NYU JOURNAL OF
Law & Business

VOLUME 20 SUMMER 2024 NUMBER 3

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New York University Journal of Law & Business
Cite as N.Y.U. J.L. & Bus.
ISSN #1558-5778

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The *Journal* is available electronically on the Westlaw and LEXIS-NEXIS systems, and on the Internet at www.nyujlb.org. Individual issues, microfilm editions, and prior volumes also can be obtained directly from William S. Hein & Co., Inc., 2350 North Forest Road, Getzville, New York 14068, but might not be offered at our NYU prices.

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NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 20 SUMMER 2024 NUMBER 3

FOREWORD

EMILIANO CATAN*, ROBERT JACKSON**, & EDWARD ROCK***

Directors and officers owe fiduciary duties because of their status, but when and why do "controlling stockholders" owe fiduciary duties?[1] What fiduciary duties do they owe? And why? These issues are among the most important in corporate law.[2] In the wake of recent Delaware Supreme Court cases such as *In re Match Group*, they are also among the most timely.[3] The following article is an important analysis of this set of topics by a long-time Vice Chancellor, J. Travis Laster, of the Delaware Court of Chancery. Along with his important recent opinion

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1. *See generally* McMahon v. New Castle Assocs., 532 A.2d 601, 604 (Del. Ch. 1987) (explaining that "[a]mong the most ancient headings" of "Chancery's traditional jurisdiction over corporate directors and officers" is the view that "[t]he duties [directors and officers] owe [arise from] their legal power over corporate property"; although "[o]ne may place trust in a workman of any sort," "it would hardly be contended that such trust would warrant chancery's assuming jurisdiction over a claim that a workman . . . caused injury by want of due care," "although a claim of that very type against [an officer or director] will be entertained in a court of equity").

2. For that reason, these questions have received extensive attention in the scholarly literature. *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698 (1982); Marcel Kahan, *Sales of Corporate Control*, 91 J. L. ECON. & ORG. 368 (1993); Lucian Arye Bebchuk, *Efficient and Inefficient Sales of Corporate Control*, 109 Q.J. ECON. 957 (1994); Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV 785 (2003).

3. *In re* Match Group, Inc. Deriv. Lit., 315 A.3d 446 (Del. 2024).

in *Sears Hometown*,[4] it richly deserves the attention of anyone concerned with controlling stockholders' role in corporate law and corporate governance.

Roughly speaking, there are three general approaches to understanding controller fiduciary duties. One approach is to say that control, by itself, does not impose any fiduciary duties unless and until a controller engages in a conflict of interest transaction or otherwise takes control of the "levers" of the corporation. On this view, when a controller does so, it owes the same fiduciary duties as an officer or director. A second approach is to say that a controller, simply by virtue of becoming a controller, takes on fiduciary duties "equivalent" to those of a director or officer. A third approach is to say that a controller takes on fiduciary duties upon becoming a controller, but those fiduciary duties are substantially narrower and less all-encompassing than a director or officer's fiduciary duties.

The article that follows makes (at least) two important contributions. First, it provides a deeply researched and argued rejection of the "equivalency" thesis. It shows convincingly that courts that have said that controllers, merely by virtue of being controllers, owe the "same" fiduciary duties as directors were either speaking loosely or were simply incorrect.

Second, having rejected the equivalency thesis, the article provides a new foundation for understanding controllers' more limited but still important fiduciary duties. On Vice Chancellor Laster's analysis, the duty of care largely carries over to this context intact: like directors, controllers owe a general duty not to harm the interests of the corporation or stockholders through grossly negligent or intentional action. Thus, when selling a control bloc, a controller can be held liable for selling to a "looter."[5]

The major differences relate to the duty of loyalty. In Vice Chancellor Laster's view, unlike directors, controllers do not owe a general duty to act in the good faith pursuit of the corporation's best interests, although controllers may assume such a

4. *In re* Sears Hometown and Outlet Stores, Inc. S'holder Litig., 309 A.3d 474, 508 (Del. Ch. 2024) ("Delaware decisions . . . disconfirm the assertion that controllers owe director-equivalent fiduciary duties of loyalty and care when exercising stockholder rights. A controlling stockholder owes fiduciary duties when exercising stockholder powers, but not the same duties as a director owes.").

5. *See, e.g.*, *id.* at 509 n.24 (citing, *inter alia*, Ford v. VMWare, Inc., 2017 WL 1684089 (Del. Ch. 2017)).

duty when they take the levers of the corporation and thereby displace the directors. But controllers do owe a general duty not to harm the interests of other stockholders.

On this account, conflict of interest transactions are problematic because the controller potentially benefits at the expense of the non-controlling stockholders. The approach raises an interesting question relating to controller transactions: does preferential treatment for the controller per se violate the controller's duty of loyalty, or only when it comes at the expense of the non-controlling stockholders?[6] The "no-harm" principle might seem to require that the preferential treatment comes at the expense of non-controlling stockholders. But one could also argue that conflict of interest transactions present such *risk* of harm to non-controlling stockholders that, as a prophylactic measure, differential treatment alone should suffice.

More controversially, on Vice Chancellor Laster's analysis, the "no-harm" principle extends beyond the transactional context to the exercise of stockholder-level rights like voting.[7] This move raises a variety of fascinating issues including the fiduciary analysis of votes on transactions, bylaws and directors. Here, the discriminating factor is whether a vote preserves the status quo or changes it. To a first approximation, preserving the status quo does not trigger a fiduciary duty analysis, but changing it will be constrained by the "no-harm" principle.[8]

This approach, of course, places a great deal of importance on being able to distinguish between votes that preserve the status quo and those that change it, a distinction that immediately raises the question of the relevant baseline. To take one example that Vice Chancellor Laster discusses at length, when Conrad Black, the controller of Hollinger International, used his control to enact a bylaw requiring unanimous director approval, was that status quo preserving or status quo changing? On the one hand, it was designed to preserve his control (status

---

6. Lawrence A. Hamermesh, Jack B. Jacobs, Leo E. Strine, Jr., *Optimizing the World's Leading Corporate Law: A Twenty-Year Retrospective and Look Ahead*, 77 BUS. LAW. 321, 349-50 (2022).

7. *See In re* Sears Hometown and Outlet Stores, Inc. Stockholder Litigation, 309 A.3d at 510 (citing Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 845 (Del. 1987) ("Stockholders in a Delaware corporation have a right to control and vote their shares in their own interest. They are limited *only by any fiduciary duty owed to other stockholders*." (emphasis added)).

8. J. Travis Laster, *The Distinctive Fiduciary Duties that Stockholder Controllers Owe*, 20 N.Y.U. J. L. & BUS. 463, 502 (Sep. 2024).

quo preserving?), while on the other, it was designed to frustrate his agreement to cooperate with a sale process overseen by the controlled company's board (status quo changing?).[9]

Finally, having provided an account of controller fiduciary duties that is narrower than director fiduciary duties, Vice Chancellor Laster argues that this narrower account implies that courts need not be so anxious about the consequences of denoting a stockholder as a "controller." This implication depends, at least in part, on whether the courts' reluctance is driven by the "equivalency" thesis or other considerations. To be sure, if driven by the equivalency thesis, Vice Chancellor Laster's rebuttal of that thesis should make courts more willing to adopt a more flexible understanding of control. If, on the other hand, as explored below, the reluctance is driven by other considerations – e.g., a concern about vexatious litigation – then refuting the equivalency thesis will have a more limited impact.

Will the corporate law ecosystem find Vice Chancellor Laster's analysis persuasive? One can expect pushback from several directions. First, given that, under his analysis, nearly any decision or transaction in which a controller is involved will trigger a fiduciary duty analysis that will likely be analyzed under either "enhanced scrutiny" or "entire fairness," some will argue that this is a substantial *expansion* of controllers' fiduciary duties compared to the more "categorical" analysis of the narrow view of controllers duties. In particular, Vice Chancellor Laster's analysis rejects the conventional interpretation of *Bershad v. Curtis-Wright* as affording controllers the unfettered ability to vote their shares "selfishly," a proposition that traditionally relies on the opening sentence of the key section in the opinion, namely: "Stockholders in Delaware corporations have a right to control and vote their shares in their own interest."[10]

On the Vice Chancellor's reading, this broad permission must be understood as being limited by the next sentences: "They are limited only by any fiduciary duty owed to other stockholders. It is not objectionable that their motives may

---

9. Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1030 (Del. Ch. 2004), *aff'd*, 872 A.2d 559 (Del. 2005).

10. *Bershad*, 535 A.2d at 845. Although academics often invoke *Bershad* for the broader principle, in recent work one of us has examined the limitation on *Bershad*'s language closely, exploring what that Article calls "the right to vote selfishly." Marcel Kahan & Edward Rock, *Systemic Stewardship with Tradeoffs*, 48 J. CORP. L. 497 & n.92 (2023).

be for personal profit, or determined by whim or caprice, so long as they violate no duty owed other shareholders." This oft-neglected limitation immediately raises the question of the fiduciary duties that controllers owe to other stockholders in voting their shares. For Laster, those duties include a duty of "no-harm" to other stockholders. This reading of *Bershad* implies that controllers do not have an unlimited right to vote their shares "selfishly" but, rather, that a controller's decision to vote its shares will be subject to a fiduciary analysis, even if that analysis is limited (because a controller's fiduciary duties are limited).

Second, Laster argues that his rejection of the "equivalency" thesis (and the resulting limitation of the controller's fiduciary duties in comparison to directors' and officers' duties) should make courts more comfortable with a flexible, multi-factor approach to determining control. But the expansion of fiduciary analysis beyond conflict of interest transactions to include nearly any involvement of a controller in corporate decision-making will lead others to conclude that a narrow definition is even more essential.

Third, observers are likely to view Laster's broader fiduciary framework through a procedural lens and argue that it will make it hard or even impossible to dismiss claims involving a controller short of trial. This, they will argue, will increase the settlement value of any claim involving a controller, a result in tension with the Delaware courts' decade long effort to promote pre-trial dismissal of claims.[11]

Finally, still others will argue that Laster's analysis is trapped in the view that a controlling stockholder threatens non-controlling stockholder interests through taking "private benefits of control" without appreciating the significant benefits that come with controlling stockholders. Such stockholders, of course, can have powerful incentives to maximize the firm's value in a fashion that benefits all investors by limiting managerial agency costs.[12] Furthermore, control can allow a controller to pursue a distinctive "idiosyncratic vision" and achieve transformative success as illustrated by examples

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11. *See, e.g.*, Corwin v. KKR Fin. Holdings, LLC, 125 A.3d 304 (Del. 2015); Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014).

12. *See, e.g.*, Sanford J. Grossman & Oliver Hart, *One Share/One Vote and the Market for Corporate Control*, 20 J. FIN. ECON. 175 (1988); Gilson & Gordon, *supra* note 2, at 792.

ranging from Henry Ford's control of Ford Motor Company to some of today's most successful tech companies.[13] Imposing a fiduciary analysis on a controller's involvement in setting firm direction—indeed, holding controllers who do so to the same duties as directors owe—will, on this analysis, potentially undermine these benefits, especially as controllers, unlike directors, cannot be exculpated under DGCL § 102(b)(7).

Vice Chancellor Laster's article is a *tour de force*. It sets forth a comprehensive and conceptually sophisticated approach to controllers that is deeply rooted in both doctrine and policy. It will become an essential touchstone for any subsequent analysis. All three of us expect it to become required reading for corporate lawyers—and for our students, too.

For that reason, we are especially grateful to the Vice Chancellor for his contribution to the *Journal of Law and Business*'s partnership with the Institute for Corporate Governance to publish the Institute's annual Distinguished Jurist Lecture. Vice Chancellor Laster's article is the third in this series, which first featured the insightful commentary of Delaware's Chief Justice, C.J. Seitz, Jr., on the importance of independence in the boardroom of the modern corporation,[14] followed by Chancellor Kathaleen McCormick's thoughtful and timely remarks on Delaware's embrace of specific performance as the preferred remedy in broken-merger cases.[15]

As we have noted before, this series reflects NYU's long and deep connection to the Delaware judiciary, a connection borne of the conviction that practitioners, students, and scholars alike benefit immensely from the chance to engage with, and challenge, corporate law's leading thinkers.[16] As readers will see in the pages that follow, Vice Chancellor Laster's article is a canonical illustration of why that is so.

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

14. Collins J. Seitz, Jr., *A Declaration of Independence: Committees, Conflicts, and the Courts*, 19 N.Y.U. J.L. & Bus. 467 (2023).

15. Kathaleen St. Jude McCormick & Robert Erikson, *Delaware's Approach to Specific Performance in M&A Litigation*, 20 N.Y.U. J.L. & Bus. 7 (2023).

16. Robert J. Jackson, Jr., Edward R. Rock & Elizabeth R. Crimmins, *Foreword*, 19 N.Y.U. J.L. & Bus. 463, 465 & nn.6 & 9 (2023) (describing previous NYU lectures delivered by former Delaware Chief Justice Leo Strine, *see* Leo E. Strine, Jr., *Fiduciary Blind Spot: The Failure of Institutional Investors to Prevent the Illegitimate Use of Working Americans' Savings for Corporate Political Spending*, 97 WASH. U. L. REV. 1007 (2020), and Chancellor Andre Bouchard).

NEW YORK UNIVERSITY
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VOLUME 20 SUMMER 2024 NUMBER 3

THE DISTINCTIVE FIDUCIARY DUTIES THAT STOCKHOLDER CONTROLLERS OWE

J. TRAVIS LASTER*

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* Vice Chancellor, Delaware Court of Chancery. A version of this article was presented on October 24, 2023, at New York University School of Law as a Distinguished Jurist Lecture.

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Introduction

Delaware law treats a stockholder who controls a corporation as a fiduciary. Delaware law also posits that a stockholder controller owes the same duties as a director. Motivated by concern that the resulting duties are onerous, Delaware decisions regularly express reluctance about determining that a stockholder exercises sufficient control to warrant fiduciary status. During an approximately twelve-year period from 2006 through 2018, Delaware decisions tightened the test for establishing stockholder control, ostensibly to avoid imposing those onerous duties. But on closer examination, the equivalency assertion underlying that trend is incorrect. Setting aside whether or not a director's duties are onerous, a stockholder controller does not owe the same duties as a director.

Unlike a director, a stockholder controller need not believe in subjective good faith that it is acting in the best interests of the corporation and its stockholders as a whole. A stockholder controller's fiduciary duties manifest only as an obligation not to harm the corporation or the minority stockholders through intentional, knowing, or grossly negligent action. Nor does a stockholder controller have a prescriptive obligation to take action to protect the corporation or its stockholders from harm. For a stockholder controller, the duty of loyalty is only a proscriptive obligation of non-harm. The resulting non-harming version of loyalty applies both when the stockholder controller transacts with the corporation and when the stockholder controller exercises its stockholder-level rights.

When negotiating an interested transaction, the stockholder acts both as a counterparty and as a fiduciary. Because the stockholder controller acts in part as a counterparty, the

stockholder controller need not believe subjectively that the transaction is in the best interests of the corporation or its minority stockholders, nor must the stockholder exercise due care on their behalf. The directors on the other side of the transaction owe those duties. But unless the stockholder controller disables itself fully at both the board and stockholder levels, then the stockholder controller continues to act in a limited fiduciary role, and a court will evaluate an interested transaction involving a stockholder controller using the entire fairness test. But despite its impressive sounding moniker, entire fairness only requires non-harm. The unitary entire fairness test has two dimensions: a substantive dimension known as fair price, and a procedural dimension known as fair dealing. The substantive dimension demands that the corporation or the minority stockholders receive at least the substantial equivalent value of what they had before, which is a measure of non-harm. The procedural dimension operates in service of the fair price dimension by looking for evidence of arm's length bargaining. Where evidence of arm's length bargaining is present, the result is more likely to be a fair exchange equivalent to what a third party would pay, meaning that the corporation or its minority stockholders are not being harmed relative to what they could obtain from the market.

Extant Delaware precedent conflicts over whether a stockholder controller owes fiduciary duties when exercising stockholder-level rights. Some cases assert that a stockholder controller never owes duties when exercising stockholder-level rights. Others assert that a controller always owes director-equivalent obligations, even when exercising stockholder-level rights.

A detailed examination of Delaware precedent supports a middle position. The cases first reveal that a stockholder controller can opt not to exercise any of its stockholder-level rights without triggering fiduciary review. By extension, cases permit a controller to use its stockholder-level powers to defend the status quo and its control position free of fiduciary constraint.

The cases also reveal that when a stockholder controller exercises its stockholder-level rights affirmatively and unilaterally, the stockholder controller owes both a duty of care and a duty of loyalty. The duty of care requires that the stockholder controller not harm the corporation or the minority

stockholders through grossly negligent action. The duty of loyalty manifests as an obligation not to harm the corporation or its minority stockholders knowingly or intentionally. Here again, the stockholder controller need not believe in subjective good faith that it is acting in the best interests of the corporation and all of its stockholders, nor does the stockholder controller have an affirmative obligation to exercise its stockholder powers in the best interests of the corporation and its stockholders as a whole.

It is thus incorrect to say that a stockholder controller does not owe fiduciary duties when exercising stockholder-level rights. It is also incorrect to assert that the stockholder controller's duties are the same as a director's. Delaware cases should stop making those claims and instead elaborate on the fiduciary framework based on the duty of non-harm.

Building on that insight, Delaware cases should hold that a stockholder controller owes a similar duty of non-harm when exercising other rights, such as statutory or contractual rights. Under this regime, a stockholder controller could exercise other statutory or contractual rights to defend the status quo or to protect its control position, but it could not use its rights to harm the corporation or its minority stockholders intentionally, knowingly, or through grossly negligent action.[1]

Finally, these insights provide a foundation for reconsidering a trend from approximately 2006 through 2018 that witnessed intermittent tightening of the test for controller status. To the extent that trend had a policy justification, it rested on the ostensibly onerous duties that controller status imposes. Because stockholder controllers owe more limited duties, that justification carries less weight. Instead, Delaware courts can employ a more predictable presumption that infers controller status at stock ownership levels of 20-25%.

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1. Other aspects of a controlling stockholder's duties are less clear. A stockholder controller does not appear to owe a duty of oversight, which is a duty that directors and officers owe. A stockholder controller does owe a duty of disclosure that seems to parallel the director's duty, meaning that the controller must disclose all material information when requesting stockholder action and, if the controller chooses to speak, must speak honestly and completely. That duty fits with the obligation of non-harm, because stockholders are harmed if forced to make decisions without material information or based on misleading information. In the interest of brevity, this article does not discuss those duties.

I.
The Equivalency Claim and Its Implications

American law treats a stockholder that possesses the power to control a corporation as a fiduciary. That has been true since the late nineteenth and early twentieth centuries, when both federal courts and state courts reached that conclusion.[2] In Delaware, Chancellor Josiah O. Wolcott, a judicial luminary who put the Court of Chancery on the map in the early twentieth century, held similarly in *Allied Chemicals & Dye Corporation v.*

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2. S. Pac. Co. v. Bogert, 250 U.S. 483, 487–88 (1919) ("The rule of corporation law and of equity invoked is well settled and has been often applied. The majority has the right to control; but when it does so, it occupies a fiduciary relation toward the minority."); Wheeler v. Abilene Nat. Bank Bldg. Co., 159 F. 391, 394 (8th Cir. 1908) ("This devolution of unlimited power imposes on a single holder of the majority of the stock a correlative duty, the duty of a fiduciary or agent, to the holders of the minority of the stock, who can act only through him, the duty to exercise good faith, care, and diligence to make the property of the corporation produce the largest possible amount, to protect the interests of the holders of the minority of the stock, and to secure and pay over to them their just proportion of the income and of the proceeds of the corporate property."); Ervin v. Or. Ry. & Nav. Co., 27 F. 625, 631 (C.C.S.D.N.Y. 1886) ("When a number of stockholders combine to constitute themselves a majority in order to control the corporation as they see fit, they become for all practical purposes the corporation itself, and assume the trust relation occupied by the corporation towards its stockholders. Although stockholders are not partners, nor strictly tenants in common, they are the beneficial joint owners of the corporate property, having an interest and power of legal control in exact proportion to their respective amounts of stock. The corporation itself holds its property as a trust fund for the stockholders who have a joint interest in all its property and effects, and the relation between it and its several members is, for all practical purposes, that of trustee and cestui que trust."); *accord* Bangor Punta Operations, Inc. v. Bangor & Aroostock R.R. Co., 417 U.S. 703, 716 n.13 (1974) (viewing the fiduciary duty of stockholder controllers as "settled law"); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971) ("The stockholder controller owes the corporation a fiduciary obligation—one designed for the protection of the entire community of interests in the corporation—creditors as well as stockholders" (internal quotation marks omitted); Pepper v. Litton, 308 U.S. 295, 306 (1939) ("A director is a fiduciary. So is a dominant or stockholder controller or group of stockholders." (citations omitted)); Jones v. H.F. Ahmanson & Co., 460 P.2d 464, 471-72 (Cal. 1969) ("[M]ajority shareholders, either singly or acting in concert to accomplish a joint purpose, have a fiduciary responsibility to the minority and to the corporation to use their ability to control the corporation in a fair, just, and equitable manner. Majority shareholders may not use their power to control corporate activities to benefit themselves alone or in a manner detrimental to the minority. Any use to which they put the corporation or their power to control the corporation must benefit all shareholders proportionately and must not conflict with the proper conduct of the corporation's business.").

Steel & Tube Company of America.[3] Since then, Delaware decisions have consistently recognized that principle.[4]

Fiduciary status based on control arises when a person can exercise a majority of a corporation's outstanding voting power. In one of the first articles to address the implications of corporate control, Adolf Berle labeled that "outright or absolute control."[5] Today, we might call it majority control, mathematical control, or hard control.

Fiduciary status based on control can also arise when a person has sufficient power, whatever the source, to exercise control over a corporation's business and affairs, even without wielding a majority of the voting power.[6] Berle called this

3. Allied Chem. & Dye Corp. v. Steel & Tube Co. of Am., 120 A. 486, 491 (Del. Ch. 1923) (Wolcott, Jos., C.) (stating that it was "clear" that the relationship between a majority stockholder and the minority is "of a fiduciary character.")

4. *E.g.*, Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1113 (Del. 1994) (imposing fiduciary duties on a stockholder who "owns a majority interest in or *exercises control* over the business affairs of the corporation") (internal quotation marks omitted); Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 70 (Del. 1989) (imposing fiduciary duties on a majority stockholder or a minority stockholder who exercises "actual control of corporate conduct"); Ivanhoe Partners v. Newmont Min. Corp., 535 A.2d 1334, 1344 (Del. 1987) ("Under Delaware law a shareholder owes a fiduciary duty only if it owns a majority interest in or exercises control over the business affairs of the corporation."); Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 109–10 (Del. 1952) ("Plaintiffs invoke the settled rule of law that Hilton as majority stockholder of Mayflower and the Hilton directors as its nominees occupy, in relation to the minority, a fiduciary position in dealing with Mayflower's property.").

5. Adolf A. Berle, Jr., *"Control" In Corporate Law*, 58 COLUM. L. REV. 1212, 1213 (1958).

6. "It is the fact of control of the common property held and exercised, not the particular means by which or manner in which the control is exercised, that creates the fiduciary obligation." *S. Pac. Co.*, 250 U.S. at 492. A controller thus need not be a stockholder. *See In re* Pattern Energy Grp. Inc. S'holders Litig., 2021 WL 1812674 (Del. Ch. May 6, 2021). Lender liability cases provide further evidence for this proposition. *See, e.g.*, Joanna M. Shepherd *et. al., What Else Matters for Corporate Governance?: The Case of Bank Monitoring*, 88 B.U. L. REV. 991, 1002 (2008) ("The detailed reporting obligations and contract constraints imposed by the loan agreement, as well as the bank's ability to control the borrower's cash, enable the bank literally to control the firm."); Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209, 1243-45 (2006) (explaining role of private debt as a "lever of corporate control"); *id.* at 1231-32 (describing features of loan agreements that afford lenders influence and control). In a variant of controller liability, courts have held lenders liable when they have exercised influence over a company that goes "beyond the domain of the usual money lender" and, while doing so, acted negligently or in bad faith. *E.g.,* NVent, LLC v. Hortonworks, Inc., 2017 WL 449585, at *9

"working control,"[7] which is a term we still use. Debate currently exists, however, over when a non-majority stockholder obtains sufficient power to be treated as a fiduciary,[8] what counts as

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(Del. Super. Feb. 1, 2017) (internal quotation marks omitted) (quoting Connor v. Great W. Sav. & Loan Ass'n, 44 P.2d 609, 616 (Cal. 1968)). *See generally* Daniel R. Fischel, *The Economics of Lender Liability*, 99 YALE L.J. 131 (1989) (analyzing lender liability as remedy for lender misbehavior); Margaret Hambrecht Douglas-Hamilton, *Creditor Liabilities Resulting from Improper Interference with a Management of a Financially Troubled Debtor*, 31 BUS. LAW. 343 (1975) (cataloging cases of lender liability). Other cases expressly impose fiduciary duties on a creditor who "exercise unreasonable or excessive control over its borrower." *E.g.*, Limor v. Buerger (*In re* Del-Met Corp.), 322 B.R. 781, 809–11 (Bankr. M.D. Tenn. 2005) (discussing controller creditor duties under Delaware, New York, and Tennessee law); *see* Jeffrey Jon Haas, *Insights into Lending Liability: An Argument for Treating Controlling Creditors as Controlling Shareholders*, 135 U. PA. L. REV. 1321, 1345–59 (1987). Courts also have recognized found a fiduciary relationship to exist in other contractual settings involving significant power disparities. *E.g.,* Calvin Klein Trademark Trust v. Wachner, 123 F. Supp. 2d 731 34 (S.D.N.Y. 2000) ("[S]pecial factors [may] create fiduciary relationships between contracting commercial parties, such as, for example, when one party's superior position or superior access to confidential information is so great as to require the other party to repose trust and confidence in the first party."); Peoples Bank & Trust Co. v. Cermack, 658 So.2d 1352, 1359 (Miss. 1995) ("A fiduciary relationship may arise in a legal, moral, domestic, or personal context, where there appears on the one side an overmastering influence or, on the other, weakness, dependence or trust, justifiably reposed." (internal quotation marks omitted)).

7. Berle, *supra* note 5, at 1213.

8. *See* notes 143 & 144, *infra* and accompanying text. A 2014 decision looked at ten precedents and failed to find "any sort of linear, sliding scale approach whereby a larger share percentage makes it substantially more likely that the court will find the stockholder was a stockholder controller." *In re* Crimson Expl., Inc. S'holders Litig., 2014 WL 5449419, at *10. If anything, that description undersold the lack of consistency. Prior decisions had citing decisions that treated ownership stakes of 21.5%, 27.7%, 33.5%, 33.7%, 39.5%, 44%, and 46% as insufficient to support an inference of control, while other treating ownership stakes of 17.5%, 35%, 40.3%, 43.3%, and 49% as sufficient to support an inference of control. *Id.* A more detailed examination of those decisions is beyond the scope of this article, but for present purposes, it suffices to say that whether a stockholder with less than a majority of the voting power can exercise control turns on multiple factors, not just voting power. A stockholder could be deemed to be a controller at lower levels of voting power if the stockholder also possesses other sources of power, such as board representation, blocking rights, or high-status roles (like founder, chairman, or CEO). Those factors complicate any effort to find an obvious, linear relationship. All else equal, however, there should be a positive correlation between stockholder voting power and control simply because of the mathematics surrounding the exercise of voting rights and the need for the party opposing a large block holder to poll and increasingly higher supermajority rates. *See* Voigt v. Metcalf, 2020 WL 614999, at *18–19 (Del. Ch. Feb. 10, 2020) (discussing voting implications of increasing blocks of voting power).

cognizable sources of power for that purpose,[9] and the test to

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9. For example, disagreement exists over whether contractual blocking rights are relevant to a finding of control. One line of decisions generally discounts contractual rights as irrelevant, although without meaningful analysis. That line of decisions can be traced to the *Superior Vision* case, which technically considered whether a stockholder could be subjected to fiduciary duties when exercising a specific blocking right. *See* Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co., 2006 WL 2521426, at *2 (Del. Ch. Aug. 25, 2006) (rejecting the idea that "specific and fairly negotiated contractual right" could be subject to fiduciary limitation that would limit the counterparty's ability to "just consider its interests."). Later decisions have built on *Superior Vision* to assert more broadly that contractual rights should not be part of the control calculus. *See In re* KKR Fin. Hldgs. LLC S'holder Litig., 101 A.3d 980, 994 (Del. Ch. 2014) (relying on *Superior Vision* and holding "[a]t bottom, plaintiffs ask the Court to impose fiduciary obligations on a relatively nominal stockholder, not because of any coercive power that stockholder could wield over the board's ability to independently decide whether or not to approve the merger, but because of pre-existing contractual obligations with that stockholder that constrain the business or strategic options available to the corporation. Plaintiffs have cited no legal authority for that novel proposition, and I decline to create such a rule."), *aff'd sub nom.* Corwin v. KKR Fin. Hldgs. LLC, 125 A.3d 304 (Del. 2015); Thermopylae Cap. Partners, L.P. v. Simbol, Inc., 2016 WL 368170, at *13 (Del. Ch. Jan. 29, 2016) ("Under Delaware law, however, contractual rights held by a non-majority stockholder do not equate to control, even where the contractual rights allegedly are exercised by the minority stockholder to further its own goals." (citing *Superior Vision*)); *see also* Calesa Assocs., L.P. v. Am. Cap., Ltd., 2016 WL 770251, at *10 (Del. Ch. Feb. 29, 2016) (agreeing with argument that "exercise of contractual rights, alone are not sufficient to demonstrate control" but holding on other grounds that the plaintiffs had plead sufficient facts establishing that majority of board was under actual control and influence of alleged controller) (citing *Superior Vision*); *cf. In re* Sirius XM S'holder Litig., 2013 WL 5411268, at *8–9 (Del. Ch. Sept. 27, 2013) (discussing *Superior Vision* and holding that "[t]here are many situations when corporations enter into contractual arrangements that have important implications for corporate control in conceivable future situations; for example, debt instruments commonly give creditors rights that, if used, may result in their assuming control. The use of such rights to obtain control in the situations specifically contemplated by those contracts does not constitute a fiduciary breach.") (footnote omitted). These cases do not acknowledge, much less account for, the lender liability cases that have imposed fiduciary duties and liability based on purely contractual rights found in loan agreements. *See* note 7, *supra*.

By contrast, other cases explain that contractual rights are pertinent to a control determination. *See, e.g.*, *Voigt*, 2020 WL 614999, at *20 (explaining that contractual blocking rights weighed "in favor of an inference that CD&R exercised control over the Company generally by giving CD&R power over the Company beyond what the holder of a mathematical majority of the voting power ordinarily would possess"); *In re* Loral Space & Commc'ns Inc., 2008 WL 4293781, at *21 (Del. Ch. Sept. 19, 2008) (weighing large stockholder's "blocking power" when making post-trial finding of control); Williamson v. Cox Commc'ns, Inc., 2006 WL 1586375, at *4 (Del. Ch. June 5, 2006) (noting that "veto power is significant for analysis of the control issue" because it

use for assessing fiduciary status.[10] This article therefore will not consider the concept of working control.

When considering the fiduciary duties of a majority controller, Delaware cases often assert a controller owes the same fiduciary duties as a director. Chancellor Wolcott said so in the *Allied Chemicals* decision from 1923.[11] Writing seventy years

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enabled the holders of the veto rights "to shut down the effective operation of the At Home board of directors by vetoing board actions"); *cf.* W. Palm Beach Firefighters' Pension Fund v. Moelis & Co., 2024 WL 747180, *9–10 (Del. Ch. Feb. 23, 2024) (describing stockholder agreement that included eighteen pre-approval requirements that were "so all-encompassing as to render the Board an advisory body. [the founder,] not the Company, is running the show."). A rights-holder can use veto rights to cut off alternatives and channel a corporation into a particular course of action. Conceptually, there is not a significant difference between directing behavior by ordering a particular action and directing behavior by cutting off alternative sources of action. *E.g.*, Basho Techs. Holdco B, LLC v. Georgetown Basho Invs., LLC, 2018 WL 3326693, at *35 (Del. Ch. July 6, 2018) ("By creating a situation in which the Company had no other alternatives and no more money, Georgetown forced the Company to accept its deal. Because Georgetown exercised actual control over the Company for purposes of the Series G Financing, Georgetown became a fiduciary for purposes of evaluating that transaction."), *aff'd sub nom.* Davenport v. Basho Techs. Holdco B, LLC, 221 A.3d 100 (Del. 2019). Still other decisions have considered the significance of a right, such as the ability to cut off a company's access to cash, because "[w]hen cash is like oxygen, self-interested steps to choke off the air supply provide a strong indicator of control." *Id.* at *29; *accord Voigt*, 2020 WL 614999, at *19; *see* Skye Min. Invs., LLC v. DXS Cap. (U.S.) Ltd., 2020 WL 881544, at *27 (Del. Ch. Feb. 24, 2020) ("The Complaint well-pleads that the Blocking Rights allowed DXS and PacNet to block all of SMP's efforts to finance any of its ongoing operations—with either debt or equity. That, in turn, prompted the Noble Loan default, the Fourth Amendment and the subsequent acquisition of the Noble Loan by Waterloo. . . . [A]s pled, the Blocking Rights gave DXS and PacNet the unilateral power to shut SMP down—full stop." (footnotes omitted). Still other decisions have attempted to distinguish between types of contractual rights based on whether they resemble board-level rights or stockholder-level rights. *See Thermopylae Cap. Partner's*, 2016 WL 368170, at *14 (examining whether contractual right is one under which the holder "operates the decision-making machinery of the corporation," thereby becoming a classic fiduciary who controls the property of others, as opposed to "an individual who owns a contractual right, and who exploits that right—even in a way that forces a reaction by the corporation.").

10. *See* notes 143 & 144, *infra*, and accompanying text.

11. *Allied Chem.*, 120 A. at 491 ("The same considerations of fundamental justice which impose a fiduciary character upon the relationship of the directors to the stockholders will also impose, in a proper case, a like character upon the relationship which the majority of the stockholders bear to the minority. When, in the conduct of the corporate business, a majority of the voting power in the corporation join hands in imposing its policy upon all, it is beyond all reason and contrary, it seems to me, to the plainest dictates of

later, Chancellor William T. Allen said the same thing in *Harris v. Carter*.[12] Consistent with that statement of law, other Delaware cases describe stockholder controllers as owing the duties of loyalty and care, which are the same duties that directors owe.[13]

Putting those principles together makes a finding of control seem significant and hence something that should be difficult to establish. One illustrative Delaware decision frames the implications in precisely those terms: "[A] finding that a stockholder is a controller has dramatic consequences—she

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what is just and right, to take any view other than that they are to be regarded as having placed upon themselves the same sort of fiduciary character which the law impresses upon the directors in their relation to all the stockholders. Ordinarily the directors speak for and determine the policy of the corporation. When the majority of stockholders do this, they are, for the moment, the corporation."); *accord. S. Pac. Co.*, 250 U.S. at 487–88 ("The majority has the right to control; but when it does so, it occupies a fiduciary relation toward the minority as much so as the corporation itself or its officers and directors."); *see* Berle, *supra* note 5 at 1222 ("[T]he law has long recognized and imposed certain liabilities on the holders of control if they use their influence over directors to cause specific corporate action. Briefly stated, the risk is that where holders of control, without assuming the title of directors, move into the directors' room or the managerial offices and specifically direct corporate action, they are held to the same standards of conduct which apply to directors.").

12. Harris v. Carter, 582 A.2d 222 (Del Ch. 1990) ("[W]hen a shareholder presumes to exercise control over a corporation, to direct its actions, that shareholder assumes a fiduciary duty of the same kind as that owed by a director to the corporation.").

13. *See, e.g.*, Summa Corp. v. Trans World Airlines, Inc., 540 A.2d 403, 406 (Del. 1988) (referring to the stockholder controller's "general fiduciary duties of loyalty and care"); *In re* MultiPlan Corp. S'holders Litig., 268 A.3d 784, 799 (Del. Ch. 2022) ("There is no dispute that Churchill's directors, officers, and controlling stockholder owed fiduciary duties of care and loyalty to stockholders."); Bocock v. INNOVATE Corp., 2022 WL 15800273, at *19 (Del. Ch. Oct. 28, 2022) ("As controlling stockholders of DTV America at the time of the transaction, the Innovate Entities owed DTV America fiduciary duties of loyalty and care."); Gilbert v. Perlman, 2020 WL 2062285, at *6 (Del. Ch. Apr. 29, 2020) ("Where in fact [a stockholder] exerts such control, a controlling stockholder is bound by Delaware's common law fiduciary duties of loyalty and care."); Cinerama, Inc. v. Technicolor, Inc., 1991 WL 111134, at *19–20 (Del. Ch. June 24, 1991) ("[W]hen a shareholder, who achieves power through the ownership of stock, exercises that power by directing the actions of the corporation, he assumes the duties of care and loyalty of a director of the corporation."), *rev'd in part on other grounds sub nom.* Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993). *But see* Jens Dammann, *The Controlling Shareholder's General Duty of Care: A Dogma That Should Be Abandoned*, 2015 U. ILL. L. REV. 479 (2015) (surveying authorities which suggest that a stockholder controller owes a duty of care and arguing for the rejection of the duty).

is no longer able to act in self-interest, but must act in the corporate interest only, and entire fairness applies to transactions with the controller."[14] That decision then posits that stockholder controllers, like other fiduciaries, "are prohibited from considering their self-interest in making corporate decisions [and] must exercise their business judgment on behalf of the entity and its stockholders, free from the taint of personal interest."[15] Those assertions do not reflect an isolated or idiosyncratic assessment of the law. They illustrate a commonly held perception of a stockholder controller's duties. They also fairly summarize the duties that should apply if a stockholder controller were to owe the same duties as a director.

Rather than treating fiduciary equivalency as a postulate, it should be treated as a hypothesis. That hypothesis can be tested by examining how cases address specific situations. The results of that examination disconfirm the hypothesis.

II.
THE DUTIES DIRECTORS OWE

Testing the hypothesis of fiduciary equivalency requires a baseline measured by the duties that directors owe. Delaware law subjects a director to two fiduciary duties: the duty of care and the duty of loyalty.

Before discussing those duties, it is necessary to acknowledge the distinction in entity law between the standard of conduct and the standard of review.[16] The standard of conduct frames the duty that the fiduciary is supposed to fulfill, such as "act in the best interests of the beneficiary" or "exercise reasonable care." Instead, a court measures a director's compliance with the standard of conduct using one of three standards of

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14. Sciabacucchi v. Liberty Broadband Corp., 2017 WL 2352152, at *16 (Del. Ch. May 31, 2017).

15. *Id.*

16. Chen v. Howard-Anderson, 87 A.3d 648, 666 (Del. Ch. 2014); *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 35–36 (Del. Ch. 2013) (*Trados II*). *See generally* William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of Van Gorkom and its Progeny as a Standard of Review Problem*, 96 NW. U. L. REV. 449, 451–52 (2002); William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function Over Form: A Reassessment of the Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1295–99 (2001); Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437, 461–67 (1993).

review: a default standard of review that is highly deferential and known as the business judgment rule; an intermediate standard of review known as enhanced scrutiny; and an onerous standard of review known as the entire fairness test.[17]

The standard of review introduces a range of permissible actions centered around the standard of conduct. A court only holds the fiduciary in breach if the conduct falls outside that range.[18] With the business judgment rule, the range is expansively broad. With the entire fairness test, it is relatively narrow. With enhanced scrutiny, it falls in between. In each manifestation, the standard of review is more forgiving than the standard of conduct.[19]

In effect, the standard of review introduces a margin for error, and a finding of breach only results if the director's degree of deviation from the standard of conduct exceeds the margin for error. Incorporating a margin for error acknowledges that directors must always exercise some degree of fact-specific judgment about what action to take, and there will always be a level of epistemic uncertainty when a court reviews their actions.[20]

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17. *See In re* Columbia Pipeline Grp., Merger Litig., 299 A.3d 393 (Del. Ch. 2023); Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 457–59 (Del. Ch. 2011).

18. *See* Eisenberg, *supra* note 16 at 467-68 ("Because lawyers tend to focus on the operational questions of liability and validity, it is easy to overlook the point that standards of review, which govern liability and validity, are not themselves standards of conduct. A director or officer who engages in self-interested conduct without having dealt fairly has acted wrongly, even though he is protected against liability by the relevant standard of review. A director or officer who makes an unreasonable decision has acted wrongly, even though he is protected against liability under the business-judgment rule. If directors or officers who violate the standards of reasonableness and fairness sometimes escape liability because of a less demanding standard of review, it is not because they have acted properly, but because utilizing standards of review that were fully congruent with the relevant standards of conduct would impose greater costs than the costs of letting some persons who violated their standards of conduct escape liability. Such an officer or director may therefore be held *accountable,* even if not *liable,* for failure to meet the relevant standard of conduct.").

19. *Chen*, 87 A.3d at 667.

20. *See* Allen et al., *supra* note 16 at 451–52 ("(1) directors must often make decisions in an environment of imperfect (that is, limited or incomplete) information; (2) the risk of liability under the applicable standard of conduct for assuming a given corporate role may dwarf the incentives for assuming the role; (3) if the risk of liability is disproportionate to the directors' incentives for service, directors may avoid making economically valuable decisions that might subject them to litigation risk; (4) courts are ill-equipped to determine after the fact whether a particular business decision was

This article focuses on the standard of conduct, which both establishes the baseline obligation and provides the orientation for the court's range-based review. It touches only indirectly on the standards of review through which a court would analyze compliance with the standard of conduct.

A. *The Duty of Care*

Directors of a Delaware corporation owe a duty of care.[21] The standard of conduct for the duty of care requires that a director consider all information reasonably available before making a decision. "Directors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them. Having become so informed, they must *then* act with requisite care in the discharge of their duties."[22]

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reasonable in the circumstances confronting the corporation; and (5) institutional and prudential considerations sometimes counsel judicial deference to the corporate decision maker."); Eisenberg, *supra* note 16, at 437–38 ("Perhaps standards of conduct and standards of review in corporate law would always be identical in a world in which information was perfect, the risk of liability for assuming a given corporate role was always commensurate with the incentives for assuming the role, and institutional considerations never required deference to a corporate organ. In the real world, however, these conditions seldom hold, and the standards of review in corporate law pervasively diverge from the standards of conduct.").

21. *E.g.*, Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006); *accord* Mills Acq. Co. v. Macmillan, Inc., 559 A.2d 1261, 1280 (Del. 1989) ("[D]irectors owe fiduciary duties of care and loyalty to the corporation and its shareholders."); Polk v. Good, 507 A.2d 531, 536 (Del.1986) ("In performing their duties the directors owe fundamental fiduciary duties of loyalty and care to the corporation and its shareholders."); *In re* Orchard Enters., Inc. S'holder Litig., 88 A.3d 1, 32 (Del. Ch. 2014) ("Directors of a Delaware corporation owe two fiduciary duties—care and loyalty.").

22. *Technicolor, Inc.*, 634 A.2d at 367 (quoting Aronson v. Lewis, 473 A.2d 805 (Del. 1984)). Properly characterizing *Aronson*'s subsequent history is a chore. In Brehm v. Eisner, 746 A.2d 244, 253–54 (Del. 2000), the Delaware Supreme Court overruled seven precedents, including *Aronson* to the extent that they reviewed a Rule 23.1 decision by the Court of Chancery under an abuse of discretion standard or otherwise suggested deferential appellate review. *Id.* at 253 n.13 (overruling in part on this issue Scattered Corp. v. Chi. Stock Exch., 701 A.2d 70, 72–73 (Del. 1997); Grimes v. Donald, 673 A.2d 1207, 1217 n.15 (Del. 1996); Heineman v. Datapoint Corp., 611 A.2d 950, 952 (Del. 1992); Levine v. Smith, 591 A.2d 194, 207 (Del. 1991); Grobow v. Perot, 539 A.2d 180, 186 (Del. 1988); Pogostin v. Rice, 480 A.2d 619, 624–25 (Del. 1984); and *Aronson*, 473 A.2d at 814. The *Brehm* Court held that going forward, appellate review of a Rule 23.1 determination would be *de novo* and plenary. *Brehm*, 746 A.2d at 254. The seven partially overruled precedents oth-

In the context of a transaction or sale process, directors "must be particularly vigilant."[23] One of the Delaware Supreme Court's clearest teachings is that "directors cannot be passive instrumentalities during merger proceedings."[24] The duty of care therefore requires that directors maintain "an active and direct role in the context of the sale of the company from beginning to end,"[25] including by "identifying and responding to actual and potential conflicts of interests."[26] "[D]irectors can breach their duty of care by failing to obtain information that they should have obtained, even when the information was withheld by others."[27]

Although the standard of conduct of the duty of care is framed in terms of reasonableness, the standard necessary to find a breach of duty varies depending on the standard of review that applies.[28] When the business judgment rule applies, the level of carelessness is gross negligence.[29] When enhanced scrutiny applies, the level of carelessness is action that falls outside a range of reasonableness.[30] When entire fairness applies, the level of carelessness is action resulting in a decision-making process that fails to satisfy the fair dealing dimension of the unitary entire fairness test.[31] Ultimately, however, before

erwise remain good law. More recently, the Delaware Supreme Court overruled *Aronson* and *Rales*, to the extent that they set out alternative tests for demand futility. United Food & Com. Workers Union & Participating Food Indus. Empls. Tri-State Pension Fund v. Zuckerberg, 262 A.3d 1034, 1059 (Del. 2021). The high court adopted a single, unified test for demand futility. *Id.*

23. *Columbia Pipeline.*, 299 A.3d at 468.

24. *Cede*, 634 A.2d at 368.

25. *Id.*

26. RBC Cap. Mkts., LLC v. Jervis, 129 A.3d 816 (Del. 2015).

27. *In re* Rural Metro Corp., 88 A.3d 54, 93–96 (Del. Ch. 2014).

28. *See Columbia Pipeline*, 299 A.3d at 468–69.

29. *Id.*

30. *E.g.*, Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34, 36 (Del. 1993). (rejecting a sale process that "was not reasonable as to process or result"); *id.* at 45 (identifying as a key feature of enhanced scrutiny "the adequacy of the decision-making process employed by the directors, including the information on which the directors based their decision"); *id.* (noting that the directors bore "the burden of proving that they were reasonably informed"); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 949, 955, 958 (Del. 1985) (requiring a "reasonable investigation").

31. *E.g.*, Ams. Mining Corp. v. Theriault, 51 A.3d 1213, 1244 (Del. 2012) (affirming trial court's finding that "the process by which the Merger was negotiated and approved was not fair" and produced an unfair price); *In re* Walt Disney Co. Deriv. Litig., 906 A.2d 27, 52 (Del. 2006) (*Disney II*) (explaining

imposing personal liability for the duty of care, Delaware law always requires a showing of gross negligence.[32] Not only that, but gross negligence in the corporate context has a special meaning under Delaware law that is akin to recklessness.[33] For

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that the business judgment rule can be rebutted by establishing that "the directors breached their fiduciary duty of care" and that "[i]f that is shown, the burden then shifts to the director defendants to demonstrate that the challenged act or transaction was entirely fair to the corporation and its shareholders"); Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) (explaining that the fair dealing dimension of the entire fairness test includes "how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors . . . were obtained").

32. *RBC*, 129 A.3d at 857 ("When disinterested directors themselves face liability, the law, for policy reasons, requires that they be deemed to have acted with gross negligence in order to sustain a monetary judgment against them.").

33. *In re* McDonald's Corp. S'holder Derivative Litig., 291 A.3d 652, 689 (Del. Ch. 2023) ("In the corporate context, gross negligence has its own special meaning that is akin to recklessness."); *In* re Lear Corp. S'holder Litig., 967 A.2d 640, 652 n.45 (Del. Ch. 2008) ("[T]he definition [of gross negligence in corporate law] is so strict that it imports the concept of recklessness into the gross negligence standard...."); Albert v. Alex. Brown Mgmt. Servs., Inc., 2005 WL 2130607, at *4 (Del. Ch. Aug. 26, 2005) ("Gross negligence has a stringent meaning under Delaware corporate (and partnership) law, one which involves a devil-may-care attitude or indifference to duty amounting to recklessness." (cleaned up)); Tomczak v. Morton Thiokol, Inc., 1990 WL 42607, at *12 (Del. Ch. Apr. 5, 1990) ("In the corporate context, gross negligence means reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason." (cleaned up)).

In civil cases not involving business entities, the Delaware Supreme Court has defined gross negligence as "a higher level of negligence representing 'an extreme departure from the ordinary standard of care.'" Browne v. Robb, 583 A.2d 949, 953 (Del. 1990) (quoting W. Prosser, Handbook of the Law of Torts 150 (2d ed. 1955)). This test "is the functional equivalent" of the test for "[c]riminal negligence." Jardel Co., Inc. v. Hughes, 523 A.2d 518, 530 (Del. 1987). By statute, Delaware law defines "criminal negligence" as follows:

A person acts with criminal negligence with respect to an element of an offense when the person fails to perceive a risk that the element exists or will result from the conduct. The risk must be of such a nature and degree that failure to perceive it constitutes a gross deviation from the standard of conduct that a reasonable person would observe in the situation. Del. Code Ann. tit. 11, § 231(a). The same statute provides that a person acts recklessly when "the person is aware of and consciously disregards a substantial and unjustifiable risk that the element exists or will result from the conduct." *Id.* § 231(e). As with criminal negligence, the risk "must be of such a nature and degree that disregard thereof constitutes a gross deviation from the standard of conduct that a reasonable person would observe in the situation." *Id.; see id.* § 231(a). Under this framework, gross negligence "signifies more than ordinary inadvertence or inattention," but it is "nevertheless a degree of negligence, while recklessness connotes a different type of conduct akin to the

purposes of determining the enforceable standard that could result in liability for a director, the standard is gross negligence as recklessness.

B. *The Duty of Loyalty*

For a director, acting loyally means seeking to maximize the value of the corporation for the benefit of its stockholders in the aggregate.[34] The director's duty of loyalty incorporates an obligation to act in good faith, which the Delaware Supreme Court has described as a prerequisite for loyal action.[35] Acting in good faith means acting with the subjective belief that the decision serves the best interests of the corporation and its stockholders.[36] A director acts in bad faith—and therefore disloyally—by acting "with a purpose other than that of advancing the best interests of the corporation."[37] A director certainly

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intentional infliction of harm." *Jardel*, 523 A.2d at 530. The comparison shows the protectiveness of Delaware's corporate law standard: To hold a director liable for gross negligence requires conduct more serious than what is necessary to secure a conviction for criminal negligence.

34. *Rural Metro*, 88 A.3d at 81 ("More concretely, the fiduciary relationship between the Board and Rural's stockholders required that the directors act prudently, loyally, and in good faith to maximize Rural's value over the long-term for the benefit of its stockholders."); *see also* Gantler v. Stephens, 965 A.2d 695, 706 (Del.2009) (holding that "enhancing the corporation's long term share value" is a "distinctively corporate concern[ ]"); TW Servs., Inc. v. SWT Acq. Corp., 1989 WL 20290, at *7 (Del. Ch. Mar. 2, 1989) (Allen, C.) (describing as "non-controversial" the proposition that "the interests of the shareholders as a class are seen as congruent with those of the corporation in the long run" and explaining that "[t]hus, 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"); Andrew A. Schwartz, *The Perpetual Corporation*, 80 Geo. Wash. L. Rev. 764, 777–83 (2012) (arguing that the corporate attribute of perpetual existence calls for a fiduciary mandate of long-term value maximization for the stockholders' benefit); William T. Allen, *Ambiguity in Corporation Law*, 22 Del. J. Corp. L. 894, 896–97 (1997) ("[I]t can be seen that the proper orientation of corporation law is the protection of long-term value of capital committed indefinitely to the firm.").

35. *See Stone*, 911 A.2d at 370 (quoting Guttman v. Huang, 823 A.2d 492, 506 n. 34 (Del. Ch. 2003)).

36. *Columbia Pipeline*, 299 A.3d at 455 ("Acting loyally requires acting in good faith, and acting in good faith requires that the fiduciary subjectively believe that the course of action is in the best interests of the corporation and its stockholders.") (citing United Food & Com. Workers Union v. Zuckerberg, 250 A.3d 862, 895 (Del. Ch. 2020), *aff'd*, 262 A.3d 1034 (Del. 2021)).

37. *Disney II*, 906 A.2d at 67; *accord Stone*, 911 A.2d at 369.

acts in bad faith if the director has an "actual intent to do harm" to the corporation or its stockholders. [38] A director also acts in bad faith by engaging in an "intentional dereliction of duty," such as a "conscious disregard for one's responsibilities."[39] But those extreme levels of intent are not required. Any human emotion can cause a director to act in bad faith, including greed, hatred, lust, envy, revenge, shame or pride.[40]

III.
Can There Be Other Fiduciary Formulations?

To reiterate, Delaware decisions often posit the fiduciary equivalence of director and stockholder controller duties. One possible reason for fiduciary equivalency might be if director-level duties were universal. In such a world, if someone is a fiduciary, then they owe the same duties as a director, but not because of anything special about director duties. They owe those duties because every fiduciary owes them.

For the duty of care, the possibility of other standards is easily perceived, and Delaware cases discuss how Delaware's corporate law version of gross negligence as recklessness compares to other possibilities.[41] To reiterate, for a standard common law tort claim, the test is simple negligence measured by what a reasonable person would have done under the circumstances. A moderately higher standard is a version of gross negligence that still functions as a form of negligence, but which requires a gross departure from what a reasonable person would have done. Delaware's corporate version is still more onerous and requires conduct akin to recklessness.

For the duty of loyalty, Delaware cases do not acknowledge alternatives, but it turns out that variants exist. Scholars have explored a spectrum of increasingly meaningful loyalty obligations.

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38. *Disney II*, 906 A.2d 27, 66 (Del. 2006); *accord* Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 240 (Del. 2009).

39. *Disney II*, 906 A.2d at 66; *accord Lyondell Chem. Co.*, 970 A.2d at 240.

40. *In re* McDonald's Corp. S'holder Deriv. Litig., 291 A.3d 652, 688 (Del. Ch. 2023); *In re* RJR Nabisco Inc. S'holders Litig., 1989 WL 7036, at *12 (Del. Ch. Jan. 30, 1989), at *15; *see Guttman*, 823 A.2d at 506 n.34.

41. *See* notes 29-34, *supra.*

A. *A Spectrum of Loyalties*

Where the spectrum of loyalties begins is a contested issue. Some commentators put the loyalty floor at an obligation not to engage in self-dealing. Under this version, beyond that minimal requirement, the fiduciary need not specifically consider the beneficiary's interests at all.[42] Technically, under this version, a fiduciary cannot receive compensation from the beneficiary, but that limitation has generally been tempered to allow for fair compensation. Outside of permitted compensation, however, the fiduciary cannot engage in any other types of transactions with the beneficiary. The only other-regarding component of this formulation is the command to avoid transactions with the beneficiary.

Other commentators insist that the minimum level of loyalty must contain some outward-regarding dimension.[43] From that standpoint, the minimum level of loyalty requires that the fiduciary not betray the beneficiary.[44] In this setting, betrayal is

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42. *See* Andrew S. Gold, *The Loyalties of Fiduciary Law*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 176, 178 (Andrew S. Gold & Paul B. Miller, eds. 2014) [hereinafter Fiduciary Loyalties] (describing this version). Prominent commentators have taken this position. *E.g.*, Irit Semet, *Fiduciary Loyalty as Kantian Virtue*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 125, 126 (Andrew S. Gold & Paul B. Miller, eds. 2014) (Andrew S. Gold & Paul B. Miller, eds. 2014) [hereinafter Kantian Virtue]; Paul B. Miller, *A Theory of Fiduciary Liability*, 6 MCGILL L.J. 235, 257 (2011); Larry Ribstein, *Fencing Fiduciary Duties*, 91 B.U. L. REV. 899, 909 (2011).

