goshen, *supra* note 19, at 567.

¹⁴⁸ Goshen, *supra* note 21, at 968.

¹⁴⁹ To be sure, under the DCF method, the pre-transaction value of the company depends on the projected income of the company, which in turn may depend on those parts of the controller vision that have been already implemented into the company's business. See Hamdani & Kastiel, *supra* note 144.

of shares, and the controller normally would not even attempt to justify the transaction by reference to its vision or unique contribution to company value. Other self-dealing transactions, in contrast, may involve the controller's vision. Awarding compensation to a controller-CEO, for example, requires the board and shareholders to assess the value of the controller's vision and determine whether it justifies the proposed pay.

We do not intend to offer a legal test that would identify those self-dealing transactions that involve vision. While the shortcomings that we identify in the MFW framework may be especially troublesome for such transactions, these shortcomings affect other types of self-dealing transactions as well. Our proposals, therefore, should apply to all types of self-dealing transactions and they will improve the regulation of these transactions without the need for courts to identify which self-dealing transactions involve a controller's vision.

B. Judicial Valuation as Part of Entire Fairness Review

The impossibility of predictably and reliably valuing idiosyncratic vision complicates the most demanding standard of review under Delaware law: entire fairness. As discussed in the previous Part, Delaware courts police the fairness of controller transactions to protect investors from opportunistic self-dealing by controlling shareholders.¹⁵⁰ Delaware will engage in a review of the transaction's price as well as the process that led to it, unless two procedural cleansing mechanisms—a special committee and majority of minority shareholder approval—are employed.¹⁵¹ In this Section, we highlight the difficulties of conducting judicial valuation under entire fairness review when idiosyncratic vision is at stake. We use two cases, *Tornetta v. Musk* and *In re Tesla Shareholders Litigation*, as illustrative examples. To preview our analysis, the *Tornetta* court did not directly engage in judicial valuation of Musk's value to Tesla; instead, the court focused most of its attention on the compensation committee's bargaining process. As we will show, the court's analysis underscores two flaws arising from the application of entire fairness review to a controllers' vision: first, in critiquing the bargaining process, the court implicitly compared Musk's compensation with that of the average CEO; second, the inability to value vision

¹⁵⁰ See Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Law and Economics of Self-Dealing*, 88 J. FIN. ECON. 430, 430–31 (2008) (describing the increasing emphasis of academics on corporate self-dealing over the last twenty years); Ronald J. Gilson & Alan Schwartz, *Constraints on Private Benefits of Control: Ex Ante Control Mechanisms Versus Ex Post Transaction Review*, 169 J. INSTITUTIONAL & THEORETICAL ECON. 160, 180–81 (2013) (arguing that ex post judicial review of transactions with controlling shareholders or their affiliates is superior to ex ante limits on dual-class and other leveraged control structures).

¹⁵¹ See *Weinberger*, 457 A.2d at 703, 711 (Del. 1983) (describing how transaction involving potential self-dealing concerns invoke the entire fairness standard).

led the court to focus on other factors, such as the form that the negotiations took and how the transaction fared in hindsight. We then discuss another case involving Tesla and Musk that illustrates that courts are also required to make impossible calculations of value when determining the fairness of a conflicted acquisitions by controlled companies.

i. Tornetta v. Musk

In June 2018, Tesla stockholder Richard Tornetta filed a lawsuit alleging that the Tesla board breached its fiduciary duty by awarding Elon Musk a stock option grant potentially exceeding \$50 billion.¹⁵² The compensation plan employed a familiar structure based on performance-vesting equity: Musk was granted shares of Tesla that would only vest upon achieving specific performance targets related to Tesla's market value, revenues, and profits.¹⁵³ Indeed, this was the very structure that Tesla used to compensate Musk in previous compensation packages.¹⁵⁴

The boldness of the plan came from both the ambitious goals it set forth and the magnitude of Musk's pay if these goals were met. If Tesla's market value failed to exceed \$100 billion by 2028, Musk would receive nothing. However, if Musk could elevate Tesla's market value from approximately \$59 billion to \$650 billion within ten years, he stood to make \$55 billion.¹⁵⁵ The revenue targets were equally staggering, requiring Tesla to generate \$175 billion, which was 17 times its most recent annual revenue at the time the plan was adopted.¹⁵⁶

Not only did commentators doubt Musk's ability to achieve these goals, but the market also exhibited skepticism. On the day the plan was announced, Tesla's stock price was \$23.52 per share;¹⁵⁷ two days later, it dropped to \$22.50, and when shareholders approved the plan, it further declined to \$21.10 per share.¹⁵⁸ Therefore, when Tesla first announced Musk's compensation plan

¹⁵² *Tornetta*, 310 A.3d at 494.

¹⁵³ *Id.* at 486.

¹⁵⁴ *Id.* at 453-454.

¹⁵⁵ *Tornetta*, 310 A.3d at 543.

¹⁵⁶ Karl West, *Tesla Boss Elon Musk Pursues his Most Unlikely Goal Yet: A \$55bn Bonus*, THE GUARDIAN (Jan. 26, 2018).

¹⁵⁷ Note that this price has been adjusted to account for stock splits.

¹⁵⁸ Market prices reflect investors' expectations about a corporation's future value. *See generally* MALKIEL, BURTON G., A RANDOM WALK DOWN WALL STREET (New York: W. W. Norton & Co., 1973, 1st edition.) In this case, two factors shape these expectations: the likelihood of achieving the plan's goals and the probability of court approval. If investors doubt the goals' achievability, the stock price will likely remain stable. However, if the market believes these goals are attainable, the price should quickly rise to reflect the anticipated amazing future value. Similarly, if investors expect courts to cancel the plan before Musk can achieve the goals, thus removing his incentives, the stock price will not increase. Conversely, if the market anticipates court cancellation only after Musk has met the goals, the price should promptly rise to reflect the expected high future value.

in January 2018,¹⁵⁹ and later, when the plan was “overwhelmingly approved” by Tesla shareholders that March,¹⁶⁰ many considered it extremely unlikely Musk would earn this payday.¹⁶¹ In fact, detractors called the requisite milestones “laughably impossible.”¹⁶²

Things only got worse for Tesla a few months after the plan’s adoption, when the company was posting record losses and struggling to reach production targets on its new car, the Model 3.¹⁶³ Tornetta filed his claim amidst Tesla’s struggles, in June 2018, when the average stock price was still at \$23 a share.¹⁶⁴ But Tesla’s situation continued to be dire. A few months later, in October 2018, when Tesla’s share price fell to below \$17 a share, David Einhorn, the manager of the hedge fund Greenlight Capital, wrote to his investors that Tesla bore a resemblance to Lehman Brothers before its 2008 bankruptcy (a collapse that Einhorn had foreseen months before it occurred).¹⁶⁵ Indeed, some predicted outright that Tesla would soon file for bankruptcy,¹⁶⁶ while others speculated on who should replace Elon Musk as CEO.¹⁶⁷

In June 2019, Tesla’s stock price fell further, below \$12 a share, marking a 48% drop since the announcement of the pay package. Even a year later, in October 2019, as Tesla delivered a rare third-quarter profit, experts remained “concerned on 2020 momentum/profitability.”¹⁶⁸ At that time, the stock price hovered around \$17 a share. Only on December 11, 2019 did the stock price return to \$23.51 a share, finally matching the price of the stock two years earlier when the plan was announced. Musk himself described this period as “incredibly difficult and painful” to the

¹⁵⁹ Press Release, *Tesla Announces New Long-Term Performance Award for Elon Musk*, TESLA INVESTOR RELATIONS (Jan. 23, 2018).

¹⁶⁰ Jonathan Berr, *Elon Musk’s \$2.6 Billion Pay Package Gets Tesla Shareholder Approval*, CBS NEWS: MONEYWATCH (Mar. 21, 2018).

¹⁶¹ Andrew Ross Sorkin, *Tesla’s Elon Musk May Have the Boldest Pay Plan in Corporate History*, N.Y. Times (Jan. 23, 2018).

¹⁶² *Id.*

¹⁶³ *Tesla Posts Record \$710m Net Loss as it Struggles to Produce Model 3 Cars*, THE GUARDIAN (May 2, 2018), <https://www.theguardian.com/technology/2018/may/02/tesla-loss-model-3-elon-musk>.

