Compensated to the Moon: The Impact of Excessive Compensation on Director Independence Post *Tornetta v. Musk*

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Excessive director compensation erodes the independence that directors are supposed to bring to boardrooms. In theory, directors are meant to serve as objective parties, overseeing corporations using their care, skill, and loyalty to promote sound decisionmaking. However, excessive compensation can create the unintended ill-effect of rendering a director beholden to upper management and unable to make clear-eyed, impartial decisions. To mitigate this problem, this Note advocates for the implementation of tenure limits, compensation caps, and enhanced proxy disclosures to ensure that board members uphold their fiduciary duties and make decisions in the best interests of the corporations they serve rather than in their own self-interests.

This Note explores the tension between offering competitive compensation to retain qualified directors while still expecting directors to remain free enough to challenge upper management's decisions. Part I provides an overview of the historical background and recent trends in director compensation. Part II analyzes the recent case Tornetta v. Musk *to understand how courts define materiality in director compensation, and to display the effect excessive compensation has on approving corporate transactions. Part III advocates for potential solutions to the problem of excessive compensation eroding independence by outlining measures aimed at increasing transparency for shareholders.*

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TABLE OF CONTENTS

INTRODUCTION

Director compensation has risen steadily since the 1920s. Directors play a distinct role in corporate governance because they offer high-level strategic guidance and oversight, which are intended to act as checks on the virtually unchecked power of upper management. Upper management typically refers to the company's executive team—such as the CEO, CFO, and other C-suite officers—who are responsible for the day-to-day operations of the company. In contrast, directors are part of the board of directors, a group elected by shareholders to set long-term goals for the company, represent shareholder interests, and ensure that upper management is held accountable.

A problem arises when director remuneration is so high as to be considered materially relevant to a director. How can directors be expected to make objective decisions in the corporation's best interests if they depend on income resulting from their board roles, in effect making them beholden to upper management's wishes?

This Note argues that excessive director compensation can undermine the independence expected from board members, which leads to potential conflicts of interest and reduced transparency for shareholders. This is an important area to explore because directors are legally required, through the duty of loyalty, to provide unbiased guidance in the best interests of corporations. When compensation is excessive, directors are less inclined to challenge management, which ultimately acts as a detriment to shareholders.

To address this concern, this Note proposes a series of measures, including reframing the role of director, limiting tenure, imposing compensation caps, and enhancing proxy disclosure requirements to help shareholders make informed decisions about the true status of director independence. These measures aim to strike a balance between recognizing that attractive compensation plans help retain qualified, diligent directors, while acknowledging that seeking true director independence is crucial for effective corporate governance.

I. TRENDS IN DIRECTOR COMPENSATION

A. HISTORICAL BACKGROUND

In the early 1900s, directors were usually majority shareholders who did not receive additional compensation to fulfill their director duties.[1] Early case law indicates that it was "the custom of directors of corporations to serve gratuitously," with no expectation of compensation.[2] For example, in the 1921

1. Charles M. Elson, *Director Compensation and the Management-Captured Board—The History of a Symptom and a Cure*, 50 SMU L. REV. 127, 131 (1996).

2. Nat'l Loan & Inv. Co. v. Rockland Co., 94 F. 335, 337 (8th Cir. 1899). *But see* Elson, *supra* note 1, at 138 ("[T]his did not necessarily mean that directors received absolutely no additional reward for their services. . . . [I]t was not uncommon for directors to receive some kind of 'nominal' payment for their attendance at board meetings—usually a gold double eagle (worth twenty dollars) placed in front of their seats at each board meeting.").

case *Cahall v. Lofland*, the Delaware Chancery Court ruled that it was impermissible for directors to issue themselves stock and annual salaries through a vote of directors.[3] The court reasoned that the directors' action was not authorized by the corporate charter, bylaws, or stockholders, and further, that the directors did not perform any services considered extraordinary.[4]

Since directors were usually majority shareholders, incentives were aligned between directors and the corporations they served, but the role of director was not thought of as a separate, extra role deserving any additional pay.[5] Board seats were largely symbolic, and directors were described by courts as "gratuitous mandatories."[6]

In the 1930s, the expansion of large public corporations in the United States brought with it seismic changes in corporate governance. Companies were no longer privately controlled and managed by a few wealthy majority shareholders—usually bankers and financiers.[7] Rather, they were owned by thousands of investors located throughout the nation, who individually held little say in either the corporation's day-to-day activities or its higher-level direction and strategy.[8] Appointed managers now selected and retained directors, wielding power and influence over them. Directorship thus became a role which required additional responsibility and incurred distinct liability.[9] As a result, societal attitudes about director compensation began to shift and courts began to recognize that directors were spending considerable time, energy, and effort in their board roles, so they should be compensated for their work.[10]

By the 1940s, directors were increasingly receiving cash compensation for their services.[11] Additionally, directors were now allowed to vote to set their own compensations. This practice was endorsed by the Model Business Corporation Act in 1953.[12] Marking a departure from early case law, the Act provided that

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3. Cahall v. Lofland, 114 A. 224, 234 (Del. Ch. 1921).

4. *Id.* at 232.

5. In 2024, it is still common for directors in venture capital-backed companies not to receive remuneration for their board duties. *Paying Your Board Members: How and How Much?*, STARTUP CFO SOLS. (May 16, 2023), https://www.startupcfosolutions.com/blog/paying-your-board-members-how-and-how-much.

6. Spering's Appeal, 71 Pa. 11, 17 (1872); *see also* Dalia Tsuk Mitchell, *Status Bound: The Twentieth Century Evolution of Directors' Liability*, 5 N.Y.U. J.L. & BUS. 63, 73 (2009).

7. CAROLA FRYDMAN, ERIC HILT, & LAUREN MOSTROM, OWNERSHIP AND CONTROL OF AMERICAN PUBLIC CORPORATIONS, 1880-1920, at 3 (2021); *see also* Christian C. Day, *Partner to Plutocrat: The Separation of Ownership from Management in Emerging Capital Markets—19th Century Industrial America*, 58 U. MIA. L. REV. 525, 563–64 (2004) ("In such a chaotic legal environment filled with corruption, investment banks had to create a system of governance that would assure foreign investors that their investments would be secure. J. P. Morgan & Co. 'pioneered' the technique of placing a partner of the investment firm on the board of the corporation.").

8. Elson, *supra* note 1, at 139.

9. *See* Mitchell, *supra* note 6.

10. *See* Elson, *supra* note 1, at 132.

11. *Id.* at 143 ("The average outside director received about $850 during 1945, with other directors averaging $625. By 1946, according to a study of 184 directors of large companies, about 3 out of 5 were receiving in the aggregate over $1,000 per year[] . . . .").

12. *See* MODEL BUS. CORP. ACT § 33 (AM. L. INST. 1953).

boards had the authority to "fix the compensation of directors unless otherwise provided in the articles of incorporation."[13] This allowance represented a significant shift in perspective since the early days of American business in which directors were presumed to serve without compensation or the expectation of it.[14]

By the 1960s, courts and American businesses normalized and accepted director compensation as part of the general corporate landscape.[15] The actual amounts of total compensation rose significantly throughout the following years. By 1981, the median annual retainer[16] for directors of companies in the Fortune 100[17] was $15,000, while the median payment for attending board meetings was $500.[18] By 1989, the median annual retainer had risen to $24,000, and board meeting fees had doubled to $1,000.[19] Additionally, it became the norm for companies to give directors substantial pensions following their retirement.[20] By 1995, the largest industrial companies paid a median of $60,000 annually.[21]

Director compensation packages grew increasingly sophisticated and robust,[22] and included not only cash general retainers, but meeting fees, retirement arrangements, life insurance, medical insurance, arrangements for charitable contributions made by the corporation on the directors' behalf, opportunities to defer cash compensation for tax-favored treatment, and stock options and grants.[23] The benefits of a typical compensation package far exceeded the dollar amount annual retainer, especially with the inclusion of pensions. Overall, these compensation packages demonstrate the significant growth trend in director compensation in the twentieth century, a trend that continues through the present day.

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13. *Id.* The current comparable provision is located at § 8.11 which provides: "Unless the articles of incorporation or bylaws provide otherwise, the board of directors may fix the compensation of directors." MODEL BUS. CORP. ACT § 8.11 (AM. L. INST. 1991).

14. *See* Nat'l Loan & Inv. Co. v. Rockland Co., 94 F. 335, 337 (8th Cir. 1899).

15. Elson, *supra* note 1, at 146.

16. An annual retainer is the annual fee payable to a director for their board service. *Annual Retainer Fee Definition*, LAW INSIDER, https://www.lawinsider.com/dictionary/annual-retainer-fee (last visited Feb. 27, 2025).

17. The Fortune 100 is a list of the 100 largest companies in the US based on revenue, published by Forbes Magazine. Will Kenton, *Fortune 100 Definition, Requirements, and Top Companies*, INVESTOPEDIA (Mar. 30, 2024), https://www.investopedia.com/terms/f/fortune-100.asp.

18. Elson, *supra* note 1, at 147.

19. *Id.* at 154.

20. *Id.*

21. *Id.* at 155.