43. Gold, *Fiduciary Loyalties*, *supra* note 42 at 176 ("Indeed, it is commonly thought that if a purported fiduciary does not owe a duty of loyalty to a beneficiary, then the relationship is not actually a fiduciary relationship. In this sense, duties of loyalty are an essential feature of fiduciary law."); *accord* James Edelman, *The Role of Status in the Law of Obligations: Common Callings, Implied Terms, and Lessons for Fiduciary Duties*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 21, 22 (Andrew S. Gold & Paul B. Miller, eds. 2014) ("An 'obligation' to be 'loyal' invites the question: loyal to what end? . . . In law as in life, loyalty cannot be understood without knowing the performance in relation to which loyalty is required."); *See* Deborah A. DeMott, *Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences*, 48 ARIZ. L. REV. 925, 296 (2006) (arguing that "the law applicable to fiduciary duty can best be understood as responsive to circumstances that justify the expectation that an actor's conduct will be loyal to the interests of another"); Arthur Laby, *The Fiduciary Obligation as the Adoption of Ends*, 56 BUFF. L. REV. 99, 129 (2008) (explaining that fiduciary loyalty "entails a commitment by the fiduciary to adopt the principal's objectives, goals or ends as a fiduciary's own and to promote those ends"); *id.* at 134 ("[T]he fiduciary's role identification with eh principal requires him to re-orient his moral view-point away from pursuing the overall best state of affairs to furthering agent-oriented objectives.").

44. Gold, *Fiduciary Loyalties*, *supra* note 42, at 179; Lyman Johnson, *After Enron: Remembering Loyalty Discourse in Corporate Law*, 28 DEL. J. CORP. L. 27, 37-38 (2003).

defined as intentionally harming the beneficiary. Self-dealing can cause the beneficiary harm, so the non-betrayal concept incorporates harmful self-dealing. Unlike the no-self-dealing version, the non-betrayal formulation permits self-dealing that is beneficial, or at least not harmful to the beneficiary. That includes compensation but also could allow other transactions. The non-harming version goes beyond self-dealing by preventing the fiduciary from engaging in acts that a non-fiduciary could pursue, such as competing with the beneficiary.

The next level of loyalty requires that the fiduciary follow the course of action that the fiduciary subjectively believes is in the best interest of the beneficiary.[45] A fiduciary who acts with a different mental state has acted disloyally. Recognizing that humans can have multiple reasons for acting, this level of loyalty has two versions.[46] The more onerous version is deliberative exclusivity, which requires that only the beneficiary's interest be considered.[47] The less onerous version is deliberative priority, which requires that the beneficiary's interest be the dominant consideration, although other factors may come into play.[48]

An even higher level of loyalty moves beyond subjective intent to consider objective results. Loyalty in this sense involves being held accountable for outcomes. If the baseline standard is non-harm, then the fiduciary is liable for harm. If the baseline standard is to pursue the best interests of the beneficiary, then the fiduciary is liable if the best outcome is not achieved.

At its maximum, loyalty contemplates self-sacrifice. A loyal supporter contributes to a cause without obligation. A loyal

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45. Gold, *Fiduciary Loyalties*, *supra* note 42, at 179; Semet, *Kantian Virtue*, *supra* note 42, at 127.

46. *See* J. E. Penner, *Is Loyalty a Virtue, and Even If It Is, Does It Really Help Explain Fiduciary Liability?*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 159, 166 (Andrew S. Gold & Paul B. Miller, eds. 2014) (discussing deliberative priority and deliberative exclusivity).

47. *Id.* English law best reflects this concept by interpreting the duty of loyalty to prohibit the fiduciary from acting when any potential conflict of interest exists. *Id.* at 159. Penner starts from the no-betrayal view but expands that view to include the avoidance of conflicts. *Id.* He also identifies an obligation to provide disclosure about conflicts and contemplates liability for a fiduciary who fails to disclose a conflict and thereby causes the beneficiary to suffer harm. *Id.* at 159–60. The latter is a subset of the former. Liability turns on the existence of the conflict. Disclosure and approval by the beneficiary may negate the conflict. Liability exists in the absence of disclosure because of a non-negated conflict, not because of the absence of disclosure.

48. *Id.*; *see Columbia Pipeline*, 299 A.3d at 403.

employee remains so despite better opportunities elsewhere. A loyal soldier sacrifices his life for his country.

The duty of loyalty also has another axis. In each manifestation, the duty can be either proscriptive or prescriptive. A prospective duty applies when a fiduciary chooses to act, but does not force a fiduciary to act.[49] A prescriptive duty demands affirmative action and forces a fiduciary to act. The resulting distinction is intuitive, because human brains generally attribute greater agency to action than to inaction.[50] But the distinction is ultimately unstable, because inaction often has significant and obvious consequences, and conscious inaction is just as much of a decision as conscious action.[51] Any effort to

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49. *See* Lionel D. Smith, *Can We Be Obliged to be Selfless?*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 141, 145 (Andrew S. Gold & Paul B. Miller, eds. 2014) (describing Australian view that fiduciary duties are only proscriptive).

50. *See, e.g.*, David Gray, *"You Know You've Gotta Help Me Out ..."* 126 PENN. ST. L. REV. 337, 351–65 (2022) (identifying and rejecting reasons for distinction between acts and omissions); George C. Christie, *The Defense of Necessity Considered from the Legal and Moral Points of View*, 48 DUKE L.J. 975, 1013 (1999) (applying intuition to the Trolley Problem and analogizing to common law distinction between misfeasance and nonfeasance). This intuition may stem from lived experiences which suggest that inaction is less likely to be intentional. *Cf.* Richard S. Kay, *Causing Death for Compassionate Reasons in American Law*, 54 AM. J. COMP. L. 693, 712 (2006) (explaining that the persistence of a distinction between action and inaction "may reflect some idea that inaction often can be explained by inadvertence or mistake, while positive actions are, more generally, intentional" and that when the categories each involve intentional decisions, "the differential legal treatment of misfeasance and nonfeasance seems contrived").

51. *See Aronson* 473 A.2d at 813 ("[A] conscious decision to refrain from acting may nonetheless be a valid exercise of business judgment and enjoy the protections of the rule.") (subsequent history omitted); Quadrant Structured Prods. Co. v. Vertin, 102 A.3d 155, 183 (Del. Ch. 2014) ("The Complaint alleges that the Board had the ability to defer interest payments on the Junior Notes, that the Junior Notes would not receive anything in an orderly liquidation, that [Defendant] owned all of the Junior Notes, and that the Board decided not to defer paying interest on the Junior Notes to benefit [Defendant]. A conscious decision not to take action is just as much of a decision as a decision to act."); *In re* China Agritech, Inc. S'holder Deriv. Litig., 2013 WL 2181514, at *23 (Del. Ch. May 21, 2013) ("The Special Committee decided not to take any action with respect to the Audit Committee's termination of two successive outside auditors and the allegations made by Ernst & Young. The conscious decision not to take action was itself a decision."); Krieger v. Wesco Fin. Corp., 30 A.3d 54, 58 (Del. Ch. 2011) ("Wesco stockholders had a choice: they could make an election and select a form of consideration, or they could choose not to make an election and accept the default cash consideration."); Hubbard v. Hollywood Park Realty Enters., Inc., 1991 WL 3151, at *10 (Del. Ch. Jan. 14, 1991) ("From a semantic and

insulate conscious inaction from fiduciary review will founder on these realities. Thus, even a thin version of fiduciary loyalty—non-betrayal—can be framed as requiring that a fiduciary not sit passively if the fiduciary knows that inaction will cause the beneficiary to suffer harm.

B. *Locating Directors on the Spectrum of Loyalties*

When located within this spectrum, the director's duty of loyalty manifests as an intermediate version that uses the concept of good faith to require an explicit, other-regarding mindset. The director's duty does not turn on objective outcomes nor does it require self-sacrifice or altruism.

To reiterate, for a director to act in good faith under Delaware law means acting with the subjective belief that the decision serves the best interests of the corporation and its stockholders. For a director to act in bad faith means acting with an actual intent to do harm to the corporation or its stockholders or by engaging in an intentional dereliction of duty, such as a conscious disregard for one's responsibilities.[52]

These characterizations capture two different levels of the duty of loyalty. The examples of bad faith capture the non-betrayal version. The concept of good faith goes beyond non-betrayal version to require the affirmative subjective pursuit of the other's best interests, such that a director can be disloyal by acting "with a purpose other than that of advancing the best interests of the corporation."[53] Affirmative betrayal is

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even legal viewpoint, 'inaction' and 'action' may be substantive equivalents, different only in form."); Jean-Paul Sartre, Existentialism Is a Humanism 44 (Carol Macomber trans., Yale Univ. Press 2007) ("[W]hat is impossible is not to choose. I can always choose, but I must also realize that, if I decide not to choose, that still constitutes a choice.").

52. *See* Part II.B, *supra*.

53. *Disney II*, 906 A.2d at 67; *accord Stone*, 911 A.2d at 369 ("A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation . . . ."); *see* Gagliardi v. Trifoods Int'l Inc., 683 A.2d 1049, 1051 n.2 (Del. Ch. 1996) (Allen, C.) (defining a "bad faith" transaction as one "that is authorized for some purpose *other than* a genuine attempt to advance corporate welfare or is *known to constitute* a violation of applicable positive law"); *RJR Nabisco*, 1989 WL 7036 at *15 (Allen, C.) (explaining that the business judgment rule would not protect "a fiduciary who could be shown to have caused a transaction to be effectuated (even one in which he had no financial interest) for a reason unrelated to a pursuit of the corporation's best interests").

not required. The reason why the director lacked the necessary other-regarding mindset also does not matter.[54] The absence of the necessary mental state can result from any human emotion that causes the director "to place his own interests, preferences, or appetites before the welfare of the corporation," including greed, hatred, lust, envy, revenge, shame or pride.[55]

Under Delaware law, the duty of loyalty does not require deliberative exclusivity, only deliberative priority. A director can have other motivations for acting, as long as the principal or predominant motivation is to serve the best interests of the corporation and its stockholders.[56] A director thus can believe that paying herself compensation is in the best interests of the company and would act in good faith by approving the compensation arrangement, even though she necessarily has a personal interest in the compensation.

For directors, the duty of loyalty is clearly prescriptive. In *Unocal*, the Delaware Supreme Court held that "in the broad context of corporate governance, including issues of fundamental corporate change, a board of directors is not a passive instrumentality."[57] The board instead has a "fundamental duty and obligation to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, irrespective of its source."[58]

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54. *In re* Walt Disney Co. Deriv. Litig., 907 A.2d 693, 754 (Del. Ch. 2005) (*Disney I*) ("It makes no difference the reason why the director intentionally fails to pursue the best interests of the corporation."), *aff'd*, 906 A.2d 27 (Del. 2006); *see* Nagy v. Bistricer, 770 A.2d 43, 48 n.2 (Del. Ch. 2000) ("[R]egardless of his motive, a director who consciously disregards his duties to the corporation and its stockholders may suffer a personal judgment for monetary damages for any harm he causes," even if for a reason "other than personal pecuniary interest.").

55. *RJR Nabisco*, 1989 WL 7036 at *15; *see Guttman*, 823 A.2d at 506 n.34 ("The reason for the disloyalty (the faithlessness) is irrelevant, the underlying motive (be it venal, familial, collegial, or nihilistic) for conscious action not in the corporation's best interest does not make it faithful, as opposed to faithless.").

56. *See* Coster v. UIP Companies, Inc., 300 A.3d 656, 675 (Del. 2023) (affirming judgment for fiduciary defendants who had mixed motives where their predominant motive was to protect the corporation and advance its best interests).

57. *Unocal*, 493 A.2d at 954.

58. *Id. accord* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (explaining that because directors have taken on a role that calls for representing "the financial interests of others," they have "an affirmative duty to protect those interests. . . .") (subsequent history omitted).

The director's duty of loyalty stops short of the highest level and does not require altruism or self-sacrifice. A director is not obligated to provide capital to a struggling corporation. And a director can freely resign, even if the director believes that remaining would be in the corporation's best interests.[59]

IV.
A Stockholder Controller's Duties

Having established a baseline by identifying the fiduciary duties of a director, the next step is to examine the fiduciary duties of a stockholder controller. If the assertion of fiduciary equivalency is accurate, then the duties should be identical. That turns out to be true for the duty of care, but not for the duty of loyalty.

A. *The Stockholder Controller's Duty of Care*

Under the general rule that stockholder controllers owe the same duties as directors, a stockholder controller should owe a duty of care. As noted previously, Delaware decisions have often spoken of stockholder controllers owing duties of both loyalty and care.[60]

Three cases have questioned the extent to which a stockholder controller could owe a duty of care. In *Harris v. Carter*, the plaintiff alleged that a stockholder controller had breached its duty of care by selling its control block without investigating whether the buyer posed a threat to the corporation.[61] Chancellor Allen held that the plaintiff had stated a viable claim, but took pains to ground the care-based obligation on the general duty that anyone in society owes to every other person, and he expressly analogized the controller's alleged misconduct to a negligent driver who injures her passenger in a collision.[62] Chancellor Allen had elsewhere expressed the view that a stockholder controller could take action as a stockholder without any overlay of fiduciary duties whatsoever,[63] so that move may

59. *See* Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401, 408 (Del. 1985) ("Directors are also free to resign.").

60. *See* note 13, *supra* (collecting cases).

61. *Harris*, 582 A.2d at 232.

62. *Id.* at 235.

63. *E.g.*, Thorpe v. CERBCO, Inc., 1995 WL 478954 (Del. Ch. Aug. 9, 1995) (*Thorpe I*), (asserting that "[w]here [stockholder controllers] exercise

have been an effort to maintain coherence with the no-duties position. Ironically, shifting away from the fiduciary framework subjects the controller to liability for negligence, rather than the higher recklessness standard that governs the fiduciary version of the claim.

Later decisions also questioned whether a stockholder controller could owe a duty of care when selling its control block, at least when a corporation has a charter provision that exculpates directors for beaches of the duty of care.[64] One decision asserted more generally that a stockholder controller cannot be

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no power over the corporation to facilitate their own sale, (putting aside questions of inside information under federal securities law) they are privileged to sell their shares for what they can get, even while the corporation itself is selling its stock."), *aff'd in part, rev'd in pertinent part sub nom.* Thorpe by Castleman v. CERBCO, Inc., 676 A.2d 436 (Del. 1996); Freedman v. Rest. Assocs. Indus., Inc., 1990 WL 135923, at *6 (Del. Ch. Sept. 19, 1990) ("Thus, a shareholder, even a majority shareholder, has discretion as to when to sell his stock and to whom, and I find no basis for holding the management group liable to plaintiffs for exercising that discretion qua shareholder."); *see also* Abraham v. Emerson Radio Corp., 901 A.2d 751, 759 (Del. Ch. 2006) (asking "by what logic does the judiciary extend liability to a controller exercising its ordinarily unfettered right to sell its shares?").

English decisions demonstrate how difficult it is to maintain the formalistic position. Because the right to vote is an attribute of the stockholder's shares, English decisions nominally describe that right as one that even a majority stockholder can exercise in a non-fiduciary capacity. *See* Zipora Cohen, *Fiduciary Duties of Controlling Shareholders: A Comparative View*, 12 U. PA. J. INT'L BUS. L. 379, 381 (1991); *see id.* at 379 ("English law denies the imposition of a fiduciary duty on controlling shareholders."). Yet despite this baseline assertion, English decisions place limits on the ability of a majority stockholder to exercise its voting rights. One applies to amendments to the articles of association, where "the majority may alter the company's constitution only when this power is exercised in good faith for the benefit of the company." *Id.* Another involves the concept "fraud on the minority," which generally means the majority expropriating either the property of the company or the property of the minority. *Id.* at 382. A stockholder controller would commit a fraud on the minority that equity would not allow if it used its majority voting power to ratify an interested transaction between the company and the stockholder's representative on the board, or if it used its majority voting power to approve an amendment to the articles of association that would impose a redemption call right on the shares. *Id.*

64. *See Emerson Radio Corp.*, 901 A.2d at 759 (expressing doubt about whether "our common law of corporations should recognize a duty of care-based claim against a stockholder controller for failing to (in a court's judgment) examine the bona fides of a buyer, at least when the corporate charter contains an exculpatory provision authorized by 8 Del. C. § 102(b)(7)."). *See also* Firefighters' Pension Sys. of City of Kan. City, Mo. Tr. v. Presidio, Inc., 251 A.3d 212, 284 (Del. Ch. 2021) (disagreeing with *Shandler* on the implications of Section 102(b)(7) for controllers).

held liable for a breach of the duty of care if the corporation's charter contains an exculpatory provision.[65] But that decision supported that proposition by citing a non-Delaware decision that relied on principles of agency law, including the proposition that "[o]rdinarily, a principal cannot be sued for acts of an agent for which the agent cannot be sued."[66] Delaware law generally does not deploy agency principles when analyzing the fiduciary relationship between directors and stockholders.[67] Regardless, introducing the concept of exculpation presumes the existence of an underlying duty of care that warrants exculpation. Consistent with cases acknowledging that stockholder controllers owe duties of both loyalty and care, a more recent decision holds that a stockholder controller owes a duty of care when exercising stockholder-level rights.[68]

The better reading of the cases imposes on stockholder controllers a duty not to harm the company or its minority stockholders through grossly negligent action, with gross negligence

65. Shandler v. DLJ Merch. Banking, Inc., 2010 WL 2929654, at *16 (Del. Ch. July 26, 2010).

66. Off. Comm. of Unsecured Credit. of Color Tile, Inc. v. Investcorp S.A., 137 F. Supp. 2d 502, 515 (S.D.N.Y. 2001), *cited in Shandler*, 2010 WL 2929654, at *16 n.140.

67. *See, e.g.*, Weinstein Enters., Inc. v. Orloff, 870 A.2d 499, 509 (Del. 2005); *Skye Mineral*, 2020 WL 881544 at *24; Abercrombie v. Davies, 123 A.2d 893, 898–99 (Del. Ch. 1956). There are isolated cases that loosely refer to stockholders as principals and directors as their agents, but these descriptions appear more metaphorical than doctrinal. *See, e.g.,* Calma v. Templeton, 114 A.3d 563, 579 (Del. Ch. 2015) ("In the corporate law context, stockholders (as principal) can, by majority vote, retrospectively and, at times, prospectively, act to validate and affirm the acts of the directors (as agents)." (footnote omitted)); Desimone v. Barrows, 924 A.2d 908, 917 (Del. Ch. 2007) (asserting that requiring directors to specify the precise amount and form of their compensation when seeking stockholder ratification "ensure[s] integrity" in the underlying principal-agent relationship between stockholders and directors); UniSuper Ltd. v. News Corp., 2005 WL 3529317, at *8 (Del. Ch. Dec. 20, 2005) (analogizing directors to agents and stockholders to principals). Given that Section 141(a) of the Delaware General Corporation Law confers statutory authority on the board of directors to manage the business and affairs of the corporation, "[c]learly, directors are not mere agents." Julian Velasco, *Fiduciary Duties and Fiduciary Outs*, 21 GEO. MASON L. REV. 157, 164 (2013); *see* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 605 (2003) (reviewing authorities and concluding that "the board of directors is not a mere agent of the shareholders"); Deborah A. DeMott, *The Mechanisms of Control*, 13 CONN. J. INT'L L. 233, 253 (1999) ("Even when the parent owns all the stock in the subsidiary, its directors are not agents of the parent.").

68. *In re* Sears Hometown & Outlet Stores, Inc. S'holder Litig., 2024 WL 262322 (Del. Ch. Jan. 24, 2024) (*Sears*).

having the stringent connotation of recklessness that Delaware corporate law imposes. That duty of care parallels the directors' duty. At least as to the duty of care, the assertion of fiduciary equivalence holds.

B. *The Stockholder Controller's Duty of Loyalty*

Case law shows that unlike the duty of care, the duty of loyalty operates differently for directors and stockholder controllers. The duty of loyalty governs the behavior stockholder controllers in two different settings. One is where the stockholder controller exercises corporate power as part of an interested transaction. The other is when the stockholder controller unilaterally exercises stockholder-level rights. Those rights fall into three general categories: governance rights, such as the right to vote; economic rights, such as the right to sell or receive dividends; and litigation rights, such as the right to sue.[69]

1. *Interested Transactions with a Stockholder Controller*

Interested transactions provide the most familiar setting that implicates the fiduciary duties of a stockholder controller. Envision a proposed squeeze-out merger in which the subsidiary board has an independent majority. In this setting, the controller has not taken over the boardroom. To make the hypothetical even cleaner, assume that any directors who are affiliated with the controller absent themselves from any discussions about the transaction and recuse themselves from the vote. In this setting, the stockholder controller has only two roles. One is as the corporation's contractual counterparty under the merger agreement. The other is as the provider of stockholder-level approval for the merger.

In this setting, the directors owe the full range of fiduciary duties. They must exercise due care.[70] They must act in good faith by believing subjectively that the merger serves the best interests of the corporation and its stockholders.[71] And they must act loyally by not allowing the interests of the stockholder

69. New Enter. Assocs. 14 L.P. v. Rich (NEA), 295 A.3d 520, 570 (Del. Ch. 2023).
70. *Supra,* Sec. III.A.
71. S*upra,* Sec. III.B.

controller to shape the terms of the transaction and by not extracting unfair benefits for themselves.[72]

The director's duty in this setting is not merely to seek a fair price. Rather, their duty is to seek the highest possible price through "the energetic, informed, and aggressive negotiation that one would reasonably expect from an arm's length adversary."[73] The directors cannot merely assess whether a transaction is fair; they must "approve only a transaction that is in the best interests of the public shareholders, [and] to say no to any transaction that is not fair to those shareholders and is not the best transaction available."[74]

The stockholder controller's loyalty obligation is different. The stockholder controller has no obligation as a contractual counterparty to believe that the transaction is in the best interests of the company or to pursue that end. As the potential acquirer, the stockholder controller can bargain in its own self-interest.

But because the stockholder controller also delivers the necessary vote, the stockholder controller is not freed of all fiduciary obligation. The stockholder controller cannot use its voting power to approve terms that are unfair, meaning terms that harm the corporation or the minority stockholders.[75] Chancellor Wolcott first articulated that principle in the seminal *Allied Chemical* decision. The case involved a sale of substantially all of the corporation's assets,[76] which was the principal transactional structure of the day.[77] The Chancellor explained that

72. *In re* Trans World Airlines, Inc. S'holders Litig., 1988 WL 111271, at *7 (Del. Ch. Oct. 21, 1988) (Allen, C.).

73. *See id.*

74. *In re* First Boston, Inc. S'holders Litig., 1990 WL 78836, at *7 (Del. Ch. June 7, 1990) (Allen, C.)

75. *Id.*

76. *Allied Chem.*, 120 A. at 488.

77. *See, e.g.,* Stream TV Networks, Inc. v. SeeCubic, Inc., 250 A.3d 1016, 1033 (Del. Ch. 2020) ("The current dominance of the merger as the transactional vehicle for selling a corporation has caused the earlier predominance of the sale of assets to fade from memory."). In the Nineteenth Century "a merger almost always meant the melding of two different businesses into one, akin to the formation of a partnership among individual proprietorships. All of the stockholders in all of the constituent corporations had to approve the combination, and each automatically became a stockholder of the surviving corporation." 2 David A. Drexler et al., Delaware Corporation Law and Practice, § 35.03, at 35-4.(2018 & Supp. 2020). "The concept of a 'merger' thus meant a direct, stock-for-stock merger between two entities, and it required unanimous stockholder approval to effectuate." *Stream TV*, 250 A.3d at 1033.

while the Delaware General Corporation Law gave a majority stockholder the power to approve the transaction, the existence of the statute "supplies no reason for clothing it with a superior sanctity, or vesting it with the attributes of tyranny."[78] Instead, a court of equity would act "if it should appear that the power is used in such a way that it violates any of those fundamental principles which [are] the special province of equity to assert and protect."[79]

For the stockholder controller, that equated to a more limited duty of loyalty.[80] As Chancellor Wolcott explained, the duty of loyalty did not require that the stockholder controller act "in the best interests of the corporation" when deciding whether or not to vote in favor of the transaction.[81] It required instead that the stockholder controller only approve a sale "upon terms and conditions that are fair to the corporation."[82] At the time, that obligation applied not only when the buyer was an affiliate of the stockholder controller, but also in a third party sale, when the controller still had an obligation to obtain "a fair and adequate price."[83] Today, the obligation only applies in interested transactions, which includes nominally third-party transaction

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The merger remained a "cumbersome, seldom-used mechanism," in the first half of the twentieth century, when *Allied Chemical* was decided. The merger's dominance as the prevailing form of transaction after amendments to the DGCL in 1941 and 1967 significantly loosened the requirements for executing a merger. 43 Del. Laws ch. 132, § 12 (1941); 56 Del. Laws ch. 50 (1967); *see* 1 R. Franklin Balotti & Jesse A. Finkelstein, The Delaware Law of Corporations & Business Organizations § 9.11 (3d ed. 1998 & 2011 Supp.); *see also* Del. Code Ann. tit. 8, § 251. Before Delaware's General Assembly liberalized Delaware's merger statues, the preferred transaction structure involved the target corporation selling all of its assets to the acquirer, then dissolving and distributing the consideration to its stockholders. *See generally* 2 David A. Drexler et al., Delaware Corporation Law and Practice §§ 37.04 at 37-8 to -9; Henry Winthrop Ballantine, Ballantine on Corporations §§ 279–80 (1946); George S. Hills, *Consolidation of Corporations by Sale of Assets and Distribution of Shares*, 19 Cal. L. Rev. 349 (1931).

78. *Allied Chem.*, 120 A. at 491.

79. *Id.*

80. *Id.* at 490–91.

81. *Id.* at 490 ("As I read the statute, therefore, the bald question of whether the entire assets should be sold is to be determined by the stockholders entirely aside from the question of whether it would be to the best interests of the corporation to sell them.").

82. *Id.* ("The price to be paid, the manner of payment, the terms of credit, if any, and such like questions, must all meet the test of the corporation's best interest.").

83. *Id.*

in which the stockholder controller receives a unique benefit, such as differential consideration, or uniquely avoids a detriment.[84]

Delaware decisions subsequently extended these principles to squeeze-out mergers.[85] The stockholder controller in that setting can vote its shares to approve the merger, but the controller's duty of loyalty still requires fair terms.

In an interested transaction, therefore, the scope of the controller's duty of loyalty becomes equivalent to the substance of the entire fairness test. Although that test has been described as Delaware's "most onerous standard of review,"[86] it technically does not require anything more than non-harm. Yes, the standard imposes a unitary test that requires a court to consider all aspects of fairness, but all the standard ultimately requires is that stockholders receive at least "the substantial equivalent in value of what [they] had before."[87] That is the essence of non-harm.

The entire fairness test is a unitary standard with two dimensions: a substantive dimension, colloquially referred to as a fair price, and a procedural dimension, colloquially referred to as fair dealing.[88] The Delaware courts have held that in a transaction untainted by fraud, coercion, or other serious instances

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84. *E.g.*, Harcum v. Lovoi, 2022 WL 29695, at *13 (Del. Ch. Jan. 3, 2022); *In re* Crimson Expl., Inc. S'holders Litig., 2014 WL 5449419, at *12–14 (Del. Ch. Oct. 24, 2014).

85. Tanzer v. Int'l Gen. Indus., Inc., 379 A.2d 1121, 1124 (Del. 1977) ("IGI, as a stockholder of Kliklok, had a right to look to its own corporate concerns in determining how to conduct the latter's affairs, including a decision to cause it to merge. The formal way in which that interest was exercised was in voting its shares generally, and on the merger proposal, specifically. In short, in so doing, IGI is entitled to the benefit of the Ringling rule. And that includes a decision to cause the Kliklok merger (subject, of course, to the duty it owes other stockholders)."), *overruled on other grounds by* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983) (rejecting the business purpose test that *Tanzer* also applied).

86. *Coster*, 300 A.3d at 662.

87. *Sterling*, 93 A.2d at 114; *accord* Rosenblatt v. Getty Oil Co., 493 A.2d 929, 940 (Del. 1985) ("[T]he correct test of fairness is 'that upon a merger the minority stockholder shall receive the substantial equivalent in value of what he had before.' " (quoting *Sterling*, 93 A.2d at 114)); *see* Lawrence A. Hamermesh & Michael L. Wachter, *The Fair Value of Cornfields in Delaware Appraisal Law*, 31 J. Corp. L. 119, 139 (2005) (arguing for a remedial standard that "provides the minority shareholders with the value of what was taken from them. . . . ").

88. *Weinberger*, 457 A.2d at 711 ("[T]he test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.").

of unfair dealing, the substantive dimension will be "the preponderant consideration."[89] The test for fair price is "a price that is within a range that reasonable men and women with access to relevant information might accept."[90] That means the value that either the corporation or the minority stockholders could obtain from a third party in an arm's length transaction. As long as that standard is met, the beneficiary has not been harmed relative to what the market would pay, and the resulting price is fair.

The procedural dimension of fair process operates in service of the substantive fair price assessment. Steps taken to replicate arm's length bargaining provide strong evidence of a fair process and hence supports a finding of overall fairness.[91] That is because arm's length bargaining supports an inference that the negotiations resulted in a market price, meaning that the corporation and its minority stockholders were not harmed relative to what they could have obtained from a third party.

There is a further complication that requires additional analysis: Under Delaware law, a fiduciary is not only liable for harm caused, but also can be forced to disgorge any benefit received.[92] Disgorgement, however, is another way of achieving non-harm. If a fiduciary wrongfully takes an asset, there are two remedial paths to restore the beneficiary to the equivalent of its unharmed, *ex ante* position. One is compensatory damages, the other is rescission.

The standard remedy of compensatory damages values the harm at the time of the taking, thereby eliminating any harm as measured at that point in time. The court then brings the amount necessary to achieve non-harm current to the time of judgment by awarding interest.

The equitable remedy of rescission is another means of achieving non-harm, but it achieves that goal by undoing the transaction that caused harm. That step eliminates all harm by restoring the plaintiff to the *status quo ante*. Rescission is

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89. *Id.*

90. Kahn v. Tremont Corp., 1996 WL 145452, at *1 (Del. Ch. Mar. 21, 1996), *rev'd on other grounds*, 694 A.2d 422 (Del. 1997).

91. *In re* Tesla Motors, Inc. S'holder Litig., 298 A.3d 667, 701 (Del. 2023); *accord Cinerama*, 663 A.2d at 1172; *Weinberger*, 457 A.2d at 711.

92. *E.g.*, Kahn v. Kolberg Kravis Roberts & Co., L.P., 23 A.3d 831, 838 (Del. 2011); Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939); Pike v. Commodore Motel Corp., 1986 WL 13007, at *3 (Del. Ch. Nov. 14, 1986) *aff'd*, 529 A.2d 772 (1987).

often impractical, and under those circumstances, the court can award rescissory damages to provide the monetary equivalent of rescission. A rescissory damages award values what the fiduciaries gained as of the time of judgment, then subtracts the value of what the beneficiaries received, also measured at the time of judgment. By awarding the difference as rescissory damages, the court puts the beneficiary in the same financial position as if the transaction had been rescinded, thereby eliminating any harm.

Disgorgement is a form of rescissory damages. The underlying goal is to eliminate the consequences of the fiduciary breach, which in a disgorgement setting involved the fiduciary's receipt of an improper benefit. But for the fiduciary breach, that benefit could have inured to the benefit of the beneficiary. Compared to what the beneficiary's legitimate expectations, the beneficiary was harmed. Forcing the fiduciary to disgorge the benefit avoids the harm the beneficiary suffered relative to the position it could have been in had the fiduciary acted loyally.

All of the potential remedies for a fiduciary breach thus seek to achieve non-harm from the standpoint of the beneficiary. Rescissory damages and disgorgement both achieve that goal by forcing the fiduciary to disgorge any benefit that the fiduciary may have received, that is not a new or different remedial component. It is a different way of approaching the goal of eliminating all possibility of harm.

Interestingly, current Delaware law prioritizes awards of compensatory damages, rather than rescissory damages. In 1983, just two years after holding that rescissory damages could be awarded for a cash-out merger that was infected with disclosure violations,[93] the Delaware Supreme Court retreated and emphasized that rescissory damages should not be the "exclusive" remedy, instead prioritizing a fair value measure equivalent to appraisal.[94] By doing so, the Delaware Supreme Court pointed courts and litigants towards a compensatory measure that is arguably less effective at fully achieving the goal of non-harm. Since *Weinberger*, very few decisions have awarded

93. Lynch v. Vickers Energy Corp., 429 A.2d 497 (Del. 1981), *overruled by Weinberger*, 457 A.2d 701.
94. *Weinberger*, 457 A.2d 701.

rescissory damages.[95] Even fewer have ordered disgorgement.[96] Both are often cited as possible remedies, but the court ultimately grants a compensatory award.[97]

Delaware thus operates a fiduciary regime for interested transactions based on non-harm. Even in an interested transaction, a stockholder controller's duties are limited to that version of the duty of loyalty. A stockholder controller need not act in the best interests of the corporation or its minority stockholders.

2. *Unilateral Actions by a Controller*

Most lawsuits that challenge a stockholder controller's actions involve an interested transaction. But stockholder controllers can take some actions unilaterally. Most notably, a stockholder controller can vote its shares, sell its block, or sue the directors. Because every stockholder has similar rights, some decisions assert that their exercise is never subject to fiduciary review and treated the formalistic answer as the end of

95. *E.g.*, Deane v. Maginn, 2022 WL 16557974, at *1 (Del. Ch. Nov. 1, 2022), *appeal dismissed*, 291 A.3d 651 (Del. 2023) ("After trial, I find that Maginn breached his duty of loyalty when he usurped from New Media II-B the opportunity to obtain the new warrants. I award rescissory damages to remedy that harm."); Basho Techs. Holdco B, LLC v. Georgetown Basho Invs., LLC, 2018 WL 3326693 (Del. Ch. July 6, 2018) ("The plaintiffs seek a rescissory damages . . . . In my view, a damages award of this nature is warranted on the facts of this case. . . ."), *aff'd sub nom.* Davenport v. Basho Techs. Holdco B, LLC, 221 A.3d 100 (Del. 2019); Strassburger v. Earley, 752 A.2d 557, 579–82 (Del. Ch. 2000) (awarding rescissory damages against three directors for breach of duty of loyalty in connection with share repurchases).

96. *E.g.*, Valeant Pharm. Int'l v. Jerney, 921 A.2d 732, 752–53 (Del. Ch. 2007) ("Because Jerney has failed to show that the transaction was entirely fair, it is clear that he has no right to retain any of the $3 million bonus he received. As between Jerney and the company, that payment must be rescinded, requiring Jerney to disgorge the full amount.").

97. *E.g.*, *Sears*, 2024 WL 262322, at *50–51 (considering an award of rescissory damages but granting a compensatory remedy); Bamford v. Penfold, L.P., 2022 WL 2278867, at *51–52 (Del. Ch. June 24, 2022) (considering an award of disgorgement but granting a compensatory remedy); *In re* Dole Food Co., Inc. S'holder Litig., 2015 WL 5052214, at *44–46 (Del. Ch. Aug. 27, 2015) (considering an award of rescissory damages but granting a compensatory remedy); *Reis*, 28 A.3d at 466–68, 479 (considering an award of rescissory damages but granting a compensatory remedy); *In re* Sunbelt Beverage Corp. S'holder Litig., 2010 WL 26539 (Del. Ch. Jan. 5, 2010) (considering an award of rescissory damages but granting a compensatory remedy).

the story.[98] Other decisions, however, disconfirm that approach, at least for the right to sell and the right to vote. Cases have not yet explored the extent to which fiduciary limitations apply to the right to sue.

a. The Right to Vote

The right to vote is where Delaware decisions have been most explicit about a stockholder controller's duties. Exercising that right, a stockholder controller approve or reject any issue that requires the affirmative vote a majority of the outstanding shares, such as a mergers,[99] sales of all or substantially all assets, [100] charter amendments,[101] or dissolution.[102] A stockholder controller also can use its voting power to amend, alter, or repeal bylaws.[103] Finally, a stockholder controller can use its voting power to elect or remove directors.[104]

The Delaware Supreme Court's decision in *Bershad v. Curtiss-Wright* provides the canonical authority on the right to vote. The relevant passage states:

> Stockholders in Delaware corporations have a right to control and vote their shares in their own interest. *They are limited only by any fiduciary duty owed to other stockholders.* It is not objectionable that their motives may be for

98. *See* note 64, *supra.* As discussed previously, English law shows how difficult it is to maintain the formalistic position. *See* note 63, *supra. see id.* at 379 ("English law denies the imposition of a fiduciary duty on controlling shareholders."). Yet despite this baseline assertion, English decisions place limits on the ability of a majority stockholder to exercise its voting rights. One applies to amendments to the articles of association, where "the majority may alter the company's constitution only when this power is exercised in good faith for the benefit of the company." *Id.* Another involves the concept "fraud on the minority," which generally means the majority expropriating either the property of the company or the property of the minority. *Id.* at 382. A stockholder controller would commit a fraud on the minority that equity would not allow if it used its majority voting power to ratify an interested transaction between the company and the stockholder's representative on the board, or if it used its majority voting power to approve an amendment to the articles of association that would impose a redemption call right on the shares. *Id.*

99. DEL. CODE ANN. tit. 8, § 251.

100. *Id.* § 271.

101. *Id.* § 242.

102. *Id.* § 275.

103. *Id.* § 109.

104. *Id.* §§ 141 & 211.

> personal profit, or determined by whim or caprice*, so long as they violate no duty owed other shareholders.*[105]

Most corporate lawyers are familiar with the non-italicized text, particularly the reference to whim or caprice. The italicized text, however, often gets ignored.

The *Bershad* court's reference to fiduciary limitations on the right to vote did not come out of thin air. In 1977, after surveying the history of Delaware law on stockholder controller voting, the Delaware Supreme Court used quite similar language, stating similar: "[F]or more than fifty years our Courts have held, consistent with the general law on the subject, that a stockholder in a Delaware corporation has a right to vote his shares in his own interest, including the expectation of personal profit, limited, of course, by any duty he owes to other stockholders."[106] Four decades earlier, Chancellor Wolcott explained that "stockholders have the right to exercise wide liberality of judgment in the matter of voting and may admit personal profit or even whims and caprice into the motives which determine their choice, so long as no advantage is obtained at the expense of their fellow stockholders."[107]

Cases implementing these principles fall into the three general areas where stockholders have a right to vote: votes on transactions, votes on bylaws, and votes for directors.

i. Voting on Transactions

Delaware cases have provided the most insight into voting on transactions. The *Bershad* decision stated flatly that the controller in that case "had no duty to sell [the controller company] to anyone."[108] Building on that statement, Court of

105. *Bershad*, 535 A.2d at 845.

106. *Tanzer*, 379 A.2d at 1124, *overruled on other grounds by Weinberger*, 457 A.2d 701.

107. Heil v. Standard Gas & Elec. Co., 151 A. 303, 304 (Del. Ch. 1930); *accord* Stroud v. Grace, 606 A.2d 75, 83–84 (Del. 1992) ("The fact that controlling shareholders voted in favor of the transaction is irrelevant as long as they did not breach their fiduciary duties to the minority holders."); Ringling Bros.-Barnum & Bailey Combined Shows v. Ringling, 53 A.2d 441, 447 (Del. 1947) ("Generally speaking, a shareholder may exercise wide liberality of judgment in the matter of voting, and it is not objectionable that his motives may be for personal profit, or determined by whims or caprice, so long as he violates no duty owed his fellow shareholders.").

108. *Bershad*, 535 A.2d at 847 ("Curtiss-Wright, of course, had no duty to sell Dorr-Oliver to anyone.").

Chancery decisions have asserted that a stockholder controller can vote against a transaction without any fiduciary overlay.[109] Summarizing *Bershad* and its progeny, a 2015 decision by the Delaware Supreme Court referred to a "long-standing rule that a controller does not have to entertain offers."[110]

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109. *See In re* Synthes, Inc. S'holder Litig., 50 A.3d 1022, 1041 (Del. Ch. 2012) (explaining that a controller could vote against competing transaction because "controllers have a right to vote their shares in their own interest."); Emerson Radio Corp. v. Int'l Jensen Inc., 1996 WL 483086, at *17 (Del. Ch. Aug. 20, 1996) ("But even if Shaw and Blair Fund were Jensen's 'controlling' stockholder, they violate no fiduciary duty by opposing Emerson's proposal or by supporting Recoton's, because even a majority stockholder is entitled to vote its shares as it chooses, including to further its own financial interest."); Frank v. Elgamal, 2014 WL 957550, at *21 (Del. Ch. Mar. 10, 2014) ("Because a stockholder controller has no duty to sell its stock, it has the obvious ability to reject any transaction it does not like."); *In re* John Q. Hammons Hotels Inc. S'holder Litig., 2009 WL 3165613, at *12 (Del. Ch. Oct. 2, 2009) (noting that a stockholder controller "could effectively veto any transaction").

110. Buttonwood Tree Value Partners, LP v. Sullivan, 126 A.3d 643, 2015 WL 6437218, at *1 (Del. 2015). In addition to relying on Chancery decisions, the *Buttonwood* decision cited *Malpiede v. Townson*, 780 A.2d 1075, 1099 (Del. 2001), which it describes as "agreeing with the Court of Chancery's conclusion that the majority stockholder had the 'right[ ] to vote down any transaction it did not favor.'" *Buttonwood*, 2015 WL 6437218, at *1 n.5. The *Malpiede* court did not express agreement with that statement of law, but rather with the Court of Chancery's dismissal of a tortious interference claim. The Delaware Supreme Court reached the same result on different grounds. The justices may well have agreed with the Court of Chancery's statement of the law, but that is not evident form the passage that the *Buttonwood* decision references. The *Buttonwood* decision also cites *Thorpe by Castleman v. CERBCO, Inc.*, 676 A.2d 436, 444 (Del. 1996), where the Delaware Supreme Court observed that "Because the alternative transaction would have been covered by [DGCL] § 271, the Eriksons had the statutory right as [controlling] shareholders to veto this transaction."). Acknowledging that a stockholder controller has a statutory right does not address whether the stockholder controller owes fiduciary duties when exercising the right. In *Thorpe*, the Delaware Supreme Court rejected the argument that a controller could exercise its statutory right free of any fiduciary duty, stating: "The shareholder vote provided by § 271 does not supersede the duty of loyalty owed by control persons, just as the statutory power to merge does not allow oppressive conduct in the effectuation of a merger. Rather, this statutorily conferred power must be exercised within the constraints of the duty of loyalty. In practice, the reconciliation of these two precepts of corporate law means that the duty of a controlling shareholder/director will vary according to the role being played by that person and the stage of the transaction at which the power is employed." *Thorpe*, 676 A.2d at 442. Later in the decision, the Delaware Supreme Court agreed that on the facts of the case, the controlling stockholders could block the transaction. *Id.* at 443.

Earlier Delaware case law was not so clear on this point. In *Epstein v. Celotex Corp.*, Chancellor Marvel contemplated that a majority stockholder's "higher duty to the public stockholders" might require it to vote in favor of

If the controller votes in favor of the transaction, however, then the controller has a loyalty-based obligation not to harm the minority or the corporation intentionally or knowingly. That obligation recalls Chancellor Wolcott's observation that a stockholder controller can vote freely "so long as no advantage is obtained at the expense of their fellow stockholders."[111] It also recalls his decision in *Allied Chemical*, where he held that a stockholder controller owed fiduciary duties when exercising its power to approve a sale of all a corporation's assets such that "if it should appear that the power is used in such a way that it violates any of those fundamental principles which it is the special province of equity to assert and protect."[112]

ii. Voting on Bylaw Amendments

A stockholder controller can also use its voting power to adopt, amend, or repeal bylaws. As with voting on transactions, Delaware law in this area suggests that a stockholder controller operates under a duty of loyalty that permits the stockholder controller to protect its control position (analogous to a vote against a transaction) but prevents a stockholder controller from knowingly or internationally harming the corporation or its minority stockholders. Both of the leading cases involve a controller's adoption of a bylaw that required board unanimity to take action. In each case, the unanimity requirement had the effect of locking up the board and preventing the board from taking action against the controller.

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a sale of assets, but concluded that the controller "had lived up to such duty" by acting fairly. Epstein v. Celotex Corp., 238 A.2d 843, 847 (Del. Ch. 1968).

111. *Heil*, 151 A. at 304; *accord Stroud*, 606 A.2d at 83-84 ("The fact that controlling shareholders voted in favor of the transaction is irrelevant as long as they did not breach their fiduciary duties to the minority holders."); Ringling Bros.-Barnum & Bailey Combined Shows v. Ringling, 53 A.2d 441, 447 (Del. 1947) ("Generally speaking, a shareholder may exercise wide liberality of judgment in the matter of voting, and it is not objectionable that his motives may be for personal profit, or determined by whims or caprice, so long as he violates no duty owed his fellow shareholders."). The *Stroud* decision thus explicitly calls out a controller's fiduciary duties when voting. The *Ringling Brothers* decision speaks of not violating a duty owed to other stockholders, which logically encompasses a fiduciary duty. If the *Ringling Brothers* only anticipated a potential contractual duty, the justices logically would have referred to a contractual duty. They instead referred in open ended fashion to "a duty."

112. *Allied Chem.*, 120 A. at 491.

The first decision was the Delaware Supreme Court's opinion in *Frantz Manufacturing*.[113] The controller implemented the bylaw amendment to prevent the incumbent board from diluting the controller's stake, which the incumbent directors believed was in the best interests of the corporation. In a clipped and enigmatic ruling, the justices described the bylaw amendment as "a permissible part of [the stockholder's] attempt to avoid its disenfranchisement as a majority shareholder" and concluded that the amendment was "not inequitable under the circumstances."[114] The decision suggests that the justices thought it was legitimate for the controlling stockholder to protect its majority stake against dilution and maintain the status quo. On the latter issue, the Delaware Supreme Court appeared to view the stockholder controller as having acted legitimately to protect its majority stake from dilution.

In *Hollinger v. Black*, by contrast, the Delaware Court of Chancery invalided a similar unanimity bylaw using an analysis that suggested a violation of the non-harming principle.[115] The stockholder controller had committed in writing to support a sale process overseen by the controlled company's board. The stockholder controller subsequently sought to implement a different transaction that was in his own best interest. To prevent the board from blocking his efforts, the stockholder controller adopted an unanimity bylaw. The court found that the amendments sought to "disable[] the [company] board from protecting the company from his wrongful acts."[116] The court concluded that the amendments "were clearly adopted for an inequitable purpose and have an inequitable effect" because they interfered with the board's ability to maximize value under the strategic process that [the stockholder controller] had agreed to support.[117] Put differently, the bylaw amendments injured the company by interfering with the board's rights under the sale process agreement.[118] The sale process agreement had defined the status quo, and the controller breached its duties by intentionally using its stockholder power to change

113. *Frantz Mfg.*, 501 A.2d 401.
114. *Id.*, at 407, 409.
115. Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1030 (Del. Ch. 2004), *aff'd*, 872 A.2d 559 (Del. 2005).
116. *Id.* at 1029–30.
117. *Id.* at 1080.
118. *Id.* at 1082.

it, knowingly harming the company in the process. In an abbreviated decision, the Delaware Supreme Court affirmed.[119]

Read together, *Frantz* and *Hollinger* suggest a standard of conduct under which a stockholder controller owes a duty of loyalty when amending, altering, or repealing bylaws, but that duty does not require that the stockholder controller act subjectively in the best interests of the entity. If the stockholder controller takes action to defend itself and preserve the status quo, as in *Frantz*, then the stockholder controller has acted permissibly, just as a stockholder can vote against a proposed transaction. But if the stockholder controller takes action affirmatively and intentionally harms the corporation, as in *Hollinger*, then the stockholder controller has breached its duty of loyalty.

iii. Voting on Directors

A controller's greatest power is the right to elect or remove directors. To explain the influence that comes from being able to determine who serves on the board, Chief Justice Leo Strine has colorfully invoked the political philosophy of Eddie Cochran in *Summertime Blues*: "I called my Congressman and he said quote, I'd love to help you, son, but you're too young to vote."[120] The *Summertime Blues* principle means that when push comes to shove, directors will help the constituency that has the power to remove or replace them. In a controlled company, that constituency is the stockholder controller.

Unfortunately, Delaware law provides minimal guidance about whether a stockholder controller owes fiduciary duties when electing, removing, or replacing directors. Some things are clear. For example, a stockholder controller is free to elect individuals with conflicts, including individuals who are loyal to the controlling stockholder, and a stockholder controller is not accountable under agency doctrines like *respondeat superior* for any actions that its appointees take merely because the

119. Black v. Hollinger Int'l Inc., 872 A.2d 559 (Del. 2005).

120. Leo E. Strine, Jr., *The Social Responsibility of Boards of Directors and Stockholders in Change of Control Transactions: Is There Any "There" There?*, 75 S. CAL. L. REV. 1169, 1186-87, 1187 n. 35 (2002) (citing Eddie Cochran, *Summertime Blues* (Liberty Records 1958) ("I'm gonna take two weeks, gonna have a fine vacation/I'm gonna take my problem to the United Nations/Well I called my congressman and he said, quote/'I'd love to help you, son, but you're too young to vote.'")).

stockholder controller elected the director.[121] Delaware decisions have also considered situations in which the members of a board of directors have been prepared to take action adverse to the interests of a controlling stockholder, such as by issuing a block of shares to dilute the controlling stockholder's interest, and held that a controller can respond legitimately to those efforts by removing directors.[122] Not only that, but Delaware decisions have asserted that the directors have a duty to inform the stockholder controller representatives about their plans so that the stockholder controller can take action to defend itself, even when the controller takes action contrary to what an independent board of directors has determined in its business judgment to be in the best interests of the company.[123]

At the same time, it is hard to believe that Delaware law would turn a blind eye to a scenario in which a controller acted knowingly or recklessly to elect directors who looted the company. There does not appear to be any principled distinction

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121. *See In re* PLX Tech. Inc. S'holders Litig., 2018 WL 2018535, at *50 (Del. Ch. Oct. 16, 2018) ("Delaware law does not recognize any basis to attribute the actions of an independent director to the control of the stockholder that nominated or appointed him, simply by virtue of the fact of the nomination or appointment."); Khanna v. McMinn, 2006 WL 1388744, at *28 (Del. Ch. May 9, 2006) (declining to impute liability to stockholder who appointed director under doctrine of *respondeat superior*"); Emerson Radio Corp. v. Int'l Jensen Inc., 1996 WL 483086, at *20 n.18 (Del. Ch. Aug. 20, 1996) (declining to impose fiduciary status on fund where one of three general partners who controlled the fund also served as a corporate director). That does not mean that a stockholder controller could not be held liable under *respondeat superior* if other factors were present, such as a true agency relationship between the controller and the director, independent of the controller's election of the director to the board.

122. *E.g.*, CBS Corp. v. Nat'l Amusements, Inc., 2018 WL 2263385, at *6 (Del. Ch. May 17, 2018) (holding that controller had the right to go first by protecting itself before board of directors could act against the controller).

123. *E.g.*, Adlerstein v. Wertheimer, 2002 WL 205684, at *11 (Del. Ch. Jan. 25, 2002) (holding that failure to inform chairman, CEO, and stockholder controller in advance of plan to dilute his block with the issuance of preferred stock constituted "trickery or deceit" that equity would not countenance); *see also* OptimisCorp v. Waite, 137 A.3d 970, 2016 WL 258871, at *2 (Del. 2016) (characterizing the term "super-director" as tendentious when used to describe the assertion in *Adlerstein* that a director who was not entitled to advance notice of meeting topics under the charter or bylaws in his capacity as a director nor as a stockholder was nevertheless entitled to advance notice because the individual was both a director and a controlling stockholder; expressing the contrary concern that "cliques of the board may confer and sandbag a fellow director" and that the law should not "encourage board factions to develop Pearl Harbor-like plans" that would enable directors affiliated with large blockholders to be "blindsided").

between (i) a claim against a stockholder controller for amending the bylaws in bad faith to harm the corporation and (ii) electing directors to do the same thing. Any duty that a stockholder controller owes when voting for directors would thus seem to be of the minimal, non-harming variety.

iv. The Composite Picture for the Right to Vote

Taken together, the authorities on voting indicate that when a stockholder controller acts to preserve the status quo, the stockholder controller is not subject to any fiduciary duty, including a duty of loyalty. If, however, a stockholder controller acts to change the status quo, then the stockholder controller owes a duty of loyalty. That duty only demands that the stockholder controller not harm the corporation or its minority stockholders knowingly or intentionally. It is thus fundamentally different than the standard that governs a director, which requires that the director believe in good faith that the transaction is in the best interest of the corporation and then act on that belief.

b. The Right to Sell

A stockholder controller's rights at the stockholder-level also include the right to sell. The cases in this area point to principles for the duty of loyalty that parallel the principles that govern the right to vote.

The *Bershad* decision again provides the starting point. There, the Delaware Supreme Court stated, "[c]learly, a stockholder is under no duty to sell its holdings in a corporation, even if it is a majority shareholder, merely because the sale would profit the minority."[124] As with the *Bershad* decision's comment on voting, that statement is ambiguous. On the one hand, the use of the phrase "no duty" indicates that a stockholder controller could decide not to sell free of any fiduciary constraint. On the other hand, the statement that a duty to sell would not exist "merely because the sale would profit the minority" leaves open the possibility that a stockholder controller might have a duty to sell under other circumstances.

As with votes against transactions, subsequent Delaware decisions have interpreted *Bershad* as standing for the proposition that a stockholder controller has an absolute right to

124. *Bershad*, 535 A.2d at 845.

refuse to sell.[125] At this point in the evolution of Delaware law, the decision not to sell is thus one that a controller does not make in a fiduciary capacity and to which fiduciary duties do not apply. It is not a fiduciary act.

The situation is different when a stockholder controller decides to sell its block. The common law originally permitted a stockholder controller to sell freely to anyone and at any price, without any duty to the corporation or the minority stockholders.[126] During the first half of the twentieth century, however, courts held that directors could breach their fiduciary duties by transferring their shares to a buyer for an above-market price, adding representatives of the buyer to the board, then resigning from their positions as directors.[127] Several cases involved buyers who proceeded to loot the corporation, and those cases held that the directors breached their duties by facilitating a takeover by the looter.[128] Having held that directors acted disloyally in that setting, courts found it easy to expand the paradigm to a stockholder controller. The doctrine thus emerged that a stockholder controller owed fiduciary duties when selling its shares and that those duties could be breached if a controller sold its shares to a looter, either knowingly or as a result of gross negligence.

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125. *Buttonwood*, 2015 WL 6437218, at *1 ("As a controlling stockholder of Central Steel, the trust was entitled to refuse to sell its 62.1% stake in Central Steel and control of Central Steel could therefore not pass without its consent."); Peter Schoenfeld Asset Mgmt. LLC v. Shaw, 2003 WL 21649926, at *1 (Del. Ch. July 10, 2003) ("Hughes, as a controlling stockholder, had no duty to sell its PanAmSat shares."), *aff'd*, 840 A.2d 642 (Del. 2003); Cincinnati Bell Cellular Sys. Co. v. Ameritech Mobile Phone Serv. of Cincinnati, Inc., 1996 WL 506906, at *12 (Del. Ch. Sept. 3, 1996) ("A majority stockholder in a Delaware corporation owes no duty to sell its holdings in the corporation just because the sale would profit the minority."); Mendel v. Carroll, 651 A.2d 297, 306 (Del. Ch. 1994) ("No part of [the Carroll family's] fiduciary duty as controlling shareholders requires them to sell their interest."); Freedman v. Rest. Assocs. Indus., Inc., 1990 WL 135923, at *6 (Del. Ch. Sept. 19, 1990) ("Thus, a shareholder, even a majority shareholder, has discretion as to when to sell his stock and to whom, and I find no basis for holding the management group liable to plaintiffs for exercising that discretion qua shareholder.").

126. Cohen, *supra* note 63 at 407.

127. *E.g.*, Insuranceshares v. N. Fiscal Corp., 35 F. Supp. 22, 24–25 (E.D. Pa. 1940); Bacchus v. Finkelstein, 23 F.2d 357, 359 (D. Minn. 1927); Forbes v. McDonald, 54 Cal. 98, 100 (1880); Gerdes v. Reynolds, 28 N.Y.S.2d 622, 631–33 (Sup Ct. 1941); Porter v. Healy, 91 A. 428, 431 (Pa. 1914).

128. *E.g.*, *Insuranceshares,* 35 F. Supp. at 24–25; *Gerdes*, 28 N.Y.S.2d at 661–63; *see* David S. Ruder, *Duty of Loyalty—A Law Professor's Status Report*, 40 BUS. LAW. 1383, 1395–96 (1985) ("The corporate fiduciary is not entitled to act in an arm's-length manner when dealing with the corporation or its shareholders.").

