Abstract

Rapid technological changes and the rise of winner-take-all markets have increased demand for larger-than-life corporate leaders, who can move swiftly and disrupt entrenched players. These CEOS have—or so investors believe—the vision, superior leadership, or other exceptional qualities that make them uniquely valuable to their corporation. While the business press, management experts, and financial economists have long studied the phenomena of “superstar” CEOs, the legal literature has largely overlooked it. This Article fills this gap, providing the first comprehensive theory of superstar CEOs and exploring the challenges they pose for corporate law.

We show that, even in the present era of increasingly powerful shareholders, superstar CEOs have significant power over boards of directors. The power of superstar CEOs arises not from their formal influence over director nomination, or shareholders’ rational apathy, or directors’ agency costs. Rather, it is based on the widespread belief that these CEOs, and only these particular CEOs, have what it takes to produce superior returns for shareholders. Consequently, superstar CEOs’ power is actually fragile and limited, and is likely to vanish when markets lose faith in their star qualities. Consequently superstar power cannot be abused in a way that causes harm to the company that exceeds the value of the CEO’s unique contribution. This theory, we show, explains Elon Musk’s continuous entanglement with Delaware courts, board failure at Uber and WeWork, the rise of dual-class shares, the *Caremark* doctrine, and the puzzling jurisprudence regarding management buyouts. It also cautions against reliance on existing governance arrangements to induce companies advance stakeholder interests.

# Introduction

Elon Musk is a visionary, leading Tesla in its radical disruption of the car industry to become the world’s most valuable car manufacturer.[[1]](#footnote-2) He has also repeatedly pushed the boundaries of corporate law. Musk is currently the direct target of two derivative lawsuits and the subject of a third one. One lawsuit attacks Tesla’s 2016 acquisition of SolarCity—a public company in which Musk and his brother were the largest shareholders.[[2]](#footnote-3) Another suit challenges Musk’s unprecedented pay arrangement which, according to some estimates, could potentially provide him with up to $56 billion.[[3]](#footnote-4) The third lawsuit accuses Tesla’s directors of abdicating their responsibility to monitor Musk’s use of his Twitter account, which prompted the SEC to intervene.[[4]](#footnote-5)

Musk’s entanglement with Delaware courts presents several paradoxes to corporate law scholars. The first is that his status as a visionary whose leadership is critical for Tesla’s phenomenal success has been used by courts *against* Musk. Whereas Delaware courts are known for quickly dismissing lawsuits challenging executive pay and other business decisions, the Chancery Court declined to dismiss the two lawsuits against Musk.[[5]](#footnote-6) One of the reasons for this outcome was Tesla’s dependence on Musk’s leadership. In the context of corporate law doctrine, this fact led the court to hold that Musk *controls* Tesla, thereby subjecting his transactions with the company to close judicial scrutiny under the entire fairness standard.[[6]](#footnote-7)

Second, although investors could be expected to resist a CEO who is the target of multiple lawsuits for self-dealing, Musk nonetheless continues to enjoy broad support from Tesla shareholders. Having faced reelection to the board twice since Tesla went public, in 2017 and 2020, he was approved for reappointment as CEO each time by extremely high margins (97% of the votes cast).[[7]](#footnote-8) Moreover, the transactions underlying the lawsuits against Musk were submitted to a shareholder vote by Tesla and were approved by a majority of disinterested shareholders.[[8]](#footnote-9) Musk’s exceptionally generous compensation arrangement, for example, was supported by 73% of Tesla shareholders unaffiliated with management.[[9]](#footnote-10)

The last paradox concerns the failure of Tesla’s board to control Musk’s Twitter use. While in the past, directors were described as lacking the motivation to resist CEOs, legal reforms and market developments over the last two decades have empowered shareholders to discipline directors who are perceived as too deferential to management.[[10]](#footnote-11) In fact, this rise of shareholder power and its effect on directors’ accountability has led Zohar Goshen and Sharon Hannes to argue that corporate law is dead.[[11]](#footnote-12) Tesla, however, is not the only example of board failure to control CEO misconduct. Boards have failed to control CEO wrongdoing even in private companies with powerful and sophisticated investors, such as Uber and WeWork.[[12]](#footnote-13)

These paradoxes, we argue, are typical of a phenomenon long recognized by the business press, management experts, and financial economists, but largely overlooked by corporate law scholars[[13]](#footnote-14)—the “Superstar CEO.” Some chief executive officers have—or investors believe they have—the vision, superior leadership, or other exceptional qualities that make then uniquely valuable to their corporations. Elon Musk is perhaps the most famous example, but other names include Jeff Bezos (Amazon), Jamie Dimon (J.P. Morgan), Reed Hastings (Netflix) and even John Schnatter (Papa John).[[14]](#footnote-15)

Superstar CEOs pose significant challenges to corporate law and governance. We show that, even in the era of increasingly powerful shareholders, superstar CEOs’ unique contribution to company value accords them significant power over boards of directors. This power, however, depends on investors’ continuing belief in the CEOs’ ability to produce above-market returns. In this Article, we develop the first account of the nature of superstar CEO power and explore its implications for corporate law.