¹⁶⁴ *Tornetta*, 310 A.3d at 487.

¹⁶⁵ Tae Kim, *Einhorn on Tesla: ‘Like Lehman, We Think the Deception Is About to Catch Up’*, CNBC (Oct. 5, 2018, 12:26 PM EDT), <https://www.cnbc.com/2018/10/05/einhorn-on-tesla-like-lehman-we-think-the-deception-is-about-to-catch-up-to-tesla.html> [<https://perma.cc/AM9N-3NGD>].

¹⁶⁶ Mike Guy, *Here’s Why Tesla Will Go Bankrupt in 2019*, DRIVE (Oct. 19, 2018), <https://www.thedrive.com/tech/24261/elon-musk-and-10-billion-of-debt-why-tesla-will-go-bankrupt-in-2019> [<https://perma.cc/TU3Y-QYMU>].

¹⁶⁷ Sam Abuelsamid, *Who Should Replace Elon Musk as Tesla CEO?*, FORBES (Oct. 1, 2018, 8:00 AM EDT), <https://www.forbes.com/sites/samabuelsamid/2018/10/01/who-should-replace-elon-musk-as-tesla-ceo> [<https://perma.cc/8UM2-3MZ9>].

¹⁶⁸ Paul A. Eisenstein, *Tesla Reported a Surprise Profit—But How Long Can CEO Elon Musk Stay Ahead?*, CNBC (Oct. 24, 2019, 11:12 AM EDT), <https://www.nbcnews.com/business/autos/tesla-reported-surprise-profit-how-long-can-ceo-elon-musk-n1071296> [<https://perma.cc/XD2V-TPMN>].

point where he was “sleeping on the floor of the factory” as he tried to solve the production delays.¹⁶⁹ And in the interim, as Musk tried to turn around Tesla’s outlook and achieve the hugely ambitious goals set out in the compensation plan, he was receiving no guaranteed compensation of any kind.¹⁷⁰

Of course, we know what happened next—Tesla’s stock price continued to ascend after December 2019, ultimately making it the world’s most valuable car company by November 2021.¹⁷¹ Around this time, the court heard arguments in the case challenging Musk’s compensation, by which point Musk had already achieved the final milestone. Thus, although Tesla stockholder Richard Tornetta filed suit shortly after the plan’s adoption,¹⁷² the case was litigated only after Musk had earned the stock grants, and not when they were in serious doubt.

The Court of Chancery issued its opinion rescinding the grants in January 2024, concluding that Musk was a controlling shareholder with respect to the compensation plan and that he did not meet his burden to establish the fairness of the transaction.¹⁷³ After losing an earlier motion to dismiss, Musk conceded that *MFV* was not satisfied because the company did not use a special negotiating committee.¹⁷⁴ Instead, Musk argued for a burden shift on the grounds that the board had conditioned the implementation of the plan on garnering the support of a majority of the minority shareholders.¹⁷⁵ Notably, 73% of shareholders—excluding Musk, who did not vote his shares—approved the plan, which allowed it to go into effect.¹⁷⁶

As discussed in the previous Part, under entire fairness, the court evaluates whether the “price” of a self-dealing transaction is fair. Admirably in this case, the court did not attempt to value Musk’s vision and its singular contribution to Tesla during this period, an impossible task. But herein lies the quandary—without some reliable estimate or measure of value, how could the

¹⁶⁹ Clifford, *supra* note 11.

¹⁷⁰ See Mak, *supra* note 8.

¹⁷¹ Indeed, Tesla became more valuable than General Motors, Ford, Toyota, Mercedes-Benz, Volkswagen, Honda, Nissan and Hyundai combined. Loveday, *supra* note 15.

¹⁷² *Tornetta*, 310 A.3d at 494.

¹⁷³ *Id.* at 495.

¹⁷⁴ In an earlier motion to dismiss, the defendants argued that both *MFV* conditions were satisfied. The court, however, found that pled facts questioned the independence of Tesla’s compensation committee. See *Tornetta v. Musk*, 250 A.3d 793, 809 (Del. Ch. 2019) (“[S]ince Plaintiff has well pled the Compensation Committee and Board processes with respect to the Award were also subject to the controller’s coercive influence, at this stage, I must conclude the Award was not duly approved by either of Tesla’s qualified decision makers.”)

¹⁷⁵ *Tornetta*, 310 A.3d at 487 (“Board approval was not the finish line, because the Board conditioned the 2018 Grant on approval by a majority vote of disinterested stockholders.”).

¹⁷⁶ *Id.* at 490. Another interested shareholder, Kimbal, also recused himself from the vote. *Id.* at 454.

court determine whether the price was fair? How could it even begin to assess whether the price fell within a range of fairness?¹⁷⁷

One way to resolve this difficulty is to rely on the disinterested shareholder vote as a strong indication of fair price. The court, however, ultimately gave no credit to the shareholder vote after it found that the disclosure was flawed primarily because the proxy statement did not disclose to the shareholders that the directors who negotiated the compensation package were conflicted and omitted material information about the compensation committee's process.¹⁷⁸ The absence of both cleansing methods put the burden on Musk to prove that the transaction was entirely fair.¹⁷⁹ Musk did not attempt to offer any evidence about the fairness of his compensation. Without any acceptable method to price the value of Musk's idiosyncratic vision for the company, the court was left with no reliable method but its own judgment to determine the fairness of Musk's compensation.

The court relied on two guideposts to deal with this intractable problem: pay benchmarks derived from other companies and information about the special committee's bargaining process. We address each of these guideposts below.

Benchmarks and Average Pay. Without an estimate of value, the *Tornetta* court appeared to have been swayed by the record-breaking dollar value of the compensation package.¹⁸⁰ Although the court did not explicitly review a benchmarking analysis (indeed, because the board did not have one¹⁸¹) the court's analysis was colored by the sheer size of the award.¹⁸² For instance, the court noted that Musk's maximum payout under the compensation plan was "250 times larger than the contemporaneous median peer compensation plan and 33 times larger than the plan's closest comparison."¹⁸³

But comparing compensation based on total dollars alone tells only part of the story because managers can perform very differently. For instance, Jim Hackett, the former CEO of Ford

¹⁷⁷ *Tornetta*, 310 A.3d at 533 (quoting *In re Dole Food Co., Inc. Stockholder Litig.*, No. CV 8703-VCL, 2015 WL 5052214, at *33 (Del. Ch. Aug. 27, 2015) ("Instead of picking a single number, the court's task is 'to determine whether the transaction price falls within a range of fairness.'").

¹⁷⁸ *Id.* at 521. The court reject the defendants' argument that "the stockholder vote was fully informed because the most important details of the Grant—the economic terms—were disclosed." *Id.* at 525-526.

¹⁷⁹ *Id.* at 526.

¹⁸⁰ *Tornetta*, 310 A.3d at 445.

¹⁸¹ *Id.*

¹⁸² *Id.* at 446 ("The defendants were thus left with the unenviable task of proving the fairness of the largest potential compensation plan in the history of public markets.").

¹⁸³ *Id.* at 445.

(a peer firm of Tesla's), earned approximately \$69 million from 2017 to 2020¹⁸⁴ while Ford's stock price hit a ten-year low.¹⁸⁵ A similar story took place at General Motors.¹⁸⁶ In contrast, Elon Musk earned \$55.8 billion, but he created \$590.9 billion in shareholder value.¹⁸⁷ Thus, Ford's and GM's shareholders paid their CEO much less but ended up paying for losses. And yet, despite genuine differences in skill and effort, the *Tornetta* court essentially viewed Musk as just another CEO.¹⁸⁸

The absence of an estimate of value also raises concerns that the court's decision will be influenced by hindsight bias. The court emphasized the dollar size of the pay package that was earned after all of the milestones were achieved and gave little weight to the company's prospects on the date of the grant, when Tesla's future was deeply uncertain. Colored by hindsight, the court viewed the milestones as all but guaranteed.¹⁸⁹ But what if the court had to decide the case in 2018, when Tesla neared bankruptcy and when most of the milestones seemed unlikely to be achieved? Would it still have concluded that the pay package was unfair?¹⁹⁰ This result seems unlikely; similarly, if Musk failed to meet all (or any) of the milestones and was left with a much smaller stock grant, the court would have likely reached a different conclusion about fairness.¹⁹¹

¹⁸⁴ Christina Rodgers, *Ford CEO Received \$16.7 million Pay for 2017*, WSJ <https://www.wsj.com/articles/ford-ceo-received-16-7m-pay-for-2017-1522360484>; <https://www.bloomberg.com/news/articles/2020-04-03/ford-ceo-s-pay-slips-2-2-for-not-nearly-good-enough-year?embedded-checkout=true>; <https://www.freep.com/story/money/cars/ford/2021/04/01/ford-salaries-executive-team/4833859001/>.