22. *See* SOLOMON ETHE & ROGER M. PEGRAM, CONFERENCE BOARD REPORTS: CORPORATE DIRECTORSHIP PRACTICES 6 (1959).

23. Elson, *supra* note 1, at 132.

B. RECENT TRENDS

The past decade has seen a steady increase in director compensation levels.[24] This Subpart will specifically focus on analyzing trends from large-cap S&P 500 companies. The S&P 500 index tracks the performance of the 500 largest publicly traded companies in the United States weighted by market capitalization.[25] The SEC began requiring disclosure of executive and director compensation in 2006, thus data is more widely available after that time.[26]

From 2000 to 2023, there have been numerous modifications in how large public corporations have compensated their directors.[27] Gone are the days of cushy retirement plans and exorbitant board meeting fees.[28] Equity compensation is now usually granted in the form of full-value shares.[29] There are stock ownership guidelines for directors, and corporations give supplemental cash retainers to committee chairs in recognition of their increased time commitments.[30] These changes show how corporate governance practices have evolved over time.[31]

S&P 500 total direct compensation for directors has increased about 2 percent on an annualized basis since 2015.[32] Total direct compensation is the sum of cash and equity which directors receive for their service as board members. In 2013, the average total direct compensation for each director (including the independent chairperson, who received additional pay compared

24. *See* Matthew Friestedt, Marc Treviño & Melissa Sawyer, *Trends in U.S. Director Compensation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 16, 2020), https://corpgov.law.harvard.edu/2020/08/16/trends-in-u-s-director-compensation; *see also* James Reda, *The Evolution of Director Compensation*, GALLAGHER, https://www.ajg.com/us/news-and-insights/2018/12/the-evolution-of-director-compensation (last visited Feb. 27, 2025).

25. Will Kenton, *S&P 500: What It's for and Why It's Important in Investing*, INVESTOPEDIA (June 12, 2024), https://www.investopedia.com/terms/s/sp500.asp.

26. Press Release, SEC, SEC Votes to Adopt Changes to Disclosure Requirements Concerning Executive Compensation and Related Matters (July 26, 2006), https://www.sec.gov/news/press/2006/2006-123.htm.

27. Julie Hembrock Daum, *Spencer Stuart Board Index: How Boards Are Changing*, BLOOMBERG (Mar. 16, 2010, 10:31 AM PDT), https://www.bloomberg.com/news/articles/2010-03-16/spencer-stuart-board-index-how-boards-are-changing.

28. John Ellerman, Peter England & Blaine Martin, *The Evolution and Current State of Director Compensation Plans*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 5, 2017), https://corpgov.law.harvard.edu/2017/09/05/the-evolution-and-current-state-of-director-compensation-plans.

29. *Id.*

30. *Id.*

31. Particularly notable shifts were spurned by the 1996 NACD Report on Director Professionalism that dismantled director pension plans and benefits programs, the Sarbanes-Oxley Act in 2002 that included an expanded role for the Audit Committee, the general diminishment of staggered board elections, the separation of the CEO and board chair roles, and the Dodd-Frank regulations that introduced the shareholder vote on executive compensation. *See* Diane Lerner, *Board of Directors Compensation: Past, Present and Future*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 14, 2017), https://corpgov.law.harvard.edu/2017/03/14/board-of-directors-compensation-past-present-and-future.

32. Linda Pappas, Christine Skizas & Olivia Wakefield, *Trends in S&P 500 Board of Director Compensation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 29, 2024), https://corpgov.law.harvard.edu/2024/02/29/trends-in-sp-500-board-of-director-compensation.

to other directors) was $249,168.[33] "More than half of director compensation [came] in the form of equity," a trend that has continued to the present day.[34] By 2023, the average total direct compensation for each director increased to $321,220.[35] To keep this number in perspective, the average salary for workers in the United States in 2023 was $59,428.[36] Thus, the ratio between director compensation at S&P 500 firms and average U.S. employee compensation was about 5.4 to 1.[37]

The decade from 2013 and 2023 saw director compensation increase by 28.92 percent in the United States.[38] Director compensation levels have been steadily rising ever since directors were given the ability to set their own compensation.[39] For the sake of comparison, in the United Kingdom, directors are paid on average £43,227 per year,[40] while the average UK employee makes £36,920 annually.[41] The ratio between director pay and employee pay in the UK is therefore 1.2 to 1.[42] The lower disparity between director and employee pay in the United Kingdom can be attributed to a combination of factors, including

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33. SPENCER STUART, 2014 SPENCER STUART BOARD INDEX 35 (2014), https://www.spencerstuart.com/~/media/pdf%20files/research%20and%20insight%20pdfs/ssbi2014web14nov2014.pdf%20target=.

34. *Id.* at 7, 35.

35. SPENCER STUART, 2023 S&P 500 COMPENSATION SNAPSHOT 2–3 (2023), https://www.spencerstuart.com/-/media/2023/august/2023compsnapshot/2023-sp-500-compensation-snapshot.pdf.

36. Belle Wong, *Average Salary by State in 2024*, FORBES (Sept. 27, 2024, 4:17 PM), https://www.forbes.com/advisor/business/average-salary-by-state.

37. Average total direct director compensation in 2023 was $321,220. SPENCER STUART 2023 S&P 500 COMPENSATION SNAPSHOT, *supra* note 35. This figure is divided by $59,428, the average salary for workers in the United States in 2023. Wong, *supra* note 36. This results in the figure that a director, on average, made 5.4 times as much money as the average employee in the United States in 2023.

38. "The average total director compensation for all S&P 500 companies also increased . . . to $249,168 in 2013." SPENCER STUART, U.S. FINANCIAL SERVICES BOARD INDEX 2013, at 14 (2014). "The average total compensation for S&P 500 directors [increased in] 2023 [to] $321,220." SPENCER STUART 2023 S&P 500 COMPENSATION SNAPSHOT, *supra* note 35, at 1. The percentage increase in total compensation for S&P 500 directors from 2013 to 2023 was calculated using the standard percentage change formula: Percentage Change = [(New Value – Old Value) / Old Value] x 100. Plugging in these values: [(321,220 – 249,168) / 249,168] x 100 = 28.92%. Thus, the total compensation for S&P 500 directors increased by approximately 28.92% over the 2013 to 2023 period.

39. *See* ETHE & PEGRAM, *supra* note 22, at 29.

40. Stephen Conmy, *How Much Are Board Members Paid?*, THE CORP. GOVERNANCE INST., https://www.thecorporategovernanceinstitute.com/insights/news-analysis/how-much-are-board-members-paid-in-the-uk-the-us-and-europe (last visited Feb. 27, 2025). At the time of this writing, 43,227 EUR is equivalent to 56,493 USD.

41. *See* Jo Thornhill & Laura Howard, *Average UK Salary By Age in 2024*, FORBES (Feb. 19, 2025, 8:24 AM), https://www.forbes.com/uk/advisor/business/average-uk-salary-by-age. At the time of this writing, 32,900 EUR is equivalent to about 45,610 USD.

42. These figures for total direct compensation are averages, and they conceal a wide range of actual pay amounts which vary by company. Company size correlates with amount of director pay, as larger companies generally pay higher director fees. The averaged figures also conceal how much stock directors of large S&P 500 companies hold, as the figures only indicate how much additional cash and equity directors are receiving each year, while their stock holdings are compounding year after year which can produce exorbitant results. *See* Lerner, *supra* note 31.

more stringent regulations governing executive pay in the UK,[43] greater shareholder scrutiny,[44] and a corporate culture that tends to emphasize more equitable compensation practices compared to the United States.[45]

An inverse correlation has developed between director compensation, which has been steadily rising, and average number of meetings directors attend annually, which has been steadily falling. Directors of S&P 500 companies currently attend board meetings less frequently than they did in the past. In 1986, boards met on average 11 times;[46] in 2009, this figure decreased to 9 meetings;[47] in 2023, this figure further decreased to 7.6 meetings.[48] There could be numerous explanations for the drop in meeting frequency, including perhaps directors spending more time outside of board meetings to come up to speed on critical issues and review routine matters.[49] A 2023 survey from Ernst & Young indicates that directors are seeking ways to adapt in a complex and uncertain business environment.[50] The surveyed directors also expressed a desire to increase their engagement with management and employees rather than passively listening to presentations in board meetings, and this shift in preferred engagement style could help explain the reduced meeting frequency.[51]

According to the U.S. Bureau of Labor Statistics, employees in the private sector work about 34.4 hours a week, or about 1,789 hours annually, assuming 52 working weeks, to receive their yearly salaries.[52] Directors, on the other hand, logged an average of 5.56 hours a week, or 278 hours annually, on their most complex board to receive their salaries in 2023.[53] While directorship entails

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43. Paul Townsend & Martin Reynolds, *The Fast-Evolving UK Executive Pay Landscape*, WTW (July 22, 2024), https://www.wtwco.com/en-gb/insights/2024/07/the-fast-evolving-uk-executive-pay-landscape; *see also* Bobby V. Reddy, *Getting in a Bind—Comparing Executive Compensation Regulations in the US and the UK* 7–8 (Univ. of Cambridge Faculty of L. Rsch. Paper No. 5/2024, 2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4722367.

