Submitted by the Council to the membership of
The American Law Institute
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THE AMERICAN LAW INSTITUTE | 100

Restatement of the Law
Corporate Governance

Tentative Draft No. 1

(April 2022)

SUBJECTS COVERED

CHAPTER 1	Definitions (§§ 1.10, 1.23, & 1.24)
CHAPTER 2	The Objective of a Corporation (§ 2.01)
CHAPTER 4	Duty of Care and the Business Judgment Rule (§§ 4.01 & 4.02)
CHAPTER 5	Duty of Loyalty (§§ 5.01, 5.02, & 5.10)
APPENDIX A	Black Letter of Tentative Draft No. 1

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Restatements are primarily addressed to courts. They aim at clear formulations of common law and its statutory elements or variations and reflect the law as it presently stands or might appropriately be stated by a court.

a. Nature of a Restatement. Webster's Third New International Dictionary defines the verb "restate" as "to state again *or* in a new form" [emphasis added]. This definition neatly captures the central tension between the two impulses at the heart of the Restatement process from the beginning, the impulse to recapitulate the law as it presently exists and the impulse to reformulate it, thereby rendering it clearer and more coherent while subtly transforming it in the process.

The law of the Restatements is generally common law, the law developed and articulated by judges in the course of deciding specific cases. For the most part Restatements thus assume a body of shared doctrine enabling courts to render their judgments in a consistent and reasonably predictable manner. In the view of the Institute's founders, however, the underlying principles of the common law had become obscured by the ever-growing mass of decisions in the many different jurisdictions, state and federal, within the United States. The 1923 report suggested that, in contrast, the Restatements were to be at once "analytical, critical and constructive." In seeing each subject clearly and as a whole, they would discern the underlying principles that gave it coherence and thus restore the unity of the common law as properly apprehended.

Unlike the episodic occasions for judicial formulations presented by particular cases, however, Restatements scan an entire legal field and render it intelligible by a precise use of legal terms to which a body reasonably representative of the legal profession, The American Law Institute, has ultimately agreed. Restatements—"analytical, critical and constructive"—accordingly resemble codifications more than mere compilations of the pronouncements of judges. The Institute's founders envisioned a Restatement's black-letter statement of legal rules as being "made with the care and precision of a well-drawn statute." They cautioned, however, that "a statutory form might be understood to imply a lack of flexibility in the application of the principle, a result which is not intended." Although Restatements are expected to aspire toward the precision of statutory language, they are also intended to reflect the flexibility and capacity for development and growth of the common law. They are therefore phrased not in the mandatory terms of a statute but in the descriptive terms of a judge announcing the law to be applied in a given case.

A Restatement thus assumes the perspective of a common-law court, attentive to and respectful of precedent, but not bound by precedent that is inappropriate or inconsistent with the law as a whole. Faced with such precedent, an Institute Reporter is not compelled to adhere to what Herbert Wechsler called "a preponderating balance of authority" but is instead expected to propose the better rule and provide the rationale for choosing it. A significant contribution of the Restatements has also been anticipation of the direction in which the law is tending and expression of that development in a manner consistent with previously established principles.

The Restatement process contains four principal elements. The first is to ascertain the nature of the majority rule. If most courts faced with an issue have resolved it in a particular way, that is obviously important to the inquiry. The second step is to ascertain trends in the law. If 30 jurisdictions have gone one way, but the 20 jurisdictions to look at the issue most recently went

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the other way, or refined their prior adherence to the majority rule, that is obviously important as well. Perhaps the majority rule is now widely regarded as outmoded or undesirable. If Restatements were not to pay attention to trends, the ALI would be a roadblock to change, rather than a "law reform" organization. A third step is to determine what specific rule fits best with the broader body of law and therefore leads to more coherence in the law. And the fourth step is to ascertain the relative desirability of competing rules. Here social-science evidence and empirical analysis can be helpful.

A Restatement consists of an appropriate mix of these four elements, with the relative weighing of these considerations being art and not science. The Institute, however, needs to be clear about what it is doing. For example, if a Restatement declines to follow the majority rule, it should say so explicitly and explain why.

An excellent common-law judge is engaged in exactly the same sort of inquiry. In the words of Professor Wechsler, which are quoted on the wall of the conference room in the ALI headquarters in Philadelphia:

> We should feel obliged in our deliberations to give weight to all of the considerations that the courts, under a proper view of the judicial function, deem it right to weigh in theirs.

But in the quest to determine the best rule, what a Restatement can do that a busy common-law judge, however distinguished, cannot is engage the best minds in the profession over an extended period of time, with access to extensive research, testing rules against disparate fact patterns in many jurisdictions.

Like a Restatement, the common law is not static. But for both a Restatement and the common law the change is accretional. Wild swings are inconsistent with the work of both a common-law judge and a Restatement. And while views of which competing rules lead to more desirable outcomes should play a role in both inquiries, the choices generally are constrained by the need to find support in sources of law.

An unelected body like The American Law Institute has limited competence and no special authority to make major innovations in matters of public policy. Its authority derives rather from its competence in drafting precise and internally consistent articulations of law. The goals envisioned for the Restatement process by the Institute's founders remain pertinent today:

It will operate to produce agreement on the fundamental principles of the common law, give precision to use of legal terms, and make the law more uniform throughout the country. Such a restatement will also effect changes in the law, *which it is proper for an organization of lawyers to promote* and which make the law better adapted to the needs of life. [emphasis added]

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PROJECT STATUS AT A GLANCE

No portion of this project has previously been approved by the membership.

History of Material in This Draft

The Council approved the initiation of this project in January 2019.

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Foreword

At its January 2019 meeting, the ALI Council approved the launch of the Restatement of the Law, Corporate Governance. This project is the ALI's second foray into this area following the completion in 1993 of Principles of Corporate Governance.

This project will differ from the prior one in two important ways. First, it will be a Restatement, which is grounded in sources of positive law, as opposed to a Principles project, which sets forth best practices for the affected institutions. Second, in the more than quarter century that elapsed from the completion of the Principles and the launch of this Restatement, corporate law has evolved in important ways. In particular, with the reconcentration of shares in the hands of institutional investors, the emergence of activist hedge funds, and the emphasis on environmental, social, and governance (ESG) issues. As a result, the Council decided that it was timely to launch this new project.

This project is led by Professor Edward B. Rock of New York University School of Law as Reporter and Professors Jill Fisch of the University of Pennsylvania Carey Law School and Marcel Kahan of New York University School of Law as Associate Reporters. I am really grateful to them for undertaking this important project and for their terrific work so far, and to the Advisers and Members Consultative Group for their significant input during multiple meetings.

It is exciting that the first portions of this project are now coming before the membership for approval. They include important foundational topics, including the objective of a corporation, the business judgment rule, the duty of care, and portions of the duty of loyalty.

RICHARD L. REVESZ
Director
The American Law Institute

April 10, 2022

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RESTATEMENT OF THE LAW, CORPORATE GOVERNANCE

REPORTERS' MEMORANDUM

TENTATIVE DRAFT NO. 1

Edward B. Rock, Jill E. Fisch, and Marcel Kahan

March 28, 2022

We come before the membership for the first time with Tentative Draft No. 1.

In January 2019, the American Law Institute approved a new project: the Restatement of the Law, Corporate Governance. I was appointed the Reporter. Jill Fisch (University of Pennsylvania Carey Law School) and Marcel Kahan (New York University School of Law) were appointed Associate Reporters.

As many of you may recall, the ALI's Principles of Corporate Governance: Analysis and Recommendations (PCG) was launched in 1978 and completed in 1993. As the project progressed, it collided with the "Takeover Wars" of the 1980s and generated a fair amount of controversy. In the 25 years since then, the world of corporate governance has changed, inter alia, with the reconcentration of shares in the hands of institutional investors, the emergence of activist hedge funds, and the emphasis on "ESG" issues. The ALI Council concluded that it was time to revisit the law of corporate governance and that this time around, it should be a Restatement rather than a Principles project.

In drafting a Restatement that follows a Principles project, we face the question of how much of the prior work to retain. On the one hand, the PCG represents a huge amount of collective effort by the Reporters, the Advisers, and the members of the ALI. On the other hand, it was a Principles project rather than a Restatement, replete with various proposals to change the law. As Director Revesz will explain in greater detail, "Restatements are primarily addressed to courts. They aim at clear formulations of common law and its statutory elements or variations and reflect the law as it presently stands or might appropriately be stated by a court."

In general, we take the PCG as our starting point, but are not bound by it.

In this Tentative Draft No. 1, we present:

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- *Table of Contents:* based on the table of contents from the PCG, this gives a sense of the overall scope of the project. It is tentative in both scope and detail.
- *Chapter 2: (§ 2.01 (The objective of a corporation)):* this Section describes a key characteristic of the corporate form as it exists in the two main variations that are observed: the traditional common-law approach; and the stakeholder or constituency approach reflected in statutes that were enacted in many states during the 1980s, and subsequent case law.
- *Chapter 4: (§ 4.01 (the Duty of Care) and § 4.02 (the Business Judgment Rule)):* these Sections describe directors' and officers' "Duty of Care" and the default standard that courts apply in reviewing directors' and officers' decisions.
- *Chapter 5 (the Duty of Loyalty):* This Chapter restates the "Duty of Loyalty" of directors, officers and controllers. In this Tentative Draft, we present the first Sections of what will be a long Chapter: the general duty (§ 5.01); and its application to related party transactions involving directors and officers (§ 5.02) and controllers (§ 5.10). In subsequent drafts, we will address "good faith," oversight, use of corporate position and property, corporate opportunities, and competition with the corporation.
- *Chapter 1 (Definitions):* This (partial) Chapter includes definitions relevant to the substantive Chapters described above. Additional definitions will be added throughout the drafting process.

We look forward to your questions and advice at the Annual Meeting.

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CHAPTER 1
DEFINITIONS

1 **§ 1.10. Controller**

2 **A "controller" of a corporation means a person [§ 1.28] or a group of persons that,**
3 **directly or indirectly:**

4 **(a) Owns voting securities [§ 1.43] of the corporation entitling the holder to**
5 **cast more than 50 percent of the votes in the election of the directors of the**
6 **corporation; or**

7 **(b) Otherwise exercises a controlling influence over the business and affairs of**
8 **the corporation.**

9 **Comment:**

10 *a. Use of definition.* The definition of "controller" is used in Chapter 5, Duty of Loyalty,
11 and Chapter 6, Role of Directors and Shareholders in Transactions in Control and Tender Offers.
12 As discussed in Chapters 5 and 6, a controller owes certain fiduciary duties to the corporation and
13 to other shareholders. These duties, among others, provide that transactions between the
14 corporation and the controller must either be fair to the corporation or be approved by disinterested
15 directors and shareholders.

16 *b. Comparison with existing law.* While courts in most states have recognized that
17 shareholders who exercise a sufficient degree of control over a corporation owe fiduciary duties
18 to the corporation and to other shareholders, many have not specified the exact set of persons who
19 owe such duties. The courts in those jurisdictions that have done so have generally adopted a two-
20 pronged standard: under the first prong, a person is presumed to be a controlling shareholder if the
21 person owns a majority of the voting securities; under the second prong, a person who does not
22 own a majority of the voting securities is still a controlling shareholder if such person exercises
23 actual control. Courts have considered various factors under the second prong in determing
24 whether a person is a controller including: the person's ownership of voting securities; the person's
25 managerial authority at the corporation; the person's contractual control rights; lack of
26 independence by board members from the person; and the person's control over corporate bank
27 accounts and records. However, a person must exercise a substantial degree of power over a

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corporation's internal decisionmaking processes to be considered a controller under the second prong. Courts have held that the requisite degree of control can be shown to exist either generally or with regard to the particular transaction that is being challenged in a lawsuit. While many cases use the terminology of "controlling shareholder," "majority shareholder," or "dominant shareholder" to refer to a person exercising such power over the corporation, holders of nonequity voting securities may also have voting rights. Since such holders may exercise majority voting control over a corporation, this Restatement uses the term "controller," which is more apt and is also employed in the case law.

c. Comparison with the PCG. The definition of "controlling shareholder" in the Principles of the Law, Corporate Governance: Analysis and Recommendations (PCG) has been changed to remove the presumption that a person is a controller if that person owns more than 25 percent of the voting power of a corporation since the presumption has no basis in the case law.

d. Ownership of securities. While there is no ownership threshold of voting securities below which a person can never be a controller, the amount of voting securities a person must hold in order to to be a controller typically should be substantial enough to be a factor in enabling the person to exercise a controlling influence. A person who, through a contract, understanding, or otherwise, controls the voting of securities can be treated as the owner of such securities for purposes of this definition. A group of two or more persons who, through a contract, understanding, or otherwise, agree on the voting of securities owned by the members of the group may be treated as a "controller" for purposes of this definition. For such a control group to exist, members must be connected through a legally significant relationship; a mere confluence of self-interest among several holders of securities is not sufficient to establish a control group.

Illustrations:

1. Z Corporation owns 20 percent of the common stock of X Corporation (the only voting security of X Corporation), and places four of its directors on X Corporation's 15-member board of directors. None of these directors serves on X Corporation's compensation or executive committees. Of the remaining 11 members of X Corporation's board, one is a senior executive of X Corporation. All of the other board members are independent of Z Corporation and have no relationship to X Corporation other than their position on X's board. Board discussions are characterized by a dynamic exchange of

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1 views, with no director giving special deference to the representatives of Z Corporation. Z
2 Corporation is not a controller of X Corporation.
3 2. The facts being otherwise as stated in Illustration 1, Z Corporation owns 51
4 percent of the common stock of X Corporation. Z Corporation is a controller of X
5 Corporation.
6 3. Z Corporation owns 43 percent of the voting securities of X Corporation and four
7 of its officers are on X Corporation's 10-person board of directors. Of the remaining
8 directors, one is the chief executive officer of X Corporation. The other five directors are
9 individuals who are not employed by X Corporation and have no significant relationship
10 to Z Corporation or X Corporation other than their positions on X's board. In board
11 discussions, the representatives of Z Corporation note that Z Corporation is a major
12 shareholder of X Corporation. When this occurs, discussions end, and the other directors
13 defer to the views of the representatives of Z Corporation. Z Corporation is a controller of
14 X Corporation.

REPORTERS' NOTES

15 1. *Definition of controller*. For support for the definition of "controller," see Citron v.
16 Fairchild Camera & Instrument Corp., 569 A.2d 53, 70 (Del. 1989) ("For a dominating relationship
17 to exist in the absence of controlling stock ownership, a plaintiff must allege domination by a
18 minority shareholder through actual control of corporate conduct."); Kahn v. Lynch Commc'n
19 Sys., 638 A.2d 1110,1113–1114 (Del. 1994) ("[A] shareholder owes a fiduciary duty only if it
20 owns a majority interest in or *exercises control* over the business affairs of the corporation.")
21 (emphasis in original); Carsanaro v. Bloodhound Techs., Inc., 65 A.3d 618, 659 (Del. Ch. 2013)
22 ("The requisite degree of control can be shown to exist generally or 'with regard to the particular
23 transaction that is being challenged.'" (quoting Williamson v. Cox Commc'ns Inc., No. 1663-N,
24 2006 WL 1586375, at *4 (Del. Ch. June 5, 2006))); In re Morton's Rest. Grp. S'holders Litig., 74
25 A.3d 656, 664–665 (Del. Ch. 2013) (holding that a person who holds only minority voting power
26 "is not considered to be a controlling stockholder unless it exercises such formidable voting and
27 managerial power that [it], as a practical matter, [is] no differently situated than if [it] had majority
28 voting control"); Papay v. Papay, No. 2006-C-2956, 2011 Pa. Dist. & Cnty. Dec. LEXIS 878, at
29 *8 (Pa. C.P. Lehigh June 10, 2011, aff'd sub nom. Papay v. Penn Big Bed Slate Co., 60 A.3d 558
30 (Pa. Super. 2012) (Table)) ("[Pennsylvania case law] holds that a shareholder who is so strong that
31 he dominates the board of directors and controls the corporation is, by his very nature, a controlling
32 shareholder, and owes the traditional duties of loyalty and care."); Trans-Oceanic Motors, LTD v.
33 Dubicki, No. 4003532, 2006 WL 3491390, at *3 (Conn. Super. Ct. Nov. 13, 2006) (finding that
34 under Connecticut law, "a dominant or majority shareholder bears the same fiduciary duty to the

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1 corporation and its minority shareholders as does a director" (quoting Governors Grove Condo.
2 Ass'n v. Hill Dev. Corp., 414 A.2d 1177, 1183–1184 (Conn. Super. Ct. 1980))); MAZ Partners
3 LP v. Shear (In re PHC, Inc. S'holder Litig.), 894 F.3d 419, 429 (1st Cir. 2018) (holding under
4 Massachusetts law "that a non-majority shareholder who dominates a corporation through actual
5 control of corporate conduct may be deemed a controlling shareholder" (citing Kahn v. Lynch
6 Commc'n Sys., 638 A.2d at 1114)); Locati v. Johnson, 980 P.2d 173, 176 (Or. Ct. App. 1999),
7 rev'd on other grounds, 131 P.3d 779 (Or. Ct. App. 2006) (holding under Oregon law that a
8 controlling shareholder is either "an individual who owns a majority of the shares or who, for other
9 reasons, has domination or control of the corporation," or "a member of a small group of
10 shareholders who collectively own a majority of shares or otherwise have that domination or
11 control").
12 2. *Factors*. Case law has recognized that a person's controlling influence can derive from
13 factors other than share ownership, such as the person's position in the company or the person's
14 influence over other directors. See, e.g., GPC XLI L.L.C. v. Loral Space & Commc'ns Inc. (In re
15 Loral Space & Commc'ns Consol. Litig.), Nos. 2808, 3022, 2008 WL 4293781 (Del. Ch. Sep. 19,
16 2008) (finding a controlling influence where a majority of board members were affiliated with
17 controller and controller had "practical control" over corporation's financing); Basho Techs.
18 Holdco B, LLC v. Georgetown Basho Invs., LLC, No. 11802, 2018 WL 3326693 (Del. Ch. July
19 6, 2018), aff'd sub nom., Davenport v. Basho Techs. Holdco B, LLC, 221 A.3d 100 (Del. 2019)
20 (noting that controller had contractual rights to cut off corporation's other sources of funding and
21 used misleading, combative, and threatening behavior to further manipulate management into
22 approving the transactions at issue); In re Cysive Inc., S'holder Litig., 836 A.2d 531, 552 (Del.
23 Ch. 2003) (noting controller's "day-to-day managerial supremacy" as chairman, CEO, and creator
24 as factors in finding a controlling influence); FrontFour Capital Grp. LLC v. Taube, No. 2019-
25 0100-KSJM, 2019 WL 1313408, at *21–25 (Del. Ch. Mar. 11, 2019) (noting that members of the
26 special committee were beholden to controller and allowed controller to control much of the
27 negotiation process); Neuburger v. S.F. Network Inc., No. A125443, 2011 WL 3503307, at *9
28 (Cal. Ct. App. Aug. 10, 2011) (noting controller's positions as chairman and CEO as factors in
29 finding a controlling influence); Beach v. Briganti, No. B252049, 2014 WL 5141651, at *7 (Cal.
30 Ct. App. Oct. 14, 2014) (noting controller's sole and exclusive control over the corporation's
31 financial data, bank accounts, and records as factors in finding such control); In re Tesla Motors,
32 Inc. S'holder Litig., No. 127112018 WL 1560293, at *16 (Del. Ch. Mar. 28, 2018) (noting that
33 Elon Musk exercised close and hands-on management of the company's operations, that the
34 company relied significantly on his management to continue operating effectively, and that Musk
35 possessed significant influence over Tesla's board with regard to the transaction at issue as factors
36 in holding that plaintiffs met pleading burden that Musk was controller of Tesla); *Williamson*,
37 2006 WL 1586375, at *5 (noting as factor in finding a controlling influence that controller was the
38 only significant customer of corporation); Whale Art Co. v. Docter, 743 S.W.2d 511, 514 (Mo. Ct.
39 App. 1987) (finding that shareholder exercised de facto control over the corporation in that he had
40 exclusive control over the accounts and sales of the corporation; he decided not to pay plaintiff a

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1 bonus; and set his own salary); Sciabacucchi v. Liberty Broadband Corp., No. 11418, 2017 WL
2 2352152, at *57–58 (Del. Ch. May 31, 2017) (finding that provisions in stockholder agreement
3 and charter that limited Liberty Broadband's right to acquire more than 35% of shares, designate
4 more than 4 of 10 directors, or solicit proxies and required approval by certain directors and
5 majority of unaffiliated shareholders for certain transactions were significant in analyzing whether
6 Liberty Broadband was a controller). As some courts have noted, "[i]t is impossible to identify or
7 foresee all of the possible sources of influence that could contribute to a finding of actual control."
8 Voigt v. Metcalf, No. 2018-0828, 2020 WL 614999, at *32 (Del. Ch. Feb. 10, 2020) (citing *Basho*,
9 2018 WL 3326693, at *26).