¹⁸⁵ *Market Capitalization of General Motors*, COMPANIES MARKET CAP, <https://companiesmarketcap.com/general-motors/marketcap/> (last visited Mar. 3, 2014) (taking the year end 2022 market cap of \$47.79 billion less the 2014 market cap of \$55.85 billion); see also Andrew Bary, *GM Stock has Suffered During Mary Barra's 9 Years as CEO*, BARRONS (Oct. 26, 2023).

¹⁸⁶ Mary Barra, CEO of General Motors (a peer firm of Tesla's), earned \$248.3 million from 2014 to 2022, while GM's market capitalization fell by about \$8 billion. Andrew Bary, *GM Stock has Suffered During Mary Barra's 9 Years as CEO*, BARRONS (Oct. 26, 2023).

¹⁸⁷ Tesla, Inc., *Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934*, SEC, https://www.sec.gov/Archives/edgar/data/1318605/000119312518035345/d524719ddef14a.htm#toc524719_8.

¹⁸⁸ See *Tornetta*, 310 A.3d at 519 ("That is a hard sell. As CEO, Musk's job was the same as every other public company CEO: improve earnings and create value.").

¹⁸⁹ *Tornetta*, 310 A.3d at 448.

¹⁹⁰ Note that this same concern about hindsight also affects the court's scrutiny of the special committee's bargaining, where the court assumed that Musk would be successful and meet all of the milestones. But recall that in real-time, experts and the stock market were skeptical that the goals outlined in the options grant could ever be achieved. In the immediate aftermath of the grant, Tesla's stock price did not rise to reflect the fantastic future anticipated by management and memorialized in the agreement, but instead declined, continuing to do so for some time. Under these conditions, what makes one fantastic term fairer than another? It is difficult to fault the special committee process from this vantage point.

¹⁹¹ The court repeatedly emphasized that the committee believed that the first three milestones were "70% likely to be achieved" at the time of the grant. *Tornetta*, 310 A.3d at 539. Leaving aside the fact that this statement was not a "real" prediction but rather required for accounting purposes and to satisfy bond covenants, if Tesla had not gone further than this, Musk would have been entitled to purchase only 3% of Tesla's stock.

In sum, without reliable estimates of value, the courts' determination of "fair price" was affected by hindsight as well as benchmarks that likened Musk's performance to that of an average CEO.

Special Committee Process. In addition to pay benchmarks, the court heavily weighted the special committee's negotiating *process* in evaluating whether the *price* was fair—as the court put it, "process can infect price."¹⁹² It concluded that because the process lacked disinterested and adversarial negotiation, the court could not trust the price. It therefore rejected all of Tesla's arguments supporting the grant—including that the compensation package was necessary to keep Musk engaged and focused on the company's ambitious goals.¹⁹³

Reliance on the special committee bargaining process to determine the value of the controller's vision suffers from several shortcomings. First, as we explained in Part I.A, the court's ability to assess the fairness of the process also relies on its ability to evaluate the fairness of the price. Recall that the starting point for bargaining is an assessment of the value of the proposed transaction for the company and minority shareholders. But when idiosyncratic vision is at stake, the starting point is uncertain. Moreover, valuation experts do not offer much to supplement this process.¹⁹⁴ As a result, when the special committee negotiates against a visionary controller, the directors must decide whether to put faith in the controller's vision based on their knowledge of the controller's competence and integrity, as well as the firm's performance to date. The lack of a reliable measure of value makes it difficult for the court to determine whether the process was appropriate.

In *Tornetta*, the lack of a reliable method for valuing and quantifying Musk's contribution to Tesla significantly undermined the court's ability to evaluate the special committee process. Members of the compensation committee did not hire an expert to provide an evaluation of Musk's expected contribution to Tesla,¹⁹⁵ which in any case would not have been useful. Instead, the

¹⁹² *Tornetta*, 310 A.3d at 527.

¹⁹³ And "where the pricing terms of a transaction that is the product of an unfair process cannot be justified by reference to reliable markets or by comparison to substantial and dependable precedent transactions, the burden of persuading the court of the fairness of the terms will be exceptionally difficult." *Tornetta*, 310 A.3d at 533 (quoting *Valeant Pharms. Int'l v. Jerney*, 921 A.2d 732, 748 (Del. Ch. 2007)).

¹⁹⁴ The Tesla board defended its decision to not use benchmarks in its evaluation of the compensation package for this very reason. *Tornetta*, 310 A.3d at 518. Nonetheless, the court held the decision against the board when evaluating the process. *Id.* at 519. Our analysis suggests that the court should not necessarily have penalized the board given the limited usefulness of such studies when vision is at stake.

¹⁹⁵ *Id.*

committee decided to embrace Musk's vision, but tied the compensation to observable and verifiable performance metrics.

If it is difficult for a board to engage in such negotiations, it is even more challenging for courts to evaluate them *ex post*. Without an estimate of value, the *Tornetta* court focused on the board's negotiation style and criticized the board for a lack of adversarial negotiations.¹⁹⁶ But the nature of the transaction affects the nature of effective negotiations, whether adversarial or collaborative. Adversarial negotiations can be effective where parties play hardball and bargain over a zero-sum transaction,¹⁹⁷ though they can also backfire.¹⁹⁸ And collaborative negotiations are likely to be preferable in situations where the parties treat the ongoing relationship as an important and valuable element of the deal while seeking an equitable and fair agreement.¹⁹⁹ Indeed, keeping Musk content at Tesla and energized about leading the company was chief goal of the compensation arrangement. It would be strange to design a compensation package with the aim of preserving and strengthening a relationship, only to undermine it with an adversarial negotiation process. Ultimately, the committee must navigate the process in a way that avoids bargaining failure and preserves the relationship with the entrepreneur, ensuring a viable path forward for the ambitious vision.

When viewed from this lens, the negotiations between Musk and the committee look different. Indeed, certain facts suggest that the committee *did* push back against Musk's initial ask in a way that preserved the relationship. Musk began by requesting a ten-tranche structure in exchange for \$500 billion in total milestones, and the board countered with a twelve-tranche

¹⁹⁶ *Id.*

¹⁹⁷ For instance, in a freeze-out, where the controller becomes the company's sole owner after the transaction closes, the negotiation is a zero-sum game: any increase in the price paid to the minority shareholders directly reduces the controller's share and vice versa. In such scenarios, the absence of the controller's idiosyncratic vision allows the special committee to rely on expert valuation reports, and the impending end of the relationship permits adversarial negotiations to secure a higher price for the minority shareholders.

¹⁹⁸ According to negotiation experts, "negotiators with an adversarial bargaining style often fare worse than negotiators with a collaborative approach." *Adversarial Bargaining*, HARVARD LAW SCHOOL, <https://www.pon.harvard.edu/tag/adversarial-bargaining/>; see also James Kelleher, *Review of Traditional and Collaborative Models for Negotiation*, J. OF COLLECTIVE NEGOT. IN THE PUBLIC SECTOR (2000) 321.