44. Bobby Reddy, *U.K. Executive Compensation is Lower Than in the U.S., but Let's Not Be So Quick to Blame Regulation*, OXFORD BUS. L. BLOG (June 10, 2024), https://blogs.law.ox.ac.uk/oblb/blog-post/2024/06/uk-executive-compensation-lower-us-lets-not-be-so-quick-blame-regulation ("[S]hareholders . . . have a binding vote on the policy pursuant to which directors will be paid in future years.").

45. Reddy, *supra* note 43, at 32.

46. Spencer Stuart, *Spencer Stuart's 25th Annual Board Study Highlights Major Changes in Governance*, PR NEWSWIRE (Oct. 20, 2010, 12:29 PM ET), https://www.prnewswire.com/news-releases/spencer-stuarts-25th-annual-board-study-highlights-major-changes-in-governance-105355798.html.

47. *See* 2014 SPENCER STUART BOARD INDEX, *supra* note 33, at 7.

48. SPENCER STUART, 2023 U.S. SPENCER STUART BOARD INDEX 8 (2023), https://www.spencerstuart.com/-/media/2023/september/usbi/2023_us_spencer_stuart_board_index.pdf.

49. BARTON EDGERTON, EY, HOW TODAY'S BOARDS ARE TRANSFORMING FOR TOMORROW 4, 7 (2023), https://www.ey.com/content/dam/ey-unified-site/ey-com/en-us/campaigns/board-matters/documents/ey-cbm-how-todays-boards-are-transforming-for-tomorrow.pdf.

50. *Id.* at 2, 5.

51. *Id.* at 5.

52. Employees worked 34.4 hours a week on average for private industries in September 2023. *Current Employment Statistics Highlights*, U.S. BUREAU OF LAB. STAT. (Oct. 6, 2023), www.bls.gov/ces/publications/highlights/2023/current-employment-statistics-highlights-09-2023.pdf.

53. *Spencer Stuart Director Pulse Survey: Time Commitment 2023*, SPENCER STUART (Mar. 2023), https://www.spencerstuart.com/research-and-insight/spencer-stuart-director-pulse-survey-time-commitment.

higher risks, duties, and increased obligations which create liability where the average employee has none, these factors alone may not fully justify the significant disparity in compensation. Directors are shielded by indemnification clauses and directors and officers (D&O) insurance, both of which limit their personal exposure to liability.[54] Despite directors' increased level of responsibility, directorship remains a part-time position, that is, on average, 5.4 times[55] more lucrative than being an employee, while requiring only about one-sixth of the time commitment.[56] While it could be said that the increased risk justifies the higher compensation, the risks may not fully justify the magnitude of compensation seen in recent years.

Like regular employees, directors are hired by the corporation, yet they devote significantly less time to their roles than employees do. It seems unreasonable that they should earn five times more than employees, with some directors receiving salaries that can exceed $300,000 annually, a figure that is comparable to the total income of a highly paid employee. Just as discussions surrounding CEO-to-employee pay ratios have sparked conversations about income inequality, examining director-to-employee pay ratios further sheds light on the stark disparities embedded in corporate compensation structures.

Directors' ability to set their own compensation can sometimes lead to excessive and seemingly unbelievable outcomes. For example, between 2017 and 2020, twelve directors at Tesla, Inc. awarded themselves approximately 11 million stock options as part of their remuneration.[57] In reaction, shareholders brought a derivative suit in 2020 claiming that the directors breached their fiduciary duties by grossly overpaying themselves.[58] The directors agreed to settle to avoid the risk of litigation, and agreed to return $735 million in stock awards back to the company.[59] This is one of the largest shareholder settlements of its kind.[60]

54. *Indemnity and Insurance: How Directors and Officers Can Enhance Their Protections*, COOLEY (Aug. 15, 2022), https://www.cooley.com/news/insight/2022/2022-08-15-indemnity-and-insurance-how-directors-and-officers-can-enhance-their-protections; *see also* Julia Kagan, *Directors and Officers (D&O) Insurance: What Is It, Who Needs It?*, INVESTOPEDIA (July 10, 2022), https://www.investopedia.com/terms/d/directors-and-officers-liability-insurance.asp.

55. *Supra* text accompanying note 37.

56. Directors worked 278 hours on their most complex board in 2023. *Spencer Stuart Director Pulse Survey: Time Commitment 2023*, *supra* note 53. Employees in the private sector worked 1,789 hours in their roles in 2024 assuming 52 weeks of work. *See Average Weekly Hours and Overtime of All Employees on Nonfarm Payrolls by Industry Sector, Seasonally Adjusted*, U.S. BUREAU OF LAB. STAT. (Feb. 7, 2025), https://www.bls.gov/news.release/empsit.t18.htm. 278 hours divided by 1,789 hours is 0.15, which is about one-sixth (0.16). This is how the one-sixth figure was calculated.

57. *Tesla Directors Agree to Return $735m to Settle Claims They Were Grossly Overpaid*, GUARDIAN (July 17, 2023, 6:10 PM EDT), https://www.theguardian.com/technology/2023/jul/17/tesla-directors-compensation-lawsuit-settlement.

58. *Id.*

59. Jef Feely, *Tesla's Board Will Return $735 Million in Stock and Cash to Settle Claims Directors Were Grossly Overpaid*, FORTUNE (July 18, 2023, 2:18 AM PDT), https://fortune.com/2023/07/18/tesla-board-return-735-million-stock-cash-settle-claims-directors-grossly-overpaid.

60. *Tesla Directors Agree to Return $735m to Settle Claims They Were Grossly Overpaid*, *supra* note 57.

It should be noted that there is nothing inherently wrong with directors being compensated, and even compensated generously, as remuneration for their duties.[61] Directors and shareholders generally share the goal of increasing shareholder value, and the problem lies not in the fact of compensation itself but in its structure and scale. It takes skill, effort, and business acumen to be a director, and directors are usually seasoned professionals with extensive experience.[62] Attracting and retaining qualified directors can be done through appealing compensation packages.

The problem arises when director compensation is so high as to rise to the level of materiality.[63] As this Note will further explore in Part II, *Tornetta v. Musk* seems to suggest that compensation is material when it is substantial enough that it renders a director beholden to upper management, effectively compromising a director's ability to push back against the CEO's decisions.[64] Excessive compensation undermines effective decisionmaking because it is inherently conflicted; it is unlikely and unrealistic to expect directors to exercise objective judgment when their financial interests are tied to preserving their high standards of living.

This raises the question: Can excessively compensated directors remain independent enough to challenge the decisions of upper management? The concept of director independence arose in part to alleviate the problem of board passivity, where directors would indiscriminately agree to the wishes of upper management.[65] The following Subpart explains the rise of the director independence framework, as well as areas in which the framework falls short.

C. THE RISE OF DIRECTOR INDEPENDENCE

Corporate governance experts and reform advocates, including Melvin A. Eisenberg in his book *The Structure of the Corporation: A Legal Analysis*,[66]

61. Elson, *supra* note 1, at 156.

62. David F. Larcker & Brian Tayan, *Board of Directors: Selection, Compensation, and Removal*, CORP. GOVERNANCE RSCH. INITIATIVE 3 (2020), https://www.gsb.stanford.edu/sites/default/files/publication-pdf/cgri-quick-guide-04-board-directors-selection-compensation-removal.pdf.

63. Materiality is the standard the judge uses in *Tornetta v. Musk* to decide if information about the directors' lack of independence due to their financial interest needed to be disclosed. *See* Tornetta v. Musk, 310 A.3d 430, 521–22 (Del. Ch. 2024) ("A director's conflict with a transactional counterparty is material information that should be disclosed. In fact, a director's *potential conflict* with a transactional counterparty is material information that should be disclosed.").

64. *Id.* at 531 (Suffice it to say, the Compensation Committee operated under a 'controlled mindset.'"); *id.* at 532 ("Five of the six directors who voted on the Grant were beholder to Musk or had compromising conflicts."); id. at 509 ("[For] Denholm and Buss. . . . Their most significant, potentially compromising factor [was] the compensation each received as a Tesla director.")

65. Elson, *supra* note 1, at 128–30.

66. *See generally* MELVIN A. EISENBERG, THE STRUCTURE OF A CORPORATION: A LEGAL ANALYSIS (1976) (examining the role of officers, directors, and shareholders in the governance of the modern publicly held corporation and discussing the importance of independent directors). *See also* Harald Baum, *The Rise of the Independent Director: A Historical and Comparative Perspective*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 23, 2016), https://corpgov.law.harvard.edu/2016/08/23/the-rise-of-the-independent-director-a-historical-and-comparative-perspective.

introduced the concept of director independence in the 1970s,[67] as a solution to management-controlled, passive boards.[68] In Eisenberg's view, directors needed to be independent from the executives they were supposed to monitor, so that they could actually effectuate proper oversight.[69]

There has been a push in corporate governance practices towards filling boards with mostly independent directors since the 1970s.[70] The average board size for S&P 500 firms is now 10.8 directors,[71] with 9.2 independent directors and 1.6 non-independent directors.[72] The CEO is the only non-independent director on 65 percent of S&P 500 boards.[73]

Independence involves an inquiry into whether the director's decision resulted from the director being controlled, dominated, or beholden to another party.[74] A director is considered beholden to another when the controlling entity has the power to decide whether the challenged director continues to receive a benefit, whether financial or otherwise.[75] This benefit is so important and materially significant to the director that the threatened loss of the benefit raises doubts about whether the controlled director can objectively consider the corporate merits of the contested transaction.[76] Maintaining independence, then, is about being able to objectively evaluate corporate decisions in the face of conflicting interests.