During the middle of the twentieth century, some scholars built on those decisions to argue that a stockholder controller should be subject to an even more onerous fiduciary constraint when selling a control block. Writing with Gardiner Means in *The Modern Corporation and Private Property*, Berle argued that "the power going with 'control' is an asset which belongs only to the corporation; and that payment for that power, if it goes anywhere, must go to the treasury."[129] In 1955, the United States Court of Appeals of the Second Circuit adopted that approach in a split decision,[130] holding that the Chairman and President Newport Steel Corporation, who also controlled 33% of its voting power, breached his fiduciary duties by selling his shares at a premium. The majority held that the corporation was entitled to damages equal to the difference between the price the Chairman received and the value of shares "without the appurtenant control."[131]

The *Perlman* decision generated strong reactions, with some praising it[132] and others criticizing it.[133] Four years later, in 1961, the United States District Court for the District of Minnesota used the same logic to award damages for a sale of control, and its decision was affirmed.[134] But rather than establishing a new watermark for stockholder controller duties, later decisions retreated to the rule that a controller only would breach its duties by knowingly or negligently selling to a looter.[135] Even Berle, who had favored a shared premium concept,

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129. ADOLF BERLE & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 244 (1933).

130. Perlman v. Feldman, 219 F.2d 173 (2d Cir. 1955).

131. *Id.* at 176.

132. *E.g.*, David Cowan Bayne, *The Sale of Control Premium: The Definition*, 53 MINN. L. REV. 285 (1969); Adolf A. Berle, *The Price of Power: Sale of Corporate Control*, 50 CORNELL L.Q. 628 (1965); William D. Andrews, *The Stockholders Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505 (1965); *see also*, Richard W. Jennings, *Trading in Corporate Control*, 44 CALIF. L. REV. 1 (1956); *see generally* Berle, *supra* note 5. David C. Bayne was a particularly prolific proponent of the shared-control rule and critic of control premiums for large blocks. Between 1963 and 2001, he published nineteen articles on the subject of corporate control, the impropriety of control premiums for large blocks, and the rationale for the shared control rule.

133. *E.g.*, Wilber G. Katz, *The Sale of Corporate Control*, 38 CHI. BAR RECORD 376 (1957); George B. Javoras, *Equal Opportunity in the Sale of Controlling Shares: A Reply to Professor Andrews*, 32 U. CHI. L. REV. 420 (1965); Alfred Hill, *The Sale of Controlling Shares*, 70 HARV. L. REV. 986 (1957).

134. Honigman v. Green Giant Co. 208 F. Supp. 754 (D. Minn. 1961), *aff'd*, 309 F.2d 667 (8th Cir. 1962), *cert. denied*, 372 U.S. 941 (1963).

135. *E.g.*, Swinney v. Keebler Co., 480 F.2d 573, 578 (4th Cir. 1973).

abandoned that position and endorsed no-selling-to-a-looter doctrine.[136]

Delaware follows the no-selling-to-a-looter doctrine, but it has added some twists. As discussed previously, two decisions have sought to limit the extent to which the duty of care could apply in such a setting.[137] No decision has questioned whether a stockholder controller owed a duty of loyalty when selling a control block. One decision has stated "a controlling shareholder has the right to sell his control share without regard to the interests of any minority shareholder, so long as the transaction is undertaken in good faith."[138] The decision did not define what "good faith" meant, but it presumably means a version of the duty of loyalty that requires, at a minimum, a good faith belief that the buyer is not a looter. Another decision acknowledges that a stockholder plaintiff can state a claim against a controlling stockholder by pleading "facts that indicate that the controller knew there was a risk that the buyer was a looter or otherwise intended to extract illegal rents from the subsidiary, at the expense of the subsidiary's remaining stockholders."[139] That is the essence of a loyalty claim.

Taken together, the cases addressing the sale of a control block parallel the decisions regarding a stockholder controller's exercise of its voting power. They indicate that when a stockholder controller decides not to sell, the stockholder controller is not subject to any fiduciary duty. But when a stockholder controller decides to sell, the stockholder controller owes a duty of loyalty that require the stockholder controller not to harm the corporation or its stockholders by intentionally or knowingly selling to a looter. Those duties are fundamentally different than the duties that a director owes, which include a requirement that the director believe in good faith that the transaction is in the best interest of the corporation and its stockholders.

c. Suing

The last of the three principal rights of a stockholder is the power to sue. Because a controller controls the corporation,

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136. Adolf A. Berle, *The Price of Power: Sale of Corporate Control*, 50 CORNELL L.Q. 628, 636 (1965).

137. *See Abraham*, 901 A.2d at 759; *Harris*, 582 A.2d at 232.

138. *In re* CompuCom Sys., Inc. S'holders Litig., 2005 WL 2481325, at *6 (Del. Ch. Sept. 29, 2005).

139. *Abraham*, 901 A.2d at 762.

the controller will generally not need to sue derivatively on the corporation's behalf. If the controller wants the corporation to pursue a claim, it can cause the corporation to pursue it. The controller also generally will not have any reason to sue the directors for breach of fiduciary duty, precisely because the directors usually do what the controller wants. In some situations, however, a controller may acquire a controlling position, such by acquiring a majority of the shares, and yet face resistance from directors who want to dilute the controller or otherwise defeat its control. In that setting, a controller may pursue litigation to assert its control or to remediate harm the controller suffered before it could assert its control. Those claims might invoke statutory rights that a stockholder can assert, such as by bringing an action under Section 225 of the DGCL to establish the validity of a corporate election or action taken by written consent. It could also involve an action for breach of fiduciary duty, either to stop incumbent directors from taking action or to recover for harm they caused the corporation to suffer. Or it could involve efforts to enforce other rights that the controller or the corporation possesses.

There do not appear as yet to have been any cases addressing whether a stockholder controller could breach its duty of loyalty by filing suit. By analogy to the scenarios involving a sale of stock or the adoption of a bylaw, a suit filed with the intent to harm the corporation presumably could breach the controller's duties of loyalty or care. That said, other remedies would also be available, such as Rule 11 sanctions, bad faith fee shifting, or a cause of action for malicious prosecution.

By analogy to the scenarios involving a sale of stock or the adoption of a bylaw, it seems clear is that a stockholder controller is not obligated to act in the best interest of the corporation and its stockholders when filing suit. A stockholder controller can assert its own rights against the corporation even if the litigation would redound to the corporation's detriment.

C. *No Duty of Self-Sacrifice*

Delaware authorities establish that like a board of directors, a stockholder controller's duty of loyalty does not require altruism or self-sacrifice.[140] At a minimum, that means that a

140. *See* Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883, 888 (Del. 1970) ("[T]he duty [of a parent to its subsidiary] does not require self-sacrifice from

stockholder controller does not have any duty to support the controlled firm when it experiences financial difficulties.[141] It also means that a stockholder controller need not share its own business opportunities or assets with the controlled corporation.[142] And a stockholder controller need not accept less attractive consideration to subsidize a third-party transaction that would deliver more value to the minority stockholders.[143]

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the parent."); *iSynthes*, 50 A.3d at 1040 ("Delaware law does not, however, go further than that and impose on stockholder controllers a duty to engage in self-sacrifice for the benefit of minority shareholders."); Odyssey Partners, L.P. v. Fleming Cos., Inc., 735 A.2d 386, 411 (Del. Ch. 1999) (stockholder controller was under no fiduciary obligation to agree to a proposal that would have "required significant and disproportionate self-sacrifice"); Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584, 598 (Del. Ch. 1986) ("While the law requires that corporate fiduciaries observe high standards of fidelity and, when self-dealing is involved, places upon them the burden of demonstrating the intrinsic fairness of transactions they authorize, the law does not require more than fairness. Specifically, it does not, absent a showing of culpability, require that directors or controlling shareholders sacrifice their own financial interest in the enterprise for the sake of the corporation or its minority shareholders.").

141. Cohen, *supra* note 63, at 396 ("The fiduciary duty which the majority shareholders owe to the company and to the minority does not require them to extend financial aid to the company when it experiences financial difficulties. . . . A breach would not exist even where the controlling shareholders are aware that such a contribution is the only way to save the company from being wound up."). 12B WILLIAM MEADE FLETCHER, FLETCHER CYC. CORP. § 5810, Westlaw (database updated Sept. 2023) ("[T]here is no duty on the part of majority shareholders to assist the corporation financially in its money difficulties and thereby shield it from financial destruction.").

142. In *Getty Oil Co. v. Skelly Oil Co.*, the Delaware Supreme Court held that Getty had no obligation to share an oil allotment it had received from a government regulator with its controlled subsidiary, stating that the parent's duty of loyalty "does not require self-sacrifice from the parent." 267 A.2d 883, 888 (Del. 1970). The Court of Chancery reached the same conclusion regarding a parent's tax asset. Meyerson v. El Paso Nat. Gas Co., 246 A.2d 789, 794 (Del. Ch. 1967).

143. *iSynthes*, 50 A.3d at 1041 ("'Controlling shareholders, while not allowed to use their control over corporate property or processes to exploit the minority, are not required to act altruistically towards them.' [The controller] was thus entitled to oppose a deal that required him to subsidize a better deal for the minority stockholders by subjecting him to a different and worse form of consideration. To hold otherwise would turn on its head the basic tenet that controllers have a right to vote their shares in their own interest.") (alteration removed) (quoting Thorpe v. CERBCO, Inc., 1993 WL 443406, at *7 (Del. Ch. Oct. 29, 1993) (Allen, C.)); *see CompuCom Sys.*, 2005 WL 2481325, at *7 ("This claim, that the minority shareholders were entitled to more per share consideration than Safeguard, the controlling shareholder, is not supported by Delaware law.").

The no-self-sacrifice principle lies at the heart of the concept that a stockholder controller can take action to protect itself and maintain the status quo.[144] A stockholder controller need not allow itself to be diluted, even if doing so is in the best interests of the corporation and its stockholders as a whole.[145] A stockholder controller also need not allow a board to take action, such as by pursing an acquisition or selling the company, even if doing so is in the best interests of the corporation and its stockholders as a whole.[146]

D. *Prescriptive or Proscriptive?*

The cases involving both interested transactions and unilateral action finally show that a stockholder controller's duty of loyalty differs from a directors in that it is prescriptive, not proscriptive. The ability of a stockholder controller to refuse to sell its shares into a value-maximizing transaction or vote in favor of a value-maximizing transaction demonstrates that a stockholder controller does not have an affirmative obligation to act in the best interests of the corporation and its stockholders. Instead, a stockholder can refuse to act, even if non-action prevents an outcome that would benefit the corporation and its stockholders.

V.
THE MYTH OF FIDUCIARY EQUIVALENCE DISPELLED

Delaware authorities thus dispel the myth of fiduciary equivalency. Authorities addressing specific examples of stockholder controller behavior disconfirm the assertion that stockholder controllers owe the same duties as directors. The negation of fiduciary equivalency also negates principles that depend on that assertion.

One claim that this article identified at the outset asserts that a stockholder controller "is no longer able to act in self-interest, but must act in the corporate interest only, and entire fairness applies to transactions with the controller."[147] The first half of this statement is not true. A stockholder controller can

144. *Sears*, 2024 WL 262322, at *27.
145. *Frantz Mfg.*, 501 A.2d at 407.
146. *Sears*, 2024 WL 262322, at *21.
147. *Liberty Broadband*, 2017 WL 2352152, at *16.

act self-interestedly when voting against a transaction or refusing to sell its block. A stockholder controller can also sell its block in lieu of a transaction that would share a premium ratably with the other stockholders. The second half of the statement, however, is true. Entire fairness applies to transactions with the controller, but even the entire fairness standard is another manifestation of the stockholder controller's obligation of non-harm.

Another claim derived from the concept of fiduciary equivalency asserts that stockholder controllers, like other fiduciaries, "are prohibited from considering their self-interest in making corporate decisions [and] must exercise their business judgment on behalf of the entity and its stockholders, free from the taint of personal interest."[148] That is also not true. A controller can consider its own self-interest. A controller can act affirmatively to protect the status quo and its own interests, even if an objective view of the best interests of the entity as a whole would suggest a different course of action.

Finally, as noted, a stockholder controller's duties also are not proscriptive. Those propositions make a stockholder controller's duty of loyalty different from a director's.

In two respects, however, the duties are equivalent. Just as directors must exercise due care, so too must a stockholder controller. And just as a director need not engage in self-sacrifice, a stockholder controller need not either.

A stockholder controller's duties thus overlap with a director's duties, but they are not the same. The assertion of fiduciary equivalency is not accurate.

VI.
Explaining the Divergence

Having established that a stockholder controller's duties diverge a director's, the question becomes why? One obvious reason is that directors and stockholder controllers have different relationships with the corporation.

A director *qua* director only possesses power by virtue of that office. All of the powers that the director has are entrusted to the director in a fiduciary capacity. It follows that the director only can exercise power in a fiduciary capacity. Everything a director does when exercising corporate power carries the fiduciary imprimatur.

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148. *Id.*

The same is not true for a stockholder controller, which possesses stockholder-level rights by virtue of owning shares. By aggregating a sufficient level of stockholder rights, however, a stockholder obtains a level of control that warrants fiduciary status. Once that level is achieved, those stockholder powers gain a hybrid quality. They can no longer be exercised completely free of fiduciary constraint, but they also are not wholly fiduciary. They retain a degree of their original nature as private property rights, but the controller's influence is sufficiently great to have stretched the baseline allocation of power within the entity.

Before a stockholder aggregates sufficient power to constitute control, the corporation's stockholders can rely on the board of directors to act on their behalf. They can also rely on their ability to elect new directors to constrain director conduct. And they can rely on the requirement of stockholder approval for significant transactions to check the board's ability to effect fundamental changes in the corporate form.

After a stockholder aggregates sufficient power to constitute control, the minority stockholders can no longer rely on those protections. They can no longer be certain that the board of directors is acting act on their behalf, because the *Summertime Blues* principle comes into play: The stockholder controller's influence over election outcomes can cause the directors to give deliberative priority to the stockholder controller's interests. Minority stockholders can no longer rely on their ability to elect new directors to constrain director conduct, because the stockholder controller determines who serves as directors. And they can no longer rely on the requirement of stockholder approval for significant transactions as a means of preventing fundamental changes in the corporate form, because the stockholder controller can deliver the necessary vote.

The aggregation of sufficient power thus creates a need for some check on that power—hence the fiduciary overlay—while at the same time acknowledging the origins of the powers in traditional property rights. That combination explains why stockholder controller duties and director duties would diverge.

VII.
Normative Implications

The divergence between the fiduciary duties of directors and stockholder controllers has a number of implications. The most obvious is that judges should stop saying that stockholder

controllers owe the same fiduciary duties as directors. Academics should help extinguish that false dogma. Practitioners and commentators should lend a hand as well.

The existence of fiduciary divergence means that courts need to speak in terms of the duties that stockholder controllers owe in specific settings. When a stockholder controller acts affirmatively, those duties are generally minimal, manifesting as an obligation of non-harm. When a stockholder controller declines to exercise its powers, those duties are non-existent.

Relatedly, cases must distinguish between two types of controller action. One type involves scenarios where the stockholder controller deploys its own powers as a stockholder to obtain a result, such as by determining what to do with its control block, voting in favor of an interested transaction, adopting a bylaw, or negotiating for an interested transaction. Those types of actions are different than a controller who affirmatively enters the boardroom and deploys board-level corporate powers to achieve its ends. Such an example might involve a controller populating a board with its own representatives or own agents, such as parent corporation officers, then causing those officers to exercise board-level authority on the controller's behalf. Another example is *McMullin v. Beran*,[149] where a subsidiary corporation delegated upwards to its stockholder controller the task of conducting a sale process for the controlled corporation. The law can and should treat those situations differently. When a stockholder controller enters the boardroom or substitutes itself for the board of directors, the stockholder controller should owe the same duties that directors owe.

The lesser nature of controller duties also supports the Court of Chancery's current, multi-factor approach to evaluating control. Historically, Delaware decisions supported a presumption of control when a stockholder could exercise 20-25% of the voting power.[150] Section 203 of the Delaware

149. 765 A.2d 910 (Del. 2000).

150. For a summary of earlier decisions, *see* Robbins & Co. v. A.C. Israel Enters., Inc., 1985 WL 149627 (Del. Ch. Oct. 2, 1985) (recognizing that "[t]his Court and others have recognized that substantial minority interests ranging from 20% to 40% often provide the holder with working control" and collecting authorities). For an example, *see* Rosenthal v. Burry Biscuit Corp., 60 A.2d 106, 107 (Del. Ch. 1948) (Seitz., V.C.) (treating 10% holder who was also CEO and director as controller). The Supreme Court of the United States helped shape understandings of control by holding that DuPont gained controlling influence over General Motors by acquiring a 23% stake, which later

General Corporation Law, which protects against tunneling and expropriation by substantial stockholders, likewise establish a presumption of control at 20%.[151] Although Section 203's definition of control technically applies only for purposes of that statutory section, the General Assembly enacted the statute to constrain the ability of a person who acquired a large stock position in a company (more than 15%) from engaging in transactions with the company.[152] Section 203 thus seeks to address the same types of tunneling and expropriation that the fiduciary law governing controllers seeks to address. In that context, Section 203 represents a policy determination by the General Assembly as to where those concerns kick in. Consistent with those ranges, stockholder rights plans initially used an ownership stake of 20%, before a consensus emerged at 15%.[153] The disclosure-oriented regimes that Rule 13D starts at 5%.[154]

During a period from 2006 to 2018, however, some Delaware Court of Chancery decisions sough to ratchet the

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led to antitrust violations. *See* United States v. E.I. duPont de Nemours & Co. 353 U.S. 586 (1957).

151. DEL. CODE ANN. tit. 8, § 203(c)(4) ("A person who is the owner of 20% or more of the outstanding voting stock of any corporation, partnership, unincorporated association or other entity shall be presumed to have control of such entity, in the absence of proof by a preponderance of the evidence to the contrary"). Two federal statutes use 25%. *See* Investment Company Act of 1940, 17 C.F.R. § 248.120(h) ("Control of a company means the power to exercise a controlling influence over the management or policies of a company whether through ownership of securities, by contract, or otherwise. Any person who owns beneficially, either directly or through one or more controlled companies, more than 25 percent of the voting securities of any company is presumed to control the company."); Bank Holding Company Act of 1956. 28 U.S.C. § 1841(a)(2)(A) ("Any company has control over a bank or over any company if—(A) the company directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank or company[.]").

152. DEL. CODE ANN. tit. 8, § 203(a).

153. Tornetta v. Musk, 2024 WL 343699, at *48 (Del. Ch. Jan. 30, 2024); Williams Cos. S'holder Litig., 2021 WL 754593, at *1 (Del. Ch. Feb. 26, 2021); Marcel Kahan & Edward Rock, *Anti-Activist Poison Pills*, 99 B.U. L. REV. 915, 922 (2019).

154. Securities and Exchange Act of 1934, 17 CFR § 240.13d-1(a) ("Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is specified in paragraph (i)(1) of this section, is directly or indirectly the beneficial owner of more than five percent of the class shall, within five business days after the date of the acquisition, file with the Commission, a statement containing the information required by Schedule 13D (§ 240.13d-101).").

threshold upward,[155] relying on the theory that "finding that a stockholder is a controller has dramatic consequences."[156] Some decisions pooh-poohed the influence of comparatively large blocks, describing a 33.5% stake as "not impressive,"[157] another 33.5% stake as "relatively low,"[158] a 33.3% stake that could be increased to 45% as similarly "not impressive,"[159] and a 33% stake as something that "means little."[160] The math says otherwise.[161] Having disconfirmed the assertion that a controller

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155. The main catalyst for the tightening seems to have been a decision that characterized a 33.5% stake, without explanation, as "relatively low." *In re* PNB Hldg. Co. S'holders Litig., 2006 WL 2403999, at *10 (Del. Ch. Aug. 18, 2006). During the tightening period, decisions echoed *PNB* by describing similar stakes as "not impressive." *In re* Rouse Props., Inc., 2018 WL 1226015, at *18 (Del. Ch. Mar. 9, 2018); *accord In re* GGP, Inc. S'holder Litig., 2021 WL 2102326, at *20 (Del. Ch. May 25, 2021), *aff'd in part, rev'd in part and remanded*, 282 A.3d 37 (Del. 2022). Another catalyst seems to be the erroneous assertion, made in 2013, that a prior finding of control at 35% had been "perhaps" the Court of Chancery's "most aggressive finding that a minority blockholder was a controlling stockholder." *In re* Morton's Rest. Grp., Inc. S'holders Litig., 74 A.3d 656, 664–66 (Del. Ch. 2013) (discussing *In re* Cysive, Inc. S'holders Litig., 836 A.2d 531, 553 (Del. Ch. 2003)). That statement was incorrect in 2013, because the Court of Chancery had found control at lower levels. *See Crimson Expl.*, 2014 WL 5449419, at *10 (collecting precedents). Yet a series of decisions repeated the assertion as if it were accurate. *E.g.*, *GGP*, 2021 WL 2102326, at *23 n.244; *Rouse*, 2018 WL 1226015, at *19; *Liberty Broadband*, 2017 WL 2352152, at *18; Larkin v. Shah, 2016 WL 4485447, at *14 (Del. Ch. Aug. 25, 2016); *In re* Zhongpin Inc. S'holders Litig., 2014 WL 6735457, at *7 (Del. Ch. Nov. 26, 2014), *rev'd on other grounds sub nom. In re* Cornerstone Therapeutics Inc, S'holder Litig., 115 A.3d 1173 (Del. 2015); *In re* KKR Fin. Holdings LLC S'holder Litig., 101 A.3d 980, 991 (Del. Ch. 2014), *aff'd sub nom.* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015);; Veloric v. J.G. Wentworth, Inc., 2014 WL 4639217, at *10 n.44 (Del. Ch. Sept. 18, 2014). The assertion is plainly incorrect today. *See Tornetta*, 2024 WL 343699, at *45 n.556 (collecting cases involving determinations that minority stockholders were controllers, including eight at levels below 35%); *id.* at *47 (finding after trial that 22% stockholder controlled company for purposes of stock grant).

156. *Liberty Broadband*, 2017 WL 2352152, at *16.

157. *Rouse*, 2018 WL 1226015, at *18.

158. *PNB*, 2006 WL 2403999, at *10.

159. *GGP*, 2021 WL 2102326, at *20 (Del. Ch. May 25, 2021), *aff'd in part, rev'd in part and remanded*, 282 A.3d 37 (Del. 2022).

160. Zlotnick v. Newell Cos., 1984 WL 8242, at *2 (Del. Ch. July 30, 1984).

161. *See Voigt*, 2020 WL 614999, at *18–19. A presumption of control at 20% makes sense, because with a block of that size, the voting power math tilts heavily in favor of the blockholder. Assuming a typical 80% turnout at a stockholder meeting, the blockholder only needs another 35% of the unaffiliated shares to win. Anyone opposing the blockholder must capture 68% of the unaffiliated vote. *See id.* The Delaware Court of Chancery has described disinterested majorities of 60% and 66 2/3% as "more commonly associated with

finding is so momentous, the policy-based demand for a heightened level of ownership relaxes.

During the tightening trend, some Delaware decisions also advocated for a new test for control. Traditionally, Delaware decisions spoke in terms of determining whether control existed by evaluating the person's ability to exercise control over the corporation or its business.[162] That test contemplates a holistic examination of the levers that a controller can use to exercise control over the corporation and its business. In 2006,

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sham elections in dictatorships than contested elections in genuine republics." Chesapeake Corp. v. Shore, 771 A.2d 293, 342 (Del. Ch. 2000). The record in *Air Products* showed that no insurgent had ever achieved a 67% vote and that polling votes at this level was not realistically attainable. Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 117 (Del. Ch. 2011).

162. The test originally looked to whether the alleged controller could exercise control over *the corporation*, either generally or for purposes of a particular transaction. *E.g.*, Martin v. D.B. Martin Co., 88 A. 612, 614–15 (Del Ch. 1913) (Curtis, C.) ("It results, further, that the officers of corporation A, which holds all, or a controlling portion, of the shares of corporation B, have a fiduciary relation towards the latter, which must necessarily be friendly. And further, if by reason of such ownership, or control, there can be an injury done to corporation B by the officers of corporation A, which would also be detrimental to the stockholders of corporation A, a court of equity would, notwithstanding the existing of the separate corporate entities, give relief according to the real equities of the case at the suit of a stockholder of corporation A."). Beginning in the 1980s, the Delaware Supreme Court restated the test as an inquiry into whether the stockholder could exercise control "over the business affairs [sic] of the corporation." *Ivanhoe*, 535 A.2d at 1344; *see Weinstein Enters.*, 870 A.2d at 507 (basing working control on "the *actual exercise* of control over the corporation's conduct." (emphasis in original)); Emerald P'rs v. Berlin, 726 A.2d 1215, 1221 n.8 (Del. 1999) (noting that minority stockholdings with "some additional allegation of domination through actual control of corporate conduct" may give rise to controller status); *Citron.*, 569 A.2d at 70 (referring to either majority voting power or "actual control of corporation [sic] conduct"); *see Cysive*, 836 A.2d at 553 ("In view of that framework, the analysis of whether a stockholder controller exists must take into account whether the stockholder, as a practical matter, possesses a combination of stock voting power and managerial authority that enables him to control the corporation, if he so wishes."). A majority of Court of Chancery decisions have used this test. *See* New Enter. Assocs. 14, L.P. v. Rich, 292 A.3d 112, 173 (Del. Ch. 2023); Delman v. GigAcquisitions3, LLC, 288 A.3d 692, 716 (Del. Ch. 2023); Crispo v. Musk, 2022 WL 6693660, at *12 (Del. Ch. Oct. 11, 2022); *In re* Vaxart, Inc. S'holder Litig., 2021 WL 5858696, at *15 (Del. Ch. Nov. 30, 2021); *In re* Pattern Energy Grp. Inc. S'holders Litig., 2021 WL 1812674, at *37 (Del. Ch. May 6, 2021); *Presidio, Inc.*, 251 A.3d at 258 (Del. Ch. 2021); *In re* WeWork Litig., 2020 WL 7343021, at *12 (Del. Ch. Dec. 14, 2020); *In re* USG Corp. S'holder Litig., 2020 WL 5126671, at *15 (Del. Ch. Aug. 31, 2020), *aff'd sub nom.* Anderson v. Leer, 265 A.3d 995 (Del. 2021); *Voigt*, 2020 WL 614999, at *11; *Basho Techs.*, 2018 WL 3326693, at *26.

however, a Delaware decisions reinterpreted that test to require a showing of *board-level* control, namely the actual ability to dictate outcomes in the board room.[163] The board-control concept lay dormant for nearly a decade, until the Delaware Supreme Court issued a pair of decisions that referenced the concept of board control.[164] That test is more onerous and would lead to fewer findings of control, which seems to be the point.[165]

Neither of the Delaware Supreme Court decisions held that board control was the exclusive test, nor did either overrule the host of precedents that looked for control over the business affairs of the corporation. Some Court of Chancery decisions have therefore treated board control as one means of establishing control, which it plainly is, but not the exclusive method.[166] Because a finding of control is not so momentous as has been feared, the policy underpinning for narrower tests falls away.

Yet another normative implication concerns whether a stockholder controller should owe duties when exercising statutory or contractual rights. The no-duty-to-sacrifice principle has historically been proffered as a basis for asserting that a stockholder controller can exercise contractual or statutory rights free of fiduciary constraint.[167] One case frames the general rule

163. *Superior Vision*, 2006 WL 2521426, at *4 ("Delaware case law has focused on control of the board.").

164. *See* Olenik v. Lodzinski, 208 A.3d 704, 718 (Del. 2019); *Corwin*, 125 A.3d at 307.

165. *See* Lawrence A. Hammermesh, Jack B. Jacobs & Leo E. Strine, Jr., *Optimizing the World's Leading Corporate Law: A Twenty-Year Retrospective and Look Ahead*, 77 BUS. LAW. 321, 334–48 (2022) (expressing concern about a supposedly expanding definition for control).

166. *See In re* Tesla Motors, Inc. S'holder Litig., 2020 WL 553902, at *4 (Del. Ch. Feb. 4, 2020) ("A minority blockholder can, as a matter of law, be a stockholder controller through 'a combination of potent voting power and management control such that the stockholder could be deemed to have effective control of the board without actually owning a majority of stock.'" (quoting *Corwin*, 125 A.3d at 307)); Klein v. Wasserman, 2019 WL 2296027, at *8 (Del. Ch. May 29, 2019) (citing "effective control of the board" under Olenik as one way to establish general control).

167. *See, e.g.*, *Odyssey Partners*, 735 A.2d at 415. ("Chancellor Allen found that Fleming was not constrained by fiduciary duties when acting as a creditor in relation to the foreclosure sale. . . . In my view, this rationale applies with equal force both to the claim that Fleming was obligated to pay a fair price in the foreclosure sale and that it (or Lawson) was obliged to disclose to ABCO's directors its analyses of ABCO's value to it. Fleming was not acting in a fiduciary capacity when it bid at the foreclosure sale and, thus, its conduct thereat is not subject to a fiduciary duty analysis."); *Superior Vision*, 2006 WL 2521426, at *5 ("Here, ReliaStar is alleged to have taken advantage of its contractual

as follows: "[A] controller is free to exercise its bargained-for contractual rights without breaching its fiduciary duties, even when doing so might be to the detriment of the stockholders to whom the duties are owed."[168] But as shown by the prior discussion, the capacity distinction does not hold. Some decisions have made similar assertions about stockholder-level rights like the right to sell or vote, but this article had demonstrated that a limited fiduciary regime applies to those areas.[169]

Delaware law should extend the same fiduciary treatment to contractual and statutory rights. The rights to vote and sell are already statutory and contractual. They arise under the Delaware General Corporation Law[170] (a statute) and the corporate charter (which is treated as a contract).[171] The same principle of non-harm should apply to the exercise of other statutory and stockholder rights.

Under the non-harming standard, a court would analogize the exercise of a contract right to the exercise of a voting right. The controller could use its contract rights to maintain the status quo or to defend its interests, and a controller also would be able to exercise its rights as long as the other stockholders received the equivalent of what they had before. For example, when a corporation becomes insolvent, a stockholder controller could exercise its creditors' rights to foreclose on the corporation's assets without violating any non-harming obligation, not because no fiduciary obligation applied, but because the stockholders' interests had no realistic value such that they could suffer harm.[172] What a controller could not do is use the

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rights for its own purposes. Without more, that is not sufficient to allege that ReliaStar is a 'controlling shareholder' bound by fiduciary obligations.").

168. Gamco Asset Mgmt. Inc. v. iHeartMedia Inc., 2016 WL 6892802, at *12 (Del. Ch. Nov. 23, 2016), *aff'd*, 172 A.3d 884 (Del. 2017).

169. *See* Parts IV.A & B, *supra*.

170. *See* DEL. CODE ANN. tit. 8, §§ 159, 212.

171. *See Air Products*, 8 A.3d at 1188 ("Corporate charters and bylaws are contracts among a corporation's shareholders...."); STAAR Surgical Co. v. Waggoner, 588 A.2d 1130, 1136 (Del.1991) ("[A] corporate charter is both a contract between the State and the corporation, and the corporation and its shareholders."); Centaur Partners, IV v. Nat'l Intergroup, Inc., 582 A.2d 923, 928 (Del.1990) ("Corporate charters and by-laws are contracts among the shareholders of a corporation....").

172. Economics scholars will argue that even in this setting, the underwater common has option value, just as an out-of-the-money option has value. That could well be true. But a plaintiff would have to come forward and prove that the common stock had non-zero option value. In a case that was the most

blocking right to hold up a beneficial transaction for the corporation, simply because the controller want to extract a toll for itself. Nor could a controller use a series of blocking right to force a controlled corporation into a crisis that it would not otherwise face.

The resulting regime is what Chancellor Wolcott envisioned. In *Allied Chemicals*, he explained that the statutory source of a power "supplies no reason for clothing it with a superior sanctity, or vesting it with the attributes of tyranny" and admonished that a court of equity would act "if it should appear that the power is used in such a way that it violates any of those fundamental principles which it is the special province of equity to assert and protect."[173] That reasoning applies to contract and statutory rights as well.

Conclusion

A stockholder controller's duties are not the same as a director's. For stockholder controllers, Delaware law imposes a fiduciary framework grounded in non-harm. The stockholder controller's duty never incorporates the best-interests duty that a director must fulfill. Only the minimal non-harming duty applies, and when a controller acts to preserve the status quo or opts not to take action, then the controller does not act in a fiduciary capacity. Thus stockholder controllers owe distinctive and limited fiduciary duties. Courts should acknowledge that fact and take notice of its implications.

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logical candidate for that type of argument, the plaintiff failed to advance it, relying instead on a discounted cash flow analysis. *See Trados II*, 73 A.3d at 73.

173. *Allied Chem.*, 120 A. at 491.

NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 20 SUMMER 2024 NUMBER 3

THE AMERICAN ANTIMONOPOLY TRADITIONS: ORIGINS, CONTRADICTIONS, AND TRANSFORMATIONS

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Proponents of antitrust reform argue for the rediscovery of an American antimonopoly tradition that predated the Sherman Act by centuries and suggests the reimagination of a more robust contemporary policy against concentrated economic power. But historically there have been a number of distinct and often contradictory strands of American antimonopoly. The American colonists inherited a weak, recent, and largely invented antimonopoly common law tradition focused on exclusive grants of privilege from the crown. In the nineteenth century, antimonopoly became a generative and ubiquitous concept in state legislatures and courts, but one with multiple, inconsistent meanings that evolved in the decades leading up to the Sherman Act. Initially, antimonopoly was primarily focused on the grant of exclusive privileges by legislatures and hence served as a limitation on state power. Later, antimonopoly became simultaneously statist and anti-statist, both a source of state regulatory power and an anti-regulatory doctrine. In parallel, the primary meaning of monopoly shifted from state intervention in the market to privately acquired economic power. Courts pivoted from defining monopoly as necessarily involving a state grant to necessarily not involving a state grant. The Sherman Act enacted this more recent sense of antimonopoly as federal law, but it did not terminate the contestation between the different senses of antimonopoly that continued into the twentieth century and beyond. There is not a unified American antimonopoly tradition, but rather a set of competing impulses or traditions loosely organized under the antimonopoly banner.

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I am very grateful to Alexandra Hudon for excellent research assistance.

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Introduction

Ever since the Emperor Tiberius apologetically coined the word "monopolium" before the Roman Senate in the first century A.D.,[1] the word "monopoly" has been one of opprobrium, both politically and legally. In the seventeenth century, Lord Coke largely invented the idea that monopoly was prohibited by Magna Carta and against the common law, and the idea jumped the Atlantic to the American colonies and stuck.[2] On many occasions, American state and federal courts have repeated or paraphrased the maxim, enshrined in the constitution of three states, that "monopolies are odious" and "contrary to the spirit of a free government."[3] One could amend the West Virginia Supreme Court's 1880 assertion that "the spirit of the age is against monopolies"[4] by noting that the spirit of the *ages* is against monopoly. From the European colonization of North America to the present, an abhorrence of monopoly has played out as a central feature of American republicanism.

Today, at a moment of fierce backlash against the perceived growth of industrial concentration and market power in the United States, hegemony of Big Tech, and failure of antitrust policy, there have been renewed calls for rediscovering a historical antimonopoly tradition that is older, broader, and more vigorous than antitrust. On the political left, antimonopoly nostalgia stands for the dispersal of private economic power, anti-domination, and a robust check on wealth inequality.[5]

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1. Suetonius, The Lives of the Twelve Caesars: An English Translation, Augmented with the Biographies of Contemporary Statesmen, Orators, Poets, and Other Associates (J. Eugene Reed & Alexander Thomson, eds., Gebbie & Co. 1889).

2. William Letwin, Law and Economic Policy in America: The Evolution of the Sherman Antitrust Act 19–32 (1965).

3. *E.g.*, Coombs v. MacDonald, 62 N.W. 41, 42 (Neb. 1895); Md. Const. of 1776, art. XXXIX (prohibiting monopolies because "monopolies are odious, contrary to the spirit of a free government, and the principles of commerce").

4. Mason v. Harper's Ferry Bridge Co., 17 W. Va. 396, 418 (1880).

5. *See, e.g.*, Amy Klobuchar, Antitrust: Taking on Monopoly Power from the Gilded Age to the Digital Age (2021) (arguing for a return to an antimonopoly tradition as old as the American founding); Matt Stoller, Goliath: The 100-Year War Between Monopoly Power and Democracy (2019) (arguing for a renewed understanding of an antimonopoly tradition associated with Thomas Jefferson and Louis Brandeis); Lina M. Khan, *The End of Antitrust History Revisited,* Harv. L. Rev. 1655, 1671 (2020) (reviewing Tim Wu, The Curse of Bigness: Antitrust in the New Gilded Age (2018)) (calling for "reinvigorating antitrust law as part of a broader antimonopoly project to structure private power to serve public ends"); Tim Wu,

At the same time, voices on the political right have called for re-familiarization with another side of the Anglo-American antimonopoly tradition, one focused on anticompetitive government policies.[6] Antimonopoly is thus expressed as both regulatory and deregulatory, and concerned with alternatively private and public power.

There is nothing new about these contradictions, nor are they historically illegitimate. To borrow from Kenneth Shepsle, the antimonopoly tradition is "They," not an "It."[7] In fact, there is not a single, unified antimonopoly tradition, but rather a web of often contradictory legal and political impulses rhetorically flying the antimonopoly banner. While at times these impulses converge on particular questions, they are more often apt to prescribe contradictory or mutually exclusive policies. Historically, antimonopoly could be directed exclusively against the government or exclusively against private firms, or could either limit or expand the government's powers. Antimonopoly was an adaptive and evolving ideal that took in a wide variety of political and ideological impulses.

This Article aims to excavate the origins and development of the American antimonopoly traditions, which took root as legal doctrines in the nineteenth century. It shows that antimonopoly began as a limitation on the grant of exclusive privileges by the sovereign state, transformed in the late nineteenth century into both a preoccupation with privately acquired economic power and a simultaneously pro- and anti-regulatory principle, shifted in the mid-twentieth century to focus nearly exclusively

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The Utah Statement: Reviving Antimonopoly Traditions for the Era of Big Tech, OneZero by Medium (Nov. 18, 2019), https://onezero.medium.com/the-utah-statement-reviving-antimonopoly-traditions-for-the-era-of-big-tech-e6bel98012d7 [https://perma.cc/FUV3-VTHM].

6. *See, e.g.*, Steven G. Calabresi & Larissa C. Leibowitz, *Monopolies and the Constitution: A History of Crony Capitalism*, 36 Harv. J. L. & Pub. Pol'y 983 (2013) (analyzing constitutional antimonopoly tradition focused on government interventions in the market); Ben Sperry, *The Forgotten Strand of the Anti-Monopoly Tradition in Anglo-American Law* (Jan. 13, 2021), https://truthonthemarket.com/2021/01/13/the-forgotten-strand-of-the-anti-monopoly-tradition-in-anglo-american-law/ ("[T]oday's "anti-monopolists" focus myopically on alleged monopolies that often benefit consumers, while largely ignoring monopoly power granted by government. The real monopoly problem antitrust law fails to solve is its immunization of anticompetitive government policies. Recovering the older anti-monopoly tradition would better focus activists today.").

7. Kenneth A. Shepsle, *Congress is a "They," Not an "It": Legislative Intent as Oxymoron*, 12 Int'l Rev. L. & Econ. 239 (1992).

on privately acquired power, then shifted back toward a focus on the state's regulatory power in the later twentieth century. All of these movements were associated with a common aversion to something called "monopoly," a flexible, ambiguous, and changing concept.

The remainder of this Article proceeds as follows. Part I sets the stage by considering the prerevolutionary and founding era roots of the antimonopoly tradition. It shows Lord Coke's creative invention of a longstanding antimonopoly principle of the common law, its importation into the American colonies, its role in revolutionary ideology, and the debates over monopoly and corporate chartering that ignited some of the fiercest controversies between Federalists and Anti-Federalists during the founding era.

Part II analyzes the matter at the heart of this Article—the splintering and transformations of the antimonopoly tradition in American law that occurred during the nineteenth century. In brief, during the nineteenth century antimonopoly ideas became embedded in American law, mostly in state constitutions and judicial opinions. Initially, the predominant understanding of "monopoly" was an exclusive grant of governmental privilege. Courts and legislatures created legal doctrines to prevent such grants or limit their scope. Gradually, monopoly took on a different legal connotation as a market condition that the government could rightly regulate through its police power. Antimonopoly thus shifted from a limitation on the government to an affirmative grant of power to the state. But, at around the same time, courts began increasingly to deploy antimonopoly to invalidate not only explicit grants of exclusive privilege, but more general regulatory schemes that impeded competition or individual enterprise. Thus, even while antimonopoly was expanding the government's regulatory powers, it was simultaneously taking them away. Concurrently with these movements, the predominant understanding of monopoly was shifting away from a grant from the state to privately acquired market power, and the antimonopoly principle was increasingly deployed to constrain the power of private firms. By the close of the nineteenth century, all of these disparate meanings of antimonopoly had taken root in American law.

Part III considers the continuing lives of the antimonopoly traditions in the twentieth century and beyond. It begins with the triumph of antimonopoly as limitation on private power, reflected in the Sherman Act's focus on privately created trusts

and the Supreme Court's retreat from economic substantive due process and refusal to allow the Sherman Act to be deployed against the state. From the perspective of the late New Deal, the meaning of antimonopoly seemed to have inverted entirely within a century from a near-exclusive focus on public power to an exclusive focus on private power. Yet that turned out not to be the end of history either, and the older strands of state-focused antimonopoly returned in force in the later twentieth century as the Supreme Court contracted state action immunity from the Sherman Act and neo-liberal scholars argued that governmental intrusion in markets was the source of most monopoly problems. Part III concludes by observing that, although the possible meanings and implications of antimonopoly have shifted since the nineteenth century, the core set of preoccupations—with either public or private power, and with expanding or contracting the power of the state—remain durable features of the American legal, political, and ideological landscape.

I.
Prerevolutionary and Founding Era Roots

A. *The Inherited Antimonopoly Tradition*

The American colonists brought with them the belief that, as Englishmen, the common law was their patrimony. Largely through Lord Coke, who wrote the only published report on the landmark 1602 King's Bench decision *Darcy v. Allein*, "*The Case of Monopolies*," the American colonists inherited a belief that monopoly was contrary to Magna Carta and an unbroken line of common law cases and hence contrary to their ancient rights as Englishmen.[8] Both *The Case of Monopolies* and the Act of Parliament it spurred reflected a peculiar and limited genus of antimonopolism, but that did not prevent the adoption of a wider antimonopoly ideology in the American colonies.

The Case of Monopolies was hardly the first opinion to limit the power of monopolies,[9] but it stood out for its audacity

8. Darcy v. Allein (1602) (The Case of Monopolies), 77 Eng. Rep. 1260 (KB); 11 Co. Rep 84 a; Calabresi & Leibowitz, *supra* note 6, at 1007 (discussing American colonists' beliefs that anti-monopoly rights reflected in *Darcy v. Allein* applied to American colonists).

9. *See, e.g.*, Davenant v. Hurdis (1599), 72 Eng. Rep. 769 (KB) (invalidating ordinance of Company of Merchant Tailors requiring each member to

and novelty in challenging the Crown's prerogative to grant commercial monopolies.[10] Darcy had received from Queen Elizabeth an exclusive privilege via a "letter patent" to buy playing cards overseas and import them into England.[11] In exchange for this privilege, he remitted 100 marks to the Queen annually, thus sharing his monopoly profits with the Crown in an arrangement typical of many sovereign grants of exclusivity.[12] When Allein started importing playing cards, Darcy complained that he was doing so in violation of Darcy's patent and that this competition was making it impossible for him to remit the contracted payments to the Crown.[13]

The King's Bench struck down the exclusive privilege as "utterly void." In passing, it identified "three inseparable incidents to every monopoly:"

> (1) That the price will be raised.
> (2) After the monopoly grant, the commodity is not so good as it was before.
> (3) It tends to the impoverishment of divers artificers and others who before by their labour had maintained themselves and their families, who now will of necessity be constrained to live in idleness and beggary.[14]

Despite the breadth of this language, its suggestion of broad prohibition on monopoly, and its resonance with strands of the antimonopoly tradition, it would be a mistake to read *Darcy v. Allein* as a broad holding that monopolies were illegal as against the common law, as Coke inventively would have it.[15] The real point of the case was that Parliament, rather than the Crown, had the exclusive power to grant monopolies, a power Parliament happily exercised a few years after *Darcy v. Allein* by granting an identical exclusive right to the Company of

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send minimum of one-half the cloth sent out to be dressed to another member of the corporation).

10. *See generally* Thomas B. Nachbar, *Monopoly, Mercantilism, and the Politics of Regulation*, 91 VA. L. REV. 1313 (2005).

11. *Darcy*, 11 Co, Rep. at 84–85.

12. Sidney T. Miller, *The Case of the Monopolies: Some of its Results and Suggestions*, 6 MICH. L. REV. 1, 4 (1907).

13. *Id.*

14. *Darcy*, 11 Co, Rep. at 86.

15. LETWIN, *supra* note 2, at 30 (describing Coke's "powerful but inaccurate polemics" concerning the common law antimonopoly tradition).

Card Makers.[16] Rather than a full-blooded antimonopoly case, *Darcy v. Allein* was an important landmark in the continuing jurisdictional struggle between the Crown and Parliament. The playing card monopoly may have been unlawful since "[t]he Queen was deceived in her grant,"[17] but Parliament had every right to—and did—grant many such monopolies.[18]

In the early seventeenth century, a Whig campaign against state-issued monopolies yielded the 1624 Statute of Monopolies.[19] But, here again, the label had "a deceptive ring," since the statute was "based not on a preference for competition, but on constitutional objections to the power which the Crown presumed in granting monopolies and to the arbitrary reasons for which it had granted them."[20] Nonetheless, the idea of the Statute of Monopolies as a charter of freedom would grow in resonance over the years, particularly across the Atlantic. Over two centuries later, Chancellor Kent would refer to the Statute of Monopolies as "the Magna Charta [of] British Industry."[21] Coke himself had found an even earlier source—the Magna Carta itself. In his *Second Institute, Commentary on Magna Carta,* published in 1642, Coke listed among the great "liberties" guaranteed by Magna Carta a prohibition upon the creation of monopolies. Coke asserted that "[g]enerally all monopolies are against this great charter, because they are against the liberty and freedome of the subject, and against the law of the land."[22] That was certainly an exaggeration. The relevant provision of Magna Carta—Section 41—granted merchants the right to be "safe and secure … to buy and sell free from all maletotes [impositions] by the ancient and rightful customs,"[23] but had never been construed as a general prohibition on the grant of monopolies.

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16. *Id.* at 32.
17. *Id.* at 28.
18. Barbara Malament, *The "Economic Liberalism" of Sir Edward Coke*, 76 YALE L.J. 1321, 1351 (1967).
19. Statute of Monopolies, 1623, 21 Jac. 1, c. 3, § 1 (Eng.); Letwin, *supra* note 2, at 31.
20. LETWIN, *supra* note 2, at 31.
21. JAMES KENT, COMMENTARIES ON AMERICAN LAW 272 (Oliver W. Holmes, Jr. ed., 1873).
22. Edward Coke, *Second Institute, Commentary on Magna Carta* (1642), *reprinted in* ROSCOE POUND, THE DEVELOPMENT OF CONSTITUTIONAL GUARANTEES OF LIBERTY 150 (1957).
23. Magna Carta sec. 41, 1215, *reprinted in* JAMES C. HOLT, MAGNA CARTA 327 (1965).

That Coke largely invented the antimonopoly common law tradition did not prevent its lodging durably in English law and then jumping the Atlantic.[24] The American colonists, heavily schooled in Coke, took up his interpretation of British constitutionalism in their early antimonopolism. William Penn wrote in his *The Excellent Priviledge of Liberty & Property Being the Birth-Right of the Free-Born Subjects of England* that "[g]enerally all Monopolies are against this great charter because they are against the Liberty and Freedom of the Subject, and against the Law of the Land."[25] Even before the publication of Coke's Commentary, the 1641 Massachusetts Body of Liberties provided: "No monopolies shall be granted or allowed amongst us, but of such new Inventions that are profitable to the Countrie, and that for a short time."[26] Connecticut adopted a similar provision in 1672.[27]

To the early colonial ear, the term "monopoly" connoted exclusive royal privilege of the kind Queen Elizabeth accorded to the British East India Company for trading privileges east of the Cape of Good Hope and the Straits of Magellan.[28] By 1781 when Edmund Burke—a member of Parliament sympathetic to the American cause—famously lacerated the East India Company in Parliament for inefficiency, treachery, and corruption,[29] it was common ground among the American colonists that

24. Donald O. Wagner, *Coke and the Rise of Economic Liberalism*, 6 ECON. HIST. REV. 30, 35 (1935); *see* 4 W.S. HOLDSWORTH, A HISTORY OF ENGLISH LAW 343–62 (1924); Jacob I. Corré, *The Argument, Decision, and Reports of* Darcy v. Allen, 45 EMORY L.J. 1261, 12621262 (1996).

25. William Penn, *The Excellent Priviledge Of Liberty & Property* (1687), *as reprinted in* A.E. DICK HOWARD, THE ROAD FROM RUNNYMEDE: MAGNA CARTA AND CONSTITUTIONALISM IN AMERICA 421 (1968).

26. The Body of Liberties of 1641; A Coppie of the Liberties of the Massachusets Colonie in New England, *in* THE COLONIAL LAWS OF MASSACHUSETTS 35 (William H. Whitmore ed., 1890).

27. THE LAWS OF CONNECTICUT: AN EXACT REPRINT OF THE ORIGINAL EDITION OF 1673, at 52 (1865) ("It is ordered; That there shall be no Monopolies granted or allowed amongst us, but of such new Inventions as shall be judged profitable for the Country, and that for such time as the General Court shall judge meet.").

28. *See e.g.*, JOHN MICKLETHWAIT & ADRIAN WOOLDRIDGE, THE COMPANY: A SHORT HISTORY OF A REVOLUTIONARY IDEA 22 (2003); *see also*, LETWIN, *supra* note 2 at 62–63; *see also*, JAMES WILLARD HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES: 1780–1970 (1970).

29. Edmund Burke, *Speeches on the Impeachment of Warren Hastings*, *in* THE PORTABLE EDMUND BURKE 388 (Isaac Kramnick ed., 1999); *see generally* Mithi Mukherjee, *Justice, War, and the Imperium: India and Britain in Edmund Burke's*

state-granted monopoly was a threat not only to economic freedom, but to good government and social and political liberty. The theme of monopoly as political corruption and decadence would play out in American law for centuries to come.

B. *Antimonopoly as Revolution*

But there were economic costs as well. By the middle of the seventeenth century, the American colonists began unhappily to internalize the burden of English mercantilist policy with its guarantees to English merchants of exclusive trading rights in the colonies.[30] Things were to get worse. In the eighteenth century, Parliament intensified its restrictions on colonial trade, which showed that monopoly was not merely a corruption of royal prerogative, but of any sovereign ill-disposed to commercial freedom.[31] Parliament's mercantilist policies sowed bitter resentment in the colonies. As one historian has noted, "the efforts of the English government, backed by English merchants and manufacturers, to deny to the Americans the right to compete in foreign markets and to secure the benefits of foreign competition was one of the most potent causes of the American Revolution."[32] The Boston Tea Party arose out of a monopoly grant to the East India Company, "causing many historians to cite antimonopoly sentiments as one of the roots of the struggle for American independence."[33] In *The Rights of Man*, Thomas Paine criticized colonialist Britain as "cut up into monopolies," and asked "[i]s this freedom?"[34] Similarly, James Madison would complain "[t]hat is not a just government, nor is property secure under it, where arbitrary restrictions, exemptions, and monopolies deny to part of its citizens that free use of their faculties, and free choice of their occupations...."[35]

Prosecutorial Speeches in the Impeachment Trial of Warren Hastings, 23 L. & Hist. Rev. 589 (2005).

30. Franklin D. Jones, *Historical Development of the Law of Business Competition*, 36 Yale L.J. 42, 49–50 (1926).

31. *Id.*

32. *Id.* at 52.

33. 1 The Antitrust Impulse 5 (Theodore P. Kovaleff ed., M.E. Sharpe, Inc. 1994).

34. Thomas Paine, Collected Writings: Common Sense, The Crisis, and other Pamphlets, Articles and Letters, The Rights of Man, the Age of Reason 471 (Eric Foner ed., Literary Classics of the U.S. 1995).

35. James Madison, *Property*, *in* James Madison: Writings 516 (Jack N. Rakove ed., 1999).

The fledgling republic would soon learn that monopoly was not solely the province of either the British Crown or Parliament, or the East India Company. During the Revolutionary period, rampant inflation and fluctuating commodity prices led to political agitation against domestic "forestallers and engrossers."[36] These pressures led to recommendations from the Continental Congress, passed by legislatures in New Jersey and Massachusetts, to "prevent monopoly and oppression" by fixing maximum prices for commodities.[37] These statutes were among the first instances in the early America Republic to think of antimonopoly in terms of privately acquired economic power—a perspective that would grow in importance over the course of the nineteenth century.[38]

Despite these legal innovations, antimonopoly remained primarily focused on grants of exclusive privilege by the state. As discussed further in Part II B 1, the post-Revolutionary constitutions of Maryland, North Carolina, and Massachusetts contained provisions prohibiting monopoly grants by the state.[39] For a moment, it seemed that antimonopoly might become a core constitutional principle, including in the federal constitution. As things worked out, it became no feature at all of the federal constitution, and one of few state constitutions until the end of the nineteenth century, when it became a very different kind of feature.

C. *Federalists, Antifederalists, and Corporate Charters*

Debates around the framing and ratification of the Constitution set off new rounds of antimonopoly discourse that would play out in domestic politics and constitutional law for at least half a century. During the Philadelphia constitutional convention in 1787, Madison introduced a proposal to grant Congress the power "[t]o grant charters of incorporation in cases where the Public good may require them, and the authority of a single

36. *Id.* at 52–53.

37. *See generally* DANIEL A. CRANE & WILLIAM J. NOVAK, ANTIMONOPOLY AND AMERICAN DEMOCRACY (2023).

38. Earlier colonial legal tradition focused on "forestalling" and "engrossing," essentially the wrong of cornering markets. *See* Franklin D. Jones, *Historical Development of the Law of Business Competition*, 36 YALE L.J. 42, 43–44 (1926).

39. *Infra* note 55, 56.

State may be incompetent."[40] When Benjamin Franklin later moved to grant Congress the power to cut canals, Madison reintroduced his own proposal to give Congress an even wider power to incorporate, and one not limited to common carriers or other lines of business affected with the public interest.[41] This proposal led to a sharp exchange between Federalist and Anti-Federalist delegates, with Federalists like James Wilson arguing that an explicit power to incorporate might be unnecessary because it was already inherent in the proposed commerce clause of what became Article I, Section 8, and Anti-Federalists like George Mason expressing horror of "monopolies of every sort, which he did not think were by any means already implied by the Constitution as supposed by Mr. Wilson."[42]

Madison's chartering proposal did not carry, but that was of cold comfort to the Anti-Federalists who had heard Wilson loud and clear on the Federalist interpretation of the commerce clause. George Mason and Elbridge Gerry refused to sign the proposed Constitution because "[u]nder their own Construction of the general Clause at the End of the enumerated Powers, the Congress may grant Monopolies in Trade & Commerce."[43] A slew of Antifederalist writers attacked the proposed Constitution on the ground that it permitted Congress to grant monopolies, and a number of state ratifying conventions, including Massachusetts, New Hampshire, and New York, sent instructions requesting that Congress include an antimonopoly provision in a Bill of Rights.[44] Jefferson wrote to Madison from Paris in 1787 complaining that the proposed constitution lacked, among other provisions, a "restriction against monopolies."[45]

And then came Hamilton's proposal for a national bank—the embodiment of corrosive monopoly to Jefferson, Madison,

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40. James Madison, *Notes on the Constitutional Convention* (Aug. 18, 1787) (proposal of James Madison), *in* 2 THE RECORDS OF THE FEDERAL CONVENTION OF 1787, at 324, 325 (Max Farrand ed., 1966) [hereinafter Farrand's Records].