¹⁹⁹ *Id.* The court recognized that "negotiations over CEO compensation give rise to strange dynamics because the parties need to work collaboratively after the negotiations have ceased, but that is true in many negotiations and in virtually every salary negotiation." It nonetheless concluded that "this was also not the place for it. When considering the largest compensation plan in the history of the public markets, the directors needed to do more than accommodate the CEO." *Tornetta*, n. 733. In other words, the court recognized that a collaborative approach could be necessary in exactly these circumstances and yet the size of the grant suggested more was necessary from the committee. In other words, the price element infected the court's conclusion about the special committee process once again.

structure in exchange for \$600 billion.²⁰⁰ While the court viewed this change as the board's preference for a grant that was easier to calculate,²⁰¹ the counteroffer meant that for the same number of shares, Musk now needed to deliver an additional \$100 billion in value.²⁰² Musk, a seasoned entrepreneur, would have understood that this "technical" change "for ease of computation" would require him to do far more,²⁰³ but he said nothing and accepted the request. This is a tell-tale sign of a collaborative negotiation, in which parties work together to arrive at a mutually advantageous outcome without hostility.²⁰⁴

Therefore, the inability to value Musk's vision led the court to scrutinize the bargaining process for adversity. And two unintended consequences stem from this ruling: negotiators may be swayed to engage in adversarial negotiations when a different approach would be preferable, or they may engage in cosmetic compliance, pretending to play hardball to avoid a finding of unfairness.²⁰⁵

In sum, although the court attempted to avoid the valuation issue, its conclusion about the unfairness of the price was colored by hindsight and comparisons to other companies, as well as its belief about deficiencies in the negotiating process. In the next Part, we offer guidance for courts forced to conduct entire fairness review that will help courts avoid these pitfalls. But first, we discuss another case that reveals the limitations of judicial valuation in the context of a conflicted controller acquisition, again involving Tesla and Musk.

ii. *In re Tesla Shareholders Litigation*

In re Tesla arose out of Tesla's acquisition of SolarCity in August 2016.²⁰⁶ Soon after, Tesla shareholders sued the board, claiming that Musk pushed Tesla to pay far too much for SolarCity (a company on the verge of bankruptcy) because of Musk's strong ties to SolarCity. Specifically,

²⁰⁰ *Tornetta*, 310 A.3d at 530.

²⁰¹ "The Board viewed total outstanding shares as a simpler metric and had used it when issuing the 2012 Grant." *Tornetta*, 310 A.3d at 447. The court's approach might have resulted from trying to "read the tea leaves" of the negotiation posture in order to avoid evaluating what is impossible to value.

²⁰² *Tornetta*, 310 A.3d at 447 footnote 346.

²⁰³ *Id.*

²⁰⁴ Note, further, the committee achieved a clever solution given their inability to value Musk's efforts over time. Musk had made outlandish promises about Tesla's future value that seemed far-fetched at the time of the negotiation, as Tesla neared bankruptcy. So rather than accept those promises as given, the committee embraced a compensation package that was contingent on his promises bearing out. If Tesla did not perform as promised, Musk would receive nothing. But if Musk's vision was achieved, he would be amply rewarded for the shareholders' success.

²⁰⁵ Goshen, *supra* note 21, at 966.

²⁰⁶ *In re Tesla Motors*, 2022 WL 1237185, at *3.

SolarCity was founded by Musk's cousins, and Musk was the chairman of the board and the largest shareholder.²⁰⁷

Musk did not own a majority stake in Tesla, but the plaintiff shareholders argued that he did control both Tesla and SolarCity and therefore the transaction was subject to entire fairness review.²⁰⁸ Tesla did not appoint a special committee to negotiate the acquisition, but it did subject it to a vote by a majority of disinterested shareholders. Rather than resolve the disputed issue of Musk's status as a controller of Tesla and the burden of persuasion under *MFV*, the court went directly to evaluating the transaction under the entire fairness standard.²⁰⁹ As such, the court was required to determine whether the price that Tesla paid for SolarCity was fair.

This valuation task is significantly different than the more common valuation task that courts face in freezeouts or the sale of the company to a third party. This case required the court to determine SolarCity's value to Tesla, including the value of synergies expected to arise from the acquisition. This value in turn depended on Musk's vision for Tesla, which had been set out under a "Master Plan" to "accelerate the world transition to sustainable energy," with SolarCity as a key part of this vision.²¹⁰

Therefore, this example reveals that just as idiosyncratic vision can surface in a compensation decision, it can also appear in an acquisition of a company on the part of the *buyer*. When the buyer assesses the value of a target, the cash-flow those assets are expected to generate plays a role. But in addition to cash-flows, a buyer also considers the contemplated synergies between it and the target, which are expected to increase the value of the combined companies over-and-above what they are worth on their own.²¹¹ Indeed, when reviewing the price paid by the buyer, courts take into account the value of expected synergies.²¹² The ultimate value of these synergies depends on the buyer's vision. A visionary entrepreneur might predict that a target company will play a synergistic role in implementing their vision for the buying company. This in turn will lead the visionary bidder to attach a value to the target company that would be much higher than its value for other bidders. Thus, to determine the value of the company to the buyer

²⁰⁷ *Id.*

²⁰⁸ *Id.* at *27.

²⁰⁹ *Id.*

²¹⁰ *Id.* at *6.

²¹¹ See *In re Tesla*, 298 A.3d at 726 ("[P]otential synergies are often a prime motivator for an acquiring company.")

²¹² See *In re Tesla*, 298 A.3d at 726 ("synergistic values are a relevant input for a court to consider in assessing the entire fairness of an acquisition.")

in that specific transaction, the court will have to confront the value of an entrepreneur's idiosyncratic vision for the combined companies.

As we have shown, neither courts nor the financial experts hired by independent directors have the tools to reliably and objectively ascertain the value of Musk's vision for Tesla and its effect on the expected synergies from the SolarCity acquisition.²¹³ To its credit, the Delaware Chancery Court recognized that it needed to evaluate these synergies in light of Musk's vision for the company and that this task would be exceedingly difficult.²¹⁴ After considering several indications of value—including SolarCity's market value and shareholder approval of the transaction,²¹⁵ the court concluded that the price paid was fair.²¹⁶

Interestingly, the court admitted that, given the difficulty of valuing Musk's vision, hindsight might have played a role in favor of Musk, stating that: "while the synergistic effects of the Acquisition are still unfolding, the astronomic rise in Tesla's stock price post-Acquisition is noteworthy."²¹⁷ In other words, although the relevant inquiry in an entire fairness analysis is whether the acquisition target was worth the price paid when the deal was consummated, the court weighed current facts that suggested that Musk was right about the acquisition. At the time of the trial, Tesla was no longer valued as a car company, but as a "a first-of-its-kind, vertically integrated clean energy company."²¹⁸ Whether the acquisition played a large or small part in Tesla's impressive growth is not clear, but it certainly allowed Tesla to become what it had long told the market it strives to be—an agent of change that will "accelerate the world's transition to sustainable energy" by "help[ing] to expedite the move from a mine-and-burn hydrocarbon economy towards a solar electric economy."²¹⁹

²¹³ As further evidence for this point, consider that the parties presented widely varying views on the fair price of SolarCity—different by over \$2 billion dollars. *Id.* at *39-40.

²¹⁴ *Id.* at 41.

²¹⁵ The court stated that it was unconvinced that "a DCF analysis is the proper method by which to value SolarCity given the facts." *Id.* at *41. The court looked at other evidence, such as Solar City's stock price, the Tesla shareholders' approval of the transaction, and expert reports about the value of the synergies between the companies. *Id.* at *46.

²¹⁶ *Id.*

²¹⁷ *Id.* at *47.

²¹⁸ *Id.*

²¹⁹ *Id.* at *47. In August 2016, when the acquisition was announced, Tesla's stock price was only \$15 a share. The price remained around \$15 a share through September, when the lawsuit was filed. By November 17, 2016, when shareholders approved the transaction, the stock price had dropped to \$12.58 a share. Such a drop in price might suggest that the market estimated that Tesla overpaid for Solar City. But by the time the trial took place in July 2021, Tesla had become a success. The stock price had risen to \$220 a share. When the decision affirming the price was rendered in April 2022, Tesla's stock had reached \$381 a share.

Simply put, Musk was able to convince shareholders that his vision for the company would generate significant growth—a vision that included the acquisition of SolarCity. This belief could not be backed up with hard evidence at the time. Only after several years had passed did it become clear that Musk’s vision would drive above-market returns. And when the court examined the facts at that later date, it concluded that the transaction was fair to Tesla’s minority shareholders.

But what if the court was required to determine the transaction’s fairness on September 2016, when both SolarCity and Tesla appeared to be approaching bankruptcy? As one commentator explained at the time, “Tesla latching on to SolarCity is the equivalent of a shipwrecked man clinging to a piece of driftwood grabbing on to another man without one.”²²⁰ Without a means of valuing vision, the court would have little to guide it—and it could have easily reached the opposite conclusion.