The question of independence involves more than just an inquiry into director compensation. A director can be beholden to a CEO for many reasons, such as personal relationships and financial incentives, all of which can compromise objectivity. The concept of independence is intertwined with the concept of interestedness. Interestedness is understood as the question of whether a director will gain any personal benefit from a corporate transaction in the sense of self-dealing.[77] Directors are considered interested if they either appear on both sides of a transaction or will gain any personal financial benefit

67. Harald Baum, *The Rise of the Independent Director: A Historical and Comparative Perspective* 2 (Max Planck Inst. for Compar. & Int'l Priv. L., Research Paper No. 16/20, 2017).

68. Elson, *supra* note 1, at 148.

69. Baum, *supra* note 67, at 13-14.

70. *See* Jeffery N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1477 (2007). *See generally* EDGERTON, *supra* note 49 (indicating how boards have transformed to increase productivity).

71. Matteo Tonello, *Recent Trends in Board Composition and Refreshment in the Russell 3000 and S&P 500*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 7, 2023), https://corpgov.law.harvard.edu/2023/12/07/recent-trends-in-board-composition-and-refreshment-in-the-russell-3000-and-sp-500.

72. 2023 SPENCER STUART BOARD INDEX, *supra* note 48, at 26.

73. *Id.*

74. ALAN PALMITER, FRANK PARTNOY & ELIZABETH POLLMAN, BUSINESS ORGANIZATIONS: A CONTEMPORARY APPROACH 608 (West Academic 3d ed. 2019).

75. *Id.*

76. *Id.*

77. Andrew M. Johnston & S. Mark Hurd, *Corporate Governance, Overview—Special Committees of Independent Directors*, BLOOMBERG L., https://www.bloomberglaw.com/external/document/X2NCVI7C000000/corporate-governance-overview-special-committees-of-independent- (last visited Mar. 3, 2025).

from the transaction.[78] These two concepts of interestedness and independence come into play when evaluating director compensation. Directors always accrue financial benefits from their compensation packages, which implicates interestedness, and they are usually working closely with upper management to fulfill their duties, which implicates independence or beholden-ness.

The independence framework is meant to promote objective decisionmaking and oversight, but measuring whether independence actually improves board independence is challenging. "Empirical studies have shown that a majority independent board does not [consistently lead to] improve[d] firm performance."[79] However, the values that the independence framework encourages, such as remaining objective, selfless, and ready to stand and speak out against decisions that are not in the shareholders' and corporations' best interests, are beneficial in that they promote trust and stability within the corporate landscape. Director independence is also important because independent oversight creates a crucial check on the otherwise virtually unchecked power of upper management.

Part II provides analysis of the *Tornetta v. Musk*[80] case, in which directors failed to act within shareholders' and their company's best interests because they were so financially and personally interested in arriving at the CEO's desired results that their judgment was clouded. The Delaware Chancery Court judge presiding over the case ruled that the directors' excessive compensation was material, meaning so substantial to the director that independence could no longer be presumed. The case provides an important example showing how excessive compensation can erode the independence that directors are supposed to exemplify in boardroom decisions.[81]

II. TORNETTA V. MUSK

A. OVERVIEW

Richard Tornetta filed a derivative lawsuit against Tesla, Inc. in 2019.[82] He alleged that Tesla directors breached their fiduciary duties by approving CEO Elon Musk's compensation package valued at $55.8 billion.[83] The compensation

78. *See id.*

79. Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447, 450 (2008).

80. Tornetta v. Musk, 310 A.3d 430 (Del. Ch. 2024).

81. *Id.* at 509–10 (Del. Ch. 2024) ("Ordinary, market-rate compensation does not compromise a director's independence. Outsized director compensation can."). Though this is not the central argument of the case, it was two of the directors' "most significant, potentially comprising factor[s]" when analyzing their actions regarding the approval of an outsized CEO compensation package. *Id.* at 509.

82. Tornetta v. Musk, 250 A.3d 793, 796 (Del. Ch. 2019).

83. *Tornetta*, 310 A.3d at 445. As of April 2024, the compensation package was valued at $44.9 billion due to a decline in the value of Tesla stock in 2024. Tom Krisher & David Hamilton, *Elon Musk Gets 77% Approval from Shareholders to Get Back His Big, $44.9 Billion Tesla Pay Package*, ASSOCIATED PRESS (June 14, 2024, 6:13 AM PST), https://apnews.com/article/tesla-elon-musk-pay-package-shareholder-vote-8b6cce1a1aa460dbbaac69eb73e0e5e7.

package was structured in tranches, so that every milestone Musk surpassed for the next ten years would grant Musk more shares of Tesla stock.[84] The compensation package was daring and unprecedented: $55.8 billion is an astronomical amount of money.[85] CEO Elon Musk justified the figure by stating that it was needed to fulfill his ambition of funding a project to move humanity to Mars.[86] He believed that artificial intelligence would diminish humanity's significance, turning humans into the intellectual equivalents of house cats.[87] This led him to also believe that he needed to establish life on another planet, which would naturally take massive amounts of funding, hence the massive compensation package.

Predictions about the future aside, Musk's compensation package faced contentious debate in court, and presently, *Tornetta v. Musk* may still be overturned. The directors on the compensation committee who put together the award grant faced intense scrutiny. Even though the directors followed procedural sanitizing rules[88] by holding a vote of disinterested shareholders who approved the grant, the proxy statement used for the sanitizing vote was deemed materially deficient because the proxy statement did not disclose conflicts of interest stemming from the directors' business and personal relationships with Elon Musk.[89] The judge remarked that shareholders were not adequately informed about either conflicts of interest within the board or the process describing how the board arrived at the nearly $56 billion compensation award amount.[90] The shareholder vote was therefore deemed materially deficient.[91]

Though the company followed procedural sanitizing rules aimed at shielding the compensation package from scrutiny, the underlying lack of

84. *Tornetta*, 310 A.3d at 445.

85. *Id.* at 447.

86. *Id.* at 452.

87. *Id.*

88. Procedural sanitizing rules refer to the processes designed to ensure that a director's conflicting interest transaction is approved in a fair and unbiased manner. A director's conflicting interest transaction can be insulated from judicial review if it is approved by qualified disinterested directors or a majority of disinterested shareholders, or if a court finds that the transaction meets the entire fairness standard. Under the entire fairness test, the transaction must be substantively and procedurally fair to the corporation and its shareholders. Here, disinterested Tesla shareholders voted and approved the compensation award grant in an attempt to sanitize the transaction so that the transaction would not be further scrutinized by courts. However, the Delaware court declined to use the business judgement rule in the case, and instead proceeded using the entire fairness standard. *See* Delaware General Corporation Law, DEL. CODE ANN. tit. 8, § 144 (2025); PALMITER ET AL., *supra* note 74, at 614.

89. PALMITER ET AL., *supra* note 74, at 508–10, 523. In June 2024, six months after the *Tornetta* case had been decided, Tesla shareholders voted on and approved the compensation package again, despite opposition from institutional investors. The favorable vote does not guarantee that Musk will receive the all-stock compensation anytime soon. The compensation package is expected to remain entangled in legal proceedings at the Delaware Chancery Court and Supreme Court for several months, as Tesla seeks to challenge the Delaware judge's decision. Associated Press, *Elon Musk Wins Back His $44.9 Billion Tesla Pay Package in Shareholder Vote*, NPR (June 14, 2024, 1:23 AM ET), https://www.npr.org/2024/06/14/g-s1-4359/elon-musk-tesla-pay-package-shareholder-vote.

90. *See Tornetta*, 310 A.3d at 525, 544.

91. *Id.* at 523.

director independence (and potential conflicts of interest) due to excessive director compensation undermined the integrity of the approval process. Excessive compensation compromises director independence because directors who benefit significantly by keeping the CEO satisfied are unlikely to meaningfully negotiate against the CEO. Delaware Chancery Court Judge McCormick declined to use the business judgment rule[92] as the standard of review in Tornetta, writing that "a director lacks independence if he or she is 'so beholden to an interested director that his or her discretion would be sterilized.' Both past and future rewards are relevant to this analysis. The inquiry is 'highly fact specific' and there is 'no magic formula to find control.'"[93] The judge reasoned that the directors who approved this transaction could not be considered independent because they were beholden to Musk based on the past and future rewards they would receive for serving on the boards of his companies.[94] The directors' lack of meaningful negotiation against Musk when he asked for an enormous compensation package was used as evidence that their discretion was "sterilized," a term indicating a rubber-stamping, docile board.[95]

In addition to their high compensation, the Tesla directors' extensive personal and business relationships with Musk also rendered them beholden to him.[96] One of the Tesla directors was part of Musk's immediate family, and many of the directors were his friends.[97] Some of the directors sitting on the board of Tesla also sat on the board of other companies founded by Musk.[98] One director, Antonio Gracias, testified that Musk's companies had provided him with "dynastic or generational wealth."[99] That the directors were so intertwined with Musk goes against the entire principle of director independence.