10 3. *Significance of share ownership*. Even when a person owns less than a majority of voting
11 securities, the amount of securites owned is often a factor in the determination that such person is
12 a controller. See, e.g., Superior Vision Servs. v. ReliaStar Life Ins. Co., No. Civ.A. 1668-N, 2006
13 WL 2521426, at *4 (Del. Ch. Aug. 25, 2006) (holding that control may arise from "the *de facto*
14 power of a significant (but less than majority) shareholder, which, when coupled with other factors,
15 gives that shareholder the ability to dominate the corporate decision-making process"); *Voigt*, 2020
16 WL 614999, at *12 (listing "ownership of a significant equity stake (albeit less than a majority)"
17 as a potential sign of "[e]ffective control"); *Cysive*, 836 A.2d at 551–552 (noting, as a factor in
18 finding a 35-percent shareholder controlling, that he "[held] a large enough block of stock to be
19 the dominant force in any contested . . . election"); Reith v. Lichtenstein, No. 2018-0277, 2019
20 WL 2714065, at *8 (Del. Ch. June 28, 2019) (using *Cysive*'s reasoning to find a 35.62 percent
21 shareholder controlling); Oliver v. Bos. Univ., No. 16570, 2006 WL 1064169, at *19 n.185 (Del.
22 Ch. Apr. 14, 2006) (noting, as a factor in finding a minority shareholder controlling, that its
23 "percentage holding . . . was always significant—approaching 50%"); In re Zhongpin Inc.
24 S'holders Litig., No. 7393, 2014 WL 6778537, at *18–28 (Del. Ch. Nov. 26, 2014), rev'd on other
25 grounds, 115 A.3d 1173 (Del. 2015) (finding that it was reasonably inferable that a 17.3%
26 shareholder was a controller where that shareholder was the largest shareholder and the company's
27 SEC filings stated that he had significant influence over the company's management and affairs
28 and that his loss would have a material adverse effect on the business and operations); In re KKR
29 Fin. Holdings LLC S'holder Litig., 101 A.3d 980, 994 (Del. Ch. 2014), aff'd sub nom., Corwin v.
30 KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015) (in not finding a less-than-one-percent
31 shareholder controlling, noting, as a factor that it lacked a sufficient percentage holding to
32 influence the board's decisionmaking).

33 Some courts have reviewed prior decisions and concluded that there was no correlation between
34 percentage of holdings by the alleged controller and the determination of control status. See, e.g.,
35 Calesa Assocs., L.P. v. Am. Capital, Ltd., No. 10557, 2016 WL 770251 (Del. Ch. Feb. 29, 2016)
36 (explaining that there is "no correlation between the percentage of equity owned and the
37 determination of control status"); In re Crimson Expl. Inc. S'holders Litig., No. 8541, 2014 WL
38 5449419, at *10 (Del Ch. Oct. 24, 2014) (noting that prior decisions fail to reveal "any sort of
39 linear, sliding-scale approach whereby a larger share percentage makes it substantially more likely
40 that the court will find the stockholder was a controlling stockholder"); see also *FrontFour Capital*,

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2019 WL 1313408, at *21 ("In determining whether a minority stockholder is a controller, the level of stock ownership is not the predominant factor, and an inability to exert influence through voting power does not foreclose a finding of control."); *Tesla Motors*, 2018 WL 1560293, at *14 ("[T]here is no absolute percentage of voting power that is required in order for there to be a finding that a controlling stockholder exists." (quoting In re PNB Holding Co. S'holders Litig., No. 28-N, 2006 WL 2403999, at *9 (Aug. 18, 2006))).

As another court has noted, however, "[a]ll else equal, a relatively larger block size should make an inference of actual control more likely, even though the interplay with factors makes the correspondence difficult to perceive. The relationship derives from simple mathematics." *Voigt*, 2020 WL 614999, at *17; see also *Corwin*, 125 A.3d 304 (noting that when a party does not have majority control of the entity's voting stock the court should look for a combination of potent voting power and management control in determining whether a person is a controller).

4. *Control over challenged transaction.* The issue of whether a person is a controller of a corporation typically arises in the context of a particular transaction involving the corporation in which the alleged controller is interested and the terms of which are alleged to be unfair to the corporation or the noncontrolling shareholders. To show that a person exercises a controlling influence over the management or policies of the corporation and hence is a controller, courts have held that it is not necessary to show that the person exercised control generally or over the day-to-day operations of the corporation but that it suffices to show that the person exercised control with regard to the particular transaction that is being challenged. See, e.g., *In re KKR Fin. Holdings*, 101 A.3d at 991; *Tesla Motors*, 2018 WL 1560293, at *13; *Voigt,* 2020 WL 614999, at *12; *Williamson*, 2006 WL 1586375, at *4 (Del. Ch. June 5, 2006); *Super. Vision*, 2006 WL 2521426, at *4.

5. *Control group*. Courts in Delaware, the only jurisdiction with extensive case law on that matter, have held that "multiple stockholders together can constitute a control group exercising majority or effective control" if they are "connected in some legally significant way—such as by contract, common ownership, agreement, or other arrangement—to work together toward a shared goal" as opposed to being connected through a "mere concurrence of self-interest among certain stockholders." Sheldon v. Pinto Tech. Ventures, L.P., 220 A.3d 245, 251–252 (Del. 2019). A vice chancellor of the Delaware Court of Chancery found a legally significant connection between two shareholders of a company sufficient to establish that it was reasonably conceivable that a control group existed when the shareholders and their affiliated entities had a long history of coordinating investment strategies in multiple companies, including the company at issue, had been identified as "key stockholders" and granted exclusive rights to negotiate directly with a potential acquirer of the company, had entered into voting agreements requiring them to vote their shares in favor of the adoption of a merger agreement with that acquirer, and had entered into stock-purchase agreements with the acquirer that minority shareholders did not sign. In re Hansen Med., Inc. S'holders Litig., No. 12316, 2018 WL 3025525 (Del. Ch. June 18, 2018). Another vice chancellor found a similar connection when two shareholders of a company had a long history of co-investment in that company, management granted them preferential review and exclusive weigh-

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in before the board had considered the proposed transaction at issue, and management treated them as a collective unit. Garfield v. BlackRock Mortg. Ventures, LLC, No. 2018-0917-KSJM, 2019 WL 7168004 (Del. Ch. Dec. 20, 2019); see also Frank v. Elgamal, No. 6120, 2012 WL 1096090 (Del. Ch. Mar. 30, 2012) (holding that complaint sufficiently alleged formation of a control group). But see Van der Fluit v. Yates, No. 12553, 2017 WL 5953514 (Del. Ch. Nov. 30, 2017) (holding that an investor-rights agreement that contained no voting, decisionmaking, or other agreements bearing on the transaction at issue did not constitute legally significant connection); In re PNB Holding Co., No. 28-N, 2006 WL 2403999 (Del. Ch. Aug. 18, 2006) (finding that a mere confluence of interest among a group of 20 persons was not enough to create a control group). For a case outside of Delaware, see Mroz v. Hoaloha Na Eha, Inc., 410 F.Supp. 2d 919 (D. Haw. 2005) (applying Hawaiian law and holding that control group was formed when three shareholders each owning 25 percent of the stock acted in concert).

6. *Contractual control rights*. While shareholder agreements allocating governance rights are not common in publicly held corporations, investors in large private firms regularly use such agreements to contract about governance rights. For an overview of the prevalence and contents of such agreements, see Gabriel Rautenberg, *The Separation of Voting and Control: The Role of Contract in Corporate Governance*, 38 YALE J. ON REG. 1124 (2021).

§ 1.23. Interested

(a) A director, officer, or controller of a corporation is "interested" in a transaction involving the corporation or conduct by the corporation if either:

(1) both the corporation and the director, officer, or controller are parties to the transaction; or

(2) the director, officer, or controller receives a benefit (or suffers a detriment) as a result of the transaction or conduct when the benefit (or detriment) is not shared with shareholders pro rata according to the number of shares held, and that benefit (or detriment) is of such significance to that particular director, officer, or controller that it would reasonably be expected to affect the director's, officer's, or controller's judgment with respect to the transaction or conduct.

(b) A shareholder of a corporation is "interested" in a transaction involving the corporation or in conduct by the corporation for purposes of § 1.16 if:

(1) the shareholder is a director, officer, or controller of the corporation, or an affiliate of a director, officer, or controller of the corporation, that is interested in the transaction or conduct or that is not independent of a person that is interested in the transaction or conduct; or

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(2) both the corporation and the shareholder are parties to the transaction or conduct; or

(3) the shareholder receives a benefit (or suffers a detriment) in the transaction or conduct which is not generally shared with (or suffered by) the other shareholders of the corporation, and that benefit (or detriment) is of such significance to that particular shareholder that it would reasonably be expected to affect the shareholder's judgment with respect to the transaction or conduct.

Cross-References:

§ 1.15. Disinterested Directors; § 1.16. Disinterested Shareholders.

Comment:

a. Use of definition. The definition of "interested" in subsections (a) and (b) of this Section is adopted by incorporation in: § 1.15, Disinterested Directors (the definition will provide that an action by "disinterested directors" requires the affirmative vote of a majority of directors of the decisionmaking body who are both independent [§ 1.24] and not interested in the transaction or conduct); § 1.16, Disinterested Shareholders; § 4.02, Business Judgment Rule; and various provisions of Chapter 5, Duty of Loyalty, and Chapter 6, Role of Directors and Shareholders in Transactions in Control and Tender Offers. On the burden of proving interest or disinterestedness, see Chapter 4, Duty of Care and the Business Judgment Rule, and Chapter 5.

Under § 5.16, Transfer of Control in Which a Director or Principal Senior Executive is Interested, the standard that governs certain transfers of control in which directors or principal senior executives are interested depends in part on whether disinterested shareholders have approved the transaction or have accepted a tender offer through which the transaction is effected. The mere fact that a shareholder accepts such a tender offer does not render the shareholder "interested" for purposes of subsection (b) of this Section or § 5.16.

The issue of a person's "interestedness" in a transaction or conduct arises in several contexts. The first context relates to the determination of whether a corporate fiduciary—a director, officer, or controller—is interested. Transactions or conduct involving a corporation in which a corporate fiduciary is interested may be subject to a higher degree of judicial scrutiny. The second context relates to the determination of whether a conflict transaction has been approved by disinterested, as well as independent, directors. Subsection (a) of this Section provides the

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definition of "interested" for these two contexts. The third context relates to the determination of whether a transaction or conduct has been approved by disinterested *shareholders*. Subsection (b) of this Section provides the definition of "interested" for the context of disinterested shareholder approval. Because approval of a conflict transation by disinterested and independent directors or by disinterested shareholders may lessen the degree of judicial scrutiny that would otherwise apply to the transaction, they are referred to as "cleansing acts."

b. Distinction between an interested director, officer, or controller and an interested shareholder. Under subsection (a)(2), a director, officer, or controller is "interested" if such director, officer, or controller receives a requisite benefit "as a result of" a transaction or conduct. By contrast, under subsection (b)(3), a shareholder is "interested" for purposes of § 1.16 if such shareholder receives a requisite benefit "in" a transaction or conduct.

The phrase "receiving a benefit in a transaction" includes a narrower set of circumstances than the phrase "receiving a benefit as a result of a transaction." In particular, a shareholder may have a conflict of interest in voting on a transaction because: (i) the shareholder, under the express terms of the transaction, is treated like an interested director, officer, or controller and unlike other shareholders (a conflict due to differential treatment); (ii) the shareholder would receive a side benefit under some other agreement if the transaction is approved (a conflict due to side benefits); or (iii) the shareholder owns sufficient shares or derivatives in an interested fiduciary, or in an entity that is a party to the transaction and that is partly owned by the fiduciary, such that its economic interests are aligned with those of the interested fiduciary rather than with the interests of other shareholders of the corporation (a conflict due to common ownership). Under subsection (b)(3), if a conflict due to differential treatment results in the shareholder receiving a benefit that is not generally shared with the other shareholders of the corporation and that benefit is of such significance to that particular shareholder that it would reasonably be expected to affect the shareholder's judgment with respect to the transaction or conduct, that benefit would be regarded as being received "in" the transaction or conduct and the shareholder would be deemed "interested." However, if a conflict due to side benefits or common ownership results in such a benefit, that benefit would be regarded as being generated "as a result" of but not "in" the transaction or conduct. Note, however, that if a shareholder is also a director, officer, or controlling shareholder, that shareholder will be deemed interested for purposes of § 1.16 if the shareholder has a sufficiently strong conflict due to side benefits or common ownership under subsection (a)(2).

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Even though conflicts due to common ownership pervade shareholder voting, courts have not addressed the questions of whether and when such conflicts render a shareholder "interested" for purposes of § 1.16 and therefore this Restatement does not take a position on this issue. There are substantial policy reasons both for and against treating shareholders with material conflicts due to common ownership as "interested" for purposes of § 1.16. On one hand, a core reason why approval of a conflict transaction by disinterested shareholders of a corporation should change the applicable standard of review is that shareholders who have no economic conflict would benefit from the transaction only if the transaction is in fact beneficial to the corporation and shareholders at large. Approval of the transaction by a majority of such shareholders then, in turn, provides evidence of the fairness of the transaction and therefore justifies a lesser degree of judicial scrutiny. But approval by shareholders whose economic interests are aligned with those of an interested fiduciary generates no inference that a transaction is beneficial to the corporation and shareholders at large and thus provides no justification for a lesser degree of judicial scrutiny of the fairness of the transaction.

On the other hand, there are arguments that counsel against a definition of "interestedness" that encompasses all conflicts due to common ownership. Given the heterogeneity of investors' portfolios and the ever-changing shareholder base, it will be very difficult for a fiduciary or a factfinder to determine to what extent a shareholder's financial interests with respect to a given transaction, taking into account portfolio effects and ownership changes after the record date, are aligned with those of a conflicted fiduciary. Allowing plaintiffs to challenge a majority of the disinterested shareholders' approval of a transaction on the basis of some shareholders' overall portfolio interests could also prevent courts from dismissing cases without first engaging in protracted discovery into the nature of those shareholders' interests and undermine the incentive to subject transactions to a vote by disinterested shareholders.

c. Dividends. If a corporation makes a dividend distribution to its shareholders, the mere fact that a director, officer, or controller receives a payment which is shared equally with the other shareholders of the corporation on a per share basis does not render the director, officer, or controller "interested" in the dividend.

d. Liquidity. Generally speaking, when a controller's interest in a merger as a stockholder results from the controller receiving the merger consideration in exchange for the controller's shares in a corporation, the controller is not considered "interested" so long as the transaction treats

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all shares equally and the controller does not stand on both sides of the transaction. Courts, however, have recognized that, in limited circumstances, a controller's interest in liquidity can be sufficiently strong to render the controller "interested" in a cash merger or similar transaction even if all shares are treated equally.

e. Indirect benefit or detriment. A director, officer, or controller would be "interested" in a transaction or conduct within the meaning of this Section if the director, officer, or controller *indirectly* receives a material benefit (or suffers a material harm) as a result of the transaction or conduct or is *indirectly* a party to a transaction with the corporation. For example, a director would receive a benefit indirectly if the benefit is received by a business organization in which the director or the spouse of the director has a substantial financial interest, and a director would be indirectly a party to a transaction with the corporation if the transaction is between the corporation and another entity and the director owns that entity or is an officer or director of that entity. Likewise, in determining whether a director, officer, or shareholder of a corporation would be "interested" in a transaction with or conduct by the corporation within the meaning of this Section, a transaction or conduct by a subsidiary of the corporation would be deemed equivalent to a transaction or conduct by the corporation itself. Courts evaluate the overall context of a transaction or conduct in determining whether a director, officer, controller, or shareholder is indirectly a party to a transaction, whether a director, officer, controller, or shareholder indirectly receives a benefit as a result of or in a transaction or conduct, and whether any such benefit is of material significance to the particular director, officer, controller, or shareholder.

f. Model Business Corporation Act. Prong (a)(2) of the definition of "interested" is substantially equivalent to "material interest" for purposes of the definition of "qualified director" in the Model Business Corporation Act.

g. Incentive compensation. Incentive-compensation arrangements that align the interests of a corporation's officers or directors with those of its shareholders generally do not render such directors or officers interested in the corporation's transactions or conduct merely because the transactions or conduct would have the effect of increasing the directors' or officers' compensation under such incentive schemes. However, incentive-compensation arrangements can cause officers or directors to be "interested" within the meaning of this Section to the extent that the arrangements generate material conflicts between the interests of officers or directors and the interests of shareholders.