In sum, both *Tornetta* and *In re Tesla* reveal the challenges that courts face when determining the fairness of a transaction that involves idiosyncratic vision. They further demonstrate that although courts are keenly aware of their limits, additional guidance is needed; without it, courts are stuck relying on their own hindsight, comparing the transaction to that of a comparable company, or demanding that negotiators adopt a certain process or style.

Getting this legal framework right is crucially important. Calibrating the legal regime that governs controlling shareholder transactions so that it protects minority shareholders and also preserves incentives for value-increasing transactions is of fundamental importance for economic growth.²²¹ As we have shown, the current framework cannot satisfactorily differentiate between unfair self-dealing and value-increasing transactions in real time. A judicial framework that is so central to Delaware jurisprudence and our economy more broadly must do better. In the next Part, we provide a path forward.

IV. FRAMEWORK FOR JUDICIAL REVIEW AND CLEANSING WHEN VISION IS AT STAKE

The *MFW* framework was designed to avoid the need for judicial review by allowing disinterested shareholders and independent directors to determine whether a proposed transaction is fair. As explained in Part II,²²² the requirements underlying this framework do not accord proper weight to disinterested shareholders’ views and too often lead to the failure of the *MFW* conditions.

²²⁰ Spencer Jakab, *A Double Dose of Risk for Tesla in SolarCity Deal*, WALL STREET J. (Aug. 1, 2016, 11:59 AM), <https://www.wsj.com/articles/a-double-dose-of-risk-for-tesla-in-solarcity-deal-1470067165>.

²²¹ Gilson & Gordon, *supra* note 29; Gilson, *supra* note 29.

²²² See Part I.B., *supra*.

While these flaws affect controller transactions of all stripes, they are especially troubling for those self-dealing transactions, like compensation, that involve the controller's vision.

This Part discusses our proposals to address these challenges. Our modified regime distinguishes between cleansing under *MFW* and entire fairness review when cleansing fails. In Section A, we present our proposed changes to the *MFW* conditions that would better respect the choices of minority shareholders. In Section B, we offer suggestions for courts applying entire fairness review of controller transactions, including those that involve idiosyncratic vision. More specifically, we argue that courts should ascribe different effects to the lack of informed disinterested shareholder vote and the lack of an effective bargaining by a special committee. These changes would allow courts to continue to police controller transactions but would ensure that searching judicial review of the transaction's price would be limited to scenarios where it is most needed.

Before turning to our proposals, we offer a few words about their scope. To begin, we recognize that not all controller transactions will involve idiosyncratic vision. For instance, freezeout transactions—the area in which entire fairness and *MFW* cleansing emerged—or the sale of the company to a third party typically do not involve vision. However, we do not offer a legal test that would separate self-dealing transactions that involve vision from those that do not. And that is because our proposals to refine and improve the *MFW* framework apply to all self-dealing transactions. While the valuation issues that we identify are especially troublesome for transactions involving vision, these shortcomings affect other types of self-dealing transactions as well. Our proposals, therefore, would improve the regulation of all types of self-dealing transactions without the need for courts to apply different regimes to different transactions. The Sections that follow describe our proposals in detail.

A. Adapting the MFW Framework

This Section describes our proposed changes to the *MFW* framework, which as we have shown, has become too prone to failure. First, we suggest that disclosure deficiencies concerning the special committee process should not undermine the cleansing effect of the shareholder vote. Second, we suggest that courts adopt a *Corwin*-style rule to incentivize companies to disclose information concerning the special committee and its bargaining process.

i. The Majority of Minority Condition Should Not Depend on Special Committee Disclosure

As we explained above, the *MFW* framework has evolved to discredit the vote of disinterested shareholders even when they receive full disclosure of the transaction’s financial terms. Courts have held that information about the special committee process (including director independence, the bargaining process, and potential conflicts of the committee’s advisors) not only count as “material information” required to be disclosed to shareholders, but also lead to the failure of the majority of minority shareholder vote condition when they are not disclosed. Consequently, a failure of the special committee often leads to a failure of the shareholder vote as well.²²³

Our first proposal is that courts should not deny the cleansing power of the shareholder vote based on a company’s failure to disclose information about the special committee process. Specifically, under our proposal, so long as the shareholders are informed about the material terms of the transaction, the majority-of-minority *MFW* condition would be satisfied. Any failure to disclose information about the bargaining process or the independence of the directors should not be a reason to discredit the shareholder vote, so long as the financial terms were properly disclosed to the shareholders.²²⁴ And if the transaction was also properly negotiated by a special committee, the court should apply the deferential business judgment standard of review.

Our proposal offers several advantages. First, it respects the independent nature of *MFW*’s dual cleansing mechanisms in a way that is consistent with the rationale underlying Delaware caselaw. Disinterested shareholder approval based on all material information concerning the economic terms of the transaction is an important indication of fairness. Consider, for example, a controller that, from the outset, decides to subject a self-dealing transaction to a vote by disinterested shareholders but does not use a special committee to negotiate the transaction. Under both pre-*MFW* case law and *MFW*, this approval would shift the burden to the plaintiff to prove that the transaction was unfair.

The *MFW* framework was designed to encourage controllers to combine this cleansing mechanism with the use of a special committee. And the failure of the special committee (including failure to disclose information about the special committee) should not mean that the other cleansing mechanism—the disinterested shareholder vote—should also be disregarded.

²²³ The failure of the special committee would not lead to a failure of the shareholder vote requirement if the deficiencies in the special committee’s process were disclosed to shareholders.

²²⁴ Of course, falsehoods in the proxy would be subject to liability under securities provisions that prohibit fraud in proxy statements. 17 C.F.R. § 240.14a-9.

The existing regime leads to another problematic outcome. The bar for a direct challenge of the special committee's process is high and can only be done if the board acts with gross negligence.²²⁵ Therefore, litigants and courts may be attempting to improve the special committee process via the shareholder disclosure requirement. Under the current regime, courts could find that the special committee acted adequately (i.e., was not grossly negligent), but that the shareholder vote was undermined due to incomplete disclosure about the committee's process, all presumably with the goal of pushing the committee to do better. But if the goal is to hold special committees to a higher standard, then a better approach would be to alter the standard for the special committee condition under *MFW* directly, so that a committee with weak procedural safeguards does not satisfy *MFW*.

A second advantage of our proposal is that it recognizes that the shareholder vote is the critical lodestar for fairness when idiosyncratic vision is at stake. As the previous Part revealed, the inability to value vision complicates the special committee's job; it also renders the court's review of the committee process challenging as well. But unlike independent directors or courts, shareholders' competence to determine the value of vision does not depend on the availability of an objective valuation model. The main driver of the minority shareholders' willingness to approve the proposed transaction is their subjective assessment of the controller's idiosyncratic vision.²²⁶ Of course, the shareholders might be wrong, just as any party to a transaction might be wrong about its profitability. But investors who stand to gain or lose from the transaction are the most suitable party to make that decision.²²⁷

Therefore, the voting process aggregates the individual subjective valuations of the shareholders and indicates whether investors believe that the controller's vision justifies the proposed price. As such, it acts as a referendum on vision. Consider how, with regard to Musk's

²²⁵ *In re MFW*, 67 A.3d at 530 (discussing the special committee's obligation to act with due care).

²²⁶ Indeed, this is why entrepreneurs may insist on retaining control over the corporation. See Goshen, *supra* note 19.

²²⁷ What about the fact that institutional shareholders approving the transaction may have conflicts of interest that lead them to vote in favor of the transaction? See James D. Cox, Tomas J. Mondino & Randall S. Thomas, *Understanding the (Ir)relevance of Shareholder Votes on M&A Deals*, 69 DUKE L.J. 503 (2019) ("Ratification voting frequently suffers from conflicts of interest. When this happens in a merger, the shareholders voting—often large institutional investors—may not be voting to maximize the value of the target firm but rather to further some other interest."). We agree that pronounced conflicts of interest may be a reason to discredit the disinterestedness of the vote, as the plaintiffs in the SolarCity litigation argued. *In re Tesla Motors, Inc. Stockholder Litig.*, 2018 WL 1560293, at *26 n.183 (highlighting the argument that because institutional shareholders held stock of the buyer and the target, they no longer qualified as disinterested, and predicting that this argument would resurface); see also Sean J. Griffith & Dorothy S. Lund, *Conflicted Mutual Fund Voting in Corporate Law*, 99 B.U. L. REV. 1151 (2019) (arguing that judges should consider whether conflicted mutual fund votes qualify as disinterested).

pay package, leading proxy advisors ISS and Glass Lewis recommended that shareholders vote against it, likely utilizing conventional valuations to conclude Musk's leadership was not worth the \$55.8 billion he was eligible to receive.²²⁸ But Tesla's shareholders made a different call. They bet on Musk generating the returns that would benefit not only him but all shareholders. This is a bet that paid off handsomely.