The issue in *Tornetta* was that directors did not push back against the CEO when he wanted a massive pay structure. They worked alongside the CEO in discussions which were not adversarial even when they should have been.[100] The judge remarked that the directors were operating under a "controlled

92. *Tornetta*, 310 A.3d at 508. The business judgment rule presumes that directors and officers acted in good faith, without conflicts of interest, and made decisions on a reasonably informed basis, with the honest belief that their actions serve the corporation's best interests. This presumption assumes that the duties of care and loyalty have been fulfilled. When a court applies the business judgment rule as the standard of review, it defers to the directors' and officers' decisions, assuming that both duties were met, and refrains from second-guessing their judgment. *Business Judgement Rule*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/business_judgment_rule#:~:text=The%20business%20judgment%20rule%20provides,the%20parameters%20of%20the%20rule (last visited Mar. 4, 2025).

93. *Tornetta*, 310 A.3d at 508 (first quoting Highland Legacy Ltd. v. Singer, No. 1566-N., 2006 WL 741939, at *5 (Del. Ch. Mar. 17, 2006); and then quoting Calesa Assocs., L.P. v. Am. Cap., Ltd., No. 10557, 2016 WL 770251, at *11 (Del. Ch. Feb 29, 2016)).

94. *Id.* at 509.

95. *Id.* at 508–09.

96. *Id.* at 509.

97. *Id.* at 508.

98. *Id.*

99. *Id.*

100. *Id.* at 513.

mindset," meaning the directors were focused on getting the outcome that the CEO wanted instead of meaningfully negotiating in the interests of shareholders.[101] Realistically, though independence is based on multiple factors, such as personal relationships and loyalty, how were the directors supposed to remain independent, objective, and rational in the face of astronomical personal compensation? How could they have felt free enough to challenge the CEO if their past and future rewards depended on, to a certain extent, being agreeable?

The following Subpart will analyze the materiality standard as applied in the case, and will show how director compensation which rose to the level of materiality influenced the directors' decisionmaking. The lack of pushback against the "superstar CEO"[102] indicated that the board was "captured," passive, and lacking objectivity necessary to determine executive compensation in an arm's length fashion.[103]

B. Director Compensation as Materially Relevant

Excessive compensation erodes director independence when it rises to the level of materiality. Director compensation was considered materially relevant to the judge's reasoning in *Tornetta v. Musk*.[104] Independence could not be presumed to be sustained in the face of "life-changing" generational wealth.[105] This Note argues that when compensation rises to the level of materiality, directors' self-interests outweigh their interests in acting for the benefit of shareholders.

During the events of this case, Tesla had a nine-person board comprised of Elon Musk, his brother Kimbal Musk, Brad Buss, Robyn Denholm, Ira Ehrenpreis, Antonio Gracias, Steve Jurvetson, James Murdoch, and Linda Johnson Rice.[106] Jurvetson took a prolonged leave of absence during the relevant period, so his conduct was excluded from the case.[107] The Tesla board had a compensation committee responsible for negotiating CEO Musk's compensation plan,[108] comprised of Ehrenpreis, Buss, Denholm, and Gracias, with Ehrenpreis as chair.[109] Each of the directors on the board, except for Linda Johnson Rice, was found by the court to be beholden to Musk to varying degrees,

101. *Id.* at 511.
102. *Id.* at 507.
103. Bernice Grant, *Independent Yet Captured: Compensation Committee Independence After Dodd-Frank*, 65 Hastings L.J. 761, 764 (2014) ("The term 'captured board' refers to a board that is serving the interests of management rather than shareholders.").
104. *Tornetta*, 310 A.3d at 457, 510.
105. *Id.* at 457.
106. *Id.* at 454.
107. *Id.* at 454–55.
108. *Id.* at 454.
109. *Id.*

even though each director was classified as independent on the proxy statement used to give shareholders information on the CEO award grant.[110]

The directors made incredible amounts of money from Elon Musk's companies, which the Delaware court said rendered the directors beholden to Musk. Between 2011 and 2015, Ehrenpreis was granted 865,790 Tesla options as a director; he exercised less than a quarter of them in 2021 and netted over $200 million.[111] Buss reported his compensation as a Tesla director from 2011 to 2018 was about $17 million.[112] He realized about $24 million for sales of Tesla stock and owed about 44 percent of his entire net worth to Musk entities.[113] Gracias amassed "dynastic," "generational" wealth from investing in Musk's early and current companies, including Paypal, SpaceX, SolarCity, The Boring Company, and Neuralink.[114] Gracias was the third-largest individual investor in Tesla.[115] His Tesla stock alone was worth approximately $1 billion.[116] The directors' compensation in the form of stock options ostensibly made it quite difficult for them to do anything but rubber-stamp any decisions CEO Elon Musk wanted to make. The director independence framework is supposed to act as a check against unilateral managerial decisionmaking. However, remaining unbeholden in the face of excessive compensation is a complex, possibly even unrealistic endeavor, which these directors ultimately failed to carry out.

The majority of the remaining directors were rendered beholden because of their personal relationships with Elon Musk.[117] Kimbal Musk, Elon's brother, was not considered independent and recused himself from having any role in determining the CEO compensation award due to their familial relationship.[118] James Murdoch was deemed to lack independence because he and Elon were longtime friends who frequently vacationed together.[119]

Despite all nine directors being reported as such on the proxy statement, only one was truly independent.[120] The only genuinely independent director was Linda Johnson Rice, as she had no compromising personal or business ties with Elon Musk, did not exercise the Tesla stock options she received in compensation for being a director, and left the board shortly after the events of the case transpired.[121]

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110. *Id.* at 510. "[T]he Proxy could have discussed the relevant relationships while stating that the Board did not view them as serious impediments to independence, thereby allowing stockholders to make their own assessment. . . . The Proxy was materially deficient on this point." *Id.* at 523.
111. *Id.* at 455.
112. *Id.* at 456.
113. *Id.*
114. *Id.* at 457–58.
115. *Id.* at 457.
116. *Id.* at 457–58.
117. *Id.* at 508–10.
118. *Id.* at 454.
119. *Id.* at 510.
120. *Id.* at 446.
121. *Id.* at 460.

Director Robyn Denholm's role provides the most concrete example of how excessive director compensation can erode independence. Denholm served on the compensation committee and received stock options worth exorbitant amounts for her services.[122] She did not have any personal ties to Elon Musk outside of her board service.[123] Denholm derived "the vast majority of her wealth from her compensation as a Tesla director."[124] Her compensation as a Tesla director from 2014 to 2017 was valued at about $17 million when it was issued, "an amount [that] she acknowledged was material to her at the time."[125] Denholm "ultimately received $280 million through [the sale] . . . of just some of the Tesla options she received as part of her director compensation."[126] She testified that this transaction was "life-changing."[127] Between 2017 and 2019, Denholm "received approximately $3 million per year in her non-Tesla position[,]" indicating that a substantial portion of her net worth was tied to Tesla.[128] Her Tesla director compensation "far exceeded the compensation she received from other sources."[129] The "life-changing," "material" amount of money Denholm made in her role as a Tesla director was deemed relevant in the Delaware Chancery Court's analysis of whether Elon Musk's compensation award was fair, and the judge reasoned Denholm could not be considered independent because her compensation was material to her.

Compensation was the most significant factor in deciding whether a director was beholden in *Tornetta*. Judge McCormick wrote that Denholm's actions in connection with the compensation award demonstrated that Denholm was beholden for purposes of determining the award.[130] The judge remarked that Denholm's and Buss's "most significant, potentially comprising factor is the compensation each received as a Tesla director. . . . [Compensation] is a factor that must be considered when evaluating how Denholm and Buss acted when negotiating the Grant."[131] That director compensation was the single most potentially compromising factor points to the tension between director compensation and the duty of loyalty. Director compensation is a thorny issue precisely because in theory, directors are meant to look out for shareholders, but in reality, incentives between shareholders and directors do not neatly line up, as directors are often interested in maintaining their own income sources.

The unspoken impact effect of excessive director compensation is profound. Excessive director compensation fosters a situation wherein directors who derive substantial income from their board roles cannot truly be considered

122. *Id.* at 457.
123. *Id.*
124. *Id.*
125. *Id.*
126. *Id.*
127. *Id.*
128. *Id.*
129. *Id.*
130. *Id.* at 509.
131. *Id.* at 509–10.

independent. Consequently, only directors who primarily amass most of their wealth from other sources can genuinely challenge executive management, which is a tremendously important function. Scholars Alberto Salazar and Muthana Mohamed write that allowing directors to determine executive compensation undermines the success of corporations.[132] They explain that the current process "has resulted in extremely excessive compensation, outrageous pay disparities between executives and workers, poor short-term performance, recurrent corporate failures[,] and economic recession."[133] One reason for this phenomenon is that when directors are approving compensation packages for CEOs, the directors themselves are financially interested in keeping CEOs satisfied and content. If the directors are making income that is material to them in their board roles, they may strive to maintain their own streams of income and access to future financial opportunities to the detriment of the shareholders.