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REPORTERS' NOTES

1. *Definition of "interested*." The definition of interested in subsection (a) is applied in multiple jurisdictions. See, e.g., Orman v. Cullman:

> [A] disabling 'interest,' as defined by Delaware common law, exists in two instances. The first is when (1) a director personally receives a benefit (or suffers a detriment), (2) as a result of, or from, the challenged transaction, (3) which is not generally shared with (or suffered by) the other shareholders of his corporation, and (4) that benefit (or detriment) is of such subjective material significance to that particular director that it is reasonable to question whether that director objectively considered the advisability of the challenged transaction to the corporation and its shareholders. The second instance is when a director stands on both sides of the challenged transaction.

794 A.2d 5, 25 n.50 (Del. Ch. 2002); Rales v. Blasband:

> A director is considered interested where he or she will receive a personal financial benefit from a transaction that is not equally shared by the stockholders. . . . Directorial interest also exists where a corporate decision will have a materially detrimental impact on a director, but not on the corporation and the stockholders.

634 A.2d 927, 936 (Del. 1993); Marx v. Akers, 666 N.E.2d 1034, 1042 (N.Y. 1996) (holding under New York law that "[d]irectors are self-interested in a challenged transaction where they will receive a direct financial benefit from the transaction which is different from the benefit to shareholders generally"); Rapoport v. Schneider, 278 N.E.2d 642, 646 (N.Y. 1972) (holding that under New York law, "[a] director is 'interested' if he is an officer or director of another corporation apparently involved in the questioned transaction[.]"); Hudson v. Prime Retail, Inc., No. 24-C-03-5806, 2004 WL 1982383 (Md. Cir. Ct. Apr. 1, 2004) (under Maryland law, "loyalty issues arise in cases where directors stand to receive benefits from a transaction that are not generally enjoyed by the stockholders, or where a director stands on both sides of a corporate transaction"); Game Sys. v. Forbes Hutton Leasing, Inc:

> [U]nder Texas law a director is considered 'interested' in a transaction if the director (1) makes a personal profit from a transaction by dealing with the corporation or usurps a corporate opportunity; (2) buys or sells corporate assets; (3) transacts business in his director's capacity with a second corporation of which he is also a director or significantly financially associated; or (4) transacts business in his director's capacity with a family member."

No. 02-09-00051-CV, 2011 WL 2119672 at * 25 n.22 (Tex. Ct. App. May 26, 2011), (citing Gearhart Indus., Inc. v. Smith Int'l, Inc., 741 F.2d 707, 719–720 (5th Cir. 1984)); In re PSE & G S'holder Litig., 801 A.2d 295, 314 (N.J. 2002), quoting In re Prudential Ins. Co. Derivative Litig., 659 A.2d 961, 971 (N.J. 1995) ("[D]irectorial interest exists when divided loyalties are present, or where the director stands to receive a personal financial gain from the transaction not equally shared by the shareholders.").

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See also In re Amerco Derivative Litig., 252 P.3d 681, 698 (Nev. 2011) (quoting Seminaris v. Landa, 662 A.2d 1350, 1354 (Del. Ch. 1995)) (holding that under Nevada law, "director interestedness can be demonstrated through alleged facts indicating that 'a majority of the board members would be 'materially affected, either to their benefit or detriment, by a decision of the board, in a manner not shared by the corporation and the stockholders.''"; Bader v. Anderson, No. 1-05-CV-041521 2007 Cal. Super. LEXIS 592, at *17 (Jan. 31, 2007) (holding that under California law, "[a] director is considered 'interested' if the director will receive a personal financial benefit from a transaction that is not equally shared by the stockholders"); Fujimoto v. Au, 19 P.3d 699, 731 (Haw. 2001) (citing In re Gen. Instrument Corp. Sec. Litig., 23 F. Supp. 2d 867, 874 (N.D. Ill. 1998))) (holding that under Hawaiian law, "'[a]n 'interested' director is one who receives 'a personal financial benefit from the challenged transaction which is not equally shared by the stockholders.''"

Transactions such as dividends or mergers, pursuant to which payments are made to all shareholders as a group, are not conceived of as transactions in which both the corporation and the director, officer, or controller are parties and would not render a director, officer, or controller interested under subsection (a)(1), though they may do so under subsection (a)(2). See Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971) (holding that a dividend payment where controller and minority shareholders received a proportionate amount of money was not a self-dealing transaction).

In some states, the concept of "interestedness" encompasses both interestedness in the traditional sense and the concept of a lack of independence. See, e.g., *Marx*, 666 N.E.2d at 1041 ("Director interest may either be self-interest in the transaction at issue . . . or a loss of independence because a director with no direct interest in a transaction is 'controlled' by a self-interested director."); Harhen v. Brown, 730 N.E.2d 859, 864 n.5 (Mass. 2000) (under Massachusetts law, a director is "interested" if that director is a party to the transaction or has a business, financial, or familial relationship with a party to the transaction or conduct, and that relationship would reasonably be expected to affect the director's judgment). This Restatement follows the approach of those states, as well as the Model Business Corporation Act, that use two separate terms "interested" and "independent" (or, in the case of the Model Business Corporation Act, "material interest" and "material relationship") because doing so accords more with the ordinary usage of these terms and is analytically clearer.

2. *Approval by disinterested shareholders*. The rationale for shifting the burden of proof or the standard of review as a result of the vote of "disinterested" shareholders is that such approval indicates that the transaction is in the interest of such shareholders. See Corwin v. KKR Fin. Holdings LLC:

> When the real parties in interest—the disinterested equity owners—can easily protect themselves at the ballot box by simply voting no, the utility of a litigation-intrusive standard of review promises more costs to stockholders in the form of litigation rents and inhibitions on risk-taking than it promises in terms of benefits to them. The reason for that is tied to the core rationale of the business judgment

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> rule, which is that judges are poorly positioned to evaluate the wisdom of business decisions and there is little utility to having them second-guess the determination of impartial decision-makers with more information (in the case of directors) or an actual economic stake in the outcome (in the case of informed, disinterested stockholders.

125 A.3d 304, 313–314 (Del. 2015):

> Traditionally, our equitable law of corporations has applied the business judgment standard of review to sales to arm's-length buyers when an informed, uncoerced vote of the disinterested electorate has approved the transaction. . . . This effect on the standard of review is, of course, only available to disinterested stockholder approval for good reason—only disinterested stockholder approval is a strong assurance of fairness.

In re Morton's Rest. Grp., Inc. S'holders Litig. 74 A.3d 656, 663 n.34 (Del. Ch. 2013); Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377, 388 (Del. 2010) \(“[W]hat legitimizes the stockholder vote as a decision-making mechanism is the premise that stockholders with economic ownership are expressing their collective view as to whether a particular course of action serves the corporate goal of stockholder wealth maximization.”; Harbor Fin. Partners v. Huizenga:

> If fully informed, uncoerced, independent stockholders have approved the transaction, they have . . . made the decision that the transaction is a ‘fair exchange.’. . . In this day and age in which investors also have access to an abundance of information about corporate transactions from sources other than boards of directors, it seems presumptuous and paternalistic to assume that the court knows better in a particular instance than a fully informed corporate electorate with real money riding on the corporation's performance.

751 A.2d 879, 901 (Del. Ch. 1999). Under this rationale, the votes by any shareholder who has a material conflict of interest that would induce the shareholder to favor a transaction that is not generally beneficial to shareholders should not count towards the vote by “disinterested” shareholders. Yet, the case law on when a shareholder vote is not counted for purposes of determining whether a transaction has been approved by “disinterested” shareholders is not fully developed and there are substantial policy reasons why particular conflicts due to common ownership should not render a shareholder interested. See In re CNX Gas Corp. S'holders Litig., 4 A.3d 397, 417 (Del. Ch. 2010) (cautioning that an expansive definition may cause “fishing expeditions”). As a result, it is not clear whether all conflicts that would render a fiduciary “interested,” or lacking independence, under § 1.23(a) would also result in disregarding a shareholder vote under § 1.23(b) for purposes of § 1.16.

Case law has addressed circumstances in which some shareholders received the same treatment under the terms of the transaction as the conflicted fiduciary (and different from the treatment received by other shareholders) and in which some shareholders were affiliated with the conflicted fiduciary. In re PNB Holding Co. S'holders Litig., No. 28-N, 2006 2006 WL 2403999 (Del. Ch. Aug. 18, 2006) involved a reorganization pursuant to which shareholders who held below

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a threshold number of shares were to be cashed out. The board of PNB Holding was conflicted because all board members held shares above the threshold amount. The court held that the set of disinterested shareholders included only shareholders who were to be cashed out (and hence excluded shareholders who were not cashed out even if those shareholders were not board members). In re Pure Res. S'holders Litig., 808 A.2d 421 (Del. Ch. 2002) involved a tender offer by Unocal Corp. (a controller) for the shares of Pure Resources conditioned on a majority of the shares not owned by Unocal tendering. The court, treating the majority-tender condition as functionally equivalent to a majority vote by disinterested shareholders, held that the set of disinterested shareholders should have excluded management of Pure Resources because management was affiliated with Unocal. The court reasoned:

> Requiring [disinterested shareholders] to be defined exclusive of stockholders whose independence from the controlling stockholder is compromised is the better legal rule (and result). Too often, it will be the case that officers and directors of controlled subsidiaries have voting incentives that are not perfectly aligned with their economic interest in their stock and who are more than acceptably susceptible to influence from controlling stockholders.

Id. at 446.

The case law has been less clear on the relevance of conflicts due to common ownership. This gap is peculiar as conflicts due to common ownership are pervasive. One Delaware Chancery court case that addresses such conflicts is *CNX*. Like *Pure*, *CNX* involved a tender offer by a controlling shareholder, CONSOL Energy. The terms of the tender offer were negotiated between CONSOL and T. Rowe Price, which was CNX's largest minority shareholder and which also held a significant position in CONSOL. Consummation of the tender was conditioned on a majority of the outstanding minority shares of CNX being tendered, excluding shares owned by directors or officers of CONSOL or CNX, but including shares owned by T. Rowe Price. The court noted that "[t]o the extent the Tender Offer shortchanges CNX Gas holders, T. Rowe Price gains proportionately through its CONSOL ownership" and concluded that T. Rowe Price "has materially different incentives than a holder of CNX Gas common stock, thereby calling into question the effectiveness of the majority-of-the-minority condition." *CNX*, 4 A.3d at 416. Later in the opinion, however, the Court walked away from the broad implications of those statements regarding conflicts due to common ownership:

> But nothing about this case requires that Delaware courts conduct generalized inquiries into 'the extent of institutional stockholders' other investments' or 'their true motivations for tendering.' It was neither the plaintiffs nor this Court that put the focus on T. Rowe Price and its cross-ownership. It was CONSOL who elected to pre-negotiate the terms of the Tender Offer with T. Rowe Price, a third-party non-fiduciary, rather than negotiating with the Special Committee. It was CONSOL and T. Rowe Price who chose to enter into the tender agreement. T. Rowe Price's incentives are at issue because of decisions that CONSOL and T. Rowe Price chose to make.

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Id. at 416–417. The peculiar facts of *CNX*—that T. Rowe Price, the shareholder with common ownership, negotiated the terms of the transaction with the controlling shareholder—make it unclear whether the holding in the case—that T. Rowe Price should not be included in the set of disinterested shareholders—applies generally to shareholders with conflicts due to common ownership. The issue of whether conflicts due to common ownership render a shareholder interested was also raised, but not decided, in *Tesla Motors*. See Defendants' Reply Brief in Further Support of Motion to Dismiss the Second Amended Complaint, In re Tesla Motors, Inc. S'holder Litig., No. 12711, 2017 WL 3638974 (Del. Ch. Aug. 10, 2017); Plaintiffs' Answering Brief in Opposition to Defendants' Motion to Dismiss the Second Amended Complaint, In re Tesla Motors, Inc. S'holder Litig., No. 12711, 2017 WL 3316057 (Del. Ch. July 27, 2017); Defendants' Opening Brief in Support of Motion to Dismiss the Second Amended Complaint, In re Tesla Motors, Inc. S'holder Litig., No. 12711, 2017 WL 2721681 (Del. Ch. June 19, 2017).

3. *Liquidity as source of conflict*. Courts have struggled with the notion that a controller may be interested in a merger with a third party unaffiliated with the controller in which all shareholders receive the same pro rata consideration for their shares. Courts have recognized in principle that the controller may have a sufficiently strong desire for liquidity to render the controller "interested." See, e.g., McMullin v. Beran, 765 A.2d 910 (Del. 2000); In re Synthes, Inc. S'holder Litig., 50 A.3d 1022 (Del. Ch. 2012); Data Key Partners v. Permira Advisers LLC, 849 N.W.2d 693 (Wisc. 2014); English v. Narang, No. 2018-0221-AGB, 2019 WL 1300855 (Del. Ch. Mar. 20, 2019); In re Mindbody, Inc. Stockholders Litig., No. 2019-0442-KSJM, 2020 WL 5870084 (Del. Ch. Oct. 2, 2020); Firefighters' Pension Sys. v. Presidio, Inc., 251 A.3d 212 (Del. Ch. 2021); see also In re PLX Tech. S'holders Litig., No. 9880, 2018 WL 5018535 at *42 (Del. Ch. Oct. 16, 2018) (finding a conflict for an activist whose investment thesis depended entirely on a short-term sale of company to bidder who had emerged during the go-shop period and who had "argued vehemently" that company "should be sold quickly" during the proxy contest).

In practice, however, courts have been reluctant to give credence to such claims. See, e.g., *Mindbody*, 2020 WL 5870084, at *18 ("[I]t is a rare set of facts that will support a liquidity-driven conflict theory[.]"); *Synthes*, 50 A.3d at 1036 ("It may be that there are very narrow circumstances in which a controlling stockholder's immediate need for liquidity could constitute a disabling conflict of interest irrespective of pro rata treatment."); GAMCO Asset Mgmt. v. iHeartMedia Inc., No. 12312, 2016 WL 6892802, at *17 (Del. Ch. Nov. 23, 2016) (describing N.J. Carpenters Pension Fund v. infoGROUP, Inc., No. Civ.A. 5334 (Del. Ch. Oct. 6, 2011) in which the court declined to dismiss a complaint asserting a liquidity-driven conflict claim, as an "extreme case"); In re Crimson Expl. Inc. S'holder Litig., No. 8541, 2014 WL 5449419, at *19 (Del. Ch. Oct. 24, 2014) (describing *infoGROUP* as involving "much more extreme facts").

In analyzing liquidity-driven conflict claims, courts have focused on two factors: the materiality of the alleged desire for liquidity and the urgency of the need of cash. The rationale is that only a desire for liquidity that is sufficiently strong would induce a controller to agree to a price for its shares that is less than the fair price. See, e.g., *infoGROUP* (finding a liquidity-based conflict when the interested stockholder was alleged to owe $12 million in settlement payments

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and $13 million in loans, to have no sources of cash inflow, to have recently paid out $4.4 million, and to plan to start a new expensive business venture); *Presidio*:

> It is possible that a combination of weak indications of a desire for liquidity could add up to a collective picture supporting a reasonable inference of a divergent interest. In this case, however, the plaintiff's allegations, even taken together, do not support a reasonable inference that [the controller's] desire for liquidity was so strong that [it] would choose to leave money on the table.

251 A.3d at 260; *Mindbody*, 2020 WL 5870084 at *16 ("Stollmeyer [the controller] could only 'sell tiny bits' of his Mindbody stock pursuant to a 10b5-1 plan—a process he described as 'kind of like sucking through a very small straw.' And Stollmeyer's personal financial situation was such that it required cash flow.") And even a significant need for cash, unless sufficiently urgent, would enable the controller to obtain a fair price through an orderly sales process. See *Synthes*, stating that that the circumstances in which a controlling stockholder's immediate need for liquidity could constitute a disabling conflict of interest irrespective of pro rata treatment:

> would have to involve a crisis, fire sale where the controller, in order to satisfy an exigent need (such as a margin call or default in a larger investment) agreed to a sale of the corporation without any effort to make logical buyers aware of the chance to sell, give them a chance to do due diligence, and to raise the financing necessary to make a bid that would reflect the genuine fair market value of the corporation.

50 A.3d at 1036; Larkin v. Shah, No. 10918, 2016 WL 4485447, at *17 (Del. Ch. Aug. 25, 2016) (noting, as a basis for rejecting a liquidity-driven conflict theory, that the company's "public disclosures describe a robust shopping period that ultimately secured stockholders the highest available offer" for their stock); In re Morton's Rest. Grp. S'holders Litig., 74 A.3d 656, 662 (Del. Ch. 2013) ("[P]laintiffs plead no facts supporting a rational inference that it is conceivable that Castle Harlan's support for an extended market check involving an approach to over 100 bidders in a nine-month process reflected a crisis need for a fire sale."); In re Merge Healthcare Inc., S'holders Litig., No. 11388, 2017 WL 395981, at *8 (Jan. 30, 2017) ("The Complaint states that Ferro has been slowly selling his stock for the past six years, which, to my mind, severely discredits any claims of a fire sale or a severe liquidity crunch."); *Narang*:

> Nor do the facts pled in the Complaint support a reasonable inference that NCI was sold in a crisis or 'fire sale' without any effort to make logical buyers aware of the chance to bid or to give them a meaningful chance to do so. To the contrary, the Complaint acknowledges that the sale process extended over a period of more than eighteen months[.]

2019 WL 1300855, at *9; Van der Fluit v. Yates, No. 12553, 2017 WL 5953514, at *113 n.133 (Del. Ch. Nov. 30, 2017) (noting absence of "fire sale" need for liquidity); In re Cyan, Inc. S'holders Litig., No. 11027, 2017 WL 1956955, at *10 (Del. Ch. May 11, 2017) (noting absence of "immediate need for liquidity" that "amounted to 'a crisis' or a 'fire sale'"); Kachelmyer v. MRV Commc'ns, No. BC669601 C/W BC669740, 2018 Cal. Super. LEXIS 20727, at *7 (Cal.

