ESSAY

LEAVING DELAWARE? THE ESSENTIAL ROLE OF SPECIALIZED CORPORATE COURTS

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Following the Delaware Court of Chancery's invalidation of Elon Musk's fifty-six-billion-dollar compensation package, Tesla moved its incorporation from Delaware to Texas. Shortly thereafter, Delaware's legislature, seeking to protect Delaware's dominant incorporation position, passed the most sweeping corporate law amendments in fifty years.

Both supporters of Musk and defenders of Delaware's judiciary have accused each other of partisanship, but neither side has addressed the central question: What is the role of specialized corporate courts?

This Essay presents a novel theory of why such courts are necessary. Corporate disputes are distinct because they arise within ongoing relationships between shareholders and management, governed by incomplete contracts. To address managerial disloyalty or incompetence, shareholders can replace managers or sue for breaches of fiduciary duties. In this dynamic, courts become third-party participants in these incomplete contracts when they decide which claims merit judicial intervention, and which do not. Judicial review in corporate law thus culminates in claim-dismissal specialization.

The business judgment rule, this Essay reveals, is designed to enable specialized courts to limit intervention to conflicts of interest while referring mismanagement cases to shareholders. This Essay demonstrates that Delaware's judiciary has largely fulfilled its intended role while highlighting the constraints it faces regarding both shareholders and legislatures in correcting errors. Meanwhile, with its recent home reincorporation in Texas, Tesla can gain insulation from hostile takeovers and activism, prioritizing long-term business strategies and the broader

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** Associate Professor, University of Alabama School of Law. We thank Sania Anwar, Andrew Appleby, Ben Bates, Lucian Bebchuk, Lauren Cunningham, Lawrence Cunningham, Ofer Eldar, Merritt Fox, Joel Friedlander, Caleb Griffin, Assaf Hamdani, Sharon Hannes, Joan Heminway, Hidefusa Iida, Robert Jackson, Larissa Katz, Jeremy Kessler, Dorothy Lund, Joshua Mitts, Moran Ofir, Gabriel Rauterberg, Anthony Rickey, Bernard Sharfman, Zen Shishido, Reilly Steel, Eric Talley, Masayuki Tamaruya, and Gad Weiss, as well as participants in the 2025 annual meeting of the American Law and Economics Association, the Columbia Law School Faculty Workshop, and the University of Tokyo Faculty of Law Workshop for their helpful comments and suggestions. We also thank Koren Grinshpoon, John V. Merle II, Max Pearl, Roshaan Wasim, and Elliott Werner for excellent research assistance.

community. Finally, this Essay provides the policy blueprint for over twenty other states that have already adopted specialized corporate courts.

INTRODUCTION

To infinity . . . and Texas? Following an adverse decision in the Delaware Court of Chancery, Elon Musk announced his hope that Tesla would leave Delaware and reincorporate in the state of Texas.[1] In a post announcing a similar move for SpaceX, Musk warned others, "If your company is still incorporated in Delaware, I recommend moving to another state as soon as possible."[2] And, indeed, in its June 13, 2024, shareholder meeting, Tesla shareholders approved the move of the company to Texas.[3]

The Delaware litigation sparking Tesla's move south centered around a compensation package that promised its prominent CEO 1% of the company's shares for every $50 billion increase in Tesla's value.[4] Musk accomplished all the milestones set for him by Tesla's board of directors and became entitled to shares valued at nearly $56 billion.[5] An objecting shareholder brought suit in Delaware court, which subsequently blocked Tesla from paying Musk the promised shares.[6] Nevertheless, in the same June 13 shareholder meeting, Tesla shareholders ratified the compensation package the Delaware Chancery Court invalidated.[7] Musk's vindication, however, was only temporary: In a later ruling, the Chancery Court doubled down on its earlier position and rendered the ratification invalid.[8] And even prior to this latest decision, Musk's compensation saga had already pushed him from state competition to federalism: "When there are egregiously wrong legal judgments in a single state that substantially harm American citizens in all other 49 states, the Federal government should take immediate corrective action."[9]

While Musk's ire over his withheld bonus payment may be understandable, the benefits of reincorporating in Texas are not as obvious. Nor is it clear whether Delaware's Chancery Court has truly taken a wrong turn away from its position as a trustworthy corporate law court. Then again,

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1. See Tornetta v. Musk, 310 A.3d 430, 446 (Del. Ch. 2024) (invalidating Elon Musk's $56 billion compensation package); Elon Musk (@elonmusk), X (Feb. 1, 2024), https://x.com/elonmusk/status/1752922071229722990 [https://perma.cc/XM86-96UW] (announcing an immediate move to vote on Texas reincorporation).

2. Elon Musk (@elonmusk), X (Feb. 14, 2024), https://x.com/elonmusk/status/1757924482885583112 [https://perma.cc/5K4C-XDKK].

3. Tesla, Inc., Current Report (Form 8-K) (June 13, 2024), https://www.sec.gov/ix?doc=/Archives/edgar/data/0001318605/000110465924071439/tm2413800d31_8k.htm (on file with the *Columbia Law Review*) ("[V]otes cast in favor of approving Proposal 3 [Texas reincorporation] constituted approximately 63% . . . .").

4. *Tornetta*, 310 A.3d at 445 (describing the compensation package).

5. Id.

6. Id.

7. Tesla, Inc., supra note 3 ("[V]otes cast in favor of approving Proposal 4 [Elon Musk's compensation package] constituted approximately 76% . . . .").

8. Tornetta v. Musk, 326 A.3d 1203, 1212 (Del. Ch. 2024).

9. Elon Musk (@elonmusk), X (Nov. 7, 2024), https://x.com/elonmusk/status/1854567200113533325 [https://perma.cc/R2B9-NAT8].

Tesla was not alone in its desire to reincorporate out of Delaware. For instance, Tripadvisor attempted to reincorporate in Nevada but was stopped by a striking decision by Delaware's Chancery, which was later reversed by Delaware's Supreme Court.[10]

Despite being one of the smallest states in the union, Delaware has long been the preferred state for incorporation, even though most companies do not maintain a headquarters or significant facilities there.[11] Scholars have offered many reasons why Delaware has maintained a position atop the incorporation hierarchy, but all have centered around either the existence of judicial expertise or the uniqueness of Delaware corporate law.[12]

These analyses are undoubtedly important, but they have also left a gaping hole in our understanding of corporate courts and corporate law: What is so special about corporate law that we couch it in judicial expertise and specialized courts? While other legal areas like tax,[13] patents,[14] and bankruptcy[15] have specialized courts, other complex fields like medical malpractice do not. This discrepancy indicates that complexity alone is insufficient to warrant specialization. Each specialized area has unique reasons justifying its need for specialized courts.[16] Therefore, understanding the specific rationale for corporate law's specialization, beyond just its complexity, is critical. This Essay answers these questions by offering a novel theory of the connection between corporate law and specialized courts.

Unlike most state courts in the United States, the Delaware Chancery Court's jurisdiction focuses nearly exclusively on equity cases, a focus that

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10. Maffei v. Palkon, 339 A.3d 705, 710 (Del. 2025) (en banc) (reversing the Chancery Court and holding that the business judgment rule applies to corporate reincorporation).

11. See Roberta Romano, The Genius of American Corporate Law 6–8 (1993) [hereinafter Romano, The Genius of American Corporate Law] (providing a seminal exploration of Delaware's dominance).

12. See, e.g., id. at 39–40 (explaining that Delaware's dominance was due to judicial specialization and laws developed to protect shareholders); William L. Cary, Federalism and Corporate Law: Reflections Upon Delaware, 83 Yale L.J. 663, 685–88 (1974) (explaining that Delaware's dominance was due to laws developed to enable managerial abuse of shareholders); Ehud Kamar, A Regulatory Competition Theory of Indeterminacy in Corporate Law, 98 Colum. L. Rev. 1908, 1923–27 (1998) (arguing that Delaware's advantage comes from the concentration of firms, judicial specialization, and Delaware's strong commitment to corporate value).

13. See Leandra Lederman, (Un)Appealing Deference to the Tax Court, 63 Duke L.J. 1835, 1836–39 (2014) (describing the Tax Court's role).

14. See Rochelle Cooper Dreyfuss, The Federal Circuit: A Case Study in Specialized Courts, 64 N.Y.U. L. Rev. 1, 1–3 (1989) (exploring the rationale for the specialization of patent courts).

15. See Jonathan M. Seymour, Against Bankruptcy Exceptionalism, 89 U. Chi. L. Rev. 1925, 1926–35 (2022) (exploring the rationale for bankruptcy courts' specialization).

16. For instance, family courts and probate courts handle sensitive matters like custody, divorce, and estate disputes, illustrating a social rationale. See, e.g., Ellen R. Jordan, Specialized Courts: A Choice?, 76 Nw. U. L. Rev. 745, 746, 748 (1981).

evolved into a specialty for corporate disputes.[17] For decades, it has been the gold standard for resolution of complex business and corporate governance disputes.[18] As of 2020, twenty-five states have come to appreciate the benefits that specialized business courts can bring and have created their own specialized courts.[19]

Texas joined this trend in 2023, endorsing the creation of the Texas Business Court.[20] Like Delaware's Court of Chancery, this court exclusively hears business and corporate governance disputes.[21] Strikingly, Tesla and SpaceX decided to reincorporate in Texas shortly after this announcement, even though the court would not begin operating until September 2024.[22] Even to this day, the court remains in its infancy.[23] This raises the question: What benefits does reincorporating in Texas bring?

As the Texas court is still developing, its doctrinal form is uncertain. While practical and political considerations may help mold the court over time, relying on a newly created court to settle high-stakes business suits comes with a certain amount of unpredictability and risk.[24] The lack of established precedents also means corporate managers face uncertainty about potential liability for their desired plans of action.

In other words, the Texas Business Court represents a blank canvas—an opportunity to offer its own vision for handling corporate law and governance suits. But can Texas structure this vision to be as successful as Delaware's established system? Can Nevada, which has similarly proposed

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17. See William T. Quillen & Michael Hanrahan, A Short History of the Delaware Court of Chancery—1792–1992, 18 Del. J. Corp. L. 819, 831–34 (1993). The court also has any statutory jurisdiction conferred by law. See Del. Const. art. IV, § 10.

18. See About the Division of Corporations, Del. Div. Corps., https://corp.delaware.gov/aboutagency/ [https://perma.cc/RS43-VCVB] (last visited Aug. 16, 2025) ("More than 66% of the Fortune 500 have chosen Delaware as their legal home. . . . The Delaware Court of Chancery is a unique, more than 225 year old business court that has written most of the modern U.S. corporation case law.").

19. Lee Applebaum, Mitchell Bach, Eric Milby & Richard L. Renck, Through the Decades: The Development of Business Courts in the United States of America, 75 Bus. Law. 2053, 2057 (2020).

20. Welcome to Texas: Texas Governor Signs Law Creating Specialized Business Courts, Sidley Austin LLP (June 12, 2023), https://www.sidley.com/en/insights/newsupdates/2023/06/welcome-to-texas_texas-governor-signs-law-creaing-specialized-business-courts [https://perma.cc/4BFU-BN6U] [hereinafter Welcome to Texas].

21. Id.

22. Id.; see also Tesla, Inc., supra note 3 (noting the date of Tesla's decision).

23. See Eight Months In—What's Happening in the New Texas Business Court, O'Melveny & Myers LLP (May 9, 2025), https://www.omm.com/insights/alerts-publications/eight-months-in-what-s-happening-in-the-new-texas-business-court/ [https://perma.cc/QT36-X3JM] ("Although the early opinions from the Texas Business Court largely concern jurisdictional issues, litigants can expect to see more substantive opinions as cases proceed past the initial gatekeeping stage.").

24. See Welcome to Texas, supra note 20 ("[T]here are likely to be some growing pains and a number of unexpected effects . . . .").

to establish a business court in February 2025,[25] do the same? To answer these questions, we need to examine why specialized business courts are necessary to resolve corporate governance disputes.

Assessments of corporate courts exist within corporate law's broader political economy: States compete with one another to attract incorporations to their state—a significant source of franchise taxes and other benefits.[26] And as Musk is clearly acutely aware, this competition is not just interstate: States like Delaware must also weigh the threat that the federal government will intervene and take over the laws they develop, as it has in the past, particularly in the context of laws regarding shareholder votes.[27]

Within this regulatory context, traditional justifications for creating specialized courts can be described as either "public-facing" or "business-facing." Public-facing arguments claim that specialized courts will attract businesses, creating economic benefits such as jobs, revenue, and enhanced incorporation tax income for public services.[28] Business-facing justifications highlight the advantages specialized courts bring to incorporated businesses[29]: Judges overseeing only business disputes develop expertise, leading to quicker resolutions and more predictable, higher-quality decisions over time.[30]

While valid, these justifications do not fully explain why specialized courts are necessary to resolve complex corporate governance disputes. The main issue is that the cited benefits lack a clear connection to the specific subject matter of these courts. In other words, these justifications could apply to specialization in any legal area.

Consider, for example, lawsuits arising from brain surgery complications. Such cases can be extremely complex, requiring judges to understand advanced medical concepts.[31] One could argue for specialized courts

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25. Kyle Chouinard, Establishing a Nevada Business Court Could Attract Billions in Revenue, Lawmaker Says, L.V. Sun (Feb. 9, 2025), https://lasvegassun.com/news/2025/feb/09/establishing-a-nevada-business-court-could-attract/ [https://perma.cc/T95L-6A5F].

26. See, e.g., Lucian Arye Bebchuk, Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law, 105 Harv. L. Rev. 1435, 1442–48 (1992) (describing the states' incentives and competition).

27. See Mark J. Roe, Delaware's Competition, 117 Harv. L. Rev. 588, 596–600 (2003) (describing the impact of federal law and threat of further federalization on corporate law).

28. See, e.g., N.Y. Com. Div., The Benefits of the Commercial Division to the State of New York 1–3 (c. 2018), https://www.nycourts.gov/LegacyPDFS/courts/comdiv/PDFs/TheBenefitsoftheCommercialDivisiontotheStateofNewYork.pdf (on file with the *Columbia Law Review*) (explaining the benefits of business courts).

29. See, e.g., Romano, The Genius of American Corporate Law, supra note 11, at 44 ("[T]he more firms there are in Delaware, the more legal precedents will be produced, further providing a sounder basis for business planning . . . .").

30. See, e.g., Ad Hoc Comm. on Bus. Cts., Business Courts: Towards a More Efficient Judiciary, 52 Bus. Law. 947, 951–53 (1997) (explaining the benefits of selecting appropriate scope in judicial specialization).

31. Deciding whether a doctor failed to exhibit the same level of care that other reasonable brain surgeons would have exercised requires a certain level of understanding of

in this area too, citing efficiency and predictability. Yet, there has not been a significant push for medical malpractice courts. Similarly, courts adjudicating high-stakes debt agreements with multiple claimants, outside the bankruptcy context, are also not specialized, despite the evergreen impact of debt on corporate America.[32] The American judicial system is seemingly content to allow courts of general jurisdiction to handle these cases, despite both the judges' lack of expertise in a complex subject matter and the presence of multiple claimants and high economic stakes. Therefore, citing generic benefits of specialization is insufficient to reveal the distinct rationale for corporate disputes specialization. We must identify the unique characteristics of corporate law and governance disputes that set them apart from other legal matters.

Corporate disputes are not isolated conflicts but rather take place in the context of an ongoing relationship between shareholders and management, among shareholders themselves, and between shareholders and other corporate stakeholders.[33] The cardinal relationship between shareholders and management can be thought of as an *incomplete contract* between a principal and an agent.[34] The principal (the shareholders) invests in the firm, and the agent (the board) manages the firm to create future value.[35] Beyond the general instruction to "maximize firm value," there are few (if any) enforceable precepts as to how to manage the firm.[36] Instead, the parties agree to a general allocation of *control rights*, which govern the distribution of decisionmaking power over the firm, and *cash flow rights*, which govern the distribution of firm-generated value.[37] In this incomplete contract, conflicts may arise as to the allocation and use of these two types of rights.[38]

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the underlying science, an area of medicine that requires years of study and with which the judge is most likely unfamiliar. See, e.g., Trees v. Ordonez, 311 P.3d 848, 854 (Or. 2013) (explaining that the necessity of expert testimony in most medical malpractice cases follows from the rationale that a layperson lacks the requisite technical knowledge to assess the standard of care).

32. See Tomer S. Stein, Debt as Corporate Governance, 74 Hastings L.J. 1281, 1290–96 (2023) [hereinafter Stein, Debt as Corporate Governance] (describing the complexity of debt agreements and their governing laws).

33. See Ad Hoc Comm. on Bus. Cts., supra note 30, at 952–53 (explaining that corporate disputes can impact "numerous persons throughout society, including employees, shareholders, creditors, supplies, or customers of the companies involved").

34. Zohar Goshen & Sharon Hannes, The Death of Corporate Law, 94 N.Y.U. L. Rev. 263, 269 (2019).

35. Id.

36. For the seminal case, see Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) ("A business corporation is organized and carried on primarily for the profit of the stockholders.").

37. See Zohar Goshen & Richard Squire, Principal Costs: A New Theory for Corporate Law and Governance, 117 Colum. L. Rev. 767, 785 (2017) (describing the nature of control and cash flow rights).

38. Corporate control rights conflicts are most visible in contests for control over the entire corporation, such as a hostile takeover. Challenging the right of the target corpora-

To begin, the allocation of control rights to agents leads to *agent costs* that include both *competence costs*, such as the costs imposed by a loyal but incompetent manager, and *conflict costs*, capturing the costs imposed by disloyal managers motivated to benefit themselves at the expense of the firm and its shareholders.[39] Both types of costs reduce firm value. To cope with potential manager–agent costs, the principal-shareholders keep two rights: *discretionary control rights* such as shareholder voting allowing them to dismiss the manager and *duty-enforcement rights* such as the right to sue the agent for breach of directors' fiduciary duties.[40]

When shareholders choose to use discretionary control rights, they may be imposing *principal costs* that include both *competence costs* (e.g., mistakenly firing a loyal and competent manager) and *conflict costs* (e.g., shareholders demanding short-term profits at the expense of long-term value).[41] Both types of costs harm firm value. Importantly, the use of discretionary control rights is tantamount to a self-help remedy, as shareholders need not explain why, for instance, they replaced the manager.[42] But when the principals enlist the help of courts by using duty-enforcement rights, they may be imposing *adjudication costs* that include both *competence costs* (e.g., honest mistakes made by inexperienced judges while determining whether an agent breached fiduciary duties) and *conflict costs* (e.g., plaintiffs' lawyers filing meritless suits).[43] Both types of costs reduce firm value.

To maximize firm value, the parties need to minimize the *total control costs*: agent costs, principal costs, and adjudication costs. One important consideration to minimizing control costs is whether to hold an agent accountable through discretionary control rights (and bear the principal costs) or through duty-enforcement rights (and bear the adjudication costs). Obviously, that decision should depend on the relative size of principal costs compared with adjudication costs. Theoretically, the

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tion's board to adopt "takeover defenses" without shareholder consent is a dispute over the allocation of control rights between the board and shareholders. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161, 1165–82 (1981) [hereinafter Easterbrook & Fischel, Responding to a Tender Offer] (analyzing the interests of shareholders and managers in the takeover context). Disputes over the allocation of cash flow rights, on the other hand, arise when a conflict has the potential to influence the division of cash flows or assets. For example, minority shareholders in a public corporation may dispute whether the price offered for the minority shares by the controlling owner in a merger was fair. See, e.g., Ronald J. Gilson & Jeffrey N. Gordon, Controlling Controlling Shareholders, 152 U. Pa. L. Rev. 785, 787–88 (2003) (theorizing the role of law in disputes between controlling and minority shareholders).

39. Goshen & Squire, supra note 37, at 788, 793.

40. Id. at 779.

41. Id. at 786, 791.

42. Id. at 800 ("In the enforcement of [discretionary control] rights, there is no distinction between seeking the relief and granting it . . . .").

43. See id. at 770–71.

shareholders will decide to sue the manager only when adjudication costs are lower than principal costs.

But shareholders do not decide whether to sue the managers; it is plaintiffs' lawyers who make this decision.[44] The plaintiffs' lawyer's incentives to litigate are not always aligned with the interest of the shareholders.[45] Regardless of the relative size of principal costs and adjudication costs, the plaintiffs' lawyer's interest is to file a suit whenever there is a positive probability for rewards either through a court's ruling or a settlement. This reality transfers to the court the role of deciding which issues to accept for litigation and which issues to send back to the shareholders to solve on their own through discretionary control rights. The court's role of sorting cases transforms it into a third party participant in the incomplete contract governing the ongoing relationship between shareholders and management.[46]

In this triangular arrangement, the agents, principals, and courts are not only concerned with resolving the dispute in front of them, but they are also concerned with how the choice of dispute resolution mechanism (be it discretionary control right or duty-enforcement right) impacts the efficient performance of the firm. Understanding this dynamic is key to understanding the role of specialized corporate courts and why they are necessary.

The crucial point is that the total control costs of managing a firm exist before, during, and after any business harm occurs. This is distinct from other types of legal disputes.[47] Consider our brain surgery example from before.[48] The plaintiff and doctor had virtually no relationship before the injury. There is no balancing of rights between them or negotiation over responsibilities and entitlements. Once harm occurs, the plaintiff's sole recourse is judicial intervention. They lack other mechanisms to address the damage or influence the doctor's behavior. Similarly, when lenders and borrowers enter into a contract, both their relationship and

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44. See Ronald J. Gilson & Robert H. Mnookin, Disputing Through Agents: Cooperation and Conflict Between Lawyers in Litigation, 94 Colum. L. Rev. 509, 510 (1994) (describing the conditions under which lawyers dominate principal–agent conflicts).

45. See id. at 513 ("[T]he incentives for a cooperative lawyer, who is a repeat player concerned with maintaining [their] reputation over time, differ from those of [their] client, who as a one-shot litigant may be tempted to defect.").

46. The court becomes a third party to the contract functionally but not formally (i.e., becoming a signatory). The notion of "incomplete contract" in this context is economic rather than legal.

47. For discussion of the interplay between corporate law and other types of legal disputes, such as tort litigation, see, e.g., Robert J. Rhee, The Tort Foundation of Duty of Care and Business Judgment, 88 Notre Dame L. Rev. 1139, 1143 (2013) ("Tort theory provides not just the lexicon of liability, but the foundational principles of the duty and liability of corporate boards.").