In the past, the combination of shareholder passivity and CEOs’ formal influence over directors nominations made all CEOs quite powerful. Today, however, legal reforms limit CEO involvement in director elections, large institutional investors are more engaged, and activist hedge funds do not hesitate to challenge directors who fail to protect shareholder interests. These changes have significantly increased directors’ capacity to exercise oversight over CEOs.[[15]](#footnote-16)

Even directors who are faithful agents of shareholders, however, might struggle to fulfil their oversight duties when the CEO is believed to have star qualities. How effective can directors be in questioning the CEO’s proposed strategy when markets believe that the CEO’s singular vision is what makes the company succeed? And how likely are directors to take harsh measures in response to the misconduct of a CEO who is commonly viewed as critical to the company’s success?

It would appear then, that, contrary to the view that corporate law is dead, superstar CEOs’ power calls for legal intervention to protect investors. Indeed, the fact that boards have only limited ability to contain superstar CEOs might explain the link the Delaware Chancery Court found between Musk’s unique contribution to Tesla and his legal status as the company’s controller. We argue, however, that the power held by superstar CEOs is limited, thereby making the case for legal intervention a more complex one.

First, in the era of active and engaged shareholders, superstar CEOs’ power does not arise from their formal influence over director nomination, shareholders’ rational apathy, or directors’ agency costs. Rather, superstar CEOs derive their power from shareholders’ widespread belief that these CEOs, and only these CEOs, have what it takes to produce superior returns for shareholders. This makes superstar CEOs’ power fragile, as it is likely to vanish when markets lose faith in their ability to outperform. Second, superstar CEOs’ power is limited in magnitude; boards can discipline superstar CEOs or even terminate their employment if their harm to the company value exceeds their expected contribution.

Our account leads to novel insights into the corporate governance of firms with superstar CEOS. We can use these insights to explain board failure at startup companies, the rise of dual-class IPOs, and investors’ limited ability to press companies to protect stakeholders.

First, board failure to control managers is not necessarily the result of directors’ incentives not being aligned with those of shareholders. Even truly independent directors who are genuinely committed to shareholders might be limited in their ability to stand up to superstar CEOs. Thus, contrary to the prevailing view, enhancing director independence might not improve their performance in exercising oversight over CEOs.

Second, regardless of their degree of sophistication and power, shareholders themselves might fail to contain superstar CEOs. As the Tesla and Netflix examples that we discuss below demonstrate, as long as the CEO is viewed as a superstar, shareholders are likely to tolerate practices that would be met with fierce resistance if other CEOs were to engage in them.[[16]](#footnote-17) The tendency of shareholders to defer to superstar CEOs explains, for example, why Elon Musk continues to enjoy overwhelming shareholder support, notwithstanding the many allegations against him.[[17]](#footnote-18)

This analysis sheds new light on a dilemma that has thus far eluded an answer from governance scholars: why do directors tend to turn a blind eye to a CEO’s unlawful conduct that is not likely to benefit the corporation (such as self-dealing, drug use, or even discriminatory workplace practices) even at startups, which have powerful, sophisticated investors? We show that directors and investors might hesitate to discipline superstar CEOs because they fear that losing them will have dire consequences for the company.

We also offer nuanced insights into the controversial use of dual-class structures that enable company founders to retain control by holding shares with superior voting rights.[[18]](#footnote-19) We show that founders need this governance structure for the time when the market loses faith in their star qualities and investors might want to change the company’s leadership. But why would investors agree to such a system at the outset? Under our framework, founders’ early-stage star power enables them to demand uncontestable control from the firm’s investors. This could explain why the number of dual-class IPOs have increased with the rise of winner-take-all markets, despite the widespread opposition of institutional investors to the use of this structure.[[19]](#footnote-20)

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

We identify two fundamental challenges that superstar CEOs pose for corporate law. First, how should the law respond to the power that these CEOs hold over directors and shareholders? Second, assuming that a CEO does make a unique contribution to company value, should corporate law intervene in the allocation of the surplus created by the CEO between shareholders and the CEO? These challenges, we argue, underlie recent debates regarding courts’ expansion of the definition of controlling shareholders, their treatment of management buyouts, and directors’ duty of oversight.

In the *Tesla* decision, the court treated Elon Musk as Tesla’s controlling shareholder given his “singularly important role in sustaining Tesla in hard times and providing the vision for the Company's success.”[[20]](#footnote-21) This approach could be explained as corporate law’s response to the power held by superstar CEOs. If boards cannot be trusted to prevent self-dealing by visionary CEOs, should not courts assume the task?