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Super. May 9, 2018) (noting lack of "liquidity crisis that would cause [defendant] to agree to a fire sale"); *Data Key*, 849 N.W.2d at ¶ 64 (noting lack of "pressing need to sell their interests at fire-sale price"); *Crimson Exploration*, 2014 WL 5449419, at *19 (noting absence of "crisis, fire sale"). But see *Mindbody*, 2020 WL 5870084 at *17 (describing references to "crisis" and "fire sale" in *Synthes* as hyberbolic and finding a liquidity-based conflict without focusing on whether the desire for liquidity was urgent); *Presidio*, 251 A.3d 212 (focusing on degree of divergence of interest between the party with the liquidity-driven conflict and other shareholders and rejecting notion that exigent need for cash is always required to plead a liquidity-driven conflict).

The reluctance to find a controller interested in a merger in which the controller is, prima facie, treated the same, pro rata, as all other shareholders is also supported by substantial policy considerations. To protect minority stockholders, it is desirable to offer a controller the protection of the business judgment rule if minority shareholders are afforded pro rata treatment. If the controller may be regarded as interested in a merger even if it shares the merger consideration ratably with all other shareholders, the controller might as well seek to obtain a differential premium for itself or just to sell their control bloc. See, e.g., *Morton's*:

> When a large stockholder supports an arm's-length transaction resulting from a thorough market check that spreads the transactional consideration ratably across all stockholders, Delaware law does not regard that as a conflict transaction. To the contrary, as cases like *Citron v. Fairchild Camera & Instrument Corp.* and *In re Synthes* point out, such conduct presumptively considers equal treatment as a safe harbor and immunizes the transaction because it allows all the stockholders to share in the benefits of a transaction equally with the large blockholder.

74 A.3d at 662; Iroquois Master Fund, Ltd. v. Answers Corp.:

> When a large stockholder supports a sales process and receives the same per share consideration as every other stockholder, that is ordinarily evidence of fairness, not of the opposite, especially because the support of a large stockholder for the sale helps assure buyers that it can get the support needed to close the deal.

No. 109, 2014, 2014 Del. Ch. LEXIS 573, at *1 n.1 (Feb. 3, 2014), aff'd, 105 A.3d 989 (Del. 2014) (Table); *Synthes*:

> [W]hen a stockholder who is also a fiduciary receives the same consideration for her shares as the rest of the shareholders, their interests are aligned. . . . Controlling stockholders typically are well-suited to help the board extract a good deal on behalf of the other stockholders because they usually have the largest financial stake in the transaction and thus have a natural incentive to obtain the best price for their shares.

50 A.3d at 1035.

4. *Indirect interests*. For purposes of deciding whether a director, officer, or controller is interested, courts often do not distinguish between the direct interests of the director, officer, or controller and the interests of a close family member of the director, officer, or controller, an entity owned by the director, officer, or controller, or an entity for which the director, officer, or controller is a fiduciary. See, e.g., Fliegler v. Lawrence, 361 A.2d 218, 221 (Del. 1976) (finding

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that the individual defendants stood on both sides of the transaction in implementing and fixing the terms of the option agreement between the company and the other entity a majority of whose stock was owned by the individual defendants); Steiner v. Meyerson, No. 13139, 1995 WL 441999 at *9 (Del. Ch. July 19, 1995) (noting that director defendant would be interested in consulting agreement between the company and a company owned by defendant's wife); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 722–723 (Del. 1971) (finding that contract between Sinven, an entity controlled by Sinclair Oil, and International, a wholly owned subsidiary of Sinclair Oil, constituted self-dealing by Sinclair Oil); In re Freeport-McMoran Sulphur Inc. S'holders Litig., No. 16729, 2001 WL 50203 (Del. Ch. Jan. 5, 2001), rev'd on other grounds sub. nom. Krasner v. Moffett, 826 A.2d 277 (Del. 2003) ("By virtue of being directors and officers of both FSC and MOXY, these three directors stood on both sides of the Merger, and accordingly, must be deemed to have had a conflicting interest in that transaction."); Gries Sports Enters. v. Cleveland Browns Football Co., 496 N.E.2d 959, 966 (Ohio 1986) ("We conclude, and so hold, that the evidence supports the finding that the Browns' directors, Bailey and Cole, 'stood on both sides of the transaction' as a result of their holding stock and/or positions in both corporations[.]"); In re Trados Inc. S'holder Litig., 73 A.3d 17, 46–47 (Del. Ch. 2013) ("Three of the directors—Gandhi, Scanlan, and Stone—were fiduciaries for VC funds that received disparate consideration in the Merger in the form of a liquidation preference. . . . The plaintiff proved at trial that Gandhi, Scanlan, and Stone faced a conflict of interest as dual fiduciaries."); Zimmerman v. Crothall, No. 6001, 2012 WL 707238, at *12 (Del. Ch. Mar. 5, 2012) ("Although Gausling did not participate personally in any of the transactions, he served as a managing partner of Originate, which did participate in each of the transactions. Thus, Zimmerman ultimately could succeed in proving that Gausling was interested[.]"); Cumming v. Edens, No. 13007, 2018 WL 992877, at *13 (Del. Ch. Feb. 20, 2018) (finding that plaintiff has raised a reasonable doubt as to whether Malone, as a director of Walker & Dunlop, was disinterested in a transaction in which Walker & Dunlop had a material interest).

§ 1.24. Independent

A director is "independent" with respect to a transaction or conduct if the director is not subject to the influence of, and does not have a relationship with, a person who is interested in the transaction or conduct such that the person's influence or relationship would reasonably be expected to affect the director's judgment regarding the transaction or conduct.

Comment:

a. Use of definition. The definition of "independent" in this Section is adopted by incorporation in § 4.02(c), Business Judgment Rule, and § 1.15, Disinterested Directors (the definition will provide that action by "disinterested directors" requires the affirmative vote of a

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majority of directors of the decisionmaking body who are both independent and not interested in the transaction or conduct).

b. Independence under federal securities laws and stock-exchange rules. The concept of independence under this Section is not identical to the concept of independence under federal securities laws and stock-exchange rules. "Independence" under this Section is judged in relation to a specific transaction or conduct. By contrast, "independence" under federal securities laws and stock-exchange rules is evaluated in relation to the corporation. Moreover, this Section employs a standards-based approach to evaluating "independence," whereas the securities laws and stock-exchange rules employ a rules-based approach. As a result, a director may be regarded as "independent" under the securities laws or stock-exchange rules but nevertheless lack "independence" under this Section, or vice versa. For example, a director without any other relationship to the corporation would typically be "independent" under the securities laws and stock-exchange rules, but that director may lack independence under this Section with respect to a transaction between the corporation and an entity from which that director receives significant remuneration. For similar reasons, the concept of independence under this Section differs from the concept of a lack of a significant relationship with senior executives of the corporation set forth in § 1.35 of the Principles of Law, Corporate Governance: Analysis and Recommendations.

c. Relationships. In determining whether a director is "independent," courts generally examine the director's professional, personal, and family relationships with an interested party. The determination of "independence" is fact-specific and is made in the context of the particular transaction at issue. Relationships that can provide the basis for a determination that a director lacked "independence" include the director being employed by an interested party, an interested party having control over whether the director will continue to receive material financial benefits (subject to comment *f*), and a close personal friendship between the director and an interested party. The purpose of a court's inquiry may also affect its determination of the director's "independence." Thus, for example, given the same set of relationships, a director may lack "independence" for purposes of a special litigation committee but may be "independent" for purposes of giving approval to a transaction that has not yet occurred.

d. Affiliated entities. In determining whether a director has a relationship to a party within the meaning of this Section, a corporate group consisting of a parent and one or more subsidiaries

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should normally be considered a single party so that a relevant relationship to one member of the corporate group would be deemed an equivalent relationship to another member of the group.

e. Board service. This definition does not call for a person to be treated as lacking "independence" in relation to another person solely because he or she served for a long time on a board of directors with such other person. However, when a senior executive of one corporation and senior executive of another corporation sit on each other's board of directors and each senior executive is in a position to review the other's compensation or any transactions or conduct in which the other senior executive is interested, a court could consider that fact in determining whether, in the circumstances of a particular case, a senior executive lacks "independence" when reviewing the other's conflict-of-interest transaction or conduct.

f. Directors of companies with controller. A director of a corporation with a controller, as that term is defined in § 1.10, does not lack independence from the controller merely because the controller can cause the director to lose his or her directorship and the associated usual and customary directors' fees and nonpecuniary benefits. However, if the director has additional professional, personal, family or other relationships with the controller, those relationships may weigh more heavily in a court's assessment of the director's independence from a controller when the controller is also in a position to control whether the director will retain his or her directorship.

g. Model Business Corporation Act. The Restatement's definition of "independent" is substantially equivalent to "material relationship" for purposes of the definition of "qualified director" in the Model Business Corporation Act.

REPORTERS' NOTES

1. *Definition of "independent*." Different jurisdictions employ slightly varying definitions of independence. See, e.g., Harhen v. Brown, 730 N.E.2d 859, 864 n.5 (Mass. 2000) (defining lack of independence as "a business, financial, or familial relationship with a party to the transaction or conduct" that "would reasonably be expected to affect the director's . . . judgment with respect to the transaction or conduct in a manner adverse to the corporation"); Einhorn v. Culea, 612 N.W.2d 78, 89 (Wis. 2000) (holding that a member of special litigation committee is not independent if such member "has a relationship with an individual defendant or the corporation that would reasonably be expected to affect the member's judgment with respect to the litigation in issue"); Orman v. Cullman, 794 A.2d 5, 25 n.50 (Del. Ch. 2002) (holding that independence "involves an inquiry into whether the director's decision resulted from that director being *controlled* by another. A director can be controlled by another if in fact he is *dominated* by that other party, whether through close personal or familial relationship or through force of will . . . [or] is *beholden* to the

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allegedly controlling entity. A director may be considered beholden to (and thus controlled by) another when the allegedly controlling entity has the unilateral power (whether direct or indirect through control over other decision makers), to decide whether the challenged director continues to receive a benefit, financial or otherwise, upon which the challenged director is so dependent or is of such subjective material importance to him that the threatened loss of that benefit might create a reason to question whether the controlled director is able to consider the corporate merits of the challenged transaction objectively."); Bader v. Anderson, 101 Cal. Rptr. 3d 821, 834 (Cal. Ct. App. 2009) (holding that a lack of independence "may be demonstrated by specific facts 'showing that the director is 'beholden' to an interested director or officer, 'or so under their influence that their discretion would be sterilized'" (citing In re IAC/InterActiveCorp Sec. Litig., 478 F. Supp. 2d 574, 599 (S.D.N.Y. 2007))); Marx v. Akers, 666 N.E.2d 1034, 1041 (N.Y. 1996) (holding that a lack of independence by a director with no direct interest can be demonstrated by showing that the director "is 'controlled' by a self-interested director*");* In re DISH Network Derivative Litig., 401 P.3d 1081, 1090 (Nev. 2017) (holding that a director lacks independence when the director is unduly influenced or beholden to someone who is interested); Pinchuck v. State St. Corp., 28 Mass.L.Rptr. 37 (Mass. Super. Ct. 2011) ("[A]n independent director is one who does not have a personal interest in the challenged transaction and does not have a relationship, personal or otherwise, with the defendants that influences the director in the defendants' favor."). In jurisdictions that have adopted the Model Business Corporation Act, the term corresponding to lacking "independence" is having a "material relationship," which is defined as "a familial, financial, professional, employment or other relationship that would reasonably be expected to impair the objectivity of the director's judgment when participating in the action to be taken." MODEL BUS. CORP. ACT § 1.43 (AM. BAR ASS'N 2016). The differences in the definitions are unlikely to make any difference to the ultimate assessment of a director's independence. In particular, although some cases use terms such as "controlled," "dominated," or "beholden" to describe the directors who lack independence, the significance of these terms is to denote a degree of influence that, in the specific context, could reasonably be expected to affect a director's judgment, rather than control, domination and beholdenness in a general sense.

2. *Directors in companies with controlling shareholder*. Case law establishes that the mere fact that a person is an outside director of a corporation that has a controlling shareholder and can be removed from the directorship by that shareholder does not mean that the director lacks independence. Aronson v. Lewis, 473 A.2d 805, 815 (Del. 1983) ("[P]roof of majority ownership does not strip the [other] directors of the presumptions of independence."); In re Martha Stewart Living Omnimedia, Inc. S'holder Litig., No. 11202-VCS, 2017 WL 3568089, at *21 (Del. Ch. Aug. 18, 2017) ("[T]he controller's ability to remove or replace directors does not, by itself, demonstrate a capacity to control them absent 'allegations that remaining on [the] board is material to the outside directors[.]'"). On the other hand, a director who is a full-time employee of a corporation would be regarded as lacking independence with respect to a person with considerable influence over whether that director will remain an employee. See, e.g., Rales v. Blasband, 634 A.2d 927, 937 (Del. 1993); In re The Limited, Inc. S'holders Litig., No. 17148-NC, 2002 WL

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537692, at *5 (Del. Ch. Mar. 27, 2002) ("[A]s a general matter, compensation from one's principal employment is 'typically of great consequence' to the employee.").

3. *Factors*. Independence is a fact-specific determination made in the context of a particular case. It depends, among other factors, on the purpose of the inquiry. See, e.g., Beam v. Stewart, 845 A.2d 1040, 1049–1050 (Del. 2004) ("Independence is a fact-specific determination made in the context of a particular case. The court must make that determination by answering the inquiries: independent from whom and independent for what purpose?"); Gordon v. Bindra, No. 2:14-cv-01058, ODW(ASx), 2014 WL 2533798, at *5 (C.D. Cal. June 5, 2014) (holding under California law that "independence is a 'fact-specific determination' that depends on the totality of the circumstances presented in a particular action"); Einhorn v. Culea, 612 N.W.2d at 90 (holding that independence should be assessed based on "the totality of the circumstances"). Given the same set of relationships, a director may lack independence for purposes of a special litigation committee but may be independent for purposes of giving approval to a transaction that has not yet occurred. See, e.g., Marchand v. Barnhill, 212 A.3d 805, 819 (Del. 2019) (noting that "the decision whether to sue someone is materially different and more important than the decision whether to part company with that person on a vote about corporate governance, and [Delaware's] precedent recognizes that the nature of the decision at issue must be considered in determining whether a director is independent."); In re Oracle Corp. Derivative Litig., 824 A.2d 917, 940 (Del. 2003) ("It is, I daresay, easier to say no to a friend, relative, colleague, or boss who seeks assent for an act (*e.g.,* a transaction) that has not yet occurred than it would be to cause a corporation to sue that person.")

More generally, in evaluating independence, courts make a holistic asessment of the relationship between a director alleged to lack independence and the interested party. A finding of lack of independence may be based, among other considerations: on a close personal, family, or professional relationship, see *Beam*, 845 A.2d at 1050 (noting that some "professional or personal friendships, which may border on or even exceed familial loyalty and closeness," may be basis for finding lack of independence but cautioning that "[n]ot all friendships, or even most of them, rise to this level"); *Einhorn*, 612 N.W.2d. at 92 (holding that personal relationships and employment status bear on assessment of independence); In re DISH Network Derivative Litig., 401 P.3d 1081, 1091 (Nev. 2017) (holding that close personal and professional ties can result in directors lacking independence); Boylan v. Bos. Sand & Gravel Co., No. 02-2296-BLS1, 2009 WL 765404 at *7 (Mass. Super. Ct. Jan. 23, 2009) (finding that director who had 60-year friendship with father of defendant and obtained consulting income from the company was not sufficiently independent to consider whether derivative action should be dismissed); Boland v. Boland**,** 31 A.3d 529, 564 (Md. 2011) ("In determining whether the SLC was sufficiently independent from the defendant-directors, the court should first consider any significant business relationship or affiliations between the SLC members and the defendant directors."); Shlensky v. S. Parkway Bldg. Corp., 166 N.E.2d 793, 802 (Ill. 1960) (finding that Bernstein, who was a lawyer for Englestein and Englestein's business enterprises, was not independent of Engelstein); *Oracle*, 824 A.2d at 942 (noting that director was a professor on the same faculty, was taught by, and had maintained

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contact with interested party). On a relationship indicating the desire for future benefits, see Gantler v. Stephens, No. 132, 2008 WL 401124, at *14 (Del. Ch. Feb. 14, 2008) ("In the case of both current and future employment, an employee or prospective employee is beholden to his superior because of the prospect of future employment."); Orman v. Cullman, 794 A.2d 5, 30 (Del. Ch. 2002) (holding that a director's interest in future renewals of a consulting contract with corporation at $75,000 per year created a reasonable inference of lack of independence vis-a-vis corporation's controller); In re infoUSA, Inc. S'holders Litig., 953 A.2d 963, 991 (Del. Ch. 2007) (finding that an attorney serving as name partner in a law firm receiving $500,000 or more per year in fees from the company created a reasonable doubt as to the attorney's independence from the company); Houle v. Low**,** 556 N.E.2d 51, 58 (Mass. 1990) (finding dispute as to material fact regarding independence where director's "professional advancement appears to be dependent on the individual defendants"). On gratitude for past acts, see In re The Limited, Inc. S'holders Litig., No. 17148-NC, 2002 WL 537692 at * 7 (Del. Ch. Mar. 27, 2002) ("[T]he determination of whether a particular director is 'beholden' to an allegedly controlling person is not limited to the power to affect the director in the future. One may feel 'beholden' to someone for past acts as well."); In re Ply Gem Indus., S'holders Litig., No. 15779-NC, 2001 WL 1192206, at *1 (Del. Ch. Sept. 28, 2001) ("[P]ast benefits conferred by [the interested person] . . . may establish an obligation or debt (a sense of 'owingness') upon which a reasonable doubt as to a director's loyalty to a corporation may be premised."); or "on evidence that in the past the relationship caused the director to act non-independently vis à vis an interested [person]," see *Beam*, 845 A.2d at 1051. Courts have also found that a director lacks independence as a result of a combination of various facts that, on their own, would not have been sufficient to render a director nonindependent. See *infoUSA*, 953 A.2d at 992 (finding a reasonable inference that outside director lacks independence when director's remuneration as board member exceeded director's salary, director received a financial grant deriving from director's relationship with interested party, and interested party was member on other boards that could affect director's professional advancement).

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CHAPTER 2

THE OBJECTIVE OF A CORPORATION

§ 2.01. The Objective of a Corporation

(a) The objective of a corporation is to enhance the economic value of the corporation, within the boundaries of the law;

(1) in common-law jurisdictions: for the benefit of the corporation's shareholders. In doing so, a corporation may consider:

(a) the interests of the corporation's employees;

(b) the desirability of fostering the corporation's business relationships with suppliers, customers, and others;

(c) the impact of the corporation's operations on the community and the environment; and

(d) ethical considerations related to the responsible conduct of business;

(2) in stakeholder jurisdictions: for the benefit of the corporation's shareholders and/or, to the extent permitted by state law, for the benefit of employees, suppliers, customers, communities, or any other constituencies.