48. See supra note 31 and accompanying text.

their recourse is limited by the tenor and express terms of the agreement.[49] After the suit concludes, judicial interaction likely ends.

Corporate disputes differ from isolated conflicts, such as medical torts or debt contracts, as they involve ongoing relationships between shareholders, management, and the court.[50] While judicial recourse is the plaintiff's only option in brain surgery or debt agreement cases, corporate disputes offer alternative mechanisms to address agent costs. Furthermore, courts know that any decision they impose on the corporation will change the corporate arrangement going forward.

This unique characteristic of corporate disputes necessitates specialized courts with knowledge and expertise in corporate law, and a capacity to play an integral and ongoing role in corporate arrangements. Knowledgeable courts are aware of their own competence and conflict costs, understanding that legal remedies aren't always necessary to resolve a corporate dispute. Shareholders and managers can use other mechanisms to handle matters on their own. Accordingly, expert courts limit their intervention to cases in which shareholders exercising legal rights would be more efficient than shareholders addressing the problems themselves. The ability to distinguish these scenarios is rare, uniquely required in corporate law, and drives the need for specialized corporate courts. It is this tripartite allocation of competence and conflict costs across courts, shareholders, and managers that makes specialized corporate courts necessary and important.

Viewed in this context, the business judgment rule[51] should be seen as a representation of specialized corporate courts' proper role in the ongoing relationship among management, shareholders, and the courts. The business judgment rule embodies the core reason for specialized courts: limiting judicial intervention to certain types of agent costs. For some types of agent costs, such as those resulting from nonconflicted decisions that did not pan out, the business judgment rule effectively prevents judicial intervention.[52] This is not because specialized courts are unable to adjudicate these matters but rather because the court recognizes that it would be more efficient for shareholders to address this type of mismanagement instead. In essence, being a specialized court requires knowing when to apply the business judgment rule and when not to. And beyond the business judgment rule, specialized courts understand that even when their involvement is necessary, their enforcement role is not absolute, and

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49. See Tomer S. Stein, Rules vs. Standards in Private Ordering, 70 Buff. L. Rev. 1835, 1873–77 (2022) (comparing lender and shareholder contractual arrangements).

50. See infra section I.A.

51. See In re Walt Disney Co. Derivative Litig., 906 A.2d 27, 52 (Del. 2006) (en banc) ("[In business judgment rule review,] [o]ur law presumes that 'in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company.'" (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984))).

52. See infra section IV.A.

they must remain sensitive to the impact of their decisions on principals and agents going forward.

From this perspective, specialized corporate courts function similarly to constitutional courts.[53] When deciding constitutional matters, a constitutional court recognizes that it is also adjudicating the scope and allocation of its own powers relative to the executive and the legislative branches.[54] It understands that not every problem requires judicial intervention, as other recourse exists.[55] Some disputes might better be resolved by turning to the executive or the legislature, indirectly leaving the issue for the voters.[56] Similarly, specialized corporate courts recognize that adjudicating corporate disputes requires regulating their own powers relative to the shareholders and managers. This expertise goes much beyond resistance to judicial error or bias and the vagaries of politics[57]—even if our constitutional or corporate judges avoid partisanship, it takes a different skillset to know when judicial intervention is not appropriate despite the judge's best judgment as to what might be an unbiased understanding of a legal dispute.

In other words, specialized corporate courts are needed not only because of *how* they resolve corporate disputes but because they know *when* to do so and, more importantly, *when not* to do so. Rather than presuming they must resolve all corporate governance disputes, these courts consider what is the most efficient resolution of each dispute. Sometimes direct court intervention is best; other times creating rules that will allow shareholders to resolve the issue themselves is more appropriate. The utility of a specialized corporate court stems from the fact that it views itself not as an adjudicator overseeing a dispute between two distant parties. Rather, specialized corporate courts recognize that they are ongoing participants in a triangular relationship.

To be sure, specialized corporate courts continue to perform the core adjudicatory functions common to all courts, including the efficient management of trial proceedings, the development of precedent, the supervi-

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53. For discussion of the proper role of constitutional courts, see generally Stephen Gardbaum, What Makes for More or Less Powerful Constitutional Courts?, 29 Duke J. Compar. & Int'l L. 1 (2018) (exploring various constitutional courts to explain the sources and scope of a constitutional court's judicial power).

54. See, e.g., Nuno Garoupa & Tom Ginsburg, Building Reputation in Constitutional Courts: Political and Judicial Audiences, 28 Ariz. J. Int'l & Compar. L. 539, 544 (2011) (explaining the interaction between constitutional courts and the political branches when addressing constitutional issues).

55. See, e.g., Lawrence Gene Sager, Fair Measure: The Legal Status of Underenforced Constitutional Norms, 91 Harv. L. Rev. 1212, 1239–40 (1978) (describing doctrinal underenforcement as an invitation by the Supreme Court for participation by other branches of government).

56. Id.

57. See Ofer Eldar & Gabriel Rauterberg, Is Corporate Law Nonpartisan?, 2023 Wis. L. Rev. 177, 212–20 (analyzing the role of partisanship in corporate law).

sion of settlements, and the evaluation of expert testimony.[58] The distinguishing feature of specialized corporate courts, however, lies in their capacity to regulate their own institutional role within the ongoing, tripartite relationship among shareholders, managers, and the judiciary. Identifying this salient self-regulatory function is essential to understanding the distinctive role of specialized corporate courts.

Given the necessity of specialization, Tesla's move to Texas is strategic, even though Texas's specialized corporate law courts are still in their infancy. While a successful specialized court in Texas, following this Essay's blueprint, would offer benefits similar to those in Delaware, Texas has a unique advantage: It is Tesla's home state, hosting some of Tesla's factories and its headquarters.[59] Unlike Delaware, which is only interested in collecting incorporation fees, Texas is also interested in the benefits of Tesla's business activity and its impact on the state's economy. Texas can provide insulation from hostile takeovers and hedge fund activism, prioritizing not only shareholder profits but also the welfare of employees and other residents.[60] This environment enables Tesla to pursue long-term, innovative projects that benefit employees and, eventually, shareholders as well.[61]

This Essay offers a novel justification for specialized corporate courts by examining their unique role in regulating corporate affairs. Part I analyzes the participation of the courts in the incomplete contract between shareholders and management, identifies the prototypes of corporate value loss, and explains how the parties would like to address them. Part II discusses "mismanagement" losses, explaining why judicial intervention is inefficient in these cases. Part III contrasts "mismanagement" with "managerial takings," when shareholders cannot adequately address losses independently, thus warranting judicial intervention. Part IV argues for specialized courts over general courts given their reluctance to adjudicate mismanagement cases and their ability to address takings cases effectively. This Part presents a new rationale for the business judgment rule and related review doctrines, considering specialized corporate courts' proper role in managing the ongoing management–shareholder relationship, and these courts' relationship with legislative bodies. Lastly, this Part discusses legislative interventions as a form of correcting judicial mistakes. Using this novel framework, Part V resolves the issues underlying the Tesla jurisdictional dispute and draws out the profound policy implications for the future development of state corporate law.

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58. In corporate disputes, the court's ability to evaluate financial testimony becomes particularly important. See infra notes 244–248 and accompanying text.

59. See supra note 3.

60. See infra Part V.

61. See infra Part V.

I. AGENT COSTS AND THEIR MOST EFFECTIVE DETERRENT

This Part begins in section I.A by detailing the nature of the incomplete contract between shareholders (the principals) and management (the agent). Section I.B then proceeds to detail seven possible explanations for an agent's motivations and conduct whenever there is a loss in corporate value and explores in which of these cases the parties would like to impose sanctions on the agent.

A. *Defining the Incomplete Contract*

When shareholders hire managers, such as corporate directors and officers, to work on their behalf, they create a separation between ownership and control.[62] While the shareholders own the corporation, it is the directors and officers who control the corporation's operations and business decisions.[63] Shareholders are willing to relinquish control of their corporations, and directors and officers are willing to assume such control, because separating ownership and control provides benefits that cannot otherwise be achieved.[64] Shareholders, for their part, can invest in businesses that they would not have the time or expertise to manage, and directors and officers, in consideration, are able to be compensated for their skills in managing a business without having to personally incur the costs and risks of owning a business.[65] But the benefits of separating ownership and control also carry a unique set of costs that is a defining feature of the corporate contract: contractual incompleteness.[66]

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62. See Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. Fin. Econ. 305, 306 (1976) (providing a pioneering examination of the separation of ownership and control).

63. For a seminal examination of this phenomenon, see Adolf A. Berle & Gardiner C. Means, The Modern Corporation and Private Property (Routledge 2017) (1932) (examining the existence and implications of the corporation's separation of ownership and control).

64. See, e.g., Stephen G. Marks, The Separation of Ownership and Control, *in* 3 Encyclopedia of Law and Economics 692, 694–95 (Boudewijn Bouckaert & Gerrit de Geest eds., 2000).

65. Id.

66. For further background on the concept of an "incomplete contract," see generally Frank H. Easterbrook & Daniel R. Fischel, The Corporate Contract, 89 Colum. L. Rev. 1416, 1418 (1989) (describing the wide discretion given to managers and directors in the execution of their corporate duties); Sanford J. Grossman & Oliver D. Hart, The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration, 94 J. Pol. Econ. 691, 691–92 (1986) (arguing that, due to the impossibility of avoiding contractual incompleteness, it may be more effective for one party to purchase all residual rights unspecified by the contract); Oliver Hart & John Moore, Incomplete Contracts and Renegotiation, 56 Econometrica 755, 755 (1988) (describing the difficulty of writing a complete contract and outlining possibilities for managing contractual incompleteness); Jonathan R. Macey, Corporate Law and Corporate Governance: A Contractual Perspective, 18 J. Corp. L. 185, 190 (1993) (explaining how a lack of mandatory legal rules governing corporations allows for both customization and uncertainty).

When shareholders and managers agree that the latter shall act on behalf of the former, they enter into what can best be described as a principal–agent contractual arrangement.[67] Shareholders, acting as the principals, invest in the firm, while management, acting as the agent, is charged with managing the firm in an effort to maximize the firm's value.[68] But beyond the general mandate for value maximization, there is not much, if any, description as to *how* the firm should be managed and what would be considered appropriate performance.[69] This principal–agent contract, however beneficial, is inherently incomplete: Neither party's rights and responsibilities can be fully articulated when the relationship between the two is formed.[70] This incompleteness is inevitable because the agent's efforts, ideas, and motivations are unobservable and thus non-contractible. Moreover, it is impossible to predict all possible future contingencies that may occur during the life of the firm. For example, an investor hiring an engineer to develop autonomous vehicles faces contingencies that cannot be contractually accounted for: which detection technologies should be used in the long term, how to respond to any future supply chain disruptions, or what constitutes acceptable performance under uncertainty in the first place.

While this incompleteness problem is inevitable, and too costly to fully address by smart contracting parties, a principal–agent arrangement, such as that between shareholders and directors, develops general strategies to mitigate its costs. Parties to this arrangement address incompleteness by seeking to adequately restrain and incentivize each other's behavior by balancing *cash flow* rights and *control* rights.[71] Cash flow rights entitle the holder to value generated by the firm, whereas control rights grant the holder decisionmaking authority over the firm.[72] In a nutshell, principals

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67. This Essay refers to principals and agents in the broader economic sense, not the technical legal sense, which requires the right to provide interim instruction to the agent. See Restatement (Third) of Agency § 1.01 (Am. L. Inst. 2006) (providing the legal definition of agency).

68. See McRitchie v. Zuckerberg, 315 A.3d 518, 562 (Del. Ch. 2024) ("Because a stockholder makes a presumptively permanent investment in a presumptively perpetual firm, the proper orientation of the directors' fiduciary duties is toward maximizing the value of the firm . . . ."). See generally Philippe Aghion & Richard Holden, Incomplete Contracts and the Theory of the Firm: What Have We Learned Over the Past 25 Years?, J. Econ. Persps., Spring 2011, at 181 (summarizing the literature on the incompleteness of the corporate contract).

69. See Aghion & Holden, supra note 68, at 182–83 (explaining the necessity of discretion in contracts governing asset management).

70. For a general analysis of transaction costs and incomplete contracts, see Robert E. Scott & George G. Triantis, Incomplete Contracts and the Theory of Contract Design, 56 Case W. Rsrv. L. Rev. 187, 190–91 (2005).

71. See Goshen & Squire, supra note 37, at 794–96 (modeling the economic analysis of this balancing act).

72. See Zohar Goshen & Assaf Hamdani, Corporate Control and Idiosyncratic Vision, 125 Yale L.J. 560, 584–87 (2016) [hereinafter Goshen & Hamdani, Idiosyncratic Vision] (theorizing the roles of control and cash flow rights in balancing agent costs).

and agents attempt to mitigate the costs of contractual incompleteness by distributing rights to firm-generated cash and firm control in a way that balances the incentives of the shareholders and managers—shareholders assume most of the cash flow rights, and directors and officers assume most of the control rights.[73]

Alas, this remedial distribution is not perfect, as it too imposes costs through incentive misalignment: While control rights determine the ability to manage, cash flow rights determine the incentive to manage properly. Managers with control but limited cash flow rights thus lack sufficient motivation to maximize firm value.[74]

This mismatch between cash flow and control rights creates agent costs. These costs manifest both in the form of agent *conflict costs* and in the form of agent *competence costs*.[75] Agent conflict costs arise from managers' disloyal or self-seeking conduct and the costs incurred by shareholders to prevent such conduct in the first place.[76] Since managers with fewer cash flow rights have reduced reasons to manage properly, they face greater incentives to shirk their duties and divert firm value to themselves, at the expense of shareholders.[77] Agent competence costs can be defined as costs resulting from honest mistakes and human error, as well as the costly efforts undertaken to reduce or mitigate such mistakes.[78] While shareholders have incentives to find the most competent individuals to join their management, sometimes they can get it wrong. Incompetent managers can make ill-advised decisions that hurt the firm's revenue.[79] Furthermore, even if managers are incredibly bright and sufficiently competent, they can still make honest mistakes.[80] Even if significant steps are taken to reduce both the misguided decisions of disloyal managers and the honest mistakes of loyal managers, those efforts would still constitute a cost that shareholders must bear.[81] The principal and agent therefore seek to allocate cash

73. Id. at 568.

74. See Goshen & Squire, supra note 37, at 794 (providing examples of agent-conflicted incentives).

75. See Goshen & Hannes, supra note 34, at 270–71 (describing agent costs as including both competence and conflict costs).

76. See Goshen & Squire, supra note 37, at 779, 793–95 (detailing agent conflict costs).

77. See Jensen & Meckling, supra note 62, at 308 (explaining agent conflicts of interests).

78. See Goshen & Squire, supra note 37, at 788 (theorizing agent competence costs).

79. Id.

80. See Goshen & Hannes, supra note 34, at 293 ("Competence costs arise when the party exercising control makes an honest mistake that reduces firm value." (emphasis omitted)).

81. Prevention efforts are especially costly given the informational asymmetries between agents and principals. See Goshen & Hamdani, Idiosyncratic Vision, supra note 72, at 565–66.

flow and control rights in a manner that minimizes the agent's conflict and competence costs in an effort to increase overall corporate value.[82]

Shareholders aim to minimize agent costs by keeping two types of control rights for themselves: *discretionary control* rights and *duty-enforcement* rights.[83] Discretionary control rights are rights that principals may exercise without first having to prove that the agent violated an established restriction.[84] Paradigmatic examples include the rights of corporate shareholders to elect and replace directors and to vote on proposed mergers.[85] One can think of discretionary control rights as ways shareholders can resolve problems themselves, without the need for intervention by third parties, such as courts. Duty-enforcement rights enable a principal to invoke judicial review and sue an agent for breach of a legal restriction on the agent's exercise of control.[86] Instances of these rights include, for example, the right to sue for breach of directors' fiduciary duties.[87] Importantly, fiduciary duties are also part of the incomplete contract, as they are open ended and not clearly defined, leaving the discretion to the court to decide ex post whether a given agent's behavior breached their duties.[88]

Taken together, discretionary control rights and duty-enforcement rights provide shareholders with two different tools to cope with agent costs.[89] In deciding which mechanisms should apply to which agent costs, the principal and the agent must decide whether the agent costs can best be resolved by shareholders directly (i.e., when discretionary control rights are the optimal solution) or with the aid of a court (i.e., when duty-enforcement rights might be necessary).[90]

Importantly, the principal's exercise of their discretionary control rights is itself subject to *principal costs*.[91] Indeed, agents are not alone in bringing competence and conflict costs into the firm.[92] Recall why management was hired in the first place: The principal-shareholder lacks the time or expertise to manage the business, and the manager-agent is called

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82. See Goshen & Squire, supra note 37, at 788, 793 (describing the need to reduce agent competence and conflict costs, respectively).

83. Id. at 798–801 (comparing discretionary control and duty-enforcement rights).

84. Id. at 800.

85. Id.

86. Id. at 798.

87. Id. at 799; see also William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., Realigning the Standard of Review of Director Due Care With Delaware Public Policy: A Critique of *Van Gorkom* and Its Progeny as a Standard of Review Problem, 96 Nw. U. L. Rev. 449, 454–55 (2002) (explaining the difficulty of enforcing the duty of care).

88. See Frank H. Easterbrook & Daniel R. Fischel, Contract and Fiduciary Duty, 36 J.L. & Econ. 425, 445 (1993) [hereinafter Easterbrook & Fischel, Fiduciary Duty] (theorizing fiduciary duties as tools for judicial gap filling).

89. See Goshen & Squire, supra note 37, at 799–801 (theorizing the tradeoffs between the two options).

90. See id. at 801.

91. See id. at 786, 791.

92. Id.

to fill these gaps. If principals interfere with the agent's managerial decisions, they may interfere with the agent's proper exercise of their expertise. For instance, imagine that the investor funding the autonomous vehicle business decides to use their discretionary control rights to strong-arm the engineer-manager into pursuing a technological path that may bring the product to market quicker, but that the engineer has correctly deemed that path impractical from a technical standpoint in the long run. Imagine further that the investor did so both because they are incentivized to make money sooner rather than later and because they are not as knowledgeable as the engineer. This will harm the firm's value. In other words, principals too bring about principal costs, which include both competence and conflict costs, and these costs must be weighed in any attempt to address agent costs.[93]

Similarly, using duty-enforcement rights is not free of costs. Enforcing fiduciary duties in courts will create *adjudication costs* that also include conflict and competence costs. Normally, the case will be filed in court by the plaintiffs' bar, which might have interests that diverge from the interests of the shareholders, thereby generating conflict costs in the form of strike suits or improper settlements.[94] Once the case is brought to court, the judges will generate competence costs, in the form of potentially mistaken decisions. The higher the quality of the judges, the lower the competence costs.[95]

Notably, in this framework, the court becomes another "party" to the incomplete contract between the principal and the agent and to their ongoing relationship. Once the court is called to act by a principal's enforcement of fiduciary duties, it needs to first decide whether the court or the shareholders are the appropriate body to resolve the issue.[96] Second, when appropriate, the court needs to decide how to fill the gaps in the incomplete contract by concretizing and enforcing fiduciary duties.

Together, the costs imposed by the principal, by the agent, and by the courts amount to the *total control costs* of the firm.[97] The goal of the parties is to minimize the total control costs in order to increase the value of the firm. For that purpose, it is important to decide when it is more efficient to reduce agent costs using discretionary control rights (and bearing the

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93. Id.

94. Goshen & Hannes, supra note 34, at 295 ("Because the possibility of plaintiff's counsel's conflict is only introduced when parties engage the court to resolve this type of dispute, the resulting conflict costs are effectively species of adjudicatory conflict costs.").

95. Id. at 296 ("If the [nonexpert] court itself has a comparable level of competence costs . . . replacing the competence costs of the principal with the competence costs of the court . . . may not reduce total control costs. However, if the [expert] court has low competence costs . . . this court is likely to make fewer mistakes . . . ." (emphasis omitted)).

96. Indeed, under certain conditions, the court might delegate this task to disinterested directors through the demand requirement. See, e.g., United Food & Com. Workers Union v. Zuckerberg, 262 A.3d 1034, 1047 (Del. 2021) (en banc).

97. See Goshen & Hannes, supra note 34, at 270.

associated principal costs), or duty-enforcement rights (and bearing the associated adjudication costs). The next section begins to explore this question.

B. *Management's Role in Corporate Losses*

This section explores how management can cause a loss in corporate value and whether parties would prefer sanctions (judicial or shareholder-imposed) on managers in each scenario. Consider the following hypothetical: Management invests $100 million in a research and development (R&D) project that fails, resulting in a loss in company value. Given that most public companies in the United States have ultimate dispersed ownership,[98] assume the company operates under such a structure and that shareholders own diverse portfolios.[99] Also, assume a world without informational asymmetries, in which parties always know the exact cause of the loss in value.

There are several possible causes for loss, each falling into three general categories of harm. First, some losses are a natural and ordinary part of doing business. Since managing firms does not occur in a controlled environment, firms will inevitably experience harm even without any agent or principal costs. Second, some losses result from mismanagement, when the agent failed to exercise the necessary care and expertise or knowingly made a suboptimal decision, harming the firm. Third, some losses are due to takings, when the agent harms the firm to personally benefit at the firm's expense. In each of the following scenarios, consider whether it is a normal business loss, a mismanagement case, or a takings case, and whether sanctions should be imposed.

Misfortune. In scenario one, the agent was competent and loyal, but the project failed due to bad luck. The $100 million investment had a 90%

98. In a dispersed ownership structure, no single investor owns enough shares to control the firm, with ownership being dispersed among numerous shareholders. See Sean Quinn, Controlled Companies in the S&P 1500: Performance and Risk Review, Harv. L. Sch. F. on Corp. Governance (Oct. 25, 2012), https://corpgov.law.harvard.edu/2012/10/25/controlled-companies-in-the-sp-1500-performance-and-risk-review/ [https://perma.cc/L34L-3HCT] ("At most U.S. firms, ownership is dispersedly-held and voting power is proportionate to capital at risk.").