Our analysis, however, cautions against the use of corporate law to protect *shareholders* from CEOs who are powerful only because the market believes in their star qualities. These CEOs’ ability to act opportunistically is constrained by the limits on their power, i.e., the magnitude of their unique contribution. The benefits from such intervention, therefore, are likely to be modest as well. One may take the position that corporate law should ensure that superstar CEOs do not capture all of their singular contribution to company value. Yet, creating a rule that would target only superstar CEOs raises a host of institutional concerns, such as the lack of a clear test for identifying these CEOs and courts’ limited ability to determine what is a unique contribution.

The question whether superstar CEOs—and not shareholders—are entitled to their singular contribution to firm value also underlies the legal treatment of management buyouts (MBOs). Specifically, it sheds new light on the choice between two legal approaches for ensuring investors’ right to the fair value of their shares. The first approach relies on judicial valuation of the company under the appraisal remedy. The second approach relies on the transaction price achieved after an effective process of selling the company[[21]](#footnote-22) We demonstrate that the appraisal approach awards *shareholders* the value created by a superstar CEO, while the transaction price approach, in contrast, allocates this value to the *CEO.*

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

The Article proceeds in the following order. Part I describes the transformation of powerful CEOs into powerful shareholders. It also shows that even in this era of sophisticated, powerful, and engaged shareholders, corporate law is still far from being dead. Part II describes the rise of superstar CEOs and analyzes their unique characteristics. Part III discusses the ways in which the star qualities of some CEOs provide them with power vis-à-vis boards and shareholders. It also highlights the limits of such power and considers the implications of our analysis for recent corporate governance developments, including corporate scandals in start-up companies, the rise of dual-class shares, and stakeholder governance. Part IV highlights the implications of our analysis for recent corporate law debates regarding courts’ expansion of the definition of controlling shareholders and treatment of management buyouts, and regarding directors’ duty of oversight. Part V concludes.

SUMMARY

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

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

1. *Factbox: Tesla Market Cap Eclipses that of Top 5 Rival Carmakers Combined,* Reuters (Oct. 26, 2021), https://www.reuters.com/business/autos-transportation/tesla-market-cap-eclipses-that-top-5-rival-carmakers-combined-2021-10-26/. [↑](#footnote-ref-2)
2. *See* *Tesla Motors*, 2018 WL 1560293, at \*26 (Del. Ch. Mar. 28, 2018). See also *infra* notes 243-245 and accompanying text. [↑](#footnote-ref-3)
3. If all conditions are satisfied. *See* McCarter & English LLP, *Elon Musk’s Compensation*, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (May 22, 2018), https://corpgov.law.harvard.edu/2018/05/22/elon-musks-compensation/. [↑](#footnote-ref-4)
4. *See infra* notes 154-155, and accompanying text. [↑](#footnote-ref-5)
5. *See* Lawrence A. Hamermesh & Michael L. Wachter, *The Importance of Being Dismissive: The Efficiency Role of Pleading Stage Evaluation of Shareholder Litigation*, 42 J. Corp. L. 597 (2017). [↑](#footnote-ref-6)
6. *See* the discussion in *infra* Section III.A. [↑](#footnote-ref-7)
7. *See infra* note 160, and accompanying text. [↑](#footnote-ref-8)
8. *See infra* note 261*.* [↑](#footnote-ref-9)
9. *See infra* note 163-164, and accompanying text*.* [↑](#footnote-ref-10)
10. *See infra* Part I. [↑](#footnote-ref-11)
11. *Zohar* Goshen & Sharon Hannes, *The Death of Corporate Law*, 94 N.Y.U. L. Rev. 263, 279-265 (2019) (hereinafter: Goshen & Hannes) (“transformation of American equity markets from retail to institutional ownership has relocated control over corporations from courts to markets and has led to the death of corporate law”). [↑](#footnote-ref-12)
12. *See infra* Section III.B.2. [↑](#footnote-ref-13)
13. For a notable exception *see*, Guhan Subramanian, *Deal Process Design in Management Buyouts*, 130 Harv. L. Rev. 590, 619-23 (2016) (discussing the impact of valuable management). We discuss his analysis in *infra* Section IV.B.1. [↑](#footnote-ref-14)
14. *See infra* Sections II.A.2 and IIIA.3. [↑](#footnote-ref-15)
15. *See* the discussion in *infra* Section I.B. [↑](#footnote-ref-16)
16. *See infra* II.A.2, and accompanying text. [↑](#footnote-ref-17)
17. *See infra* note 160, and accompanying text. [↑](#footnote-ref-18)
18. *See, e.g.,* Lucian A. Bebchuk & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 Geo. L.J. 1453 (2019) (hereinafter: Bebchuk & Kastiel, The Perils of Small-Minority Controllers). [↑](#footnote-ref-19)
19. For an elaborated discussion *see infra* Section III.B.3. [↑](#footnote-ref-20)
20. *In re* Tesla Motors, Inc., 2020 Del. Ch. LEXIS 51, 2020 WL 553902 (Del. Ch. Feb. 4, 2020). [↑](#footnote-ref-21)
21. For an elaborated discussion *see infra* Section IV.B. [↑](#footnote-ref-22)