(b) A corporation, in the conduct of its business, may devote a reasonable amount of resources to public-welfare, humanitarian, educational, and philanthropic purposes, whether or not doing so enhances the economic value of the corporation.

Comment:

a. Scope note. Section 2.01 describes the objective of the enterprise form "the corporation," both as it exists in common-law jurisdictions such as Delaware and as it exists in jurisdictions that have adopted constituency statutes. Section 2.01 has three broad purposes. First, it sets forth the basic (or default) objective of the for-profit business corporation, namely, to enhance the economic value of the corporation (the "economic objective"). The economic objective distinguishes for-profit business corporations from nonprofit corporations (which fall outside the scope of this Restatement), as well as from some of the newer business forms. As the social demands on corporations evolve, environmental and social concerns become prominent, and the menu of

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1 organizational forms expands, there is value in articulating the default objective of a for-profit
2 business corporation to clarify what people opt into when they form a corporation and, importantly,
3 when outsiders invest in such a corporation. In light of the large number of states that have passed
4 statutes relating to the objective of the corporation, this Section restates both the "common law"
5 approach to corporate objective and the "stakeholder" approach.

6 Second, by stating an objective, the law informs the individuals involved in running a
7 corporation, e.g., directors and officers, what the corporation's ultimate objective is, and is not. As
8 such, a corporation's objective is the beginning (but only the beginning) of an answer to a new
9 director's reasonable question: "What are we trying to accomplish here?"

10 Third, the Section sets a backdrop for the other, more specific provisions of the
11 Restatement—Chapter 1's definition of "waste," § 1.44; Chapter 4, Duty of Care and the Business
12 Judgment Rule; Chapter 5, Duty of Loyalty; and Chapter 6, Role of Directors and Shareholders in
13 Transactions in Control and Tender Offers—that set out specific standards of conduct for corporate
14 officials and govern liability for conduct that falls below those standards. By specifying the default
15 goal, it rules out some alternative goals and thus informs the analysis of what it means to act in
16 good faith.

17 Because § 2.01 speaks only of the corporation, its provisions do not in themselves impose
18 any obligations or liabilities on corporate officials.

19 *b. Comparison with present law.* In all jurisdictions, the core objective of a corporation is
20 to enhance the economic value of the corporation. Where the jurisdictions differ is on whether this
21 is understood to be "for the benefit of the shareholders" alone or whether the intended beneficiaries
22 may be a broader group of "stakeholders" or "constituencies."

23 During the 1980s and 1990s, largely in reaction to the wave of corporate takeovers and the
24 Delaware Supreme Court's decision in Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506
25 A.2d 173 (Del. 1986), which made clear that in the sale of the corporation, shareholder interests
26 must be given exclusive weight, many states adopted antitakeover statutes, including so-called
27 constituency statutes. Although they vary in their details, these statutes are generally designed to
28 give boards of directors more leeway to protect (nonshareholder) stakeholders in transactions in
29 corporate control than existed under Delaware law. These statutes now exist in a numerical
30 majority of American states but vary as to the extent to which they modify the common-law
31 approach; judicial interpretation of these statutes further increases the variation. These statutes

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generally provide the board with explicit discretion to consider the interests of nonshareholder stakeholders and vary as to the degree to which those interests may be elevated to the same level as the interests of shareholders as ends of corporate governance. A few make clear that the board has no obligation to prioritize any particular interest, including the interests of shareholders.

In light of this divergence among the states, and in light of the ability of business planners to choose which state's enterprise form to use in organizing a business, this Section restates both the common-law and the stakeholder approaches. Because of the variation among stakeholder jurisdictions, this Restatement often conditions Illustrations on the specific statute and judicial interpretation in a given jurisdiction. In the Illustrations below, the Restatement notes when the Illustrations may come out differently depending on the type of jurisdiction. Unless otherwise stated, the Illustrations come out the same in both types of jurisdictions.

More recently, many states have adopted a third basic option: the benefit corporation. This new model goes beyond the permissive constituency statutes to mandate stakeholder-focused governance. Under this model, the corporation typically must be operated for the benefit of all the corporation's stakeholders and in a manner that is environmentally and socially responsible. This requires that the board balance "the stockholders' pecuniary interests, the best interests of those materially affected by the corporation's conduct, and the public benefit or public benefits identified in its certificate of incorporation." DEL. CODE ANN. tit. 8, § 362. Unlike the permissive (may) model reflected in constituency statutes, benefit corporations are more prescriptive (shall) and typically permit stockholders to bring a derivative suit if they believe that the board has not complied with its duties to stakeholders or society. Although this model is new, a form of it now exists in 34 states. Because it is so new, there is little case law interpreting its provisions and thus it would be premature to restate this form in the black-letter law.

The differences among these models are important but should not be overstated. Under each of the models (as will become clear in the illustrations and in later sections that focus on fiduciary duties), boards of directors have substantial discretion to balance the interests of all stakeholders. On most questions affecting the corporation (other than distributional questions), all stakeholders are in alignment, and that is particularly so for employees and shareholders. Even more than stockholders, employees of a company depend on its continued profitability and viability, as employees cannot diversify away the risk of firm failure. Employees and stockholders thus have a shared interest in the company's productivity and profitability. Likewise, none of a company's

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stakeholders benefit from unfair self-dealing by top management, controlling stockholders, or directors, and thus they all share an interest in enforcing the duty of loyalty. For that and similar reasons, in the area in which the enforcement of fiduciary duties has traditionally been most salient, the differences among these statutory models are unlikely to generate different outcomes.

When decisions involve tradeoffs among stakeholders, the differences between the models become more important and can affect outcome. While under the traditional approach, consideration of nonshareholder interests must be "rationally related" to shareholder benefits, in a "may" or "shall" jurisdiction, consideration of nonshareholder interests sometimes will not only be permissible without regard to shareholder benefit but may be mandatory.

c. The common-law approach: Traditional jurisdictions like Delaware do not explicitly define the objective of the corporation. Under these jurisdictions' common-law approach, which can be traced back to the 19th-century origins of the corporate form, the objective is to enhance the value of the corporation for the benefit of the shareholders, although as discussed in more detail below, this typically involves also considering the interests of other stakeholders. This approach is often referred to as "shareholder primacy."

The priority and distinctiveness of shareholder interests emerges in several ways. For example, under § 1.23's definition of "interested", a director or officer is interested in a transaction or conduct only when he or she receives "a direct or indirect benefit (or suffers a detriment) as a result of, or from, the transaction or conduct when the benefit (or detriment) is not generally shared pro rata according to the number of shares held." The fact that a director or officer who holds shares is not considered interested when the director or officer receives a benefit that is shared pro rata according to the number of shares held illustrates how the priority of shareholder interests is part of the deep structure of corporate law. As a result, the decision by directors who are also shareholders to pay a dividend is not considered an interested transaction and typically is not subject to heightened scrutiny because shareholders receive dividends on a pro rata basis.

Shareholder priority likewise emerges from the basic corporate statutes in which only shareholders are endowed with the power to elect directors and to approve an amendment of the certificate of incorporation, mergers, a sale of all or substantially all the assets, or a dissolution. Finally, when the interests of shareholders diverge from the interests of other participants in the firm, e.g., preferred shareholders and bondholders, courts in common-law jurisdictions have consistently held that shareholder interests must be given priority. At the same time, the board of

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1 directors has wide discretion to take into account the interests of nonshareholder constituencies as
2 it deems appropriate, as both the discussion below and the discussion of the business judgment
3 rule in § 4.02 make clear.

4 *d. The stakeholder approach:* Because of the variation among constituency statutes and
5 additional variations introduce by judicial interpretation, it is best to think of the stakeholder
6 approach as a range of approaches. The statutes can be divided into three principal types: "modified
7 shareholder-primacy" statutes that make clear that a board *must* consider the best interests of
8 shareholders and *may* consider other interests; the "level-playing-field" statutes that list the factors
9 a board *may* consider and lists the interests of shareholders as one of a number of interests without
10 an indication of any priority; and "strong-form level-playing-field" statutes that contain language
11 making it clear that a board may totally sublimate some of the listed factors to others. At present,
12 no state makes the consideration of nonshareholder interests mandatory, although one state,
13 Connecticut, did so until 2010. While the history of stakeholder statutes makes clear that they were
14 intended to grant boards of directors more discretion in selling the company than Delaware law
15 was thought to provide, the extent to which they were intended to change the basic economic
16 objective is unclear. Subsequent case-law development has not generally clarified the scope of the
17 expanded discretion provided to boards of directors. The treatment of the noncontrol contest
18 Illustrations in the Comment reflects this paucity of authority.

19 *e. The economic objective.* In very general terms, § 2.01 may be thought of as a broad
20 exhortation to enhance economic returns within the bounds of the law. But that economic objective
21 does not mean that the directors or officers must maximize shareholder value in the short term. On
22 the contrary, long-run profitability and shareholder gain are often at the core of the economic
23 objective. Activity that entails a short-run cost to achieve an appropriately greater long-run profit is
24 therefore not a departure from the economic objective. An orientation toward lawful, ethical, and
25 public-spirited activity will normally fall within the economic objective. The modern corporation
26 by its nature creates interdependencies with a variety of groups with which the corporation has
27 legitimate concern, including employees, customers, suppliers, and members of the communities in
28 which the corporation operates. The long-term profitability of the corporation generally depends on
29 meeting the fair expectations of such groups. Short-term profits may properly be subordinated to
30 the recognition that responsible maintenance of these interdependencies is likely to contribute to
31 long-term corporate profit and shareholder gain. Accordingly, the corporation, in its conduct, may

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typically take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business, and it may devote a reasonable amount of resources to public-welfare, humanitarian, educational, and philanthropic purposes.

For comparable reasons, the economic objective does not imply that the corporation must extract the last penny of profit out of every transaction in which it is involved. Treating contractual counterparties fairly will usually redound to the long-run benefit of the corporation. Moreover, taking steps to preserve a system of cooperative exchange is consistent with the economic objective.

Although directors and officers must meet a standard of care in making decisions, that standard can be satisfied even when the prospective profit cannot be quantified. Recurring instances of this sort include efforts to maintain the confidence of other business organizations, to foster the morale of employees, or to encourage favorable or forestall unfavorable government regulation. Examples also include abstaining from conduct that would engender unfavorable public reaction against the corporation, providing lawful assistance in connection with lobbying or referenda activities, and voluntarily adopting a course of conduct to forestall legislation that would instead mandate such conduct. There is also no conflict with the economic objective when a corporation takes an action that will generate profit, or reduce the level of losses, not only for itself but also for other firms, so long as the corporation's benefit is likely to exceed the corporation's costs.

Finally, corporations may take into account their effects on the environment, as well as the social impact of their operations. In general, if the corporate officials who authorize a decision satisfy the test of § 4.02, the Business Judgment Rule, the decision itself would satisfy § 2.01.

To the extent that the corporate decisionmaker concludes that the path to long-term prosperity is for the corporation to act with a "purpose," understood to mean "a concrete goal or objective for the firm that reaches beyond profit maximization," nothing in § 2.01 should be understood as interfering with a corporation doing so. Claudine Gartenberg, Andrea Prat & George Serafeim, *Corporate Purpose and Financial Performance*, ORGANIZATION SCIENCE 30(1):1-18) (2019). Indeed, it may often be the case that the economic objective of the corporation is best achieved by organizing the corporation around a common strategy and focusing attention on pursuing that strategy rather than directly pursuing profits.

As noted above, stakeholder jurisdictions provide corporations with greater discretion to consider the interests of nonshareholder constituencies. In light of that, any Illustration favoring

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the interests of stakeholders that is consistent with the economic objective for common-law jurisdictions stated in § 2.01 will typically also be consistent with the economic objective for stakeholder jurisdictions. When an Illustration is not consistent with the economic objective for common-law jurisdictions, it will sometimes be consistent with the economic objective in stakeholder jurisdictions. While the "economic objective" provides great flexibility, it is not unlimited, as Illustrations 8 and 9 show.

Illustrations with no divergence among jurisdictions:

1. Corporation A is a publicly held corporation [§ 1.31] with annual earnings in the $ 20–30 million range. A has entered into a contract that is unenforceable against it under the Statute of Frauds. Performance of the contract will involve a loss of $700,000. Corporation A nevertheless performs the contract because the relevant corporate decisionmaker made a judgment, in a manner that meets the standards of § 4.02, that the loss is likely to be exceeded by long-run profits from preserving confidence in A's willingness to honor its commitments. Corporation A's action does not involve a departure from the economic objective stated in § 2.01 in either type of jurisdiction.

2. Corporation B is a publicly held corporation with annual earnings in the $60–80 million range. W, a long-time middle manager of B, is forced to retire because of serious injuries suffered in an automobile accident. B has a pension plan covering W, but the plan was adopted only recently, and W's benefits are only 30 percent vested. B purchases an annuity for W at a cost of $500,000 to bring W's retirement income up to a reasonable level, because the relevant corporate decisionmaker made a judgment, in a manner that meets the standards of § 4.02, that the cost of the annuity will be exceeded by long-run economic benefits from improving the morale of B's remaining employees. B's action does not involve a departure from the economic objective stated in § 2.01 in either type of jurisdiction.

3. Corporation A, Corporation B, and Corporation C, the dominant firms in the cigarette industry, each voluntarily decides to follow a code, recommended by a trade group, setting forth unusually high advertising standards. C believes it would probably sell more cigarettes in the short run, and perhaps in the long term, by not adhering to the code, regardless of the conduct of A and B. C nevertheless follows the code because the relevant corporate decisionmaker made a judgment, in a manner that meets the standards of § 4.02,

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that adherence will potentially forestall costly governmental regulation of cigarette advertising. C's action does not involve a departure from the economic objective stated in § 2.01 in either type of jurisdiction.

4. Steel producer Corporation D is a large, publicly held corporation [§ 1.xx] with annual net earnings of approximately $100 million. The United States is engaged in a limited overseas ground war, and the president has vigorously urged price restraint. Most steel producers have held the line on steel prices, but some have circumvented the price-restraint policy by extracting no-interest or low-interest loans from their customers. D could increase its annual earnings by approximately $10 million through engaging in this practice. It does not do so, however, because the relevant corporate decisionmaker made a judgment, in a manner that meets the standards of § 4.02, that the practice would undermine clearly stated national economic policy and would result in highly unfavorable public reaction against D and other large corporations, and would thereby threaten to diminish its long-run profitability. D's course of conduct does not involve a departure from the economic objective stated in § 2.01 in either type of jurisdiction.

5. Finance Company E is a publicly held corporation with annual earnings of approximately $100 million. It has never discriminated in its lending policies. E adopts a program of making five percent of its loans to finance inner-city projects that do not meet its normal risk standards based on a belief that the continued health of the finance industry depends on maintaining the vitality of urban areas in which the industry lends, and that some relaxation of traditional lending standards on the part of major lenders is essential if this vitality is to be maintained. The program will probably entail forgoing profits of approximately $3 million annually over the near term because of increased risk of loss, but the relevant corporate decisionmaker made a judgment, in a manner that meets the standards of § 4.02, that E's long-term economic interests will nevertheless be advanced by the program. E's action does not involve a departure from the economic objective stated in § 2.01 in either type of jurisdiction.

6. Corporation X is a large and very successful publicly held software company. The corporate decisionmaker has made a judgment, in a manner that meets the standards of § 4.02, that its success (financial and otherwise) comes from being a purpose-driven

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1 organization. In furthering that purpose, X has committed to and implements throughout
2 the organization a "mission statement" that articulates the company's core values and says:

3 We believe the business of business is improving the state of the world for
4 all of our stakeholders, including our stockholders, customers, employees,
5 community, environment, and society. We are committed to creating a
6 sustainable, low-carbon future, advancing equality and diversity, and
7 fostering employee success. We try to integrate social good into everything
8 we do. All of these goals align with our long-term growth strategy and
9 financial and operational priorities.

10 X's action does not involve a departure from the economic objective stated in § 2.01 in
11 either type of jurisdiction.

12 7. Management Company Inc. (MCI) is a management company for a group of
13 mutual funds and is owned by the funds it advises. MCI sets its management fee to just
14 cover costs, without any effort to generate a profit. MCI's action does not involve a
15 departure from the economic objective stated in § 2.01.

16 **Illustrations (with potential divergence among jurisdictions):**

17 8. The facts being otherwise as stated in Illustration 5, Finance Company E raises
18 the percentage of loans made under the program to 40 percent, and E's annual forgone
19 profits over the long term will be approximately $24 million. The judgment of the corporate
20 decisionmaker is that while the short-term and long-term value of E will decrease under
21 the program, E's inner-city customers and their neighborhoods will benefit substantially.
22 The corporate decisionmaker does not identify any other countervailing benefits to the
23 shareholders and there are no apparent countervailing benefits.

24 *Common-law jurisdictions*: E's action involves a departure from the
25 principles stated in § 2.01.

26 *Stakeholder jurisdictions*: The outcome is unclear and requires close study
27 of the particular stakeholder statute adopted and any cases interpreting it.

28 9. Corporation Q, a publicly traded corporation, has a market capitalization of $2
29 billion. The board of directors has concluded that it is time to sell the corporation and has
30 solicited competing offers. Two fully financed cash offers have emerged. Corporation A is
31 willing to pay $2.9 billion and has indicated that it plans to reduce the workforce by

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subcontracting a substantial portion of the manufacturing operations to lower-cost suppliers. Corporation B has offered $2.7 billion and will leave the current manufacturing operations unchanged. The relevant corporate decisionmaker (here, the board of directors) has concluded that Corporation B's offer is better for the corporation as a whole, including its employees, and enters into significant defensive measures that interfere with shareholders' ability to accept or vote for Corporation A's offer.

Common-law jurisdictions: The action is a departure from the economic objective under § 2.01 because the action cannot be justified as in the interests of the shareholders whose interest in Corporation Q will end after the sale. Revlon v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

Stakeholder jurisdictions: The action does not involve a departure from the economic objective of § 2.01. Most constituency statutes were adopted specifically to reject *Revlon* and to permit this decision.

10. Corporation X has found that there has been a sharp increase in the demand for the widgets it produces. It has determined that it should build a new plant to expand its production of widgets. One plant could be constructed in a community where a substantial number of its present employees and their families live. This choice would please employees, a number of whom will be replaced in their present jobs by technology. The construction and opening of the new plant should increase the profitability of X by five percent a year over the next five years. An alternative would be to build the plant in Developing Country where labor costs are much cheaper. Doing so would provide much-needed jobs in Developing Country. It is estimated this new plant would increase profitability by 15 percent a year over the next five years.