99. If not dispersed directly, these companies have concentrated ownership in the hands of institutional investors who are themselves accountable to dispersed beneficial owners. See Lucian Bebchuk & Scott Hirst, The Specter of the Giant Three, 99 B.U. L. Rev. 721, 723 (2019) (documenting the robust control of institutional investors). The literature is split as to whether concentrated ownership in the hands of institutional investors changes traditional corporate governance analysis. Compare Lucian A. Bebchuk, Alma Cohen & Scott Hirst, The Agency Problems of Institutional Investors, J. Econ. Persps., Summer 2017, at 89, 93 (arguing that institutional investors are themselves inflicted by agent costs due to their own dispersed ownership), with Marcel Kahan & Edward B. Rock, Index Funds and Corporate Governance: Let Shareholders Be Shareholders, 100 B.U. L. Rev. 1771, 1777–79 (2020) (arguing that institutional investors do have an incentive structure that changes the dispersed ownership model). This Essay addresses the impact of concentrated ownership below in sections II.D and III.D.

chance of generating $300 million and a 10% chance of losing all $100 million, with an expected value of $260 million.[100] Unfortunately, the project failed, costing the company $100 million. For example, a competing artificial intelligence technology with a low chance of success might have surfaced and rendered the R&D project obsolete. This loss cannot be classified as a takings case since the agent did not benefit from it, nor as mismanagement, as the decision properly accounted for the risks involved. In such situations, sanctions should not be imposed on managers. Holding managers liable for investments that fail due to bad luck would lead to overly cautious behavior, deterring them from making smart business decisions.[101] To maximize company value, managers must feel comfortable pursuing desirable business risks without fearing negative consequences. From the shareholders' perspective, managers taking such calculated risks in all of their portfolio corporations will, on average, generate higher value than those who avoid risk.[102]

Idiosyncratic Vision. In scenario two, the agent was competent and loyal, but the project failed because it was based on an idiosyncratic vision that needed more time to bear fruit.[103] For instance, the agent's project might have been a highly innovative and disruptive business idea that initially generated negative cash flow and was interrupted before it could turn a profit. This could be due to an unexpected loss of key employees or a temporary lack of necessary financing. This loss is neither a mismanagement nor a takings case; it is an interim consequence of pursuing highly innovative or long-term projects. In such situations, imposing liability or other consequences would be undesirable. Holding agents accountable for idiosyncratic visions that have not yet turned profitable would deter them from pursuing innovative and long-term strategies. Agents would fear reprimand if their projects took too long to show promise or were too innovative to persuade others of their future viability, thereby reducing the innovation activities across all corporations in the shareholder's portfolio.

Honest Mistakes. In scenario three, the agent was competent and loyal, but his project failed due to an honest business mistake despite significant investment of time and effort.[104] For example, a manager plans a $100 mil-

100. Based on the calculation of: *90%*$300M–10%*$100M.*

101. See Lori McMillan, The Business Judgment Rule as an Immunity Doctrine, 4 Wm. & Mary Bus. L. Rev. 521, 572 (2013) (noting that too stringent review of management decisions could have "a possible chilling effect on decision-making").

102. Steven L. Schwarcz, Corporate Governance and Risk-Taking: A Statistical Approach, 3 U. Chi. Bus. L. Rev. 149, 177 (2023) (discussing how shareholders' ability to diversify their portfolios makes them risk-prone to managerial decisionmaking).

103. See Goshen & Hamdani, Idiosyncratic Vision, supra note 72, at 578 (providing the paradigmatic example of this).

104. See Robert Cooter & Ariel Porat, Lapses of Attention in Medical Malpractice and Road Accidents, 15 Theoretical Inquiries L. 329, 330–32 (2014) (explaining why lapses should not be subject to liability).

lion investment in a new medical device. If approved by regulatory agencies, it would generate substantial revenue; if denied, the investment would be lost. To manage this risk, the manager commissions a report indicating a 1% probability of nonapproval, implying an expected loss of $1 million. As a precaution, they invest $1 million and allocate top resources to meet health regulators' standards. Unfortunately, the product is not approved, resulting in a $100 million loss. It later emerges that although the manager read the commissioned report twice, they missed that the probability of nonapproval was actually 2%. An additional $1 million in regulatory research could have prevented the loss. Should the agent be sanctioned for this honest mistake? The agent neither shirked their duties nor diverted value for personal gain; their sole intention was to promote the firm's value. Sanctioning managers for honest mistakes could lead to overinvestment in precautions, which would be detrimental. For instance, the manager might spend $5 million on regulatory diligence: $2 million for reasonable due diligence and an additional $3 million to avoid personal liability. Such excessive precautions would harm not only this firm but also other firms in the shareholder's portfolio.

Incompetence. In scenario four, the agent was loyal but incompetent, leading to the project's failure. They incorrectly assessed the investment's probabilities of success, estimating a 90% chance of generating $300 million and a 10% chance of losing $100 million, while the actual probabilities were reversed. Any experienced manager would have recognized this discrepancy. The agent did not benefit from the firm's loss nor shirk their duties; they simply made a poor decision due to incompetence. Should the principal impose sanctions on the agent? Sanctions might deter disloyal agents who misrepresent their competence, but such sanctions would also distort incentives for loyal and competent agents. Some individuals might honestly underestimate or overestimate their abilities.[105] Those underestimating their competence might avoid applying for jobs due to fear of liability, while those that overestimate their abilities might still apply. If this latter group is held accountable for their mistakes, honest individuals might start underestimating their competence, applying only for jobs they are overqualified for to avoid liability. Sanctioning incompetence also distorts a principal's choice between hiring an inexperienced agent at a lower salary or an experienced one at a higher salary, as potential candidates might avoid liability-prone jobs. Principals would struggle to appoint agents highly competent in one area but less so in another, as no agent would accept liability for mistakes in their weaker areas. Employees offered promotions or transfers might refuse opportunities requiring a learning period to avoid liability.

105. Self-evaluations are notoriously susceptible to mistake. See, e.g., Russell Korobkin, The Endowment Effect and Legal Analysis, 97 Nw. U. L. Rev. 1227, 1228 (2003) (depicting how individuals overvalue things because they possess them).

In summary, imposing liability for incompetence is undesirable. Strong candidates will avoid the firm, and current employees will resist skill development in new areas and decline promotions. This outcome is unfavorable for shareholders, who cannot attract and retain talent, and for management, who might face unfair liability for honest mistakes. Neither sanctions nor rewards can increase an agent's competence; if an agent is loyally performing to the best of their ability, punishment will not improve their skills.

Negligence. In scenario five, the agent was competent but disloyal, and the project failed due to the agent's negligence.[106] The agent prioritized personal leisure over work, leading to financial loss for the company. For example, the agent went to a movie instead of reviewing the probability analysis of the project's chances of success. Consequently, they assumed the $100 million investment had a 90% chance of generating $300 million and a 10% chance of losing $100 million, whereas the actual probabilities were reversed. The agent's negligence caused the project to fail. Should sanctions be imposed on the agent?

Negligence, unlike incompetence, is about effort, not ability. The agent is knowingly mismanaging the firm. But the harm to the corporation is not directly and proportionally tied to the manager's benefits from shirking their duties. If managers could enjoy the benefits of their negligence without harming the corporation, they would prefer it. The agent's benefit from watching a movie is not correlated to the loss caused by their negligence. Watching a movie might be worth $500 to the agent, but the lack of diligence inflicted a $100 million loss on the company. Thus, if the sanctions for negligence cost the agent more than $500, they will reconsider neglecting their duties. Reducing managerial negligence can be addressed by imposing liability. Sanctioning the manager for the $100 million loss will deter them from shirking their duties for a leisure activity valued at $500. We classify negligence as *mismanagement* because a competent agent *knowingly* decides not to invest the required effort in managing the firm.

Pet Project. In scenario six, the agent was competent but disloyal, and the project failed because it served the agent's personal interests rather than the company's. For example, the agent might have invested $100 million in an industry in which the company had no expertise or potential for success solely because the agent had a personal interest in learning about that industry. This kind of investment, known as a "pet project," generates personal benefits for the manager but does not provide an appropriate return for the firm.[107] Like negligence, pet projects yield benefits for the

106. Negligence is understood objectively, rather than by a subjective determination of a particular actor's abilities. Omri Ben-Shahar & Ariel Porat, Personalizing Negligence Law, 91 N.Y.U. L. Rev. 627, 646–56 (2016); see also Metro Storage Int'l LLC v. Harron, 275 A.3d 810, 844 (Del. Ch. 2022) (holding that a director's enhanced level of expertise does not change the liability analysis).

107. See, e.g., Steven Kaplan, The Effects of Management Buyouts on Operating Performance and Value, 24 J. Fin. Econ. 217, 234 (1989) (offering evidence in support of

manager that are not directly correlated with the damage to the firm. The manager might value the benefit gained from learning about the new industry at $100,000, while the company incurs a $100 million loss. But there is a critical difference. Damages from negligence occur "accidentally" due to inappropriate precautions, whereas in a pet project scenario, *knowingly* making a bad investment is necessary to generate the manager's private benefits. Despite this difference, the key similarity is that the manager's benefits are not tied to the company's loss. Thus, like negligence, it is a form of mismanagement, involving a knowing decision to invest in a losing project for indirect benefits. Imposing liability greater than the $100,000 personal benefit the agent gains from the pet project, such as holding them accountable for the $100 million loss, will deter such behavior.

Self-Dealing. In scenario seven, the agent was competent but disloyal, and the project failed because the $100 million investment was taken by the agent. For example, the agent may have outsourced R&D to their spouse's inexperienced company at a substantial premium. A transaction between the agent (or their affiliates) and the company is known as "self-dealing."[108] In most self-dealing scenarios, unlike pet projects and negligence, there is a direct correlation between the firm's loss and the agent's benefits.[109] The $100 million the firm lost ends up in the agent's spouse's bank account. Unfair self-dealing can be seen as the agent taking value directly from the company—every dollar lost by the company goes to the manager's pocket. While both self-dealing and mismanagement involve intentional decisions, they differ in how they benefit the agent: directly in self-dealing and indirectly in mismanagement. Clearly, preventing unfair self-dealing is crucial, as it involves the agent simply taking money from the company. The direct gain to the agent must therefore be met with a sanction of at least equal magnitude. Holding agents accountable for unfair self-dealing will deter disloyal transactions that deplete company value.

The above analysis shows that sanctions should be imposed on the agent in cases of mismanagement (negligence and pet project scenarios) and takings (unfair self-dealing), but not for ordinary losses due to misfortune, unsuccessful pursuit of idiosyncratic vision, honest mistakes, or incompetence. In a world without informational asymmetries, it would be

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the empire-building—pursuing size for the sake of size rather than profitability—hypothesis). Another example is managers diversifying their personal risk through inefficient acquisitions. See Yakov Amihud & Baruch Lev, Risk Reduction as a Managerial Motive for Conglomerate Mergers, 12 Bell J. Econ. 605, 605–06 (1981).

108. It is important to recognize that some transactions should be pursued despite an element of self-dealing associated with them. See infra Part III.

109. Other conflicted transactions involve the manager accepting a bribe to make the company enter a deal with a third party on nonmarket terms. These cases also constitute a taking from the company, although the premium given to the third party does not always directly correlate with the bribe amount.

clear which scenario caused the loss and whether the agent should be sanctioned. Shareholders and courts could equally make this determination.

In the real world, however, informational asymmetries make it difficult to ascertain the true cause of a loss. Managers may always blame losses on bad luck or misunderstood idiosyncratic vision. Determining the real cause of the loss is crucial, as mistakenly assigning managerial liability—such as finding negligence when it was bad luck, or vice versa—will distort incentives for shareholders and managers, leading to inefficient firm operations. The critical question is who should determine whether sanctions should be imposed on the agent: courts or shareholders? Parts II and III answer these questions for mismanagement and takings cases, respectively.

II. DENYING LEGAL LIABILITY FOR MISMANAGEMENT

Informational asymmetries between principals and agents are commonplace. Due to the incomplete nature of contracts, principals have imperfect information about their agents' actions and motivations.[110] These asymmetries make it difficult for principals—and judges—to accurately diagnose the cause of any loss in corporate value among the different prototypical scenarios.[111] It is extremely challenging to distinguish between losses resulting from managerial mismanagement, such as negligence and pet projects (when sanctions are warranted), versus those resulting from misfortune, unrealized idiosyncratic vision, honest mistakes, or incompetence.[112] This difficulty suggests that imposing sanctions for mismanagement could frequently lead to erroneous liability for losses actually caused by bad luck (scenario one), idiosyncratic vision (scenario two), honest mistakes (scenario three), or incompetence (scenario four). Consequently, the harmful effects of wrongly imposing sanctions and the failure to impose sanctions in negligence or pet project scenarios are likely to occur, distorting managerial incentives.

This Part analyzes whether cases of mismanagement (scenarios five and six) still warrant the imposition of legal liability given the probability of mistake. It addresses two key questions: First, who has a lower probability of mistake—judges or shareholder-principals? Second, who has a broader and more appropriate range of remedies to handle mismanagement?

Section II.A discusses the principal's lower probability of mistakes compared to the court in holding an agent accountable for mismanagement cases. Section II.B shows that principals, rather than courts, have a broader and more appropriate range of remedies to handle mismanage-

110. See, e.g., Goshen & Hamdani, Idiosyncratic Vision, supra note 72, at 566 ("Therefore, it is hard for investors to determine the real cause of a corporation's poor performance: it could be the entrepreneur's incompetence or laziness, temporary business setbacks, or simply bad luck.").

111. As a result, these informational asymmetries create further control costs. See id. at 565 (outlining the benefits that control offers entrepreneurs).

112. See id. at 566.

ment. Together, these sections explain why principals, not courts, should handle mismanagement cases. Sections II.C and II.D demonstrate that the relative superiority of shareholders in addressing mismanagement is bolstered by various market mechanisms and the presence of concentrated ownership, respectively.

A. *Probability of Mistakes in Holding Agents Accountable for Mismanagement*

While informational asymmetries in cases of corporate loss inhibit both shareholders and the judiciary, shareholders are better suited to handle losses from mismanagement. The information asymmetry between managers and the court is more severe than between managers and shareholders. The principal–agent asymmetry is significantly diminished outside the context of a judicial proceeding, which must adhere to strict procedural and evidentiary rules.[113] While a court is limited in considering certain types of information, these limitations do not apply to principals.[114] For instance, a court cannot consider past acts as evidence,[115] but principals can, enabling them to review the agent's past business decisions and their outcomes. Shareholders can also consider hearsay statements and rely on third-party opinions, such as analysts' reports, which are not subject to cross examination.[116] This allows shareholders to gather more information about the cause of a particular loss. Therefore, shareholders are less likely than the court to misinterpret the cause of a loss as negligence and erroneously sanction an innocent manager when the loss was actually due to an honest mistake or misfortune.

The same is true regarding the size of damages. While sometimes damages are easily verified and calculated, many damages are not. For example, when a manager negligently invests in a project that results in a total loss, the damage is the amount of the lost investment. But what about a pet project that functions moderately rather than completely failing? Imagine the project generates a low return but unexpectedly boosts the firm's industry reputation, aiding recruitment of high-quality talent. Many mismanagement cases, such as investments and acquisitions, fall into this category.[117] These transactions are motivated by personal interest and pro-

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113. See generally Alex Stein, Foundations of Evidence Law (2005) (providing a broad introduction to the rules and function of evidence law).

114. See Goshen & Hannes, supra note 34, at 294 ("Courts . . . may lack the . . . information about the firm's business that the agents and principal possess.").

115. See, e.g., Mercedes-Benz of N. Am. Inc. v. Norman Gershman's Things to Wear, Inc., 596 A.2d 1358, 1365 (Del. 1991) ("[Delaware's rule prohibiting the admissibility of character evidence] has equal application to civil . . . cases." (citing 1 Stephen A. Saltzburg & Michael M. Martin, Federal Rules of Evidence Manual § 404B (5th ed. 1990))).

116. See, e.g., Del. R. Evid. 802 ("Hearsay is not admissible except as provided by law or by these Rules.").

117. See, e.g., Douglas K. Smith & Robert C. Alexander, Fumbling the Future: How Xerox Invented, Then Ignored, the First Personal Computer 51–115 (1999) (detailing how Xerox's investment in its Palo Alto Research Center was designed to investigate new tech-

duce questionable benefits for the firm. Courts lack clear information sources to measure the damages and opportunity costs in such scenarios.[118] Shareholders and the investment community, including analysts, can better evaluate these inefficient transactions, reflecting their impact in the company's stock price.[119]

One might object that even if principals have lower informational asymmetry, judges might still have a lower risk of error in certain cases due to the judicial process. Formal procedures such as deposition or discovery can reveal hidden information, potentially offsetting the limited information judges are legally allowed to consider. This might be true in self-dealing scenarios, when the distinguishing facts depend on observable and verifiable conflicts of interest.[120] But this is not the case in mismanagement scenarios, when the critical facts often involve the manager's intentions—facts that are not easily observable or verifiable.[121] Observable facts in mismanagement cases typically pertain to flawed processes, which do not provide reliable differentiating data.[122]

B. *The Range of Remedies to Handle Mismanagement*

Informational asymmetries are not the only factor affecting the risk of mistakes in holding an agent accountable—the type of remedy also impacts this risk. The main remedy available to courts is the imposition of legal liability on the agent for damages caused to corporate value.[123] By its nature, the court must make a binary decision (liable or not liable) about a past event and provide a remedy that is usually monetary and irreversible.[124] Such a remedy can have significant side effects if the judgment is

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nologies that were never properly commercialized but nonetheless gave Xerox significant reputational gains).

118. See, e.g., Lewis v. Vogelstein, 699 A.2d 327, 336 (Del. Ch. 1997) ("Courts are ill-fitted to attempt to weigh the 'adequacy' of consideration under the waste standard or, *ex post*, to judge appropriate degrees of business risk.").

119. Reflection of these risks in the stock prices requires only minimal assumptions of market efficiency. See Ronald J. Gilson & Reinier Kraakman, The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias, 28 J. Corp. L. 715, 717 (2003) (concluding that the efficient market hypothesis remains predictive even when adjusted to the objections of behavioral finance).

120. See infra section III.A.

121. This is not to say that courts cannot adjudicate based on such facts of motivation, as they often do in fields such as criminal law. It is just that principals in the corporate arrangement are better equipped to do so.

122. Indeed, given the difficulty of assessing process, courts defer to agents and principals. See, e.g., Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 45 (Del. 1994) ("There are many business and financial considerations implicated in investigating and selecting the best value reasonably available. The board of directors is the corporate decisionmaking body best equipped to make these judgments.").

123. See, e.g., In re Orchard Enters., Inc. S'holder Litig., 88 A.3d 1, 38–41 (Del. Ch. 2014) (explaining various forms of damages for corporate harm).

124. The finality of this decision assumes all appeals have been exhausted.

mistaken.[125] In contrast, principals have a broader range of potential remedies to both ex ante prevent damage and ex post discipline mismanagement. These remedial measures can minimize the risk of a mistaken response to an agent's loss of company value and its side effects.

Ex Ante Remedies. Principals can use ex ante remedies to prevent mismanagement by improving the agent's incentives and monitoring their actions.[126] Mismanagement reflects an indirect taking of private benefits, so even a small change in the incentive structure can deter such behavior.[127] For instance, in the negligence scenario mentioned earlier, the manager's decision to watch a movie provided a benefit of $500. If the agent's compensation included 0.1% of the company's shares, a $100 million loss would result in a $100,000 personal loss, incentivizing the agent to avoid negligence and manage the firm properly. Additionally, managers' decisions are continuously monitored by the board of directors and third parties, like analysts and rating agencies.[128] This allows principals to learn about the agent's motivation and competence before mismanagement occurs, providing the opportunity to preemptively remove the agent if necessary.[129]

Ex Post Remedies. Principals with discretionary control rights can replace an agent when loyalty and competence are questionable. While this remedy may entail side effects similar to erroneous impositions of liability, it differs significantly from judicially imposed legal liability. A court must make a definitive decision about the agent's legal liability based on the information presented at trial.[130] In contrast, the principal-owner

125. A request for a preliminary injunction has a lower risk of mistakes given the requirements of proving "irreparable harm" and "likelihood of success on the merits." Cantor Fitzgerald, L.P. v. Cantor, 724 A.2d 571, 579 (Del. Ch. 1998).

126. See, e.g., Jensen & Meckling, supra note 62, at 308 ("The *principal* can limit divergences from his interest by establishing appropriate incentives for the agent and by incurring monitoring costs . . . ."); see also Steven Shavell, Risk Sharing and Incentives in the Principal and Agent Relationship, 10 Bell J. Econ. 55, 55–57 (1979) (discussing the impact of fee structures between principals and agents).

127. In addition to incentive packages, companies that wish to discourage managers from thwarting certain proposals (such as a CEO who works to block a tender offer to maintain their position) provide management with special incentives to approve such proposals (such as a generous severance package, serving as a "golden parachute" if the company were to change hands). See Eliezer M. Fich, Anh L. Tran & Ralph A. Walkling, On the Importance of Golden Parachutes, 48 J. Fin. & Quantitative Analysis 1717, 1718 (2013) (describing the potential benefits of golden parachutes).

128. Other times a corporation is monitored by a third party designed to review remediation efforts. See Veronica Root Martinez, Public Reporting of Monitorship Outcomes, 136 Harv. L. Rev. 757, 758–59 (2023) (explaining when an independent monitor is used to oversee remediation efforts).

129. If the governance structure chosen by the parties allows the shareholders to replace the manager, they will decide whether to exercise that right; if the parties elected for a governance structure under which the investors waived the right to replace management, these investors would simply bear the costs of the investment's failure.

130. See, e.g., Beard Rsch., Inc. v. Kates, 8 A.3d 573, 613 (Del. Ch. 2010) ("Nevertheless, when acting as the fact finder, this Court may not set damages based on

can choose to wait and not immediately replace the agent after a loss occurs.[131] The principal-owner can observe the agent's conduct over a longer period (before and after the bad decision), work to reduce informational asymmetries, and decide whether to fire the agent based on past and future observations.[132] Additionally, while a court ruling is final, the owner can reverse a decision and rehire the agent if they realize they made a mistake.[133] This flexibility and discretion in dismissing an agent allow the principal to minimize the risks of mistakes compared to a court imposing legal liability.