C. COUNTERARGUMENTS

It should be noted that CEOs deserve adequate compensation in return for leading their corporations to major financial successes. To suggest otherwise seems like a denial of general business norms and the ethos of corporate America. In *Tornetta*, Musk received high compensation because Tesla performed well. Musk created over $600 billion in value for shareholders, an unprecedented number.[134] His compensation package, valued at nearly $56 billion, was less than one-tenth of the value of Tesla stock at its peak.[135] Maximizing value for shareholders is one of the key purposes of corporations, so it would seem like the directors' approval of Musk's grant award was not actually detrimental to shareholders. However, the Delaware Chancery Court disagreed, though the case may still be overturned on appeal. Regardless of the debate over excessive CEO compensation, excessive *director* compensation is particularly concerning because it encourages rubber-stamping and the approval of transactions—like the one in *Tornetta*—that are irrational, unreasonable, and likely to face legal challenges. This leads to executives spending time in litigation instead of performing their duties and running their companies, which is undoubtedly detrimental to shareholders.

132. Alberto Salazar & Muthana Mohamed, *The Duty of Corporate Directors to Tie Executive Compensation to the Long-Term Sustainability of the Firm* 1 (Osgoode Legal Stud. Rsch. Paper Series, Research Paper No. 20, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2701455.

133. *Id.*

134. Matt Levine, *Elon Musk is Overpaid, Or So Says a Delaware Judge*, BLOOMBERG (Jan. 31, 2024, 9:24 AM PST), https://www.bloomberg.com/opinion/articles/2024-01-31/elon-musk-is-overpaid.

135. *Id.* ("In the most optimistic case, if Tesla's equity market capitalization grew about 1,000%—from $59 billion at the time of the grant in 2018 to $650 billion by 2028—Musk would get all of the options, which in that scenario would be worth about $55.8 billion. In fact, Tesla's market cap hit $650 billion by the end of 2020; it peaked at over $1.2 trillion in late 2021. (It's around $600 billion again [on Jan. 31, 2024].) Musk got all his options, much faster than expected, and they ended up being worth more than $100 billion at their peak.").

The Delaware Chancery Court notes in *Tornetta* that excessive executive compensation was not required to retain Musk as CEO,[136] implying the award grant was not the key factor propelling Tesla's growth. Musk wanted additional compensation for a purpose unrelated to meeting new company growth milestones.[137] Tesla directors argued that the large award grant was necessary to keep Musk engaged with Tesla instead of his many other companies,[138] but the Delaware court rejected this argument, stating that there was no evidence that Musk would have diverted his attention elsewhere if not for the grant.[139] The court implied that Tesla would have grown even if Musk had been paid less.[140] There was a disconnect between Tesla's growth goals and the amount of CEO compensation awarded, as was evidenced by Musk's statement that he mainly needed the additional compensation to fund his expeditions to Mars.[141]

In *Tornetta*, there was some debate over whether the milestones set up for the CEO to achieve in the award grant were actually easily achievable and perhaps not tied to meaningful corporate growth.[142] CEO Musk's compensation plan was contingent on his achieving milestones set forth in the grant's terms. If Tesla's market capitalization rose by $50 billion and Tesla achieved either an EBITDA target or revenue target, a new tranche of Musk's compensation would be unlocked and awarded to him.[143] Pay-for-performance CEO compensation structures are not uncommon for current businesses.[144] However, Tesla's board of directors conceded that some of the milestones set forth in the grant were projected to be 70 percent achievable soon after the grant was approved.[145] The board's concession indicates that Tesla's growth would have occurred naturally, rather than by Musk propelling the company towards more growth because of

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136. *Tornetta*, 310 A.3d at 448 ("Was the plan even necessary for Tesla to retain Musk and achieve its goals?"); *id.* at 537 ("If the goals were retention, engagement, and alignment, then Musk's pre-existing equity stake provided a powerful incentive for Musk to stay and grow Tesla's market capitalization.").

137. *Id.* at 473.

138. *Id.* at 538 ("Defendants' arguments ignore the obvious: Musk stood to gain considerably from achieving the Grant's market capitalization milestones (over $10 billion for each $50 billion increase in market capitalization).").

139. *Id.* at 475.

140. *See id.* at 448.

141. *Id.* at 473 ("Musk reminded Maron that '[t]he added comp is just so that I can put as much as possible towards minimizing existential risk by putting the money towards Mars if I am successful in leading Tesla to be one of the world's most valuable companies. This is kinda crazy, but it is true.'").

142. *Id.* at 540 ("[T]he revenue milestones were not dependent on profitability. . . . ISS noted that 'up to eight tranches . . . may vest based on market capitalization and revenue goals, even if earnings do not clear the EBITDA performance hurdles.' Thus, Musk could still receive billions under the Grant without Tesla experiencing the fundamental growth that the Grant was intended to incentivize.").

143. *Id.* at 445.

144. Ben McClure, *A Guide to CEO Compensation*, INVESTOPEDIA (Oct. 27, 2024), https://www.investopedia.com/managing-wealth/guide-ceo-compensation.

145. *Tornetta*, 310 A.3d at 541 ("Defendants argue that the Grant price was fair because its milestones were difficult to achieve. . . . It is hard to square Defendants' coordinated trial testimony concerning Tesla's internal projections with the contemporaneous evidence. The Board deemed some of the milestones 70% likely to be achieved soon after the Grant was approved. This assessment was made under a conservative accounting metric[] . . . .").

the pay-for-performance incentive. Musk also already owned significant shares of Tesla stock, so in theory he was already incentivized to grow his company.[146]

This Note does not suggest that CEOs should receive less remuneration, and much has already been written on the subject of executive pay. Instead, this Note suggests that directors should receive less remuneration. Decreasing director compensation would presumably lead to a decrease in executive compensation because it would result in a less-beholden board, wherein directors would likely not approve outsized executive compensation packages. Whether or not CEOs deserve excess pay, it is generally accepted that directors do not require as much compensation as executives do. Executives control the day-to-day management of the corporation. Directors are meant to provide high-level oversight and are discouraged from stepping too much on managers' toes.[147] Director compensation should be reduced because directors are inherently conflicted when they receive excessive remuneration. They become interested in approving corporate transactions which will keep them serving in their board roles, which seems to inherently contradict the duties of loyalty and oversight.

D. Flaws in the Independence Framework

Seven out of the eight relevant Tesla directors were determined to be nominally independent in the proxy statement but actually beholden to the CEO during the determination of the CEO award grant. Delaware Judge McCormick made this determination by analyzing each director's level of beholden-ness when negotiating the grant.[148] The independence framework as applied by Delaware courts is somewhat unrealistic to uphold in its current form.[149] Scholar George Dent writes, "[The current approach] is gravely flawed. It treats independence as an all or nothing, black or white issue, with huge stakes riding on the determination of independence because of the extreme difference in treatment of interested and disinterested transactions. This approach ignores reality . . . ."[150] The independence framework is perhaps overly simplistic because it ignores the complexities of how directors interact with each other on the board, and the subtle ways in which personal relationships can influence decisionmaking. Perhaps additional research and a re-thinking of how the

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146. *See id.* at 547.

147. Lena Eisenstein, *The Difference Between Governance and Management*, BoardEffect (July 20, 2021), https://www.boardeffect.com/blog/difference-between-governance-management.

148. *See Tornetta*, 310 A.3d at 525. Companies self-report the status of director independence on proxy statements but they have incentives to say people are independent when they really are not, because courts are more likely to use the business judgement rule if transactions are approved by independent directors. *See* Oderah C. Nwaeze, *Director Independence—Keeping the Board and Board Actions Conflict-Free*, Faegre Drinker (July 24, 2024), https://www.faegredrinker.com/en/insights/publications/2022/2/the-corporate-guide-keeping-board-actions-conflictfree.

149. George W. Dent, Jr., *Independence of Directors in Delaware Corporate Law*, 54 U. Louisville L. Rev. 73, 74 (2016).

150. *Id.*

independence framework operates would be beneficial so that it could be more realistic to uphold.