Common-law jurisdictions: Either alternative may be consistent with § 2.01 if a judgment is made by the relevant corporate decisionmaker, in a manner that meets the standards of § 4.02, that it is in the long-term interests of the corporation and its shareholders.

Stakeholder jurisdictions: Either alternative may be consistent. In choosing, boards typically may take into account the interests of employees even when those interests do not benefit shareholders.

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f. Compliance with legal rules. Under § 2.01, the corporation is obliged to act within the boundaries set by law. Some maintain that a corporation's decision whether to adhere to a given legal rule may properly depend on a kind of cost–benefit analysis in which probable corporate gains are weighed against either probable social costs, measured by the dollar liability imposed for engaging in such conduct, or probable corporate losses, measured by potential dollar liability discounted for likelihood of detection. Section 2.01 rejects this position. Typically, dollar liability is not a "price" that can properly be paid for the privilege of engaging in legally wrongful conduct. Cost–benefit analysis may have a place in a state's determination as to whether to deem a given type of conduct legally wrongful. Once that determination has been made, however, the resulting legal rule represents a normative decision that the conduct is wrongful as such, so a cost–benefit analysis as to whether to obey the rule is generally out of place.

Accordingly, in conducting its business, the corporation, like all other citizens, is under an obligation to act within the boundaries set by law. In determining those boundaries, the corporation should not rest simply on past precedents or an unduly literal reading of statutes and regulations. Rather, it should give weight to all the considerations that the courts would deem proper to take into account in their determinations, including relevant principles, policies, and legislative purposes.

Section 2.01 is based on the moral norm of obedience to law. In this connection, there are certain limited exceptions under which the norm of obedience to law is usually deemed inapplicable or counterbalanced by other considerations. Thus, notwithstanding the norm of obedience to law, a corporation may be justified in not complying with the law under the concept of necessity in extraordinary situations in which compliance would inflict substantial harm on third parties, and noncompliance would not. This might occur, for example if, despite all efforts, a public utility was unable to complete a modification of its plant in time to meet a statutory clean-air deadline and the failure posed no imminent danger to health and safety, while shutting down the plant would cut off power to the local community. Similarly, a corporation may be justified in not complying with the law under the concept of desuetude, i.e., disuse, when both social morality and relevant government authorities condone a departure from a legal rule. The norm of obedience to law also is usually deemed counterbalanced when, under appropriate conditions, a rule is violated openly for the purpose of testing its validity or interpretation. Similarly, although a breach of contract may violate the moral norm that promises should be kept, contractual obligations do not

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necessarily derive independent support from the norm of obedience to law, and § 2.01 permits a corporation to engage in a cost–benefit analysis when deciding whether to breach a contract.

These exceptions are not exhaustive. For example, isolated and de minimis violations do not violate the principle of § 2.01, although a widespread or extensive practice of overlooking individually de minimis violations could. Similarly, there may be cases in which it is widely understood that liability is properly viewed as a price of noncompliance, such as parking tickets for overstaying a parking meter.

Corporations operate in complex environments and face a multitude of overlapping rules and regulations. In such contexts, legal risks are pervasive. A corporation must manage its legal risks and, in doing so, should have an adequate compliance program. See generally, American Law Institute, Principles of the Law, Compliance and Enforcement for Organizations.

Illustrations:

11. F Corporation is a publicly held corporation with annual earnings in the $30–50 million range. F hopes to be awarded a supply contract by P, a large, publicly held corporation. The anticipated profits on the contract are $50 million over a two-year period. A vice president of P has approached Brown, the relevant corporate decisionmaker of F, with the suggestion that if F pays the vice president $200,000, F will be awarded the contract. Brown knows such a payment would be illegal but correctly regards the risk of detection as being extremely small. After carefully weighing that risk and the consequences of detection, Brown causes F to pay the $200,000. F's action involves a departure from the principle stated in §2.01.

e. Opting out of or tailoring the economic objective. Many corporations are organized for a purpose other than economic value and shareholder benefit. Typically, these corporations are organized as nonprofit corporations, which exist in every state. Nonprofit corporations are beyond the scope of this Restatement (see § 1.12) and are the subject of the Restatement of the Law, Charitable Nonprofit Organizations. Similarly, such corporations are excluded from the operation of many business-corporation laws and the revised Model Business Corporation Act, which define the term "corporation" to mean a corporation for profit. See, e.g., N.Y. BUS. CORP. § 102(a)(4) (McKinney 1963); MODEL BUS. CORP. ACT (2016 Revision) § 1.40(4) (AM. BAR. ASS'N 2017).

With the enactment of "benefit corporation" statutes in 34 states, the organizational options have expanded. When an entity is organized as a benefit corporation that follows the Model Benefit

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Corporation Legislation, its board of directors is required to "consider the effects of any action or inaction upon" shareholders, employees, customers, communities, the environment, and its identified public-benefit purposes and "need not give priority to a particular interest or factor." MODEL BENEFIT CORP. LEGIS. § 301 (BENEFIT CORP. 2017). See also DEL. CODE ANN. tit. 8, § 362. In many states, a corporation may become a benefit corporation by means of a simple amendment to the certificate of incorporation, so long as the heading in the certificate of incorporation includes the words "public benefit corporation" or "P.B.C." See id; MODEL BENEFIT CORP. LEGIS. § 104 (BENEFIT CORP. 2017). The benefit-corporation form, although still in its early years, is growing in use, especially among new companies. It is likely to become the primary channel for opting out of, or tailoring, both the common-law form and the stakeholder form of the corporation.

There is an open question whether the benefit corporation will become the exclusive means for modifying a corporation's default economic objective. In particular, it is unclear whether and and to what extent corporation may opt out of the economic objective by adopting a provision in its certificate of incorporation (other than by a provision opting into "benefit-corporation" status), by bylaw, or by one of the other corporate governance documents that the Securities and Exchange Commission's rulemaking and stock-exchange-listing requirements now mandate for listed firms' audit committees, compensation committees, and nomination committees. N.Y. STOCK EXCH., LISTED CO. MANUAL § 303A (2010), See Part III. In light of that uncertainty, this Restatement does not take a position on whether and to what extent a corporation may opt out of the economic objective by these means.

f. Ethical considerations. Corporations are generally expected to act according to ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business. Section 2.01 provides sufficient flexibility for a corporation to take into account these expectations. This does not mean that corporate officials can properly take into account any ethical consideration, no matter how idiosyncratic. Because corporate officials are dealing with other people's money, they act properly in taking ethical principles into account only when they are reasonably regarded as being appropriate to the corporation's responsible conduct of its business and thus further the corporation's economic objective. However, it should be recognized that new principles may emerge over time, and the ethical considerations that further a corporation's economic objective may change. A corporate official therefore should be permitted to take into account emerging ethical principles that are reasonably regarded as appropriate to the responsible

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conduct of business and have significant support although less-than-universal acceptance. When an ethical determination has been made by an independent and disinterested board of directors, the collective nature of the decision itself is a guard against idiosyncratic considerations.

The ethical considerations reasonably regarded as appropriate to a corporation's responsible conduct of its business necessarily include ethical responsibilities that it may owe to persons other than shareholders with whom the corporation has a legitimate concern, such as employees, customers, suppliers, and members of the communities within which the corporation operates. The content of these responsibilities may vary according to the type of business in question and the history and established standards of the particular corporation. For example, a manufacturer of consumer goods may owe an ethical obligation to produce safe products using a sustainable and socially responsible supply chain, while newspapers may owe ethical obligations that are defined in part by the professional standards of journalism. Similarly, the content of the fairness obligation owed to groups such as employees may depend in part on a corporation's past statements and practices that have engendered reasonable reliance or legitimate expectations. If, however, it appears that an action that would be in the corporation's best economic interests would violate the official's personal ethical principles, but not ethical principles reasonably regarded as appropriate to the responsible conduct of business, the official should either take the action that is in the corporation's best interest or refrain from participating in the decision.

Illustrations:

12. Corporation R, a large national retailer, decides after a tragic school shooting to stop selling guns. Gun sales, while profitable, only amount to three percent of total sales. The corporate decisionmaker makes a judgement in a manner that meets the standards of § 4.02 that ceasing the sale of guns is best for the corporation for a combination of reasons: employees are uncomfortable selling them; in parts of the country, there is concern that customers may boycott the store unless they cease to sell guns; several of the directors believe that ceasing to sell guns is morally required, given the surrounding events. R's action does not involve a departure from the principle stated in § 2.01.

13. The facts being otherwise as stated in Illustration 12, R continues to sell guns. R's action does not involve a departure from the principle stated in § 2.01.

14. Corporation CP, a national consumer-products company, has noticed that revelations of human-rights abuses and corruption in competitors' supply chains have hurt

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1 those companies' reputations and financial performance. In response, CP has taken
2 significant steps to set standards for its supply chain at a significant cost, despite no legal
3 obligation to do so. CP's action does not involve a departure from the principle stated in
4 § 2.01. See also Illustrations 15, 16, 22, and 23.

5 *g. Public welfare, humanitarian, educational, and philanthropic contributions.*
6 Corporations routinely make donations, in reasonable amounts, for public-welfare, humanitarian,
7 educational, or philanthropic purposes. While public-spirited concerns sometimes enter into the
8 decision, the contributions typically are also intended to enhance corporate value. For example, a
9 donation to public television may be made for reasons comparable to those for sponsoring a
10 commercial, and a contribution to local Red Cross or Community Chest activities may be made
11 for reasons of employee well-being and morale or local good will. At least when the amounts are
12 reasonable, they do not involve a departure from the principle stated in § 2.01(a).

13 Section 2.01(b) goes beyond these justifications and allows corporate resources to be
14 devoted to public-welfare, humanitarian, educational, and philanthropic purposes even without a
15 belief that it will promote the value of the corporation. Although historically, gifts, including gifts
16 to charity, were considered ultra vires and required unanimous shareholder ratification (as with
17 waste), many states enacted statutes to authorize contributions of corporate resources to public
18 purposes without regard to corporate benefit. N.Y. BUS. CORP. § 202(a)(12); CAL. CORP. CODE
19 § 207(e); N.J. STAT. § 14A:3-4(1). These statutes, and the common-law approach followed in
20 states without such statutes, permit a corporation to consider the social impact of its activities. For
21 example, a corporation may take into account, within reason, public-welfare concerns relevant to
22 groups with which the corporation has a legitimate concern, such as employees, customers,
23 suppliers, and members of the communities within which the corporation operates. Furthermore,
24 because of the central position of corporations in the economic structure, the cooperation of
25 corporations in furthering established governmental policies is often critical to the success of such
26 policies. Social policy also favors humane behavior by major social institutions. Finally, social
27 policy favors the maintenance of diversification of educational and philanthropic activity, and this
28 objective would be more difficult to achieve if corporations, which control a great share of national
29 resources, were not allowed to devote a portion of these resources to those ends. Corporate activity
30 that is justified solely by social considerations, however, is subject to a limit of reasonableness.

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The determination whether the amount of resources used for such purposes is reasonable in any given case, like other questions of reasonableness in the law, depends on all of the circumstances. Among the principal factors to be considered are the customary level at which resources are devoted to such purposes among comparable corporations in proportion to earnings and assets, and the strength of the nexus between the use of corporate resources and the corporation's business. In general, the greater the amount of corporate resources expended, the stronger should be the nexus. Extreme conditions, such as a national emergency, may justify activity beyond that which would be reasonable under normal conditions. Contributions can be both monetary and nonmonetary, including the provision of skills, manpower, physical facilities, and the like. In determining the reasonableness of a corporate contribution, courts often make reference to limits of deductibility under the Internal Revenue Code. I.R.C. § 170(b)(2)(A) (limit of 10 % of taxable income).

Determining whether activity is humanitarian, educational, or philanthropic is normally not difficult. The same sometimes cannot be said of determining whether activity is for the public welfare. The type of conduct that most readily falls within this description is activity in aid of a clearly defined governmental policy. One major category of such conduct is activity that, although technically not required by statute, is designed to further the policy underlying a statute, such as activity designed to further policies concerning preserving the environment or avoiding discrimination in employment practices. A second major category is the provision of resources to federal, state, or local governments, e.g., making property available for public use without compensation.

Illustrations:

15. The facts being otherwise as stated in Illustration 2, Corporation B is about to liquidate. Accordingly, it will have no remaining employees and therefore cannot justify the purchase of an annuity for W on the basis of long-term profitability. B's assets net of liabilities are $ 30 million. W is the only employee whom the liquidation will leave without retirement security. The relevant decisionmaker causes B to purchase an annuity, at a cost of $500,000, to bring W's retirement income up to a reasonable level, partly for humanitarian reasons, and partly because ethical considerations that B reasonably regards as appropriate to the responsible conduct of business suggest that a business should make reasonable provision for a faithful long-term employee who has made a contribution to the

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1 business and is forced by ill health to retire while in the corporation's employ. B's action
2 does not involve a departure from the principles stated in § 2.01.
3 16. The facts being otherwise as stated in Illustration 15, B does not purchase an
4 annuity. B's action does not involve a departure from the principles stated in § 2.01.
5 17. Cement Company M is a publicly held corporation with assets of approximately
6 $ 1.2 billion and annual earnings in the range of $130–150 million. All of M's facilities are
7 located in the western United States, and the nature of the cement business is such that M
8 cannot practicably make sales outside the region. Solely on the basis of philanthropic
9 considerations, M makes an anonymous donation of $30 million to a local-history museum
10 in New York City. M's action involves a departure from the principles stated in § 2.01. A
11 contribution equal to approximately 20 percent of M's annual earnings for a use that lacks
12 any meaningful nexus to M's business is inconsistent with § 2.01 because it is not
13 motivated by profit considerations and, given the nature of M's business, there would be
14 no basis for concluding that the contribution would increase either short- or long-term
15 profitability. The gift is inconsistent with § 2.01(b) because a donation of 20 percent of
16 annual earnings will not generally be considered reasonable and is above the limits of
17 deductibility under the Internal Revenue Code (often used by courts as imposing an upper
18 bound on what is a reasonable amount). I.R.C. § 170(b)(2)(A) (limit of 10 % of taxable
19 income).
20 18. The facts being otherwise as stated in Illustration 17, except that a major
21 customer or source of financing, located in New York City, solicited the contribution. If
22 the relevant decisionmaker makes a judgment, in a manner that meets the standards of
23 § 4.02, that the contribution was justified as a way of cultivating the major customer or
24 source of financing, the contribution does not involve a departure from the principles stated
25 in § 2.01.
26 19. The facts being otherwise as stated in Illustration 17, M donates only $100,000
27 to the museum. M's action does not involve a departure from the principles stated in § 2.01.
28 Based on present corporate practice, contributions of relatively small amounts for purposes
29 specified in § 2.01(b) are normally permissible even though a clear nexus to the
30 corporation's business is lacking.

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1 20. Movie Company N is a publicly held corporation with annual earnings in the
2 range of $700–800 million. N recently completed and released a movie based on a comic-
3 strip character. It earned over $ 80 million from the movie. The character was created in
4 the 1930s by Silver and sold to a comic-book company for $150. Silver is now 68 and
5 destitute. Silver writes N and asks if it would make some payment in recognition of Silver's
6 contribution. N agrees to pay Silver $50,000 a year for life, partly for reasons of public
7 relations and reputation, and partly out of humanitarian considerations. N's action does not
8 involve a departure from the principles stated in § 2.01 because the fact that Silver's efforts
9 resulted in a significant benefit to the enterprise for which Silver never received
10 commensurate compensation provides a close nexus between the action and N's business.
11 21. The facts being otherwise as stated in Illustration 20, N does not make a payment
12 to Silver. N's action does not involve a departure from the principles stated in § 2.01.
13 22. Corporation O, a publicly held corporation, has assets of $1 billion and annual
14 earnings in the range of $130–150 million. O owns three aluminum plants, which are
15 profitable, and one plastics plant, which is losing $40 million a year. The plastics plant
16 shows no sign of ever becoming profitable because of its high operating costs, and there is
17 no evidence that the plant and the underlying real estate will increase in value. O decides
18 to sell the plastics plant. The only bidder for the plant is Gold, who intends to use the plant
19 for a new purpose, introduce automation, and replace all existing employees. O turns down
20 Gold's bid and keeps the plastics plant operating indefinitely for the purpose of preserving
21 the employees' jobs. In common-law jurisdictions, O's action involves a departure from
22 the principles stated in § 2.01. The action cannot be justified under § 2.01 because the
23 action is not motivated by profit considerations and because a corporation is not generally
24 considered to be ethically obliged to continue indefinitely the operation of a business that
25 is losing more than one fourth of the corporation's earnings for the purpose of keeping
26 workers employed. In stakeholder jurisdictions, the outcome is unclear and requires close
27 study of the particular stakeholder statute adopted and any cases interpreting it.
28 23. The facts being otherwise as stated in Illustration 22, the only person who bids
29 on the plant is a real-estate developer who plans to close the plant and hold the land for
30 investment. The developer is agreeable to leasing the plant back to O at a moderate rent for
31 up to 12 months. O enters into a three-month lease and continues to operate the plant during

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that period, at a loss of $500,000, to provide the employees at the plant a period of adjustment prior to its closing. This action is taken partly out of humanitarian considerations and partly because generally accepted ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business suggest that an enterprise should make reasonable provision to cushion the transition of long-term employees who are about to be discharged. O's action does not involve a departure from the principles stated in § 2.01. A decision to sell the plant to the developer without taking a leaseback would also not involve a departure from the principles stated in § 2.01.

24. Corporation P is a large publicly held corporation that manufactures powerful computers that has annual earnings of $600–700 million. P has been negotiating with a foreign country for the sale of three computers. Negotiations were essentially complete, and a contract ready to sign, when the State Department announced that within the next few days the President would adopt an executive order prohibiting the shipment of certain high-technology products to that country because its conduct was highly inimical to the United States and threatened the stability of the entire region. The State Department also announced that the prohibition would not be applied to contracts made before the order became effective but urged voluntary compliance as of the date of the announcement. It was clear that when the executive order became effective it would apply to P's computers. P estimates that the sale would generate earnings of $60 million and that short- and long-term costs entailed by completing the sale would not be significant. P nevertheless decides not to sign the contract because its officials believe that sale of the computers would contravene a strong and clearly announced national policy. P's action does not involve a departure from the principles stated in § 2.01. Although the amount of forgone income is high, it is reasonable under the circumstances.