41. Daniel A. Crane, *Antitrust Antifederalism*, 96 CAL. L. REV. 1, 8 (2008).

42. Farrand's Records at 616.

43. 8 THE DOCUMENTARY HISTORY OF THE RATIFICATION OF THE CONSTITUTION OF THE UNITED STATES OF AMERICA 45 (Merrill Jensen ed., 1976).

44. 1 DEBATES IN THE SEVERAL STATE CONVENTIONS ON THE ADOPTION OF THE FEDERAL CONSTITUTION 323, 326, 330, 337 (J. Elliot ed. 1866).

45. Letter from Jefferson to Madison (Dec. 20, 1787), *reprinted in* 12 THE PAPERS OF THOMAS JEFFERSON 438, 440 (J. Boyd ed. 1955) (emphasis added).

and their newly minted opposition party. Hamilton prevailed with Washington and got his "monster bank," which the vacillating President Madison granted a second term following the War of 1812.[46] The Supreme Court endorsed Hamilton's vision for muscular federal economic powers in *McCulloch v. Maryland*,[47] upholding the constitutionality of the bank. Andrew Jackson then vetoed the bank's second renewal charter, complaining of its "exclusive privilege under the authority of the General Government, a monopoly of its favor and support."[48] The Jacksonian movement against special charters and for general laws reacted to a particular pedigree of monopolism—the crony capitalist system of legislatures dispensing special economic privileges to favored citizens.[49] But, by the time of Jackson, antimonopoly sentiment was finding a variety of expressions in state legislatures and the courts—expressions that would grow in creative contradiction and evolution until the passage of the Sherman Act at the end of the century.

II.
Antimonopoly in Nineteenth Century Law: Transformation and Inversion

A. *Ideology and Law*

There is a tendency to reduce the American antimonopoly tradition to a unified and coherent ideology in tension with other ideologies, something like Coke's Whiggish account of antimonopoly embedded in Magna Carta and the common law. Thus, one could say that, in the nineteenth century, antimonopoly "was an expression of the producerist-republican tradition that emphasized the dangers of government in the private economy and critiqued the power of large aggregations of capital in corporations and banks."[50] Certainly, that was part of it.

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46. Crane, *supra* note 41, at 11.

47. McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819).

48. Andrew Jackson, Bank Veto Message (July 10, 1832), https://avalon.law.yale.edu/19th_century/ajveto01.asp.

49. *See* Naomi R. Lamoreaux & John Joseph Wallis, *General Laws and the Mid-Nineteenth Century Transformation of American Political Economy*, https://ccl.yale.edu/sites/default/files/files/Lamoreaux%20and%20Wallis%2C%20General%20Laws%2C%202019-10-04.pdf.

50. Kenneth Lipartito, *The Antimonopoly Tradition*, 10 U. St. Thomas L. J. 991, 994 (2013).

But, in fact, antimonopoly ideology operated in a number of different registers. For instance, Richard John has identified four distinct strands of antimonopoly ideology spanning the eighteenth, nineteenth, and twentieth centuries, each associated with a different public intellectual.[51] For John Adams, "monopoly was a form of commercial domination that artful diplomacy could countermand."[52] For William Leggett, monopoly "was a legislatively mandated special privilege that a vigilant citizenry had an obligation to confront." For Henry George, "it was a social injustice that legislation could contain."[53] And for Walter Lippman, "it was an economic colossus that social movements could be mobilized to control."[54] All four versions showed up rhetorically in American political discourse and their influences appear in the major economic issues of the nineteenth century—banking, access to the corporate form, monetary policy, international trade, the railroads and the Granger movement, and the transition from an agrarian to an industrial economy.

What was distinctive about the antimonopoly principle in the nineteenth century was that it showed up with increasing frequency in law, operating concretely in constitutions, statutes, and adjudicated cases. To say that it operated concretely is not to say that it operated uniformly, consistently, or coherently, but rather that the antimonopoly principle invented by Coke and transported to the colonies became a ubiquitous feature of American law—a principle that could drive, or at least justify, legal outcomes. Over the course of the nineteenth century, legislatures and judges (with some exceptions) began with the premise that monopoly was disfavored by law, or downright abhorrent, and that it fell to them to deploy legal devices to control it.

B. *State Constitutions: From Antimonopoly, to General Laws, to Private Power*

Although an antimonopoly provision was never added to the federal constitution as the Anti-Federalists proposed, such

51. *See* Richard John, *Reframing the Monopoly Question: Commerce, Land, and Industry*, *in* ANTIMONOPOLY AND AMERICAN DEMOCRACY (Daniel A. Crane & William J. Novak, eds. 2023).

52. *Id.* at 37.

53. *Id.*

54. *Id.*

provisions did find their way into some states' constitutions. The evolution of state antimonopoly provisions over the course of the nineteenth century showcases the evolving meanings of the antimonopoly tradition. Early provisions were squarely directed against "monopoly" in its primary original sense—a grant of exclusive privilege by the state. During the Jacksonian Era, aversion to crony capitalism and legislative corruption prompted the passage of a different kind of antimonopoly provision requiring legislatures to act by general laws, which eventually consumed the space previously occupied by the antimonopoly provisions. In the later nineteenth century, yet a third form of antimonopoly provision, this one concerned with the state's responsibility toward *privately created* monopoly, began to infuse state constitutions.

1. *Constitutional Prohibitions on Grants of Exclusive Privileges*

In 1776, two states—Maryland and North Carolina—adopted antimonopoly constitutional provisions directed against grants of exclusive privileges by the state. Maryland's constitution provided that "monopolies are odious, contrary to the spirit of a free government, and the principles of commerce; and ought not to be suffered," while North Carolina's constitution read "that perpetuities and monopolies are contrary to the genius of a free State, and ought not to be allowed."[55] Tennessee adopted a virtually identical provision in 1796.[56]

But these states were outliers. Another forty years would pass before a fourth state would adopt a similar provision—Arkansas, in its first constitution in 1836.[57] These antimonopoly provisions attracted little attention. Indeed, in 1884 the Arkansas Supreme Court complained that the Bouvier law dictionary had listed only Maryland, North Carolina, and Tennessee as have constitutional antimonopoly provisions, overlooking Arkansas.[58] Between 1838 and 1907, only five other states—Florida, Louisiana, Texas, Wyoming, and Oklahoma—adopted similar antimonopoly provisions directed against the state.[59]

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55. MD. CONST. of 1776, art. XXXIX; N.C. CONST. of 1776, Declaration of Rts., art. XXIII. Both have been retained.

56. TENN. CONST. of 1796, art. XI, § 23.

57. ARK. CONST. of 1836, art. II, § 19.

58. *Ex Parte* Levy, 43 Ark. 42, 52 (1884).

59. FLA. CONST. of 1838, art. I, § 24 ("That perpetuities and monopolies are contrary to the genius of a free State, and ought not to be allowed.");

As discussed in Part II C 1 b below, the absence of an explicit constitutional prohibition on granting monopolies did not impede state courts from invalidating state grants of exclusive privileges throughout much of the nineteenth century, as the courts relied on other constitutional or common law principles. But antimonopoly as an explicit provision of state constitutionalism ran into two countercurrents: the general laws movement of the Jacksonian era and, later, the shift in antimonopolism toward a focus on privately acquired market power.

2. *General Laws Requirements*

One factor that blunted the spread of antimonopoly constitutional provisions focused on the state's grant of monopoly rights was the general laws movement of the mid-nineteenth century. These laws were animated by some of the same concerns as antimonopoly clauses, but gave expression to a separate legal principle that, in time, largely subsumed and replaced the state-focused antimonopoly principle.

Enacting special legislation was a regular legislative practice for nearly a hundred years following American independence, but one that fell out of favor politically during the Jacksonian period.[60] A provision barring special legislation was first adopted by Massachusetts's 1780 constitution, which declared:

> No man, nor corporation or association of men, have any other title to obtain advantages, or particular and exclusive privileges, distinct from those of the community, than what arises from the consideration of services rendered to the public; and this title being

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LA. CONST. of 1845, title VI, art. 125 ("The general assembly shall never grant any exclusive privilege or monopoly, for a longer period than twenty years."); TEX. CONST. of 1845, art. I, § 18 ("Perpetuities and monopolies are contrary to the genius of a free government, and shall never be allowed: nor shall the law of primogeniture or entailments ever be in force in this State."); WYO. CONST. art. I, § 30 ("Perpetuities and monopolies are contrary to the genius of a free state and shall not be allowed. Corporations being creatures of the state, endowed for the public good with a portion of its sovereign powers, must be subject to its control."); OKLA. CONST. art. II, § 32 ("Perpetuities and monopolies are contrary to the genius of a free government, and shall never be allowed, nor shall the law of primogeniture or entailments ever be in force in this State.").

60. Naomi R. Lamoreaux & John Joseph Wallis, *Economic Crisis, General Laws, and the Mid-Nineteenth-Century Transformation of American Political Economy*, 41 J. EARLY REPUBLIC 403, 407 (2021).

> in nature neither hereditary, nor transmissible to children, or descendants, or relations by blood, the idea of a man born a magistrate, law-giver, or judge, is absurd and unnatural.[61]

But Massachusetts's provision was a rarity. Early provisions barring special corporate legislation were most often aimed at preventing the *creation* of corporations by special legislation, not preventing the extension of benefits to already existing private companies (banking functions being an exception), and were largely adopted in the mid-1800s.[62] New York's 1846 constitution required that corporations be formed under general laws except where the legislature determined that special laws were required for the corporation to function, and many state constitutions had nearly identical provisions.[63]

With few exceptions, states began enacting provisions that barred special grants to existing corporations in the 1850s.[64] Some legislatures clearly intended these clauses to constrain both individuals and corporations. South Dakota's 1889 constitution provided: "No law shall be passed granting to any citizen, class of citizens, or *corporation*, privileges or immunities which upon the same terms shall not equally belong to all citizens or *corporations*."[65] Others, arguably most, were less explicit,[66] although state privileges or immunities clauses adopted in the mid-nineteenth century often did similar work.[67]

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61. MASS. CONST. Part the First, art. VI.

62. *See, e.g.*, LA. CONST. of 1845, title. VI, art. 122, which entirely banned the creation of corporations with banking or discounting privileges.

63. N.Y. CONST. of 1846, art. VIII, § 1. This language appears to be modeled after much earlier provisions barring the special incorporation of churches and other organizations. *See, e.g.*, FLA. CONST. of 1838, art. XIII, § 1.

64. However, Steven Calabresi and Larissa Leibowitz have argued that privileges or immunities clauses were commonly interpreted by courts to include corporations and used to combat monopolistic behavior. Calabresi & Leibowitz, *supra* note 6, at 1077–81.

65. S.D. CONST. art. VI, § 18 (emphasis added).

66. *See, e.g.*, ARK. CONST. art. II, § 3 ("The equality of all persons before the law is recognized, and shall ever remain inviolate; nor shall any citizen ever be deprived of any right, privilege or immunity; nor exempted from any burden or duty, on account of race, color or previous condition.").

67. *See, e.g.*, VA. CONST. of 1776, ch. I, § 4; CONN. CONST. of 1818, art. I, § 1; TENN. CONST. of 1834, art. XI, § 7; TEX. CONST of 1845, art. I, § 2.; *see also* Woodward v. May, 5 Miss. (4 Howard) 389, 392 (1840) (purpose of state privileges or immunities clause was to "inhibit all those unjust and insidious exemptions from the burthens of government, and all those monopolies

For most states, bans on special corporate legislation emerged following Indiana's adoption of its 1851 constitution, and went hand-in-hand with provisions mandating the uniform application of general laws. In the 1840s, Indiana was one of several states to default on their bonded debt.[68] As Naomi Lamoreaux and John Wallis have shown, most of the debt obligations of northern states like Indiana stemmed from transportation projects.[69] One method by which states would obtain funding for these projects was to grant special privileges to groups in exchange for financial support or labor.[70] Indiana had enlisted the Morris Canal and Banking Company to sell state bonds on credit that would fund its $10 million canal, railroad, and turnpike project.[71] When the bank informed the state it could no longer make payments for the bonds, construction halted, property values and tax revenues shrunk, and the state defaulted, unable to pay the interest on the bonds.[72] In response, Indiana adopted provisions requiring the state to act through general laws in its 1851 constitution:[73]

Provisions banning special legislation were quickly adopted or copied by numerous states in the following years, likely because many engaged in the same practices that caused Indiana to default. By 1900, thirty-one states had adopted constitutional provisions modeled after Indiana's, often including the catch-all requirement: "In all other cases where a general law can be made applicable no SPECIAL law shall be enacted."[74] A number of states extended the language to bar grants of special corporate privileges or charters even where language mandating general laws had already been included. The nineteenth item in California's version was a prohibition on "granting to

and encroachments of the few upon the rights and natural liberties of the many, which sprung up during the dark ages").

68. Lamoreaux & Wallis, *supra* note 60, at 417.

69. *Id.*

70. *Id.* at 418.

71. *Id.* at 419, 421.

72. *Id.* at 421.

73. *See* Mowrey v. Indianapolis & C.R. Co., 17 F. Cas. 930, 933 (C.C.D. Ind. 1866). Indiana also proposed an antimonopoly provision during its 1851 convention, but the measure failed and was not revisited.

74. *See, e.g.*, WYO. CONST., art. III, § 27; TEX. CONST., art. III, § 56 (amended 2001); MONT. CONST. of 1889, art. V, § 26; COLO. CONST., art. V, § 25 (amended 2000). Four more states would eventually adopt similar provisions.

any corporation, association, or individual any special or exclusive right, privilege, or immunity."[75]

While many of the constitutional restraints on corporations have weakened over time, virtually all of the states that enacted these particular types of provisions retain some version of them today. Thus, while explicit antimonopoly provisions remain a feature of a few state constitutions, almost every state but two has enacted and maintains constitutional provisions that either bar special legislation or mandate the uniform operation of general laws.

As noted, the general laws requirements arose from antimonopoly impulses similar to those that animated the antimonopoly clauses discussed in the previous section. As a New Jersey court asserted in 1888, "the purpose [of these provisions] was to deprive the legislature of the power of creating monopolies by requiring them to pass general laws. . . ."[76] But although general laws requirements might impede a legislature from creating a corporation with monopoly rights by special legislation, they would not prevent a state from legislating in anticompetitive ways or setting up companies with exclusive prerogatives through general laws.[77] General laws provisions reoriented the antimonopoly principle from *outcomes* to *processes*. Monopoly derived from the state would not necessarily be a forbidden outcome, so long as it was enacted in a democratic and transparent manner in a general law.

3. *Constitutional Provisions Empowering State Action Against Private Monopoly*

During the Reconstruction Era and early Gilded Age, a different kind of antimonopoly provision—one directed against private economic power rather than state grants—began to spring up in state constitutions. By the time of the Sherman Antitrust Act's adoption in 1890, twenty-five states had antimonopoly provisions, and over the next few decades, seven more would join. Overwhelmingly, these new provisions targeted

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75. *See* CAL. CONST., art. IV, § 25 (repealed 1966); *see also* COLO. CONST., art. V, § 25 (amended 2000); ILL. CONST. of 1870, art. IV, § 22.

76. Atl. City Water-Works Co. v. Consumers' Water Co., 44 N.J. Eq. 427, 436 (N.J. Ch. 1888).

77. *E.g.*, Talbot v. La. Highway Comm'n, 159 La. 909, 918 (1925) (holding that general law's requirement did not prohibit legislature from granting exclusive franchises through general laws).

combinations by private corporations, not state-sanctioned monopolies.

These new provisions were either generally applicable to all private monopolies or focused on particular industrial sectors. Some, like Kentucky, required the legislature to enact laws aimed at all monopolistic behavior: "It shall be the duty of the General Assembly from time to time, as necessity may require, to enact such laws as may be necessary to prevent all trusts, pools, combinations or other organizations, from combining to depreciate below its real value any article, or to enhance the cost of any article above its real value."[78] Significantly, this type of provision extended bans not simply to monopolies but to monopolistic behavior, addressing concerns like price fixing or harm to competition.[79]

Of the thirty-two states that adopted antimonopoly provisions, many chose to enact provisions targeting specific industries the states recognized as conducive to monopoly. A minority of states, including Illinois, Michigan, and Pennsylvania, adopted industry-specific provisions alone.[80] Alabama's 1901 constitution, like a number of others, contained both types of antimonopoly provisions. The state retained an 1875 provision that preemptively blocked the monopolization of the telegraph industry:

> Any association or corporation organized for the purpose, or any individual, shall have the right to construct and maintain lines of telegraph within this state, and connect the same with other lines; and the general assembly shall, by general law of uniform operation, provide reasonable regulations to give full effect to this section. No telegraph company shall consolidate with or hold a controlling interest in the stock or bonds of any other telegraph company owning a competing line, or acquire, by purchase or otherwise, any other competing line of telegraph.[81]

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78. KY. CONST., § 198 (repealed 2002).

79. *See* S.D. CONST., art. XVII, § 20.

80. *See, e.g.*, ILL. CONST. of 1870, art. XI, § 11; MICH. CONST. of 1850, art. XIX–A, § 2 (1870); PA. CONST., art. XVI, § 12 (repealed 1966); *id.* art. XVII, § 4 (repealed 1967).

81. ALA. CONST. of 1901, art. XII, § 239.

Alabama also introduced a new provision that regulated monopolies generally:

> The Legislature shall provide by law for the regulation, prohibition or reasonable restraint of common carriers, partnerships, associations, trusts, monopolies, and combinations of capital, so as to prevent them or any of them from making scarce articles of necessity, trade or commerce, or from increasing unreasonably the cost thereof to the consumer, or preventing reasonable competition in any calling, trade or business.[82]

These provisions were often written in parallel with coordinating provisions that fixed the status of these corporations as common carriers and granted state government the power to regulate rates.[83] Some states, like Louisiana, enacted provisions that created regulatory boards, which were vested with the authority not only to enact regulations but also to investigate and punish industry offenders.[84] Many states also accompanied these provisions with ones intended to ward off bribes, barring corporations from passing along free or discounted tickets to elected officials.[85] Some states also enacted provisions to prevent these types of companies from gaining status as foreign corporations by combining with out-of-state companies. States like Louisiana, Mississippi, and Montana all included provisions that would allow their state courts to maintain jurisdiction over suits involving these companies.[86]

Today, twenty-four states retain provisions regulating or banning monopolies, whether general or industry-specific.[87]

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82. *Id.*, art. IV, § 103.

83. *See* WASH. CONST., art. XII, § 14 (repealed 1977).

84. *See, e.g.*, LA. CONST. of 1898, art. 284. For more information on these types of provisions, see J.D. Forrest, *Anti-Monopoly Legislation in the United States*, 1 AM. J. SOCIO. 411, 417–18 (1896).

85. *See, e.g.*, ALA. CONST. of 1875, art. XIV, § 23.

86. *See* MO. CONST. of 1875, art. XII, § 18; LA. CONST. of 1879, art. 246; MISS. CONST., art. VII, § 197 (repealed 1989).

87. *E.g.*, ARIZ. CONST., art. XIV, § 15 ("Monopolies and trusts shall never be allowed in this state and no incorporated company, co-partnership or association of persons in this state shall directly or indirectly combine or make any, ◦ prices, limit the production, or regulate the transportation of any product or commodity. The legislature shall enact laws for the enforcement of this section by adequate penalties, and in the case of incorporated companies, if necessary for that purpose, may, as a penalty declare a forfeiture of their franchises.").

Many provisions, particularly those regulating railroads, were repealed in the 1960s and 70s.[88]

In sum, the American antimonopoly tradition experienced evolutionary expression in state constitutional provisions during the nineteenth century, progressing through three overlapping stages. A first stage focused squarely on monopoly as grant of exclusive privilege by the state. A second stage, which largely subsumed the first, altered the relationship between legislatures, the courts, and the market by prohibiting special legislative acts and requiring that economic policy be formulated through general acts. This shift in emphasis may have strengthened good government and curtailed crony capitalism, but it also diluted antimonopoly as a limitation on the power of the state by generalizing the concept and relinquishing the distinctive focus on monopoly outcomes. Finally, when antimonopoly entered state constitutions in the third phase, the focus had flipped from the state to private actors and from limiting the state to empowering the state, thus contributing to the reversal of an antimonopoly tradition primarily focused on restraining public power to one primarily focused on restraining private power.

C. *Judicial Decisions: Four Strands of Antimonopoly*

In the century leading up to the passage of the Sherman Act, antimonopoly sentiment flowed through state and federal judicial opinions. Thousands of cases wrestled with claims concerning the law's abhorrence of monopoly. However, apart from the generality of view (occasionally honored in the breach) that the law disfavored monopoly, these cases instantiated distinct and often conflicting perspectives on the nature and implications of the antimonopoly principle. Based on a review of every nineteenth century state and federal decision concerning monopoly, I have classified these decisions into four buckets, the first three concerning state power and the last concerning private power. To introduce these classifications, it may be helpful to consider a typology illustrated by a well-known Supreme Court decision associated with each of the four varieties of antimonopoly ideology:

88. For example, the 1850 provision of the Michigan Constitution prohibiting railroad mergers, MICH. CONST. of 1850, art. 19A, § 2, was not renewed in Michigan's 1962 Constitution.

Charles River Bridge:[89] In the *Charles River Bridge* case, the Court held that the Commonwealth of Massachusetts' grant of the right to build a bridge to one company did not imply an exclusive privilege that would prevent the state from granting a second company a similar right at a later date. The case is associated with antimonopoly as a limitation on the grant of exclusive privileges by the state, the dominant understanding of antimonopoly for most of the nineteenth century.[90]

Munn:[91] In *Munn*, the Court upheld an Illinois statute establishing price controls for grain elevators, observing that the defendants had a "practical monopoly" due to their control of fourteen elevators in Chicago.[92] Following *Munn*, "monopoly, and more generally market power, became the leading theory justifying nondiscriminatory access and rate regulation in the twentieth century."[93] *Munn* can thus be associated with a view of antimonopoly as a source of state police power, a view that increased in prominence in the late nineteenth century and into the early twentieth century and faded in the New Deal when the set of permissible justifications for the exercise of state regulatory power over economic matters expanded considerably.

Slaughter-House Cases:[94] In the *Slaughter-House* cases, the Court rejected a Fourteenth Amendment challenge to a Louisiana statute prohibiting the operation of slaughterhouses except at the Crescent City Live-Stock Landing and Slaughter-House Company. The arguments the Court rejected flowed from a strand of antimonopoly ideology concerned with limiting the state's regulatory power—antimonopoly as anti-regulation. Although these arguments were unsuccessful in *Slaughter-House*, similar arguments gained traction in scores of nineteenth century state court decisions and eventually the Supreme Court's *Lochner* decision, where the Supreme Court invalidated a

89. Proprietors of Charles River Bridge v. Proprietors of Warren Bridge, 36 U.S. 420 (1837).

90. William L. Barney, The Passage of the Republic: An Interdisciplinary History of Nineteenth-Century America 307 (1987).

91. Munn v. Illinois, 94 U.S. 113 (1877).

92. *Id.* at 131.

93. Thomas B. Nachbar, *The Public Network*, 17 CommLaw Conspectus 67, 96 (2008).

94. Slaughter-House Cases, 83 U.S. 36 (1872).

statute entrenching a baker's union at the expense of immigrant labor,[95] reflecting antimonopoly ideology.[96]

Standard Oil:[97] In its landmark *Standard Oil* decision, the Court found that Standard Oil had violated Sections 1 and 2 of the Sherman Act and ordered the company broken up. The Court acknowledged that monopoly, as understood by the common law, "embraced only a consequence arising from an exertion of sovereign power, [that] no express restrictions or prohibitions obtained against the creating by an individual of a monopoly as such," and that "nowhere at common law can there be found a prohibition against the creation of monopoly by an individual."[98] However, "as modern conditions arose, the trend of legislation and judicial decision came more and more to adapt the recognized restrictions to new manifestations of conduct or of dealing which it was thought justified the inference of intent to do the wrong which it had been the purpose to prevent from the beginning."[99] Hence, an antimonopoly tradition that had at first been directed against exclusive grants by the sovereign adapted over time to prohibit the same effect when undertaken by a private individual. In short, the antimonopoly principle operated as a limitation on privately acquired economic power.

1. *Anti-Monopoly as Limitation on Exclusive Privilege*

In the first half of the nineteenth century, monopoly was associated primarily with a legislative grant of an exclusive economic privilege or right—such as building a bridge or ferry—to a corporation in its chartering document. Judicial opinions wrestled with two sorts of related questions under this broad umbrella: (a) had a monopoly in fact been granted; and

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95. PAUL KENS, LOCHNER V. NEW YORK: ECONOMIC REGULATION ON TRIAL (1998); and David E. Bernstein, *The Story of* Lochner v. New York: *Impediment to the Growth of the Regulatory State*, *in* CONSTITUTIONAL LAW STORIES 299 (Michael Dorf ed., 2d ed. 2009); Lochner v. New York, 198 U.S. 45 (1905).

96. HOWARD GILLMAN, THE CONSTITUTION BESIEGED: THE RISE AND DEMISE OF LOCHNER ERA POLICE POWERS JURISPRUDENCE 120–29 (1993) (arguing that *Lochner* grew out of Jacksonian anti-monopoly tradition); Jedediah Britton-Purdy et al., *Building a Law-and-Political-Economy Framework: Beyond the Twentieth-Century Synthesis*, 129 YALE L.J. 1784, 1795 n.38 (2020) (asserting that "*Lochner* and the legal culture that surrounded it" were influenced by Jacksonian anti-monopoly politics).

97. Standard Oil Co. of N.J. v. United States, 221 U.S. 1 (1911).

98. *Id.* at 52, 55.

99. *Id.* at 57–58.

(b) was the grant constitutional. In both subcategories, the anti-monopoly principle served to contract the power of the state or the scope of the monopoly grant.

a. Had a Monopoly Been Conferred in the Legislative Grant?

The *Charles River Bridge* case is of a type with numerous nineteenth century decisions determining whether a grant by the legislature to a corporation included an actual or implied right to freedom from competition. In some cases, the courts forthrightly held that a legislative grant constituted a monopoly.[100] Well into the nineteenth century, some courts continued to opine that monopoly rights are inherent in the charter of certain types of companies, such as railroads.[101] And, despite the steady drumbeat of antimonopoly rhetoric that grew in the courts as the nineteenth century progressed, the occasional judge continued to speak up in favor of monopoly. In 1871, the Chief Justice of the Georgia Supreme Court remarked that "[m]onopolies are evidences of civilization, and invoke no captious criticism at my hands."[102] Similarly, in 1874, the District of Columbia Supreme Court opined "modern political economists" believe that the granting of municipal monopolies for commodities like gas tends to improve quality and reduce prices.[103] (Economists would disagree).

But such pro-monopoly sentiments were by far the exception rather than the rule. Far more common was the sentiment that a monopoly "is a thing disfavored in law; an abuse, a public nuisance,"[104] and that "[c]hartered monopolies of every character are inimical to republican institutions."[105] Courts often equated granting monopolies with democratic corruption, oppression, and despotism, and derived various legal techniques to control monopoly. In 1855, the Florida Supreme Court, citing the Walker treatise on American law held: "A monopoly, as the name imports, is a special privilege conferred

100. Beekman v. Saratoga & Schenectady R.R. Co., 3 Paige Ch. 45 (1831) ("The grant of this railroad is a monopoly. The company have the exclusive use of it, for exclusive benefit").

101. Wilmington, Columbia & Augusta R.R. Co. v. Board of Com'rs, 72 N.C. 10 (1875)

102. S.C. R.R. Co. v. Steiner, 44 Ga. 546, 558 (1871).

103. Bates v. District of Columbia, 8 D.C. (1 MacArth.) 433, 445 (1874).

104. Knoup v. Piqua Branch of State Bank, 1 Ohio St. 603, 614 (1853).

105. Stein v. City of Mobile, 24 Ala. 591 (1854).

on one or more persons, to the absolute exclusion of others. In this sense it is deservedly odious, because it is essentially anti-republican."[106]

Chief among the legal doctrines employed to limit the spread of state-granted monopolies was the ubiquitous maxim that a monopoly could not be granted through implication but only through clear and express language in the corporate charter.[107] Grantees of governmental privileges wishing to claim that their charter excluded competition faced an uphill fight in the absence of express exclusivity language in the granting document. As a Connecticut court put it with characteristic feeling in 1860, "[a] grant of monopoly is odious in the eyes of the law making power, and therefore should never be inferred in a legislative grant when not plainly expressed."[108]

Already in the early decades of the nineteenth century, judges began to observe a shift in zeitgeist from early state

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106. Barbee v. Jacksonville & A. Plank Rd. Co., 6 Fla. 262, 269 (1855).

107. Tuckahoe Canal Co. v. Tuckahoe & J.R.R. Co., 38 Va. (11 Leigh) 42 (1840) ("A monopoly cannot be *implied* from the mere grant of a charter to a company to construct a work of public improvement . . . to give such a monopoly, there must be an express provision in the charter, whereby the legislature restrains itself from granting charters for rival and competing works."); Comm'rs of N. Liberties v. N. Liberties Gas Co., 12 Pa. 318, 321 (1849) (monopoly or exclusivity rights cannot be found by implication from legislative grant); Westfall v. Mapes, 3 Grant 198 (Pa. 1855) (grants of monopolies are strictly construed against the grantee); Michigan Cent. R. Co. v. Michigan S. R. Co., 4 Mich. 361 (Mich. 1856) (public grants strictly construed as against monopoly rights); Collins v. Sherman, 2 George 679 (Miss High Ct. Errors 1856) (monopoly cannot be granted by implication); Wetmore v. Atl. White Lead Co., 37 Barb. 70 (N.Y.Gen. Term 1862) (grants of privileges to be strictly construed against monopoly and in favor of the public); Chenango Bridge Co. v. Binghamton Bridge Co., 27 N.Y. 87 (1863) (monopoly cannot be created by inference, but only by express grant); City of San Francisco v. Spring Val. Waterworks, 39 Cal. 473 (1870) ("All grants of privileges are to be liberally construed in favor of the public, and, as against grantees of the monopoly franchise, to be strictly interpreted"); Philadelphia W. & B.R. Co. v. Bowers, 9 Del. (4 Houst.) 506 (1873) (exclusive privileges cannot be derived by implication from charter; monopolies strictly construed); De Lancey v. Rockingham Farmers' Mut. Fire Ins. Co., 52 N.H. 581 (1873) (presumption against grant of monopoly rights); State v. Vanderbilt, 37 Ohio St. 590 (1882) (grants of privileges construed strictly against grantee); Appeal of Scranton Elec. Light & Heat Co., 15 A. 446 (Pa. 1888) (stating that "monopolies are favorites neither with courts or people" and legislative grants must be strictly construed against grant of monopoly); N. Baltimore Pass. Ry. Co. v. N. Ave. Ry. Co., 23 A. 466 (Md. 1892) (monopoly cannot be created by implication); Jackson Cnty. Horse-R.R. Co. v. Interstate Rapid-Transit Ry. Co., 24 F. 306 (C.C.D. Kan. 1885) (monopoly cannot be created by implication).

108. Hartford Bridge Co. v. Union Ferry Co., 29 Conn. 210, 217 (1860).

legislation favoring cronyism and monopoly toward antimonopoly legislative sentiment. Toward the beginning of the Jacksonian Era, the Tennessee Supreme Court noted that Tennessee law had moved away from the "monopolizing spirit" of a prior act preventing anyone from operating a ferry within ten miles of a licensed ferry to a system of enhanced powers for counties to license competitive ferries.[109] At the tail end of that era, a Justice of the Vermont Supreme Court observed that he had "heard repeated complaints of the abuse and danger of monopolies and incorporations, and, on the other hand, of the danger of all their rights being prostrated before popular excitement; and I have no hesitation in saying, as my belief, that the principles of civil liberty are more regarded and individual and chartered rights more firmly secured and protected now, than when I first commenced active life."[110] Statements of this kind operated as self-prescribed mandates for judges to exercise their judicial power to curtail monopoly rights.

A definitional issue often arose concerning the meaning of "monopoly." Since monopoly was a term of opprobrium and its label invited judicial invalidation or curtailment of rights, companies often argued that the exclusive rights they claimed were not monopolistic at all since they involved correlative public obligations. These arguments were sometimes met with success. In a divided opinion in the *Charles River Bridge* case, the Massachusetts Supreme Court the court defined a monopoly as "a grant of a benefit without any burden."[111] Where the recipient of an exclusive governmental grant had a reciprocal obligation to provide a public service—as with respect to ferries and bridges—the grant should not be considered "monopoly" at all.[112] According to the court, "[a]ll the public improvements in the country have arisen from what the defendants call monopoly; from a grant by the public, of security for private benefits, for the benefit of using them."[113] Similarly, in 1845, the Connecticut Supreme Court of Errors had to decide whether the legislature's grant of an exclusive right to build a bridge was unconstitutionally encumbered by the legislature's subsequent grant to another of the right to build a railroad bridge

109. Blair v. Carmichael, 10 Tenn. 306, 308 (1829).
110. State v. Bosworth, 3 Vt. 402 (1841).
111. *Charles River Bridge*, 24 Mass. at 437.
112. *Id.*
113. *Id.*

in the same locale.[114] Finding that the railroad grant impaired the bridge company's contract and hence amounted to an unconstitutional taking requiring just compensation, the court observed that, although both contracts involved exclusivity, both existed to promote a public benefit and therefore neither involved "monopoly, in the odious sense of the term."[115]

An antimonopoly judicial technique lying somewhere between interpretation and invalidation was to construe monopoly grants as limited or narrow. Courts frequently described the legislative grant of exclusive privileges as circumscribed. As an Ohio court expressed in holding invalid a bank note drawn at an interest rate of greater than six percent, "[a]ll privileged associations should be watched with argus eyes. They should be regarded with distrust. It is the duty of courts to keep them within the bounds prescribed by the legislature. They are opposed to the genius of our government, and, if tolerated, should not be permitted to abuse the privileges with which they are intrusted."[116] Courts could also limit monopoly grants by limiting their duration, as a Tennessee court did in 1847 in holding that to construe a franchise as perpetual would violate the constitutional prohibition on perpetuities and monopolies.[117]

b. Was the Grant of a Monopoly Constitutional?

In addition to interpreting corporate charters in light of the antimonopoly principle, courts were frequently called upon to determine whether the state—either the legislature or a local government such as a town or county—had the constitutional power to grant monopoly rights. As discussed in Part II B 1 above, a number of state constitutions contained explicit prohibitions on the grant of monopoly rights. But even in the absence of such provisions, courts often drew on general constitutional principles such as enumerated powers and

114. Enfield Toll Bridge Co. v. Hartford & N.H.R. Co., 17 Conn. 40 (1845).

115. *Id.* at 55. On the other hand, monopoly could be equated with any exclusive privilege, whether or not it had any effect on competition. For example, in 1840, the Supreme Court of Missouri struck down an 1836 Missouri statute exempting members of the "central fire company" from jury service as an instance of "odious" monopoly. McGunnegle v. State, 6 Mo. 367 (1840).

116. Bank of Chillicothe v. Swayne, 8 Ohio 257, 260 (1838).

117. Franklin v. Armfield, 34 Tenn. (2 Sneed) 305 (1854).

due process, or even general principles of the common law, to challenge governmental grants of monopoly rights, particularly those granted by local governments.

As with all dimensions of antimonopoly, there was considerable ambiguity and diversity in the courts' treatment of antimonopoly arguments directed against the state. Some courts held the state's power to grant monopoly to be clear. In 1840, the Pennsylvania Supreme Court held that:

> It seems scarcely necessary to say that monopolies are not prohibited by the constitution; and that to abolish them, would destroy many of our most useful institutions. Every grant of privileges so far as it goes, is exclusive; and every exclusive privilege is a monopoly. Not only is every rail-road, turnpike, or canal such, but every bank, college, hospital, asylum, or church, is a monopoly; and the ten thousand beneficial societies incorporated by the executive on the certificates of their legality, by the attorney general and judges of the Supreme Court, are all monopolies.[118]

Again in 1843, the same court observed that the Pennsylvania constitution did not prohibit monopolies and that "not every preference or monopoly is illegal. On the contrary, we have a countless number of them which are entirely consistent with the constitution and the laws."[119] In 1863, the Supreme Court of California wrestled with whether the legislature had the power to grant monopolies, given that the state constitution neither expressly permitted nor prohibited such a grant.[120] The court opined that grants of franchises—such as to build a ferry—necessarily implied an exclusive right, since a subsequent grant of the same right to another person impairs the contractual rights of the first.[121] Hence, the power to grant public works franchises necessarily implied the power to grant monopolies.[122]

Yet, the more general tendency was to treat monopoly grants as at least disfavored by law, if not outright prohibited. In 1840,

118. Case of Philadelphia & T.R. Co., 6 Whart. 25 (Pa. 1840).
119. Commonwealth *ex rel.* Leech v. Canal Comm'rs, 5 Watts & Serg. 388, 394 (Pa. 1843).
120. Cal. State Tel. Co. v. Alta Tel. Co., 22 Cal. 398, 423–25 (1863).
121. *Id.* at 422–23.
122. *Id.*

a New York court held that grants of exclusive privilege "should not be favored" and could "only be made in order to accomplish some important object of public good, not otherwise so well or fully attainable."[123] And even the Pennsylvania Supreme Court eventually came around to the view that monopoly was unlawful when granted for private gain as opposed to public benefit.[124]

Other courts showed little hesitation in invalidating monopoly grants. For example, in 1831 the Illinois Supreme Court invalidated a county's grant of an exclusive right to run a ferry, holding that the county had no express power to grant monopolies and that monopolies cannot be conferred by implied grants of power.[125] Courts struck down a New York City ordinance granting the privilege to lay a railroad track as an unconstitutional "perpetual monopoly,"[126] a North Carolina statute granting the perpetually exclusive right to erect a bridge over stream,[127] various municipal ordinances granting the exclusive privilege to lay gas pipes through city streets,[128] a city's exclusive contract with a water company for 25 years,[129] a contract between a city and developer to build a luxury hotel with exclusive rights to sell liquors within city limits, [130] a county's grant of an exclusive privilege to transport passengers across a river within three miles of town,[131] and a provision in a corporate charter granting the corporation an exclusive privilege of manufacturing and selling gas in St. Louis.[132]

As antimonopoly as a limitation on governmental power became an established principle, courts wrestled with

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123. Thompson v. People *ex rel.* Taylor, 23 Wend 537, 554 (N.Y. 1840).

124. Phila. Ass'n for Relief of Disabled Firemen v. Wood, 39 Pa. 73, 82–83 (1861).

125. Betts v. Menard, 1 Ill. (Breese) 395, 400 (1831); *see also* Gales v. Anderson, 13 Ill. 413 (1851) (holding that county commissioners had no authority to grant exclusive ferrying privileges).

126. Milhau v. Sharp, 9 How. Pr. 102, 109 (N.Y. Sup. Ct. 1853).

127. McRee v. Wilmington & Raleigh R.R. Co., 47 N.C. (2 Jones) 186 (1855).

128. Norwich Gas Light Co. v. Norwich City Gas Co., 25 Conn. 19 (1856); Parkersburg Gas Co. v. City of Parkersburg, 4 S.E. 650 (W. Va. 1887); Citizens' Nat. Gas & Mining Co. v. Town of Elwood, 16 N.E. 624 (Ind. 1888).

129. Altgelt v. City of San Antonio, 17 S.W. 75 (Tex. 1890).

130. Mayor of Jackson v. Bowman, 10 George 671 (Miss. High Ct. Err. & App. 1861).

131. Wash. Toll Bridge Co. v. Comm'rs of Beaufort, 81 N.C. 491 (1879).

132. St. Louis Gas-Light Co. v. St. Louis Gas, Fuel & Power Co., 16 Mo. App. 52 (Mo. Ct. App. 1884).

categorization questions: When was a governmental grant a prohibited monopoly? Courts distinguished between an unlawful grant of monopoly, which required "the right to exclude others from the exercise or enjoyment of like privileges or franchises," and the grant of special privileges, which might serve the public interest.[133] They held that, definitionally, a grant of exclusive privilege (such as a ferry company's rights to use a wharf) was not a monopoly within the Maryland Bill of Rights' prohibition, since a privilege to be exercised for the public benefit is not a monopoly.[134] They held that whatever general objections there may be to the creation of monopolies, those are overcome with respect to ferries which are necessary to the public advantage.[135] And they held that a general banking law that allowed entities to incorporate banks was not unconstitutional; although the incorporated banks had all the essential features of corporate bodies, they did not partake of "character of monopolies or special grants of privilege."[136]

A related set of judicial techniques straddled the line between direct confrontation with legislatures and municipal governments and the late-nineteenth century turn toward a focus on privately acquired power (discussed in Part II C 4). Courts sometimes construed legislative grants narrowly to prevent the acquisition of private power that, if derived from a grant by the state, might run afoul of constitutional limitations. Thus, foreshadowing the extensive use of the *quo warranto* action in the later nineteenth century,[137] some early nineteenth century cases narrowly construed corporate charters to prohibit actions by the firm that might extend corporate power. In 1819, the Kentucky Court of Appeals held that the Bank of the United States had no power to acquire a private note, observing that the powers of corporations with "extensive and monopolizing character" ought to be strictly construed.[138] Similarly, in 1844, the Supreme Court of Michigan held that a corporate charter allowing a bank to purchase land for the convenient transaction of its business did not permit the bank to buy and sell land

133. *In re* Application of Union Ferry Co., 98 N.Y. 139, 150 (1885).
134. Broadway & Locust Point Ferry Co. v. Hankey, 31 Md. 346 (1869).
135. Burlington & Henderson Cnty. Ferry Co. v. Davis, 48 Iowa 133 (1878).
136. Curtis v. Leavitt, 17 Barb. 309 (N.Y. Gen. Term 1853).
137. *See* Crane, *supra* note 41 at 14.
138. Bank of U.S. v. Norvell, 9 Ky, (2 A.K. Marsh) 101, 105 (1819).

for profit, which was necessary to "prevent monopolies, and to confine those powerful bodies strictly within their proper sphere."[139]

The antimonopoly principle limited the state's power to create monopolies, but also to undo them. For instance, when the Louisiana legislature tried to abrogate a gas-light monopoly previously granted, the state Supreme Court held that it had unlawfully impaired the obligation of contracts.[140]

2. *Antimonopoly as Police Power*

If the antimonopoly principle served to limit the power of the state, as just seen, it also served the opposite purpose—expanding the state's police power to regulate on economic matters. From early in the nineteenth centuries—decades before *Munn*—courts held that preventing monopoly was a legitimate reason for the exercise of state regulatory power.[141] Thus, for example, in 1839, the New York Supreme Court of Judicature rejected a challenge to a New York statute expanding the availability of licenses to establish offices of discount, deposit, and circulation—essentially, banks.[142] The court contrasted the legislative creation of monopolies which entailed "the attendant corruption of legislation," to legislative acts "opening the field to all," which could not be unconstitutional.[143] In 1858, the Wisconsin Supreme Court held that chartered monopolies such as a municipal gas service, being "repugnant to the genius and spirit of our republican institutions," could be held accountable to public regulation "to meet the convenience or necessity which tolerates their existence."[144]

The development of new technologies in the Civil War and Reconstruction eras led to an expansion of this antimonopoly police power.[145] Drawing on the common carrier tradition,

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139. Bank of Mich. v. Niles, 1 Doug. 401, 405 (Mich. 1844).

140. New Orleans Gas Co. v. La. Light Co., 115 U.S. 650 (1885).

141. Aldridge v. Tuscumbia, Cortland. & Decatur. R.R. Co., 2. Stew. & P. 199, 204 (Ala. 1832) ("The sovereign authority is frequently exerted over personal rights and private property. It is done in the enforcement of all quarantine regulations—for the prevention of monopolies . . . .")

142. Thomas v. Dakin, 22 Wend. 9 (N.Y. Sup. Ct. 1839).

143. *Id.* at 30–32.

144. Shepard v. Milwaukee Gas Light Co., 6 Wis. 539, 547 (1858).

145. The economic dislocations caused by the Civil War also prompted judicial decisions recognizing a broad legislative power to combat monopoly. For example, in 1869, the Georgia Supreme Court invoked the prevention of

courts held that monopoly power of railroads justified imposition of a non-discrimination obligation, such as prohibiting the charging of higher rates on freight to be carried on another route after reaching the railroad's terminus.[146] In an 1869 decision, Maine's highest court held that a railroad that had granted exclusive use of a separate apartment in a car attached to each of its passenger trains, for the purpose of transporting the express company's messenger and merchandise was liable for damages to another express carrier excluded by this arrangement.[147] "The very definition of a common carrier excludes the idea of the right to grant monopolies or to give special and unequal preferences."[148] The common carrier, being itself a species of monopoly, had no power to grant further monopolies of its own. The courts held that parties that accepted monopoly rights also had to accept regulation of their business conduct.[149]

As with respect to the cases limiting the state's power to grant exclusive privileges, one of the questions raised in these cases was what sort of economic power constituted a monopoly sufficient to justify the exercise of the state's police power. As discussed in greater detail below, many courts were uncertain until well into the nineteenth century whether economic power acquired through private conduct rather than the grant of exclusive rights from the state met the definition of monopoly. Following *Munn*, the courts began to hold that the state's regulatory power was not dependent upon the presence of "legal monopoly" but could also apply in a case of "practical monopoly."[150] The New York Court of Appeals considered

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monopoly as a justification for a reconstruction homestead measure preventing creditors from seizing distressed assets. Hardeman v. Downer, 39 Ga. 425 (1869).

146. Twells v. Pa. R.R. Co., 2 Walk. 450 (Pa. 1863); *see also* Buffalo E. Side R.R. Co. v. Buffalo St. R.R. Co., 19 N.E. 63 (N.Y. 1888) (upholding statute regulating street car rates); Currier v. Concord R.R. Corp., 48 N.H. 321 (1869) (upholding antimonopoly railroad legislation); *cf.* City of St. Louis v. Bell Tel. Co., 10 S.W. 197 (Mo. 1888) (conceding that telephone company was a monopoly, but holding that municipality had no power to regulate telephone rates).

147. New England Express Co. v. Me. Cent. R.R. Co., 57 Me. 188 (1869).

148. *Id.* at 196–97.

149. Laurel Fork & Sand Hill R.R. Co. v. W. Va. Transp. Co., 25 W. Va. 324 (1884) (citing Aldnutt v. Ingels, 12 East 537, for proposition that party who accepts a monopoly must "as an equivalent perform the duty attached to it").

150. People v. Budd, 22 N.E. 670, 675 (N.Y. 1889).

Munn's application to legislation fixing the maximum charge for elevating grain.[151]

This pro-regulatory turn in the antimonopoly tradition would perhaps have the widest implications for economic policy in the twentieth century. As Bill Novak has written, this sense of "American antimonopoly was first and foremost a question of the democratic distribution of power and authority in a supposedly self-governing republic" and "generated the template for a modern law of regulated industries."[152]

3. *Antimonopoly as Anti-Regulation*

A third strand of antimonopoly legal doctrine concerned constitutional limitations on the states' power to legislate on a class basis or in favor of narrowly defined interest groups.[153] Like the first category and unlike the second, this set of doctrines operated to constrain rather than expand state power, when successfully invoked.

The success of this line of antimonopoly argument has been underestimated given its failure in the *Slaughter-House Cases*. There, the butcher-plaintiffs explicitly positioned their argument on antimonopoly grounds, reading Coke's report of *Darcy v. Allein* to the Court,[154] and Justice Field's dissenting opinion expressed sympathy to their assertion of a constitutional antimonopoly tradition.[155] However, the majority rejected the butchers' interpretation of the Reconstruction Amendment, reading down the privileges and immunities clause of the Fourteenth Amendment to a narrow scope incapable of carrying the weight of the antimonopoly tradition.

But the success of antimonopoly as anti-regulation was more mixed in the state courts. Two years after *Slaughter-House*,

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151. *See also* City of Zanesville v. Zanesville Gas-Light Co., 23 N.E. 55, 60 (Ohio 1889) (holding a gas company's "virtual monopoly" of gas supply gives state power to regulate gas prices); Spring Valley Water Works v. City of San Francisco, 22 P. 910 (Cal. 1889) (upholding ordinance requiring water company to furnish water meter).

152. William Novak, New Democracy: The Creation of the Modern American State 183–84 (2022).

153. *See* Calabresi & Leibowitz, *supra* note 6 at 1023–42.

154. *Id.* at 1042–43.

155. *See also* Bartemeyer v. Iowa, 85 U.S. 129, 136 (1873) (Bradley, J., concurring) (arguing for a constitutional right to be free from "tyrannical and corrupt monopolies" that limit a person's right to pursue "such lawful avocation" as they choose).

the Illinois Supreme Court invalidated a similar slaughter-house ordinance, invoking antimonopoly principles.[156] Similarly, the Supreme Court of California held that an exclusive corporate franchise to lay down water pipes in San Francisco could not be granted by special legislation, but only by a general act.[157] The requirement of general legislation was necessary to prevent the past practice of "hasty or corrupt legislation" creating "great monopolies" where "[c]apital was aggregated in the hands of large corporations" with "[e]xtraordinary privileges [and] oppressive powers . . . denied to others engaged in the same business."[158] Such schemes might be tolerable if they could be corrected by subsequent legislatures, but given that legislative grants once made could not be repealed because of the Contracts Clause, democratic self-correction was not an available remedy.[159] Although the Supreme Court had upheld such a scheme in the *Slaughter-House Cases* as a matter of federal constitutional law, it could not pass muster under the California constitution. On the other hand, the Louisiana Supreme Court backed off, holding that "however odious monopolies may be," it was up to the people and their elected representatives to determine whether to exercise the "unwise, unfair, and arbitrary power" of granting exclusive rights.[160] The court subsequently upheld challenges to slaughter-house ordinances under the provision of the Louisiana constitution prohibiting special privileges and monopolies.[161]

Other courts took from the *Slaughter-House Cases* the moral that restrictions on commercial activity would be upheld only insofar as they involved "police regulation… necessary for the health and comfort of the people," and that otherwise the restrictions might still be invalidated as "odious" monopolies.[162]

156. City of Chicago v. Turner, 80 Ill. 419 (1875); Tugman v. City of Chicago, 78 Ill. 405 (1875).
157. City & Cnty of San Francisco v. Spring Valley Water Works, 48 Cal. 493 (1874).
158. *Id.* at 511.
159. *Id.* at 511–12.
160. Crescent City Gaslight Co. v. New Orleans Gaslight Co., 27 La. Ann. 138, 146–47 (1875).
161. Commonwealth v. Whipps, 80 Ky. 269, 278 (1882).
162. Crescent City Live Stock Landing & Slaughter-House Co. v. City of New Orleans, 33 La. Ann. 934 (1881); *see also* Mueller v. State, 76 Ind. 310, 314 (1881) (affirming conviction of a hotel-keeper for selling cigars on Sunday in violation of a blue law and rejecting defendant's argument that the statute did not apply to an inn-keeper furnishing his own guests on the ground that

There was older precedent for the idea of applying antimonopoly as a constraint on regulations that did not serve the public interest and often involved political patronage or rent-seeking. In 1828, the Massachusetts Supreme Court had upheld a by-law of the City of Boston prohibiting anyone not licensed by the mayor or aldermen from removing dirt or offal from the city.[163] Rejecting arguments that the by-law was a "restraint of trade and operates as a monopoly," the court distinguished an English decision invalidating a London by-law requiring that carmen be licensed by paying a fee to a hospital warden as one involving "private benefit of the wardens of the hospital" as opposed to benefit to the public at large.[164] By contrast, the Boston by-law was made for the health of the inhabitants, and therefore was reasonable.[165]

Mid-to-late nineteenth century state courts showed themselves quite willing to invalidate regulations that limited market participation and entrenched incumbent economic interests. Courts read state constitutional prohibitions on "perpetuities and monopolies" as prohibiting all "partial and class legislation."[166] Liquor licensing provided a fount of antimonopoly claims. In 1855, the Indiana Supreme Court invalidated a state statute prohibiting the sale of liquors except by certain authorized county agents as an unconstitutional enactment of monopoly.[167] In 1884, the Arkansas Supreme Court applied the provision of its constitution prohibiting the grant of "perpetuities and monopolies" to hold that liquor licenses could not be arbitrarily withheld from qualified applicants.[168] While wrestling with the meaning of "monopoly," the court ultimately determined that monopoly consisted of the "sole power to sell," which amounted to an abuse recalling the "oppressive measures of the

this would give inn-keepers a competitive advantage over keepers of boarding houses, restaurants, or other dealers in cigars, with the effect of creating "odious and intolerable monopoly"); State v. Ohmer, 34 Mo. App. 115 (1889) (upholding conviction under similar ordinance).

163. *In re* Vandine, 23 Mass. (6 Pick.) 187 (1828).

164. *Id.* at 191.

165. *Id.* at 192.

166. Simonton v. Lanier, 71 N.C. 498, 503 (N.C. 1874) (provision in bank charter allowing bank to lend at interest rates agreed between parties could not be read to immunize bank from statutory usury ceilings without running afoul of state constitutional prohibition on granting perpetuities and monopolies).

167. Beebe v. State, 6 Ind. 501 (1855).

168. *Ex parte* Levy, 43 Ark. 42, 52 (1884).

Tudors and Stuarts."[169] Even courts that upheld restrictions on liquor sales tipped their hats to the antimonopoly tradition. In upholding a liquor blue law, the Pennsylvania Supreme Court observed that "monopolies are odious. Freedom of trade is a natural right which government has no authority to interfere with, except under pressure of some great public exigency."[170] Similarly, in the context of upholding a heavy municipal tax on saloons, the Michigan Supreme Court observed that "[i]t has always been considered improper to pass by-laws in restraint of trade, as tending to discourage enterprise and create monopolies", except in circumstances where the conduct restrained was dangerous to the public—which liquor presumably was.[171]

Regulations on many other sectors of the economy fell prey to the antimonopoly principle: a municipality's effort to prevent private individuals from surveying city lots in order to protect the city surveyor;[172] a municipal ordinance restricting peddling;[173] municipal ordinances prohibiting sale of meat outside public markets;[174] and a statute regulating the issuance of insurance policies.[175] Representatively, in 1880, the New Jersey Supreme Court struck down a Long Branch ordinance requiring the licensure of hawkers and peddlers.[176] The court reasoned that the ordinance could not operate as a tax, since the legislature had not granted municipalities the power to tax trade, nor could it operate as a regulation, since it did not fall within the police power relating to public health, morals, and order. Consequently, the ordinance was "in restraint of trade" and its

169. *Id.* at 53.

170. Omit v. Commonwealth, 21 Pa. 426, 434 (1853).

171. Kitson v. City of Ann Arbor, 26 Mich. 325, 327 (1873).

172. City of Cincinnati v. Broadwell, 3 Ohio Dec. Reprint 286 (Ct. Com. Pl. Ohio 1857); *see also* Scribner v. Chase, 27 Ill. App. 36 (1886) (invalidating county regulation prohibiting private abstract and recordation companies from using abstractor's office).

173. Sipe v. Murphy, 31 N.E. 884 (Ohio 1892).

174. City of St. Paul v. Laidler, 2 Minn. 190 (1858) (invalidating ordinance); Town Council of Winnsboro v. Smart, 45 S.C.L. 551 (S.C. Ct. App. 1858) (upholding ordinance); *see also* Ash v. People, 11 Mich. 347 (1863) (upholding similar ordinance); City of Chicago v. Rumpff, 45 Ill. 90 (1867) (invalidating similar ordinance as creating monopoly); City of St. Louis v. Weber, 44 Mo. 547 (1869) (upholding similar ordinance); State v. Fisher, 52 Mo. 174 (1873) (rejecting argument that statute regulating trafficking in dead animal carcasses was in restraint of trade and creating a monopoly; statute well within police power).