The disclosure framework for director independence is inadequate because it provides companies with too much discretion in what is reported.[151] Shareholders are left with insufficient information to cast meaningful votes.[152] The *Tornetta* case is a testament to this: the proxy given to shareholders was deemed inadequate because every director was categorized as independent when this was not actually the case.[153] It should not be permissible for directors to be considered independent on proxy statements when they are not independent in reality. If there were less discretion in what Tesla had to disclose, this problem could be alleviated.[154]

Delaware law suggests that while a director may demonstrate independence on certain issues, they may not necessarily exhibit it on others.[155] Delaware rejects attempts by corporate governance advocates to oversimplify independence as a fixed status and does not confine itself to predetermined designations or safe harbor rules.[156] Instead, Delaware courts examine the specific conflict arising in the relevant transaction and adopt a situational approach, which can lead to inconsistent results.[157] This inconsistency has lead certain scholars, such as Yaron Nili, to caution against a "deferential reliance" on the director independence framework.[158]

In the current regulatory framework, public companies' boards self-designate their peer directors as independent directors, and boards are only required to disclosed specific, limited information about the criteria for this designation.[159] This leaves shareholders with little information about the actual degree of independence an elected director possesses.[160] This results in directors being independent in name, but beholden in reality. Scholar Katherine Brown writes that directors need to be "independent in fact and in appearance," and that "director compensation plans should therefore be concerned with not only the incentive effects created by compensation, but also with the message that it sends to be public."[161] As Brown writes, "appearances matter when it comes to an evaluation of a director's independence and ability to effectuate [their] duties."[162]

151. Yaron Nili, *The Fallacy of Director Independence*, 2020 WIS. L. REV. 491, 503.

152. *Id.*

153. *Tornetta*, 310 A.3d at 508–09.

154. *See id.* at 491.

155. *See id.* at 501.

156. *See id.*

157. Nili, *supra* note 151, at 501–02.

158. *Id.* at 491.

159. Yaron Nili, *Out of Sight, Out of Mind: The Case for Improving Director Independence Disclosure*, 43 J. CORP. L. 35, 38 (2017).

160. *Id.*

161. Katherine M. Brown, Note, *New Demands, Better Boards: Rethinking Director Compensation in an Era of Heightened Corporate Governance*, 82 N.Y.U. L. REV. 1102, 1117 (2007).

162. *Id.*

Although the current independence framework is not perfect, it serves to promote important values such as honesty, selflessness, and altruism. The framework is still useful and should not be radically changed, but incremental changes to provide more detailed disclosure are both achievable and necessary. The following Part proposes four solutions to address the problem of passive, rubber-stamping boards, which are the result of excessive director compensation.

III. PROPOSED SOLUTIONS

Excessive director compensation is problematic because it erodes the independence that directors are supposed to bring to boardrooms. Excessive director compensation may create an implicit dynamic wherein directors must be wealthy from other sources besides their board roles in order to be unbeholden and to feel free enough to push back against the demands of upper management. When directors are compensated to an excessive degree that rises to the level of materiality, they cannot be presumed independent. There are many potential solutions to this problem, and this Note will present four.

A. REFRAMING THE ROLE OF DIRECTOR: A RETURN TO HISTORICAL ROOTS

The first solution to excessive director compensation limiting director's independence can be addressed by reframing how directors are compensated—they should be compensated minimally, and they should autonomously buy significant stakes in the companies they serve on the boards of.

The role of director has undergone numerous revisions since the beginning of the rise of big business in the United States. When large corporations began to exist in the 1920s, directors received no additional renumeration for their duties.[163] Directors were chosen from within the corporation, and they served on boards to oversee their investments.[164] The role of director should once again be reframed, and director compensation should be implemented differently than it is currently.

Directorship was not always considered a role that deserved additional remuneration.[165] This is partly because directors did not spend as much time or effort in their board positions as they do today. However, there was also a fundamentally different understanding of the role of the director around the turn of the century. Early American directorship sprang out of practices popular in

163. *See* Nat'l Loan & Inv. Co. v. Rockland Co., 94 F. 335, 337 (8th Cir. 1899).

164. Elson, *supra* note 1, at 138–39.

165. Cahall v. Lofland, 144 A. 224, 231 (Del. Ch. 1921) ("It is settled that directors are not entitled to enforce payment of salaries, and are presumed to serve without pay. Directors may be rightly allowed payment for services to the company which were clearly and unmistakably outside the scope of their duties, and may enforce payment for such services either pursuant to an express or implied agreement that they are to be paid, or in the absence of agreement may recover under a *quantum meruit*." (emphasis added)).

England.[166] Directors served on the board to oversee their investments and strategically influence the growth of those investments.[167] A similar system should be adopted where directors purchase shares of company stock independently instead of receiving shares as remuneration for board duties.

Berkshire Hathaway provides a great example of how directors could be compensated. The highest-paid non-management director on Berkshire Hathaway's board in 2022 made $6,100.[168] That year, Berkshire paid board members $900 for an in-person meeting, $300 for a telephone meeting, and directors who served on the audit committee were paid an extra $1,000 quarterly.[169] Directors on Berkshire's board receive no stock awards and do not even receive liability insurance coverage.[170] Why would a busy director decide to serve on Berkshire's board if they were not given lavish benefits? Beyond the personal honor of serving on the board of one of the most well-respected investors in history, most of the board members serve on the board because they have significant personal investments in Berkshire Hathaway, and they are committed to overseeing the corporation's successes.[171] No Berkshire director has less than a seven-figure interest in the company, and Berkshire requires this as part of its criteria for considering new directors: "In particular, any recommended candidate should own Berkshire stock that has represented a substantial portion of the candidate's investment portfolio for at least three years."[172] This framework closely mimics the structure of early businesses in the United States, in which directors owned significant stakes in the companies they served on the boards of. Warren Buffet's philosophy is that stock ownership creates personal incentives for directors and executives to make decisions based on the long-term interests of the company instead of based on their self-interests.[173] His policies make directors and executives think like owners instead of employees. This strategy has worked very well for Berkshire Hathaway, although in year 2024 with Buffet's impending retirement, we can only speculate how director compensation levels at the company might change. It is possible that without Buffet at the helm, Berkshire Hathaway may begin to compensate directors on a level more comparable to other S&P 500 companies.

If the idea of directorship could be reframed to align with traditional principles, this would lead to less conflicted interactions between directors and upper management. Directors, like those on the board of Berkshire Hathaway,

166. Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 HOFSTRA L. REV. 89, 110 (2004).

167. Elson, *supra* note 1, at 139.

168. *Berkshire's Directors Have Skin in the Game*, THE RATIONAL WALK (Mar. 12, 2022), https://rationalwalk.com/berkshires-directors-have-skin-in-the-game.

169. *Id.*

170. *Id.*

171. *Id.*

172. Berkshire Hathaway Inc., Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Form DEF 14A), at 6 (Mar. 17, 2023).

173. *Berkshire's Directors Have Skin in the Game*, *supra* note 168.

should sit on boards to oversee their investments purchased not in conjunction with their director roles. If directors are not financially dependent on their board seat remuneration as their primary source of income, they will be better positioned to act objectively and make decisions that serve the corporation's best interest. This independence will enable them to push back against management when necessary, without being constrained by concerns over their remuneration.

B. IMPOSING TENURE LIMITS

A second potential solution is for director tenure to be reduced. Although director tenure does not directly impact excessive director compensation, setting tenure limits would ameliorate one of the problems that excessive director compensation creates: directors making decisions based on extending the longevity of their board service rather than making decisions based on the needs of the corporation.

The average tenure of S&P 500 directors in 2023 was 7.8 years.[174] The 2023 U.S. Spencer Stuart Board Index found that "[w]hile few boards set tenure limits for directors, 69 percent of S&P 500 boards have mandatory retirement ages, and more than half set the age cap at 75 years of age or older."[175] The Index recommended that boards "embrace a culture of refreshing their membership to maintain the right mix of experiences and perspectives[,]" likely in recognition of the concern that extended tenure may compromise director independence.[176] Tenure limits mitigate board stagnation and introduce new perspectives. Research of European companies indicates a correlation between director tenure and CEO compensation: the longer a director stays on the board, the more both CEO and director pay tend to increase.[177] However, further research needs to be done to evaluate this effect within U.S. corporations.

Tenure limits already exist for many non-U.S. companies: twenty-eight jurisdictions around the world set a maximum tenure for independent directors ranging from five to fifteen years, with eight to ten years being the most common length.[178] Singapore, for instance, has adopted a nine-year rule on director independence, which provides that after nine years a director can no longer be

174. 2023 SPENCER STUART BOARD INDEX, *supra* note 48, at 2.

175. *Id.*

176. *Id.*

177. Dan Lin & Lu Lin, *The Interplay Between Director Compensation and CEO Compensation*, 8 INT'L J. BUS. & FIN. RSCH. 11, 11 (2014); *see also* Sylvie Berthelot, Julien Bilodeau & Katy Davignon, *The Impact of Directors' Tenure on Executive Compensation and Corporate Financial Performance*, 10 CORP. OWNERSHIP & CONTROL 164, 164 (2013) ("The results show that although the tenure of independent directors has a positive impact on senior executives' compensation, it has no significant impact on corporate financial performance.").

178. OECD, OECD CORPORATE GOVERNANCE FACTBOOK 2023, at 137 (2023), https://www.oecd.org/en/publications/oecd-corporate-governance-factbook-2023_6d912314-en.html.

considered independent and must limit his or her tenure.[179] Given that the average tenure of S&P 500 directors is only 7.8 years, implementing a nine-year limit might have little impact on most directors. A better solution might be to set a stricter limit—such as six or seven years—since it is typically directors who remain for longer periods who become too closely aligned with management which undermines their independence. Notably, after the *Tornetta v. Musk* decision, Tesla shareholders voted to reduce director tenure from three years to one, demonstrating the benefits of shorter director terms.[180]

Alternatively, rules to disqualify a certain percentage of the board from seeking reelection could be adopted. This would be an effective solution to the loss of director independence which naturally occurs once a person has worked with the same executives for a long period of time. It ensures director independence even if it does not directly limit compensation amounts in any way.