25. The facts being otherwise as stated in Illustration 24, P signs the contract. P's action does not involve a departure from the principles stated in § 2.01.

h. Environmental impact. Greater attention to environmental risks among investors and the general public has pushed firms to incorporate environmental effects in corporate governance beyond simply complying with applicable environmental regulations. Section 2.01 provides a framework for how a corporation may do so. Depending on the firm, relevant environmental issues include concerns related to:

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- climate change, including carbon emissions, the carbon footprint of products, and climate-change vulnerability;
- natural resources, including water stress, biodiversity and land use, and raw-material sourcing; pollution and waste, including toxic emissions and waste, packaging material and waste, electronic waste;
- environmental opportunities, including opportunities in clean tech, green building, and renewable energy.

As discussed above with regard to the economic objective, corporate decisionmakers have discretion in making judgements regarding long-term profitability. Although a corporate decisionmaker must meet a standard of care in making decisions, that standard can be satisfied even when, as is often the case, the prospective benefits cannot be precisely stated or quantified. This flexibility encompasses decisions made with regard to environmental considerations. As with other considerations, however, there are limits to the extent to which a business corporation may make significant changes that are neither required by regulation nor likely to benefit shareholders. See Illustration 8 above.

Illustrations:

26. A logistics company, L, has operations all over the world. The relevant corporate decisionmaker makes a judgment, in a manner that meets the standards of § 4.02, to invest significant resources to shift its European delivery fleet towards low-carbon modes of transportation because it expects the countries of the European Union to adopt a significant carbon tax. L's action does not involve a departure from the economic objective stated in § 2.01.

27. A major oil-exploration-and-production company, O, is concerned about anthropocentric climate change and, furthermore, is concerned that regulation would be very expensive for its business. The relevant corporate decisionmaker makes a judgment, in a manner that meets the standards of § 4.02, to temporarily reduce its production of oil by five percent because doing so may generate favorable publicity, may lead other producers to reduce output, and may forestall costly regulation. O's action does not involve a departure from the economic objective stated in § 2.01.

28. A major oil-exploration-and-production company, P, commits to reduce its production of oil by 20 percent by 2035 and by 50 percent by 2050, backed by third-party

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verification, because of concerns about anthropocentric climate change. There is no current regulation that limits P's output, although future regulation is thought likely. The corporate decisionmaker provides the following justification: "This is a large reduction in our output. We are doing it because we believe that cutting greenhouse gases is necessary to prevent catastrophic temperature increases that threaten humanity. Our reduction, especially if other E & P companies join our initiative, can have a significant impact. We expect to thrive through the energy transition by providing the mix of products our customers need as the energy system evolves and to sustain our societal license to operate by being a responsible energy company that operates with care for people and the environment." P's action does not involve a departure from the economic objective stated in § 2.01.

i. Social considerations. Greater attention to social considerations among investors and the general public has pushed firms to consider social issues in corporate governance. As with environmental considerations, Section 2.01 provides a framework for a consideration of what firms may consider and how they may do so. Relevant social issues include: human capital (labor/management relations, health and safety, human-capital development, supply-chain labor standards, pay equity); diversity (board diversity, workforce diversity); and social opportunities (access to communications, finance, health care). As with environmental concerns, a corporate decisionmaker that meets the standard of care in making decisions has flexibility to take these considerations into account if they can be rationally tied to shareholder benefit (in common-law jurisdictions), and, even if they do not, under § 2.01(b). In stakeholder jurisdictions, the corporate decisionmaker may have even greater discretion to take these considerations into account.

Illustrations:

29. Q is a large, publicly held corporation. The relevant corporate decisionmaker makes a judgment, in a manner that meets the standards of § 4.02, that the corporation should increase the number of women in senior management positions because greater diversity in the ranks of management is likely to lead to better decisions. Q's action does not involve a departure from the economic objective stated in § 2.01.

30. Same facts as Illustration 29, but the relevant corporate decisionmaker makes a judgment that increasing the number of women in senior management positions is good because of a growing public (and shareholder) demand for greater gender diversity, even though the corporate decisionmaker is agnostic (or dubious) about whether doing so will

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improve the quality of decisions. Q's action does not involve a departure from the economic objective stated in § 2.01.

31. Company C has annual sales of $1 billion and around 15,000 employees. A service-oriented business, the corporate decisionmaker is conscious that C's profits depend on maintaining a high-quality workforce. In order to build loyalty among its employees, the corporate decisionmaker commits to paying top wages and keeping jobs in the U.S. C's action does not involve a departure from the economic objective stated in § 2.01.

j. Remedies. As pointed out in Comment *b*, this Section sets the general objective of the business corporation. It does not, in itself, establish a cause of action or provide a remedy, although a violation of this Section, in combination with other factors, might result in a cause of action or a remedy under Chapter 4, Duty of Care and the Business Judgment Rule; § 1.44, Waste of Corporate Assets; Chapter 5, Duty of Loyalty; or Chapter 6, Role of Directors and Shareholders in Transactions in Control and Tender Offers.

REPORTERS' NOTES

1. *Objective of the corporation*. There currently exist two main approaches to the "Objective of a Corporation." In the traditional, common-law approach that prevails in Delaware and other jurisdictions, the corporation is managed for the ultimate benefit of the shareholders. Like others, we will refer to this as "shareholder primacy," although, as the Comment makes clear, care must be taken in how that term is understood. Since the 1980s, many states have opted for some version of "other-constituency statutes" that reject some or all of Delaware's approach to shareholder primacy. In keeping with the current state of the law, this Restatement restates both approaches.

2. *The economic objective.* The proposition that the objective of a business corporation is the enhancement of the economic value of the corporation for the benefit of the shareholders has deep roots in corporate-law cases, both old and new. The Supreme Court of Michigan stated it in a forceful manner:

> A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.

Dodge v. Ford Motor Co., 204 Mich. 459, 507 (Mich. 1919). See also Hutton v. West Cork Ry., 23 Ch. D. 654 (C.A. 1883).

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1 3. *Summary of the cases and statutory basis.* Some cases, mostly arising at or before the
2 turn of the 19th century, applied the concept reflected in *Dodge v. Ford,* a strict notion of ultra
3 vires, or both, to strictly preclude the utilization of corporate resources, either by way of donation
4 or otherwise, for humanitarian, educational, philanthropic, or public welfare activities. See, e.g.,
5 Brinson Ry. Co. v. Exchange Bank, 85 S.E. 634 (Ga. Ct. App. 1915); McCrory v. Chambers, 48
6 Ill. App. 445 (1892); In re Branksea Island Co., 1 Meg. Company Cases 12 (C.A. 1888). However,
7 the general thrust of the emerging case law through the first half of the 19th century was that such
8 utilization was permissible if it was likely to produce a direct benefit to the corporation. Whetstone
9 v. Ottawa Univ., 13 Kan. 320, 340 (1874). See also, e.g., Corning Glass Works v. Lucas, 37 F.2d
10 798 (D.C. Cir. 1929), cert. denied, 281 U.S. 742 (1930); Virgil v. Virgil Practice Clavier 68 N.Y.S.
11 335 (1900); Steinway v. Steinway & Sons, 40 N.Y.S. 718 (1896); Note, *Corporate Donations:*
12 *Common Law, Statutory, and Constitutional Implications*, 29 IND. L.J. 295, 297 (1954); Note,
13 *Corporate Donations to Religious and Educational Bodies*, 37 NOTRE DAME L. REV. 206, 207,
14 208 (1961). As stated by Lord Justice Bowen in *Hutton*, "The law does not say that there are to be
15 no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of
16 the company."
17 Modern cases have continued to understand the basic objective of the corporation to be the
18 promotion of corporate value for the benefit of the shareholders, i.e., the shareholder-primacy
19 approach. In In eBay Domestic Holdings v. Newmark, 16 A.3d 1 (Del. Ch. 2010), two of the
20 founding partners of Craigslist who, collectively, held a controlling position, tried to entrench their
21 "community service" approach to doing business that was largely indifferent to monetization. In
22 rejecting the founders' attempt to implement a shareholder-rights plan, Chancellor William B.
23 Chandler III held that:
24 The corporate form in which craigslist operates, however, is not an appropriate
25 vehicle for purely philanthropic ends, at least not when there are other stockholders
26 interested in realizing a return on their investment. Jim and Craig opted to form
27 craigslist, Inc. as a for-profit Delaware corporation and voluntarily accepted
28 millions of dollars from eBay as part of a transaction whereby eBay became a
29 stockholder. Having chosen a for-profit corporate form, the craigslist directors are
30 bound by the fiduciary duties and standards that accompany that form. Those
31 standards include acting to promote the value of the corporation for the benefit of
32 its stockholders. The "Inc." after the company name has to mean at least that. Thus,
33 I cannot accept as valid for the purposes of implementing the Rights Plan a
34 corporate policy that specifically, clearly, and admittedly seeks not to maximize the
35 economic value of a for-profit Delaware corporation for the benefit of its
36 stockholders—no matter whether those stockholders are individuals of modest
37 means or a corporate titan of online commerce.
38 Id. at 34.
39 The shareholder-primacy view finds support from three separate sources. Leo E. Strine Jr.,
40 *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and*

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Accountability Structure Established by the Delaware General Corporation Law, 50 WAKE FOREST L. REV. 761 (2015).

First, corporation statutes uniformly create a governance structure in which shareholders are the sole participants with any significant power. Shareholders, and shareholders alone: elect directors; vote on charter amendments; vote on mergers; vote on sales of all or substantially all the assets; and vote on dissolution. Moreover, shareholders are the only participants who can bring derivative suits on behalf of the corporation against fiduciaries. This governance structure means that, at least when shareholding is concentrated or when catalysts of shareholder action are present, managers will pay special attention to the interests of shareholders.

The cases on directors' fiduciary duty reinforce the primacy of shareholders' interests. The most important cases arise in the special circumstances in which the interests of shareholders and of other stakeholders diverge and courts have the occasion to determine primacy. First, when a corporation is sold for cash, all of the shareholders will be cashed out and will no longer have any long-term interests in the corporation as shareholders. At that point, the conflict between shareholders' interests in securing the highest price for their shares and the interests of other stakeholders such as employees (who may have an interest in avoiding layoffs), creditors (who may have an interest in retaining earnings and avoiding leverage), customers (who may have an interest in high quality products at low prices), and communities (who may have an interest in maintaining local production) becomes inescapable. In those circumstances, courts in traditional jurisdictions that have addressed the issue have generally made clear that the duty of the board is to secure the highest value reasonably available for shareholders, and the board may not balance the interests of shareholders against the interests of other stakeholders. This is the clear holding of Delaware's *Revlon* case and a long line of other cases. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1958) ("The Revlon board's authorization permitting management to negotiate a merger or buyout with a third party was a recognition that the company was for sale. The duty of the board had thus changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit. . . . The directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1264 (Del. 1989) ("Our decision in *Revlon* . . . requires the most scrupulous adherence to ordinary standards of fairness in the interest of promoting the highest values reasonably attainable for the stockholders' benefit."); Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989) ("When it becomes clear that the auction will result in a change of corporate control, the board must act in a neutral manner to encourage the highest possible price for shareholders"); Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 48 (Del. 1994) ("Since the Paramount directors had already decided to sell control, they had an obligation to continue their search for the best value reasonably available to the stockholders."). See also, *eBay Domestic Holdings*, 16 A.3d at 34.

Chancellor William T. Allen distilled the logic and meaning of *Revlon* in TW Servs., Inc. v. SWT Acquisition Corp.:

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> I take it as non-controversial that, under established and conventional conceptions, directors owe duties of loyalty to the corporation and to the shareholders; that this conjunctive expression is not usually problematic because the interests of the shareholders as a class are seen as congruent with those of the corporation in the long run; that directors, in managing the business and affairs of the corporation, may find it prudent (and are authorized) to make decisions that are expected to promote corporate (and shareholder) long run interests, even if short run share value can be expected to be negatively affected, and thus directors in pursuit of long run corporate (and shareholder) value may be sensitive to the claims of other "corporate constituencies." Thus, broadly, directors may be said to owe a duty to shareholders as a class to manage the corporation within the law, with due care and in a way intended to maximize the long run interests of shareholders.
>
> There is a time, however, when the board's duty becomes more targeted and specific and its range of options becomes narrower. In *Revlon* . . ., the board of directors had decided in the exercise of its judgment to engage in a sale transaction that might terminate the interest of all of the existing holders of stock. In that circumstance, the Supreme Court held that the board's duty was the single one: to exercise its judgment in an effort to secure the highest price available. . . .
>
> In the setting of a sale of a company for cash, the board's duty to shareholders is inconsistent with acts not designed to maximize present share value, acts which in other circumstances might be accounted for or justified by reference to the long run interest of shareholders. In such a setting, for the present shareholders, there is no long run. For them it does not matter that a buyer who will pay more cash plans to subject the corporation to a risky level of debt, or that a buyer who offers less cash will be a more generous employer for whom labor peace is more likely. The rationale for recognizing that non-contractual claims of other corporate constituencies are cognizable by boards, or the rationale that recognizes the appropriateness of sacrificing achievable share value today in the hope of greater long term value, is not present when all of the current shareholders will be removed from the field by the contemplated transaction.

CIV A. Nos. 10427, 10298, 1989 WL 20290, *7 (Del. Ch. Mar. 2, 1989) (citations omitted).

Second, a corporation with a single shareholder, such as a wholly owned subsidiary, presents a situation in which the "shareholder's interest" is clear and expressed and is not blurred by any heterogeneity among shareholders or difficulties of dispersed shareholders acting together.

The cases addressing the relationship between wholly owned subsidiaries and parent companies fully embrace shareholder primacy and hold that the duty of the wholly owned (and solvent) subsidiary is to serve the parent/sole stockholder. Trenwick American Litig. Trust v. Ernst & Young, LLP, 906 A.2d 168, 201 (Del. Ch. 2006), citing Anadarko Petroleum Corp. v. Panhandle E. Corp., 545 A.2d at 1174 (citing Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)). See also Quadrant Structured Prods. Co. v. Vertin, 103 A.3d 155, 184 (Del. Ch. 2014) ("When a

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controller owns 100% of a corporation's equity and the subsidiary is solvent, the interests of the corporation and its fiduciaries are fully aligned with those of the controller. The fiduciary duties of the directors and officers require that the subsidiary be managed for the benefit of the controller, and the fiduciary duties imposed on the controller self-referentially require the same thing.") The director of a wholly owned subsidiary owes no duty "to second-guess the business judgment of its parent corporation when following and supporting the parent's strategy would not violate any legal obligation the subsidiary owes to another." *Trenwick*. This is true even if the parent company board intentionally took actions that made the subsidiary less valuable as an entity. Id.

The form of enterprise form chosen for the subsidiary may affect this relationship. Thus, for example, when a parent incorporates a subsidiary as a "benefit corporation" under the relevant provisions of the state's corporation law, the commitment to nonshareholder interests required by that form will affect the extent to which the subsidiary is run for the benefit of the parent.

Similarly, when a company has a complex capital structure with common stock, preferred stock, and debt, and the interests of the different classes of investors diverge, the courts have been clear that the duties of the board run to the common stockholders. Katz v. Oak Indus., 508 A.2d 873 (Del. Ch. 1986); Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584 (Del. Ch. 1986); HB Korenvaes Inv., L.P. v. Marriott Corp., Civ. A. No. 12922, 1993 WL 205040 (Del. Ch. June 9, 1993); Equity-Linked Investors L.P. v. Adams, 705 A.2d 1040 (Del. Ch. 1997); In re Trados Inc. S'holder Litig., Civ. Action No. 1512-CC, 2009 WL 2225958 (Del. Ch. July 24, 2009); LC Capital Master Fund, Ltd. v. James, 990 A.2d 435 (Del. Ch. 2010).

Third, the history of reform efforts provides further evidence that shareholder primacy, in the sense described above, is the legal standard in the traditional jurisdictions. Two separate reform efforts illustrate this point. When, during the 1980s, Delaware first articulated the *Revlon* principle that clarified shareholder primacy in the sale of a company context, there was push back in other states. Thus, Pennsylvania, in enacting what was considered to be one of the toughest antitakeover statutes, amended its corporate law to make it clear that boards could consider the interests of all stakeholders and need not give shareholders' interest primacy. Armstrong World Indus. v. Adams, 961 F.2d 405 (3d Cir. 1992). As will be discussed in detail in Reporters' Note 5, at least 32 states have adopted similar statutes. These statutes would not have been necessary except that the majority rule, as reflected in *Revlon*, made it clear that unless a state changed its law, shareholder primacy was likely to control and require the board to sell the company to the highest bidder.

More recently, the successful efforts to enact benefit corporation provisions were justified as necessary because the existing law would not permit such a deviation from shareholder primacy. The provision in Delaware General Corporation Law § 365(a) that explicitly permits the board of directors to "manage or direct the business and affairs of the public benefit corporation in a manner that balances the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct, and the specific public benefit or public benefits identified in its certificate of incorporation[,]" DEL. CODE ANN. tit. 8, § 365 (West 2020), would not have been necessary if directors of "regular" corporations already could do so.

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4. *Corporate purpose*. In recent years, a movement to reorient large business enterprise towards greater concern for stakeholder interests has gathered steam in both the United States and the United Kingdom. Prominent stakeholder-focused statements include: the Business Roundtable's 2019 "Statement on the Purpose of a Corporation," which committed to delivering value to all of their stakeholders (customers, employees, suppliers, communities, and shareholders), without addressing the relative priority. Statement on the Purpose of a Corporation (BUS. ROUNDTABLE, Aug. 19, 2019), https://s3.amazonaws.com/brt.org/BRT-StatementonthePurposeofaCorporationJuly2021.pdf; the World Economic Forum's 2016 "New Paradigm," The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth (WORLD ECON. F. Sept. 2016) https://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.25960.16.pdf, and its 2020 "Davos Manifesto," Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution (WORLD ECON. F. Dec. 2, 2019), https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/; BlackRock chief executive officer Larry Fink's annual letters to CEOs beginning in 2015, see, e.g., https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter; the British Academy's 2021 "Policy & Practice for Purposeful Business," THE BRITISH ACADEMY, POLICY & PRACTICE FOR PURPOSEFUL BUSINESS: THE FINAL REPORT OF THE FUTURE OF THE CORPORATION PROGRAMME (2021), https://www.thebritishacademy.ac.uk/publications/policy-and-practice-for-purposeful-business/; and the UK Financial Reporting Council's 2018 Corporate Governance and 2020 Stewardship Codes, FINANCIAL REPORTING COUNCIL, THE UK CORPORATE GOVERNANCE CODE, 2018, https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code; FINANCIAL REPORTING COUNCIL, THE UK STEWARDSHIP CODE 2020, https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf.