In sum, the principal's informational and remedial advantages indicate that principals are better suited than courts to address losses from mismanagement. Put differently, the court's competence costs—its ability to correctly identify and sanction mismanagement cases—are higher than those of shareholders. Principals have a lower likelihood of making mistakes when distinguishing between mismanagement and other business-related losses. As the following section demonstrates, this is even more evident considering the various markets in which principals and agents operate.

C. *Mismanagement and the Market*

Principals and agents do not operate in a vacuum. They exist within a larger market composed of various actors who can regulate corporate relationships. Shareholders not only enjoy informational and remedial advantages over courts but can also rely on market mechanisms to address mismanagement. Various markets, including the capital market, the market for corporate control, the product market, and the market for manag-

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mere 'speculation or conjecture' . . . ." (quoting Medek v. Medek, No. Civ.A. 2559-VCP, 2009 WL 2005365, at *12 n.78 (Del. Ch. July 1, 2009))).

131. Indeed, determining if the cause of the loss was in fact managerial incompetence requires the gathering of information over a prolonged time period.

132. A long-term relationship between the principal and the agent provides the former a broader perspective of the latter based on a larger number of observations. See Roy Radner, Monitoring Cooperative Agreements in a Repeated Principal–Agent Relationship, 49 Econometrica 1127, 1128 (1981) (using the theory of repeated games to explore situations in which long-lasting, informalized relationships encourage and maintain cooperative behavior by signaling intentions to punish defectors from informal agreements); see also Bengt Holmström, Managerial Incentive Problems: A Dynamic Perspective, 66 Rev. Econ. Stud. 169, 170 (1999) (investigating the idea that career concerns induce efficient managerial behavior); Joseph E. Stiglitz, Principal and Agent (ii), *in* The New Palgrave Dictionary of Economics 10,737, 10,738–41 (John Eatwell, Murray Milgate & Peter Newman eds., 3d ed. 2018) (explaining the challenges of designing incentive structures within the principal–agent's ongoing, imperfectly defined relationship).

133. For example, consider the firing and later rehiring of Steve Jobs from Apple. See Walter Isaacson, Steve Jobs 183–206 (2011) (describing Steve Jobs's return to Apple after being ousted); Randall Lane, John Sculley Just Gave His Most Detailed Account Ever of How Steve Jobs Got Fired From Apple, Forbes (Sep. 9, 2013), http://www.forbes.com/sites/randalllane/2013/09/09/john-sculley-just-gave-his-most-detailed-account-ever-of-how-steve-jobs-got-fired-from-apple [https://perma.cc/4YW4-8AMA] (last updated Sep. 11, 2013).

ers, regulate management's behavior and reduce the risk of mismanagement. These markets work in parallel to support the relative superiority of principals in addressing cases of mismanagement. This section will address each market in turn.

The capital markets, particularly the equity markets, disincentivize mismanagement.[134] When managers engage in mismanagement, informed and sophisticated investors will adjust the stock price to reflect the negative consequences.[135] An efficient equity market thus reduces the risk that corporate mismanagement will go unnoticed. Furthermore, the threat of exposure by these investors deters corporate directors and officers from engaging in mismanagement.[136] Shareholders can expect that, in some instances, even prospective investors will detect or address cases of mismanagement on their behalf.[137]

The market for corporate control challenges inefficient managers. The fear of a hostile takeover is a strong deterrent against mismanagement, as managers risk being replaced immediately after a change of control.[138] Similarly, the threat of shareholder activism, particularly by activist hedge funds, deters mismanagement.[139] The more an agent mismanages a company, the greater the likelihood it will become a target for activist hedge funds or hostile takeover raiders. Fearful that raiders or activist involvement will result in their replacement, agents are motivated to avoid mismanagement to protect their positions.

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134. See Zohar Goshen & Gideon Parchomovsky, The Essential Role of Securities Regulation, 55 Duke L.J. 711, 750 (2006) ("The analysts' market reduces . . . mismanagement.").

135. Id. at 750–51.

136. See Zohar Goshen, The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality, 91 Calif. L. Rev. 393, 423 (2003) [hereinafter Goshen, Self-Dealing] (explaining that the capital market serves "an important function: informing market participants about existing and potential expropriations and incorporating this information into the price of the stock"); see also Robert B. Thompson, Collaborative Corporate Governance: Listing Standards, State Law, and Federal Regulation, 38 Wake Forest L. Rev. 961, 972–74 (2003) (explaining the corporate governance role of stock exchanges).

137. This reliance can, at times, be even stronger if the corporation is at least partially held by groups of particularly committed and sophisticated shareholders. See Lawrence A. Cunningham, The Case for Empowering Quality Shareholders, 46 BYU L. Rev. 1, 5 (2020) (detailing profiles of investment conviction as measured by the degree of an investor's portfolio diversification versus concentration).

138. See, e.g., Easterbrook & Fischel, Responding to a Tender Offer, supra note 38, at 1173–74 (theorizing tender offers as a monitoring force); Andrei Shleifer & Robert W. Vishny, Value Maximization and the Acquisition Process, J. Econ. Persps., Winter 1988, at 7, 11–12 (discussing the same and offering suggestions for improving the takeover process); see also Bernard S. Sharfman & Marc T. Moore, Liberating the Market for Corporate Control, 18 Berkeley Bus. L.J., no. 2, 2021, at 1, 30–41 (presenting empirical evidence that the market for corporate control improves shareholder value).

139. See Paul Rose & Bernard S. Sharfman, Shareholder Activism as a Corrective Mechanism in Corporate Governance, 2014 BYU L. Rev. 1015, 1051 (modeling the corrective role of shareholder activism); Bernard S. Sharfman, A Theory of Shareholder Activism and Its Place in Corporate Law, 82 Tenn. L. Rev. 791, 794 (2015) (theorizing the value-enhancing role of offensive shareholder activism).

The products market in which the firm operates also deters mismanagement.[140] A mismanaged company is inefficient and will inevitably produce inferior and more expensive products compared to well-managed companies.[141] This is especially true in highly competitive markets, when the marginal costs of mismanagement can mean the difference between profitability and financial ruin.[142] In such environments, failing companies are driven out of the market, and managers who wish to maintain their positions cannot afford to mismanage. Admittedly, in uncompetitive markets, the products market's ability to regulate managers diminishes.[143] Managers in concentrated markets or monopolies can extract private benefits from consumers without risking the company's viability, as sizable margins allow them to extract value before jeopardizing their jobs.[144]

Finally, the risk of reputational harm regulates management's conduct.[145] Public exposure of mismanagement harms the manager's personal reputation, reducing their market value as a manager and negatively impacting both current compensation and future job prospects. Consequently, mismanagement is discouraged by the fear of exposure and social punishment.[146]

The net result is that various market mechanisms help diminish the likelihood and costs of mismanagement. By reducing the expected losses

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140. See Oliver D. Hart, The Market Mechanism as an Incentive Scheme, 14 Bell J. Econ. 366, 366 (1983) (theorizing the impact of products markets on agent costs); Klaus M. Schmidt, Managerial Incentives and Product Market Competition, 64 Rev. Econ. Stud. 191, 191 (1997) (theorizing that the disciplining impact of the products markets may sometimes harm profitability); Rachel Griffith, Product Market Competition, Efficiency and Agency Costs: An Empirical Analysis 25 (Inst. for Fiscal Stud., Working Paper No. 01/12, 2001), https://www.econstor.eu/bitstream/10419/71529/1/33016659X.pdf [https://perma.cc/7JKF-HEH9] (providing empirical evidence that the products market plays a key role in reducing agent costs).

141. See Hart, supra note 140, at 366.

142. Id. at 370–71 (examining the products market under perfectly competitive conditions and finding that profits decrease as the cost of supervising managers increases).

143. Id. at 372–73 (modeling the reduced discipline of the products markets under monopolistic conditions).

144. Although market competitiveness significantly regulates the agency problem between management and shareholders, it is primarily regulated through antitrust law and import–export regulations. See Ramsi A. Woodcock, The Antitrust Case for Consumer Primacy in Corporate Governance, 10 U.C. Irvine L. Rev. 1395, 1426 (2020) (analyzing the connections between antitrust and corporate governance).

145. See, e.g., Thomas David, Alberta Di Giuli & Arthur Romec, CEO Reputation and Shareholder Voting, J. Corp. Fin., Dec. 2023, at 1, 1–2 ("[R]esearch in corporate governance has outlined that managerial reputation, and in particular the fear of damaging it, can serve as an effective governance mechanism by deterring managers to act in self-interested ways." (citations omitted)); Claire A. Hill, Marshalling Reputation to Minimize Problematic Business Conduct, 99 B.U. L. Rev. 1193, 1196 (2019) (discussing the role of reputation in the management of corporations).

146. See Eugene F. Fama, Agency Problems and the Theory of the Firm, 88 J. Pol. Econ. 288, 291–92 (1980) (describing the impact of reputation on managers competing in the labor market).

from mismanagement, these mechanisms reinforce the idea that mismanagement cases are best resolved by principals directly. Principals can rely not only on their own advantages but also on market mechanisms to internalize much of the costs of monitoring agents, making their review of mismanagement significantly more effective than that of courts. By deterring mismanagement, market mechanisms ensure that the expected losses regulated by principals are smaller than those from erroneous judicial impositions of unwarranted legal liability.[147]

D. *Concentrated Ownership and Its Effect on Mismanagement*

Enter concentrated ownership. Some firms have a single shareholder or a small group of shareholders who control the majority of the firm's stock.[148] While the previous analysis highlighted how market mechanisms deter mismanagement, it was based on the assumption of dispersed ownership. Firms with concentrated ownership, when a single investor or group of investors holds control, are relatively insulated from market mechanisms. No market for hostile takeovers exists when a firm has a controlling owner,[149] and the power of hedge fund activists is similarly limited,[150] as all other shareholders hold a minority or noncontrolling stake.

Despite their relative immunity from market forces, firms with concentrated ownership can adequately guard against mismanagement costs without judicial intervention. When a firm has concentrated ownership, the principal–agent dynamics must be adjusted. A shareholder with a controlling block of shares effectively becomes the agent of the corporation and its minority shareholders, exerting control either directly or through appointed directors. The noncontrolling shareholders remain the principals of the firm.

Importantly, when the controlling owner holds a considerable number of shares with cash flow rights, they are strongly incentivized to detect and prevent mismanagement by hired managers without relying on market mechanisms for support.[151] Otherwise, the controlling owner will bear the greatest part of any damage caused by mismanagement.

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147. See Goshen, Self-Dealing, supra note 136, at 421 ("[I]f the legal system generates prohibitive adjudication costs, these [market] mechanisms are likely to produce less expensive means of enforcement or to reduce negotiation costs to a point where recourse to the courts is unnecessary.").

148. See generally Ann M. Lipton, The Three Faces of Control, 77 Bus. Law. 801 (2022) (analyzing the controlling shareholder concept in corporate law).

149. See, e.g., Zohar Goshen, Controlling Corporate Agency Costs: A United States–Israeli Comparative View, 6 Cardozo J. Int'l & Compar. L. 99, 115 (1998) ("The market for corporate control is powerless when faced with the control problem.").

150. See Kobi Kastiel, Against All Odds: Hedge Fund Activism in Controlled Companies, 2016 Colum. Bus. L. Rev. 60, 75 n.54 (describing the disciplining impact of activism in controlled companies as "almost impossible").

151. This analysis may raise questions with respect to dual-class companies and companies that contractually assign control to another without an investment of a considerable

Controlling shareholders can often leverage their positions to act as managers. Even in cases of potential mismanagement by a controlling owner, however, there is no direct link between the private benefits they extract and the damage caused to the company. The indirect benefits a controlling owner-agent might receive from mismanagement are rarely greater than the substantial direct damages to their controlling stake.[152] In previous examples of mismanagement, the agent received a limited benefit while the company bore the damage. In a concentrated ownership structure, the controlling owner-agent experiences both the relative benefit that could incentivize mismanagement and the damage it causes. Since any benefits from mismanagement are minimal compared to the damage to the company's value, a concentrated ownership structure disincentivizes mismanagement.[153]

As illustrated in Part III, this is not true for self-dealing cases, when the damage to the firm is directly proportional to the benefit gained by controlling shareholders. But in mismanagement cases, principals are better suited to address these scenarios than the courts, even with concentrated ownership. They rely on an owner-agent whose incentives are to closely monitor the firm, thereby reducing agent conflict and competence costs.

III. JUDICIAL INTERVENTION IN SELF-DEALING

The discussion above demonstrates that legal liability ought to be avoided in cases of mismanagement. Self-dealing scenarios are different. They present distinct considerations that often justify judicial intervention. As with cases of mismanagement, when reviewing a conflicted transaction, informational asymmetries between the court, principal, and agent make it difficult to determine the real reason for the company's losses. Acting under such uncertainties carries a risk that managers falsely suspected of unfair self-dealing will face liability. But there are four important differences in cases of self-dealing. First, the risk of the judiciary mistakenly identifying a self-dealing scenario (scenario seven above) is significantly lower than that of mistakenly identifying a mismanagement case. Second, the principal's remedies are insufficient to deal with self-dealing. Third, market mechanisms do not provide adequate safeguards to support principals in combating takings scenarios. Lastly, the concentration of ownership

amount of capital. See, e.g., Dorothy S. Lund, Nonvoting Shares and Efficient Corporate Governance, 71 Stan. L. Rev. 687, 701–14 (2019) (providing a historical account of dual-class structures and regulations).

152. This is not to say that managers appointed by the controlling owner are immune from committing negligence, but that the controlling owner has a greater incentive than any other shareholder to ensure that management does not act negligently.

153. See Goshen & Hamdani, Idiosyncratic Vision, supra note 72, at 593 ("[S]ubstantial equity investment by the entrepreneur strongly aligns [their] interests with those of the investors, thereby reducing management agency costs.").

does not reduce the incentive of the agent to divert value from the firm to themselves. Sections III.A, B, C, and D proceed in this order.

A. *Probability of Mistakes in Holding Agents Accountable for Unfair Self-Dealing*

When an agent engages in takings, or unfair self-dealing, they enter into a transaction between the company and themselves (or affiliates) that does not reflect fair market value, diverting value from the company to themselves.[154] The key difference between self-dealing (scenario seven) and other corporate losses (scenarios one through six) is the conflict of interest, which can be objectively observed and verified with a low risk of error. This contrasts with suspected mismanagement, when the crucial factor is the agent's *state of mind*, which is difficult to observe and verify, leading to a high risk of error. For example, if a director pressures the company to buy raw materials from their private metals company, courts can easily identify the conflict of interest by noting the contract's existence. But if the chosen supplier was not the director's company, and the issue was whether it was an adequate choice, courts would still face a high risk of misjudging it as mismanagement.

Detecting self-dealing is not only easier than identifying mismanagement, but courts also have the tools to reveal instances of self-dealing. The hallmark of self-dealing is the objective presence of conflict, not the agent's subjective mental state, as in mismanagement cases.[155] This allows courts to use their authority and evidentiary tools to lower their probability of mistake. For example, courts can compel the discovery of documents and testimony to uncover conflicts of interest.[156] If a director might benefit from a contract between their firm and another company, the court could order the production of that company's stockholder ledger to reveal hidden connections.[157] Courts can also enforce the shareholder's books and records right to obtain details on suspicious transactions when directors refuse shareholder requests.[158] For instance, if a shareholder requests a

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154. 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) (offering a robust economic analysis of the law of self-dealing).

155. Self-dealing falls under the duty of loyalty, which otherwise also captures bad faith acts. See Stone ex rel. AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006) (en banc) ("[T]he fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith.").

156. See, e.g., Shapiro v. Nu-W., No. C.A. 15442-NC, 1998 WL 732891, at *1, *5 (Del. Ch. Oct. 1, 1998) (finding that discovery "reasonably calculated" to showing a conflict of interest may even outweigh expectations of privacy).

157. See, e.g., Gill v. Regency Holdings, LLC, No. 2023-0349-BWD, 2023 WL 4607070, at *1 (Del. Ch. June 26, 2023) ("Plaintiffs are entitled to rely on the Company's membership ledger to establish their standing to demand books and records.").

158. Highland Select Equity Fund, L.P. v. Motient Corp., 906 A.2d 156, 164 (Del. Ch. 2006) ("Delaware law provides a statutory right for a stockholder to inspect the books and

copy of materials provided to the board in connection with a transaction they approved, and the board refuses, the court can enforce this right if the request is made in "good faith" and serves a "proper purpose."[159] Principals lack access to these powerful investigative tools without court intervention, making the courts' probability of error significantly lower than that of principals acting independently.[160]

Similar considerations apply to the court's ability to assess damages caused by self-dealing. Unlike in mismanagement cases, in which courts face complexities in assessing damages, in self-dealing cases, the quality of the business decision is the issue, and courts can assess damages based on the valuations of the exchanged values.[161] In mismanagement cases, the agent benefits indirectly from an inefficient decision, requiring an estimate of how much worse the decision is compared to an optimal one. This complex task involves hypothetical and counterfactual analysis, making it difficult for courts to provide predictable and accurate answers.[162] As explained in section II.A, principals are better suited to handle this task as they experience fewer informational asymmetries given their access to information about past and future managerial acts and by having better competence to evaluate the quality of business decisions.

In self-dealing scenarios, courts do not suffer from the same informational asymmetries. These cases involve determining the fairness of a transaction, asking whether the price paid in a conflicted transaction is comparable to nonconflicted ones. For example, the court would determine if the price paid to the raw materials company owned by the conflicted director is similar to what an identical company not owned by that director would have received. Although this is a complex task, the court can rely on expert opinions and acceptable valuation models, leading to predictable and accurate outcomes.[163] Unlike in mismanagement cases,

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records of a corporation under 8 Del. C. § 220, so long as the form and manner requirements for making a demand are met, and the inspection is for a proper purpose." (emphasis omitted)), aff'd, 922 A.2d 415 (Del. 2007).

159. Del. Code tit. 8, § 220 (2025) (providing that, procedurally, all requests must be "specifically related to the stockholder's purpose," which must be communicated with "reasonable particularity").

160. The shareholders' inability to unilaterally guarantee the enforcement of the books and records right also reduces their ability to detect mismanagement. But since mismanagement centers on the state of mind of the agent rather than the brute facts of the transaction, this reduction pales in comparison to the power of the shareholders' other assessment tools in mismanagement. See supra section II.A.

161. In tort terms, the harm is more akin to embezzlement than to accidental damage.

162. See, e.g., In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996) ("[There are] good policy reasons why it is so difficult to charge directors with responsibility for corporate losses for an alleged breach of care . . . .").

163. See, e.g., William J. Carney & Keith Sharfman, The Death of Appraisal Arbitrage: Ending Windfalls for Deal Dissenters, 43 Del. J. Corp. L. 61, 91 (2018) (analyzing corporate law's sensitivity to the field of finance). There are, however, challenging cases in which valuation is not attainable. See, e.g., Zohar Goshen & Assaf Hamdani, Corporate Control,

courts examining self-dealing are not left to review damages based on inaccessible information, such as the agent's motivations or hypothetical optimal decisions.

B. *The Range of Remedies to Handle Self-Dealing*

Beyond informational asymmetries, the range of remedies available to courts in self-dealing cases is superior to that available to principals. This contrasts with mismanagement scenarios, when principals have wide latitude in administering both ex ante and ex post remedies.[164] In self-dealing cases, the agent's extraction of value might be so substantial that the principal lacks leverage to discipline them, whether ex ante or ex post.

From an ex-ante perspective, principals lack sufficient leverage to deter self-dealing effectively. In mismanagement cases, like the agent negligently causing $100 million in damages by watching a movie, granting the agent 0.1% of the company's shares can prevent such behavior due to the small indirect benefit. But in self-dealing cases when the agent is taking $100 million, no incentive plan, not even granting 50% of the shares, can prevent it. Incentive structures effective against mismanagement fail here, as agents can often extract more from self-dealing than from any incentive-based compensation package.[165]

Principals are also ill-equipped to handle self-dealing cases ex post. In mismanagement cases, principals can use their access to past and future information and their ability to fire and rehire agents to discourage mismanagement. But these remedies are ineffective against self-dealing. In takings cases, the agent can take a large amount and be indifferent to being removed or rehired.[166] Only courts can effectively address self-dealing by forcing the agent to compensate the principal for the amount taken.

Monitoring the agent alone is insufficient to combat takings, despite the possibility of spotting suspected self-dealing transactions. The right to fire the agent is only effective if exercised before the private benefits are taken. If the agent can extract greater private benefits than the value of their position, the threat of eventual dismissal is not a deterrent. Thus, companies must establish means beyond monitoring to either prevent self-dealing ahead of time or recover the taken benefits afterward, which necessitates judicial action for enforcement.

Dual Class, and the Limits of Judicial Review, 120 Colum. L. Rev. 941, 946 (2020) (describing the inherent difficulties in valuing the reallocation of control rights).

164. See supra section II.B.

165. For discussion of the effectiveness of compensation packages in decreasing conflict costs, see generally Lucian Arye Bebchuk & Jesse M. Fried, Executive Compensation as an Agency Problem, J. Econ. Persps., Summer 2003, at 71 (debating whether executive compensation is structured to reduce agent costs or is itself a manifestation of them).

166. See Djankov et al., supra note 154, at 430–31 (explaining how agents can expropriate resources from the corporation and "'take the money and run' in an unregulated environment").

Courts are better situated to address self-dealing cases than principals. When handling managerial takings, courts do not face the same informational asymmetries, and they possess the necessary remedial powers for a more efficient resolution, making adjudication costs lower than principal costs in self-dealing cases.[167] By focusing on whether self-dealing occurred and determining the difference between a fair and unfair price, courts avoid the heightened probability of mistakes and lack of remedial flexibility that they face in mismanagement cases. Principals, on the other hand, cannot use compensation packages or discretionary control rights to adequately deter or address self-dealings. The following section demonstrates that this remains true even when considering the various market mechanisms that principals typically rely on.

C. *Self-Dealing and the Market*

While market mechanisms limit the principal costs associated with mismanagement, they are much less effective against managerial takings, further supporting the need for judicial intervention in self-dealing scenarios. Self-dealing occurs *despite* the potential deterrence of market mechanisms because the agent's direct taking of private benefits outweighs the expected costs. Agents will engage in self-dealing only if the benefits significantly exceed the costs imposed by markets, including the capital, corporate control, products, and managerial markets. Without court involvement, principals are ill-equipped to handle self-dealing, even with market mechanisms.