175. Commonwealth v. Vrooman, 30 A. 217 (Pa. 1894).

176. Mülenbrinck v. Long Branch Comm'rs, 42 N.J.L. 364 (N.J. 1880).

"direct tendency [was] to create monopoly."[177] Particularly vulnerable to the antimonopoly axe were municipal ordinances that favored residents at the expense of non-residents.[178]

State courts frequently diverged on the application of the antimonopoly principle as applied to regulations ostensibly connected to health and safety. As already noted, the courts divided on regulations prohibiting the sale of meat outside of public markets.[179] In 1888, the Supreme Court upheld a Pennsylvania statute prohibiting the manufacture or sale of oleomargarine as within the state's police power.[180] But, three years before, the New York Court of Appeals struck down a similar statute on expressly antimonopoly grounds.[181] To the New York court, the legislation reflected an effort to protect butter manufacturers from competition and hence fell squarely within the common law's anti-monopoly principle running back to the *Case of Monopolies.*[182]

As with all antimonopoly questions, contestation over the shifting and controverted meaning of "monopoly" played a central role in these anti-regulatory battles. To apply antimonopoly to invalidate regulatory schemes required stretching the concept from a formal grant of an exclusive right to include state interventions in the market that had that same effect—to shift from a formal to a functional conception of monopoly. But the plasticity of the concept of monopoly equally permitted

177. *Id.* at 369.

178. *Ex parte* Frank, 52 Cal. 606 (1878) (invalidating ordinance setting a higher license fee for goods sold outside the city than for those sold within); Borough of Conshohocken v. Fennel, 5 Pa.C.C. 65 (Ct. Com. P. Pa. 1888) (invalidating higher fee charged to non-resident vendors than to residents); Village of Braceville v. Doherty, 30 Ill. App. 645 (1888) (invalidating ordinance permitting peddling only by residents); State v. Pennoyer, 18 A. 878 (N.H. 1889) (invalidating ordinance containing an exception requiring physicians who had not previously practiced in the town to obtain a license); State v. Pendegrass, 10 S.E. 1002 (N.C. 1890) (noting that municipalities may not regulate in ways that create monopolies or benefit one class of citizens over another); Simrall v. City of Convington, 14 S.W. 369 (Ky. Ct. App. 1890) (stating that municipal rules must preserve equality of right and avoid discrimination in order to prevent creation of monopoly); State v. Tenant, 14 S.E. 387 (N.C. 1892) (asserting that municipalities cannot use their power to create monopoly); City of Peoria v. Gugenheim, 61 Ill. App. 374 (1895) (invalidating ordinance discriminating against itinerant merchants).

179. *See supra* note 174.

180. Powell v. Pennsylvania., 127 U.S. 678 (1888).

181. People v. Marx, 2. N.E. 29 (N.Y. 1885).

182. *Id.* at 386.

movement in the opposite direction. In upholding a statute restricting the sale of liquor in 1894, the Supreme Court of South Carolina held that "[t]he doctrine of 'monopoly' cannot be applied to a state exercising its governmental functions."[183] This was a complete inversion of the earlier understanding that monopoly could *only* arise from an intervention by the state in the market, but it reflected an initially subtle and then dramatic shift that occurred over the course of the nineteenth from a preoccupation with public power to one with private power.

4. *Antimonopoly as Control of Privately Acquired Economic Power*

Though concerns with private economic power are traceable back to the common law roots of the antimonopoly tradition, throughout much of the nineteenth century the dominant understanding of what constituted a "monopoly" was a grant of exclusive privilege from the state. As late as 1878, jurist Thomas Cooley would devote ninety percent of his essay on monopolies to state-granted exclusive rights, before turning almost as an afterthought to "monopolies not created by the legislature."[184] Similarly, as late as 1886, Christopher Tiedeman would assert in his *Treatise on the Limitations of Police Power in the United States* that "i[t] is only in extraordinarily abnormal cases that any one man can acquire this power over his fellow-men, unless he is the recipient of a privilege from the government, or is guilty of dishonest practices."[185] In 1884, the Texas Supreme Court held that exclusive right or privilege conferred by government is "a very essential element to constitute a monopoly."[186]

Despite the predominant emphasis on monopoly as exclusive public charter, some early nineteenth century cases did recognize the potential for private agreements to create monopoly, although the tendency of the courts was to uphold private contracts restraining competition as against claims of monopoly. For instance, in an 1811 decision upholding an agreement

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183. State *ex rel.* George *v.* City Council of Aiken, 20 S.E. 221, 228 (S.C. 1894).

184. Thomas M. Cooley, *Limits to State Control of Private Business*, 1 PRINCETON REV. 233 (1878).

185. CHRISTOPHER G. TIEDEMAN, A TREATISE ON THE LIMITATIONS OF POLICE POWER IN THE UNITED STATES 242 (1886).

186. Macdonnell v. Int'l & Great N. R.R. Co., 60 Tex. 590 (1884).

for the defendant not to run his stagecoach on a particular road where the plaintiff was operating his own coach, the Massachusetts Supreme Court observed that "[b]onds to restrain trade in general are unquestionably bad, as tending to create a monopoly injurious to the public. But bonds to restrain trade in particular places may be good, if executed for a sufficient and reasonable consideration."[187] In an 1815 opinion, the same court referred to a private agreement to monopolize the selling of hats.[188] An 1825 Maine decision upheld as against claims of monopoly an agreement between printers and booksellers that the printers would not print extra copies of the book for their own use.[189] The New Jersey Supreme Court invalidated an agreement wherein a United States postmaster promised to pay another person $1,000 not to apply for the postmaster position in 1828.[190] In 1835, a New York court outlawed a conspiracy of journeymen workmen to raise wages as "a monopoly of the most odious kind."[191]

In the early nineteenth century, the general attitude of the courts expressed skepticism that private agreement could create anything like monopoly. Conversely, courts also questioned the value of competition, as the Massachusetts Supreme Court did in 1825 in upholding an agreement for exclusive carriage of the defendant's goods up and down the Connecticut river, accompanied by the stipulation that the defendant would not "encourage any other boat man to compete with the obligee in the business of boating."[192] The court opined that "[i]t would be extravagant to suppose that any one, by multiplying contracts of this kind, could obtain a monopoly of any particular trade," and cast doubt on the value of commercial competition altogether:

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187. Pierce v. Fuller, 8 Tyng 223, 225 (Mass. 1811).

188. Emerson v. Providence Hat Mfg. Co., 12 Tyng 237 (Mass.1815); *see also* Taylor v. Owen, 2 Blackf. 301 (Ind. 1830) (holding owner of a town permitted right of monopoly over vending merchandise in the town); Ratcliffe v. Allison, 3 Rand. 537, 54 (Va. 1825) (referring to tavern owner's desire to "monopolize" tavern business through control of real estate); Jones v. Watkins, 1 Stew. 81, 100 (Ala. 1827) (reporting that bill charged defendant with monopolizing money supply).

189. Williams v. Gilman, 3 Me. 276 (1825).

190. Gulick v. Ward, 10 N.J.L. 87 (N.J. 1828).

191. People v. Fisher, 14 Wend. 9, 19 (N.Y. Sup. Ct. 1835).

192. Palmer v. Stebbins, 3 Pick, 188 (Mass. 1825).

> Whether competition in trade be useful to the public or otherwise, will depend on circumstances. I am rather inclined to believe, that in this country at least, more evil than good is to be apprehended from encouraging competition among rival tradesmen or men engaged in commercial concerns. There is a tendency, I think, to overdo trade, and such is the enterprise and activity of our citizens that small discouragements will have no injurious effect in checking in some degree a spirit of competition.[193]

In one of the earliest opinions clearly identifying the private aggregation of economic power as a monopoly problem, the Supreme Judicial Court of Massachusetts invalidated a bond conditioned on the obligor's agreement never to participate in the iron founding business.[194] With resonances of *The Case Against Monopolies*,[195] but now focused not on government grants of exclusive privilege but rather on power obtained through purely private means, the court enumerated five evils of monopoly: (1) injury to the parties themselves through deprivation of livelihood; (2) deprivation to the public of the most suitable persons being in particular lines of business; (3) discouragement of industry, enterprise, ingenuity, and skill; (4) prevention of competition and enhancement of prices; and (5) particular "evils of monopoly" arising from "wealthy companies and large corporations, who have the means, unless restrained by law, to exclude rivalry, monopolize business and engross the market."[196]

Courts in the late Antebellum Era continued to wrestle with the meaning of monopoly as applied to private agreements. In 1851, the Supreme Court of Wisconsin upheld an exclusive dealing agreement between a group of warehousemen and a group of flour mills which effectively restricted the wheat business in Milwaukee to the parties to the agreement.[197] The court recognized that private monopoly agreements were unlawful, but held that the exclusive contract was not of a monopolistic nature because it only committed the parties

193. *Id.* at 192–93.
194. Alger v. Thacher, 19 Pick. 51, 54 (Mass. 1837).
195. The Case of Monopolies, *supra* note 8.
196. *Alger*, 19 Pick. at 54.
197. Kellogg v. Larkin, 3 Pin. 123 (Wis. 1851).

to exclusivity among themselves but did not restrict the rights of third parties to participate in the market.[198] Similarly, on the authority of *Mitchel v. Reynolds*,[199] the Georgia Supreme Court upheld a deed restriction prohibiting the property from being used as a tavern, observing that "special" as opposed to "general" restraints might be "beneficial to the public" by "keeping a particular place" from being "overstocked with persons engaged in the same business."[200] The Iowa Supreme Court upheld an identical restriction, finding that there could be no monopoly in a restraint on competition in a particular town, as there would if the restraint extended "throughout the kingdom."[201] Other opinions similarly rejected antimonopoly claims as to contractual restraints on competition that were local or geographically restricted in nature.[202] Contractual grants of exclusive rights by a single company to a single grantee were held not a monopoly.[203] Courts also distinguished between "partial restraints," which were upheld, and monopoly, which might be invalidated.[204]

Gradually, courts began to consider the antimonopoly principle as more broadly applicable. In *Taylor v. Blanchard*,[205] a significant 1866 decision, the Massachusetts Supreme Court invalidated a contract committing one of the parties "not to set up, exercise or carry on the trade or business of manufacturing shoe-cutters within the Commonwealth of Massachusetts." The court began by asserting that "[t]he law has always regarded monopolies as hostile to the rights and interests of the

198. *Id.* at 145–46 ("[A]ll the rest of Wisconsin was an open and unrestricted market for the sale of wheat. And even in Milwaukee, the market was open to the fiercest competition of all the world, except these obligors").

199. Mitchel v. Reynolds (1711) 24 Eng. Rep. 347 (KB).

200. Holmes v. Martin, 10 Ga. 503, 505 (1851).

201. Heichew v. Hamilton, 3 Greene 596, 598 (Iowa 1852).

202. Grasselli v. Lowden, 11 Ohio St. 349 (1860); Arnold Bros. v. Kreutzer & Wasem, 25 N.W. 138 (Iowa 1885) (upholding contract ancillary to sale of furniture business for seller not to sell furniture within two miles of former business); Diamond Match Co. v. Roeber, 13 N.E. 419 (N.Y. 1887) (upholding covenant not to compete in same line of business that was sold).

203. Cal. Steam Navigation Co. v. Wright, 6 Cal. 258, 262 (1856).

204. Laubenheimer v. Mann, 17 Wis. 542, 544 (1863); see also Brewer v. Lamar, 69 Ga. 656 (1882) (distinguishing between general and partial restraints of trade); Sutton v. Head, 5 S.W. 410 (Ky. Ct. App. 1887) (distinguishing between general restraints and special restraints); Newell v. Meyendorff, 9 Mont. 254, 259 (1890) (upholding exclusive contract to distribute particular brand of cigars in Montana).

205. Taylor v. Blanchard, 95 Mass. 370 (1866).

public."[206] One method of obtaining monopolies—the one with which the antimonopoly tradition had been most concerned—was "by grant from the sovereign to a particular individual of the sole right to exercise a particular trade."[207] But there was also a second method of obtaining the same disfavored result—"private contracts, in which one of the parties agreed not to engage in some specified trade or business."[208] As to these private restraints of trade, the court acknowledged that other courts had upheld them if only "partial and limited."[209] The plaintiff, who sought to enforce the contract, argued that this principle required upholding the Massachusetts-wide restriction, since it involved a single state and a "comparatively small" one at that.[210] The court demurred, observing that it saw no reason that "the extent of territory embraced in a state affects the principle," since even geographically limited restraints could have anticompetitive effects.[211]

Similarly, an 1871 decision of the Pennsylvania Supreme Court invalidated a cartel agreement between two coal companies involving the division of regions and a joint management committee to fix prices.[212] The court repeated the maxim that a restraint being merely "partial" was necessary to its legality, but added that the restraint must also satisfy an independent reasonableness criterion.[213] Conversely, contracts that operated

206. *Id.* at 372.
207. *Id.*
208. *Id.* at 373.
209. *Id.* at 374.
210. *Id.* at 375.
211. *Id.*
212. Morris Run Coal Co. v. Barclay Coal Co., 68 Pa. 173 (1871).
213. *Id.* at 185; *see also* McBirney & Johnston White Lead Co. v. Consol. Lead Co., 8 Ohio Dec. Reprint 310 (1883) (stating that legality of contract restraining trade depends on whether it imposes reasonable limits and for a reasonable length of time); Bishop v. Palmer, 146 Mass. 469, 473 (1888) (stating that contracts in restraint of trade invalid if broader than necessary to protect party's legitimate interests); Wright v. Ryder, 36 Cal. 342 (1868) (invalidating agreement by steamboat purchaser not to run it in California for ten years as void as in restraint of trade); Crawford & Murray v. Wick, 18 Ohio St. 190 (1868) (invalidating provision in coal mine lease that lessee should not give or accept any order for goods or merchandise on any store other than lessor's); Indianapolis, Pittsburgh & Cleveland R.R. Co. v. Allen, 31 Ind. 394 (1869) (stating that contract never to carry on a particular line of business void as it "prevents competition, enhances prices, and exposes the community to all the evils of monopoly"); More v. Bennett, 41 Ill. App. 164 (1891) (invalidating agreement by members of stenographer association to be bound by association's rate schedule); Arnot v. Pittson & Elmira Coal Co.,

state-wide might survive reasonableness review.[214] On the other hand, courts began to uphold restraints on competition that extended even to the entire geographic area of a state when there was a bona fide reason for restricting competition in that broad an area.[215] In 1876, the New York Court of Appeals found nothing wrong with an agreement between two Civil War recruiters who had agreed not to compete with each other or to furnish recruits for less than $500.[216] Since neither party controlled recruits and there were many other recruiters, the purpose of the agreement was not shown to be monopolistic.[217] The advent of the railroads and telegraph precipitated ever-increasing efforts to consider dominant infrastructure firms as problems of monopoly. Courts routinely invalidated discriminatory rates and exclusive contracts by railroads as monopolistic without fretting over whether the railroad's economic power derived from a state grant, natural monopoly, or the railroad's sharp-elbowed practices.[218] A general pro-competition principle was working its way into the law.[219] In

68 N.Y. 558 (1877) (stating that agreement between two coal mines that one would buy all of other's coal for resale void as in restraint of trade); Cent. Ohio Salt Co. v. Guthrie, 35 Ohio St. 666 (1880) (invalidating agreement of association of salt manufacturers to sell at prices fixed by a committee).

214. Herreshoff v. Boutineau, 21 A. 908 (R.I. 1890).

215. Beal v. Chase, 31 Mich. 490, 520 (1875).

216. Marsh v. Russell, 66 N.Y. 288 (1876).

217. *Id.* at 291–92.

218. Chi. & N.W. Ry. Co. v. People, 56 Ill. 365 (Ill. 1870) (invalidating railroad's grant of exclusive grain deliveries); Erie Ry. Co. v. Union Locomotive & Express Co., 35 N.J.L. 240 (N.J. 1871) (invalidating railroad contract to carry cargo for one shipper and not any other shipper); Messenger v. Pa. R. Co., 37 N.J.L. 531 (N.Y. Ct. Errors and Appeals 1874) (contract with railroad company giving certain persons exclusive access as against other shippers invalid on common carrier grounds); Scofield v. Lake Shore & M.S.R. Co., 43 Ohio St. 571 (Ohio 1885) (invalidating railroad's grant of rebate from published tariff to shipper that placed greater quantity of freights with railroad); Lake Shore & M.S.R. Co. v. Scofield, Shurmer & Teagle, 1 Ohio Cir. Dec. 5000 (Oh. Cir. Ct. 1887) (invalidating discriminatory rates granted to favored shipper); Christie v. Mo. Pac. Ry. Co., 94 Mo. 453 (Mo. 1888) (railroad may not offer lower rate to favored shipper); State *ex rel.* Kohler v. Cincinnati, W. & B. Ry Co., 47 Ohio St. 130 (Ohio 1890) (railroad has no right to discriminate in freight rates if discriminating will tend to create monopoly); Menacho v. Ward, 27 F. 529 (S.D.N.Y. 1886) (holding that common carrier cannot charge shippers a higher rate if they refuse to patronize the shipper exclusively).

219. *See, e.g.*, W. Union Tel. Co. v. Burlington & S.W. Ry. Co., 11 F. 1, 11 (D. Iowa 1882) (invalidating contract giving telegraph company a "practical monopoly" over "commodities, competition in the production and sale of

1855, the Pennsylvania Supreme Court invalidated a railroad's contract giving a shipping company exclusive access to its passenger trains (as opposed to its slower freight trains), holding that "[c]ompetition is the best protection to the public, and it is against the policy of the law to destroy it by creating a monopoly of any branch of business."[220] Similarly, the wave of Gilded Age corporate mergers led courts to search for new antimonopoly vocabulary to invalidate "combinations" that harmed competition.[221]

As courts began to reflect increasingly on the problem of privately created monopoly in the second half of the nineteenth century, they often borrowed conceptual rhetoric from the public antimonopoly tradition. Thus, for example, in 1857 a New York court found that the permanent keeping of a floating dock for vessel repair at Pike Sleep in the East River was an unauthorized nuisance, illegal because of its tendency to create a monopoly.[222] The court held that "[t]he assumption of a franchise or exclusive privilege, or, in other words, the setting up of a monopoly, unless sanctioned by the legislature, is, in law, a nuisance."[223] The idea of monopoly as "nuisance" had long been reflected in the case law limiting governmental power to grant monopolies. Now the concept was flipped, with a privately procured monopoly being a "nuisance" in the sense of tort law.

Similarly, in 1870 the Supreme Court of Washington (still then a Territory) transposed the tradition against publicly granted monopolies into a prohibition on private monopoly—in that case, an agreement between Washington citizens and an Oregon corporation not to run a steamboat or allow its

which is essential to the well-being of the community); Sharp v. Whiteside, 19 F. 156 (E.D. Tenn. 1883).

220. Sanford v. Catawissa, 24 Pa. 378, 382 (Pa. 1855).

221. Richardson v. Buhl, 77 Mich. 632 (Mich. 1889) (finding illegal a company created to buy up match companies in order to create a monopoly); People *ex rel* Peabody v. Chi. Gas Trust Co., 130 Ill. 268 (Ill. 1889) (granting quo warranto writ against company formed for illegal purpose of buying up gas or electric companies); State *ex rel* Atty. Gen. v. Standard Oil Co., 49 Ohio St. 137 (Ohio 1892) (agreement of stockholders to transfer shares to trustee in consideration of agreement of shareholders of competitor companies to do the same illegal as tending to create monopoly); Distilling & Cattle Feeding Co. v. People, 156 Ill. 448 (Ill. 1895) (trust combination of distillery companies illegal as creating monopoly).

222. Hecker v. N.Y. Balance Dock Co., 13 How. Pr. 549, 551–52 (N.Y. Sup. Ct. 1857).

223. *Id.* at 551.

machinery to be employed on any other boat in any of the waters of the States of Oregon or California.[224] Citing English precedent the court began with the premise that "[t]he law always regarded monopolies as hostile to the rights and interests of the public," and that a prohibition on the grant of monopoly rights was as old as Magna Carta (which, as noted earlier, is an exaggeration).[225] A second means of obtaining the same effect—monopoly—arose from "private contracts."[226]

Courts often blended the publicly and privately facing strands of the antimonopoly tradition into a single, comprehensive principle. In 1882, the New Jersey Court of Chancery invalidated a railroad company's purchase of a rival railroad as ultra vires and against public policy.[227] In a lengthy note, the court strung together a series of propositions demonstrating that monopoly had always been prohibited at common law: legislatures were restricted in granting monopolies; monopolies could only be granted expressly, never through implication; municipalities lacked the power to grant monopolies; railroads lacked power to transfer property to other railroads or become their stockholders; and anticompetitive contracts between railroads or between railroads and other parties would not be enforced.[228] That historically these had been quite separate doctrines did not prevent their commingling into a unified antimonopoly principle when the occasion so required.

During the Reconstruction Era, courts gradually began to identify privately acquired economic power in a manner not granted or authorized by law as the primary, perhaps even exclusive, sense in which the law prohibited monopoly. In 1871, the Minnesota Supreme Court teased out this distinction in a case involving an exclusive railroad contract.[229] In the court's view, "a monopoly is not necessarily unlawful, for it may be created, permitted, or tolerated by law."[230] What the law condemned was "unauthorized monopoly," meaning monopoly created through private agreement.[231] On the other hand, "if the right

224. Or. Steam Nav. Co. v. Hale, 1 Wash. Terr. 283 (Wash. 1870).
225. *Id.* at 285.
226. *Id.*
227. Elkins v. Camden & A.R. Co., 36 N.J. Eq. 5 (N.J. Ch. 1882).
228. *Id.* at 5–7.
229. Stewart v. Erie & W. Trans. Co., 17 Minn 372 (Minn. 1871).
230. *Id.* at 395.
231. *Id.*

to exercise a monopoly be conferred by the public authority, that fact is conclusive upon the question of public policy."[232]

The Minnesota court's understanding showcases a stark inversion of the early nineteenth century antimonopoly tradition. In contrast to the dominant understanding of monopoly as an exclusive grant from the sovereign, the Minnesota court found private monopoly to be the primary sense of monopoly. Moreover, in contrast to the long line of cases restricting the state's power to grant monopolies, the Minnesota court thought the state's power clear. The Georgia Supreme Court said much the same in invalidating an agreement between two telegraph companies: "When such exclusive rights exist, or such monopolies are established, the same should be done by a legislative grant, and not by an individual contract."[233] The New Hampshire Supreme Court struck a similar note in holding that a railroad company had no power to enter into a joint management partnership agreement with another railroad: "The public policy of New Hampshire legislation is, and always has been, antagonistic to any and all contracts in any way creating combination, consolidation, or monopoly, without express legislative consent."[234] Here again, these courts inverted the prior sense of antimonopoly. If monopoly should be done at all, it must be done by the state.

With the growth of industrial and commercial activity accompanying the Second Industrial Revolution, courts began to speak of the increasing importance of an antimonopoly policy focused on private agreements. In 1878, in the context of invalidating an exclusive contract for a ferry to shuttle passengers and cargo across the Mississippi River for a railroad, the St. Louis Court of Appeals remarked that "[t]he odious nature of monopoly, early recognized by the English law, has become more apparent as commerce has increased."[235] "The tendency of competition is [] to cheapen values… and also to promote better and do away with inferior methods."[236] But even this was contested. In 1888, the New York Court of Appeals upheld a contract for one steamship line to discontinue running over

232. *Id.* at 395–396.
233. W.W. Tel. Co. v. Am. Union Tel. Co., 65 Ga. 160, 162 (Ga. 1880).
234. Burke v. Concord R.R., 61 N.H. 160, 184 (N.H. 1881).
235. Wiggins Ferry Co. v. Chi. & A.R. Co., 5 Mo. App. 347, 373 (St. Louis Ct. App. 1878).
236. *Id.* at 374.

another's routes, observing that the prior "severity" with which the law had treated contracts in restraint of trade was being gradually relaxed "due mainly to the growth and spread of the industrial activities of the world, and to enlarged commercial facilities, which render such agreements less dangerous as tending to create monopolies."[237] The court believed that there was little present danger of monopolization, except by grants of exclusive powers to corporations.[238]

Even with that public/private dichotomy, it remained to be worked out when a restraint was public or private. In 1871, the Michigan Supreme Court invalidated a contract between the Village of Kalamazoo and a private citizen giving the citizen a right to erect a market house for the Village and the Village then passing an ordinance restricting market activities to that market house.[239] The court invalidated the contract as unlawfully creating a monopoly—not the ordinance that followed.[240]

The transformation in the judicial conception of "monopoly" over the course of the nineteenth century proceeded unevenly. Even while increasingly embracing the view that privately acquired power was a legitimate target of the anti-monopoly principle, courts continued to echo the earlier view equating monopoly with exclusive prerogative granted by the state, as a New York court affirmed in 1862, opining that "[c]orporations, of necessity, are monopolies."[241] As late as 1880, a litigant appeared to persuade the Texas Supreme Court of a distinction between true "monopoly," which required "exclusion by the power of the government," from "virtual monopoly," which might arise by "peculiar advantages or facilities possessed by the monopolist and not susceptible of being acquired by others having equal or superior capital."[242] And, in 1885, the Supreme Court of Nebraska struggled to the observation that

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237. Leslie v. Lorillard, 110 N.Y. 519, 532–33 (N.Y. 1888).

238. *Id.* at 533 ("At the present day there is not that danger, or at least it does not seem to exist to an appreciable extent, except, possibly, as suggested, in the case of corporations.").

239. *See* Chi. Gas-Light & Coke Co. v. People's Gas-Light & Coke Co., 13 N.E. 169 (Ill. 1887) (invalidating anticompetitive contract between two gas companies intended to perpetuate their expiring monopoly grants from municipality); State *ex rel.* Boardman v. Lake, 8 Nev. 276 (Nev. 1873) (party granted 10-year franchise by state to maintain toll bridge could not extend monopoly beyond term of grant by purchasing land adjacent to bridge).

240. Gale v. Kalamazoo, 23 Mich. 344 (Mich. 1871).

241. Burton v. Stewart, 62 Barb. 194, 209 (N.Y. S. Ct. 1862).

242. Ladd v. S. Cotton Press & Mfg. Co., 53 Tex. 172, 182 (Tex. 1880).

a telephone company might not be "possesse[d] of any special privilege under the statutes of the state," and therefore might not be subject to the "heavy obligations" of a common carrier, but might still be a monopoly by virtue of the "very nature and character of its business," of which "[n]o two companies will try to cover the same territory."[243] Even as the predominant meaning of "monopoly" shifted to privately acquired power, the earlier tradition associating monopoly with public power lingered.

D. *Antimonopoly in the Nineteenth Century: Summation*

The nineteenth century saw the establishment of antimonopoly as a set of contending and often contradictory principles in American law. Antimonopoly could limit the government's powers to grant exclusive privileges, curtail the scope of any such privileges granted, empower the government to regulate the market, limit the government from regulating the market, or directly regulate private firms. Within close geographic and temporal proximity, judges could confidently announce that antimonopoly applied only as against the government, only as against private firms, or simultaneously as to both.

The incidence of these respective ideas changed over the course of the century. Antimonopoly as limitation on exclusive privilege bestowed by the state was the predominant theme before the Civil War. After the Jacksonian Revolution curtailed that practice, and then with the Second Industrial Revolution and dramatic economic changes it precipitated in the later nineteenth century, emphasis shifted toward state regulation of infrastructure businesses and controls on privately acquired market power. At the same time, the rise of laissez faire political ideology gave expression to a new genus of anti-regulatory anti-monopolism.

All of these expressions of anti-monopolism remained live at the time of the political upheaval that gave rise to the Sherman Act in 1890. As discussed next, the Sherman Act selected one strand of the antimonopoly tradition—control of private market power—on which to place the imprimatur of federal law. The Sherman Act thus federalized antimonopoly and redirected it toward the trust problem. But it did not—could not—bury the contending senses of antimonopoly, which remained live well into the twentieth century and beyond.

243. State v. Neb. Tel. Co., 17 Neb. 126, 133 (Neb. 1885).

III.
THE LONG SHADOWS OF ANTIMONOPOLY

A. *The Sherman Act: The Federalization of Antimonopoly*

The Sherman Act codified the emerging strand of the antimonopoly tradition focused on controlling private economic power. Despite the occasional recognition in the legislative history of the older, state-focused sense of monopoly—such as Senator Stewart's comment that "'[m]onopoly'... is something created by law which gives a special privilege"[244]—the Act focused on trusts and monopolies created by private undertaking under the increasingly liberalized state corporate laws.[245] An article in the *Harvard Law Review* written shortly after the Sherman Act's passage observed that "[i]n the popular mind, and in judicial opinions, no clear distinction was made between monopolies with exclusive privileges, and business associations with no exclusive privileges, and all these, as well as business of magnitude carried on by individuals, were alike condemned as 'monopolies.'"[246] Another article in the same journal a year later observed that monopolies in their original sense "were nothing more than royal patents; and restriction of competition under them was effected, not by the act of the individual, but by the exclusive character of the grant," but that "[i]t is thus plain (1) that Congress could not have had in mind a 'monopoly' in the common law sense of the term; (2) that 'monopoly' at common law implied an exclusive control of one branch of industry, without legal right of any other person to interfere therewith by competition or otherwise." [247] The Supreme Court would later observe that "nothing in the language of the Sherman Act or in its history [] suggests that its purpose was to restrain a state or its officers or agents from activities directed by its legislature."[248]

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244. 21 CONG. REC. 2644 (1890).

245. *See* Daniel A. Crane, *The Dissociation of Incorporation and Regulation in the Progressive Era and the New Deal, in* CORPORATIONS AND AMERICAN DEMOCRACY (Naomi R. Lamoreaux & William J. Novak eds., 2017).

246. S.C.T. Dodd, *The Present Legal Status of Trusts*, 7 HARV. L. REV. 157, 160 (1893).

247. William F. Dana, *"Monopoly" Under the National Anti-Trust Act*, 7 HARV. L. REV. 338, 341–42 (1894).

248. *Id.* at 350–51; *Cf.* Paul E. Slater, *Antitrust And Government Action: A Formula for Narrowing Parker v. Brown*, 69 NW. U. L. REV. 71, 83 (1974) ("In truth, a full reading of the legislative history of the Sherman Act is not likely to help answer the Parker question one way or the other .... [I]f the legislative history reveals anything, it is that the purpose of the act is to strike down

The Sherman Act thus enacted antimonopoly as a limitation on privately acquired economic power, completing the shift in emphasis from the earlier sense of antimonopoly as state intrusion in the market that had predominated earlier in the nineteenth century.

It has been widely recognized that the Sherman Act federalized *antitrust* insofar as it largely displaced state-level antitrust movements and laws.[249] By 1890, thirteen states had passed antitrust statutes, and another fourteen would add such provisions by the turn of the century.[250] Eventually, every state (excepting Pennsylvania) adopted its own antitrust law.[251] However, state antitrust laws became mere shadows of the Sherman Act as the courts interpreted the state statutes in conformity with federal precedent,[252] with the effect that state antitrust law added little to what was prohibited or permitted by federal law.[253]

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arrangements which have anti-competitive effects .... regardless of whether the state is a participant.").

249. *See, e.g.*, Lina M. Khan, *The Ideological Roots of America's Market Power Problem*, 127 YALE L.J. 960, 965–67 (2018); Spencer Weber Waller, *The Internationalization of Antitrust Enforcement*, 77 B.U. L. REV. 343, 352–53 (1997).

250. James May, *Antitrust Practice and Procedure in the Formative Era: The Constitutional Law and Conceptual Reach of State Antitrust Law*, 135 U. PA. L. REV. 495, 499 (1987).

251. *See* Michael A. Lindsay, *Repatching the Quilt: An Update on State RPM Laws*, 13-3 ANTITRUST MAG. ONLINE 1, 6 (Feb. 2014) https://advance-lexis-com.proxy.library.nyu.edu/api/document?collection=analytical-materials&id=urn%3acontentItem%3a5BPT-SBT0-02PM-W05J-00000-00&context=1519360&identityprofileid=9M4FW351751 (reporting that Pennsylvania is the only state that does not have an antitrust law).

252. Richard A. Duncan & Alison K. Guernsey, *Waiting for the Other Shoe to Drop: Will State Courts Follow Leegin?*, 27 FRANCHISE L.J. 173, 174 (2008) (finding that majority of states give their antitrust statutes same interpretation as Sherman Act).

253. In more recent decades have states begun to peel away from federal interpretation of the Sherman Act on such questions as indirect purchaser standing and resale price maintenance. *See generally* Robert H. Lande, *New Options for State Indirect Purchaser Legislation: Protecting the Real Victims of Antitrust Violations*, 61 ALA. L. REV. 447 (2010). Several states are currently considering antitrust reform legislation that would make state antitrust statutes considerably more aggressive than their federal analogues, *e.g.*, N.Y. Senate Bill S6748, N.Y. State Senate Bill 2023-S6748 (nysenate.gov), although there are also reform bills pending in Congress. *E.g.*, Press Release, Sen. Amy Klobuchar, Senator Klobuchar Introduces Sweeping Bill to Promote Competition and Improve Antitrust Enforcement (Feb. 4, 2001) https://www.klobuchar.senate.gov/public/index.cfm/2021/2/senator-klobuchar-introduces-sweeping-bill-to-promote-competition-and-improve-antitrust-enforcement.

But there is a more general sense in which the Sherman Act may also have federalized *antimonopoly*. Many scholars view the passage of the Sherman Act as the terminus of a broad antimonopoly tradition and its replacement with a narrowly focused antitrust policy. Richard White argues that antitrust coopted and then swallowed antimonopoly, gutting the nineteenth century antimonopoly tradition by protecting consumers, stockholders and wageworkers at the expense of an egalitarian society of small producers.[254] Similarly, Kenneth Lipartito argues that antitrust law ended the antimonopoly tradition by sweeping aside "the old antimonopoly warnings about power, control, and equality."[255]

Care should be taken with such generalizations. Certainly, antimonopoly in other flavors continued outside of antitrust law—for example, in banking,[256] intellectual property,[257] and telecommunications law.[258] The Sherman Act may have federalized a particular strand of antimonopoly focused on certain problems of private market power, but it did not subsume antimonopoly in all of its contending historical manifestations. In particular, federal antitrust law did not directly address the libertarian versions of antimonopoly focused on limiting the regulatory power of the state. That task fell in the first instance to constitutional law and the battle over economic substantive due process in the early decades of the twentieth century.

B. *Closing the Door on Antimonopoly as Limitation on the State*

Nineteenth century state and federal courts drew on general antimonopoly principles to invalidate regulatory schemes that limited competition, often without precision on the legal grounds for judicial review. A representative example of the

254. Richard White, *From Antimonopoly to Antitrust, in* ANTIMONOPOLY AND AMERICAN DEMOCRACY (Daniel A. Crane & William J. Novak, eds. 2023).

255. Kenneth Lepartito, *The Antimonopoly Tradition*, 10 U. ST. THOMAS L. J. 991, 1019 (2013).

256. Jamie Grischkan, *Banking and the Antimonopoly Tradition: The Long Road to the Bank Holding Company Act, in* ANTIMONOPOLY AND AMERICAN DEMOCRACY (Daniel A. Crane & William J. Novak, eds. 2023).

257. Thomas F. Cotter, *The Procompetitive Interest in Intellectual Property Law*, 48 WM. & MARY L. REV. 483 (2006).

258. Harvey J. Levin, *Competition, Diversity, and the Television Group Ownership Rule*, 70 COLUM. L. REV. 791 (1970).

courts' attitude can be found in an 1856 Connecticut Supreme Court opinion, which was clear on antimonopoly, but uncertain about its doctrinal home: "[A]lthough we have no direct constitutional provision against a monopoly, yet the whole theory of a free government is opposed to such grants."[259] Eventually, libertarian antimonopoly would find a doctrinal home in economic substantive due process. Contemporaneously with the passage of the Sherman Act and the federalization of antimonopoly focused on private power, the federal courts also federalized and broadened the libertarian stand of antimonopoly, eventually culminating in New Deal rejection of economic substantive due process.

In the *Slaughter-House Cases*, Justice Field had articulated a version of substantive due process grounded in the antimonopoly tradition.[260] Although Field's arguments were in dissent, the Supreme Court eventually adopted a version of Field's perspective. In *Allgeyer v. Louisiana*,[261] in the context of invalidating a statute designed to deter doing business with out-of-state insurance companies, the Court adopted Field's substantive due process, albeit one broader than antimonopoly.[262] Justice Peckham's *Lochner* opinion began with *Allgeyer*, and generally reflected the anti-monopoly strain concerned with special interest legislation promoting redistribution and monopoly.[263]

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259. *Norwich Gaslight Co.*, 25 Conn. at 38.

260. *Slaughter-House Cases*, 83 U.S. at 122 ("[A]ny law which establishes a sheer monopoly, depriving a large class of citizens of the privilege of pursuing a lawful employment, does abridge the privileges of those citizens...In my view, a law which prohibits a large class of citizens from adopting a lawful employment, or from following a lawful employment previously adopted, does deprive them of liberty as well as property, without due process of law."); Howard J. Graham, *Justice Field and the Fourteenth Amendment*, 52 YALE L.J. 851, 853 (1943); Charles W. McGurdy, *Justice Field and the Jurisprudence of Government-Business Relations: Some Parameters of Laissez-Faire Constitutionalism, 1863–1897*, 61 J. AM. HIST. 970, 977–78 (1975).

261. Allgeyer v. Lousiana, 165 U.S. 578, 590 (1897).

262. FRANK STRONG, SUBSTANTIVE DUE PROCESS OF LAW 91 (1986) ("[I]n severing this right to freely contract from its tie with antimonopoly the Court . . . catapulted into an uncharted domain in which substantive due process could become the obstacle to endless instances of legal, economic and social reform.").

263. Gillman, *supra* note 96, at 120; Aaron R. Hall, *Class Jurisprudes: Free Labor Ideology and For-Profit Penal Labor in the Gilded Age Courts*, 43 LAW & SOC. INQUIRY 678, 679–80 (2018) ("A large body of literature has established that Lochner-era jurisprudence arose from free labor ideology and a corollary antipathy for monopoly, state privilege, and intervention for one class over another."); see *also* Editorial, *A Check to Union Tyranny*, THE NATION, May 4,

Of course, the Progressives disdained *Lochner* for interfering with economic reforms and substituting judges' economic views for those of the elected branches. In the New Deal constitutional revolution of the late 1930s, the Supreme Court announced that it would no longer invalidate legislation that enacted what the Justices considered poor economic policy.[264] This included the sorts of laws protecting discrete groups from competition that had been targeted in the nineteenth century antimonopoly case. In cases like *Williamson v. Lee Optical*[265] (fitting lenses), *Kotch v. Pilot Commissioners*[266] (harbor piloting), and *Ferguson v. Skrupa*[267] (debt adjustment services), legislatures acted to grant monopolies to special interests, but the Supreme Court declined to invalidate the scheme for fear of falling back into the habits of *Lochner*.[268]

The New Deal constitutional revolution showed up in antitrust as well. In *Parker v. Brown*[269] in 1943, the Supreme Court made clear that it would not permit the Sherman Act to be used to circumvent the anti-*Lochner* cases and draw the courts back into a form of substantive due process under the guise of federal antitrust law. *Parker* involved a Sherman Act challenge to California's Agricultural Prorate Act, which required farmers to participate in a marketing plan to limit raisin production.[270] Finding that the Sherman Act was not meant as a limitation on governmental power at all, the Court created a doctrine of state action immunity for anticompetitive state and local laws. As now-Attorney General Merrick Garland has observed, *Parker*

1905, at 346–47 (endorsing *Lochner* Court for stopping "the subterfuge by which, under pretext of conserving the public health, the unionists have sought to delimit the competition of non-unionists, and so to establish a quasi-monopoly of many important kinds of labor").

264. *See generally* 2 BRUCE ACKERMAN, WE THE PEOPLE: TRANSFORMATIONS (1998).

265. Williamson v. Lee Optical of Okla., Inc., 348 U.S. 483, 487 (1955).

266. Kotch v. Pilot Comm'rs, 330 U.S. 552, 564 (1947).

267. Ferguson v. Skrupa, 372 U.S. 726, 731–32 (1963).

268. BERNARD SCHWARTZ, THE RIGHTS OF PROPERTY 90 (1965) ("[a]side from Dred Scott itself, Lochner ... is now considered the most discredited decision in Supreme Court history").

269. Parker v. Brown, 317 U.S. 341, 350–51 (1943) ("We find nothing in the language of the Sherman Act or in its history which suggests that its purpose was to restrain a state or its officers or agents from activities directed by its legislature.").

270. *Id.* at 346–49.

is best understood as a continuation of the post-1937 jurisprudence rejecting *Lochner*.[271]

With *Parker*, antimonopoly's inversion from a limitation on state power to a limitation on private power seemed to be complete. "Monopoly" in the pejorative sense of the antimonopoly tradition would now be associated exclusively with privately acquired economic power, and not with market interventions by the state. Yet this was not a stable equilibrium. There were too many other deeply rooted strands of the antimonopoly tradition to reduce it all to a limitation on private power. Before too long, the libertarian version would reemerge.

C. *Reopening the Door to Antimonopoly as Limitation on the State*

The libertarian version reemerged most obviously in the 1970s with the narrowing of the *Parker* state immunity doctrine and the corresponding recasting of the Sherman Act as a limitation on state regulatory power. Contrary to the *Parker* Court's flat pronouncement that the Sherman Act was not intended to

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271. Merrick B. Garland, *Antitrust and State Action: Economic Efficiency and Political Process*, 96 YALE L.J. 486, 499–500 (1987) ("*Parker v. Brown* was much less a case about judicial faith in economic regulation than it was a case about judicial respect for the political process. *Parker* was indeed a child of its times, but the most salient element of that historical context was the Court's recent rejection of the *Lochner era* doctrine of substantive due process, under which federal courts struck down economic regulations they viewed as unreasonably interfering with the liberty of contract. Having only just determined not to use the Constitution in that manner, the Court was not about to resurrect *Lochner* in the garb of the Sherman Act."); *see also* James C. Cooper & William E. Kovacic, *U.S. Convergence with International Competition Norms: Antitrust Law and Public Restraints on Competition*, 90 B.U. L. REV. 1555, 1570 (2010) ("*Parker* then can be seen as a necessary concession to anticompetitive state regulation to avoid a return to the *Lochner* era .... Once the federal judiciary got out of the business of second-guessing the wisdom of states' economic regulation under substantive due process analysis, it could hardly reopen this line of attack under the guise of antitrust. *Parker* prevented this outcome."); Thomas M. Jorde, *Antitrust and the New State Action Doctrine: A Return to Deferential Economic Federalism*, 75 CALIF. L. REV. 227, 230 n.20 (1987) ("The Court's own unsatisfying experience with economic due process during the *Lochner* era, just prior to *Parker*, no doubt increased the Court's sensitivity to the importance of independent state economic choices."); William H. Page, *Interest Groups, Antitrust, and State Regulation:* Parker v. Brown *in the Economic Theory of Legislation*, 1987 DUKE L.J. 618, 624 ("*Parker* was decided largely on the ground that the Court was unwilling to reenter the political mire of the *Lochner* era under the guise of Sherman Act preemption analysis.").

preempt state interventions in the market, the Supreme Court eventually came to the view that anticompetitive state policies only qualify for state action immunity when they are "clearly articulated and affirmatively expressed as state policy" and actively supervised by agents of the state.[272] State regulations not meeting this test would be invalidated as unlawful monopolies. Thus, for example, a state dental board's prohibition on non-dentists providing teeth whitening services could be invalidated under federal antitrust law,[273] in a manner reminiscent of judicial invalidation of occupational restrictions in the nineteenth century. Not surprisingly, advocacy for a more aggressive antitrust policy focused on the state has come from quarters less interested in an aggressive antitrust policy focused on private actors.[274]

The narrowing of *Parker* immunity and reupping of the strands of the antimonopoly tradition focused on regulation coincided with the emergence of neo-liberal arguments that government regulation posed a greater risk than private behavior of creating durable monopoly power.[275] This view implied

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272. Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 105 (1980).

273. N.C. State Bd. of Dental Exam'rs v. FTC, 574 U.S. 494 (2015).

274. Richard A. Epstein & Michael S. Greve, *Introduction* to Competition Laws in Conflict: Antitrust Jurisdiction in the Global Economy 13 (Richard A. Epstein & Michael S. Greve eds., 2004) (arguing for a narrowing of *Parker* immunity); Frank H. Easterbrook, *Antitrust and the Economics of Federalism*, 26 J. L. & Econ. 23 (1983), *reprinted in* Epstein & Greve, *supra* note 274 at 189 (arguing for cost externalization modification to Parker immunity); Timothy J. Muris, Chairman, Fed. Trade Comm'n, Remarks Before the Fordham Annual Conference on International Antitrust Law & Policy (Oct. 24, 2003) (detailing FTC program to challenge anticompetitive state regulations).

275. *See, e.g.*, Milton M. Friedman, Capitalism and Freedom 139–44 (1962) (arguing that firms could capture regulatory processes to obtain monopoly rents more durably than unregulated private monopolists could); George J. Stigler, *The Theory of Economic Regulation*, 2 Bell J. Econ. & Mgmt. Sci. 3, 3–6 (1971) (arguing that regulation can create durable monopoly power that private conduct cannot match, such as legal restrictions on entry); Robert Bork, The Antitrust Paradox, 347–64 (1978) (describing predation through governmental process as a serious and growing problem); Richard A. Posner, *The Social Costs of Monopoly and Regulation*, 83 J. Pol. Econ. 807 (1975) (arguing that public regulation is a greater source of social costs and privately acquired monopoly); Howard P. Marvel, *Hybrid Trade Restraints: The Legal Limits of a Government's Helping Hand*, 2 Sup. Ct. Econ. Rev. 165, 180 (1983) ("Government may or may not be the source of all monopolies; it is clearly at the heart of a substantial number of monopolies."); Stephen A. Siegel, *Understanding the Lochner Era: Lessons from the Controversy Over Railroad and*

that antimonopoly should be again focused on the government rather than private actors. As was true in the nineteenth century, delineations between the public and private as sources of forbidden monopoly were not always clear. For instance, the Reagan Administration's 1982 consent decree breaking up AT&T,[276] the largest structural monopolization decree in American history,[277] came in an administration not otherwise known for its vigorous antitrust enforcement. But the Reagan Administration saw the core problem with AT&T as its status as a regulated monopoly and its ability to prey on regulatory processes to the detriment of consumers.[278] The AT&T break-up thus reflected intersecting lines of the antimonopoly tradition, targeting a private firm but due in substantial part to its status as a vassal of the government.

The fruits of this revived strand of antimonopoly appeared in the deregulatory trend of the late twentieth century. Of course, that same deregulatory trend is often blamed for increasing concentration in many markets.[279] As in the nineteenth century, twentieth century antimonopoly ideology could support arguments both for and against government regulation. Governmental regulation could be the source of monopoly or its foil. Both sides of the argument could legitimately claim roots

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Public Utility Rate Regulation, 70 VA. L. REV. 187, 202–03 (1984) (examining the neoclassical view that only monopolies created by law are durable).

276. United States v. Am. Tel. & Tel. Co., 552 F. Supp. 131, 141–42 (D.D.C. 1982).

277. Edward Cavanagh, *Antitrust Remedies Revisited*, 84 OR. L. REV. 147, 196 (2005).

278. Lawrence A. Sullivan & Ellen Hertz, *The AT&T Antitrust Consent Decree: Should Congress Change the Rules?*, 5 HIGH. TECH. L. J. 233, 238 (1990). Assistant Attorney General Bill Baxter argued that price-regulated monopolists could engage in anticompetitive tying to extract monopoly rents from adjacent markets in which they did not face price regulation. *See* William F. Baxter, *Conditions Creating Antitrust Concern with Vertical Integration by Regulated Industries—"For Whom the Bell Doctrine Tolls"*, 52 ANTITRUST L. J. 243, 244 (1983); see generally Tim Wu, *Intellectual Property, Innovation, and Decentralized Decisions*, 92 VA. L. REV. 123, 138–39 (2006) (explaining that the doctrine described by William Baxter is referred to as Baxter's Law).

279. *E.g.*, Philip E. Strahan, *The Real Effects of U.S. Banking Deregulation*, 85 FED. RSRV. BANK ST. LOUIS REV. 111, 111, 114 (2003) (arguing that banking deregulation led to increase in concentration); Jan K. Krueckner & Pablo T. Spiller, *Economies of Traffic Density in the Deregulated Airline Industry*, 37 J. L. & ECON. 379 (1994) (finding that airline deregulation led to increases in airport and industry-wide concentration and increase in competition at the city-pair market level).

in the long arc of the American antimonopoly tradition, such is its plasticity and ambiguity.

Rounding into the twenty-first century, even Justice Field's version of libertarian antimonopolism seems poised for a potential comeback. In the last two decades, the Fifth and Sixth Circuits have invalidated state regulations restricting casket sales on the grounds that "protecting a discrete interest group from economic competition is not a legitimate governmental purpose" for purposes of equal protection analysis.[280] The Ninth Circuit has similarly held that "mere economic protectionism for the sake of economic protectionism is irrational with respect to determining if a classification survives rational basis review."[281] Although other courts have declined this invitation to reinvigorate the antimonopoly tradition as to state regulation,[282] its future in constitutional law remains up for grabs. Whether or not this particular doctrine receives the Supreme Court's blessing or otherwise enjoys a durable run in constitutional law, it exemplifies the continuing dialogue between contending versions of the antimonopoly tradition—really, between separate antimonopoly traditions—that took shape in legal doctrines in the nineteenth century.

D. *The Continuing Lives of Antimonopoly*

With all of the political attention being paid today to antitrust reform, antimonopoly as a historical tradition has naturally reentered the conversation. As with any high-stakes appeal to tradition, the meaning of the tradition itself will often be contested. Even in its concrete legal instantiation, antimonopoly has enough different historical senses to justify a wide variety of arguments about the tradition's relevance to ongoing legal, political, and regulatory debates.

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280. St. Joseph Abbey v. Castille, 712 F.3d 215 (5th Cir. 2013); Craigmiles v. Giles, 312 F.3d 220 (6th Cir. 2002).

281. Merrifield v. Lockyer, 547 F.3d 978, 991 n.15 (9th Cir. 2008)

282. *See*, *e.g.*, Sensational Smiles, LLC v. Mullen, 793 F.3d 281, 286 (2d Cir. 2015) ("We join the Tenth Circuit and conclude that economic favoritism is rational for purposes of our review of state action under the Fourteenth Amendment."); Powers v. Harris, 379 F.3d 1208, 1221 (10th Cir.2004) ("[A]bsent a violation of a specific constitutional provision or other federal law, intrastate economic protectionism constitutes a legitimate state interest.").

Some lines of argument are clearly off the table: the limitation of monopoly to a government-granted privilege; the denial that privately acquired power can constitute monopoly; or the government's need to justify economic regulation with reference to a monopoly problem are positions with no continuing salience. But many other lines remain viable and historically supported: whether government intervention in the market exacerbates or mitigates the monopoly problem; whether privately acquired market power, unsupported by governmental subsidy, tends to dissipate over time; and whether the greater threat to economic liberty, consumer interests, republican values, and the democratic order comes from the exercise of private or public power are all questions with enduring political and legal relevance. These questions were presented in the surge of antimonopoly activity in the courts and legislatures in the nineteenth century, and all remain part of the distinctively American antimonopoly tradition(s).

Conclusion

The idea of a unified and consistent American antimonopoly tradition is a myth, or at least an idea that takes as much license with history as Coke took in creating the English antimonopoly tradition. That it is an invented idea does not make it necessarily illegitimate, and certainly not without its fair uses. Strands of the antimonopoly tradition restrict the state; other strands empower it. Strands of the tradition restrict private enterprise; other strands empower it. Different strands have predominated over others at different moments in time, but no conclusive or durable equilibrium seems to have been reached. So antimonopoly rolls on as a coherent, useful, and meaningful concept, but one that can be appropriated for opposing ends.

Two preemptive comments in conclusion: *First,* responses to arguments of the sort made in this Article often take of the form of insisting that one strand of the relevant tradition is the legitimate one and that the others are imposters. Certainly, the label "antimonopoly" should not be appropriated for any purpose that does not fit. However, this Article has identified several separate legal strains with significant judicial or legislative adoption in the nineteenth century that were considered heirs to the English common law's antimonopoly doctrine. To that extent, all of them represent genuine denominations of the antimonopoly religion.

Second, a common reaction to the demonstration that a concept can mean opposite or contradictory things is to assume that it means everything and therefore nothing. It would be a mistake to take that view of antimonopoly. Its historical meanings are diverse and at times contradictory, but nonetheless discrete and identifiable. To be an antimonopolist of any denomination was to reject other positions that often garnered considerable support. For instance, it was to reject the claim that monopoly (whether privately or publicly obtained) was desirable as a hallmark of efficiency and civilization, or that that competition was inherently ruinous and undesirable. Antimonopoly is a heterogeneous and adaptive concept, but one with identifiable boundaries and predictive power. And it is therefore likely to continue to generate legal doctrines and political outcomes for a long time to come.

NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 20 SUMMER 2024 NUMBER 3

MULTINATIONAL ASSET MANAGEMENT FIRMS & ESG DISCLOSURE MANAGEMENT

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In recent years, the United States, European Union, and United Kingdom have introduced "Environmental, Social, and Governance" disclosure regulations. Multinational Asset Management Firms must now navigate the evolving and varied disclosure and labeling requirements they are subjected to across multiple jurisdictions. This Article provides a brief history of ESG disclosure regulation and provides a summary of the enacted and proposed regulations and identifies the biggest points of contention between the regulations and provides suggestions for a more comprehensive standardized regulatory framework.

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INTRODUCTION

"Environmental, Social, and Governance" ("ESG") reporting embraces the use of a metrics-based approach to measure a company's sustainability practices and socially responsible behavior,[1] and has emerged as a politically contentious topic.[2] ESG disclosures, when done correctly, have the potential to improve a company's environmental practices,[3] human rights performance,[4] and stakeholder relations.[5] However, as discussed herein, ESG reporting mechanisms have only recently been introduced by governments and remain underdeveloped.

A private environmental governance ("PEG") patchwork of voluntary certification, rating, and ranking systems has evolved

1. *See* Abhishek Vishnoi, *Five Trends MSCI Sees in the Growth in Sustainable Investing*, BLOOMBERG (Jan. 15, 2020, 11:25 PM), https://www.bloomberg.com/news/articles/2020-01-16/here-are-five-trends-msci-sees-leading-growth-in-esg-investing.

2. *See* Elizabeth Pollman, *The Making and Meaning of ESG* 22-23 (U. Pa. L. Sch. Inst. for L. & Econ., Working Paper No. 659, 2022).

3. *See* Daniel C. Esty & Quentin Karpilow, *Harnessing Investor Interest in Sustainability: The Next Frontier in Environmental Information Regulation*, 36 YALE J. REGUL. 625, 626–27 (2019).

4. *See* David Hess, *The Transparency Trap: Non-Financial Disclosure and the Responsibility of Business to Respect Human Rights*, 56 AM. BUS. L.J. 5, 5 (2019).

5. *See* Jerry K C Koh & Victoria Leong, *The Rise of the Sustainability Reporting Megatrend: A Corporate Governance Perspective*, 18 BUS. L. INT'L 233, 235–36 (2017).

over time in the absence of such requirements being mandated by governments.[6] Many of these PEG systems lack standardized metrics and uniform methodologies and remain without any centralized direction or repository. However, the evolution of voluntary climate-related disclosures and recent efforts at standardization in that area have provided a strong foundation to build on.

Recently, the United States ("US"), European Union ("EU"), and United Kingdom ("UK") have each made progress towards promoting general corporate disclosure of ESG metrics through: (1) The Enhancement and Standardization of Climate-Related Disclosures for Investors (US, 2024) ["Climate Rules"],[7] (2) The Non-Financial Reporting Directive (EU, 2014) ["NFRD"],[8] The Corporate Sustainability Reporting Directive (EU, 2021) ["CSRD"],[9] and the European Parliament Greenwashing Directive (EU, 2024) ["Greenwashing Directive"][10] and finally, (3) The Climate-Related Financial Disclosures Requirement (UK, 2022) ["CFD"].[11]

The jurisdictions' respective regulatory bodies have also published more targeted disclosure rules focused on funds and sustainable investment in the form of: (1) The Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment

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6. Michael P. Vandenbergh, *Private Environmental Governance*, 99 CORNELL L. REV. 129, 135–37 (2013).

7. The Enhancement and Standardization of Climate-Related Disclosures for Investors, 89 Fed. Reg. 21668 (Mar. 28, 2024) (to be codified at 17 C.F.R. pts. 210, 229, 230, 232, 239 & 249) [hereinafter "Climate Rules"].