These various statements coalesce around a common vision of corporate governance that Martin Lipton, a prominent commentator on corporate law and one of the founding partners of the New York law firm Wachtell, Lipton, Rosen & Katz, has summarized as follows:

> The purpose of a corporation is to conduct a lawful, ethical, profitable and sustainable business in order to ensure its success and grow its value over the long term. This requires consideration of all the stakeholders that are critical to its success (shareholders, employees, customers, suppliers, communities and society), as determined by the corporation and its board of directors using their business judgment and with regular engagement with shareholders, who are essential partners in supporting the corporation's pursuit of its purpose."

Martin Lipton, *On the Purpose of a Corporation*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (May 27, 2020) https://corpgov.law.harvard.edu/2020/05/27/on-the-purpose-of-the-corporation/.

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This vision of a stakeholder-oriented corporate governance that leads to long-term value creation is consistent with the statement in the black letter in both traditional and stakeholder jurisdictions, although, under current law, not mandated by either. To the extent that there are serious tradeoffs between the interests of shareholders and other stakeholders, the choice to incorporate in a traditional jurisdiction or a "stakeholder" jurisdiction or as a "benefit corporation" will affect how much flexibility exists. If this movement continues to grow, it could result in changes in the law applicable to public corporations, large corporations, or even all corporations.

4. Expenditures for public welfare, humanitarian, educational, and philanthropic purposes. Importantly, however, the shareholder-primacy principle does not mean the directors have an obligation to maximize short-term stock price. On the contrary, the modern cases have, in effect, dropped the older direct-benefit test and permitted the utilization of corporate resources for public welfare, humanitarian, educational, or philanthropic purposes without requiring a showing that a direct benefit is likely. This result has been achieved through two kinds of approaches. Under the first approach, the courts have in effect conclusively presumed that the utilization was for a profit-maximizing purpose, even when the evidence pointed the other way. See, e.g., Shlensky v. Wrigley, 237 N.E.2d 776 (1968); Union Pacific R.R. v. Trustees, Inc., 329 P.2d 398, 401–402 (1958); Kelly v. Bell, 266 A.2d 878 (Del. 1970). Under the second approach, using corporate resources for such purposes has been recognized as a legitimate end in itself, either on the ground that there is an independent social policy to maintain diversified centers of such activity, and full effectuation of that policy depends upon and therefore justifies corporate support, or on the ground that activity that maintains a healthy social system necessarily serves a long-run corporate purpose. See, e.g., Theodora Holding Corp. v. Henderson, 257 A.2d 398 (Del. Ch. 1969); State ex rel. Sorensen v. Chicago, B. & Q. Ry., 199 N.W. 534 (1924); 98 A.2d 581 (1953); Union Pacific R.R. v. Trustees, Inc., 329 P.2d 398, 400–401 (1958).

Generally speaking, however, under both approaches, the modern cases have invoked a limit of reasonableness on the utilization of corporate resources for public welfare, humanitarian, educational, or philanthropic purposes. For example, in *Union Pacific R.R.*, the court held that corporations have authority to make "contributions of reasonable amounts to selected charitable, scientific, religious or educational institutions, if they appear reasonably designed to assure a present or foreseeable future benefit to the corporation." In *Sorenson* the court stated: "We see no reason why a railroad corporation may not, to a reasonable extent, donate funds or services to aid in good works." Although the cases do not make explicit how reasonableness is to be determined, the authorities are consistent with the proposition that the paramount factors are the customary level of such expenditures and assets and the strength of the nexus between the use of corporate resources and the corporation's business.

For data on the level of corporate contributions, see THE CONFERENCE BOARD, GIVING IN NUMBERS: 2019 Edition. The Conference Board data is drawn from survey responses of more than 300 of the world's largest companies. For 2018, median contributions represented 0.94 percent of pretax profit.

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5. *Stakeholder jurisdictions.* As noted above, the Delaware Supreme Court's decision in the *Revlon* case—which was widely understood as requiring a board of directors, in selling a corporation, to prioritize shareholder value—led many states to adopt statutes designed to give boards of directors greater discretion in the sale-of-company context and more generally to consider the interests of nonshareholder constituencies ("constituency statutes"). These statutes can be divided into three types:

Modified shareholder-primacy statutes: These statutes, adopted in somewhere around 17 states, make clear that a board must consider the best interests of the shareholders and that it *may* consider other listed factors, and they usually include a generic phrase, i.e., "and other factors the board deems appropriate." ARIZ. REV. STAT. ANN. § 10-2702; GA. CODE ANN. § 14-2-202(b)(5); HAW. REV. STAT. § 414-221(b); IDAHO CODE ANN. §§ 30-1602, 30-1702; 805 ILL. COMP. STAT. 5/8.85; KY. REV. STAT. ANN. § 271b.12-210(4); ME. REV. STAT. tit. 13–C § 831(6); MISS. CODE ANN. § 79-4-8.30(f) NEB. REV. ST. ANN. § 21-2,102(a)(2); N.J. STAT. ANN. § 14a:6–1(2) & (3) (West); N.M. STAT. ANN. § 53-11-35(d); OHIO REV. CODE ANN. § 1701.59(f); R.I. GEN. LAWS § 7-5.2-8(a); S.D. CODIFIED LAWS § 47-33-4(1); TEX. BUS. ORGS. CODE ANN. § 21.401(b)–(e); WIS. STAT. § 180.0827; WYO. STAT. ANN. § 17-16-830(g).

New Jersey's statute is a fairly typical example:

> In discharging his duties to the corporation and in determining what he reasonably believes to be in the best interest of the corporation, a director may, in addition to considering the effects of any action on shareholders, consider any of the following: (a) the effects of the action on the corporation's employees, suppliers, creditors and customers; (b) the effects of the action on the community in which the corporation operates; and (c) the long term as well as the short-term interests of the corporation and its shareholders, including the possibility that these interests may best be served by the continued independence of the corporation.

N.J. STAT. ANN. § 14A:6-1(2) (West 1989).

Level-playing-field statutes: This sort of statute, adopted in approximately 10 states, lists the factors a board *may* consider and ostensibly includes the interests of shareholders as of equal rank with other listed constituencies. CONN. GEN. Stat. § 33-756(d); FLA. STAT. § 607.0830(3); MD. CODE. ANN., CORPS. & ASS'NS. § 2-104(b)(9); MASS. GEN. LAWS ch. 156D, § 8.30(a)(3); MINN. STAT. § 302A.251 subd. 5; MO. REV. STAT. § 351.347; OR. REV. STAT. § 60.357(5); N.D. CENT. CODE § 10-19.1-50(6); TENN. CODE. ANN. § 48-103-204; VT. Stat. Ann. tit. 11, § 8.30(a)(3).

Massachusetts' statute is a fairly typical example:

> A director shall discharge his duties as a director, including his duties as a member of a committee:
>
>> (3) in a manner the director reasonably believes to be in the best interests of the corporation. In determining what the director reasonably believes to be in the best interests of the corporation, a director may consider the interests of the corporation's employees, suppliers, creditors and customers, the economy of the state, the region and the nation, community and societal

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> considerations, and the long–term and short–term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation.

MASS. GEN. LAWS ch. 156D, § 8.30(a)(3).

Strong-form level-playing-field statutes: A third type, adopted in five states, contains language making it clear that the board may, without liability, totally sublimate some of the listed factors to others. IND. CODE § 23-1-35-1(f); IOWA CODE § 491.101B(2); NEV. REV. STAT. § 78.138(4); N.Y. BUS. CORP. LAW § 717(b); 15 PA. CONS. STAT. ANN. § 1715(b).

While each state's statute is unique, the essence is captured by Pennsylvania's statute, § 1715(b):

> Consideration of interests and factors. The board of directors, committees of the board and individual directors shall not be required, in considering the best interests of the corporation or the effects of any action, to regard any corporate interest or the interests of any particular group affected by such action as a dominant or controlling interest or factor. The consideration of interests and factors in the manner described in this subsection and in subsection (a) shall not constitute a violation of section 1712 (relating to standard of care and justifiable reliance).

6. *The judicial interpretation of stakeholder statutes.* There is a paucity of cases interpreting stakeholder statues and even fewer cases in which a litigant governed by a stakeholder statute relied in any detailed way on consideration of other constituencies or in which a court reviewed with any precision why the stakeholder provision validated board action. In AMP, Inc. v. Allied Signal, Inc. Civ. A. Nos. 98-4405, 98-4058, 98-4109, 1998 WL 778348 (E.D. Pa. Oct. 8, 1998), the court discussed at length the right of a board in a stakeholder jurisdiction to consider other constituencies without ever discussing what, if any, other constituencies the target's board *actually* considered, much less analyzing them. In Dixon v. Ladish Co., 785 F. Supp. 2d 746 (E.D. Wisc. 2011), the court granted a motion to dismiss claims for, inter alia, breach of fiduciary duty based in large part on the existence of Wisconsin's stakeholder statute without detailing precisely how it aided the target's board other than in the negation of *Revlon*-type duties.

In a few opinions, courts have used a state's stakeholder statute to validate defensive tactics that, in Delaware, are permitted on a traditional basis. See, e.g., Baron v. Strawbridge & Clothier, 646 F.Supp. 690, 698 (E.D. Pa. 1986); Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984, 1009 (E.D. Wis. 1989); Georgia-Pacific Corp. v. Great N. Nekoosa Corp., 727 F. Supp. 31, 33 (D. Me. 1989).

In some states, courts have effectively converted a stakeholder statute into a shareholder-primacy jurisdiction. Thus, for example, at least three courts have rejected the notion that a constituency statute will insulate a board from the heightened scrutiny articulated in Blasius Indus., Inc. v. Atlas Corp, 564 A.2d 651 (Del. Ch. 1998) when allegations are made that a board has improperly interfered with the voting rights of shareholders. IBS Fin. Corp. v. Seidman & Assocs., L.L.C., 136 F.3d 940, 949–950 (3rd Cir. 1998) (rejecting the application of New Jersey's

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constituency statute); Shoen v. AMERCO, No. CV-N-94-0475-ECR, 885 F.Supp. 1332, at n. 22 (D. Nev. Oct. 6, 1994) (rejecting an application of Nevada's constituency statute); and Ipalco Enters. v. PSI Resources, No. IP 93-325-C, 1993 U.S. Dist. LEXIS 19805, n. 9 (S.D. Ind. June 18, 1993) (rejecting application of Indiana's constituency statute). In Flake v. Hoskins, the court went a step further and largely excluded the consideration of nonshareholder interests:

> The possible factors to consider under *Revlon* track those listed in R.S.MO. § 351.347. The only noticeable difference is that Section 351.347(1)(4) allows the board to consider the effect of the sale on other constituencies, without expressly requiring a link to general shareholder interests. This difference does not appear to be significant, however, because in all business actions, a corporate board of directors owes a fiduciary duty to shareholders and must generally operate for their benefit. Any consideration of other constituencies must therefore have at least a reasonable relationship to the general interests of shareholders. The Court therefore finds that Missouri law does not differ in any way that would eliminate the duties of the JCN board under *Revlon*.

55 F. Supp. 2d 1196, 1214 (D. Mo. 1999).

An early evaluation by the ABA's Committee on Corporate Laws concluded:

> The Committee believes that the better interpretation of these statutes . . . is that they confirm what the common law has been: directors may take into account the interests of other constituencies but only as and to the extent that the directors are acting in the best interests, long as well as short term, of the shareholders and the corporation. While the Delaware courts have related the consideration directors may give other constituencies to the interests of shareholders by stating there must be "rationally related benefits to shareholders," it may well be that other courts may choose other words with which to express the nexus.

Committee on Corporate Laws, *Other Constituencies Statutes: Potential for Confusion*, 45 BUS. LAW. 2253, 2269 (1990).

The clearest implication that can be drawn from the stakeholder statutes is the legislative desire to give a board more discretion in contests for corporate control than the Delaware Supreme Court provided in the *Revlon* decision. Eleven statutes (CT, ID, KY, MD, IA, IN, MO, NY, OR, SD, and TN) only apply, by their express terms, in a business combination, tender offer, or change-in-control context. Eleven others (AZ, HI, MA, MN, MS, NV, ND, OH, PA, TX, and VT) ostensibly apply in all contexts, but nonetheless include, as a factor that may be weighed, "the long-term and short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation." MASS. GEN. LAWS ch. 156D, § 8.30(a)(3). In these instances, the motivation is relatively unambiguous. Pennsylvania enacted one of the most-cited statutes, 15 PA. CONS. STAT. ANN. § 1715, during the pendency of a contested takeover offer for Armstrong World Industries. See Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795, 1858 (2002).

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Beyond this, the doctrinal implications are unclear. Although the statutes stating that shareholder interests need not be taken to be primary—as in Pennsylvania, Nevada, Indiana, Iowa, and New York—could and perhaps should, in theory, justify substantial departure from the common law/traditional goal of promoting the value of the corporation for the benefit of shareholders, there are few if any cases outside of the control context that can be cited to support such a view. The treatment of the noncontrol contest Illustrations in the Comment reflects this paucity of authority.

7. *Section 2.01(b) corporate contributions*. Virtually all states have now adopted statutory provisions relating to corporate contributions. See, generally, R. Frank Balotti and James J. Hanks, Jr., *Giving at the Office: A Reappraisal of Charitable Contributions by Corporations*, 54 BUS. LAW. 965 (1999). Typical is Model Business Corporation Act § 3.02(m), which provides that every corporation has power "to make donations for the public welfare or for charitable, scientific or educational purposes." See also I. R. C. § 170. Although typically these provisions do not explicitly incorporate a limit of reasonableness, the commentators generally agree that such a limit is to be implied:

> The usual location of such statutes is among the traditional recitations of general corporate powers, such as the right of perpetual succession, amenity to suit and access to the courts, the acquisition and disposition of property, the use of a corporate seal, etc. It is beyond dispute that each of these powers can be employed by corporate representatives only in the interests of the corporation. The directors and officers cannot cause a corporation to acquire property or use its seal for purposes which are foreign to it or unconnected with its interest or benefit. Nothing in the provisions relating to corporate donations changes this principle. Nor does there appear to be any need to do so by affording such statutes a unique construction.
>
> The principle of a protected area for managerial discretion is sufficient to permit management to function without fear of harassment or liability. There should be no doubt that the dictum of Dodge v. Ford has not been emasculated by these statutes. The conversion of a business corporation into an eleemosynary institution would still be improper, as would be the giving away of all or a substantial part of the corporate assets or a constant unbalanced feeding of a "pet" charity without regard for the corporate welfare.

Bert S. Prunty Jr., *Love and the Business Corporation*, 46 VA. L. REV. 467 (1960). Of particular significance is the commentary of Ray Garrett, a principal figure in the drafting history of the Model Act:

> [D]onations should be reasonable in amount in the light of the corporation's financial condition, bear some reasonable relation to the corporation's interest, and not be so "remote and fanciful" as to excite the opposition of shareholders whose property is being used. Direct corporate benefit is no longer necessary, but corporate interest remains as a motive.

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Ray Garrett Jr., *Corporate Donations*, 22 BUS. LAW. 297 (1967). See also 6A WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 2939 (1989 rev. vol.).

8. *Modification of the economic objective.* Section 2.01 does not address the question of when a corporation organized under a business-corporation law may restrict the general profit-making objective by a shareholders' agreement or charter provision. This is a complex question as to which there is substantial legal uncertainty.

The clearest ways to depart from at least certain elements of the shareholder-primacy objective are: (a) to incorporate as a nonprofit corporation; (b) to incorporate as a "benefit corporation;" or (c) to incorporate in a stakeholder jurisdiction.

In most states, there is a separate statute for nonprofit corporations. See, generally, Restatement of the Law, Charitable Nonprofit Organizations (AM. L. INST. 2021). The key constraint in a nonprofit corporation, and a condition to tax exempt status, is that there be no distributions to shareholders or members. Henry Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L. J. 835, 838–839 (1980). Although there are some major enterprises organized as nonprofit corporations—most prominently in the health field—the nondistribution constraint makes it an extreme departure from shareholder primacy that provides no flexibility for a corporate objective that considers both shareholder and nonshareholder interests.

Today, the clearest way to depart from shareholder primacy without becoming a nonprofit is to form as a "benefit corporation," a legal form now available in 34 states. https://benefitcorp.net/policymakers/state-by-state-status. Firms that organize as benefit corporations must specify a "public benefit" that will be given priority, and, when they do, directors' duties shift and "[t]he board of directors shall manage or direct the business and affairs of the public benefit corporation in a manner that balances the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct, and the specific public benefit or public benefits identified in its certificate of incorporation." Del. Gen. Corp. L. 365(a). See also MODEL BENEFIT CORP. LEGIS. § 301 (BENEFIT CORP. 2017). A firm can organize as a benefit corporation from the outset or shift midstream by amending its certificate of incorporation or merging into an existing benefit corporation.

As discussed above, while many jurisdictions have adopted stakeholder statutes that, in principle, allow firms to depart from shareholder primacy, the case law interpreting those statutes is sparse, and courts vary in the extent to which they interpret them as allowing substantial departure from shareholder primacy outside of the sale-of-control context.

Far less clear is whether a firm may opt out of shareholder primacy by original charter provision or by charter amendment. This issue arose during the movement to enact benefit-corporation provisions when some argued that such benefit-corporation provisions were unnecessary because firms could already modify their economic objective by charter provision. There is a rich literature on this question. Joan Heminway, *Shareholder Wealth Maximization as a Function of Statutes, Decisional Law, and Organic Documents*, 74 WASH. & LEE L. REV. 939, 956–969 (2017); George Mocsary, *Freedom of Corporate Purpose*, 2016 B.Y.U. L. REV. 1319, 1359–1362 (2016). For arguments that a charter provision would suffice, see, e.g., Principles of

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1 Corporate Governance: Analysis and Recommendations, § 2.01, Reporter's Notes 6 (AM. L. INST.
2 2008).
3 The benefit-corporation provisions in states' corporation laws are quite new, and the extent
4 to which they will influence the interpretation of other provisions is unclear. While forming as a
5 benefit-corporation (or converting into a benefit corporation) provides the greatest legal certainty,
6 one cannot rule out the possibility that a firm may opt out of the economic objective at least by
7 original charter provision and possibly by mid-stream charter amendment. On the other hand, there
8 is very little law on this subject. In light of the changes in the law and the lack of binding legal
9 authority, the Restatement takes no position on whether, how, and the extent to which the objective
10 of the corporation may be varied by charter provision.

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