Market mechanisms fail to prevent self-dealing for the same reason owners struggle to do so: The agent's fear of a drop in corporate value and subsequent consequences cannot alone prevent self-dealing. Reduced company value may lower the agent's compensation or lead to their replacement, but, if the direct private benefits extracted are higher, or if the agent plans to loot the company before being fired, self-dealing remains a net gain. The market for corporate control is also ineffective in deterring self-dealing because the takeover process is long and expensive, reducing the agent's concern about post-merger replacement.[168] Similarly, hedge fund activism, given the time required to run a proxy fight to replace managers, allows managers sufficient leeway to extract private benefits before being fired.[169]

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167. See supra Part II.

168. The market for corporate control is especially ineffective at preventing self-dealing because the threat of a takeover must be substantially possible to have any effect. See Goshen, Self-Dealing, supra note 136, at 422 ("The effectiveness of the market for corporate control depends, inter alia, on the prevalence of potential tender offerors who monitor the market to locate inefficient corporations . . . and the existence of a legal regime that makes it difficult for the current controlling owners to prevent takeovers.").

169. Hedge fund activism is also more likely to be falsely targeting the wrong firm. See Zohar Goshen & Reilly S. Steel, Barbarians Inside the Gates: Raiders, Activists, and the Risk

The product market alone cannot effectively deter self-dealing because an agent's incentives to self-deal outweigh potential repercussions if their company is driven out of the market. Admittedly, the product market can theoretically enhance the deterrent effect of reputational harm.[170] In the age of social media, negative publicity and reputational damage from a self-dealing agent can lead to a consumer boycott of both the company and the agent, especially if the market offers sufficient substitutes.[171] But the product market often lags behind instances of self-dealing, allowing the agent ample time to extract personal value before any reputational harm unfolds.[172] For example, a director might direct the company to use their own company for raw materials, knowing they are inferior. Consumers may eventually notice and create a negative buzz, but these events will occur long after the director has extracted personal value and prepared for any public fallout.

While market mechanisms can occasionally restrain self-dealing, they are far less effective than in preventing mismanagement. Principals cannot rely on market mechanisms to mitigate their limitations in addressing self-dealing, as agents retain incentives to commit takings despite these market forces—further supporting the need for judicial involvement. The following section demonstrates that this holds true in firms with concentrated ownership.

D. *Concentrated Ownership and Its Effect on Self-Dealing*

Judicial involvement in reviewing self-dealing is even more necessary in firms with concentrated ownership. In such structures, agents are largely unregulated by market mechanisms, as the controlling shareholder assumes the agent's role.[173] The threats of takeovers, activism, and consequences in the product markets or negative effects arising from the agent's reputation are minimal. Controlling owner-agents do not fear intervention in company operations or being fired.[174] While insularity from markets exists in both mismanagement and self-dealing scenarios, its negative effects manifest only in self-dealing. Therefore, market mechanisms are ineffective at deterring a controlling owner from engaging in self-dealing.

Minority shareholders cannot prevent self-dealing on their own and lack effective market support to address losses from a controlling owner-agent's self-dealing. While controlling shareholders are disincentivized from mismanagement due to the proportional harm to their stake, self-

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of Mistargeting, 132 Yale L.J. 411, 415 (2022) ("[A]ctivists have a higher risk of *mistargeting*—mistakenly shaking things up at firms that only *appear to be* underperforming . . . .").

170. See supra notes 140–143, 145–146 and accompanying text.

171. See supra notes 138–139 and accompanying text.

172. The products markets only respond once sales begin, which naturally comes after any contract governing production is entered into.

173. See supra section II.D.

174. See supra section II.D.

dealing remains unchecked since the agent's gain always surpasses their loss in firm value.

The types of cases warranting judicial intervention are consistent across firms with either concentrated or dispersed ownership. While market mechanisms guard against mismanagement risks in dispersed ownership firms, they are ineffective against self-dealing. In concentrated ownership firms, insulation from market discipline deters mismanagement but encourages self-dealing. Despite the different paths each ownership structure takes, the outcome is the same: Judicial intervention is the most efficient solution only in cases of managerial takings.

IV. THE ROLE OF SPECIALIZED COURTS

Principals are better equipped to handle mismanagement cases, while courts are necessary for self-dealing cases. But why should such a court be specialized? Does it matter if the court is experienced, like Delaware's Court of Chancery, or inexperienced, like the new Texas Business Court that Tesla has moved to or the planned Nevada court? This Part answers these crucial questions and explains why specialized corporate law courts are necessary. While general courts can resolve complex factual disputes, such as those between a tort victim and a brain surgeon, specialization is necessary for corporate disputes.

Unlike other areas of law, such as medical malpractice or tort liability due to construction defects, corporate law adjudication involves ongoing, triangular relationships regulated by incomplete contracts.[175] In noncorporate private law cases, judges simply determine liability and damages without considering whether they are the most suitable party to resolve the dispute.[176] Conversely, courts dealing with corporate law must recognize they are one player alongside the shareholders and the managers in an ongoing relationship.[177] Corporate courts must consider the limits of their authority and sometimes defer to alternative mechanisms for protecting shareholders, such as the exercise of discretionary control rights or other external mechanisms.[178]

While specialized corporate courts understand their role in the tripartite arrangement between agents, principals, and courts, this alone does not explain the unique specialization of corporate law. This Part demonstrates the nexus between the adjudicatory tools developed by specialized courts and their essential functions. Sections IV.A and IV.B explain,

175. See supra section I.A.

176. See supra section I.A. Certain public law adjudication postures, including constitutional law adjudication, require similar considerations. See 1 Henry M. Hart, Jr. & Albert M. Sacks, The Legal Process: Basic Problems in the Making and Application of Law 188–89 (1958) (explaining the process and theory of adjudicating public law disputes).

177. See Hart & Sacks, supra note 176, at 6–7 (explaining the interplay between public and private decisions).

178. See supra sections II.C, III.C.

respectively, the important and specialized functions of the business judgment rule in mismanagement cases and the salient functions of the "entire fairness test" in addressing self-dealing cases. Subsequently, section IV.C situates the dynamics between corporate courts and legislatures in the development of these review doctrines. Together, this Part explains the necessity of specialized corporate law courts and the nexus between corporate law and specialization.

A. *The Business Judgment Rule and Mismanagement*

Part II concluded that both shareholders and management prefer that judges abstain from resolving mismanagement cases. To achieve this, business courts must develop specialized tools for screening the right cases. This section explains how specialized courts use the business judgment rule (section IV.A.1) and legislatively enabled exculpation provisions (section IV.A.2) to accomplish this goal. Section IV.A.3 then reveals the nexus between judicial specialization and mismanagement.

1. *The Role of the Business Judgment Rule.* — Specialized business courts' application of the business judgment rule fulfills their obligation to defer mismanagement cases to shareholders. The business judgment rule stipulates that if management makes an informed decision in good faith and without conflicts of interest, the court applies a lenient rationality test, essentially deferring to management's judgment.[179] Any challenge against such a decision is dismissed unless the plaintiff can plead that the decision was irrational.[180] The threshold for irrationality is extremely high—demonstrating unreasonableness or stupidity is not enough.[181] Plaintiffs almost never meet this heavy burden.[182]

The four prerequisites for the business judgment rule's applicability are: (1) informed (2) action[183] (3) in good faith (4) unencumbered by a conflict of interest.[184] If either of the first two prerequisites is not met (i.e.,

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179. See Aronson v. Lewis, 473 A.2d 805, 811–13 (Del. 1984) (providing an overview of the business judgment rule); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) ("A board of directors enjoys a presumption of sound business judgment, and its decisions will not be disturbed if they can be attributed to any rational business purpose.").

180. Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) (en banc) ("Irrationality is the outer limit of the business judgment rule." (footnote omitted)).

181. See id. This standard works similarly to "rational basis review" in constitutional law. See Tomer S. Stein, Judicial Review in Public and Private Governance, 102 Wash. U. L. Rev. 313, 321 (2024) (explaining the parallels).

182. Mary Siegel, The Problems and Promise of "Enhanced Business Judgment", 17 U. Pa. J. Bus. L. 47, 50 (2014).

183. Cases of omissions are captured by the duty to monitor, which also provides a high bar for directors' liability. See In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch. 1996) ("Such a test of liability—lack of good faith as evidenced by sustained or systematic failure of a director to exercise reasonable oversight—is quite high.").

184. See, e.g., In re Trados Inc. S'holder Litig., 73 A.3d 17, 43 (Del. Ch. 2013) ("The rule presumes that 'in making a business decision the directors of a corporation acted on

uninformed action or omission), Delaware law regards the decision as mismanagement or a duty of care violation.[185] If the third or fourth prerequisites are not met, Delaware law considers the action a breach of the duty of loyalty.[186] In addressing duty of care violations, courts limit their review to the existence of defective decisionmaking processes by managers that amount to gross negligence.[187] The practical implication of the business judgment rule is that courts will not intervene or impose legal liability on managerial decisions.

Scholarly explorations of the rationale for the business judgment rule are voluminous. Scholars argue that the rule ensures management is not overly cautious in overseeing a corporation's operations due to liability fears.[188] Corporate law scholar Bernard Sharfman tied this justification to courts' historical status as courts of equity, noting that the "raw power of equity" can sometimes override explicit statutory provisions.[189] Courts of equity might otherwise apply a strict "entire fairness" standard to all challenged management decisions.[190] Sharfman argues that preventing equitable courts from imposing such an exacting standard in every case is the business judgment rule's "most important function."[191]

Other scholars focus on the policy concerns driving the business judgment rule's application. The most cited policy justification is that it protects corporate management from liability for honest mistakes.[192] Judges applying the business judgment rule often cite their lack of business

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an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.'" (quoting *Aronson*, 473 A.2d at 812)).

185. See, e.g., Benihana of Tokyo, Inc. v. Benihana, Inc., 891 A.2d 150, 192 (Del. Ch. 2005) ("The duty of care includes a duty that directors inform themselves, before making a business decision, of all material information reasonably available to them." (citing *Aronson*, 473 A.2d at 812)), aff'd, 906 A.2d 114 (Del. 2006).

186. Stone ex rel. AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006) (en banc).

187. *Benihana of Tokyo*, 891 A.2d at 192 ("Director liability for breaching the duty of care 'is predicated upon concepts of gross negligence.'" (quoting *Aronson*, 473 A.2d at 812)). With respect to the court's focus on the decisionmaking process rather than the decision itself, see, e.g., Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) (en banc) ("Courts do not measure, weigh or quantify directors' judgments. We do not even decide if they are reasonable in this context. Due care in the decisionmaking context is *process* due care only." (footnote omitted)).

188. See Melvin Aron Eisenberg, The Divergence of Standards of Conduct and Standards of Review in Corporate Law, 62 Fordham L. Rev. 437, 465 (1993) ("One explanation is . . . 'we want to give you a certain amount of running room so that you are not unduly risk averse or otherwise preoccupied with liability.'").

189. Bernard S. Sharfman, The Importance of the Business Judgment Rule, 14 N.Y.U. J.L. & Bus. 27, 30 (2017) [hereinafter Sharfman, Business Judgment Rule].

190. Id.

191. Id.

192. See Henry G. Manne, Our Two Corporation Systems: Law and Economics, 53 Va. L. Rev. 259, 271 (1967) (explaining that the rule "preclude[s] the courts from any consideration of honest if inept business decisions, and that seems to be the purpose of the rule.").

expertise relative to corporate directors as a reason for not intervening.[193] In the foundational case of *Dodge v. Ford Motor Co.*, the Michigan Supreme Court stated, "judges are not business experts."[194] Some scholars see the business judgment rule as courts recognizing the private ordering of corporate authority, which typically grants decisionmaking power to management. Professor Jonathan Macey argues that private ordering leads to more efficient outcomes than formal legal rules, as it considers market factors and informal norms.[195]

Professor Stephen Bainbridge describes the business judgment rule as an abstention doctrine.[196] He notes that challenges to corporate actions require courts to balance deference and accountability, with the business judgment rule allowing courts to hear some claims but not others.[197] Bainbridge states that "[g]iven the significant virtues of discretion . . . one must not lightly interfere with management or the board's decision-making authority in the name of accountability."[198] Thus, courts usually refrain from hearing duty of care claims if certain conditions are met.[199] Professor Holger Spamann argues that the business judgment rule prevents courts from hearing duty of care claims because it functions as a cost–benefit analysis device.[200] He contends that the potential benefits of judicial intervention (e.g., monetary payment based on judicial evaluations of business decisions) are usually outweighed by the costs (e.g., litigation costs, risk of erroneous judgment).[201]

Despite the various persuasive explanations scholars have offered for the business judgment rule, little attention has been given to how business courts' specialized nature colors our understanding of what role the business judgment rule plays.

A specialized court recognizes that the principal and agent are in an ongoing business relationship governed by an incomplete contract, with

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193. See Sharfman, Business Judgment Rule, supra note 189, at 46 ("Judges recognize that they lack information, decision-making skills, expertise, and vested interest (i.e., stake in the company) relative to corporate management."); Bernard S. Sharfman, Shareholder Wealth Maximization and Its Implementation Under Corporate Law, 66 Fla. L. Rev. 389, 406–09 (2014).

194. 170 N.W. 668, 684 (Mich. 1919).

195. See Jonathan R. Macey, Public and Private Ordering and the Production of Legitimate and Illegitimate Legal Rules, 82 Corn. L. Rev. 1123, 1140–43 (1997).

196. Stephen M. Bainbridge, The Business Judgment Rule as Abstention Doctrine, 57 Vand. L. Rev. 83, 87 (2004).

197. Id. at 109.

198. Id.

199. Id. at 95 ("[T]he whole point of the business judgment rule is to prevent courts from even asking the question: did the board breach its duty of care?").

200. See Holger Spamann, Monetary Liability for Breach of the Duty of Care?, 8 J. Legal Analysis 337, 339–40 (2016) (explaining why the business judgment rule supports limiting liability, as the high costs of litigation typically outweigh the limited benefits of enhancing managerial decisionmaking incentives).

201. Id.

the court as a third player. The goal of all three parties is to minimize total control costs—conflict and competence costs—which include agent, principal, and adjudication costs. When the principal is using duty-enforcement rights against the agent, the court is invited to determine the scope of fiduciary duties. While determining the scope of the fiduciary duties, the court has to consider the existence of the principal's other route of accountability: the use of discretionary control rights. The wider the court expands the scope of fiduciary duties, the narrower the space it leaves for the use of discretionary control rights, and vice versa. The wisdom of knowing how to strike a balance between the two is a unique need in corporate law and is the essential driver behind the need for specialized corporate courts. Moreover, when the court determines the scope of fiduciary duties, it also defines the court's own authority relative to the principal. This task of delineating between the court's authority and the principal's authority requires a court willing to avoid unnecessary intervention.

Specialized corporate courts are therefore needed because they do not presume that they must resolve all corporate governance disputes. Instead, they consider which resolution method would be most efficient. Sometimes this means resolving the matter directly; other times, it involves creating rules for shareholders to address the issue themselves. The utility of specialized corporate courts lies in their understanding of their role as a party to an ongoing triangular relationship, not just as an adjudicator of isolated disputes.

As explained above, shareholders are better positioned than courts to prevent and deter managers' mismanagement.[202] Shareholders have a lower likelihood of mistaking mismanagement for ordinary business failures and possess a greater variety of flexible remedies.[203] Specialized courts recognize shareholders' superiority in these cases and direct them through the use of the business judgment rule.

The business judgment rule limits judicial intervention to cases in which the likelihood of mistakes in distinguishing mismanagement is minimal. The first step is focusing on the decisionmaking process (i.e., was it informed?) rather than the substance of the decision.[204] Specialized courts understand that evaluating the substance of managerial decisions carries a higher risk of mistaking bad luck for negligence or idiosyncratic vision for a pet project. But even a process-oriented review can incentivize an overly detailed decisionmaking process, risking wrongful liability for managers on too many occasions. Consequently, courts further require a

202. See supra Part II.

203. See supra Part II.

204. See Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) (en banc).

showing of gross negligence (rather than simple negligence) before imposing legal liability for a defective decisionmaking process.[205]

The business judgment rule reflects specialized courts' recognition of shareholders' superior ability to handle mismanagement cases. Unlike generalist courts, which see themselves as the final safeguards of plaintiffs' rights, specialized courts understand that the efficiency gains from court resolution are limited compared to shareholders' capabilities. This is not to say specialized courts are incapable of addressing mismanagement cases; they could, if necessary, handle corporate governance disputes like any other claim of professional malpractice.[206] But due to the time and costs involved in gathering information, the quality of judicial decisions would be lower than if shareholders addressed mismanagement themselves. Given the large number of daily business decisions that go awry in the market, the possibility of framing any potential negative outcome as mismanagement would create excessive litigation, thereby increasing adjudication costs. Furthermore, the issues stemming from the court's limited remedies, and the finality of its judgment, would persist. Proper application of the business judgment rule is thus what makes specialized courts special. Their expertise in knowing when to intervene, and when not to, is at the heart of what specialized courts are good for and is embodied in the specialized courts' application of the business judgment rule.

Furthermore, the business judgment rule does not act alone. Legislatively enabled exculpatory clauses in corporate charters also limit specialized courts' review of mismanagement cases, even when gross negligence is present. Section IV.A.2 below provides background on these clauses and analyzes how they work in tandem with the business judgment rule to restrict judicial intervention to takings cases only.

2. *Exculpatory Clauses and Mismanagement.* — *Smith v. Van Gorkom* marked a shift in the business judgment rule, making gross negligence,

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205. See, e.g., Benihana of Tokyo, Inc. v. Benihana, Inc., 891 A.2d 150, 192 (Del. Ch. 2005), aff'd, 906 A.2d 114 (Del. 2006).

206. See, e.g., Charles M. Elson, Why Delaware Must Retain Its Corporate Dominance and Why It May Not, *in* Can Delaware Be Dethroned?: Evaluating Delaware's Dominance of Corporate Law 225, 227 (Stephen M. Bainbridge, Iman Anabtawi, Sung Hui Kim & James Park eds., 2018) (arguing that Delaware's dominance is due to its judicial competence); Michael Klausner, Corporations, Corporate Law, and Network of Contracts, 81 Va. L. Rev. 757, 775–76 (1995) (explaining the benefits of Delaware's voluminous precedent in contract disputes); Roberta Romano, The State Competition Debate in Corporate Law, 8 Cardozo L. Rev. 709, 722 (1987) [hereinafter Romano, State Competition] (describing Delaware's strong judicial quality and volume of precedent); Amy Simmerman, William B. Chandler III & David Berger, Delaware's Status as the Favored Corporate Home: Reflections and Considerations, Harv. L. Sch. F. on Corp. Governance (May 8, 2024), https://corpgov.law.harvard.edu/2024/05/08/delawares-status-as-the-favored-corporate-home-reflections-and-considerations/ [https://perma.cc/N69D-R7MB] ("No state comes close to Delaware in the depth and breadth of corporate case law, and Delaware cases are routinely cited by courts in every state. Of course, this puts a premium on the case law developing in a stable manner over time.").

rather than bad faith, sufficient for director and officer liability.[207] In response, the Delaware legislature enabled exculpation clauses, which emerged as a mechanism allowing shareholders to restore the pre-*Van Gorkom* balance, requiring bad faith for liability.[208] Section 102(b)(7) of the Delaware General Corporation Law allows shareholders to protect directors and officers from grossly negligent breaches of their duty of care.[209] The exculpatory clause must be included in the corporation's charter, requiring consent from both directors and shareholders.[210] The exculpatory clause shields directors and officers from liability even when they were grossly negligent in failing to be properly informed or establish a reasonable decisionmaking process.[211] But exculpation clauses cannot exempt liability for bad faith,[212] defined as a conscious disregard of one's duties,[213] or in conflict of interest cases. Similarly, following an analogous shift in the treatment of controlling shareholders in cases such as *In re Sears Hometown & Outlet Stores, Inc. Stockholder Litigation*,[214] the legislature enabled a default (i.e., an opt-out) exculpation clause for gross negligence claims levied against controlling shareholders, allowing only for "duty of loyalty," bad faith, and "improper personal benefit" claims to proceed.[215]

By exempting agents (whether directors, officers, or controlling shareholders) from monetary liability for gross negligence, shareholders signal to the judiciary that they prefer no intervention in mismanagement

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207. See 488 A.2d 858, 872 (Del. 1985) (en banc) (ruling that the business judgment rule will not protect directors who were grossly negligent by not informing themselves of "all material information reasonably available to them" (internal quotation marks omitted) (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984))).

208. Del. Code tit. 8, § 102(b)(7) (2025) (allowing companies to adopt a "provision eliminating or limiting the personal liability of a director or officer . . . provided that such provision shall not eliminate or limit the liability [for] . . . acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law").

209. The original version of section 102(b)(7) only covered directors, but the statute was amended on August 1, 2022, to include officers as well (albeit only for shareholder rather than corporate harms). Id. (providing that companies cannot "eliminate or limit the liability of . . . [a]n officer in any action by or in the right of the corporation"). The justification for this legal difference is that when officers commit corporate harms, they are generally addressed by the directors (i.e., managers with superior authority), not the shareholders.

210. See id. § 242 (outlining the procedure for amending the certificate of incorporation after payment for stock).

211. While the clause protects management from monetary liability, it doesn't prevent plaintiffs from seeking injunctive relief. Since these remedies are temporary and fully reversible, they maintain the shareholders' ongoing authority and flexibility. Id. § 102.

212. See supra note 208 and accompanying text.

213. In re Walt Disney Co. Derivative Litig., 906 A.2d 27, 67 (Del. 2006) (en banc) (explaining that bad faith includes conscious disregard of duties).

214. 309 A.3d 474, 483–84 (Del. Ch.) ("The controller also owes a duty of care that demands the controller not harm the corporation or its minority stockholders through grossly negligent action."), modified on reargument, No. 2019-0798-JTL, 2024 WL 3555781 (Del Ch. July 2, 2024).

215. Del. Code tit. 8, § 144(d)(5).

cases, even when gross negligence is apparent and the business judgment rule's prerequisites are not satisfied.[216] From shareholders' perspective, imposing legal liability on agents in mismanagement cases is unwarranted, even if the decisionmaking processes appear defective.