C. IMPLEMENTING COMPENSATION LIMITS

The third potential solution for excessive compensation compromising director independence is to limit the amount of compensation that directors can receive annually. To implement these compensation limits, a multi-faceted approach could be considered. Federal-level legislation could be introduced to establish standardized limits across all public companies, which would ensure a consistent application. Alternatively, shareholder proposals could be introduced to encourage companies to adopt these limits voluntarily. Compensation limits already exist on 70 percent of S&P 500 boards in 2024.[181] This figure should increase to 100 percent. For corporations that do enforce annual limits, the median value for the annual limits on director pay is currently $750,000 for both cash and equity awards.[182] Courts would likely not consider this amount sufficient to render a director beholden to the CEO or otherwise compromise their independence,[183] especially when compared to the considerably higher compensation amounts found significant in cases like *Tornetta v. Musk*.[184]

179. Wong Pei Ting, *9-year Term Limit for Independent Directors Hard-Coded in ASEAN Corporate Governance Scorecard*, SING. INST. OF DIRECTORS (Jan. 23, 2024), https://www.sid.org.sg/Web/Web/About/News-and-Press/News%202024/2024-01-23_BT_9-year_term_limit_for_independent_directors.aspx.

180. *Elon Musk Wins Back His $44.9 Billion Tesla Pay Package in Shareholder Vote*, *supra* note 89.

181. Pappas et al., *supra* note 32.

182. *Id.*

183. *See* Tornetta v. Musk, 310 A.3d 430, 509 (Del. Ch. 2024) ("Ordinary, market-rate compensation does not compromise a director's independence. Outsized director compensation can." (citations omitted)).

184. *See id.* at 457 ("Denholm ultimately received $280 million through sales in 2021 and 2022 of just some of the Tesla options she received as part of her director compensation."); *id.* at 456 ("Between 2011 and 2018, Buss reported that compensation as a Tesla director was approximately $17 million. He realized about $24 million for sales of Tesla shares that he received as compensation . . . ."). The Tesla director compensation figures are significantly greater than the median annual limit on director pay, which is $750,000. *See* Pappas et al., *supra* note 32.

However, the level of compensation necessary to create director beholden-ness should also be further explored and addressed by courts.

In *Tornetta*, there was also a significant issue raised because director Denholm received "the vast majority of her wealth" as part of her director compensation.[185] She received $3 million in her non-Tesla position,[186] which paled in comparison to the $280 million she gained when selling her Tesla options.[187] Perhaps a number for a compensation limit could be determined by finding a percentage of how much of a director's entire income was derived from her role as director and enforcing a limit on what percentage is acceptable. It seems acceptable that no more than 25 percent of a director's entire income should stem from a directorship on a single board. Setting a limit of 25 percent would provide a meaningful boundary because this percentage would help ensure that directors maintain a diverse income portfolio, reducing the risk of conflicts of interest arising from excessive reliance on a single board's compensation.

Setting compensation limits is a good solution because directors send their compensation proposals to shareholders so that shareholders can approve them.[188] Since directors are supposed to look out for shareholders' best interests and represent shareholders, having agreement between these two parties follows director duties and ensures that shareholders approve of the amount of compensation that directors receive from the corporation. Limiting compensation would prevent the obscene amounts of director compensation that have been litigated in recent years. Ensuring that meaningful limits exist is also a good way to avoid litigation about directors breaching their fiduciary duties due to their excessive compensation amounts.[189]

D. IMPROVING PROXY STATEMENT DISCLOSURES

A fourth potential solution could work in conjunction with the third solution: The SEC should implement additional requirements for proxy disclosures so that director independence could be properly vetted and revealed.

A major issue in *Tornetta v. Musk* was that the proxy statement given to shareholders, which was meant to give them information on whether to approve CEO Elon Musk's compensation package was materially deficient. Shareholders

185. *Tornetta*, 310 A.3d at 457 ("Denholm derived the vast majority of her wealth from her compensation as a Tesla director.").

186. *Id.* (Denholm testified that between 2017 and 2019, she received approximately $3 million per year in her non-Tesla position.").

187. *Id.* ("Denholm ultimately received $280 million through sales in 2021 and 2021 of just some of the Tesla options she received as part of her director compensation.").

188. Jarrod Melson, *Director Compensation—Steps to Avoid Liability*, DELAWAREINC.COM (Jan. 29, 2024), https://www.delawareinc.com/blog/director-compensation-steps-to-avoid-liability.

189. BILL GEREK, KORN FERRY HAY GROUP, THE RISE OF DIRECTOR PAY LITIGATION: HOW YOU CAN LIMIT VULNERABILITY 18 (2016), https://www.kornferry.com/insights/briefings-for-the-boardroom/the-rise-of-director-pay-litigation-how-you-can-limit-vulnerability; *see also* Thomas Welk & Peter Adams, *Meaningful Limits on Director Compensation*, 25 SEC. LITIG. 7, 11 (2015).

should not have to vote on issues without being fully informed. The proxy statement described all the directors as independent when only one out of the seven relevant directors was truly independent.[190] The issue of being nominally independent but beholden in reality could be addressed by introducing mandatory disclosures to ensure that director independence, or lack thereof, is adequately revealed.

Another potential solution regarding disclosures mirrors the regulations enforced by the SEC as mandated by the Dodd-Frank Act: Director-to-employee pay ratios should be disclosed as readily available information. The SEC rules on pay ratio disclosure for CEOs were implemented in 2015.[191] The Dodd-Frank Act mandated that publicly traded companies disclose the ratio between the CEO's compensation and the median employee's compensation.[192] A similar rule should be adopted with regards to directors. Director compensation should be disclosed as a ratio reported in proxy statements. This would provide shareholders with more information regarding director compensation, which would in turn help shareholders make better-informed decisions when approving or limiting director compensation. Disclosing a pay ratio on director compensation would likely impact stockholders' voting practices in that stockholders would presumably not approve a plan which they thought was excessive. This would affect compensation practices in general by providing an established boundary for what is generally accepted as the norm for compensation. This would help avoid a Tesla-esque situation from arising in the future.

Establishing acceptable, meaningful limits on director compensation in relation to median employee compensation within the same company would benefit shareholders and the longevity of the corporation because it would promote fairness, altruism, and transparency. The ratio between director pay and median employee pay should serve as a benchmark to indicate the upper limit for how much a director would get paid for their duties.

CONCLUSION

In order to mitigate the erosion of director independence by excessive compensation, there are many potential solutions—this Note proposes four. The first is that directors be compensated minimally for their director duties while maintaining significant stakes in the companies they sit on the boards of, purchased independently and not in compensation for their director duties. This would have the effect of returning to a more traditional understanding in the way director compensation is approached. Second, U.S. corporations should set tenure limitations for directors, so that at minimum, every six or seven years,

190. *See Tornetta*, 310 A.3d at 446.

191. Press Release, SEC, SEC Adopts Rule for Pay Ratio Disclosure (Aug. 15, 2015), https://www.sec.gov/news/press-release/2015-160.

192. *Id.*

new perspectives are being introduced to boards. Third, meaningful limits on compensation should be set, and these limits could be determined by a ratio which compares director pay to median employee pay. Shareholders should cast approval votes for director compensation. Fourth, there should be additional proxy disclosure requirements which would mandate that companies report director pay using a ratio figure between director and employee pay. This is the same way companies currently report CEO pay, in an effort to provide reliable, accurate information about directors' actual independence statuses. Proxy disclosures should report actual independence instead of nominal independence.

In conclusion, the issue of excessive director compensation poses a significant threat to the independence and effectiveness of corporate boards. This Note has examined the historical context, recent trends, and legal implications of director compensation, highlighting the *Tornetta v. Musk* case as a pivotal example of how excessive compensation erodes director independence.

The proposed solutions, including changing how directors are compensated as well as establishing tenure limits, compensation caps, and enhanced proxy disclosures offer a multifaceted approach to addressing the problem. However, it is essential to recognize that additional research is necessary regarding the framework of director independence itself. The current framework treats director independence as a black and white issue, while human relationships are usually fluid and harder to define than simply beholden or unbeholden. The ways we affect one another are not easily categorized.

Additionally, there are huge stakes riding on whether courts find directors independent or not. This is because the business judgment rule prevents courts from second-guessing the decisions of independent and disinterested directors who act with ordinary care. If the business judgment rule applies, the courts will not make any further inquiries into the fairness of the disputed transaction. This can lead to corporations referring to their directors as independent when they are not actually independent, as they did in *Tornetta*. The falsity is detrimental to shareholders because it misleads them when they need accurate information. Additional research and perhaps a more nuanced understanding of human relationships are needed so that the independence framework can more accurately represent reality.

Ultimately, by attempting to resolve the issue of excessive director compensation, corporations can strengthen their governance structures, enhance shareholder confidence, and foster long-term corporate sustainability. Through concerted action, we can uphold the principles of accountability, transparency, and independence essential for effective corporate governance which are meant to be addressed by the director independence framework.