A third advantage of our proposal is that it recognizes that when shareholders vote to embrace or reject a transaction, information about the special committee process and the independence of its members is relevant but unlikely to change a shareholder's decision for two reasons. First, the shareholders understand that the controller has the ability to appoint and fire the independent directors.²²⁹ The conflict is therefore already front and center, and shareholders will properly assume that even an independent committee could have left money on the table and evaluate the deal accordingly.²³⁰

Second, when the self-dealing transaction is intertwined with the controller's vision, it is unlikely that shareholders give much weight to the special committee's process when deciding whether to accept the controller's vision. As evidence for this view, consider again the decision of disinterested shareholders in *Tornetta* to approve Musk's outsized compensation package. This vote indicated that shareholders believed that Musk's unique vision and its significant contribution to Tesla's value justified the proposed compensation. How likely is it that (more) information about the flaws in the bargaining process would have changed their assessment of Musk's vision? The fact that Tesla shareholders again approved the package by a wide margin in a June 2024 vote indicates that the court-identified flaws did not affect their view of the fairness of the pay.²³¹

A final but crucial advantage of our proposal is that would require courts to engage in valuation less often. Delaware courts embraced the *MFW* framework in large part because it allowed them to avoid judicial valuation when disinterested parties had approved the transaction. And yet, as Part I.B. revealed, the existing *MFW* regime causes the shareholder vote (and therefore,

²²⁸ *Tornetta*, 310 A.3d at 489.

²²⁹ This influence explains why courts do not give full cleansing power to the special committee's approval of a controller transaction. See Match.

²³⁰ But see Ryan Bubb, Emiliano Catan, and Holger Spamann (using a model to show that the controller's ability to make take it or leave it offers can lead to suboptimal outcomes for shareholders who only have the right to vote).

²³¹ Hyunjoo Jin, Ross Kerber & Akash Sriram, *Elon Musk wins Tesla shareholder approval for \$56 billion pay package*, REUTERS (Jun. 14, 2024), <https://www.reuters.com/business/autos-transportation/musk-says-both-tesla-shareholder-resolutions-passing-by-wide-margins-2024-06-13/>.

the *MFW* cleansing test) to fail more often than it should, therefore subjecting more self-dealing transactions to judicial valuation than was initially intended.

All in all, adjusting the *MFW* framework in this way would give the proper weight to the views of disinterested shareholders who have accepted a transaction's terms. Moreover, it would better respect the *MFW* framework, which was intended to offer two independent cleansing mechanisms to transactional planners. Any process deficiencies that fall below the standard of care for special committee negotiations could be challenged directly. And if the committee failed to employ independent decisionmakers or a rigorous process, their approval would not have any cleansing effect, and the court could reflect on these deficiencies in the entire fairness analysis. However, these failures should not also invalidate the shareholder vote. And by safeguarding the *MFW* framework, transactional planners would be able to avoid judicial review of entrepreneurial vision more often.

ii. Disclosure About the Special Committee

One concern with our proposal is that it might disincentivize companies to disclose information about the bargaining process and the special committee composition to shareholders. Our second proposal addresses this concern by calling on courts to adopt a *Corwin*-style rule that would encourage companies to provide full disclosure about the special committee process, including its flaws.

Although we are skeptical that disclosure of process deficiencies would likely change a voting outcome, especially for transactions involving vision, this type of disclosure might serve valuable purposes. For one, it could improve the negotiation process *ex ante*—when flaws are required to be disclosed, they are less likely to occur. Perhaps most importantly, full information about the special committee process aids shareholders who wish to challenge a transaction in court. Finally, in some cases, disclosure about flaws in the negotiation process might alert shareholders to concerns about the transaction's economic terms.²³²

For some transactions, other bodies of law that mandate disclosure within conflict transactions ameliorate some of these concerns. For example, the judicial review of freezeout

²³² One might argue that, for some shareholders, a rigorous bargaining process might provide a reason to support a self-dealing transaction. For these shareholders, the lack of disclosure about the special committee's process would provide a reason not to support a transaction. This in turn would incentivize companies to disclose information about the special committee even under our modified framework. As we explain below, misleading or incomplete disclosure would allow aggrieved shareholders to challenge the special committee *MFW* condition.

transactions occurs within the framework of extensive disclosure requirements mandated by the SEC: Rule 13e-3 requires companies to disclose comprehensive details about going private-transactions, including not only the economic terms and fairness of the proposed merger but also the negotiation process leading to it.²³³ In contrast, the SEC disclosure requirements for other related-party transactions are far less demanding. Companies are required to disclose information retrospectively, in their periodic reports, about certain material transactions in which insiders have a “direct or indirect” material interest, as well as their policies for approving these transactions.²³⁴ Companies are not required, however, to disclose information about the process leading to the transaction.

We believe that the SEC disclosure rules should be modified to require more disclosure of related-party transactions and the process underlying them.²³⁵ The existing and relatively lax disclosure environment complicates the efforts of plaintiffs to challenge related party transactions effectively.²³⁶

And yet, the disparity in disclosure requirements also highlights the role of state corporate law in incentivizing disclosure to protect shareholders in self-dealing transactions that are not going private transactions. As such, we propose that Delaware adopt a *Corwin*-style rule that would incentivize companies to provide full disclosure about the special committee process, including its flaws.²³⁷

Recall that our modified regime calls for courts to align the requirement for an effective special committee under *MFW* with the disclosure requirements concerning the committee.

²³³ See 17 C.F.R. § 240.13e-3 (2024); Warren S. de Wied, Philip Richter, & Robert C. Schwenke, *Going Private Transactions*, HARV. L. SCH. CORP. GOV. BLOG (April 18, 2020) <https://corpgov.law.harvard.edu/2020/04/18/going-private-transactions/>; *Going Private Transactions, Exchange Act Rule 13e-3 and Schedule 13E-3*, SEC (Jan. 26, 2009), <https://www.sec.gov/divisions/corpfin/guidance/13e-3-interps.htm#:~:text=Rule%2013e%2D3%20requires%20that,holders%20of%20the%20class%20of.>

²³⁴ See 17 C.F.R. § 229.404(a) (2019).

²³⁵ See Geeyoung Min, *The SEC and the Courts' Cooperative Policing of Related Party Transactions*, 3 COLUM. BUS. L. REV. 663 (2014) (arguing that the existing disclosure regime offers inadequate protection to public investors).

²³⁶ See Itai Fiegenbaum, *The Controlling Shareholder Enforcement Gap*, 56 AM. BUS. L.J. 583, 621–22 (2019) (arguing that this “required disclosures will not necessarily provide an adequate information base” that would plaintiffs to challenge abusive related party transactions).

²³⁷ Under *Corwin*, the heightened scrutiny under the *Revlon* standard is primarily designed to give shareholders a tool of injunctive relief. However, after a deal closes, post-closing claims for damages will be subject to the business judgment rule—and not *Revlon*--if the transaction was approved by an informed, uncoerced shareholder vote. *Corwin*, 125 A.3d. at 312; *Chester County Retirement System v. Collins*, No. 12072-VCL, 2016 WL 7117924, at *2 (Del.Ch. 2016) “[W]hen a transaction has been approved by a majority of the disinterested stockholders in a fully informed and uncoerced vote, the business judgment rule applies and insulates the transaction from all attacks other than on the grounds of waste.” See also Franklin A. Gevurtz, *The Shareholder Approval Conundrum*, 60 B.C. L. Rev. 1831, 1860-1863 (2019).