8. Directive 2014/95, of the European Parliament and of the Council of 22 October 2014 Amending Directive 2013/34/EU as Regards Disclosure of Non-Financial and Diversity Information by Certain Large Undertakings and Groups, 2014 O.J. (L 330) 1 [hereinafter "NFRD"].

9. Directive 2022/2464, of the European Parliament and of the Council of 14 December 2022 Amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as Regards Corporate Sustainability Reporting, 2022 O.J. (L 322) 15 [hereinafter "CSRD"].

10. Directive 2024/825, of the European Parliament and of the Council of 28 February 2024 Amending Directives 2005/29/EC and 2011/83/EU as Regards Empowering Consumers for the Green Transition Through Better Protection Against Unfair Practices and Through Better Information, 2024 O.J. [hereinafter "Greenwashing Directive"].

11. The Companies (Strategic Report) (Climate-Related Financial Disclosure) Regulations 2022, SI 2022/31 (UK); The Limited Liability Partnerships (Climate-Related Financial Disclosure) Regulations 2022, SI 2022/46 (UK) [hereinafter collectively "CFD"].

Practices (US, proposed 2022) ["Proposed Enhanced Disclosures Rule"][12] and the Investment Company Names (US, 2023) ["Names Rule"],[13] (2) The Sustainable Finance Disclosure Regulation (EU, 2019) ["SFDR"][14] and the Taxonomy for Sustainable Activities (EU, 2022) ["Taxonomy Regulation"],[15] and lastly, (3) The Sustainability Disclosure Requirements and Investment Labels (UK, 2023) ["SDR"].[16]

The world's top asset management firms serve individuals, companies, governments, and foundations across national borders. The top 15 asset management firms, which are all based in the US and Europe (The UK and Switzerland[17] are not in the EU), hold tens of billions of USD in Assets Under Management ("AUM") (See Figure 1).[18] Accordingly, their investment decisions and shareholder votes[19] have great influence on the world's corporations. Large asset managers who market to multiple jurisdictions ("Multinational Asset Management Firms", hereinafter "MAMFs") find themselves subject to the regulatory disclosure requirements of all sovereignties they avail themselves to. For this reason, many US, EU, and UK asset managers

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12. Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices, 87 Fed. Reg. 36654 (proposed June 17, 2022) (to be codified at 17 C.F.R. pts. 200, 230, 232, 239, 249, 274 & 279) [hereinafter "Proposed Enhanced Disclosures Rule"].

13. Investment Company Names, 88 Fed. Reg. 70436 (Oct. 11, 2023) (to be codified at 17 C.F.R. pts. 230, 232, 239, 270 & 274) [hereinafter "Names Rule"].

14. Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on Sustainability-Related Disclosures in the Financial Services Sector, 2019 O.J. (L 317) 1 [hereinafter "SFDR"].

15. Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the Establishment of a Framework to Facilitate Sustainable Investment, and Amending Regulation (EU) 2019/2088, 2020 O.J. (L 198) 13 [hereinafter Taxonomy Regulation].

16. FIN. CONDUCT AUTH., Policy Statement 23/16, Sustainability Disclosure Requirements (SDR) and investment labels (Nov. 28, 2023), https://www.fca.org.uk/publication/policy/ps23-16.pdf [hereinafter "SDR"].

17. The Swedish Environmental Code transposes a number of EU directives. The Swedish Accounts Act incorporates, among other things, the NFRD and the Taxonomy Regulation. The CSRD, SFDR have also been adopted by Sweden. *See* Patrik Marcelius et al., *Environmental, Social & Governance Law Sweden 2024*, INT'L COMPAR. LEGAL GUIDE (Jan. 17, 2024), https://iclg.com/practice-areas/environmental-social-and-governance-law/sweden.

18. *World's Top Asset Management Firms*, ADV RATINGS, https://www.advratings.com/top-asset-management-firms (last visited Mar. 9, 2024).

19. *See Proxy Voting Gives Fund Shareholders a Say*, INVESTOPEDIA, https://www.investopedia.com/articles/basics/04/082704.asp (last visited Apr. 27, 2023).

must navigate several evolving regulatory disclosure laws and systems at a time. This imposes a regulatory burden on asset management firms that can be remedied by standardization. Also, investors and customers alike suffer in trying to comprehend and compare ESG performance among companies.

FIGURE 1. TOP 15 ASSET MANAGEMENT FIRMS

*Source. ADV Rating*s, World's Top Asset Management Firms (last visited Mar. 9, 2024) https://www.advratings.com/top-asset-management-firms.

Rank	Company	Country	AUM $B (USD)	Balance Sheet
1	BlackRock	US	9,090	03/31/23
2	Vanguard Group	US	7,600	03/31/23
3	Fidelity Investments	US	4,240	03/31/23
4	UBS Group	Switzerland	3,960	12/31/22
5	State Street Global Advisors	US	3,600	03/31/23
6	Morgan Stanley	US	3,131	03/31/23
7	JP MorganChase	US	3,006	03/31/23
8	Goldman Sachs	US	2,672	03/31/23
9	Credit Agricole	France	2,660	03/21/23
10	Allianz Group	Germany	2,760	03/31/23
11	Capital Group	US	2,700	03/31/23
12	Amudni	France	2,103	03/21/23
13	Bank of New York Mellon	US	1,910	03/31/23
14	PIMCO	US	1,800	03/31/23
15	Edward Jones	US	1,700	03/31/23

In Section I, this Article provides background by discussing the rise of the asset management firm, the history of socially responsible investing and fiduciary duty, the growing demand for ESG disclosure, and the meaning of materiality. Section II

details the most prominent voluntary disclosure frameworks including the Global Reporting Initiative, the Greenhouse Gas Protocol Corporate Standard, the Task Force of Climate-Related Financial Disclosures, and the International Sustainability Standards Board. Section III then details the various government disclosure regulations that have emerged in the United States, European Union, and United Kingdom. Section IV explores the interplay between the different regulations. Section V provides some suggestions to improve upon ESG disclosure frameworks and lastly, this Article concludes by describing the current state of ESG regulation for Multinational Asset Management Firms. For MAMFs, staying on the pulse of the burgeoning ESG disclosure landscape is an intensive yet necessary process as governmental bodies work out the kinks of their somewhat overlapping and sometimes contradictory regulations. This Article compares the status of ESG disclosure regulations in the US, EU, and UK and underscores the notable differences between them. Understanding these differences and ensuring compliance is especially important for MAMFs. In addition to finding their investment strategies regulated, they must also stay atop company-level ESG disclosures since ESG compliance provides an educated prediction as to the long-term financial resiliency of the companies they invest in.

I.
Background

A. *Rise of the Asset Management Firm*

Asset management is "the practice of increasing total wealth over time by acquiring, maintaining, and trading investments that have the potential to grow in value."[20] There are two general categories of asset management: traditional asset management and alternative asset management. Traditional asset management firms buy and monitor securities in public markets.[21] Alternative asset management firms invest in a variety

20. *What Is Asset Management, and What Do Asset Managers Do?*, Investopedia, https://www.investopedia.com/terms/a/assetmanagement.asp (last visited Feb. 27, 2023).

21. Off. of the Comptroller of Currency, Traditional and Alternative Investment Management Services, https://www.legalbluebook.com/bluebook/v21/rules/18-the-internet-electronic-media-and-other-nonprint-resources/18-1-basic-citation-forms (last visited Mar. 9, 2024).

of asset classes and strategies including Private Equity, Hedge Funds, Real Estate, and Private Debt.[22]

Since the 1980s, shareholding power has become increasingly concentrated in the hands of large asset management firms.[23] The "Big Three" asset managers—BlackRock, Vanguard, and State Street—collectively hold, on average, over 20% of the shares of the S&P 500 companies.[24] In the United States, this trend can accurately be described as a process of *re*-concentration. At the end of the 19th century, the American economy was controlled by a handful of corporations and banks.[25]

The Gilded Age[26] came to an end in the early twentieth century as a result of robber barons issuing new shares to support takeover efforts, Progressive Era[27] antitrust laws, federal taxes aimed at robber barons, and the stock market boom of the 1920s.[28] By 1945, 94% of US equity was held by individuals.[29] Then, in the middle of the twentieth century, new capital pooling-structures, namely pension funds, emerged.[30] A similar phenomenon occurred in the United Kingdom and elsewhere in Europe starting in the 1980s.[31] Population growth and wealth

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22. Swarnabha Seth et al., *Alternative Asset Management: The Current State and Way Ahead*, WIPRO (June 2020), https://www.wipro.com/capital-markets/alternative-asset-management-the-current-state-and-way-ahead/.

23. Benjamin Braun, *American Asset Manager Capitalism*, INST. FOR ADVANCED STUDY & MAX PLANCK INST. FOR THE STUDY OF SOC. (June 24, 2020), http://acdc2007.free.fr/braun620.pdf; *see generally* Jan Fichtner et al., *Hidden Power of the Big Three? Passive Index Funds, Re-Concentration of Corporate Ownership, and New Financial Risk*, 19 BUS. & POL. 298 (2017).

24. *See* Braun, *supra* note 23, at 4.; *see also* Caleb N. Griffin, *We Three Kings: Disintermediating Voting at the Index Fund Giants*, 79 MD. L. REV. 954, 960 (2020).

25. Braun, *supra* note 23, at 5.

26. "The Gilded Age is a period of gross materialism and blatant political corruption in U.S. history during the 1870s that gave rise to important novels of social and political criticism." *Gilded Age*, ENCYCLOPAEDIA BRITANNICA, https://www.britannica.com/event/Gilded-Age (last visited Apr. 20, 2023).

27. "The Progressive movement was a political and social-reform movement that brought major changes to the United States during the late 19th and early 20th centuries. . . . [T]he movement's goals involved strengthening the national government and addressing people's economic, social, and political demands." *The Progressive Era Key Facts*, ENCYCLOPAEDIA BRITANNICA, https://www.britannica.com/summary/The-Progressive-Era-Key-Facts (last visited Apr. 20, 2023).

28. Braun, *supra* note 23, at 5.

29. *Id.*

30. *Id.* at 6.

31. Andrew G. Haldane, Exec. Dir., Bank of Eng., The Age of Asset Management?, Address at the London Business School Conference on Asset Management (Apr. 4, 2014) (transcript available at https://citeseerx.ist.psu.edu/document?repid=rep1&type=pdf&doi=1df4edb6e73ca97594b2cf4a3226b9bef5be8bce).

disparity trends suggest that the global asset management industry will continue to grow.[32] The consolidation of assets into fewer hands is relevant to the topic of ESG because large MAMFs have an increased incentive to internalize externalities.[33]

B. *History of Socially Responsible Investing and Fiduciary Duty*

The first institutions to integrate social considerations into investing decisions were faith-based organizations such as the Methodist movement within the Church of England and the Quaker Friends Fiduciary Corporation.[34] John Wesley, the founder of the Methodist movement within the Church of England delivered a sermon in 1760 outlining the basic tenets of social investing, advising that we "ought not to gain money at the expense of life . . . for to gain money we must not lose our souls."[35] To better align their investments with their religious core values, the Quaker Friends Fiduciary Corporation implemented a policy of avoiding "sin stocks" (those associated with weapons, alcohol, and tobacco) in 1898.[36]

However, for generations, the predominant capitalist belief was that corporations existed solely to generate shareholder wealth.[37] In 1970, *The New York Times* published Chicago economist Milton Friedman's notable essay in which he asserts that: "there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say engages in open and free competition without deception

32. *Id.* at 2, 15.

33. Colin Myers & Jason J. Czarnezki, *Sustainable Business Law? The Key Role of Corporate Governance and Finance*, 51 ENV'T L. 991, 1035 (2021); *see also* Madison Condon, *Externalities and the Common Owner*, 95 WASH. L. REV. 1, 3–4, 6–7, 10, 49 (2020).

34. Blaine Townsend, *History of Socially Responsible Investing and ESG Investing*. J. OF IMPACT & ESG INVESTING (2020), https://www.bailard.com/wp-content/uploads/2020/09/History-Socially-Responsible-Investing-and-ESG-Investing.pdf; See for a modern example of Church of England activity Condon, *supra* note 33, at 21.

35. John Wesley, Sermon 50: Use of Money *in* THE WORKS OF JOHN WESLEY, (ed. Thomas Jackson ed., 1872).

36. *See* Peter Roselle, *The Evolution of Integrating ESG Analysis into Wealth Management Decisions*, J. APPLIED CORP. FIN., Spring 2016, at 75, 75.

37. *See* Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 33.

or fraud."[38] Friedman's sentiment solidified into the concept of Shareholder Wealth Maximization ("SWM").[39] The theory of SWM posits that all fiduciaries must act to maximize the value of the shareholders' interest in the corporation even to the detriment of other stakeholders such as bondholders, creditors, employees, and communities where the business operates.[40] Fiduciaries are "persons or organizations that act on behalf of others and are required to put the clients' interests ahead of their own, with a duty to preserve good faith and trust."[41] The theory of SWM goes hand in hand with the concept of Shareholder Primacy, which contends that "to the extent other constituents have unprotected interests inconsistent with those of shareholders, the interests of shareholders prevail."[42] Asset management firms have a fiduciary duty to their investors just as companies have a fiduciary duty to their shareholders.

In the 1960s and the following decade, civil rights, women's rights, and anti-war activists ignited a social revolution in the United States. This social movement coincided with the rise of environmentalism. Rachel Carson's 1962 Book, *Silent Spring*,[43] inspired outcry against the indiscriminate use of pesticides.[44] Social and environmental activists challenged shareholder primacy and began demanding that corporations aim to benefit, or at the very least disclose their impact on, the greater community. Socially Responsible Investing ("SRI") emerged as a response to the activists' demands. In London, the Ethical Investment Research Services Ltd ("EIRIS")[45] was created in 1983 to provide faith-based institutions and non-governmental organizations independent research to support making socially

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38. *Id.*

39. Alan R. Palmiter, Sustainable Corporations 56 (Aspen Publishing, 2022).

40. *Id.*

41. Adam Hayes, *Fiduciary Definition: Examples and Why They Are Important*, Investopedia, https://www.investopedia.com/terms/f/fiduciary.asp (last updated Mar. 19, 2024)*; see also* Palmiter, *supra* note 39, at 57.

42. Palmiter, *supra* note 39, at 57.

43. Rachel Carson, Silent Spring (Houghton Mifflin, 1962).

44. *See* Eliza Griswold, *The Wild Life of 'Silent Spring'*, N.Y. Times Mag., Sept. 23, 2012, at 126, 128.

45. EIRIS is today a part of the French data vendor Vigeo-EIRIS; the two companies merged in 2015.

informed investment decisions.[46] The availability of SRI funds grew exponentially in the early 2000s.[47]

C. *Growing Demand for ESG Disclosure*

The acronym ESG first became prominent when it appeared in 2004 in a United Nations ("UN") Global Compact Report.[48] One year later, the UN Environmental Program Finance Initiative's ("UNEP-FI") Freshfields Report discussed the materiality of ESG and its relationship to investors' fiduciary duties.[49] In 2006, the UN-backed Principles for Responsible Investment ("PRI") launched and has since gained the support of financial institutions from around the world that manage trillions in assets.[50] In recent years, investors have demanded that companies and asset management firms disclose ESG information.[51] Disclosure frameworks and regulations are meant to shed light on a company's relationship with ESG factors and subsequently encourage those companies to make decisions more aligned to achieve ESG goals. The Hawthorne Effect, coined by sociologist Henry A. Landsberger in 1958, asserts that subjects change their behavior if they know they are being observed.[52] Accordingly, disclosure regulation aims to promote company action by increasing transparency.

Shareholder activism encouraging voluntary disclosure has become more commonplace.[53] Such activism pressures corporations to voluntarily disclose ESG data. Shareholders have followed formal and informal avenues to influence corporate behavior. Formally, shareholders have issued shareholder

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46. *About EIRIS*, EIRIS, "https://eirisfoundation.org/about-us/ [https://web.archive.org/web/20000303163945/] (last visited Mar. 24, 2023).

47. PALMITER, *supra* note 39, at 301.

48. UN ENV'T PROGRAM, *Who Cares Wins: Connecting Financial Markets to a Changing World* (2004), https://www.unepfi.org/fileadmin/events/2004/stocks/who_cares_wins_global_compact_2004.pdf.

49. Freshfields Bruckhaus Deringer, *A Legal Framework for the Integration of Environmental, Social, and Governance Issues into Institutional Investment,* UN ENV'T PROGRAM FIN. INITIATIVE (2005), https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf.

50. PRINCIPLES FOR RESPONSIBLE INV., ANNUAL REPORT 2018 6 (2018).

51. A.B.A., ESG IN THE BOARDROOM: A GUIDEBOOK FOR DIRECTORS 86. (Katayun I. Jaffari & Stephen A. Pike eds., ABA Publishing 2022).

52. HENRY A. LANDSBERGER, HAWTHORNE REVISITED (W.F. Humphrey Press Inc. 1958).

53. PALMITER, *supra* note 39, at 230.

proposals encouraging increased disclosure of ESG metrics.[54] One example is Majority Action, a non-profit shareholder advocacy organization's success with a shareholder proposal at JPMorgan Chase's annual shareholder meeting requesting that the bank align its financing to the Paris agreement goals and disclose its relevant environmental information.[55] Informally, shareholders have submitted letters requesting greater transparency.[56] In March 2023, more than 1,400 Vanguard shareholders submitted a letter to the firm complaining that not integrating ESG into its investment decisions is a breach of fiduciary duty.[57]

Overall, there has been a drastic increase in the availability of ESG funds and assets in the United States from 1995 to 2018 (*See* Appendix 1). Globally, there has also been an increase in ESG investing from 2014 to 2018 (*See* Appendix 2). Now, approximately one fourth of assets professionally managed globally are tied to some form of ESG data.[58]

Many asset management firms that have created "ESG funds" or "SRI funds" use positive screening, negative screening, best in class[59], themed funds[60], and integrated analysis[61] to curate a portfolio of targeted investment opportunities.[62] Positive screening refers to limiting investment in companies that meet certain ESG criteria such as having a low carbon footprint, promoting workplace diversity, or maintaining high standards

54. *Id.* at 305.

55. *Id.* at 231.

56. *See* Hazel Bradford, *Vanguard Pressed to Address Climate Risk as Fiduciary Duty*, PENSIONS & INVS. (Mar. 7, 2023, 3:17 PM), https://www.pionline.com/esg/vanguard-group-pressed-address-climate-risk-fiduciary-duty.

57. *Id.*

58. Georg Kell, *The Remarkable Rise of ESG*, FORBES (July 11, 2018, 10:09 AM), https://www.forbes.com/sites/georgkell/2018/07/11/the-remarkable-rise-of-esg/#5e36dbaa1695.

59. Active inclusion of companies that either lead their sectors or outperform their peers in environmental or social performance, sometimes limited to material environmental and social criteria. *See Introductory Guides to Sustainable Investment, Screening,* PRINCIPLES FOR RESPONSIBLE INV. (May 29, 2020), https://www.unpri.org/introductory-guides-to-responsible-investment/an-introduction-to-responsible-investment-screening/5834.article.

60. "Active selection of companies on the basis of investment opportunities driven by sustainability factors, such as renewable energy." *Id.*

61. "Active inclusion of environmental and social factors within conventional fund management." *Id.*

62. Myers & Czarnezki, *supra* note 33.

of corporate governance.[63] Negative screening, on the other hand, involves excluding companies that do not meet specific ESG criteria, such as engaging in environmentally harmful practices, violating human rights, or having a history of poor governance, from investment portfolios.[64]

A notable example of an SRI fund is Vanguard's FTSE Social Index Fund which holds $7.5 billion worth of assets.[65] Vanguard's fund invests in US stocks using a screening process which integrates "social, human rights, and environmental criteria."[66] Vanguard's FTSE Social Index Fund uses a negative screening process to exclude companies involved in fossil fuels.[67]

D. *Materiality*

There are two primary reasons behind the growing demand for ESG disclosure. The first reason arises from a moralistic concern for companies' negative impact on the environment and the world (*values*).[68] The other reason relates to the major risk that climate change and other ESG issues can expose a company to financially (*value*).[69]

European Union[70] and United Kingdom[71] regulations embrace the concept of "Double Materiality", which posits that corporate information can be important to investors both for its implications about a firm's financial value, and about a firm's impact on the world at large, particularly with regard to climate change and other environmental impacts.[72] For these reasons, their respective ESG regulations require disclosure of information that is material from an outside-in perspective

63. Palmiter, *supra* note 39, at 301–302.
64. *Id.*
65. *Id.*
66. *Id.*
67. *Id.*
68. Zachary Barsky, *Value vs. Values: The Evolution of ESG Considerations for Pension Plan Investments*, RPIA (Nov. 2022), https://rpia.ca/market-insights/overview/listing/views/2022/11/23/value-vs.-values.
69. *Id.*
70. *See* NFRD, *supra* note 8; *see also* CSRD, *supra* note 9.
71. See SDR, *supra* note 16.
72. Henry Engler, *"Double Materiality": New Legal Concept Likely to Play in Debate over SEC's Climate Plan*, Thomson Reuters (Apr. 12, 2022), https://www.thomsonreuters.com/en-us/posts/investigation-fraud-and-risk/sec-double-materiality-climate/.

(financial materiality) as well as an inside-out perspective (impact materiality).

The US Securities and Exchange Commission ("SEC"), however, takes a more limited view of materiality. Rooted in common law fraud, the United States Supreme Court has explained that a fact is material "if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."[73] The Supreme Court subsequently clarified that the test for materiality is intended to "filter out essentially useless information that a reasonable investor would not consider significant, even as part of a larger 'mix' of factors to consider in making [their] investment decision."[74] In the US, materiality cannot be distilled into a bright-line test, but rather, the determination is to be made on a fact specific basis as to whether the disclosure is of the type that a reasonable investor would consider significant in making an investment decision.[75]

II.
Voluntary Disclosure Frameworks

Voluntary ESG disclosure frameworks have emerged to fill the void created by, until recently, governmental inaction on mandatory disclosures. Approximately 90% of public companies in the S&P 500 produce ESG disclosures, though such voluntary reporting is less prevalent among smaller public companies.[76] ESG disclosures are made primarily in corporate sustainability reports, rather than standardized annual statements,[77] and must often be accessed from individual company websites, rather than a central public repository.[78]

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73. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

74. Basic Inc. v. Levinson, 485 U.S. 224, 234 (1985).

75. *See id.* at 240.

76. *65% of the Russell 1000 Index Published Sustainability Reports in 2019*, Governance & Accountability Inst. (Oct. 26, 2020), https://www.ga-institute.com/research-reports/flash-reports/2020-russell-1000-flash-report.html (reporting that 39% of the 500 smaller companies produced sustainability reports).

77. *See, e.g.*, U.S. Gov't Accountability Off., GAO-20-530, Public Companies: Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them 18–19 (2020), available at https://www.gao.gov/assets/gao-20-530.pdf [hereinafter "GAO-20-530"].

78. *See* Virginia Harper Ho, *Modernizing ESG Disclosure*, 2022 U. Ill. L. Rev. 277, 289 (2022).

In 2020, the SEC Investor Advisory Committee ("IAC") pointed to the mismatch between requests from investors for comprehensive, cohesive disclosure and the current fragmented state of disclosures.[79] Investors' demands for ESG disclosure are not currently being met and voluntary disclosure frameworks are attempting to fill the gap left by government delay. Investors looking to engage in ESG investing face dozens, if not hundreds, of distinct disclosure-based data sets, rating methodologies, and ranking systems. This section introduces and discusses the most prominent voluntary disclosure frameworks.

A. *Alphabet Soup & Other Deficiencies*

Studies have found that there are hundreds of ESG rankings, 170 ESG indices, over 100 ESG awards, and 120 ESG standards.[80] The International Financial Reporting Standards ("IFRS") Foundation published a paper in 2020 concluding that the ecosystem of disconnected voluntary disclosure frameworks is becoming increasingly more expensive to follow and is not improving the quality of information that reaches investors.[81]

Both investors and companies complain about the "alphabet soup" of ESG disclosure guidelines and related organizations (*See* Figure 2; *see also* Appendix 3).[82] Several key private environmental governance regimes are notable due to their influence

79. *See* INVEST.-AS-OWNER SUBCOMM. OF THE SEC INVEST. ADVISORY COMMITT., RECOMMENDATION RELATING TO ESG DISCLOSURE (2020).

80. *See Ranking of the Rankings*, BRANDING-INST., https://www.branding-institute.com/rating-the-rankings/ranking-of-the-rankings; *see also* Steve Lydenberg & Alexi White, *Responsible Investment Indexes: Origins, Nature and Purpose*, *in* THE ROUTLEDGE HANDBOOK OF RESPONSIBLE INVESTMENT 527, 528 (Tessa Hebb et al. eds., 2015); FRANCES BOWEN, AFTER GREENWASHING: SYMBOLIC CORPORATE ENVIRONMENTALISM AND SOCIETY 5 (J. Alberto Aragon-Correa et al. eds., 2014); Stephanie Mooij, *The ESG Rating and Ranking Industry; Vice or Virtue in the Adoption of Responsible Investment?* (Apr. 11, 2017) (unpublished working paper) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2960869).

81. IFRS FOUND., TRUSTEES' FEEDBACK STATEMENT ON THE CONSULTATION PAPER ON SUSTAINABILITY REPORTING (2021), https://www.ifrs.org/content/dam/ifrs/project/sustainability-reporting/sustainability-consultation-paper-feedback-statement.pdf.

82. Matt Haddon et al., *The Evolution of Sustainability Disclosure: Comparing the 2022 SEC, ESRS, and ISSB Proposals*, THE SUSTAINABILITY INST. BY ERM, https://www.sustainability.com/globalassets/sustainability.com/thinking/pdfs/2022/comparing-the-sec-efra-and-issb.pdf.

on government disclosure regulations: The Global Reporting Initiative ("GRI"); The GHG Protocol Corporate Standard; The Task Force on Climate-Related Financial Disclosures ("TCFD"); and the International Sustainability Standards Board ("ISSB"). Private environmental governance creates market demand for disclosure and provides a useful framework for governments to base regulation on.

FIGURE 2. ESG ALPHABET SOUP

Source. Maggie Pahl (Mar. 2, 2024) Word cloud generated using https://www.wordclouds.com. Credit for introducing the term "alphabet soup" in the context of ESG to Professor Stephen Brown.

The overwhelming proliferation of PEG disclosure systems is coupled with a lack of standardization among them.[83] Reporting can be based on a wide variety of data and standards, or in a manner determined entirely by the company itself.[84] Such variety in the market allows companies to pick and choose a reporting framework that presents their information in a more favorable light. Whether self-serving, or merely inconsistent,

83. *See, e.g.,* GAO-20-530, *supra* note 77.

84. *See* THE BD. OF THE INT'L ORG. OF SEC. COMM'NS, SUSTAINABLE FIN. AND THE ROLE OF SECURITIES REGULATORS AND IOSCO 23–24 (2020), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD652.pdf.

the variance between voluntary ESG disclosures can mislead investors and make it difficult for consumers to comprehend.

Also, the voluntary disclosure frameworks lack common definitions, which has been considered a barrier to effective climate change risk management.[85] Even where agreement exists on the definition of a particular term, divergent methodologies and data requirements exist when reporting on such a topic.[86] The US Government Accountability Office has found companies' ESG disclosures lacking in consistency and comparability citing "the variety of different metrics that companies used to report on the same topics, unclear calculations, or changing methods for calculating a metric."[87] Both governmental agencies and the private industry have recognized such a system as untenable.[88] However, some progress has been made in improving the voluntary climate-related disclosures framework.

B. *Global Reporting Initiative ("GRI")*

Following public outcry over the environmental damage caused by the Exxon Valdez oil spill, the Global Reporting Initiative ("GRI") launched in 1997.[89] GRI is an independent, international organization that has created the world's most widely used set of ESG reporting standards,[90] which it regularly reviews and updates.[91] GRI seeks to help governments, businesses, and other organizations better understand and

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85. Climate-Related Mkt. Risk Subcomm., Market Risk Advisory Comm. of the U.S. Commodity Futures Trading Comm'n, Managing Climate Risk in the US Financial System (2020), https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf.

86. *See, e.g.*, A.B.A, *supra* note 51, at 159–62 (comparing the divergent data considered by four ratings agencies for measuring "workplace diversity").

87. GAO-20-530, *supra* note 77.

88. *Id* at 12.; *see also* Meagan Tenety & Steve Vargas, Lost in Translation: How To Navigate Top Investor ESG Priorities 2 (2020), https://chiefexecutive.net/wp-content/uploads/2020/11/How-to-Navigate-Top-Investor-ESG-Priorities.pdf.

89. *See Our Mission & History*, Glob. Reporting Initiative, https://www.globalreporting.org/about-gri/mission-history (last visited Apr. 22, 2023).

90. *See About GRI*, Glob. Reporting Initiative, https://www.globalreporting.org/about-gri/ (last visited Feb. 26, 2023).

91. *See Continuous Improvement*, Glob. Reporting Initiative, https://www.globalreporting.org/standards/ (last visited Apr. 22, 2023).

speak to their impacts on climate change, human rights, and corruption.[92]

In 2016, GRI released the Sustainability Reporting Standards which sets out universal sustainability standards in addition to sector standards and topic-specific standards.[93] The GRI's reporting framework is organized into three series: (i) universal standards for all organizations; (ii) sector standards for specific industries; and (iii) topic standards for disclosures relevant to a particular topic.[94] The universal standards include general disclosures about a company's sustainability policies, as well as a requirement to identify and disclose how the company is managing its most significant environmental issues.[95] Disclosure requirements for certain sectors include information relating to greenhouse gas ("GHG") emissions, climate adaptation strategies, operational sites owned near areas of high biodiversity, waste generation, and water use.[96] GRI maintained a publicly accessible sustainability disclosure database containing over 63,000 reports spanning nearly 20 years from hundreds of companies. However, the database was ultimately discontinued in April 2021 due to the overhead of maintaining the collection.[97]

Most recently, the GRI revised Universal Standards, published in October 2021, came into effect January 2023. Under the revised guidelines, organizations may either report "in accordance" with GRI or "in reference" to GRI. The standards can be downloaded for free and are made available in a dozen languages.[98] GRI limits disclosure to ESG items it defines as

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92. Robert G. Eccles, *Twenty Years of the Global Reporting Initiative: Interview with CEO Tim Mohin*, FORBES (Aug. 15, 2017), https://www.forbes.com/sites/bobeccles/2017/08/15/twenty-years-of-the-global-reporting-initiative-interview-with-ceo-tim-mohin/?sh=227fe8b4150c.

93. *The GRI Standards: Enabling Transparency on Organizational Impacts*, GLOB. REPORTING INITIATIVE, https://www.globalreporting.org/media/wmxlklns/about-gri-brochure-2022.pdf [hereinafter "GRI, Enabling Transparency"]; *Universal Standards*, GLOB. REPORTING INITIATIVE (2024), https://www.globalreporting.org/standards/standards-development/universal-standards/ (explaining the shift to standards began in 2016).

94. *See id.*

95. *See* Jo-An Chen, *Choosing to "Look Up": The Case for a Single, Mandated Climate Change Disclosure Framework*, 64 B.C. L. REV. 179, 194–95 (2023).

96. *See id.* at 195.

97. *Rolf Schwery, GRI Database – A Valuable Tool Soon to Disappear*, ACTING RESPONSIBLY, https://actingresponsibly.com/gri-database-a-valuable-tool-soon-to-disappear/ (last visited Mar. 27, 2024).

98. GRI, Enabling Transparency, *supra* note 93.

"material"[99]—here defined those which reflect the organization's most significant economic, environmental, and social impacts.[100] GRI's definition of "materiality" more closely aligns with the concept of "double materiality"[101] than with the US traditional approach to "materiality".

C. *Greenhouse Gas ("GHG") Protocol Corporate Standard*

The GHG Protocol Corporate Standard was created in 2001 by a partnership between the World Resources Institute ("WRI") and the World Business Council for Sustainable Development ("WBCSD") with contributions from governments, industry associations, non-governmental organizations ("NGO"s), businesses, and other organizations.[102] Since 2001, the partnership has updated the GHG Protocol and has produced guidance to assist companies to account for emissions throughout their value chains.[103] Additionally, the GHG Protocol released a suite of calculation tools to help companies evaluate their emissions and estimate the benefits of climate change mitigation projects.[104]

As the most widely adopted GHG accounting standard,[105] the GHG Protocol has been incorporated into other voluntary and sustainability reporting frameworks including but not limited to, the GRI, the Carbon Disclosure Project ("CDP"),[106]

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99. *See supra* Section I.D discussing materiality.

100. *The GRI Standards: A Guide for Policy Makers*, GLOB. REPORTING INITIATIVE, https://www.globalreporting.org/media/nmmnwfsm/gri-policymakers-guide.pdf (last visited Mar. 27, 2024).

101. *See supra* Section I.D discussing "double materiality."

102. *See About Us*, GREENHOUSE GAS PROTOCOL, https://ghgprotocol.org/about-us (last visited Feb. 26, 2023).

103. *Id.*

104. *Id.* Calculation tools available at *Calculation Tools*, GREENHOUSE GAS PROTOCOL, https://ghgprotocol.org/calculation-tools (last visited Feb. 26, 2023).

105. *See About Us*, GREENHOUSE GAS PROTOCOL, https://ghgprotocol.org/about-us (last visited Feb. 26, 2023).

106. CDP is a non-profit charity organization that runs a global disclosure system centered on environmental impacts. CDP was formed in 2002 and was largely inspired by GRI. CDP works with, and elicits disclosure from corporations, cities, states, and regions. *See About Us*, CDP, https://www.cdp.net/en/info/about-us (last visited Feb. 26, 2023). *What We Do*, CDP, https://www.cdp.net/en/info/about-us/what-we-do ("Founded in 2000, CDP was the first platform to leverage investor pressure to influence corporate disclosure on environmental impact. Now with the world's largest, most comprehensive dataset on environmental action, the insights that CDP holds empowers investors,

and the Task Force on Climate Related Financial Disclosures ("TCFD"), as well as government regulations.

The GHG Protocol introduces the idea of three emission "Scopes": (i) Scope 1 emissions, which are direct emissions from operations owned or controlled by the company; (ii) Scope 2 emissions, which are the indirect emissions generated from the acquired energy consumed by operations owned or controlled by the company; and (iii) Scope 3 emissions, which are the indirect emissions that occur in upstream and downstream activities of a company's value chain.[107] Put simply, Scope 1 and Scope 2 emissions refer to the emissions of a company itself, whereas Scope 3 emissions encompass all other indirect emissions not covered by Scope 1 and 2.[108] The Protocol also provides uniform measurement and reporting methods for the seven GHGs covered in the Kyoto Protocol—carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, sulfur hexafluoride, and nitrogen trifluoride.[109] Quantitative disclosure related

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companies, cities, and national and regional governments to make the right choices today to build a thriving economy that works for people and planet in the long term."). For information regarding CDP's use of the GHG protocol, see *GHG Emissions Dataset*, CDP, https://www.cdp.net/en/investor/ghg-emissions-dataset. To understand how the TCFD and GRI works in conjunction with the GHG Protocol, see Mallory Thomas & Brianna Hardy, *How TCFD and the GHG Protocol are Driving ESG Regulations*, BAKER TILLY (Sept. 26, 2023), https://www.bakertilly.com/insights/how-tcfd-and-ghg-protocol-are-driving-esg-regulations; IFRS FOUND. & GLOB. REPORTING INITIATIVE, INTEROPERABILITY CONSIDERATIONS FOR GHG EMISSIONS WHEN APPLYING GRI STANDARDS AND ISSB STANDARDS (Jan. 2024), https://www.globalreporting.org/media/xlyj120t/interoperability-considerations-for-ghg-emissions-when-applying-gri-standards-and-issb-standards.pdf.

107. *See* WORLD BUS. COUNCIL FOR SUSTAINABLE DEV. & WORLD RESOURCES INST., THE GREENHOUSE GAS PROTOCOL, A CORPORATE ACCOUNTING AND REPORTING STANDARD REVISED EDITION (last visited Apr. 22, 2023), https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf.

108. *Id.*

109. *See Id.* The Kyoto Protocol, adopted in 1997, implemented the United Nations Framework Convention on Climate Change ("UNFCCC") by obtaining commitments from industrialized countries to reduce emissions of the seven identified gasses according to agreed targets. *See What is the Kyoto Protocol?*, UNFCCC, https://unfccc.int/kyoto_protocol (last visited Feb. 26, 2023); *Kyoto Protocol – Targets for the First Commitment Period*, UNFCCC, https://unfccc.int/process-and-meetings/the-kyoto-protocol/what-is-the-kyoto-protocol/kyoto-protocol-targets-for-the-first-commitment-period. The UNFCCC included nitrogen fluoride in the Kyoto GHG protocol in 2013, see Stephen Russell, *Nitrogen Trifluoride Now Required in GHG Protocol Greenhouse Gas Emissions Inventories*, WORLD RES. INST., https://www.wri.org/insights/nitrogen-trifluoride-now-required-ghg-protocol-greenhouse-gas-emissions-inventories.

to GHG emissions is important to investors because it speaks to the registrant's exposure to regulatory, technological, and market risks that may come about in the years to come as the economy transitions to relying less on GHG.[110] Both the standardized data and common definitions discussed above have been integral to the evolution of the climate-related disclosures framework.

D. *Task Force on Climate-Related Financial Disclosures ("TCFD")*

In 2015, the Group of Twenty ("G20") Finance Ministers[111] directed the Financial Stability Board ("FSB")[112] to determine how the financial sector should best address climate-related concerns.[113] The FSB concluded that investors and other market participants required better information about climate-risk and thus established the TCFD.[114]

The TCFD is an international industry-led task force entrusted to better inform investment, credit, and insurance underwriting decisions.[115] In 2017, the TCFD published a disclosure recommendation framework which categorizes material

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110. *See, e.g.*, Calvert Rsch. & Mgmt., Comment Letter on Request for Public Input on Climate Change Disclosure (June 17, 2021); Ceres, Comment Letter on Request for Public Input on Climate Change Disclosure (June 10, 2021); State of NY Off. of the State Comptroller, Comment Letter on Request for Public Input on Climate Change Disclosure (June 8, 2021); Sustainability Acct. Standards Bd., Comment Letter on Request for Public Input on Climate Change Disclosure (May 19, 2021).

111. The Group of Twenty, also known as the G20, is an intergovernmental panel comprising 19 countries and the European Union. The G20 was founded in 1999 in response to the global economic crisis. The finance ministers of the G20 meet annually to discuss the status of the global economy. *See About the G20*, G20 FOUND., https://www.g20.org/en/about-the-g20.

112. The Financial Stability Board was established by the G20 in 2009 and was tasked with monitoring and making recommendations about the global financial system. *See History of the FSB*, FIN. STABILITY BD., https://www.fsb.org/about/history-of-the-fsb/.

113. TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES, 2020 STATUS REPORT (OCT. 2020), https://www.fsb.org/wp-content/uploads/P291020-1.pdf.

114. *See About*, TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES, https://www.fsb-tcfd.org/about/ (last visited Feb. 26, 2023).

115. *See* TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES, RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES (June 2017), https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf.

climate-related risks and opportunities as either short-term, medium-term, or long-term projected financial impacts.[116] The TCFD framework establishes eleven recommended disclosures divided into four core themes: (i) Governance, which recommends disclosures of the organization's climate-related risks and opportunities. Specifically, a description of the board's oversight of, and management's role in assessing and managing, climate-related risks and opportunities; (ii) strategy, which recommends disclosure of the actual and potential impacts of climate-related risks and opportunities and the organization's strategy and financial planning where such information is material. Specifically, a description of the climate-related risks and opportunities and the impacts of those risks and opportunities on the organization's strategy, and the resiliency of that strategy, considering different climate-related scenarios; (iii) risk management, which recommends disclosure of how the organization identifies, assesses, and manages climate-related risks. Specifically, a description of the organization's processes for identifying, assessing, and managing climate-related risks, and how those processes are integrated in the organization's overall risk management; and (iv) and metrics and targets, which recommends disclosure of the metrics and targets used to assess and manage climate-related risks and opportunities where such information is material (*See* Figure 3 & Appendix 4).[117] Specifically, disclosure of how those metrics are utilized in line with the organization's strategy and risk management processes, and disclosure of Scope 1, 2 and 3 GHG emissions in metric tons of carbon.[118] An important caveat in the TCFD framework is that disclosure of Scope 3 emissions is recommended only "if appropriate."[119]

116. *Id.*
117. *Id.*
118. *Id.* at 14.
119. *Id.* at 22.

FIGURE 3. CORE ELEMENTS OF RECOMMENDED CLIMATE-RELATED FINANCIAL DISCLOSURES

Source. Recommendations of the Task Force on Climate-related Financial Disclosures, Final Report (June 2017) https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf.

TCFD's climate related reporting framework has become widely accepted by companies and investors. Notably, 1,069 financial institutions with $194B in collective AUM have expressed their support for the TCFD framework.[120] The principles of TCFD are integrated into many other disclosure frameworks including government regulations. The US, EU, and UK have all integrated different elements of the TCFD into their disclosure proposals.[121]

E. *International Sustainability Standards Board ("ISSB")*

In June 2021, the Value Reporting Foundation ("VRF") was formed through a merger of the Sustainability Accounting Standards Board[122] ("SASB") and the International Integrated

120. *See* MOODY'S, STATE OF TCFD DISCLOSURES 2021 (Oct. 18, 2021) https://assets.website-files.com/5df9172583d7eec04960799a/616d36184f3e6431a424b9df_BX9303_MESG_State%20of%20TCFD%20Disclosures%202021.pdf; 2021 STATUS REPORT: TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES, FIN. STABILITY BD. (Oct. 14, 2021), https://www.fsb.org/2021/10/2021-status-report-task-force-on-climate-related-financial-disclosures/.

121. *See* Haddon, *supra* note 82.

122. The Sustainability Accounting Standards Board is a non-profit organization, founded in 2011 to develop sustainability accounting standards.

Reporting Council[123] ("IIRC") for the purpose of developing a global baseline of ESG reporting standards.[124] Also in June 2021, the International Organization of Securities Commission ("IOSCO") published a report insisting that investors are demanding greater consistency and harmonization among disclosure mechanisms.[125] The report established three priorities: (1) encouraging globally consistent standards; (2) promoting comparable metrics and narratives; and (3) coordinating across approaches.[126] The recommendations of the report materialized in several additional consolidation events in the voluntary disclosure space, eventually culminating into the ISSB.

In November 2021, The IFRS Foundation formed the ISSB to harmonize the many global sustainability disclosure requirements.[127] At the same time, the IFRS also announced that the Climate Disclosure Standards Board ("CDSB") [128] and the VRF would be consolidated into the ISSB.[129] In June 2023, the ISSB issued IFRS S1 (General Requirements for Disclosure of Sustainability-related Financial Information) and IFRS S2 (Climate

See About Us, SASB STANDARDS (last visited Apr. 28, 2023), https://www.sasb.org/about/.

123. The International Integrated Reporting Council is a group of leaders from the corporate, investment, accounting, securities, regulatory, academic and standard-setting sectors who have gathered to create an Integrated Reporting Framework. *See Who We Are,* INT'L INTEGRATED REPORTING COUNCIL, https://www.ifrs.org/about-us/who-we-are/#history (last visited Apr. 15, 2024).

124. BD. OF THE INT'L ORG. OF SEC. COMM'NS, REPORT ON SUSTAINABILITY-RELATED ISSUER DISCLOSURES: FINAL REPORT (2021), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD678.pdf; *see also* VALUE REPORTING FOUNDATION, https://www.valuereportingfoundation.org/ The Value Reporting Foundation has consolidated into the IFRS. (last visited Feb. 26, 2023).

125. BD. OF THE INT'L ORG. OF SEC. COMM'NS, *supra* note 124.

126. *Id.* at 3.

127. *Id.*

128. The Climate Disclosure Standards Board ("CDSB") is a global consortium of businesses and non-governmental organizations established during the World Economic Forum in 2007 to set standards for climate related disclosures. The First CDSB Framework, the Climate Change Reporting Framework, was released in 2010. That Framework was updated in April 2018 to better align with TCFD; *see About the Climate Disclosure Standards Board,* CDSB (last visited Feb. 26, 2023), https://www.cdsb.net/our-story.

129. *IFRS Foundation Completes Consolidation with Value Reporting Foundation,* IFRS (Aug. 1, 2022), https://www.ifrs.org/news-and-events/news/2022/08/ifrs-foundation-completes-consolidation-with-value-reporting-foundation/.

Related Disclosures). The standards became effective in reporting periods starting January 1, 2024.[130]

The IFRS Foundation recommended that the ISSB use the TCFD framework as a starting point for developing a model "prototype" climate-related financial disclosure standard.[131] The standards are inspired by the TCFD framework but with a few significant departures.[132] The ISSB Standards are consistent with the TCFD's governance recommendations but require the disclosure of additional information, including the identity of the body or individual responsible for oversight of climate-risk, how that body's responsibilities are reflected in board mandates and related policies, how the body ensures that the appropriate skills and competencies are available to oversee climate risk response, and information about whether dedicated controls and procedures are applied to climate risk and integrated with other processes.[133]

The ISSB Standards are also consistent with the TCFD's strategy recommendations, but require additional, more granular details regarding how the organization is directly, and indirectly, responding to climate risk, how its strategy and plans will be resourced, the expected changes in financial position and performance over time, including investment plans and sources of funding, and its resilience analysis and areas of uncertainty.[134] Also, unlike the TCFD Framework, the ISSB mandates that companies provide information about emission reduction targets and the use of carbon offsets.[135] The ISSB Standards largely mirror the TCFD's risk management recommendations except that they require the inclusion of input parameters and identification of the prioritization of climate risks and opportunities.[136] The ISSB further departs from the TCFD framework

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130. *IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information,* IFRS (last visited Dec. 27, 2023), https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/ifrs-s1-general-requirements/ [hereinafter "IFRS S1"]; *IFRS S2 Climate-Related disclosures,* IFRS (last visited Dec. 27, 2023), https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/ifrs-s2-climate-related-disclosures/ [hereinafter "IFRS S2"].

131. *See* TECH. READINESS WORKING GRP., CLIMATE-RELATED DISCLOSURES PROTOTYPE (Nov. 2021), https://www.ifrs.org/content/dam/ifrs/groups/trwg/trwg-climate-related-disclosures-prototype.pdf.

132. IFRS S2, *supra* note 130.

133. *Id.* at 4–6.

134. *Id.* at 7–8.

135. *Id.* at 17.

136. *Id.* at 14–35.

by requiring disclosure based on industry metrics.[137] Further, the ISSB Standards require a different disclosure treatment of GHGs, in that organizations must prepare separate disclosures of Scope 1 and Scope 2 emissions, in metric tons of carbon, for: (i) its consolidated accounting group; and (ii) its associates, joint ventures, unconsolidated subsidiaries or affiliates not included in the consolidated accounting group. Scope 3 emissions disclosure is required under the ISSB Standards regardless of whether the organizations deem disclosure "appropriate", as recommended by the TCFD. Finally, the ISSB Standards differ from the TCFD's recommendations in that organizations must disclose how its climate targets compare with those created in the latest international agreement on climate change, and whether those targets have been validated by a third party.[138]

III.
Government Disclosure Regulations

A. *United States*

SEC disclosures are rooted in the shift away from the *caveat emptor*, or "let the buyer beware", framework that existed prior to 1933.[139] In response to the stock market collapse of 1929, Congress enacted the Securities Act of 1933[140] and Securities Exchange Act of 1934,[141] which were intended to, *inter alia*, protect investors by requiring publicly traded companies to disclose information regarding their financial condition.[142] These seminal laws introduced the expectation of publicly traded companies' transparency that continues to be built upon today.[143] The Securities Act of 1933 introduced the concept of "materiality" to disclosures by requiring companies that go

137. *Id.* at 14–40.
138. *Id.* at 14–15.
139. "This proposal adds to the ancient rule of caveat emptor the further doctrine, 'let the seller also beware.' It puts the burden of telling the whole truth on the seller. It should give impetus to honest dealing in securities and thereby bring back public confidence." Message from President Franklin Roosevelt to Congress (Mar. 29, 1933), as *quoted in* H.R. Rep. No. 73-85 (1933).
140. Securities Act of 1933, 15 U.S.C. §77a.
141. Securities Exchange Act of 1934, 15 U.S.C. §77c.
142. *See* Ruth Jebe, *The Convergence of Financial and ESG Materiality: Taking Sustainability Mainstream*, 56 Am. Bus. L.J. 645, 654 (2019).
143. *See* Richard C. Sauer, *The Erosion of the Materiality Standard in the Enforcement of the Federal Securities Laws*, 62 Bus. Law. 317 (2007).

public to produce a registration statement that provides investors with the full disclosure of material facts regarding the company and securities to be offered.[144] The complex debate surrounding the meaning of materiality in the ESG context is discussed above.

Congress created the SEC in 1934 and empowered it to promulgate disclosure requirements that are "necessary or appropriate in the public interest or for the protection of investors."[145] The Securities Exchange Act of 1934 requires publicly traded companies to file periodic reports with the SEC, including: (i) quarterly reports on Form 10-Q;[146] (ii) an annual report on Form 10-K;[147] and (iii) an interim report on Form 8-K for any month where certain specified events occur.[148] The details of what must be included in these reports are set forth in SEC Regulation S-K[149] and S-X for financial information.[150] These reporting requirements include the description of the company's business, threatened or pending legal proceedings against the company, risk factors, and management's discussion and analysis of the company's financial condition and results of operations, several of which potentially implicate ESG disclosures.

SEC regulations are framed around ensuring that investors have access to the information necessary to make informed investment decisions. The SEC first dabbled with the idea of disclosure on material environmental issues in the 1970's when it published an interpretive release encouraging registrants to include the financial impact of compliance with environmental laws.[151] At the time, the United States Government had recently

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144. *See generally* THOMAS L. HAZEN, THE LAW OF SECURITIES REGULATION, Chs. 2–3 (8th ed. 2020).

145. *See, e.g.*, Securities Act of 1933 §7, 15 U.S.C. §77g; Securities Exchange Act of 1934 §§ 12–13, 15., 15 U.S.C. §§ 781–m, 780.

146. 17 C.F.R § 249.308a (2005).

147. 17 C.F.R § 249.310 (2005).

148. 17 C.F.R § 249.308 (2005) (The events that require a Form 8-K filing include: (i) Bankruptcy or receivership; (ii) acquisition or disposition of assets; (iii) delisting of securities; (iv) non-reliance on previously issued financial documents; (v) change in board composition; and (vi) failure to make a required distribution).

149. 17 C.F.R. § 229.

150. 17 C.F.R. § 210.

151. *See* Securities Act Release No. 33, 5170, 36 Fed. Reg. 13980 (July 19, 1971). The Commission codified this interpretive position in its disclosure forms two years later. *See* Securities Act Release 33, 5386, 38 Fed. Reg. 12100 (Apr. 20, 1973) ("1972 Amendments").

enacted a series of environmental laws including the National Environmental Protection Act ("NEPA") and the Clean Air Act ("CAA") in 1970, as well as the Clean Water Act ("CWA") and Ocean Dumping Act in 1972.[152] Environmental regulations expanded in 1974 as Congress passed the Safe Water Drinking Act ("SWDA") and the Resource Conservation and Recovery Act ("RCRA") as well as the Toxic Substances Control Act ("TSCA") in 1976.[153] In 1982, the Commission adopted rules mandating the disclosure of the costs of compliance with federal, state, and local environmental laws.[154]

1. *2010 SEC Guidance*

In 2010, as a response to public requests to address the role of disclosure in climate-change risk, the SEC published guidance [hereinafter "2010 Guidance"].[155] In the 2010 Guidance, the SEC made clear that climate risk is material in certain circumstances, and therefore must be disclosed.[156] The SEC advised companies to consider the following four categories of climate risk when contemplating disclosures: (i) the impact of legislation and regulation on compliance and litigation; (ii) the impact of international climate change accords on compliance and litigation; (iii) the indirect consequences of regulation or business trends, such as consumer demand and public perception; and (iv) the physical impacts of climate change, including property damage and supply chain disruptions.[157]

In addition to its guidance on climate-risk considerations, the SEC mandated certain specific disclosures under Regulation S-K. At this time, the SEC required companies to disclose the material effects that compliance with federal, state, and local regulations will have on potential litigation,[158] and upon

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152. *Milestones in EPA and Environmental History*, ENV'T PROT. AGENCY (last visited Mar. 24, 2023), https://www.epa.gov/history/milestones-epa-and-environmental-history.

153. *Id.*

154. *See* Securities Act Release No. 33, 6383, 47 Fed. Reg. 11380 (Mar. 16, 1982) ("1982 Release").

155. *See* Commission Guidance Regarding Disclosure Related to Climate Change, Release No. 33, 9106, 75 Fed. Reg. 6290 (Feb. 8, 2010) [hereinafter "2010 Guidance"].

156. Commission Guidance Regarding Disclosure Related to Climate Change, Release No. 33, 9106, 75 Fed. Reg. 6290 (Feb. 8, 2010).

157. *Id.* at 6295–97.

158. 17 C.F.R. § 229.103(a).

its capital expenditures, earnings, and competitive position as part of the description of its business.[159] Additionally, companies are mandated to disclose the most significant factors that make its public offering speculative or risky, including those related to climate change.[160]

As a result of the 2010 Guidance, climate change disclosures by United States companies have increased.[161] However, the disclosures are inconsistent and vary from company to company. Mentions of climate change in 10-K forms (the annual report required by the SEC, that gives a comprehensive summary of a public company's financial performance) often use boilerplate[162] language.[163] As a result, investors in the United States continue to struggle locating, understanding, and comparing disclosure data.

In 2016, the SEC issued a request for preliminary comments on modernizing the disclosure requirements in Regulation S-K.[164] A significant majority of comments received addressed sustainability with many focused on climate change, while many others discussed disclosures related to diversity, gender pay equity, human rights, human capital management, sustainable palm oil, forestry, and supply-chain management.[165] A common theme of the comment letters was the need to improve the quality and consistency of ESG disclosures.[166]

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159. *Id.* § 229.101(c)(2)(i).

160. *Id.* § 229.503(c).

161. *See* PALMITER, *supra* note 39 at 352.

162. The term boilerplate refers to standardized text, copy, documents, methods, or procedures that may be used over again without making major changes to the original. James Chen, *Boilerplate Language, Uses, History, Examples, Pros & Cons*, INVESTOPEDIA (last visited Apr. 27, 2023) https://www.investopedia.com/terms/b/boilerplate.asp.

163. *Id.*

164. Business and Financial Disclosure Required by Regulation S-K, Release Nos. 33,10064; 34,77599, 113 SEC Docket 4731 (Apr. 13, 2016); TYLER GELLASCH, TOWARDS A SUSTAINABLE ECONOMY: A REVIEW OF COMMENTS TO THE SEC'S DISCLOSURE EFFECTIVENESS CONCEPT RELEASE, AMERICANS FOR FINANCIAL REFORM ET AL. (Sep. 2016), https://static1.squarespace.com/static/583f3fca725e25fcd45aa446/t/5866d3c0725e25a97292ae03/1483133890503/Sustainable-Economy-report-final.pdf.

165. *Business And Financial Disclosure Required By Regulation S-K - The Sec's Concept Release And Its Implications*, SUSTAINABILITY ACCT. STANDARD BD. (2016), https://www.sasb.org/wp-content/uploads/2016/09/Reg-SK-Comment-Bulletin-091416.pdf.

166. *See* Daniel C. Esty & Todd Cort, *Toward Enhanced Corporate Sustainability Disclosure: Making ESG Reporting Serve Investors*, 16 VA. L. & BUS. REV. 423, 431 (2022).