While gross negligence might justify judicial intervention, courts might mistakenly assign liability for a suspected case of mismanagement that was actually a normal business decision, imposing adjudication costs that disturb the principal–agent arrangement. For instance, highly informed directors may make quick decisions without external experts,[217] but fear of judicial review may force them into lengthy, technical procedures. This is unproductive because while well-organized and documented decisionmaking processes could help prevent some bad deals, they also serve to thwart beneficial transactions by the imposition of onerous transaction costs, thereby preventing the maximization of profits.[218] In real world scenarios, many business opportunities cannot be captured through a slow and methodical business process, but rather must be capitalized on through a swift and certain decision, or else the value would be lost.[219] The prominence of exculpatory clauses indicates shareholders believe the business judgment rule alone does not sufficiently limit court intervention to avoid mistakes in mismanagement cases.[220] These provisions are common in the charters of most public companies incorporated in Delaware.[221]

The application of the business judgment rule and ubiquitous inclusion of exculpatory clauses in corporate charters show that both specialized courts and the parties recognize the need to limit judicial intervention

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216. Here, the focus is the conditions of making an informed decision. Acting with bad faith in the sense of having a subjective intent to harm the corporation will be considered as a takings case. See infra section IV.B.

217. This situation is precisely what prompted *Smith v. Van Gorkom*. 488 A.2d 858, 865 (Del. 1985) (en banc) (describing a proposed price per share "based on 'rough calculations' without 'any benefit of experts'" (quoting testimony of Donald Romans, Chief Fin. Officer, Trans Union)).

218. See, e.g., Applebaum v. Avaya, Inc., 812 A.2d 880, 886–87 (Del. 2002) ("[T]his Court should not create a safeguard against stockholder inequality that does not appear in the statute. . . . [T]he proposed transaction was designed in good faith to accomplish a rational business purpose—saving transaction costs.").

219. See, e.g., Jacob A. Kling, Rethinking 363 Sales, 17 Stan. J.L. Bus. & Fin. 258, 272 (2012) ("Even when a company's assets are not perishable, the court reasoned, a 'good business opportunity' might be available that requires the company to act quickly . . . ." (quoting In re Lionel Corp., 722 F.2d 1063, 1069 (2d Cir. 1983))).

220. See Gabriel Rauterberg & Eric Talley, Contracting Out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers, 117 Colum. L. Rev. 1075, 1084 (2017) ("Public companies regularly execute such exoneration provisions.").

221. Jens Frankenreiter, Cathy Hwang, Yaron Nili & Eric Talley, Cleaning Corporate Governance, 170 U. Pa. L. Rev. 1, 37 (2021) (documenting that by 2006, 96% of Delaware public corporations had adopted director exculpation provisions); see also Sarath Sanga, Network Effects in Corporate Governance, 63 J.L. & Econ. 1, 20 (2020) (documenting an increase in reincorporation in Delaware—from 30% to 74%—following the passage of the exculpation clause provision).

in mismanagement cases. In other words, the business judgment rule and the widespread use of exculpation provisions work synergistically. The only cases carved out of the business judgment rule involve managerial bad faith or conflict of interest.[222] Bad faith includes knowingly breaching the law, intent to harm the corporation, and conscious disregard of duties. These cases do not involve decisions in which there is a risk that they might be mistaken for misfortune, honest mistake, idiosyncratic vision, or incompetence. The no-conflict requirement isolates self-dealing cases, when courts have an advantage in adjudicating. With the business judgment rule limiting judicial analysis to the decisionmaking process and exculpatory clauses further constraining intervention to bad faith or self-dealing, specialized courts effectively return mismanagement cases to shareholders, who can resolve them more efficiently. That there was a need for legislative intervention in support of this goal of specialized courts and the business judgment rule, fully explored in section IV.C below, only highlights the importance of protecting the court's essential specialization.[223]

3. *The Required Specialty in Mismanagement Cases.* — The combination of the business judgment rule and exculpatory clauses streamlines the task for specialized courts. By limiting review to the decisionmaking process and constraining intervention even in cases of gross negligence, specialized courts and corporate actors ensure judicial intervention only occurs in cases of self-dealing or bad faith. Specialized courts recognize that deciding mismanagement cases instead of shareholders increases costs.[224] Ideally, courts direct mismanagement cases back to principals without added costs. Realistically, once mismanagement cases enter the court system, inefficient judicial costs are imposed by the litigation.[225] Therefore, specialized courts must minimize these costs when mismanagement cases are erroneously brought forth.

The benefit of the business judgment rule and exculpatory clauses is that they allow defendants to swiftly remove cases from the court's docket. This occurs early in the litigation process, before extensive discovery or

222. Solomon v. Armstrong, 747 A.2d 1098, 1111–12 (Del. Ch. 1999), aff'd, 746 A.2d 277 (Del. 2000).

223. See infra section IV.C.

224. See supra Part II.

225. Judicial intervention can increase conflict costs, particularly due to the plaintiff's bar, which may pursue unnecessary litigation for attorney's fees. This adds adjudication costs and heightens judicial intervention inefficiency. See Goshen & Hannes, supra note 34, at 294–95 (explaining how the potential awarding of attorney's fees can shape counsel's incentives and create adjudicatory conflict costs). For further discussion of agent costs associated with potentially frivolous litigation, see generally John C. Coffee, Jr., Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions, 86 Colum. L. Rev. 669, 679–80 (1986) (describing that certain types of suits, such as derivative or class actions, can create high agent costs); Gilson & Mnookin, supra note 44, at 535–36 (explaining the plaintiffs' lawyer's incentives for contentious litigation).

other pretrial factual development.[226] If the defendant can show the four elements of the business judgment rule are present, a specialized court will dismiss the case.[227] In the context of exculpatory clauses, simply pointing to their inclusion in the corporate charter (or nonexclusion in the case of controlling shareholders) will warrant dismissal if the plaintiff is seeking monetary relief and is only alleging a breach of the duty of care.[228]

This highlights the first type of specialization needed by courts handling corporate governance disputes: *claim-dismissal specialization* that filters mismanagement cases from takings cases. Courts must differentiate between takings cases (warranting judicial intervention) and mismanagement instances (when dismissal is more efficient). Allowing mismanagement cases to proceed too far past the motion to dismiss stage undermines the efficiency gains of the business judgment rule and exculpatory clauses, especially if cases advance to broad and costly discovery phases.[229] Courts need expertise to quickly distinguish between mismanagement and takings cases early in the litigation process to realize these efficiency gains. If courts unfamiliar with corporate law had to conduct research or hear evidence to determine if dismissal is warranted, it would delay the case's dismissal. Longer delays will increase the costs and reduce efficiency.

Specialized courts understand that claims of mismanagement should be dismissed immediately, knowing that shareholders' discretionary control rights and other mechanisms are better suited to regulate this aspect of the incomplete contract.[230] Specialization in claim dismissal lowers judicial competence costs and aligns the court with shareholders' advantage and preference to handle mismanagement cases independently.[231] In this context, claim dismissal is a substantive rather than procedural specialization, with the business judgment rule and the exculpation provisions comprising substantive doctrinal paths for achieving that end. Procedurally, courts can effectuate claim dismissal through a variety of different mechanisms, including a motion to dismiss based on a failure to state a claim and dismissal based on a pleadings judgment.[232] Courts may also effectuate

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226. See McMillan, supra note 101, at 568 ("[T]he true value . . . is not only in preventing judgment or liability from attaching to a defendant, but also in keeping the defendant's legal bills and troubles to a minimum by abbreviating the ordeal.").

227. See supra notes 179–184 and accompanying text.

228. Del. Code tit. 8, §§ 102(b)(7), 144(d)(5) (2025); In re Cornerstone Therapeutics Inc., S'holder Litig., 115 A.3d 1173, 1177 (Del. 2015); Malpiede v. Townson, 780 A.2d 1075, 1079 (Del. 2001) (en banc).

229. For discussion of the costs and burdens imposed through discovery obligations, see Jonathan Remy Nash & Joanna Shepherd, Aligning Incentives and Cost Allocation in Discovery, 71 Vand. L. Rev. 2015, 2017–27 (2018).

230. See supra section I.A.

231. It also prevents the inefficiency that will result if strike suits are not promptly rejected—creating positive settlement value at the expense of the firm.

232. Del. Ch. Ct. R. 12(b)–(c); see also, e.g., Anchorage Police & Fire Ret. Sys. v. Adolf, No. 2024-0354-KSJM, 2025 WL 1000153, at *2 (Del. Ch. Apr. 3, 2025) ("That said, it seems imprudent to allow the plaintiffs full-blown discovery into the sale process if the plaintiffs

claim dismissal by incentivizing the parties to settle out of court.[233] These mechanisms may impose higher or lower costs depending on the context. But while the particular procedural method for claim dismissal changes, the goal remains the same: The court must attempt to limit its intervention and the cost of adjudication as much and as quickly as the case allows.

The preceding analysis highlights why specialized courts refrain from intervening in mismanagement cases and how they accomplish this via the business judgment rule and exculpatory clauses. Judicial specialization is crucial in mismanagement cases, culminating in claim-dismissal specialization. Section IV.B completes the specialization picture by showing why specialized courts are also needed to address self-dealing cases.

B. *The Entire Fairness Test and Self-Dealing*

Screening out mismanagement cases through the claim dismissal process is necessary for a specialized court, but this is only the first of its benefits. Specialization in claim dismissal is also essential for handling self-dealing cases. Specialized courts must distinguish between self-dealing and non-self-dealing cases and identify which self-dealing cases do not require judicial intervention and should be dismissed or receive lighter review. Once the cases that merit judicial intervention are identified, specialized courts are needed to administer remedial procedures effectively. Section IV.B.1 explains how specialized courts use the entire fairness doctrine to fulfill these functions. Additionally, as shown in section IV.B.2, court specialization is crucial for limiting judicial intervention to avoid deterring beneficial self-dealing transactions, initially achieved through judicial doctrines and later by legislatively enabled "safe harbors." Section IV.B.3 highlights the necessary connection between judicial specialization and self-dealing.

1. *The Role of the Entire Fairness Standard.* — The business judgment rule, as previously explained, does not apply if its prerequisites are not met, particularly in conflict of interest cases.[234] Instead, courts use the entire fairness standard for transactions involving conflicts of interest.[235]

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cannot prove the facts underlying their one viable disclosure theory. The court is therefore converting the motions to dismiss into motions for summary judgment to allow the plaintiffs limited discovery . . . .").

233. For analysis of the costs and benefits of settlements in the shadow of potential expensive discovery proceedings, see generally Frank H. Easterbrook, Comment, Discovery as Abuse, 69 B.U. L. Rev. 635, 636–39 (1989).

234. New Enter. Assocs. 14, L.P. v. Rich, 292 A.3d 112, 163 (Del. Ch. 2023) ("When directors . . . engage in self-interested conduct . . . [a]bsent some cleansing mechanism, the decision will 'lie outside the business judgment rule's presumptive protection . . . .'" (quoting Telxon Corp. v. Meyerson, 802 A.2d 257, 265 (Del. 2002))).

235. Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1162–63 (Del. 1995) ("Where, as in this case, the presumption of the business judgment rule has been rebutted, the board of directors' action is examined under the entire fairness standard." (citing Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1371 n.7 (Del. 1995))).

This standard applies both when the conflict is between a managerial agent (director or officer) and the corporation and when it is between the corporation and a controlling shareholder.[236] The entire fairness standard is "strict," offering no deference to the board's judgment.[237] The burden of proof falls on the conflicted party to demonstrate that the transaction was conducted with a fair process and at a fair price.[238] This standard examines fairness holistically, treating process and price as interrelated components.[239]

Avoiding Transaction Execution Review. Specialization is essential for adjudicating self-dealing transactions because not every aspect of a conflicted transaction requires judicial intervention. Judicial review of conflicted transactions can involve the *execution* of the transaction (whether the self-dealing should occur at all and at any price) and the *price* of the transaction (whether the self-dealing was conducted with adequate compensation). Specialized courts applying the entire fairness standard recognize that their focus should be limited to reviewing price, since conflicted transactions may, in any particular case, provide substantial benefits to the corporation.

Execution review requires determining in advance whether transactions are beneficial or harmful, which is challenging even for principals. When courts attempt this task, adjudication costs escalate similarly to when courts mistakenly adjudicate mismanagement cases instead of deferring to principals.

Principals naturally suspect that an agent's support of a conflicted transaction, even those conducted at arm's length and representing fair market value, might be motivated by the agent's self-interest. Due to informational asymmetries, principals cannot determine whether an agent's support of a conflicted transaction is properly motivated. Coping with this issue requires either giving the principal a veto right over self-dealing transactions or allowing the agent to unilaterally execute such deals, subjecting only their price to judicial review. While allowing principals to veto conflicted transactions ex ante reduces the risk of unfair self-dealing, it simultaneously introduces the risk of mistakenly blocking beneficial transactions.[240] Agents facing such a regime would have only two options: abandon the transaction entirely or pursue a less suitable alternative.

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236. See, e.g., In re Match Grp., Inc. Derivative Litig., 315 A.3d 446, 460 (Del. 2024) (en banc) (noting the entire fairness test also applies to controlling shareholders).

237. See Golden Cycle, LLC v. Allan, No. CIV.A. 16301, 1998 WL 276224, at *6 (Del. Ch. May 20, 1998) (equating entire fairness and strict scrutiny).

238. *In re Match Grp.*, 315 A.3d at 459 ("[T]he defendants bear the burden of demonstrating that the corporate act being challenged is entirely fair . . . .").

239. Id. (describing the "unitary test").

240. The risk is exacerbated when one considers that a principal's decision may be driven by their own self-interests, especially when the principal is a group. See Goshen, Self-Dealing, supra note 136, at 402 (describing that when veto power is placed in the hands "of a small group, the threat of strategic voting increases").

Either way, the principal's mistaken veto of a beneficial transaction would harm the corporation.

The risk of mistakes only increases when courts have the power to review the execution of transactions. As with mismanagement cases, informational asymmetries regarding the agent's motivation and business plans are greater between courts and agents than between agents and principals.[241] Consequently, a court's attempt to veto a conflicted transaction would be more problematic than a principal's attempt to do so. Additionally, the court's limited remedial options and the finality of its judgments, which are challenges in mismanagement contexts, also impair judicial review of transaction execution. Furthermore, some business opportunities are unique to the agent involved in a self-dealing transaction, and litigation delays could reduce or entirely preclude the benefits of such transactions.[242] Put differently, when a conflicted transaction is priced at fair market value, the only risk is that the agent may gain indirect benefits. Specialized courts using the entire fairness standard recognize that their limitations in this scenario are like those in mismanagement cases. Thus, they understand that they should not attempt to preclude the execution of the transaction entirely.

On the other hand, transaction prices that do not reflect fair market value are the root problem in self-dealing cases.[243] The private benefits that an agent extracts from improper self-dealing amount to the difference between the agreed-upon transaction price and the fair market value. When a significant price difference exists, the risk that the agent is illicitly extracting private benefits at the principal's expense is greater than the risk of the court erroneously imposing unwarranted liability. Therefore, while specialized courts avoid reviewing the execution of self-dealing transactions, they do review the transaction price. This approach targets the root of self-dealing issues (the price difference) without undermining management's fundamental control rights.

Appraisal Specialization. The entire fairness standard requires examining whether the process and price of a transaction are comparable to similar transactions. This standard is nondeferential when reviewing for "fair dealing and fair price," but it respects the agent's judgment regarding the execution of the transaction.[244]

When courts provide remedies for unfair self-dealing, they must use their price review mechanisms to quantify the difference between fair and unfair prices. This need highlights the importance of courts' *appraisal*

241. See supra section II.A.

242. See, e.g., Goshen, Self-Dealing, supra note 136, at 400 ("Indeed, in some cases, an important transaction may simply be impossible without such self-dealing.").

243. See supra section I.B. (detailing scenario seven—self-dealing).

244. See, e.g., *In re Match Grp.*, 315 A.3d at 449, 461 (quoting In re Tesla Motors, Inc. S'holder Litig., 298 A.3d 667, 700 (Del. 2023)) (explaining that conflict alone is not a cognizable harm and may be beneficial).

specialization. Courts must possess the expertise to accurately appraise remedies based on detailed financial valuations and expert reports. Consider the expertise required to determine the "fair value" of self-dealing transactions, which can range from buying land to purchasing a whole corporation, intellectual property like patents, or managerial services.[245]

Assessing fair price involves understanding complex asset valuations, which are routinely disputed by both parties.[246] Each party in entire fairness litigation typically hires specialized counsel and financial professionals who provide differing appraisals of the asset's fair value and use varying financial methodologies.[247] Financial professionals might use models that project future earnings and discount them to present value (the "discounted cash flows" approach), compare the relevant asset to similar market transactions (the "comparable company" approach), or rely on the deal terms or market price of the asset if it is publicly traded.[248]

An unspecialized and inexperienced court would struggle with this complex factual analysis and its application to the legal standard of "fairness," leading to increased adjudication costs. Conversely, a specialized court, well-versed in different valuation models and fairness standards, can efficiently navigate between financial valuations and legal principles to administer a fair price remedy with ease and predictability. But it is important to note that the appraisal complexity is not different from the complexity involved in adjudicating the medical malpractice of a brain surgeon. This part of court specialization alone is thus not what makes specialized corporate courts unique, but it does add another layer atop the need for claim-dismissal specialization.

The entire fairness standard highlights the need for specialized courts by focusing on transaction price rather than execution. Yet, judicial specialization in self-dealing transactions extends further. As the following section demonstrates, specialized courts have also developed cleansing doctrines, now altered and reinforced as "safe harbors," to complement the entire fairness standard, further curtailing judicial intervention and ensuring that beneficial conflicted transactions are not prevented from occurring in the first place.

2. *Safe Harbors and Self-Dealing*. — Even when a court limits its review of a conflicted transaction to price, self-dealing transactions remain costly due to the expense of entire fairness litigation. This added cost can deter

245. See, e.g., Cede & Co. v. Technicolor, Inc., No. Civ.A. 7129, 2003 WL 23700218, at *2 (Del. Ch. Dec. 31, 2003) ("Valuing an entity is a difficult intellectual exercise . . . ."), aff'd in part, rev'd in part, 884 A.2d 26 (Del. 2005).

246. See, e.g., Carl L. Stine, *MFW* and the Legal Fiction of Market Equivalency, 44 Del. J. Corp. L. 57, 66–67 (2020) ("Cases were no longer filed in Delaware immediately . . . . Instead, financial experts were hired and detailed complaints were filed . . . .").

247. See, e.g., In re Appraisal of Regal Ent. Grp., No. 2018-0266-JTL, 2021 WL 1916364, at *1 (Del. Ch. May 13, 2021) (explaining the centrality of experts in entire fairness analysis).

248. See id. at *18–19 (explaining the various methodologies and their treatment under Delaware law).

parties from entering beneficial conflicted transactions. Specialized courts thus face the challenge of structuring review mechanisms that provide remedies for improper self-dealing while ensuring that efficient conflicted transactions are not discouraged. To address this challenge, specialized courts developed "cleansing mechanisms"—when legislators did not provide them—to prevent beneficial conflicted transactions from being overly deterred by the costly entire fairness litigation process.

Prior to 2025, Delaware courts created "cleansing doctrines" that allowed transactions involving conflicted managers and controlling shareholders to be structured ex ante so that any litigation would be reviewed under the business judgment rule rather than the entire fairness standard.[249] These doctrines "neutralized" transactions of the risk of expensive entire fairness litigation,[250] thereby further limiting judicial intervention. Once parties complied with the cleansing requirements, the court no longer needed to conduct complex fair price valuations but instead focused solely on verifying the appropriateness of the cleansing process.[251]

In Delaware, when a conflicted transaction involved a managerial agent (a director or officer), the transaction could be cleansed so as to be subject to the business judgment rule if approved by a committee of disinterested directors *or* by a vote of fully informed, disinterested shareholders.[252] If the conflict of interest involved a controlling shareholder, however, both cleansing mechanisms were required.[253] This additional requirement arose because Delaware courts doubted whether directors are truly independent, given that their positions depend on the controlling shareholder's confidence.[254] Similarly, Delaware courts viewed the vote of disinterested shareholders as not entirely free, due to implicit concerns over retaliation from the controlling owner.[255] Therefore, both cleansing mechanisms were thought necessary in all types of controller self-dealing.[256] For similar reasons, the court further required that the controlling shareholder's cleansing commitment be made before the start of

249. See *In re Match Grp.*, 315 A.3d at 463 (explaining that the business judgment rule applies if conditions for cleansing controlling shareholder transactions are satisfied); Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 312–13 (Del. 2015) (en banc) (explaining the same in director and officer cases).

250. See *In re Match Grp.*, 315 A.3d at 459–63 (contrasting the exacting burden of the entire fairness standard with the business judgment rule).

251. See id. at 463.

252. See *Corwin*, 125 A.3d at 312–13.

253. See 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) (en banc).

254. See Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1116–17 (Del. 1994) (quoting Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 502 (Del. Ch. 1990)).

255. See id. ("Even where no coercion is intended, shareholders voting on a parent subsidiary merger might perceive that their disapproval could risk retaliation of some kind by the controlling stockholder.").

256. See J. Travis Laster, The Effect of Stockholder Approval on Enhanced Scrutiny, 40 Wm. Mitchell L. Rev. 1443, 1461–63 (2014) (explaining Delaware's cleansing doctrines).

any substantive negotiations (known as the "ab initio" requirement) and that all voting directors, rather than just a majority, be disinterested.[257]

Although Delaware's cleansing doctrines were moderately effective in reducing the chilling effect on beneficial conflicted transactions,[258] many corporations seeking to comply with the cleansing mechanisms still failed in litigation[259] because it became hard to meet the ever-evolving standards that cleansing required.[260] Some market participants and the Delaware legislature believed that the bar for meeting the cleansing conditions was too high, failing to properly reduce the chilling effect on beneficial conflicted transactions.[261] To reduce the level of judicial intervention, the Delaware legislature enacted safe harbor provisions to streamline the process for effectuating these transactions, thereby allowing specialized courts to focus their review on truly harmful self-dealing.[262]

The new provisions explicitly state that compliance with the necessary procedures for avoiding fairness litigation creates an irrebuttable presumption of validity under the business judgment rule.[263] In other words, complying with these procedures enables courts to immediately apply their claim-dismissal specialization without engaging in any assessment of the transaction's rationality.