Accordingly, under our modified regime, full disclosure concerning the committee process would play an important role in enabling the company to satisfy the special committee condition under *MFW*. Under our proposal, before the shareholder vote takes place, shareholders could sue and ask for more disclosure about the special committee’s process or enjoin the vote if there is inadequate disclosure about the special committee or if the available disclosure indicates a failure to conduct a proper special committee process. But if the company fully discloses information about the composition of the committee and the process that it used, and the disinterested shareholders then vote to approve the transaction based on this disclosure, then this vote should insulate the transaction from post-closing claims for money damages to the extent they challenge the cleansing effect of the special committee process.²³⁸

This rule offers several advantages. First, it would encourage companies to fully and accurately disclose information about the committee and its process to shareholders. Shareholder approval of the transaction based on full disclosure of all material information about the special committee would virtually eliminate the risk that courts would determine that the special committee condition under *MFW* was not satisfied. By contrast, if the disclosure is inaccurate, incomplete or misleading, the special committee process would not be protected from later challenges.²³⁹ Most important, deficient disclosure concerning the special committee process

²³⁸ One criticism of *Corwin* is that the vote to approve the transaction could be “coerced” when it bundles a positive-value resolution such as a merger with a negative-value item—absolving managers of failing to secure a better transaction. See James D. Cox, Tomas J. Mondino & Randall S. Thomas, Understanding the (Ir)relevance of Shareholder Votes on M&A Deals, 69 DUKE L.J. 503, 542 (2019); Franklin A. Gevurtz, The Shareholder Approval Conundrum, 60 B.C. L. REV. 1831 (2019). We address this argument more completely in another working paper, but for now, we simply highlight that with *Corwin*, Delaware courts determined that deference to the shareholder vote was best option, despite imperfections. Consider the alternative—if shareholders could challenge a transaction that was approved after the fact, it would tax transacting parties who could never avoid litigation—even when the shareholders in question determined the transaction was “on net, beneficial.” *Sciabacucchi v. Liberty Broadband Corp.*, No. 11418-VCG, 2017 WL 2352152 (Del. Ch. May 31, 2017). Likewise, we believe the advantages that come from encouraging the disclosure of all material details involving the special committee process and the financial terms of the transaction outweigh any concerns about coercion. This is especially true given the increasing sophistication of institutional shareholders. The prototypical shareholder is no longer a rationally apathetic individual but an institutional shareholder like a hedge fund. If that hedge fund believes that the transaction is unfair, it can lobby other investors to vote no or engage with management. See, e.g., <https://corpgov.law.harvard.edu/2024/05/06/ma-developments-hedge-fund-activism/> (In 2024, “activists have worked to block proposed M&A transactions, mostly on the target side but sometimes also on the acquiror side, with the goal of either sweetening or scuttling the transaction”). The presence of these engaged and vocal shareholders mitigates concerns about coercion.

²³⁹ It is unclear whether the rule would encourage plaintiffs to file challenges to the disclosure or the special committee’s process before the transaction closes or shareholder vote takes place. On the one hand, if the company provides full disclosure and a majority of minority shareholders voted to approve the transaction, plaintiffs will be effectively blocked from challenging the transaction. On the other hand, plaintiffs aware of disclosure flaws might wait for the transaction to close before filing a claim for damages. See Franklin A. Gevurtz, *The Shareholder Approval Conundrum*, 60 B.C.L. Rev. 1831, 1864 (2019).

would deny defendants one of the most important advantages of the *MFW* framework—the ability to avoid trial by having courts dismiss the lawsuit challenging the transaction.²⁴⁰ Therefore, the company would be highly encouraged to supply information that is comprehensive and accurate. This likely effect is especially important if the SEC does not modify the disclosure regime concerning related party transactions.

Second, our proposal creates a better alignment between the disclosure regime and the logic underlying the *MFW* framework. Disclosure about a transaction’s economic terms is critical for shareholders’ ability to determine whether the proposed transaction is beneficial. When shareholders vote to approve a transaction with incomplete or misleading information about its financial terms, their vote is not indicative of the transaction’s fairness. Accordingly, the majority-of-minority cleansing condition cannot be satisfied with deficient disclosure concerning financial terms.²⁴¹ Information about the special committee process, on the other hand, may be important, but for a different purpose, as explained above. Therefore, our proposed regime would encourage such disclosure to be made, with any inaccuracies or deficiencies rendering the company and the controller open to challenges about the special committee’s process, but not leading to the full invalidation of the shareholder vote.

In sum, our two proposals give independent weight to each cleansing mechanism while preserving incentives for companies to disclose information about the special committee process. Therefore, our regime would amply protect minority shareholders without subjecting controller transactions to judicial valuation unless absolutely necessary.

B. Adapting Entire Fairness Review

Under our proposed framework, entire fairness review would remain necessary if one the *MFW* conditions is not met. Without the threat of entire fairness review, controllers would have little incentive to subject self-dealing transactions to the procedures that benefit the company and its minority shareholders. This presents a quandary when defendants try to defend a transaction’s fairness by reference to the controller’s vision and unique contributions—how can courts

²⁴⁰ See *In re MFW*, 67 A.3d at 533-534. At the same time, our proposal allows defendants to secure business judgment review even if there were flaws in the special committee process, as long as these flaws were fully disclosed to shareholders.

²⁴¹ See Ryan Bubb, Emiliano Catan, and Holger Spamann, *Shareholder Rights and the Bargaining Structure in Control* (August 18, 2024). European Corporate Governance Institute - Law Working Paper No. 798/2024, Available at SSRN: <https://ssrn.com/abstract=4929197> (showing that an informed shareholder vote is sufficient for ensuring that (merger) transactions increase shareholder value).

implement entire fairness review when they are poorly positioned to engage in valuation of idiosyncratic vision (and to review the valuation efforts of others)?

The entire fairness standard and its emphasis on fair price and fair process offers little guidance, as Part III described. Thus, we offer guidance for courts that are required to review controller transactions that raise the valuation challenges presented above. Our guidance is grounded in the *MFW* framework and our analysis of the proper role of shareholders, independent directors, and courts in evaluating the controller's vision.

The existing *MFW* regime views the two cleansing mechanisms—special committee negotiation and the majority of the minority shareholder vote—as functionally equivalent. Each mechanism by itself can shift the burden of persuasion to the plaintiff. Our proposal, in contrast, argues that courts should treat each cleansing device differently based on its effectiveness in valuing controllers' vision.

We start with a transaction that has not been cleansed under *MFW*—i.e., a transaction that has not been embraced by an informed vote of disinterested shareholders or negotiated by a special committee. Assume that, as in *Tornetta*, the defendants argue that the transaction is fair based on the controller's vision and its expected contribution to the company's value. In other words, the defendants argue that the fairness of transaction should not be determined based on conventional valuation models. How should courts address these claims?

When reviewing this transaction, the court has no indication that an independent decisionmaker has accepted the entrepreneur's idiosyncratic vision or determined its value for the company in the context of the transaction. Therefore, the burden should be on the defendant to show that the price was appropriate relative to the *average asset's value*. Here, typical valuation techniques that depend on comparable benchmarks or companies would help the court arrive at its answer; claims about the controller having an idiosyncratic vision or any other special traits that drive above-average value would generally be disregarded.

By contrast, when the transaction has been cleansed by a single mechanism, the analysis would change. And here, we argue, the choice of the mechanism should matter. Consider first a conflicted controller transaction that is negotiated by a special committee but has not been approved by the disinterested shareholders.²⁴² Under *MFW*, the approval of the special committee will shift the burden from the controller to the plaintiff to show that the price was unfair. Imagine

²⁴² Or has been approved by shareholders based on inadequate disclosure concerning the transaction's economic terms.

that the defendants continue to argue that the transaction is fair because it reflects the value of the controller's vision, which cannot be determined based on acceptable valuation methods or reference to comparable transactions. Independent directors, however, suffer from the same valuation difficulties as courts—they lack an objective method for determining the value of the controller's vision. Further, Delaware law is skeptical that even purportedly independent directors at controlled companies will discharge their duties to the minority shareholders fairly.²⁴³ This is so for routine compensation decisions, as well as fundamental transactions like squeeze outs.²⁴⁴ As such, a lingering concern remains about the special committee's approval process: did the committee truly embrace the controller's vision and the price, or were they swayed by the controller's outsized influence over the company and the board?