The first few weeks of March 2021 marked a concerted effort by the SEC to further develop its ESG regulations. On March 3, 2021, the SEC stated in a press release that "[t]his year, the Division is enhancing its focus on climate and ESG-related risks by examining proxy voting policies and practices to ensure voting aligns with investors' best interests and expectations, as well as firms' business continuity plans in light of intensifying physical risks associated with climate change."[167] The next day, on March 4, 2021, the SEC announced the creation of a Climate and ESG Task Force in the Division of Enforcement.[168] The initial focus of the Task Force is to develop initiatives to proactively identify ESG-related misconduct.[169] On March 15, 2021, acting chair of the SEC, Allison Herren Lee, requested public input on climate disclosure and initiatives focused on broader ESG disclosure.[170] Over 600 unique responses were received with proponents of additional disclosures stating that climate change poses significant financial risks to companies and investors, and that the current disclosure framework has not produced consistent, comparable, or reliable information for investors.[171] In response, the SEC released a summary website compiling agency information about climate and ESG issues.[172]

Shortly thereafter, the SEC issued comment letters to dozens of companies on their fiscal 2020 Form 10-Ks requesting additional disclosures, or clarifying language, related to climate change.[173] Although it took several years, the SEC issued a monumental proposal in March 2022 that would advance and standardize disclosures related to climate change.[174]

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167. Press Release, SEC, SEC Division of Examinations Announces 2021 Examination Priorities (Mar. 3, 2021), https://www.sec.gov/news/press-release/2021-39.

168. Press Release, SEC, SEC Announces Enforcement Task Force Focused on Climate and ESG Issues (Mar. 4, 2021), https://www.sec.gov/news/press-release/2021-42.

169. *Id.*

170. *See* Statement Comm'r. Allison Herren Lee, SEC Public Input Welcomed on Climate Change Disclosures (Mar. 15, 2021), https://www.sec.gov/news/public-statement/lee-climate-change-disclosures.

171. Climate Rules, *supra* note 7.

172. *See A Timeline of What's Happening with Corporate ESG Disclosure Requirements in the U.S.,* BDW, https://bwdstrategic.com/timeline-of-usa-climate-change-disclosure-regulation/ (last visited Apr. 29, 2023).

173. *See, e.g., Sample Letter to Companies Regarding Climate Change Disclosures*, SEC, https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures (last modified Sept. 22, 2021).

174. Climate Rules, *supra* note 7.

2. *Climate Rules*

On March 21, 2022, the SEC proposed amendments to its rules under the Securities Act of 1933 and Securities Exchange Act of 1934.[175] The SEC invited comments on the proposed amendments which would "require registrants to provide certain climate-related information in their registration statements and annual reports."[176] In the proposal, the SEC expresses its intent to balance the need to "elicit climate-related disclosures that are consistent, comparable, and reliable" while reducing the regulatory burden and cost of such disclosure.[177]

Asset management firms in the United States were vocal about their views on the proposed SEC Climate Rules. Specifically, eight out of the top ten asset managers submitted formal response letters during the public comment period.[178] Morningstar, an Investment Research Firm, analyzed those eight response letters.[179] All eight asset managers expressed support for the SEC's efforts to provide standardized climate-risk data to investors.[180] The letters also demonstrate that US asset management firms support the disclosure of Scope 1 and 2 emissions, but generally oppose the inclusion of Scope 3 emissions in the rule.[181] The rationale provided in the letters is that reporting Scope 3 emissions will be too challenging and costly.[182] In addition, the asset managers assert that data gaps and inconsistent methodologies will result in inaccurate Scope 3 measurements.[183]

By a vote of 3-2, the SEC passed the final Climate Rules on March 6, 2024. The structure is largely inspired by the TCFD Reporting Framework core categories: governance, risk management, strategy, and metrics.[184] The rule also incorporates concepts developed by the GHG Protocol.[185] The final rule is

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175. *Id.*
176. *Id.* at 34.
177. *Id.* at 43.
178. *See* Mary Riddle, *What U.S. Asset Managers Say About the SEC's Proposed Rules on Climate-Related Disclosures*, TRIPLE PUNDIT (Aug. 9, 2022), https://www.triplepundit.com/story/2022/sec-proposed-climate-related-disclosures/751891.
179. *Id.*
180. *Id.*
181. *Id.*
182. *Id.*
183. *Id.*
184. Climate Rules, *supra* note 7, at 21343.
185. *Id.* at 21345.

discussed in further detail below. All registrants are provided with a phased in compliance timeline depending on their filer status and the content of the disclosure (*See* figure 4).[186]

FIGURE 4. COMPLIANCE DATES UNDER THE FINAL RULES

Source. Fact Sheet: The Enhancement and Standardization of Climate-Related Disclosures: Final Rules, U.S. Securities and Exchange Commission (Mar. 6, 2024) https://www.sec.gov/files/33-11275-fact-sheet.pdf.

Compliance Dates under the Final Rules[1]

Registrant Type	Disclosure and Financial Statement Effects Audit		GHG Emissions/Assurance			Electronic Tagging
	All Reg. S-K and S-X disclosures, other than as noted in this table	*Item 1502(d)(2), Item 1502(e)(2), and Item 1504(c)(2)*	*Item 1505 (Scopes 1 and 2 GHG emissions)*	*Item 1506 - Limited Assurance*	*Item 1506 - Reasonabl e Assurance*	*Item 1508 - Inline XBRL tagging for subpart 1500*[2]
LAFs	FYB 2025	FYB 2026	FYB 2026	FYB 2029	FYB 2033	FYB 2026
AFs (other than SRCs and EGCs)	FYB 2026	FYB 2027	FYB 2028	FYB 2031	N/A	FYB 2026
SRCs, EGCs, and NAFs	FYB 2027	FYB 2028	N/A	N/A	N/A	FYB 2027
	1 As used in this chart, "FYB" refers to any fiscal year beginning in the calendar year listed. 2 Financial statement disclosures under Article 14 will be required to be tagged in accordance with existing rules pertaining to the tagging of financial statements. See Rule 405(b)(1)(i) of Regulation S-T.					

The Climate Rules amend Regulation S-K to require a new, separately captioned "Climate-Related Disclosure" section in applicable SEC filings, including Form 10-K, with such requirements enumerated in the newly created subpart 1500 of Regulation S-K.

a. Item 1500: Definitions

Item 1500 of Regulation S-K defines terms used in the Climate Rules,[187] including "materiality" in the context of the rule, consistent with Supreme Court precedent: "If there is a substantial likelihood that a reasonable investor would consider it important when determining whether to buy or sell securities or how to vote or such a reasonable investor would view omission of the disclosure as having significantly altered the total mix of information made available."[188] Other relevant definitions will be discussed below.

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186. *Id.* at 21346.
187. Climate Rules, *supra* note 7.
188. *Id.* at 96; *See* 17 C.F.R. § 230.405 (definition of "material"); 17 C.F.R. § 240.12b-2 (definition of "material"). *See also Basic*, 485 U.S. at 231-32, 240

b. Item 1501: Governance

Item 1501 requires registrants to describe the board of director's oversight of climate-related risks.[189] When applicable, this section will be used for companies to identify any board or sub-committee created for the purpose of climate-related risk management or obtaining climate-related targes or goals.[190]

c. Item 1502: Strategy

Item 1502(a) of Regulation S-K requires the disclosure of any climate-related risks that have materially impacted or are reasonably likely to have a material impact on the registrant.[191] Climate-related risks are defined as the actual or potential negative impacts of climate-related conditions and events on a registrant's business, results of operations, or financial condition.[192] This includes both physical risks and transition risks.[193] "Physical risks" are broken down into acute risks (event-driven risks, i.e. shorter-term severe weather events) and chronic risks (risks resulting from longer-term weather patterns such as drought, sea level rise, sustained higher temperatures, etc.).[194] "Transition risks" are defined as risks that are attributable to regulatory, technological, and market changes to address the mitigation of, or adaptation to, climate related risks.[195] Examples of "transition risks" include the possible implementation of a carbon tax, carbon disclosure mandates, and the transition to renewable energies.[196] However, the final rule does not explicitly list what may be considered a transition risk.[197]

(holding that information is material if there is a substantial likelihood that a reasonable investor would consider the information important in deciding how to vote or make an investment decision; and quoting *TSC Indus.*, 426 U.S. at 449 to further explain that an omitted fact is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.").

189. 17 C.F.R. § 229.1501 at 21712.

190. *Id.*

191. 17 C.F.R. § 229.1502(a) at 21691

192. 17 C.F.R. § 229.1500 at 21692.

193. *Id.*

194. *Id.*

195. *Id.*

196. *Climate Risk: What are Physical & Transition Risks?* PERSEFONI (last updated Dec. 27, 2023) https://www.persefoni.com/learn/climate-risk-what-are-physical-transition-risks.

197. 17 C.F.R. § 229.1502(a).

Companies are given the option, but are not required, to disclose "climate-related opportunities".[198]

Under 1502(a) of Regulation S-K, registrants must classify climate-related risks into short-term risks (i.e. within 12 months), and long-term risks (i.e. beyond the next 12 months).[199] This temporal standard is consistent with the existing Management Discussion & Analysis ("MD&A") standard.[200]

Item 1502(b) mandates disclosure of the actual and material impacts of any climate-related risks identified in item 1502(a).[201] A non-exhaustive list of material impacts is provided and suggests that registrants may be obligated to disclose impact on: (1) business operations; (2) products and services; (3) suppliers, purchasers, or counterparties to material contracts; (4) activities to mitigate or adapt to climate-related risks; and (5) expenditure for research and development.[202]

Item 1502(c) requires discussion of whether and how the registrant considers any impacts described in response to 1502(b) as part of its strategy, financial planning, and capital allocation.[203]

Similarly, Item 1502(d) requires discussion of how the climate-related risks identified in item 1502(a) have materially impacted or are reasonably likely to materially impact the registrant's business, results of operations, or financial condition.[204] Registrants are directed to provide both quantitative and qualitative reports of the material expenditures incurred in relation to any activities to mitigate or adapt to climate-related risks.[205]

Transition plans are optional under the Climate Rules. However, Item 1502(e) requires registrants to describe such transition plans if they have adopted one.[206]

Scenario analysis is also optional under the Climate Rules. However, Item 1502(f) requires registrants to describe the methodology of its scenario analysis and report on its results.[207]

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198. *Id.*
199. *Id.*
200. Climate Rules, *supra* note 7 at 103, 104.
201. 17 C.F.R. § 229.1502(b).
202. *Id.*
203. 17 C.F.R. § 229.1502(c).
204. 17 C.F.R. § 229.1502(d).
205. *Id.*
206. 17 C.F.R. § 229.1502(e).
207. 17 C.F.R. § 229.1502(f).

Pursuant to item 1502(g), registrants must report on the use of an internal carbon price only if it is material to how it evaluates and manages a climate-related risk as identified in 1502(a).[208]

d. Item 1503: Risk Management

Item 1503 focuses on internal processes for identifying, assessing, and managing material climate-related risks.[209]

e. Item 1504: Targets and goals

Setting climate-related targets and goals is optional under the Climate Rules. However, under Item 1504, registrants that publicly establish climate-related targets and goals (such as on their websites or in press releases) must disclose such target or goal if it has materially affected or is reasonably likely to materially affect the registrant's business, result of operations, or financial condition.[210]

f. Item 1505: GHG Emissions Metrics

Under Item 1505, Registrants who qualify as large accelerated filers[211] or accelerated filers[212] must disclose its Scope 1 emissions and/or its Scope 2 emissions, if such emissions are

208. 17 C.F.R. § 229.1502(g).

209. 17 C.F.R. § 229.1503.

210. 17 C.F.R. § 229.1504.

211. *See* 17 C.F.R. § 240.12b-2 (defining "large accelerated filer" as an issuer after it first meets the following conditions as of the end of its fiscal year: (i) the issuer had an aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates of $700 million or more, as of the last business day of the issuer's most recently completed second fiscal quarter; (ii) the issuer has been subject to the requirements of Section 13(a) or 15(d) of the Exchange Act for a period of at least twelve calendar months; (iii) the issuer has filed at least one annual report pursuant to Section 13(a) or 15(d) of the Exchange Act; and (iv) the issuer is not eligible to use the requirements for SRCs under the SRC revenue test).

212. *See* 17 C.F.R. § 240.12b-2 (defining "accelerated filer" as an issuer after it first meets the following conditions as of the end of its fiscal year: (i) the issuer had an aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates of $75 million or more, but less than $700 million, as of the last business day of the issuer's most recently completed second fiscal quarter; (ii) the issuer has been subject to the requirements of Section 13(a) or 15(d) of the Exchange Act for a period of at least twelve calendar months; (iii) the issuer has filed at least one annual report pursuant to Section 13(a) or 15(d) of the Exchange Act; and (iv) the issuer is not eligible to use the requirements for SRCs under the SRC revenue test).

material, for the past completed fiscal year.[213] The methodology, inputs, and significant assumptions used for emissions calculations must be provided as well.[214] Registrants are permitted to use "reasonable estimates" when making their emissions disclosure so long as such assumptions are explicitly provided and explained.[215] Smaller reporting companies are exempt from GHG emission requirements.[216]

The final Climate Rules are notably scaled back from the 2022 proposal.[217] The most significant departure from the 2022 proposal is the elimination of the Scope 3 disclosure requirements.[218]

g. Item 1506: Attestation of Scope 1 and Scope 2 emissions disclosure

Item 1506 requires all GHG emissions disclosures to be analyzed in a GHG attestation report, completed by an independent GHG emissions attestation provider.[219]

h. Item 1507: Safe Harbor for certain climate-related disclosures

The Climate Rules provide significant safe harbors for registrants who make "forward looking statements".[220]

i. Item 1508: Structured Data Requirement

Lastly, Item 1508 requires registrants to make all data disclosed in relation to the Climate Rules available in an interactive data file.[221]

j. Financial Statement Effects (Regulation S-X Article 14)

The Climate Rules add Article 14 to Regulation S-X. This new subpart will require companies to disclose in a note to

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213. 17 C.F.R. § 229.1505.
214. *Id.*
215. *Id.*
216. *Id.*
217. *SEC Adopts Scaled-Back Climate-Related Disclosure Requirements*, LINKLATERS (Mar. 7, 2024), https://www.linklaters.com/knowledge/publications/alerts-newsletters-and-guides/2024/march/07/sec-adopts-scaled-back-climate-related-disclosure-requirements.
218. *Id.*
219. 17 C.F.R. § 229.1506.
220. 17 C.F.R. § 229.1507.
221. 17 C.F.R. § 229.1508.

their audited financial statements: (1) capitalized costs, expenditures expensed, charges and losses incurred as a result of severe weather events and other natural conditions, subject to applicable one percent and *de minimis* disclosure thresholds;[222] (2) financial impacts and accounting policy related to the use of carbon offsets or renewable energy credits or certificates (if used as a material component of stated targets and/or goals); and (3) a description of whether and how the estimates and assumptions the company uses to produce the financial statements were materially impacted by risks and uncertainties associated with severe weather events and other natural conditions or any disclosed climate-related targets or transition plans.

k. Legal Challenges

ESG investing is more controversial, and politicized in the United States than in the European Union and the United Kingdom. The reason for this is the wide-spread US Corporate belief that the SEC does not have the authority to mandate disclosure of "non-material" information and that corporate boards are breaching their fiduciary duties if they prioritize "non-material" considerations over shareholder return.[223] An anti-ESG coalition composed of the Attorneys General of 19 states headed by Texas' Ken Paxton wrote a response letter on August 4th, 2022 to asset management firm BlackRock's call for ESG investing.[224] The eight-page letter asserted that "fiduciary duty is not lip service" and that factoring ESG into investment strategy does not yield the best possible return for shareholders.[225] The letter

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222. No disclosure of expenditures expensed as incurred and losses is required if the aggregate amount is less than (i) one percent of the absolute value of income or loss before income tax expense or benefit or (ii) $100,000 for the relevant fiscal year, and no disclosure of the absolute value of capitalized costs and charges is required if the aggregate amount is less than (a) one percent of the absolute value of stockholders' equity or deficit at year end or (b) $500,000 for the relevant fiscal year. Under Regulation. 17 C.F.R. § 210.14–02(b).

223. *See* discussion of Shareholder Wealth Maximization and Shareholder Primacy *infra* Section II.2.

224. *AG Paxton Demands Blackrock Account for Its Underperforming, Potentially Illegal 'ESG' State Pension Fund Investments*, TEXAS ATTORNEY GENERAL (Aug. 8, 2022), https://www.texasattorneygeneral.gov/news/releases/ag-paxton-demands-blackrock-account-its-underperforming-potentially-illegal-esg-state-pension-fund.

225. Larry Light, *19 GOP Attorneys General Slam BlackRock Over ESG Investments,* CHIEF INV. OFF. (Aug. 9, 2022), https://www.ai-cio.com/news/19-gop-attorneys-general-slam-blackrock-over-esg-investments/.

alleges that BlackRock's deviation from neutrality concerning the fossil fuel industry may violate state and federal antitrust laws, as well as corporate law demanding fiduciary duties of loyalty and care.[226]

The Climate Rules are particularly vulnerable to legal challenge in the wake of *West Virginia v. EPA*.[227] In the 2022 case, the Supreme Court ruled that the Environmental Protection Agency ("EPA") lacked statutory authority under the Clean Air Act to set emissions caps for the purpose of generation shifting.[228] This set the precedent that under the "major questions doctrine," agencies must have explicit authorization from Congress to make rules of "vast economic and political significance."[229] Adversaries of the Climate Rules argue that the SEC's jurisdictional power is limited to the protection of investors.[230] Challengers assert that regulations requiring the disclosure of ESG information breaches corporate principles of fiduciary duty and exceed the statutory authority of the SEC.

Acting SEC Chair Allison Herrin Lee underscored that the federal securities law provides the SEC with authority to require disclosures that are "for the protection of investors" and/*or* "in the public interest."[231] Lee, instead of embracing double materiality, is arguing "that the SEC has never been limited to requiring disclosures that are deemed material to the reasonable investor."[232] This, however, is not the view of all ESG commissioners.[233]

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226. *Id.*

227. West Virginia v. Env't Prot. Agency, 142 S.Ct. 2587, 2614-16 (2022).

228. "Generation shifting" requires a shift in electricity production from certain fossil fuel power generation sources, primarily fired by coal and natural gas, to other sources that emit less carbon dioxide. *Id.*

229. *Id.* at 2605, 2610.

230. *See* Andrew N. Vollmer, *Does the SEC Have Legal Authority to Adopt Climate-Change Disclosure Rules?*, MERCATUS CTR., GEORGE MASON UNIV. 1 (2021).

231. *See generally* Securities Act of 1933, 15 U.S.C. § 77a; Securities Exchange Act of 1934,15 U.S.C. § 78a.

232. Maggie Pahl, *The Meaning of Materiality in the Context of Climate Change*, A.B.A. (Nov. 20, 2023), https://www.americanbar.org/groups/environment_energy_resources/publications/ed/the-meaning-of-materiality-in-the-context-of-climate-change/.

233. *See* Hester M. Pierce, *Green Regs and Spam: Statement on the Enhancement and Standardization of Climate-Related Disclosures for Investors*, SEC (Mar. 6, 2024), https://www.sec.gov/news/statement/peirce-statement-mandatory-climate-risk-disclosures-030624; *see also* Mark T. Uyeda, *A Climate Regulation under the Commission's Seal: Dissenting Statement on The Enhancement and Standardization of Climate-Related Disclosures for Investors*, SEC (Mar. 6, 2024),

The Security Act of 1933 and the Security Exchange Act of 1934 do not define the term "in the public interest."[234] When a term contained in a statute is ambiguous, it is up to the agency to interpret it.[235] Regardless, a court may challenge an agency's interpretation under the Administrative Procedures Act ("APA") if it is found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[236]

The SEC's final Climate Rules were met with legal challenges within 24 hours of its publication.[237] Ten Republican-led states (West Virginia, Georgia, Alabama, Alaska, Indiana, New Hampshire, Oklahoma, South Carolina, and Wyoming, and Virginia) filed a petition with the Court of Appeals in the 11th Circuit to vacate the Climate Rules, arguing that they go beyond the SEC's legal authority. During the week of March 6, 2024 to March 14, 2024, petitions were filed in several courts of appeals.[238] On March 8, petitioners Liberty Energy Inc. and Nomad Proppant Services LLC filed a motion seeking an administrative stay and a stay pending judicial review of the final rules in the Fifth Circuit, which was granted on March 15, 2024.[239] On March 19, 2024, the SEC filed a motion for Multicircuit Petitions for Review with the Judicial Panel on Multicircuit Litigation. Pursuant to 28 U.S.C. § 2112(a)(3), on March 21, 2024, the Judicial Panel on Multicircuit Petitions for Review entered an order consolidating the petitions for review

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https://www.sec.gov/news/statement/uyeda-statement-mandatory-climate-risk-disclosures-030624.

234. *Id.*; *see also* Bernard S. Sharfman, *Non-Material Mandatory Climate Change Disclosure*, OHIO STATE BUS. L. J. ONLINE (2021), https://moritzlaw.osu.edu/sites/default/files/2021-12/Non-Material%20Mandatory%20Climate%20Change%20Disclosures%20%28Author%20Final%20Clean%29.pdf.

235. Chevron U.S.A., Inc. v. NRDC, Inc., 467 U.S. 837, 844-845 (1984).

236. SEC v. Citigroup Glob. Mkts. Inc., 673 F.3d 158, 168 (2d Cir. 2012).

237. *Republican-led states sue US SEC over climate risk disclosure rules*, REUTERS (Mar. 6, 2024), https://www.reuters.com/sustainability/climate-energy/republican-led-states-say-they-will-sue-us-securities-regulator-over-climate-2024-03-06/.

238. Nat. Res. Def. Council, Inc. v. SEC, No. 24-707 (2d Cir. filed Mar. 12, 2024); Liberty Energy Inc. v. SEC, No. 24-60109 (5th Cir. filed Mar. 6, 2024); Louisiana v. SEC, No. 24-60109 (5th Cir. filed Mar. 7, 2024); Tex. All. of Energy Producers v. SEC, No. 24-60109 (5th Cir. filed Mar. 11, 2024); Chamber of Com. of U.S. of Am. v. SEC, No. 24-60109 (5th Cir. filed Mar. 14, 2024); Ohio Bureau of Workers' Comp. v. SEC, No. 24-3220 (6th Cir. filed Mar. 13, 2024); Iowa v. SEC, No. 24-1522 (8th Cir. filed Mar. 12, 2024); West Virginia v. SEC, No. 24-10679 (11th Cir. filed Mar. 6, 2024); Sierra Club v. SEC, No. 24-1067 (D.C. Cir. filed Mar. 13, 2024).

239. Liberty Energy Inc. v. SEC, No. 24-60109 (5th Cir. filed Mar. 6, 2024).

in the U.S. Court of Appeals for the Eight Circuit. Thereafter, on March 22, 2024, the Fifth Circuit dissolved its administrative stay.[240] On April 4, 2024, the SEC exercised its discretion to voluntarily stay the Climate Rules pending the adjudication of the Eighth Circuit petitions.[241] In doing so, the Commission stated that by voluntarily issuing the stay, they are "not departing from [the] view that the Final Rules are consistent with applicable law and within the Commission's long-standing authority to require the disclosure of information important to investors in making investment and voting decisions".[242]

On June 28, 2024, in *Loper Bright Enterprises v. Raimondo*, 603 U.S. ___ (2024), the Supreme Court put an end to *Chevron*[243] deference, the doctrine that allowed federal agencies to fill the gaps in ambiguous provisions of congressional statutes, if delegation was implied and the traditional tools of statutory interpretation failed, based on their specialized expertise. The SEC's defense of the Climate Rules is much less tenable without the ability to rely on the Chevron justification that the Commission, with 90 years of experience overseeing securities exchanges, securities brokers and dealers, investment advisors, and mutual funds, is best equipped to interpret the Securities Act and Securities Exchange Act as it relates to what requirements are necessary or appropriate necessary in the public interest or for the protection of investors.[244]

3. *Investment Regulations*

On May 25, 2022, the SEC proposed two additional rules targeting ESG funds: (1) The Enhanced Disclosures by Certain

240. Liberty Energy Inc. v. SEC, No. 24-60109 (5th Cir. Mar. 22, 2024), ECF No. 87.

241. SEC, Order Issuing Stay In the Matter of the Enhancement and Standardization of Climate-Related Disclosures for Investors, Release No. 11280, 99908 (Apr. 4, 2024).

242. *Id.*

243. *Chevron U.S.A.*, 467 U.S. 837 (1984).

244. Maggie Pahl, *What Does Loper Mean for the SEC Climate Rules?*, AMER. BAR. ASSOC., Aug. 27, 2024, https://www.americanbar.org/groups/environment_energy_resources/resources/newsletters/environmental-social-governance-sustainability/what-does-loper-mean/ (last visited Sept. 27, 2024); *See also* Michael Gold & Saul Ewing, *Did Loper Bright Kill the SEC's Climate Disclosure Rules?*, ESG INV., Aug. 30, 2024, https://www.esginvestor.net/did-loper-bright-kill-the-secs-climate-disclosure-rules/#:~:text=The%20central%20holding%20of%20Loper,acted%20within%20its%20statutory%20authority (last visited Sept. 27, 2024).

Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices[245] [hereinafter the "Proposed Enhanced Disclosure Rule"], and (2) Investment Company Names[246] [hereinafter the "Names Rule"]. These two rules are most pertinent to asset management firms, particularly those who are offering ESG investment funds.

a. Proposed Enhanced Disclosure Rule

The SEC proposed additional amendments to the Securities Act and the Exchange Act to promote greater disclosure regarding ESG investment practices.[247] The Proposed Enhanced Disclosure Rule is aimed at helping investors make more informed decisions about sustainable finance products.[248] The proposed rule would apply to investment advisers, registered investment companies, open-end funds, exchanged traded funds ("ETF"s), closed-end funds, and business development companies ("BDC"s).[249] The proposed amendments provide a categorization framework for ESG funds. The three categories are: (1) Integration fund, (2) ESG-focused fund, and (3) Impact fund.[250]

	SEC Fund Categorization
Integration fund	Fund that considers one or more ESG factors alongside other, non-ESG factors in its investment decisions, but those ESG factors are generally no more significant than other factors in the investment selection process, such that ESG factors may not be determinative in deciding to include or exclude any particular investment in the portfolio.

245. Proposed Enhanced Disclosure Rule, *supra* note 12.
246. Names Rule, *supra* note 13.
247. Proposed Enhanced Disclosure Rule, *supra* note 12.
248. *Id.*
249. *Id.*
250. *Id.*

ESG-focused fund	1. A fund that focuses on one or more ESG factors (such as, for example, carbon emissions, board or workforce diversity or industry specific issues) by using them as a significant or main consideration: a. in selecting investments or b. in its engagement strategy with the companies in which it invests. 2. A fund that tracks an ESG-focused index or that applies a screen to include or exclude investments in particular industries based on ESG factors.
	3. A fund that has a policy of voting proxies and engaging with the management of its portfolio companies to encourage ESG practices or outcomes. 4. A fund that has a name including terms indicating that the fund's investment decisions incorporate one or more ESG factors. 5. A fund whose advertisements or sales literature indicates that the fund's investment decisions incorporate one or more ESG factors by using them as a significant or main consideration in selecting investments.
Impact fund	An ESG-Focused Fund (see above) that seeks to achieve a specific ESG impact or impacts.

The category in which a fund falls determines the amount of enhanced disclosures required.[251] These enhanced disclosures will be required in fund prospectuses, annual reports, and adviser brochures.[252] Disclosure requirements include: (i) the specific ESG factors considered and how they are incorporated into investment recommendations; (ii) a description of any ESG criteria or methodology used in investment evaluation or selection; and (iii) a description of how ESG factors are considered in voting client securities.[253] If a fund considers environmental factors as part of their investment strategy,

251. *Id.*
252. *Id.*
253. *Id.*

such fund would be required to disclose detailed information regarding the GHG emissions of their portfolios. The required GHG disclosures consist of the fund's carbon footprint and weighted average carbon intensity and would require disclosure of the portfolio companies' Scope 1 and Scope 2 emissions regardless of whether the underlying company actually published this information. Scope 3 emissions would also have to be disclosed but only if the underlying company published this information.[254] Other "impact funds" would be subject to similar requirements related to disclosure of metrics related to the particular impact in question.[255] A technological error delayed the public comment period for this proposal.[256] The rule has not yet been finalized.

b. Names Rule

On May 25th, 2022, the SEC also proposed The Names Rule amendment to update rule 35d-1 under the Investment Company Act of 1940.[257] Rule 35d-1 requires SEC registered investment companies whose names suggest a focus in a particular type of investment to implement a policy of investing at least 80% of their total assets in those investments.[258] However, it has not been updated since its adoption in 2001.[259] The Names Rule was formally adopted by the SEC in September 2023.[260]

The Name Rule aims to prevent asset management firms from "greenwashing" by using inaccurate fund names while not following through on ESG commitments. Greenwashing is "the process of conveying a false impression or misleading information about how a company's products are environmentally sound. It involves making an unsubstantiated claim to deceive consumers into believing that a company's products are environmentally friendly or have a greater positive

254. *Id.* at 253–260.
255. *Id.* at 359.
256. Press Release, SEC, SEC Reopens Comment Periods for Several Rulemaking Releases Due to Technological Error in Receiving Certain Comments (Oct. 7, 2022), https://www.sec.gov/news/press-release/2022-186.
257. Names Rule, *supra* note 13.
258. *Id.*
259. *Id.*
260. *SEC Adopts Amendments to the Names Rule Under the 1940 Act*, SIDLEY AUSTIN (Sept. 29, 2023), https://www.sidley.com/en/insights/newsupdates/2023/09/sec-adopts-amendments-to-the-names-rule-under-the-1940-act.

environmental impact than they actually do."[261] Prior to the introduction of the Names Rule, the SEC relied upon the authority in Section 10(b) of the Exchange Act and SEC Rule 10b-5 to target Greenwashing.[262] However, to prevail in such actions, the claims must be proven fraudulent and deceitful, not merely misleading.[263]

The Names Rule clarifies the aforementioned 80% requirement, updates the rule's notice requirements, and establishes recordkeeping requirements.[264] It provides very limited circumstances in which a firm may depart from its 80% commitment and lays out specific time frames for getting back into compliance.[265] The Names Rule builds off of the Proposed Enhanced Disclosure Rule by clarifying that "integration funds", which by definition do not consider ESG factors determinative in deciding whether to include or exclude any particular investment in a portfolio, may not use terminology indicating that it promotes sustainability or is incorporates ESG principles.

4. *Future Regulations*

In addition to the Climate Rules, Enhanced Disclosure Rule, and Names Rule, SEC proposals related to human capital management and board diversity are anticipated.[266] The SEC has stated that implementing additional disclosure regulations is of high priority in the future.[267] The SEC's upcoming agenda suggests that the Climate Rules, Proposed Enhanced Disclosure Rule, and Names Rule are only the beginning of US ESG disclosure rules. The Proposed Enhanced Disclosure Rule and Names Rule target ESG funds and thus do not apply broadly to companies that are not engaged in asset management.

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261. Adam Hayes, *What is Greenwashing? How it Works, Examples, and Statistics*, INVESTOPEDIA (Jan. 22, 2024), https://www.investopedia.com/terms/g/greenwashing.asp.

262. Barbara Ballan & Jason Czarnezki, *Disclosure, Greenwashing & The Future of ESG Litigation* 81 WASH. & LEE L. REV. 545 (2024).

263. *Id.*

264. Names Rule, *supra* note 13.

265. *Id.*

266. Bridget Neill et al., *Four Key SEC Priorities in 2023*, EY (Feb. 23, 2023), https://www.ey.com/en_us/public-policy/four-key-sec-priorities-in-2023.

267. *Id.*

B. *European Union*

1. *Non-Financial Reporting Directive ("NFRD")*

The EU was at the forefront of government mandated ESG disclosures with its adoption of the NFRD in 2014.[268] In an attempt to encompass a wide variety of stakeholder interests, the NFRD introduced the concept of "double materiality," which required companies to disclose not only on how sustainability issues impact financial performance, but also on how the company impacts the environment and society on a newly mandated non-financial statement.[269] Accordingly, the NFRD required companies to disclose information related to: (i) their efforts to protect the environment; (ii) how they treat their employees; (iii) how they plan to adhere to human rights; (iv) how they mitigate corruption; and (v) how they promote diversity in their work environment.[270] Though strong on climate disclosures, the NFRD provided companies with significant flexibility and discretion in reporting on social and governance factors, and did not require uniform data collection methodologies. The NFRD requires all public-interest companies with greater than 500 employees to disclose non-financial and diversity information in their annual management reports or separate filings.[271] While the NFRD does not use the terms "sustainability" or "ESG" in its title, it addresses Environmental, Social, and Governance issues explicitly in the text.

The NFRD was significant in that it was the first noteworthy effort to encourage disclosure beyond those that are not deemed to be financially material to investors. The stated aim of the NFRD is to improve accessibility of data for banks and investors and to influence financial resources towards sustainable investments.[272] However, the NFRD fell short in that its

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268. NFRD, *supra* note 8.

269. *Id.*; *Proposal for a Directive of the European Parliament and of the Council Amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as Regards Corporate Sustainability Reporting*, at 1, COM (2021) 189 final (Apr. 21, 2021).

270. *See* NFRD, *supra* note 8.

271. *What is the EU Non-Financial Reporting Directive?*, ASSENT (last visited Mar. 16, 2023), https://www.assent.com/resources/knowledge-article/what-is-the-eu-non-financial-reporting-directive/.

272. Michelangelo Bruno & Valentina Lagasio, *An Overview of the European Policies on ESG in the Banking Sector*, SUSTAINABILITY (Nov. 16, 2021), https://doi.org/10.3390/su132212641.

scope of required disclosure was limited and it did not provide adequate guidance for data collection and measurement.[273]

The European Commission acted to improve upon the NFRD by publishing Guidelines on Non-Financial Reporting in June 2017 [hereinafter the "EU Guidelines"].[274] The stated aim of the EU Guidelines is to "help companies disclose high quality, relevant, useful, consistent and more comparable non-financial (environmental, social and governance-related) information in a way that fosters resilient and sustainable growth and employment, and provides transparency to stakeholders."[275] Notably, the EU Guidelines mention the IIRC as an example of integrated reporting to serve as a disclosure structure.[276]

Further, in December 2019, as part of the "European Green Deal", the European Commission ("EC") committed to reviewing the NFRD.[277] In February 2020, the EC began a public consultation period on the review of the NFRD.[278] After a lengthy review process, they adopted a series of measures including a proposal for a Corporate Sustainability Reporting Directive ("CSRD") which expands the scope of NFRD to all listed companies and introduces reporting standards to be further developed by the European Financial Reporting Advisory Group ("EFRAG") (*See* Appendix 5).

2. *Corporate Sustainability Reporting Directive ("CSRD")*

In 2021, the EU adopted the CSRD, which like the NFRD, takes a "double materiality" approach to ESG disclosure.[279] EU member states have a deadline of 2024 to incorporate CSRD principles into their national laws.[280] The rules introduced by the NFRD remain in force until all companies are subject to the

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273. NFRD, *supra* note 8.
274. *Guidelines on Non-financial Reporting (Methodology for Reporting Non-financial Information)*, COM (2017) (Jul. 5, 2017).
275. *Id.*
276. *Id.*
277. *Non-Financial Reporting Directive, Briefing: Implementation Appraisal*, European Parliament (2021), https://www.europarl.europa.eu/RegData/etudes/BRIE/2021/654213/EPRS_BRI(2021)654213_EN.pdf.
278. *Id.*
279. Materiality discussed *supra* Section II.4 and *infra* Section V.1.b.
280. *EU Corporate Sustainability Reporting Directive Signed into Law – Implications and Near-term Compliance Steps for U.S.-based Multinationals*, Ropes & Gray (Dec. 20, 2022), https://www.ropesgray.com/en/newsroom/alerts/2022/december/eu-corporate-sustainability-reporting-directive-signed-into-law.

new rules of the CSRD.[281] It replaces and builds upon the NFRD by including additional disclosure requirements, standardizing reporting metrics, and increasing the number of EU companies subject to regulation.[282]

According to the European Commission, the CSRD is expected to apply to approximately 49,000 companies.[283] All "large companies" are subject to disclosure regulations set out in the CSRD. In this context, a "large company" is any company, whether or not it is based in the EU, with an annual turnover greater than €150M in the EU or an EU-based company that satisfies two of the following three criteria: (1) exceeds €40M in net turnover annually; (2) exceeds €20M in Assets; or (3) employs over 250 individuals.[284]

Importantly, the CSRD requires companies to follow the reporting standards and metrics established thereunder, rather than those promulgated by other organizations.[285] This amendment furthers the improvement of comparability of information between companies. Additionally, the CSRD makes it mandatory for companies to have an independent audit of the sustainability information they report at the same audit standard required of financial statements.[286]

The disclosure regulations of the CSRD are far-reaching and will affect companies outside of the EU. The CSRD applies to EU subsidiaries with non-EU parent companies and all companies that are listed on an EU trade market or otherwise have significant business with the EU. Many other international companies will be impacted by the implementation of CSRD due

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281. *Corporate Sustainability Reporting*, EUROPEAN COMMISSION (last visited Apr. 17, 2023) https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en.

282. Alexander Schmidt & Evan Farbstein, *The Corporate Sustainability Reporting Directive (CSRD), Explained*, NORMATIVE (Feb. 8, 2023), https://normative.io/insight/csrd-explained/.

283. Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting, COM (2021) 189 final (Apr. 21, 2021).

284. *Id.*

285. *Id.*

286. Peter Wollmert & Andrew Hobbs, *How the EU's New Sustainability Directive is Becoming a Game Changer*, EY (Aug. 1, 2022), https://www.ey.com/en_gl/insights/assurance/how-the-eu-s-new-sustainability-directive-is-becoming-a-game-changer.

to reporting companies' "value chain" due diligence obligations. These companies connected through the value chain to CSRD-regulated companies will be required to complete ESG due-diligence questionnaires and will be held accountable by their EU-based connections.

Companies subject to the CSRD receive additional guidance on their disclosure reports from the European Sustainability Reporting Standards ("ESRS"). EFRAG published draft European Sustainability Reporting Standards in November 2022.[287] The European Commission adopted the standards in July 2023 for use by all companies subject to the CSRD.[288] The ESRS requires disclosure through standardized sustainability reports, as opposed to the non-financial statements utilized for disclosure under the NFRD.[289] ESRS categorizes ESG issues into the following four areas:

a. Cross-Cutting

Prior to setting forth specific metrics in subsequent ESRS's, EFRAG provides guidance on methodology and data collection to ensure that companies are utilizing standardized processes and data in formulating their reports. Similarly, companies are now required to disclose relevant information on standardized Sustainability Reports, which replace non-financial statements.[290]

b. Environment

In addition to mandating detailed descriptions of a company's transition and mitigation strategies, the CSRD mandates detailed climate disclosure metrics.[291] Companies must now disclose: (i) total amount of energy consumption by source, in mWh; (ii) Scope 1 emissions; (iii) Scope 2 emissions; (iv) Scope 3 emissions; (v) total GHG emissions in metric tons of carbon and per monetary unit; (vi) total GHG removals, with description of removal activity, from its own operations and

287. *Draft European Sustainability Reporting Standards (ESRS)*, EFRAG (2022), https://www.efrag.org/lab3 [hereinafter "ESRS"].

288. *The Commission adopts the European Sustainability Reporting Standards*, EUROPEAN COMMISSION (July 31, 2023), https://finance.ec.europa.eu/news/commission-adopts-european-sustainability-reporting-standards-2023-07-31_en.

289. ESRS, *supra* note 287 at 1.

290. *Id.* at 1, 2.

291. *Id.* at E1-1 to 1-2.

value stream; (vii) GHG mitigation projects financed through carbon credits; (viii) avoided GHG emissions, with details on assumptions, data sources, and methodology utilized; and (ix) measurable targets for climate change mitigation and adaptation. Except where noted otherwise, the above disclosures must be reported in metric tons of carbon.[292]

The CSRD contains mandated detailed disclosure metrics for pollution, water preservation, and resource use. Companies must disclose measurable targets for pollution, and their actual pollution in identifiable quantities such as total volume of emitted pollutants or amount of particular pollutants identified in the accompanying appendix, as well as the potential financial effects from such pollution.[293] Similarly, companies must disclose measurable targets for water and marine resource preservation and their water management performance by total cubic meters of water consumed, and by monetary unit.[294] Relatedly, companies must disclose the nature and quantity of marine commodities used, such as gravels, deep-sea-minerals, and seafood, in tons.[295] Finally, companies are required to disclose the total weight of materials used during the reporting period, in both absolute tons and as a percentage of renewable input materials used to manufacture products and packaging, and their total amount of waste generated in tons.[296]

c. Social

The CSRD requires companies to disclose detailed information regarding policies towards their workforce. Such disclosures must include descriptions of employee grievance processes and various strategies to improve company performance related to the following workforce disclosure metrics, which also must be disclosed: (i) characteristics of employees by gender; (ii) percentage of employees covered by health and safety management system; (iii) the number and rate of workplace injuries and fatalities; (iv) percentage of workers working more than 48 hours per week; (v) percentage of employees entitled to take family-related leaves, and those who actually

292. *Id.* at E1-3 to 1-14.
293. *Id.* at E2-1 to 2-7.
294. *Id.* at E3-1 to 3-6.
295. ESRS, *supra* note 287.
296. *Id.* at E5-1 to 5-6.

took such leave; (vi) percentage of employees whose wage is below the fair wage; (vii) ratio of compensation between men and women; (viii) total number of discrimination and harassment incidents; (ix) amount and percentage of employees with disabilities; (x) percentage of employees covered by collective bargaining agreements; and (xi) the number of data breaches involving worker data.[297]

Companies are also responsible to workers in their value chain and communities affected by their business operations and must disclose their mechanisms for ensuring such workers and communities are not subject to human rights violations.[298]

d. Governance

The CSRD imposes disclosure requirements related to a company's governance, risk management, and internal controls, including detailed descriptions of their codes of conduct, and management nomination and risk management processes. Companies are also required to disclose their governance structure and composition, including disclosures related to the gender, age, inclusion in a minority or vulnerable group, and educational background of their administrative, management, and supervisory bodies, as well as their attendance rate at meetings.[299]

Companies must also make significant disclosures regarding their anti-corruption and anti-bribery safeguards, including the number of investigations and decisions related to the same.[300] Relatedly, companies must disclose the identity of their beneficial owners and the total monetary value of financial and in-kind political contributions by members of their administrative, management, and supervisory bodies.[301] Finally, given the importance of timely cash flows to business partners, companies must disclose the average time it takes to pay an invoice in number of days.[302]

The CSRD entered into force on January 5, 2023. However, as a European Directive, it must be implemented by each EU member state's national legislation to create obligations on

297. *Id.* at S1-1 to 1-26.
298. *Id.* at S2-1 to 2-6, and S3-1 to 3-6.
299. *Id.* at G1-1 to 1-10.
300. *Id.* at G2-3, G2-7.
301. ESRS, *supra* note 287 at G2-8 to 2-9.
302. *Id.* at G2-10.

the underlying companies. The EU member states have until June 16, 2024, to transpose the CSRD into their national laws.[303]

3. *Sustainable Finance Disclosure Regulation ("SFDR")*

In 2019, the EU passed the SFDR and in March 2021, its main provisions became applicable.[304] The stated aim of the SFDR is to improve transparency in the market for sustainable investment products and to prevent "greenwashing."[305] The SFDR achieves these goals through disclosure requirements on ESG metrics at both the entity and the [financial] product level.[306]

The scope of the SFDR is different from that of the NFDR. Instead of applying to companies generally, the SFDR applies to asset management firms, financial advisers, and insurance providers in the EU, whether or not they purport to offer sustainable investment products.[307]

Under the SFDR, all asset management firms must release "core disclosures" regarding the entities' sustainability risks and principal adverse impacts. Also, for those asset management firms that offer sustainable investment products, the SFDR establishes three product categorizations: Article 9, Article 8, and Article 6.[308] "Article 9" or "dark green" products have a clear sustainable investment objective.[309] "Article 8" or "light green" products promote environmental and/or social goals but do not prioritize sustainable investing as a core objective.[310] Lastly, "Article 6" products integrate ESG risk considerations in investment decision-making but do not meet the criteria of

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303. Michael R. Littenberg & Clara Melly, *EU Corporate Sustainability Reporting Directive Signed into Law – Implications and Near-term Compliance Steps for U.S.-based Multinationals*, Ropes & Gray (Dec. 20, 2022), https://www.ropesgray.com/en/newsroom/alerts/2022/december/eu-corporate-sustainability-reporting-directive-signed-into-law.

304. EU Regulation 2019/2088 on Sustainability-related Disclosures in the Financial Services Sector 2019, SI 2019/2088 (UK).

305. *Id.*

306. *Id.*

307. Maia Godemer, *The Relationships Between SFDR, NFRD and EU Taxonomy*, Bloomberg (Mar. 31, 2021), https://www.bloomberg.com/professional/blog/the-relationships-between-sfdr-nfrd-and-eu-taxonomy/.

308. *EU SFDR Explained: A guide to the EU Sustainable Finance Disclosure Regulation for investors*, J.P. Morgan Asset Management, https://am.jpmorgan.com/us/en/asset-management/institutional/investment-strategies/sustainable-investing/understanding-SFDR/ (last updated Sep. 25, 2023).

309. *Id.*

310. *Id.*

Article 8 or Article 9 products.[311] Disclosures regarding risk and principal adverse impacts must also be made at the [financial] product level.[312] More detailed disclosures are required for all Article 8 and Article 9 products.

	SFDR Fund Categorization
Article 9 "Dark green"	Clear sustainable investment objective
Article 8 "Light green"	Promote environmental and/or social goals but do not prioritize sustainable investing as a core objective
Article 6	Integrate ESG risk considerations in investment decision-making but do not meet the criteria of Article 8 or Article 9 products

4. *Taxonomy Regulation*

The SFDR requires firms to disclose whether and to what extent financial products qualify as "sustainable" under the EU Taxonomy. The EU Taxonomy is an accompanying regulation to the SFDR, also part of the Green New Deal, which became effective January 2022.[313] The Taxonomy Regulation creates a uniform set of ESG-related definitions and establishes four requirements that an economic activity must meet to be referred to as "environmentally sustainable."[314] These requirements include: (1) make a substantial contribution to at least one of the six environmental objectives (climate change mitigation, climate change adaptation, sustainable use of water and marine sources, circular economy, pollution prevention, and healthy ecosystems and biodiversity); (2) do no significant harm to any of the other environmental objectives; (3) comply with minimum social safeguards; and (4) comply with the

311. *Id.*

312. EU Regulation 2019/2088 on Sustainability-related Disclosures in the Financial Services Sector 2019, SI 2019/2088 (UK).

313. EU Regulation on the Establishment of a Framework to Facilitate Sustainable Investment 2020, SI 2020/852 (UK); *see also* Serena Espeute, *SFDR and EU Taxonomy Disclosures: Four Data Challenges for Asset Managers*, CFA Inst. (Feb. 27, 2023), https://blogs.cfainstitute.org/marketintegrity/2023/02/27/levelling-the-playing-field-firms-find-difficulties-reporting-sfdr-and-eu-taxonomy-disclosures/.

314. EU Regulation on the Establishment of a Framework to Facilitate Sustainable Investment 2020, SI 2020/852 (UK).

technical screening criteria.[315] This regulation is particularly relevant to asset managers who seek to offer "green" or "social" funds purporting to promote ESG goals.[316] The definitions and requirements established by the Taxonomy Regulation will serve as guiding principles for EU asset management firms making sustainability claims.

5. *Directive Banning Greenwashing*

In January 2024, the European Parliament approved a new anti-greenwashing law banning misleading product sustainability claims (hereinafter "Greenwashing Directive").[317] This directive applies to consumer products as opposed to the scope of the Taxonomy regulation, which applies to financial products. The goal of the directive is to require that companies furnish proof when they make claims regarding the environmental attributes of a product (such as "environmentally friendly", "natural", "biodegradable", "climate neutral" or "eco"). The directive is meant to work together with the Green Claims Directive ("GCD")

C. *United Kingdom*

The United Kingdom published the UK Companies Act in 2006.[318] Section 172(1) of the Act recognizes the duty of directors to consider various stakeholder interests.[319] This provision creates a directorial duty to disclose non-financial information.[320] In 2014, at the time the EU NFRD[321] was passed, the UK was still part of the EU. For that reason, UK companies were subject to NFRD disclosure requirements. However, shortly after the UK left the EU due to Brexit in 2020, the Financial Conduct

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315. Peter Walsh, *EU Taxonomy Explained: Breaking Down the 4 Criteria for Sustainability & ESG*, BENCHMARK GENSUITE, (June 11, 2021), https://benchmarkgensuite.com/ehs-blog/eu-taxonomy-explained-4-criteria-for-esg/. For more information about technical screening criteria see *Breaking Down the EU Taxonomy's Technical Screening Criteria: What you need to know*, CELSIA Feb. 24, 2023), https://www.celsia.io/blogs/breaking-down-the-eu-taxonomys-technical-screening-criteria-what-you-need-to-know.

316. Espeute*, supra* note 313.

317. Greenwashing Directive, *supra* note 10.

318. Companies Act 2006, c. 46 (UK).

319. *Id.* at § 172(1).

320. PALMITER, *supra* note 39, at 354.

321. NFRD discussed *supra* IV.2.a.

Authority ("FCA") acted to develop its own regulations related to general company ESG disclosure and more targeted regulations for funds and sustainable investment.[322]

1. *Climate-Related Financial Disclosures Requirement ("CFD")*

On January 17, 2022, the UK amended Sections 414C, 414CA, and 414CB of the 2006 Companies Act.[323] Amendments made by the Companies Regulation 2022[324] and the Limited Liability Partnership Regulation 2022[325] are collectively referred to as the Climate-Related Financial Disclosures Requirement ("CFD"). Lacking some of the quantitative teeth contained in the SEC proposal, the CFD established a standardized climate reporting regime whose scope covers more than just publicly traded companies. The CFD applies to 1,300 of the largest UK-registered companies and financial institutions. The UK's largest traded companies, banks, and insurers in addition to private companies with over 500 employees and more than £500M in turnover must disclose climate-related information in their strategic report.[326] The CFD also applies to banking institutions and insurance companies.[327]

The Department for Business, Energy & Industrial Strategy has published guidance for complying with the CFD.[328] Under the CFD, companies are to disclose the following information:

"(a) a description of the company's governance arrangements in relation to assessing and managing climate-related risks and opportunities;

322. Fin. Conduct Auth., Sustainability Disclosure Requirements (SDR) and Investment Labels, 2023, PS 23/16 (UK).

323. Martin Farrar, *Climate Disclosure Requirements Set to Take Effect in UK*, FIN. MGMT. MAG. (Jan. 25, 2022), https://www.fm-magazine.com/news/2022/jan/climate-disclosure-requirements-uk.html.

324. The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022, SI 2022/31 (UK), https://www.legislation.gov.uk/uksi/2022/31/made.

325. The Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022, SI 2022/46 (UK), https://www.legislation.gov.uk/uksi/2022/46/contents/made.

326. CFD, *supra* note 11.

327. *Id.*

328. *Mandatory Climate-related Financial Disclosures by Publicly Quoted Companies, Large Private Companies and LLPS*, DEP'T FOR BUS., ENERGY & INDUS. STRATEGY (Feb. 2022), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1056085/mandatory-climate-related-financial-disclosures-publicly-quoted-private-cos-llps.pdf.

(b) a description of how the company identifies, assesses, and manages climate-related risks and opportunities;
(c) a description of how processes for identifying, assessing, and managing climate-related risks are integrated into the company's overall risk management process;
(d) a description of —
 (i) the principal climate-related risks and opportunities arising in connection with the company's operations, and
 (ii) the time periods by reference to which those risks and opportunities are assessed;
(e) a description of the actual and potential impacts of the principal climate-related risks and opportunities on the company's business model and strategy;
(f) an analysis of the resilience of the company's business model and strategy, taking into consideration different climate-related scenarios;
(g) a description of the targets used by the company to manage climate-related risks and to reali[z]e climate-related opportunities and of performance against those targets; and
(h) a description of the key performance indicators used to assess progress against targets used to manage climate-related risks and reali[z]e climate-related opportunities and of the calculations on which those key performance indicators are based."

Unlike the NFRD/CSRD and the SEC Climate Rules, the CFD does not require that companies calculate and disclose their GHG emissions.[329]

The CFD takes a scenario analysis approach. Companies must analyze how their business will be impacted by varying increases in global temperature.[330] Companies must disclose their analyses of how future scenarios, such as a global temperature increase of 1.5 degrees versus 3.0 degrees impacts their

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329. CFD *supra* note 11.
330. Mandatory Climate-related Financial Disclosures by Publicly Quoted C Companies, Large Private Companies and LLPS, supra note 328, at 14-15.

business model. While mandating disclosure of assumptions and estimates relied upon, the government recognizes that significant divergence in methodologies, assumptions, and estimates, without providing guidance on how to remediate such divergence.[331]

Finally, the CFD requires disclosure of climate targets, including timeframe, and key performance indicators ("KPIs") related to meeting same.[332]

2. *Sustainable Disclosure Requirements & Investment Labels ("SDR")*

The UK also has plans to regulate sustainable investment. In November 2021, the FCA introduced a discussion paper (DP 21/4) on the topic of Sustainable Disclosure Requirements and Investment Labels [Hereinafter collectively the "SDR"].[333] One year later, the FCA released a consultation paper (CP22/20) on the same topic.[334] The comment period for the consultation paper ended in January 2023 and the FCA stated that they planned to publish its final rules in guidance in a policy statement by the end of June 2023.[335] However, the FCA posted an update on March 29, 2023 stating that they planned to publish the Policy Statement later, in 2023, to account for the significant response during the comment period.[336] Policy Statement 23/16 (SDR) was finally published on November 28, 2023.[337]

The SDR introduces the following: (1) a general anti-greenwashing rule; (2) sustainable investment classification and labels; (3) consumer-facing disclosures on investment products; (4) detailed disclosures focusing on pre-contractual

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331. *Id.* at 15.
332. *Id.* at 16-17.
333. Fin. Conduct Auth., Sustainability Disclosure Requirements (SDR) and Investment Labels, 2021, DP 21/4 (UK), https://www.fca.org.uk/publication/discussion/dp21-4.pdf.
334. SDR, *supra* note 16.
335. Rita Hunter et al., *Sustainability Disclosure Requirements for the UK: Where are we now?*, HOGAN LOVELLS (Feb. 1, 2023), https://www.engage.hoganlovells.com/knowledgeservices/news/sustainability-disclosure-requirements-for-the-uk-where-are-we-now.
336. FCA Updates On Its Sustainability Disclosure Requirements (SDR) and Investment Labels Consultation, FIN. CONDUCT AUTH. (Mar. 29, 2023), https://www.fca.org.uk/news/news-stories/fca-updates-sustainability-disclosure-requirements-and-investment-labels-consultation.
337. Fin. Conduct Auth., Sustainability Disclosure Requirements (SDR) and Investment Labels, 2023, PS 23/16 (UK).

disclosures, ongoing sustainability-related performance information, and sustainability entity reports; (5) naming and marketing rules restricting the use of certain terms (such as "green" or "sustainable"); and (6) requirements on distributors to provide sustainable investment labels and consumer-facing disclosures to retail investors.[338]

a. General Anti-Greenwashing Rule

The FCA Handbook Principles for Business (PRIN) 2.1, Principle 7,[339] and COBS (Conduct of Business Sourcebook) 4.2.1[340] already require that all communications by regulated firms (which includes asset management firms) must be clear, fair, and not misleading. The FCA added a new section to its handbook: The ESG sourcebook.[341] The ESG sourcebook further imposes a requirement for sustainability claims of financial products to be not only clear, fair, and not misleading but also "consistent with TCFD Recommendations and Recommended Disclosures".[342] This general anti-greenwashing rule establishes a cause of action to assist FCA enforcement. This rule will come into effect May 31, 2024.[343]

b. Sustainable Investment Classification and Labels

By using sustainable investment classification and labels, the FCA attempts to help consumers distinguish between investment products based on their sustainability characteristics, themes, and outcomes in addition to the different types of sustainability products offered by asset managers.[344] Under the SDR, Asset management firms offering sustainable investment products have the option to classify their product under one of

338. *Id.*
339. Fin. Conduct Auth., FCA Handbook at PRIN 2.1 The Principles (2023), https://www.handbook.fca.org.uk/handbook/PRIN/2/1.html.
340. Fin. Conduct Auth., FCA Handbook at COBS 4.2 Fair, Clear and Not Misleading Communications (2018), https://www.handbook.fca.org.uk/handbook/COBS/4/2.html.
341. Fin. Conduct Auth., *Environmental, Social and Governance Sourcebook, in* FCA Handbook (2023), https://www.handbook.fca.org.uk/handbook/ESG.pdf.
342. *Id.* at 2.
343. Fin. Conduct Auth., Sustainability Disclosure Requirements (SDR) and Investment Labels, 2023, PS 23/16, at 12 (UK).
344. *Id.*, at 91–114.

three labels: (1) Sustainable focus; (2) Sustainable improvers; and (3) Sustainable impact.[345]

	FCA Sustainable Investment Labels
Sustainable focus	Invest in assets which a reasonable investor would consider environmentally and/or socially sustainable 70%+ of the assets must meet a credible standard of environmental and/or social sustainability or align with an explicit environmental and/or social sustainability theme Pursuit of sustainability goals through market-led channel of influencing asset prices Investor stewardship activities that pursue improvements in the sustainability performance of assets
Sustainable improvers	Invest in assets not environmentally and/or socially sustainable at the present Goal of improving sustainability profile of products assets over time (measurable) Intentional selection of portfolio assets of products best placed to improve sustainability over time Investor stewardship activities that pursue improvements in the sustainability performance of assets
Sustainable impact	Objective to obtain a measurable, positive, pre-defined environmental and/or social impact Sustainability goals pursued by directing new capital to projects and activities that offer solutions to environmental and/or social problems Investor stewardship activities that pursue improvements in the sustainability performance of assets

The FCA contemplates that not all ESG-oriented investment products will fall into one of the three aforementioned categories. For example, products that generally consider ESG

345. Hunter et al., *supra* note 335.

metrics or ESG risks but do not have a sustainability objective will not qualify for a sustainable investment label.[346] The labeling rules will come into effect July 31, 2024.[347] Use of the labels is completely optional and would require an opt-in by asset management firms. However, it is likely that it will become an industry standard in the UK once adopted by competitors.

c. Consumer Facing Disclosures on Investment Products

Consumer facing disclosure requirements will apply to asset management firms marketing investment products making claims about sustainability regardless of whether or not they use sustainable investment labels for their products.[348] The firms must make information about the sustainability-related features including a stated goal, sustainability metrics used, and the sustainable investment label used (if applicable) available to consumers.[349] This disclosure must be located somewhere accessible and prominent, such as on the asset manager's website.[350] The consumer facing disclosure requirements come into effect provisionally on December 2, 2024.[351] All consumer-facing disclosures must be reviewed and updated annually. In addition, any changes to the disclosure statements must be reviewed as well.

d. Detailed Disclosures Focusing on Pre-Contractual Disclosures, Ongoing Sustainability-Related Performance Information, and Sustainability Entity Reports

Additionally, more in-depth disclosure will be required on the product-level and entity-level.[352] These disclosures are aimed at institutional investors such as pension funds, involved shareholders, and retail investors.[353] The more detailed disclosures

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346. William Yonge et al., *UK Asset Managers: FCA Proposes New Sustainability Disclosure And Labelling Requirements*, MORGAN LEWIS (Dec. 20, 2022), https://www.morganlewis.com/pubs/2022/12/uk-asset-managers-fca-proposes-new-sustainability-disclosure-and-labelling-requirements.