Additionally, the new provisions sought to streamline the procedures for avoiding entire fairness litigation along three main parameters. First, all safe harbors now require only a majority of the shareholder votes cast,

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257. See In re Match Grp., Inc. Derivative Litig., 315 A.3d 446, 472–73 (Del. 2024) (en banc) (explaining the unanimous independence condition); see also Salladay v. Lev, No. 2019-0048-SG, 2020 WL 954032, at *10 (Del. Ch. Feb. 27, 2020) (explaining the development of the ab initio requirement).

258. See, e.g., *In re Match Grp.*, 315 A.3d at 461 ("'[A]n interest conflict is not in itself a crime or a tort or necessarily injurious to others.' In other words, 'having a "conflict of interest" is not something one is "guilty of."' Indeed, a corporation and its stockholders may benefit . . . ." (footnotes omitted) (quoting 2 Model Bus. Corp. Act Ann. §§ 8.60–8.63 introductory cmt. at 8-387 (3d ed. 1996))).

259. See Nathaniel J. Stuhlmiller & Brian T.M. Mammarella, '*MFW*' Just Turned 10, But Is It Worth the Candle?, Del. Bus. Ct. Insider (July 3, 2024), https://www.rlf.com/wp-content/uploads/2024/07/MFW-Just-Turned-10.pdf [https://perma.cc/4P9H-VFZU] (explaining that between mid-2019 to mid-2024, *MFW* cleansing defenses succeeded in only four of fifteen cases).

260. Id. (discussing the spectrum of successful challenges to the application of the business judgment rule).

261. See Morris, Nichols, Arsht & Tunnell LLP, Thirty Years Later—Why Companies Continue to Choose Delaware: General Perspectives and Thoughts on Proposed Amendments (2025), https://www.morrisnichols.com/printpilot-publication-thirty-years-later-why-companies-continue-to-choose-delaware-general-perspectives-and-thoughts-on-proposed-amendments.pdf (on file with the *Columbia Law Review*) (explaining the legislative proposals as "Balancing Amendments" heeding market demands).

262. Del. Code tit. 8, § 144(a)–(c) (2025).

263. See Morris, Nichols, Arsht & Tunnell LLP, supra note 261, at n.40 (explaining that the new statute is "merely a recitation of the consequence of the invocation of an irrebuttable version of the business judgment rule").

rather than a majority of outstanding shares.[264] Second, the approval requirements for transactions involving controlling shareholders—except for "going-private" transactions (i.e., when a controller acquires all minority shares)—were aligned with those governing managerial agents, requiring either director or shareholder approval, but not both.[265] This reflected the legislative view that concerns over underlying approvals of controlling shareholder conflicts are only warranted in going-private transactions. Third, the ab initio requirement was relaxed to allow shareholder approval, so long as the approval requirement was established before the transaction was submitted for a shareholder vote.[266]

At the time of writing this Essay, the efficacy of these amendments remains uncertain. In particular, questions persist regarding the application of safe harbors to transactions approved solely by directors when a controlling shareholder is involved.[267] Importantly, corporations wishing to opt out and revert to the previous cleansing mechanisms can do so through their charters or bylaws.[268] But the essential point is that safe harbors, like their cleansing predecessors, are designed to supplement the entire fairness standard while reinforcing the court's claim-dismissal specialization.

Safe harbors thus enable principals and agents to avoid the high costs of entire fairness litigation. Beneficial self-dealing transactions can proceed without fear of expensive litigation, knowing that securing the requisite approvals afford an irrebuttable presumption of validity under the business judgment rule. Consequently, if such self-dealing cases are brought to court, the court's role shifts from conducting fair price valuation to verifying whether the safe harbor mechanisms were properly followed—after which it promptly applies the business judgment rule. In essence, safe harbor mechanisms reengage the court's specialization in claim dismissal.

As explored further in section IV.C, the legislative support provided by the safe harbors—much like the enactment of the exculpation provisions—underscores the importance of protecting the court's essential specialization.[269]

3. *The Required Specialty in Self-Dealing Cases.* — Recall that claim-dismissal specialization is first designed to swiftly dismiss mismanagement

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264. Del. Code tit. 8, § 144(a)(2), (b)(2), (c)(1).

265. Id. § 144(b).

266. Id. § 144(b)(2)–(c)(1). Other relevant changes included tweaks to the analysis of whether directors are conflicted. See id. § 144(d)(2)–(d)(3) (aligning the definition of public company director conflict with stock exchange definitions, unless rebutted by "substantial and particularized facts").

267. These open questions stem from the concern that motivated the previous cleansing mechanisms: It is unclear if directors of controlled companies are ever sufficiently independent.

268. Del. Code tit. 8, § 144(d)(6)(a).

269. See infra section IV.C.

cases. This unique specialization carries past this first screening and extends to self-dealing cases as well. As previously discussed, specialized courts avoid intervening in the execution of self-dealing transactions and develop cleansing mechanisms to limit their intervention even further. More importantly, as shown next, the claim-dismissal specialization allows for accurately identifying harmful self-dealings while dismissing the rest, ensuring only the truly damaging cases proceed to judicial review.

Correctly identifying self-dealing requires a recognition that not all conflicted transactions are harmful and violate the duty of loyalty.[270] Since the corporate contract is incomplete, the exercise of identifying self-dealing transactions that violate the duty of loyalty requires answering a counterfactual question: What would the parties have agreed to if they had the opportunity to negotiate contractually?[271] Answering this question leans on the claim-dismissal specialization to properly identify when what may appear as a conflict of interest is not so. Specialized courts are able to do so both when reviewing corporate *transactions*, investigating whether the agent is effectively standing on both sides of a deal, and when reviewing corporate *actions* (e.g., issuing a dividend or adopting bylaws), investigating whether the function or structural nature of the action admits of takings by the agent.

Identifying self-dealing when the agent stands on both sides of a transaction (i.e., the agent contracts with the firm) is relatively straightforward for courts. Courts can utilize their experience in reviewing contracts and ownership documents to determine if an agent is acting for both the firm and themselves (e.g., an agent buying real estate from the firm through a corporation they own).[272] Similarly, the courts can utilize their experience to see if the relationship between the agent and a third-party is sufficiently close so as to be effectively the same as standing on both sides of a transaction (e.g., deciphering between cases when a director makes the company sell real estate to his spouse, on one end of the spectrum, and cases when the director pushed for a sale to a mere business acquaintance, on the other).[273]

Matters become more complex when the potential conflict concerns a corporate action. In corporate actions, correctly identifying whether it is a self-dealing case requires an understanding of the *function* of the corporate action (i.e., is it de facto a benefit to the agent) as well as the *structural*

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270. Goshen, Self-Dealing, supra note 136, at 400 (noting that conflicted transactions may benefit shareholders).

271. See Easterbrook & Fischel, Fiduciary Duty, supra note 88, at 429–30 (describing gap filling in corporate contracts).

272. See Strassburger v. Earley, 752 A.2d 557, 570 (Del. Ch. 2000) ("[W]here the controlling shareholder and the directors stand on both sides of the transaction, they bear the burden to demonstrate that the transaction was entirely fair . . . .").

273. See, e.g., Marchand v. Barnhill, 212 A.3d 805, 820 (Del. 2019) (en banc) (explaining that directors may even be considered independent of one another in the face of some level of friendship).

context of the action (i.e., are there inherent entity conflicts). This section addresses both, in this order.

When there is a potential *functional conflict* with the firm, courts are required to investigate corporate actions with equal *legal* effects on all parties but different *economic* impacts on the agent.[274] Specialized courts must discern when these economic differences warrant the entire fairness standard. For example, consider the facts of the famous *Sinclair Oil Corp. v. Levien* case involving a parent company that is a controlling shareholder of a subsidiary in the same industry.[275] The parent company appoints its employees as the subsidiary's directors and then has the subsidiary's board pay large dividends to all shareholders pro rata. The dividend could provide the parent company with resources to pursue its business opportunities while leaving the subsidiary without resources to pursue its own business opportunities. Although the dividend decision legally affects all shareholders equally, it provides the controller with a unique economic benefit. Is this self-dealing?

Experience is necessary for a court to understand that such facts alone should not trigger the entire fairness standard. Expert courts recognize that if all shareholders receive their share of the cash dividends, their corporate ownership rights are not excluded or harmed, even if the outcome is not everyone's preference.[276] Specialized courts also understand that a parent company's pursuit of a corporate opportunity in the same industry does not necessarily mean that opportunity belongs to the subsidiary.[277] In short, properly classifying functional conflicts is part of the claim-dismissal specialization.

When there is a potential structural conflict within a firm, the court must investigate a corporate action inherently mired in a conflict of interest due to the nature of the corporate structure. For example, consider a board employing defensive measures to block a hostile takeover or deter a hedge fund activist. Is this action self-dealing? Here, mixed motives are present. Blocking a hostile raider or activist helps directors keep their jobs but may also be motivated by a desire to protect the company from harm-

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274. See Cinerama, Inc. v. Technicolor, Inc., CIV. A. 8358, 1991 WL 111134, at *11 (Del. Ch. June 24, 1991) ("To follow a rule . . . that mechanically invokes the consequences of . . . fairness . . . is not required. What is required . . . is that the plaintiff plead and prove . . . [the] directors involved had material financial or other interest in the transaction different from the shareholders generally."), aff'd in part, rev'd in part sub nom., Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993), decision modified on reargument, 636 A.2d 956 (Del. 1994); William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law, 26 Del. J. Corp. L. 859, 870–71 (2001) (analyzing the role of functional analysis in Delaware law).

275. 280 A.2d 717, 719 (Del. 1971).

276. See id. at 721–22 (explaining that distributing dividends pro rata is not self-dealing).

277. This skill includes the need for specialized courts in interpreting and enforcing corporate opportunity waivers. See Rauterberg & Talley, supra note 220, at 1077–78.

ful acquisitions or activism.[278] Specialized courts recognize that such structural conflicts of interest are unavoidable and that effectively regulating them requires a nuanced approach. Instead of immediately subjecting such action to costly entire fairness review or dismissing the case through the business judgment rule, specialized courts employ an intermediate standard of review to determine if the corporate action is reasonable and proportional.[279] This reasonableness analysis further underscores the need for specialization, as courts must utilize familiarity and expertise in assessing various unique corporate technologies and their impact on both agent and principal costs.[280]

The combined utility of claim dismissal and appraisal specialization allows courts to address unfair self-dealing without vetoing beneficial conflicted transactions ex post or chilling them ex ante. In conflicted transactions, as in mismanagement cases, claim dismissal is crucial. Courts must provide remedies for unfair self-dealing when necessary and recognize when principals and agents can resolve conflicts on their own. To this end, courts utilize the safe harbor procedures to delineate which conflicted actions should not be subjected to entire fairness litigation. Essentially, courts need to discern between self-dealing cases in which adjudication costs are higher than principal costs and self-dealing cases in which principal costs are higher than adjudication costs.

C. *Specialized Courts and Legislative Interventions*

Adequately effectuating the role of specialized courts requires utilizing legislatively enabled exculpation provisions in mismanagement cases and legislatively enabled safe harbors in self-dealing cases. This raises the question: If specialized courts have such a high level of competence, why did the legislature need to intervene? One might argue, for instance, that such legislative intervention is itself evidence that the court is not adequately specialized. Conversely, others might argue that legislative intervention in a specialized corporate court's incremental doctrinal development is categorically wrong. Neither position is defensible. Legislative intervention does not entail an unspecialized court, nor are specialized courts infallible institutions immune from mistakes requiring legislative correction. Instead, the relationship between specialized courts and the legislature reinforces and safeguards the courts' essential function: claim dismissal. This section demonstrates that legislative interventions are sometimes necessary to correct judicial errors in a timely fashion,

278. See Goshen & Steel, supra note 169, at 420 (examining the net value created—or destroyed—by activists and raiders).

279. See, e.g., Kellner v. AIM ImmunoTech Inc., 320 A.3d 239, 253, 259–60 (Del. 2024) (en banc).

280. See, e.g., Marcel Kahan & Edward Rock, Anti-Activist Poison Pills, 99 B.U. L. Rev. 915, 921–25 (2019) (discussing the innovative use of poison pills in the activism context).

particularly in the area where specialized corporate courts have an inherent tendency for excessive intervention—namely, the presence of conflict.

While the careful and incremental development of judge-made law deserves much of the credit for the unique specialization of corporate courts, it is important to acknowledge that legislative interventions in corporate law are a feature, not a bug.[281] Beyond exculpation provisions and safe harbors, corporate legislation has included, for instance, the authorization of corporate opportunity waivers (allowing agents to take corporate opportunities under prescribed conditions), the establishment of corporate "captive insurance" (allowing internal corporate entities to insure agents), and the extension of a long-arm personal jurisdiction statute over corporate officers.[282] These examples show that specialized courts do not act alone and never have. Before Delaware ascended to preeminence in corporate law, New Jersey led the field, and it was Delaware's *legislative* decision to amend its constitution and adopt a statutory corporate law that ignited the judicial engine that later evolved into a specialized court.[283] Similarly, it was the legislative authorization of exculpation provisions that ultimately enabled Delaware to overtake New Jersey.[284]

The historical and contemporary significance of legislative interventions in corporate law, however, does not suggest that a court has failed to specialize. Even the most skilled professionals make mistakes, and judges specializing in corporate law are no exception. The mere fact that judges have occasionally taken corporate law in the wrong direction is insufficient to undermine the designation of a specialized corporate court. Indeed, as shown in the preceding sections, the Delaware Chancery Court's development of the business judgment rule and its related doctrines is a landmark achievement, solidifying its status as a specialized court—even if legislative adjustments to exculpation and safe harbors were necessary.

While some level of judicial error is inevitable, it is important to recognize that when specialized corporate courts make mistakes, judicial course correction is inherently slow. First, judge-made law is limited to the disputes that reach the court; judges cannot revisit a legal question unless

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281. See Assaf Hamdani & Kobi Kastiel, Courts, Legislation and Delaware Corporate Law 18–33 (Stigler Ctr. for the Study of the Econ. and the State, Working Paper No. 361, 2025), https://www.econstor.eu/bitstream/10419/324652/1/1933833394.pdf [https://perma.cc/FB5K-JS97] (detailing and classifying the history of legislative interventions in Delaware).

282. See Morris, Nichols, Arsht & Tunnell LLP, supra note 261 (internal quotation marks omitted) (quoting Del. Code tit. 8, § 145(g) (2025)).

283. See Simmerman et al., supra note 206 (explaining the early developments that led to Delaware's prominence in corporate law).

284. See Sanga, supra note 221, at 4 (describing Delaware's legislation legalizing exculpatory provisions); Andrew Verstein, The Corporate Census 13–14 (Apr. 30, 2025) (unpublished manuscript), https://papers.ssrn.com/abstract=5154952 [https://perma.cc/SJ7R-9EYB] (documenting that 1986, the year the exculpation amendment was adopted, temporally coincided with Delaware's ascent).

litigants bring it before them.[285] Second, appeals processes are expensive and time-consuming.[286] Lastly—out of respect for their own incrementalism—courts are very reluctant to overturn precedent, even when they disagree with it: "Mere disagreement with the reasoning and outcome of a prior case, even *strong* disagreement, cannot be adequate justification for departing from precedent or *stare decisis* would have no meaning."[287]

Courts are slow and methodical for good reasons, but markets move quickly. Specialized corporate courts thus occupy a unique position: Their expertise lies in knowing when to dismiss cases and allow shareholders and managers to resolve disputes privately. But judicial errors can create environments in which disputes that should have been left to private ordering become mired in unnecessary litigation and costs. Given the rapid pace of the markets and the high volume of transactions, judicial mistakes can at times impose unacceptably high costs. In such cases, legislative intervention becomes not only necessary but also beneficial, as it preserves the incrementalism that specialized judges rely on to develop their claim dismissal expertise.

The areas of corporate law in which legislative interventions are most likely to be needed are also predictable. Since specialized courts' essential function is claim dismissal, they are designed to focus on and offer remedies to cases involving conflict. Specialized courts understand that in the absence of conflict, cases should be dismissed, while the presence of conflict may warrant judicial involvement. The complexity, as demonstrated by Parts III and IV, lies in the fact that some conflicts are better left to shareholders and managers. And although specialized courts develop doctrines to focus on harmful self-dealing transactions rather than all conflict cases, they have a natural and inherent tendency to overreach in conflict-laden cases. In other words, what makes specialized corporate courts special is also precisely what sometimes leads to judicial error.

This is why exculpation clauses are to mismanagement cases what safe harbors are to self-dealing cases: legislative interventions designed to protect and reinforce the claim dismissal role of specialized courts after the presence of conflict led to over-intervention. In *Smith v. Van Gorkom*, the case that triggered the need for exculpation provisions, the charge was mismanagement, but the underlying concern was the defendant's motiva-

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285. See United States v. Rubin, 609 F.2d 51, 69 n.2 (2d Cir. 1979) (Friendly, J., concurring) ("A judge's power to bind is limited to the issue that is before him; he cannot transmute dictum into decision by waving a wand and uttering the word 'hold'.").

286. See, e.g., Gail Weinstein, Steven J. Steinman & Steven Epstein, Sponsor-Controller Cleared of Conflicts in Sale Near Fund's Term End, Harv. L. Sch. F. on Corp. Governance (Mar. 2, 2025), https://corpgov.law.harvard.edu/2025/03/02/sponsor-controller-cleared-of-conflicts-in-sale-near-funds-term-end/ [https://perma.cc/Z3G8-S3KN] ("Now, seven years later, the court, in a post-trial decision issued January 7, 2025, concluded instead that the Merger was *not* a conflicted-controller transaction.").

287. Brookfield Asset Mgmt., Inc. v. Rosson, 261 A.3d 1251, 1280 (Del. 2021) (en banc) (citing Kimble v. Marvel Ent., LLC, 576 U.S. 446, 455 (2015)).

tion to secure a cash-out deal before his nearing mandatory retirement.[288] The Delaware Supreme Court's narrowing of the business judgment rule stemmed from concerns that the transaction approval process was rushed—hastened by Van Gorkom's personal need for a payout rather than the corporation's best interest.[289] While the court did not find that the board acted in bad faith, it sought to adjust the business judgment rule to ensure shareholders had a remedy in similar conflict cases.[290]

The safe harbor amendments,[291] similarly, were triggered by cases in which the Delaware Chancery Court gradually expanded its involvement in conflicted transactions by broadening the definition of a controller[292] and incrementally heightening the requirements to cleanse nonharmful self-dealing transactions,[293] as it was naturally reluctant to curtail its role in resolving conflict cases. Obviously, the cases triggering the judicial broadening of the controller definition involved conflicts that the court believed required its specialization in providing a remedy. But not all conflicts warrant judicial intervention. Recognizing this overreach, in 2025, the Delaware legislature intervened, limiting courts' ability to designate a person as a controller subject to fiduciary duties,[294] and relaxing the cleansing requirements.[295]

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288. See 488 A.2d 858, 866 (Del. 1985) (en banc) (explaining the retirement incentive); supra section IV.A.2.

289. See *Van Gorkom*, 488 A.2d at 872–74 ("The directors . . . were grossly negligent in approving the 'sale' of the Company upon two hours' consideration . . . .").

290. See id. at 872–73, 893.

291. Del. Code tit. 8, § 144(a)–(c) (2025).

292. Originally, courts defined a controller as anyone who either (1) held a majority of the voting shares or (2) was deemed a de facto controller, typically requiring at least 35% of voting power and additional managerial influence. Elizabeth Pollman & Lori W. Will, The Lost History of Transaction-Specific Control, 50 J. Corp. L. 1095, 1101 (2025). Over time, courts broadened this definition, finding de facto control even when an individual held a small percentage—or even none—of the corporation's stock (e.g., lenders). See Stein, Debt as Corporate Governance, supra note 32, at 1296 (describing this development in controller doctrine).

Delaware courts also labeled individuals as controllers for specific transactions, even if they were not controllers in a general sense. See, e.g., Tornetta v. Musk, 310 A.3d 430, 500 (Del. Ch. 2024) (delineating transaction-specific control); Basho Techs. Holdco B, LLC v. Georgetown Basho Invs., LLC, C.A. No. 11802-VCL, 2018 WL 3326693, at *28–30 (Del. Ch. July 6, 2018) (finding that an investor was a controlling shareholder for a specific transaction because the investor could use its contractual rights to effectively block other fundraising efforts), aff'd sub nom., Davenport v. Basho Techs. Holdco B, LLC, No. 14, 2019, 2019 WL 5399453 (Del. Oct. 22, 2019); Williamson v. Cox Commc'ns, Inc., No. Civ.A. 1663-N, 2006 WL 1586375, at *4–*6 (Del. Ch. June 5, 2006) (finding that a controlling shareholder litigation can proceed past the motion to dismiss based on allegations of transaction-specific control stemming from contractual rights and the contractual leverage of being the sole significant customer); see also Pollman & Will, supra, at 1105–10 (detailing the historical development of the doctrine and pointing to the challenges it presents).

293. See supra section IV.B.2.

294. Under the new amendment, courts cannot find de facto control unless the individual owns at least one-third of the voting shares. Del. Code tit. 8, § 144(e)(2).

295. See supra section IV.B.2.

This legislative intervention was predictable because courts face a conflict case when they need to determine whether someone is a controlling shareholder subject to fiduciary duties. The challenge is that such determinations are not based solely on the presence of conflict—many third parties (e.g., customers) may have a conflict with a corporation—instead, the inquiry focuses on whether the conflict is the kind that warrants fiduciary duties. If the court were to hold that such a defendant is not subject to fiduciary duties, it would be creating a rule that would freeze them out of such conflict cases going forward. This is inherently difficult for even a specialized court to do, as, again, the very specialty and essence of a specialized corporate court is standing ready to aid in conflicted transactions. The legislative intervention thus provided a clear claim dismissal mechanism, allowing courts to simply check whether the defendant meets the minimum ownership threshold.