Without the vote of the disinterested shareholders approving the transaction, these lingering concerns remain unaddressed. Thus, we believe that courts should give little weight, if at all, to defendants' claim that an effective special committee process, standing alone, is a strong indication of the value of the controller's vision. To meet their burden, we believe that the plaintiff should be permitted to provide evidence about the average value of similar transactions. As a result, courts should generally disregard claims about the controller having an idiosyncratic vision or any other special traits that render acceptable valuation methodologies irrelevant.

Now consider a self-dealing transaction that was negotiated by non-independent directors but is conditioned on disinterested shareholder approval. Assume that the shareholders approve the deal after receiving full disclosure of its financial terms. Once again, under the *MFW* framework, the standard of review is entire fairness, with the burden of persuasion on the plaintiffs. In this scenario, when confronting the defendant's claim that the transaction reflected the value of the controller's vision, the court has evidence that disinterested parties with a stake in the outcome have embraced that vision and its value. The shareholders may err in their valuation, but aggregating their subjective valuations is surely a better measure of the fairness of the transaction and its terms than an approval by independent directors.²⁴⁵ With such a referendum on the value

²⁴³ See *Tornetta v. Musk*, 250 A.3d 793, 800; *In re Match*, 315 A.3d 446, 468.

²⁴⁴ *In re Match*, 315 A.3d. 446, 468.

²⁴⁵ Other concerns might prevent courts from giving significant cleansing power to disinterested shareholder vote. One of the *MFW* requirements, for example, is that the vote was not coerced. See *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635, 644. See also *In re Dell Techs. Inc. Class V S'holders Litig.*, No. CV 2018-0816-JTL, 2020 WL 3096748, at *20 (Del. Ch. June 11, 2020) (finding that the complaint "supports a reasonable inference that the Company engaged in coercive conduct that undermined the effectiveness of the Special Committee and the legitimacy of the [shareholder] vote.") We intend to discuss this requirement in future work.

of vision, we propose that the court give little evidentiary weight to competitive benchmarks or other evidence of average values and greater weight to the shareholder vote.

In each of these scenarios, the court should avoid a per se rule condemning collaborative negotiations as evidence of unfairness. As discussed in Part II.B., negotiations can take many forms, ranging from adversarial to collaborative.²⁴⁶ Likewise, the outcome—the dollar value of the transaction, and whether the transaction benefitted or harmed the corporation—should not color the process inquiry. Rather than focusing on these parameters, the court should instead seek out other indicia of fairness, such as whether the key negotiating parties attempted to bargain at arm’s length with the controller and whether they excised care in their deliberations.

We now return to the facts of *Tornetta* to show how our analytical framework would better guide the court’s decision-making process. The first change goes to the application of *MFW*. Recall that the compensation committee in charge of negotiating Musk’s pay was not independent, but the transaction was approved by the disinterested shareholders that were fully privy to the important financial details.²⁴⁷ Therefore, under our framework, the burden would lie with the plaintiffs to prove that the transaction was unfair to the minority shareholders.

Now consider how Musk’s compensation package would have fared under our modified entire fairness framework. As for process, the lack of an adversarial negotiation would not be dispositive. Instead, the court would ask whether the negotiating parties exercised care—*i.e.*, were they informed about the relevant details and did they think them through? The court would also look for other evidence that suggested a fair and robust process, including analyzing the timing and initiation of the transaction.²⁴⁸ Importantly, the court would refrain from judging the process based on the price that was achieved, which is a separate inquiry.

Applying this modified standard to *Tornetta* leads to a different result. Of course, the process was far from perfect: The court found that many of the directors on the special negotiating committee had ties to Musk; that Musk dictated the timing of the negotiations; and that the board did not appear to consider alternatives. This evidence was enough to establish that the first cleansing mechanism—an independent special committee negotiation—failed. But should this evidence also be enough to convince the court that the transaction was unfair to the minority

²⁴⁶ See *supra* note 165.

²⁴⁷ *Tornetta*, 310 A.3d at 490.

²⁴⁸ These factors are part of the existing fair process review framework. See *In re Tesla Motors, Inc. S'holder Litig.*, 298 A.3d 667, 700 (Del. 2023) (citing *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983)).

shareholders? Recall that the committee was informed about the package’s terms and spent many meetings evaluating them, with the help of outside advisors. The transaction’s timing was initiated by the board, who stood by their conclusion that the package was the best way to motivate and retain Musk.²⁴⁹ These facts suggest that the board did not act with gross negligence in approving the transaction. Moreover, the lack of adversarial negotiations should have been irrelevant to the court’s analysis; indeed, the collaborative negotiation approach may have allowed the board to secure more effort from Musk for the same price.

Moreover, our proposed regime would encourage Tesla to provide investors with disclosure about the independence of the compensation committee and its process.²⁵⁰ With our *Corwin*-style rule in place, Tesla would have wanted to disclose all information, including flaws, about the special committee process, as doing so would have protected it from post-closing challenges about the committee’s effectiveness. Even better, Tesla might have been encouraged to improve the special committee process—doing so would not only give the special committee negotiation cleansing effect but would also avoid the need to disclose deficiencies to the shareholders. In either case, such disclosure would prompt plaintiffs to file any suit challenging the committee quickly, seeking an injunction that would allow the committee to rectify the flaws.

Finally, as for price, recall that under our modified framework, the court will give little evidentiary weight to competitive benchmarks or other evidence of average values in light of the shareholder vote, which serves as a powerful referendum on price. Therefore, the court might have concluded that the shareholder referendum on vision after full disclosure of the financial terms of the transaction would have been a strong indication of the fairness of the price.

As this hypothetical analysis reveals, our proposed framework drastically simplifies entire fairness review for courts. In particular, our alterations to the *MFW* framework respect the independent nature of each cleansing mechanism and ensure that judicial review of visionary controller transactions will only occur when necessary. Moreover, our framework better guides the court’s review of transactions in light of the difficulties they face in valuing vision. All in all, our

²⁴⁹ See Ann Lipton, *The Bill Comes Due*, <https://blogs.law.ox.ac.uk/oblb/blog-post/2024/02/bill-comes-due> (“What motivates [Musk] psychologically isn’t (just) the money, but things he views as outrageous challenges. Maybe by gameifying his compensation package—presenting him with impossible goals and then, when he met them, ringing bells and showering confetti and gold coins—the board really *did* extract maximum performance.”).

²⁵⁰ To illustrate how our proposed framework could work, we assume that the court would consider whether *MFW* cleansing applies. As explained above, however, the *Tornetta* decision focused only on the cleansing effect of the shareholder vote.

proposed framework would advance two of Delaware's chief goals: protecting minority shareholders from controlling shareholder self-dealing and also supporting visionary entrepreneurs who use the corporate form to execute visionary ideas.

V. CONCLUSION

Using litigation over Elon Musk's \$55.8 billion compensation package as a case study, we reveal the challenges courts face when evaluating the fairness of controller transactions that involve an entrepreneur's idiosyncratic vision. We argue that traditional valuation methods cannot accurately estimate the value of vision, as they rely heavily on common market practices and observable metrics that fail to capture the potential impact of innovative ideas. And this inability to establish the value of idiosyncratic vision undermines the effectiveness of entire fairness review designed to prevent unfair self-dealing, potentially penalizing beneficial transactions.

To address these challenges, we propose several reforms that would improve the regulation of controller transactions of all types. We advocate for placing greater emphasis on shareholder votes when shareholders are fully informed about the transaction's financial terms. This adjustment would cause the *MFW* framework, which takes the valuation issue out of the hands of the court, to fail less often, offering deal planners the protection of the business judgment rule whenever there is confidence that the key decisionmakers have embraced the vision behind the transaction as well as its financial terms.

We also propose reforms to court's application of the entire fairness standard of review that better reflect the court's advantages. When shareholders have voted in favor of vision, the defendants would receive a burden shift, and the court would not consider evidence about average asset value or common market practices. If the controller transaction received only the approval of the special committee, this approval would shift the burden to the plaintiffs, who could attempt to prove unfairness based on market practices and other acceptable valuation methods.

Our proposed judicial framework balances the protection of minority shareholders with the desire to promote entrepreneurial idiosyncratic vision. It would reduce the frequency in which courts are forced to value vision and provide guardrails on their analysis when they do. Ultimately, our framework would lead to a more effective and equitable system that acknowledges the unique contributions of visionary leaders while protecting the interests of minority shareholders, fostering an environment that is conducive to innovative business leadership.

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