Legislative interventions in doctrines developed by specialized courts are neither a stain on the success of specialized courts nor necessarily deleterious. Legislatures play a critical role in ensuring timely, cost-effective mechanisms for facilitating claim dismissal, particularly in conflict cases, when specialized courts may mistakenly overreach.[296]

V. MOVING TO TEXAS? IMPLICATIONS FOR THE FUTURE OF STATE CORPORATE LAW

Specialized corporate law courts are a necessity. The chief contribution of this Essay is in unmasking this all-important judicial role and delineating how it is achieved, and ought to be further realized, through the various foundational legal doctrines of corporate law.[297] This Part takes this insight even further. Given the need for specialized courts, was Elon Musk correct in moving Tesla to Texas?[298] Were the shareholders wise to vote in favor of this move?[299] What can other states, such as Nevada, learn from Texas's efforts, and what if Musk convinces Congress to intervene? Armed with the novel insights of the foregoing Part, we can finally answer these questions and prescribe policy recommendations for the political economy of corporate law.

Regarding the ability of the Texas Business Court to serve as an effective adjudicator of corporate disputes like Delaware's Chancery, the task

296. This legislative role can be conceptualized as either the legislature becoming a fourth party to the incomplete contract or a regulator of these contracts. Either way, the goal is to protect the claim dismissal expertise and mediate between judicial and market enforcement of corporate disputes.

297. Another upshot of this theoretical contribution is the ability to assess and further develop empirical investigations of specialized corporate courts. See, e.g., Yifat Aran & Moran Ofir, The Effect of Specialised Courts Over Time, *in* Time, Law, and Change: An Interdisciplinary Study 167, 177–86 (Sofia Ranchordás & Yaniv Roznai eds., 2020) (finding empirical evidence that specialized business courts have increased judicial productivity).

298. See supra note 1 and accompanying text.

299. See supra note 3 and accompanying text.

ahead is difficult but attainable. To do so, it will have to ensure the hiring of competent judges and the development of doctrines that demonstrate expertise in participating in the special triangular relationship among courts, principals, and agents.[300] As a first step, the Texas court must understand that it is not the sole recourse for corporate harms.[301] Unlike courts that adjudicate isolated disputes, the court will need to demonstrate the prowess necessary to distinguish between cases that require its intervention and those that do not. Following the blueprint proposed in this Essay, the Texas Business Court should specialize in distinguishing between mismanagement and self-dealing cases.[302]

To achieve this specialization, judges must develop the ability to defer to corporate directors in business decisions and swiftly dismiss improperly brought cases.[303] Additionally, they need to develop appraisal specialization focusing on price review while avoiding reviewing transaction execution. To further limit their intervention, judges should develop cleansing mechanisms or utilize legislatively enabled safe harbors to help principals and agents avoid the burden of entire fairness review. Moreover, when identifying potentially conflicted actions, they must distinguish between cases that should be dismissed and those that merit enhanced judicial scrutiny.[304] Overall, the Texas Business Court should specialize in identifying when resolution is best left to the principals and when it is best served through judicial intervention.

Currently, the Texas Business Court is in its infancy, and it faces a few particularly difficult obstacles: jury trials by default, lack of precedent, and limited judicial experience.[305] But with dedication to the expert skills discussed here, Texas may yet, over time, develop the specialized court required for corporate disputes. Indeed, a May 2025 corporate law amendment demonstrates that Texas is heading in that direction.[306] Most importantly, the amendment allows corporations to opt out of jury trials.[307] This is crucial, as jurors, unlike judges, are unable to lean on economies of scale and scope to develop claim dismissal expertise. This legislative intervention could potentially enable the Texas court to develop its

300. See supra section I.A.

301. See supra Part II.

302. See supra Part II.

303. See supra section IV.A.3.

304. See supra section IV.B.

305. See Shane Goodwin, The Lone Star Docket: How the Texas Business Court Will Shape the Corporate Landscape 55–56 (SMU Cox Sch. of Bus., Working Paper No. 24-14, 2024), https://ssrn.com/abstract=5024710 [https://perma.cc/MKU9-868N] (detailing the Texas-specific rules).

306. See Press Release, Off. of the Tex. Governor, Governor Abbott Signs Pro-Growth Business Legislation Into Law (May 14, 2025), https://gov.texas.gov/news/post/governor-abbott-signs-pro-growth-business-legislation-into-law [https://perma.cc/5K6S-LKHF].

307. Id.

necessary claim dismissal function, reducing adjudication costs and improving firm value.[308]

Scholars and commentators who are sensitive to Delaware's proven track record have painted Tesla's move to Texas as a hopeless endeavor.[309] They argue that since even a successful Texas business law court will resemble Delaware's court, the move at best imposes unnecessary transaction costs.[310] They further contend that Elon Musk and the Tesla board's push for this move is driven by the expectation that Texas judges and legislators, with whom they have relationships, will design laws allowing them to entrench themselves in the Tesla corporation—thereby reducing shareholders' oversight.[311] Supporters of Tesla's move, on the other hand, point to Delaware's treatment of Musk's compensation package as a sign that Delaware has veered off its path of success.[312] They argue that the move to Texas might be justified precisely because while Texas has yet to prove that its court can achieve the required specialization, Delaware has begun to undo its own specialized doctrines anyways.[313]

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308. Other important parts of the amendment include the codification of the business judgment rule and an option for corporations to opt into limited derivative litigation mechanisms that require plaintiffs to have a certain threshold of ownership. Tex. Bus. Orgs. Code Ann. § 2.116 (West 2025). The desirability of any particulars in this legislation are of course subject to debate.

309. See, e.g., Gareth Vipers, Ryan Felton & Ginger Adams Otis, Elon Musk Wants to Move Tesla's Incorporation From Delaware to Texas, Wall St. J. (Feb. 1, 2024), https://www.wsj.com/business/tesla-to-hold-shareholder-vote-to-incorporate-in-texas-elon-musk-says-8eb78eef (on file with the *Columbia Law Review*) ("'The capital you're going to have to expend to create a real business court with that expertise is . . . a lot more, frankly, than the income it produces,' . . . . '[T]o move because [Musk] is unhappy with a particular judge's ruling at a particular point in time is very ill-advised,' . . . ." (fourth alteration in original) (quoting Charles Elson, Founding Dir., Weinberg Ctr. for Corp. Governance)); Ann Lipton, You'll Never Guess What Today's Blog Post Is About, Bus. L. Prof Blog (May 31, 2024), https://lawprofessors.typepad.com/business_law/2024/05/youll-never-guess-what-todays-blog-post-is-about.html [https://perma.cc/AA8G-Q2L5] [hereinafter Lipton, You'll Never Guess] (arguing that the timing of the Texas move is likely about a conflict of interest and otherwise has no discernible benefits).

310. See, e.g., Lipton, You'll Never Guess, supra note 309 ("[C]ontemplating an expensive switch—involving special committee payments, advisors, hours, and expert analysis, not to mention vote whipping—for benefits that even the company itself claims largely are about branding." (emphasis omitted)).

311. See, e.g., Matt Levine, Texas Tempts Tesla, Bloomberg (Feb. 1, 2024), https://www.bloomberg.com/opinion/articles/2024-02-01/texas-tempts-tesla (on file with the *Columbia Law Review*) ("Musk comes into court saying 'well that may all be true but what you are missing is that I am Elon Musk,' . . . is the Texas business court, in its first real high-profile case, going to say 'actually it's illegal to pay Elon Musk that much'? It absolutely is not.").

312. See, e.g., Keith Paul Bishop, Delaware Court Awards Attorneys Nearly $18,000/Hour for Frustrating the Will of the Stockholders, Cal. Corp. & Secs. L. (Dec. 10, 2024), https://www.calcorporatelaw.com/delaware-court-awards-attorneys-nearly-18000/hour-for-frustrating-the-will-of-the-stockholders [https://perma.cc/KQ5G-DNBN].

313. See Jai Ramaswamy, Andy Hill & Kevin McKinley, We're Leaving Delaware, and We Think You Should Consider Leaving Too, Andreessen Horowitz (July 9, 2025), https://

Both the move's supporters and its objectors are mistaken. Regarding the move's supporters, a sober look at Delaware's specialized courts, as detailed in this Essay, shows that even if we may disagree with some of its recent decisions, they are certainly not remotely close to undoing Delaware's entire jurisprudential nexus between corporate law and specialization. To be sure, while the factual and doctrinal questions surrounding the ratification of Musk's compensation package are thorny,[314] this Essay is sympathetic to the possibility that invalidating the ratification was wrong. Indeed, if and to the extent that this decision was improper, it was improper precisely for the reasons uncovered in this Essay: A court that dispels conflicted yet potentially beneficial transactions like the compensation package ex ante (i.e., invalidating the original shareholder approval) and ex post (i.e., ignoring the post-invalidation shareholder ratification) elevates its role above that of the shareholders. It could very well be that Delaware law was in need of an ironing out to its controlling shareholder wrinkles in this regard,[315] and, at any rate, the legislative amendments discussed in sections IV.B.2 and IV.C were designed to do exactly that.[316] But even if that's the case, it does not discredit the well-thought-out and carefully developed specialization that Delaware otherwise offers through its application of the business judgment rule and all related review doctrines.

Nevertheless, the objectors to Tesla's move are also wrong to paint it as ill-advised. This objection is mistaken because it fails to properly account for the impact of home incorporation on the triangular relationship among agents, principals, and courts and incorrectly assumes that board and controller entrenching mechanisms will necessarily be detrimental rather than beneficial.

Tesla's headquarters and part of its factories are in Texas, making the Texas reincorporation decision a home state incorporation decision.[317] To understand the value of this decision, we must first understand why home state incorporations have been a recurring phenomenon since at least the 1980s.[318] In the 1980s, a takeover boom struck corporate America,

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a16z.com/were-leaving-delaware-and-we-think-you-should-consider-leaving-too/ [https://perma.cc/Y4TA-P6FJ].

314. The legal and factual debate included whether post-trial ratification was possible and whether the shareholders had been properly informed before the vote. See Tornetta v. Musk, 326 A.3d 1203, 1230–33 (Del. Ch. 2024).

315. See, e.g., Zohar Goshen, Assaf Hamdani & Dorothy S. Lund, Fixing *MFW*: Fairness and Vision in Controller Self-Dealing, 15 Harv. Bus. L. Rev. (forthcoming 2025) (manuscript at 50), https://papers.ssrn.com/abstract_id=5061341 [https://perma.cc/6BYK-9BLX] (offering improvements to current Delaware controlling shareholder law).

316. See supra sections IV.B.2, IV.C.

317. See supra note 3 and accompanying text.

318. See, e.g., Lucian Arye Bebchuk & Alma Cohen, Firms' Decisions Where to Incorporate, 46 J.L. & Econ. 383, 394–404 (2003) (providing an empirical study); Roberta Romano, The Political Economy of Takeover Statutes, 73 Va. L. Rev. 111, 112–13 (1987) (analyzing the phenomenon).

sparking debates about the impact of takeovers on corporate value and society.[319] Raiders would take over a corporation, close factories, and lay off many employees.[320] One response was successful campaigns by boards of directors in home state incorporation regimes for legislative and judicial interventions that allowed management to resist these takeovers.[321] For example, in 1990, Massachusetts amended its Business Corporation Act to offer antitakeover protections to corporations incorporated in the state.[322] This law applied a staggered board structure to all public corporations in Massachusetts, making it harder to take over a corporation by requiring two annual shareholder meetings to achieve control.[323]

The prevailing corporate theory at the time predicted that management-entrenching laws would harm corporate value.[324] But the outcome was different: While some firms lost value, others thrived.[325] Insulating managers from hostile takeovers allowed loyal and competent managers to pursue long-term, innovative projects without fearing disruption by raiders seeking short-term profits.[326] These corporations benefited from the antitakeover law, while others with disloyal and incompetent managers did not.[327]

Understanding the triangular and incomplete corporate contract explained in Part I, we can appreciate the value of home state incorporation. Shareholders live all over the United States and the world, not just in Delaware.[328] Managers are located where their corporations' headquarters are, often not in Delaware.[329] Employees are located where the factories

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319. See, e.g., Jonathan R. Macey, State Anti-Takeover Legislation and the National Economy, 1988 Wis. L. Rev. 467, 471 [hereinafter Macey, Anti-Takeover Legislation] (introducing and opining on the debate); Easterbrook & Fischel, supra note 38, at 1164 (arguing that defensive measures in response to a tender offer decrease shareholder value).

320. See David Millon, Redefining Corporate Law, 24 Ind. L. Rev. 223, 234 (1991).

321. See, e.g., Macey, Anti-Takeover Legislation, supra note 319, at 470 (documenting successful lobbying by Boeing in Washington, Burlington Industries in North Carolina, Goodyear Tire in Ohio, Gillette in Massachusetts, and others).

322. Robert Daines, Shelley Xin Li & Charles C.Y. Wang, Can Staggered Boards Improve Value? Causal Evidence From Massachusetts, 38 Contemp. Acct. Rsch. 3053, 3058–60 (2021) (describing the Massachusetts legislation).

323. Id. While a regular board allows shareholders to replace the whole board in every annual meeting, a staggered board allows the replacement of only a third of the board every year.

324. See Goshen & Squire, supra note 37, at 820 (tying this prediction to existing agent costs theory).

325. Daines et al., supra note 322, at 3053, 3054–56 (outlining the evidence).

326. Id.

327. Id.

328. Ann M. Lipton, Inside Out (or, One State to Rule Them All): New Challenges to the Internal Affairs Doctrine, 58 Wake Forest L. Rev. 321, 323 (2023) [hereinafter Lipton, Inside Out] (describing the law allowing incorporation state to impact shareholders and employees residing outside the state of incorporation—the internal affairs doctrine).

329. See id.; Robert Daines, The Incorporation Choices of IPO Firms, 77 N.Y.U. L. Rev. 1559, 1575 n.58 (2002) ("[V]ery few firms locate business facilities in Delaware . . . . This is

are, usually not in Delaware.[330] Only the shareholders or the managers decide where to incorporate. Therefore, when a corporation is incorporated in Delaware, where there is no nexus with corporate operations, the triangle includes shareholders, managers, and the courts. The court is dealing with the allocation of powers (control rights) between shareholders and managers, regardless of the effects its decisions might have on other stakeholders, such as employees. Delaware courts' rulings are viewed through their effect on a single goal—maximizing shareholder value.[331] Thus, even when shareholders pressure managers to avoid long-term projects or other innovative investments and pursue short-term profits, shareholders' interests still enjoy supremacy.[332]

When a corporation incorporates in its home state, however, the legislature and the court must also consider the effects on employees and other state residents. The home state cannot succumb to shareholders' pressure for short-term profitability—commonly through hostile raiders and hedge fund activists—as that would lead to reduced investments and massive layoffs of employees.[333] Thus, the home state might insulate managers from market pressures, allowing them to pursue long-term investments that protect employment and only eventually benefit shareholders.[334]

Returning to the case of Texas, while current Texas law is not particularly management-friendly, it may soon become so, especially in light of the May 2025 amendments.[335] Critics of Tesla's home reincorporation are not wrong about the motivations but are incorrect in assuming those motivations are necessarily bad for the firm.[336] On the contrary, it may be exactly what Tesla needs. Not only could the Texas Business Court develop the specialization necessary to adjudicate corporate disputes, but it may also reflect the directors' and shareholders' judgment that incorporating in Texas is better for firm value.

Tesla is one of the most innovative corporations in the world, and its CEO, Elon Musk, has already proven he can successfully pursue his

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because there are cheaper ways to get the laws of State A than moving operations to State A—incorporating in State A.").

330. See Daines, supra note 329, at 1579–80; Lipton, Inside Out, supra note 328, at 343.

331. See McRitchie v. Zuckerberg, 315 A.3d 518, 562–64 (Del. Ch. 2024) (delineating Delaware's commitment to shareholder wealth maximization and the connection to long-term value).

332. See id.

333. See supra notes 318–322 and accompanying text.

334. See Goshen & Squire, supra note 37, at 819–21 (noting that the legislative efforts may be beneficial); Macey, Anti-Takeover Legislation, supra note 319, at 470 (detailing state legislative efforts).

335. See Press Release, Off. of the Tex. Governor, supra note 306 (announcing "three critical pieces of pro-growth, business-friendly legislation").

336. See supra notes 309–312 and accompanying text.

idiosyncratic vision.[337] This is a classic case in which shareholders would prefer insulating management from disruptive market forces such as hostile takeovers and hedge fund activism.[338] Indeed, other innovative corporations achieve such insulation for their management by adopting a dual-class structure.[339] Incorporating in the home state is an alternative way to achieve the same goal.

To be sure, the move to Texas introduces uncertainty because it will take time for the Texas Business Court to develop the necessary specialization to avoid judicial mistakes. Yet, the evaluation of Tesla's move to Texas is justified because the reduction in principal costs is likely greater than the possible increase in adjudication and agent costs. Implementing such beneficial changes to the firm's total control costs may very well outweigh any transaction costs associated with moving the corporate charter from Delaware to Texas. For the same reasons, corporations such as Meta[340] and other businesses with successful controllers with idiosyncratic visions may improve firm value in Texas as well: While lacking operational nexus to Texas, the reduction in principal costs may well outweigh all other impacts on the firm's overall value.

Extrapolating beyond this analysis of the Tesla case, we can draw important lessons for the future of state corporate law, which are particularly apt in the context of the jurisdictional competition between both the various states and the federal government.

The reason states have the desire to attract incorporations to their states is, most directly, that corporations pay franchise taxes to the state in which they incorporate.[341] For a state to be successful in this market, it must provide a system of corporate law and courts that appeals to the businesses it wants to attract. While this has proved to be a difficult task given Delaware's dominance in the market, the Tesla saga illustrates one avenue for aspiring states: States can be competitive in gaining the charters of the businesses that have substantial operations in their state. They ought to establish specialized courts that understand they are but one party in a triangular arrangement and use that understanding together with the calibrated aim of insulating management and reducing principal costs.

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337. See Assaf Hamdani & Kobi Kastiel, Superstar CEOs and Corporate Law, 100 Wash. U. L. Rev. 1353, 1368 (2023) ("Under Elon Musk's leadership, Tesla's share price increased over 23,000% in a little more than a decade since its 2010 IPO . . . .").

338. See Goshen & Steel, supra note 169, at 429–30 (discussing the potential reduction in principal cost from fighting against such control contests).

339. See Goshen & Squire, supra note 37, at 806–07 (illustrating the benefits that the dual-class structure may bring).

340. See Emily Glazer, Berber Jin & Meghan Bobrowsky, Meta in Talks to Reincorporate in Texas or Another State, Exit Delaware, Wall St. J., https://www.wsj.com/tech/meta-incorporation-texas-delware-f06e8bab (on file with the *Columbia Law Review*) (last updated Jan 31, 2025).

341. See, e.g., Bebchuk, supra note 26, at 1443 (describing the states' incentives).

And even absent the home incorporation nexus, specialization coupled with reduction in principal costs may at times be enough.

This insight also explains the value and limits of interstate competition over corporate charters. Many scholars have wrestled with the question of whether state competition over the regulation of corporate charters is desirable.[342] Supporters of interstate competition claim that when states compete for corporate charters, they are designing laws and courts that appeal to shareholders—the so-called "race to the top" theory.[343] Opponents of this regulatory competition, on the other hand, claim that competing states design laws and courts that appeal to management in lieu of shareholders—the so-called "race to the bottom" theory.[344] This Essay demonstrates that the underlying assumption of this debate is a mistake: We cannot equate either appeal to shareholders or appeal to management as categorically good or bad. Since courts, management, and shareholders each contribute to the total control costs of the firm, it is the idiosyncratic balancing of these costs that holds the secret to a successful jurisdiction.

Enter the federal government. It is not a coincidence that Musk has also invoked an appeal to federalism in his fight with Delaware.[345] As demonstrated by Professor Mark Roe, states competing over corporate charters may explain some of the reasons for the development of corporate law and courts, but it is only a part of the story.[346] For a state like Delaware, which has come to rely on collecting franchise fees as a significant source of revenues, the federalization of corporate law is a bigger threat than any other state is able to levy against it.[347] If all public corporations had to charter federally, for instance, Delaware would lose a significant source of its revenues.[348] Indeed, federal intervention in corporate law is already ongoing, particularly in laws designed to regulate the shareholder voting process (e.g., proxy rules, tender offer rules, and stock exchange listing standards).[349] Since the Tesla dispute concerns the power of shareholders to vote their way in their ongoing relationship with management, this would not be an unfamiliar avenue for congressional intervention. This Essay can therefore draw an important and timely cautionary tale for specialized courts, and particularly for Delaware: If corporate

342. See, e.g., id. at 1438 (describing the debate between the two competing accounts); Romano, State Competition, supra note 206, at 720–25 (describing the debate and advocating for a race to the top theory).

343. See, e.g., Ralph K. Winter, Jr., State Law, Shareholder Protection, and the Theory of the Corporation, 6 J. Legal Stud. 251, 289–92 (1977) (providing a seminal race to the top articulation).

344. See, e.g., Cary, supra note 12, at 665–66 (providing a seminal race to the bottom theory).

345. Supra note 9 and accompanying text.

346. See Roe, supra note 27, at 592.

347. See id. at 601–07 (describing the leverage of the federal threat).

348. See supra note 18 and accompanying text.

349. See Roe, supra note 27, at 607–34 (describing the historical incursion of federal law).

courts fail to understand their limited role in the tripartite arrangement with management and shareholders, they risk federal intervention, especially if they wield powers in ways that threaten the shareholder voting process. But there is also an inverse lesson for the federal government to heed: Establishing a specialized court with the experience and prowess to fully realize the claim-dismissal specialization is an expensive, time-consuming, and difficult process—one that swift federalization will not be able to easily accomplish.

CONCLUSION

This Essay explains why courts specializing in corporate law have been successful and necessary, enabling the judiciary to fulfill its unique role in the triangular relationship among courts, shareholders, and directors. Specialized courts acknowledge that judicial review is not warranted for mismanagement cases and is only justified for self-dealing when the reduction in overall principal and agent costs outweighs the added adjudication costs. Most importantly, specialized corporate courts recognize the tradeoffs between imposing legal liability and allowing the principal to exercise control rights (or deferring to market mechanisms), thus functioning as a third party to the incomplete contract dedicated to maximizing corporate value. Whether it's Delaware, Texas, Nevada, or the federal government, the lessons learned from the nature of specialized corporate courts are essential for the development of corporate law and policy.