347. Fin. Conduct Auth., Sustainability Disclosure Requirements (SDR) and Investment Labels, 2023, PS 23/16 (UK), at 12.

348. *Id.* at 49–54.

349. *Id.* at 50–54.

350. *Id.* at 54.

351. *Id.* at 181.

352. *Id.* at 7.

353. Yonge et al., *supra* note 346.

will provide institutional investors with better information to monitor the progress of companies ongoing sustainability performance.

These product-level details will be integrated into two existing types of documentation: (1) Fund offering memorandum or prospectus or prior information document; and (2) Sustainability product report (based on the TCFD product report).[354] Only products using a sustainable investment label will be required to disclose a full sustainability product report containing information on investment strategy, performance against key performance indicators ("KPI"), and stewardship-related efforts. The precontractual disclosures and sustainability product reports will come into effect June 30, 2024, and June 30, 2025, respectively.[355]

In addition, asset management firms must issue a sustainability report on an entity-level describing how they are managing sustainability risks and opportunities. Starting December 2, 2025, asset managers with more than £50B AUM must make this disclosure and starting December 2, 2026, asset managers with more than £5B AUM must follow suit. Asset management firms with less than £5B AUM will be exempt under this entity-level disclosure regime for the time being.[356]

e. Naming and Marketing Rules Restricting the Use of Certain Terms

The SDR also imposes restrictions on the use of certain terms when marketing sustainable investment products. Starting June 30, 2024 asset management firms will be prohibited from using the terms "Sustainable Goals ('SG')", "climate", "impact", "sustainable", "sustainability", "responsible", "green", "sustainable development goals", "Paris-aligned", or "net zero" if they do not qualify for one of the four sustainable investment labels.[357] Portfolio managers will have until December 2, 2024, to become compliant.[358]

354. Fin. Conduct Auth., Sustainability Disclosure Requirements (SDR) and Investment Labels, 2023, PS 23/16 (UK) at 55.
355. *Id.* at 71, 195–205.
356. *Id.* at 12.
357. *Id.* at 174.
358. *Id.*

f. Requirements on Distributors to Provide Sustainable Investment Labels and Consumer-Facing Disclosures to Retail Investors

Lastly, the SDR imposes requirements on distributors to ensure relevant sustainable investment labels and consumer-facing disclosures are made available to retail investors. Distributors, including investment platforms must clearly display sustainable investment labels on their platforms and provide full access to consumer-facing disclosures.[359] Distributors will also be held liable for using inaccurate labels or terms. All distributors must come into compliance with this rule by June 30, 2024.[360]

IV.
Interplay Between Different Regulations

For the purposes of analysis, this paper will divide governmental disclosure regulations into two categories: (1) general company disclosure regulations and (2) fund and investment specific disclosure regulations. In the US, the Climate Rules are a general company disclosure regulation. Its EU counterparts are the NFRD and the CFRD. The UK general disclosure rule is the CFD. Conversely, in the US, the Enhanced Disclosure Rule and the Names Rule are fund and investment specific disclosure regulations. The EU SFDR and Taxonomy regulation similarly limit their scope to funds and investment, as does the UK SDR.

	US	EU	UK
General company disclosure regulations	Climate Rules	NFRD, CFRD, Greenwashing Directive	CFD
Fund and investment specific regulations	Enhanced Disclosure Rule (proposed), Names Rule	SFDR, Taxonomy Regulation	SDR

359. *Id.* at 62.
360. Fin. Conduct Auth., Sustainability Disclosure Requirements (SDR) and Investment Labels, 2023, PS 23/16 (UK) at 71, 195–205.

A. *General Company Disclosure Regulations*

1. *Scope*

The Climate Rules apply to SEC registrants, which includes approximately 12,000 public companies, 4,600 mutual funds, 11,300 investment advisers, 600 transfer agencies, and 5,500 broker dealers for a total of 30,000 registrants.[361] Approximately 1,150 of the public companies registered with the SEC are non-US companies.[362] The Climate Rules do not apply to privately traded companies and most Small to Medium-Sized Enterprises ("SMEs").

When first enacted in 2014, The NFRD was limited in its scope, covering only public-interest companies with greater than 500 employees.[363] However, the CSRD broadened the EU's reach by extending its application to listed SMEs and "large" companies: EU-based companies that satisfy two of the following three criteria: (1) exceeds €40M in net turnover annually; (2) exceeds €20M in Assets; or (3) employs over 250 individuals.[364] The CSRD also applies to non-EU companies with a turnover of above €150M.[365] An estimated 50,000 companies will be subject to the regulation.[366]

In the UK, all UK-based companies with more than 500 employees and are either publicly traded or have a gross revenue of £500M and over fall under the CFD disclosure requirements.[367] Banking institutions and insurance companies are also subject to the CFD.[368]

The differing jurisdictional scope of the US Climate Rules, the EU NFRD and CSRD, and the UK CFD will result in some Multinational Asset Management Firms being subject to two

361. *US Securities and Exchange Commission (SEC)*, DELOITTE, https://www.iasplus.com/en/resources/regional/sec (last visited Apr. 29, 2023).
362. *Id.*
363. NFRD, *supra* note 8.
364. *Id.*
365. *Id.*
366. *Id.*
367. The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022, SI 2022/31, § 3(h), Explanatory Note (UK); The Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022, SI 2022/46, §§ 2(1A), 4(2).
368. The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022, SI 2022/31, Explanatory Note (UK); The Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022, SI 2022/46, § 2(2).

or three of the regulatory regimes discussed *supra* Section III. Large Multinational Asset Management Firms including BlackRock, State Street, and Vanguard will likely find themselves exposed to governmental regulation across three key jurisdictions. For example, any company based in the UK or otherwise with a UK-based subsidiary that is registered with the SEC and has a turnover of above €150M must bide by all three disclosure regulations. Comparing each regulation's scope would take the form of a complicated triple Venn diagram.

2. *Materiality*

"Materiality" as it relates to ESG disclosure regulations is discussed *supra* Section I.D. The TCFD[369] recommends incorporating the concept of "double materiality" into ESG disclosure rules. The EU NFRD and CSRD and the UK CFD and SDR have embraced the concept of "double materiality," which refers to "how corporate information can be important both for its implications about a firm's financial value, and about a firm's impact on the world at large, particularly with regard to climate change and other environmental impacts."[370] The SEC Climate Rules reject the concept of "double materiality" and is precise in its use of the word "material." The Climate Rules make clear that the SEC's "objective is limited to advancing the [SEC]'s mission to protect investors, maintain fair, orderly, and efficient markets, and promote capital formation by providing disclosure to investors of information important to their investment and voting decisions".[371]

This political battle over materiality is likely to continue in the US in the next few years. However, the increasingly globalized nature of financial markets means that in the future, ESG disclosure will become a prerequisite for participating fully in the international economy. It will become more difficult for one to argue that ESG disclosure requirements are not "material" if failing to make such disclosures will prohibit a company from reaching consumers in the EU and UK. Therefore, it would be a violation of fiduciary duty for companies to refuse to make

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369. TCFD discussed *supra* Section II.D.

370. Henry Engler, *"Double Materiality": New legal concept likely to play in debate over SEC's climate plan*, THOMSON REUTERS (Apr. 12, 2022), https://www.thomsonreuters.com/en-us/posts/investigation-fraud-and-risk/sec-double-materiality-climate/.

371. The Climate Rules, *supra* note 7.

ESG considerations and accompanying disclosures, effectively pre-empting full participation in regulated jurisdictions. While the conceptual debate regarding materiality and fiduciary duties is likely to continue in the US, the EU CSRD and UK CRD's far-reaching disclosure requirements will subject many US companies including MAMFs to their "double materiality" disclosure regime. US companies with EU or UK presence will be required to adhere to more stringent disclosure and marketing standards than those required domestically. Companies that don't directly market to the EU or the UK may even find themselves filling out due-diligence questionnaires as a result of being connected through the value chain to CSRD-regulated companies.

3. *Opting Out*

It is unclear whether asset management firms will be able to "opt out" of certain disclosure regulations if they demonstrate they have been compliant with an alternative jurisdiction's regulation.[372] The US Climate Rules invited public comment on whether it should consider routes of alternative compliance.[373] However, the draft rule does not currently contain a provision recognizing other jurisdictions' disclosure requirements in lieu of its own.[374] The ESRS does not allow for other reporting standards to be used in lieu of those set by the CSRD.[375] Meanwhile, the FCA CFD does not contain or allude to an opting-out provision.[376] Without the option to "opt-out" with proof of alternative regulatory compliance, MAMFs will find themselves filling out somewhat repetitive ESG disclosure forms pursuant to each government regulation.

B. *Fund and Investment Specific Disclosure Regulations*

The US, EU, and UK have all introduced their own classification or labeling system for ESG funds. The US proposed

372. The authors of this paper are skeptical that the SEC will be able to work out a substituted compliance agreement with the EU. *See* Lamar Johnson, *Gensler: EU regulations would take precedence without SEC climate rule*, ESGDive, (Dec. 8, 2023), https://www.esgdive.com/news/gensler-eu-regulations-would-apply-without-sec-climate-disclosure-rule-csrd/702029/.

373. *Id.*

374. The Climate Rules, *supra* note 7 at 21668.

375. Haddon et al., *supra* note 82.

376. Fin. Conduct Auth., Sustainability Disclosure Requirements (SDR) and Investment Labels, 2023, PS 23/16 (UK).

Enhanced Disclosure Rule introduces the following sustainable fund categories: "Integration fund," "ESG-focused fund," and "Impact fund" while the Names Rule requires asset management firms offering sustainable funds to consistently commit 80% of their assets towards the pre-defined goal.[377] The EU SFDR similarly creates a fund classification system. All funds in the EU will be classified as "Article 9," "Article 8," or "Article 6."[378] The Taxonomy Regulation supplements the SFDR and provides additional guidance on categorizing sustainable investment products.[379] The Federal Conduct Authority of the UK has established its own Sustainable Investment Labeling System. UK funds will fall into one of the three following categories: "Sustainable focus," "Sustainable improvers," or "Sustainable impact."[380] Other provisions of the UK SDR restrict the use of certain terms ("Sustainable Goals ('SG')," "climate," "impact," "sustainable," "sustainability," "responsible," "green," "sustainable development goals (SDG)," "Paris-aligned," or "net zero") if funds do not qualify for one of the three sustainable investment labels.[381] It is notable that the UK seems to establish a more lenient threshold than the US by requiring 'Sustainable Focus' funds to commit 70% as opposed to 80% of their assets towards the stated goal.

MAMFS often market in all three sovereignties and as a result, must design their funds according to the restrictions and classifications imposed by the US Proposed Enhanced Disclosure Rule and Names Rule, EU SFDR and Taxonomy Regulation, and UK SDR. However, the classification systems are not transferable. For example, terms recognized under the US and EU regulations such as "integration fund" or "Article 8" will not qualify for a sustainable investment label in the UK unless they are paired with an explicit sustainability objective.[382]

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377. *See* Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices, 87 Fed. Reg. 36654 (June 17, 2022) (to be codified 17 C.F.R. 200, 230, 232, 239, 249, 274, 279); *see also* Investment Company Names, 88 Fed. Reg. 70436 (Oct. 11, 2023) (to be codified at 17 C.F.R. Pts. 230, 232, 239, 270 and 274).

378. *See* EU Regulation 2019/2088 on Sustainability-related Disclosures in the Financial Services Sector 2019, SI 2019/2088 (UK).

379. *See* EU Regulation on the Establishment of a Framework to Facilitate Sustainable Investment 2020, SI 2020/852 (UK).

380. Hunter et al., *supra* note 335.

381. Discussed *supra* Section III.C.2.e.

382. Yonge et al., *supra* note 346.

The FCA SDR Consultation paper recognizes the incompatibility of these three systems. The FCA Consultation paper concedes that "many UK firms are already subject to the EU SFDR [in respect of their EU business] and have already invested in systems and processes to classify products according to the SFDR provisions."[383] For that reason, it provides flowcharts demonstrating how the SFDR classifications and the SEC labels relate to the FCA sustainable financial product labels (*See* Appendices 6 and 7).[384]

C. *Further Standardization*

There is a general trend of consolidation and harmonization amongst voluntary disclosure frameworks and the government regulations.[385] Chief Executive Officer of the Global Reporting Initiative, Tim Mohin challenges the perception that the various disclosure and reporting mechanisms conflict with each other. He explains that:

> "[T]here is an increasing amount of harmonization in this space, whether it be GRI, or the UN Global Compact, SASB or the IIRC. Not only do we have longstanding partnerships with those organizations and others, but we are in fact all just after the same thing, which is sustainable development."[386]

383. Fin. Conduct Auth., Sustainability Disclosure Requirements (SDR) and Investment Labels, 2023, PS 23/16 (UK) at 35.

384. Fin. Conduct Auth., Sustainability Disclosure Requirements (SDR) and Investment Labels, 2022, CP 22/20 (UK) at 83.

385. *See, e.g.*, Robert G. Eccles, *A Comparative Analysis of Three Proposal for Climate-Related Proposals*, FORBES (June 11, 2022), https://www.forbes.com/sites/bobeccles/2022/06/11/a-comparative-analysis-of-three-proposals-for-climate-related-disclosures/?sh=1154314e4e89; *see also*, Myriam Azzouz & Antonin Brisson-Félix, *Navigating the Sea of Proposed Climate-Related Disclosures: A Deep Dive Into the SEC's, ISSB's and EFRAG's Proposals*, NATIXIS CORP. INVESTING AND BANKING (June 3, 2022), https://gsh.cib.natixis.com/our-center-of-expertise/articles/navigating-the-sea-of-proposed-climate-related-disclosures-a-deep-dive-into-the-sec-s-issb-s-and-efrag-s-proposals; *see also*, Kimberley R. Anderson et al., *The SEC's Anticipated Climate-Related Disclosures Proposal and its Implications for the Energy and Natural resources Industries, The Foundation for Natural Resources and Energy law Annual Institute*, 68 NAT. RES. & ENERGY L. INST. 2, (July 21-23, 2022); *see also*, The SustainAbility Institute by ERM & Persefoni, *The Evolution of Sustainability Disclosure: Comparing the 2022 SEC, ESRS, and ISSB Proposals,* https://www.sustainability.com/globalassets/sustainability.com/thinking/pdfs/2022/comparing-the-sec-efra-and-issb.pdf.

386. Robert G. Eccles, *supra* note 92.

The US Climate Rules, the EU NFRD and CFRD, and the UK CFD each incorporate certain elements of the GHG Protocol Corporate Standard[387], The TCFD framework[388] the ISSB recommendations[389] into their ESG disclosure frameworks to varying degrees.[390] The adoption of well-established voluntary disclosure frameworks into government regulations reduces the regulatory burden on Multinational Asset Management Firms.

V.
Commonalities & Recommendations

Recent commentary has attempted to compare mandatory regimes against each other.[391] Mandatory climate-related disclosure regimes, which built on the progress of voluntary climates disclosures like the TCFD, are likely to be effective in producing more accurate and comparable climate-related disclosures than the existing voluntary frameworks.[392] While the CSRD (EU) is clearly at the forefront of attempting to improve the disclosure of social, and governance factors, the SEC (US) and CFD (UK) are lacking in those areas.[393]

Though not explicit, many of the ESG metrics included in the mandatory disclosure regimes discussed herein remedy certain of the voluntary disclosure frameworks' deficiencies discussed above.[394] Commonalities among these mandatory disclosure regimes that could be used to improve the voluntary disclosures framework include: (i) Standardized reporting forms; (ii) publication in a centralized repository; (iii) clearly identifiable disclosure; (iv) standardized units of measurement; (v) unambiguous application to certain companies; (vi) common definitions; (vii) methodology guidance and transparency; (viii) third-party attestation; and (ix) targets transparency. As more fully explained below, companies and ratings agencies

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387. *See* discussion of GHG Protocol *supra* Section II.B.
388. *See* discussion of TCFD *supra* Section II.D.
389. *See* discussion of ISSB *supra* Section II.E.
390. *See* Osborne Clarke, *US Proposals for TCFD-aligned Disclosure Rules Mark a Big Step Towards Global Adoption*, Lexology (Apr. 8, 2022), https://www.lexology.com/library/detail.aspx?g=8ce2790d-77ca-486c-9e94-cc7460b7580a.
391. Eccles, *supra* note 385.
392. *See, e.g.*, Lisa M. Fairfax, *Dynamic Disclosure: An Exposé on the Mythical Divide Between Voluntary and Mandatory ESG Disclosure*, 101 Tex. L. Rev. 273, 305-06 (2022); *see also* Chen, *supra* note 95 at 203-07.
393. *See* Azzouz & Brisson-Félix, *supra* note 385, Part 3.
394. *See supra* Sections III and I.

should adopt these commonalities to improve the voluntary ESG disclosures framework. Such improvements could produce a more transparent, standardized, and uniform voluntary disclosure regime that investors and other stakeholders will consider accurate and reliable.

A. *Standardized Reporting Forms*

Whether it be the CSRD's Sustainability Reports,[395] the SEC's "Climate-Related Disclosures" section in applicable filings such as the annual Form 10-K,[396] or the CFD's Non-Financial and Sustainability Information Statements,[397] each of the mandatory disclosure regimes require all ESG disclosures be published on an easily identifiable, standard form. However, this standardization can go a step further. ESG goals and Multinational Asset Management Firms alike would benefit from an international private-public partnership aimed at creating a baseline ESG disclosure form to be ratified by individual countries. The GHG Protocol Corporate Standard, the TCFD Framework and the ISSB universal standards, would be a good starting point.

Contentious non-material disclosure requirements may be included in a country-specific addendum. The use of a baseline disclosure form with the option for ambitious jurisdictions to supplement disclosures will promote standardization and prevent unnecessary clerical overlap while acknowledging the politicization of ESG disclosure as it pertains to non-material information in countries such as the United States.

Similarly, a singular universal sustainable fund classification system would reduce the regulatory burden of MAMFs and would provide greater clarity to investors. After designing the baseline universal ESG disclosure form, the public-private partnership could then turn its efforts to creating a singular ESG fund classification system inspired by requirements set out in the US Proposed Enhanced Disclosure Rule and Names Rule, the EU SFDR, and the UK SDR.

395. ESRS, *supra* note 287, at 1 & 2.
396. The Climate Rules, *supra* note 7.
397. The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022, SI 2022/31; The Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022, SI 2022/46.

B. *Publication in a Central Repository*

In addition to the disclosure form itself, an effective voluntary disclosure framework must include a central repository where such disclosures can be easily located by consumers and investors. The mandatory regimes require that such ESG disclosures be publicly filed.[398] Accordingly, stakeholders should be able to locate these documents, quickly, and easily, in a mandatory regime. The current norm of posting voluntary disclosures on an individual company, or third-party ratings agency website has resulted in uneven access to information and a general lack of transparency.[399] Improving the user experience of accessing ESG disclosure documents is an area where private actors could provide real improvement on both the current voluntary framework, and the government run databases that maintain disclosure forms in mandatory regimes.

C. *Methodology Guidance and Transparency*

Prior to any discussion of specific metrics, the CSRD provides guidance on methodology and data collection to ensure that companies are utilizing standardized processes formulating their disclosures.[400] Instead of mandating a specific methodology, the SEC compels companies to disclose a description of their methodology.[401] The CFD is even weaker and acknowledges that significant divergence in methodologies will be utilized without providing guidance on how to remediate such divergence.[402] The voluntary ratings agencies generally use their own methodologies for collecting and reporting ESG metrics.[403] An effective voluntary disclosures framework should model itself on the CSRD guidance on methodology to ensure that companies are utilizing uniform methodologies and playing by the same rules before the game even begins. To the extent companies diverge from the recommended methodology, they should disclose such divergence.

398. *See supra* Section III.
399. *See supra* note 78.
400. *See* ESRS, *supra* note 287, at 1 & 2 (mandating methodology disclosure for price of carbon calculation); *see also* The Climate Rules, *supra* note 7.
401. *See* The Climate Rules, *supra* note 7 at 21916.
402. *See* DEP'T OF BUS., ENERGY & INDUS. STRATEGY, *supra* note 328 at 15.
403. *See Who are the ESG Rating Agencies?, Sustainable Perspective For The Mainstream Investor*, SUSTAINABLE INSIGHT CAPITAL MANAGEMENT 5 (Feb. 2016), https://www.sicm.com/docs/who-rates.pdf.

D. *Clearly Identifiable Disclosures*

At their core, the mandatory disclosure regimes discussed herein provide a baseline of ESG metrics that must be disclosed.[404] There is no optionality or flexibility on whether certain metrics must or must not be disclosed. Each of the CSRD, SEC, and CFD unambiguously mandate disclosure of specific metrics.[405] In contrast, there is lack of metrics standardization among voluntary disclosures.[406] Simply put, companies are not necessarily disclosing the same things, and reporting certain metrics or withholding others, can be determined entirely by the company itself.[407] An effective voluntary disclosure framework must make clear what metrics are to be disclosed and cannot leave that option up to each individual company or ratings agency.

As noted above, materiality, which is the standard at the center of SEC disclosure requirements, is a fact specific inquiry as to whether the disclosure is of the type that a reasonable investor would consider significant in making an investment decision that cannot be distilled into a bright-line test.[408] As discussed *supra* Section II.4, materiality is a difficult standard for determining what ESG factors must be disclosed.[409] Courts in the United States have been inconsistent in their reasoning when determining issues of materiality and a lack of consensus on what must be disclosed will likely lead to additional litigation.[410]

E. *Standardized Units of Measurement*

One of the most common critiques of voluntary disclosure framework, is the inability to compare companies against each other.[411] Part of that difficulty stems from a lack of standardization in data.[412] Of course, not all ESG metrics can be quantified,

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404. *See supra* Section III.
405. *See id.*
406. *See, e.g.*, GAO-20-530, *supra* note 77.
407. *See* IOSCO, *supra* note 84 at 23–24.
408. *See supra* Sections III.A.2.a, I.D.
409. *See* Lee, *supra* note 170.
410. *See*, *supra* note 144, § 12.69 (discussing “soft information” generally); *see also* Ballan & Czarnezki, *supra* note 262.
411. *See, e.g.*, Jaffari and Pike, *supra* note 51, at 159–162 (comparing the divergent data considered by four ratings agencies for measuring “workplace diversity”).
412. GAO-20-530, *supra* note 77.

but to the extent that certain metrics can be, there must be a consensus on units of measurement companies use. The mandatory disclosure regimes discussed herein were wise to build upon the climate-related frameworks to further standardize metric and units of measurement.[413] The CSRD makes explicit that all environmental disclosures be measured in metric tons of carbon unless otherwise stated.[414] Where a unit of measurement other than metric tons of carbon is to be used, the CSRD makes that clear by unambiguously stating that units of measurement such as mWh[415] or cubic meters[416] be utilized. Although the SEC does mandate that metric tons of carbon be the standard measurement for GHG emissions, it does not explicitly mandate units of measurement for most other disclosures. However, it does require that companies clearly identify what unit of measurement is used.[417] The CFD, unfortunately, does not mandate that companies quantify, or otherwise disclose, the amount of their GHG emissions.[418]

The CSRD is revolutionary in its attempt to quantify certain social and governance measures. For example, the CSRD mandates the number or percentage of employees who fall within a particular metric,[419] demographics of their management,[420] and the number of investigations related to anti-bribery.[421] In providing clear direction on what needs to be disclosed and how that metric is to be measured, the CSRD will make it easier for investors and customers to compare companies on consistent metrics. An effective voluntary disclosure framework must follow the CSRD's lead and clearly define what units of measurement are to be used in each of the environmental, social, and governance factors, that can be measured. Currently, only voluntary climate-related disclosures are reported in standardized units of measurements pursuant to the TCFD recommendations and ISSB Standards.[422]

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413. *See supra* Section III.
414. ESRS, *supra* note 287, §§ E1.3–1.14.
415. *See id.* §§ E1.3–1.5.
416. *Id.* §§ E3.1–3.6.
417. The Climate Rules, *supra* note 7.
418. *See supra* Section III.C.
419. ESRS, *supra* note 287, §§ S1.1–1.26.
420. *Id.* §§ G1.1–1.10.
421. *Id.*
422. *See supra* Section II.

F. *Unambiguous Application to Certain Companies*

Approximately 90% of public companies in the S&P 500 produce voluntary ESG disclosures, though such reporting is less prevalent among smaller public companies.[423] By definition, a voluntary framework will not have eligibility requirements, but it could have transparency regarding expectations of which companies should be participating in the framework. The CSRD clearly establishes thresholds of application upon all publicly traded companies, any non-European company with a subsidiary or branch in the EU who generates over €150 million in the EU, and any company who meets two of the following criteria: (i) more than 250 employees; (ii) €40 million in revenue; and (iii) balance sheet above €20 million.[424] Similarly, the CFD clearly applies to companies with more than 500 employees, which either are publicly traded or have a gross revenue of more than £500 million,[425] and banking institutions and insurance companies.[426] While the SEC only applies to publicly traded companies, it does unambiguously impose additional requirements on companies with at least $75 million in equity shares available to the public.[427] Clearly defining the pool of eligible participants would instill a voluntary reporting framework with stakeholder confidence and should burnish the reputation of companies that voluntarily submit to the ESG disclosures framework. Conversely, such eligibility transparency could provide reputational harm to otherwise eligible companies who refuse to voluntarily publish ESG disclosures.

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423. *Flash Report: 65% of the Russell 1000 Index Published Sustainability Reports in 2019*, GOVERNANCE & ACCOUNTABILITY INST. (Oct. 26, 2020), https://www.ga-institute.com/research-reports/flash-reports/2020-russell-1000-flash-report.html (reporting that 39% of the 500 smaller companies produced sustainability reports).

424. Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting, COM (2021) 189 final (Apr. 21, 2021).

425. The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022, SI 2022/31; The Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022, SI 2022/46.

426. The Companies Regulations 2022, SI 2022/31; The Limited Liability Partnerships Regulations 2022, SI 2022/46.

427. *See* Climate Rules, *supra* note 7.

G. *Common Definitions*

One of the most important developments in ESG disclosures was the EU's establishment of a common classification system for sustainable information pursuant to the Taxonomy Regulation.[428] The Taxonomy Regulation provides common definitions on a wide range of ESG related issues, including what economic activity is considered environmentally sustainable,[429] and what is meant by contributing substantially to climate change mitigation.[430] The SEC also establishes uniform definitions for its reporting regime.[431] As noted above, definitions in the voluntary framework can vary between companies and ratings agency.[432] An improved voluntary disclosure framework must agree on a common set of definitions, which will improve the comparability, reliability, and consistency of sustainability related information for consumers and investors alike.

H. *Third Party Attestation*

Mandatory Sustainability Reports submitted pursuant to the CSRD must be independently audited at the same audit standard required of financial statements.[433] The SEC requires that Scope 1 and 2 GHG emissions reports submitted by companies with at least $75 million in equity shares available to the public obtain third-party attestation reports.[434] Voluntary sustainability reports are unaudited, and generally not subject to third party attestation beyond such verification purported to be done by the ratings agencies who are generally involved throughout the data collection and calculation processes.[435] To instill trust in the process, voluntary ESG disclosures should require a certain level of third-party attestation, similar to that contained in the ISSB Standards.[436] Though it need not

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428. Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the Establishment of a Framework to Facilitate Sustainable Investment, and Amending Regulation (EU) 2019/2088, 2020 O.J. (L 198) 14, 16, 25.
429. *Id.* at 26.
430. *Id.* at 27–28.
431. *See supra* Section III.
432. *See supra* Section II.
433. Wollmert & Hobbs, *supra* note 286.
434. *See* Climate Rules, *supra* note 7.
435. *See* Timothy M. Doyle, *Ratings that Don't Rate: The Subjective World of ESG Ratings Agencies*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 7, 2018).
436. IFRS S2, *supra* note 130 at 16–18.

necessarily rise to the level of a full audit, companies should be particularly proactive on this point so that the government does not impose strict requirements, potentially subject to liability for false statements,[437] where no transparent and reliable third-party attestation is in place.

I. *Target Transparency*

Each of the mandated disclosure regimes contains specific rules as it relates to targets and projections.[438] The CSRD mandates disclosure of measurable climate mitigation,[439] pollution,[440] and water and marine resources, preservation targets.[441] Similarly, the SEC mandates disclosure of climate goals or targets,[442] and disclosure of any metrics and targets relied upon in a company's mitigation strategies.[443] Even the CFD requires disclosure of climate targets, including timeframe, and key performance indicators related to meeting same.[444] Fortunately, the ISSB Standards explicitly require disclosure of a company's climate targets and how they compare with those created in the latest international agreement on climate change, and whether those targets have been validated by a third party.[445] The ISSB Standards also requires disclosure of a company's use of carbon credits and offsets[446] similar to the CSRD[447] and SEC[448] requirements. Confidence in the reliability of climate targets is in companies' best interests and they should ensure that the ISSB Standards do not get weakened prior to adoption. Additionally, an effective voluntary ESG disclosures framework should aim to adopt similar targets transparency disclosures for social, and governance factors based on the ISSB Standards and mandatory disclosures regimes.

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437. *See* The Climate Rules, *supra* note 7 at 21720 (subjecting a company to liability for false statements related to inaccurate or incomplete Scope 1 or Scope 2 disclosures).
438. *See supra* Section III.
439. ESRS, *supra* note 287, §§ E1.3–1.14.
440. *Id.* at §§ E2.1–2.2.
441. *Id.* at §§ E3.1–3.6.
442. *See* The Climate Rules, *supra* note 7 at 21723.
443. *See id.* at 21674.
444. Dep't for Bus., Energy & Indus. Strategy, *supra* note 328, at 16–17.
445. IFRS S2, *supra* note 130 at 16–18.
446. *Id.*
447. ESRS, *supra* note 287, §§ E1.13–1.14.
448. *See* The Climate Rules, *supra* note 7.

Conclusion

ESG disclosure requirements and ESG fund classification systems are a relatively new advancement. In the past few years, the United States, European Union, and United Kingdom have developed their own regulatory mechanisms alongside a growing voluntary ESG disclosure system offered by private organizations. Presently, governmental ESG disclosure regulation regimes are underdeveloped and overlapping.

MAMFs are faced with the challenge of navigating three, if not more, distinct regulations at the same time. The lack of harmonization of governmental regulations significantly increases the regulatory burden on asset management firms. If the regulations are implemented without additional consolidation efforts, firms may be forced to do triple the work to follow mandatory disclosure regulations and offer ESG investment opportunities.

For those reasons, MAMFs, ESG goals, and investors alike would benefit from a unified general ESG disclosure regulation and ESG fund classification system. A public-private partnership could tackle this complex ESG disclosure ecosystem by creating a universal baseline disclosure form with the option for country-specific addendums. In addition, the partnership could consolidate and simplify the fund classification systems to bridge the gap between investors and the information they need to make informed sustainable investment decisions. All disclosure regimes would also benefit from publication in a central repository, providing guidance on methodology, more clearly identifying mandatory disclosures, imposing standardized units of measurement, better clarifying which companies are subject to which disclosure requirements, standardizing relevant definitions, incorporating third party attestation, and requesting transparency of ESG targets. Considering the momentum in the ESG disclosures space, the time for unification may be upon us.

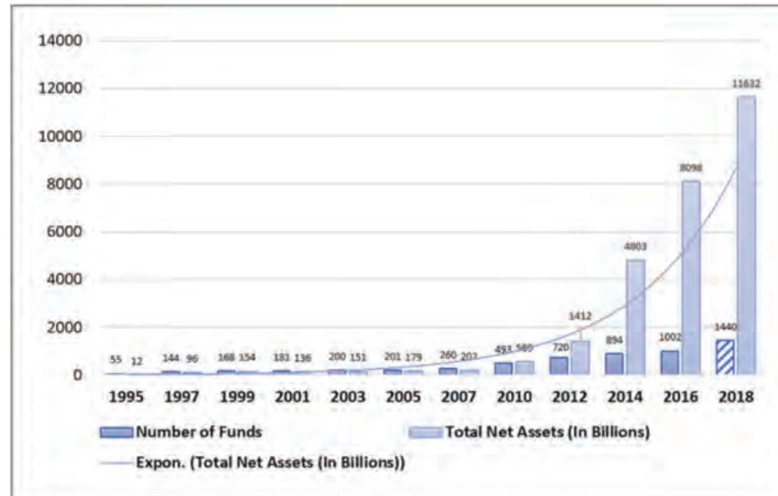
Appendices

APPENDIX 1. Investment funds incorporating ESG data, 1995 to 2018, U.S. SIF Foundation.

Source. Robert G. Eccles et al., The Social Origins of ESG: An Analysis of Innovest and KLD, Harvard Bus. Sch. Working Paper, No. 12-035 (2011).

Data from U.S. SIF Foundation (2016, p. 14); updated from U.S. SIF Foundation (2019).

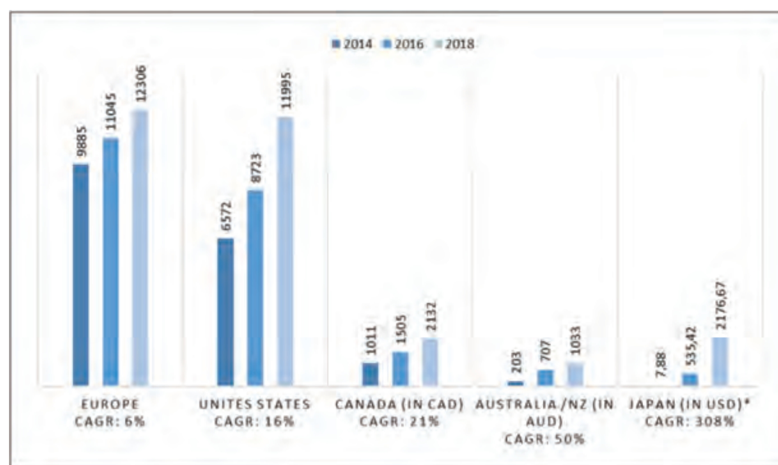
Note. Number of funds in 2018 were estimated based on trends in total net assets. ESG funds include mutual funds, variable annuity funds, closed-end funds, exchange-traded funds, alternative investment funds, and other pooled products but exclude separate accounts.



APPENDIX 2. Growth of sustainable investing assets by region, 2014 to 2018, Global Sustainable Investing Alliance.

Source. Robert G. Eccles, Ioannis Ioannou, and George Serafeim, The Social Origins of ESG: An Analysis of Innovest and KLD, Harvard Business School Working Paper, No. 12-035 (2011). Data from Global Sustainable Investing Alliance (2018, p. 8).

Note. Conversion of Yen to USD on daily rate from August 19, 2019: 1/0.0094.



APPENDIX 3. Alphabet Soup: Relevant Abbreviations

AIFMD	[United Kingdom] Alternative Investment Fund Managers Directive
AM	Asset Manager
APA	[United States] Administrative Procedure Act
AUM	Assets Under Management
BDC	Business Development Company
CAA	[United States] Clean Air Act
CDP	Carbon Disclosure Project
CDSB	Climate Disclosure Standards Board
CEO	Chief Executive Officer
COBS	[UK] Conduct of Business Sourcebook
CSRD	Corporate Sustainability Reporting Directive
CWA	[United States] Clean Water Act

EBA	European Banking Authorities
EC	European Commission
EFRAG	European Financial Reporting Group
EIOPIA	European Insurance Occupational Supervisory Pension Authority
EIRIS	Ethical Investment Research Services Ltd
EPA	[United States] Environmental Protection Agency
ESA	European Supervisory Authorities
ESG	Environmental, Social, and Governance
ESMA	European Security and Markets Authority
ESRS	European Sustainability Reporting Standards
ETFs	Exchange-Traded Fund
EU	European Union
FCA	[United Kingdom] Financial Conduct Authority
FSB	Financial Stability Board
FY	Fiscal Year
G20	Group of 20
GCD	[European Union] Green Claims Directive
GHG	Greenhouse gas
GRI	Global Reporting Initiative
IAC	[Security Exchange Commission] Investor Advisory Committee
ICFR	Internal Control over Finance Reporting
IFRS	International Financial Reporting Standards
IIRC	Integrated International Reporting Council
IOSCO	International Organization of Securities Commission
ISSB	International Sustainability Standards Board
KPI	Key Performance Indicator
MD&A	Management's Discussion and Analysis of Financial Condition and Results of Operations
NEPA	[United States] National Environmental Protection Act
NFRD	Non-Financial Reporting Directive
NGO	Non-Governmental Organization
PEG	Private Environmental Governance

PRI	Principles for Responsible Investment
RCRA	Resource Conservation and Recovery Act
RTS	Regulatory Technical Standards
SASB	Sustainability Accounting Standards Board
SBTi	Science Based Targets Initiative
SEC	[United States] Security and Exchange Commission
SDR	Sustainable Disclosure Requirements
SFDR	Sustainable Finance Disclosure Regulation
SG	Sustainable Goals
SMEs	Small- and Medium-Sized Enterprises
SRC	Smaller Reporting Companies
SRI	Socially Responsible Investing
SWDA	[United States] Safe Water Drinking Act
SWM	Shareholder Wealth Maximization
TCFD	Task Force on Climate Related Financial Disclosure
TSCA	[United States] Toxic Substances and Control Act
UK	United Kingdom
UN	United Nations
UNEP-FI	United Nations Environmental Protection Finance Initiative
US	United States
VRF	Value Reporting Foundation
WBCSD	World Business Council for Sustainable Development
WRI	World Resource Institute

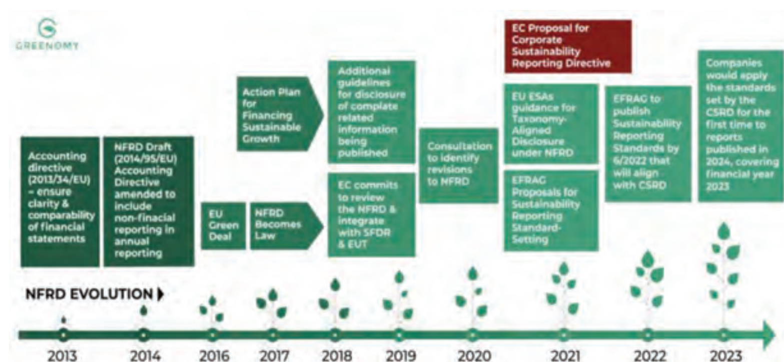
APPENDIX 4. The 11 TCFD Recommendations Translated into Plain English

Source. Graham Caswell, The TCFD Recommendations Translated into Plain English, LinkedIn (July 7, 2019) https://www.linkedin.com/pulse/tfcd-recommendations-translated-plain-english-graham-caswell/.

Governance	Strategy	Risk Management	Metrics and Targets
Disclose the organization's governance around climate-related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material.	Disclose how the organization identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.
Recommended Disclosures	**Recommended Disclosures**	**Recommended Disclosures**	**Recommended Disclosures**
a) Describe the board's oversight of climate-related risks and opportunities.	a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.	a) Describe the organization's processes for identifying and assessing climate-related risks.	a) Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.
b) Describe management's role in assessing and managing climate-related risks and opportunities.	b) Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning.	b) Describe the organization's processes for managing climate-related risks.	b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
	c) Describe the resilience of the organization's strategy, taking into consideration different	c) Describe how processes for identifying, assessing, and managing climate-related risks	c) Describe the targets used by the organization to manage climate-related risks and

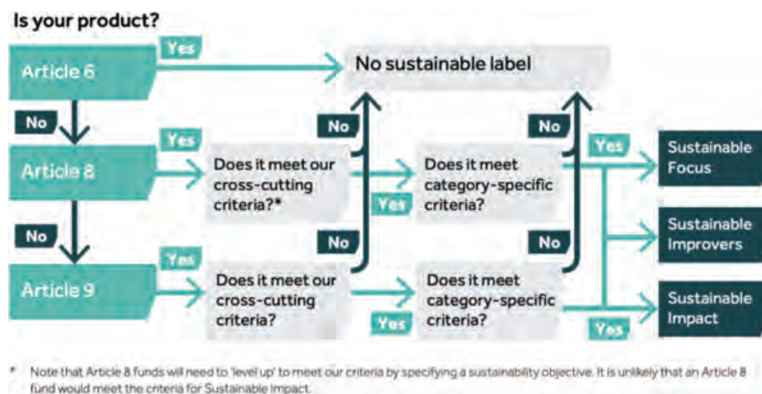
APPENDIX 5. NFRD Evolution

Source. Denis Noonan, The Evolution of NFRD into CSRD, Greenomy (last visited Apr. 22, 2023) https://greenomy.io/blog/evolution-nfrd-csrd.



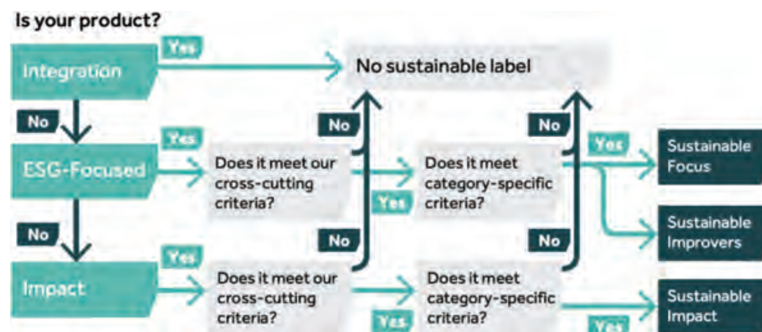
APPENDIX 6. FCA MAPPING TO SFDR REQUIREMENTS

Source. FIN. CONDUCT AUTH., SUSTAINABILITY DISCLOSURE REQUIREMENTS (SDR) AND INVESTMENT LABELS, 2022, CP 22/20 (UK) at 83.



APPENDIX 7. FCA MAPPING TO SEC FUND CATEGORIES

Source. Id.



NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 20 SUMMER 2024 NUMBER 3

THE FRONTIERS OF ARTIFICIAL INTELLIGENCE REGULATION: FIVE PERSPECTIVES FROM THE EUROPEAN UNION

ANDREW G. LIN*

Eight years after the European Union adopted the General Data Protection Act (GDPR),[1] it passed additional legislation designed to address the meteoric and transformative rise of artificial intelligence. On March 13, 2024, the European Parliament adopted the Artificial Intelligence Act ("AI Act").[2] The AI Act seeks "to protect fundamental rights, democracy, the rule of law and environmental sustainability from high-risk AI," as well as to encourage innovation and establish Europe as a leader in AI technology.[3]

The AI Act followed a flurry of legislations enacted by the European Union in the last decade. These legislations include the GDPR, the Data Act, Data Governance Act, the Digital Markets Act. Together, these legislations regulate the collection, retention, and use of data involving the E.U. or E.U. subjects.

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* Editor-in-Chief, *Journal of Law & Business*, 2023-2024; J.D., New York University School of Law, 2024; B.S., Duke University, 2019.

1. Press Release, Eur. Parliament, Data Protection Reform—Parliament Approves New Rules Fit for the Digital Era (Apr. 14, 2016), https://www.europarl.eropa.eu/news/en/press-room/20160407IPR21776/data-protection-reform-parliament-approves-new-rules-fit-for-the-digital-era?quizBaseUrl=https%3A%2F%2Fquizweb. europarl.europa.eu.
2. Press Release, Eur. Parl., Artificial Intelligence Act: MEPs Adopt Landmark Law (Mar. 13, 2024), https://www.europarl.europa.eu/news/en/press-room/20240308IPR19015/artificial-intelligence-act-meps-adopt-landmark-law.
3. *Id.*

The AI Act entered into force on August 1, 2024 and will become generally applicable by August 2, 2026.[4] Its scope is sweeping. Not only does the AI Act impart detailed obligations on data providers and end users regarding permissible uses of artificial intelligence and machine learning models, but it also imposes extraordinarily heavy fines.[5] How private actors navigate the AI Act, and how Brussels responds in turn, will be of paramount importance to Washington and London as they continue to craft their own national artificial intelligence and data protection legislation. Indeed, all eyes are on Europe.

In recognition of the importance, complexity, and timeliness of artificial intelligence legislation, The *Journal of Law & Business* interviewed five leading E.U. policymakers and practitioners to gather their thoughts on the AI Act and related legislation.

Peter Ide-Kostic, a veteran E.U. policymaker of more than two decades, begins the conversation. He served as an Administrator in the AI in the Digital Age (AIDA) special committee, the organ that crafted the AI Act. In his remarks, Mr. Ide-Kostic reveals the political process by which the AIDA committee came about, including the selection of the committee members and the concerns of the committee during the drafting process. By illuminating the politics that brought about the AI Act, Mr. Ide-Kostic provides us with important context for making sense of this sweeping legislation.

Dragos Tudorache, chair of the AIDA committee and one of the two chief negotiators of the AI Act, continues the conversation by detailing the negotiations process with different industry stakeholders. In his remarks, Mr. Tudorache discusses several important points, including (1) the adoption of the risk-based analytical approach, (2) the delivery of standards (and the decision to depart from the approach taken in the GDPR), and (3) the imposition of obligations on data providers and end users. Mr. Tudorache also previews the implementation and enforcement process scheduled to occur over the next two

4. Press Release, Eur. Comm'n, European Artificial Intelligence Act Comes Into Force (Aug. 1, 2024), https://europa.eu/newsroom/ecpc-failover/pdf/ip-24-4123_e n.pdf.

5. Art. 99: Penalties, Ch. XII, EU Artificial Intelligence Act ("Non-compliance with the prohibition of the AI practices referred to in Article 5 shall be subject to administrative fines of up to 35 000 000 EUR or, if the offender is an undertaking, up to 7 % of its total worldwide annual turnover for the preceding financial year, whichever is higher.").

years, as well as the E.U.'s coordination with legislative efforts by American policymakers.

Jérôme Phillipe, of Freshfields, shifts the conversation from the perspective of a policymaker to a seasoned practitioner. Mr. Phillipe believes that the AI Act, while extremely structured, is too cumbersome and, in many ways, premature. In his remarks, Mr. Phillipe notes that industry clients face significant uncertainties with respect to the AI Act's risk-based approach. He posits that in all likelihood, no one would be able to fully comply with the extensive requirements set forth by the AI Act. In addition, Mr. Phillipe comments on the regulatory hurdles faced by companies and points out the wide-reaching implications of the AI Act, particularly its impact on an entity's commercial policy.

Nick Wolfe, of Skadden, predicts that the AI Act will usher in a new wave of antitrust enforcement actions. In his remarks, Mr. Wolfe traces the evolution of EU and UK enforcement efforts from 2000 to the eve of the AI Act, providing the historical foundation from which the AI Act emerged. In addition, he attributes the rise of generative AI as a driver of technological uncertainty, positing that it is one of the main reasons why regulators are requesting companies for more information on transactions.

Lauren Cuyvers and Toni Pitesa, of Sidley Austin, focus on the relationship between technology, regulation, and innovation. As a threshold matter, they acknowledge the reality that AI regulation will almost always be behind the technology. In their remarks, they examine the regulatory challenges around maintaining the datasets necessary to train artificial intelligence models. They also examine the AI Act's potential anticompetitive effects due to the burden of compliance placed on startups. They acknowledge the difficulties of proactively addressing regulatory challenges posed by novel technologies, and advocate for reliance on traditional legal frameworks as a north light for *ex ante* guidance.

The five interviews offer a broad spectrum of perspectives on the AI Act from a diverse group of individuals. As the *Journal* celebrates our 20th anniversary this year, we are fortunate to have these leading policymakers and practitioners share their insights into the AI Act. Their remarks deliver valuable guidance on how businesses—from the largest companies to the earliest startups—should think about and navigate the regulatory uncertainty surrounding artificial intelligence in the twenty-first century.

NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 20 SUMMER 2024 NUMBER 3

DEVELOPING THE EU ARTIFICIAL INTELLIGENCE ACT

PETER IDE-KOSTIC*

A. THE BIRTH OF THE AI ACT

In response to the urgency underscored by the President of the European Commission, Ms. Ursula von der Leyen, who committed to prioritizing AI legislation within her first 100 days after her appointment following the EU elections in May 2019, the European Parliament began actively preparing for future AI legislation to be introduced by the European Commission. This initiative aligned with the European Commission's publication of the "White Paper on Artificial Intelligence: A European approach to excellence and trust" on February 19, 2020.

To facilitate this, the European Parliament formed the Special Committee on Artificial Intelligence in a Digital Age (AIDA), which started its work in September 2020. The committee's activities, centered on conducting parliamentary

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research, facilitating expert hearings, and engaging with various stakeholders, culminated in delivering a comprehensive report in December 2021, adopted in the Plenary session of the European Parliament in March 2022.

Concurrently, the European Commission launched a public consultation phase from February 19, 2020, to June 14, 2020. The insights gathered during this period informed the drafting of the AI Act, which the Commission published in April 2021. However, legislative work by the European Parliament did not commence at that time, as the AIDA Committee's efforts were still ongoing.

By the end of 2021, the groundwork laid by the AIDA Committee had significantly advanced, effectively supporting the legislative process on the AI Act. This progress led to the appointment of two co-rapporteurs on the AI Act in early 2022: Mr. Dragoș Tudorache (Renew political group, Romania) for the Civil Liberties, Justice, and Home Affairs (LIBE) Committee, and Mr. Brando Benifei (Political group S&D, Italy) for the Internal Market and Consumer Protection (IMCO) Committee.

On 11 May 2023, following the introduction of thousands of amendments by the seven political groups of the European Parliament, the IMCO and LIBE Committees co-adopted the proposal to amend the draft AI Act. The European Parliament then adopted the report one month later on 14 June 2023 during its plenary session.

Given the wide scope of the AI Act, balancing the core interests of both industry and fundamental rights protectors presented significant challenges, often due to conflicting priorities. Recognizing the importance of balanced representation, the political groups selected members with diverse political backgrounds but with significant experience from their work in the AIDA Committee. This strategic selection included Mr. Tudorache from the center-right Renew group for the LIBE Committee, which is competent on fundamental rights (a topic more often associated with the left), and Mr. Benifei from the left-center Socialist group for the IMCO Committee, which concentrates on market development, consumer protection, and innovation (topics more often associated with the right). Their combined experiences and political sensibilities ensured a legislative proposal that was amenable to all stakeholders involved.

Additionally, other Committees such as Legal Affairs (JURI), Culture and Education (CULT), and Industry, Research,

and Energy (ITRE) were also involved in the legislative process of amending the AI Act, though their participation was limited to areas within their specific competencies.

B. Shifting the Paradigm: The Rise of General-Purpose Artificial Intelligence Models

Up to November 2022, the European Parliament focused on the concept of AI systems operating within the common market. However, AI models and their training methods remained unregulated. The introduction of ChatGPT and the rise of foundation models—a term initially coined by Stanford and later rebranded as General-Purpose AI models—highlighted a significant oversight. These developments indicated that legislation limited to AI systems could not adequately protect fundamental rights or sustain healthy innovation and competition.

It is noteworthy that neither the European Commission's draft AI Act from April 2021 nor the European Parliament's AIDA report from March 2022 addressed General Purpose AI models. The need to regulate them became evident during the legislative amendments of the AI Act made by the European Parliament between January 2022 and May 2023.

The widespread impact of ChatGPT in November 2022 is, in fact, the main factor that underscored the need to regulate highly capable General-Purpose AI models due to their potential systemic risks for the EU internal market.

This realization is the main reason that led to an extension of the legislative process in the European Parliament, with the amended AI Act not being finalized until June 2023.

C. Trilogue to Adoption

The added complexity and additional policy challenges posed by the legislation of General-Purpose AI models (GPAIs) are key factors that complicated the final phase of the EU legislative process, along with the provisions related to law enforcement and national security.

During the final phase of the legislative process, a procedure known as "Trilogue" took place between July 2023 and December 2023. During this period, the European Parliament and the European Council confronted their respective amended versions of the AI Act. With the support of the European Commission, which initially drafted the text in April 2021, the two institutions reached the final compromised version of

the text that is expected to become law in mid-2024 at the time of writing this article.[1]

The wide range of stakeholders involved made negotiations often extremely difficult. The negotiations were led by the two co-rapporteurs, Mr. Tudorache and Mr. Benifei, from the European Parliament side, and on the Council side by Ms. Carme Artigas of the Spanish government, which held the rotating presidency of the EU Council until the end of 2023. These negotiations culminated over an almost uninterrupted three-day period on December 6, 7, and 8, ending with clear political agreements on all sensitive areas of the text.

Convincing large western EU member states fell to the EU Council, primarily represented by Carme Artigas of Spain. Her efforts to bring France and Germany to the table were instrumental in reaching a final agreement. Another concern was industry stakeholders, particularly small and medium enterprises (SMEs) and AI startups that contributed to the release of free open-source AI models (such as Mistral and AlphaDev in the EU). There were fears that over-regulation could disadvantage smaller companies vis-à-vis larger ones, as well as EU companies compared to US counterparts in some markets.

Concerns about IP protection and competition were also raised, alongside the protection of core fundamental rights. The final 36 hours of these negotiations were extremely difficult, but late on the night of December 8th, an agreement between the three bodies was reached on all sensitive areas of the legislation.

On February 13, 2024, the LIBE and IMCO committees approved the text of the act, followed by the Parliament adopting the act on March 13th. The lengthy task of reconciling the final language in the document then began. The nature of the EU means this is a particularly long task involving lawyer-linguists in all official languages of the EU and all Member States. Differences in language, compounded by differences in context and meaning, complicate translations and sometimes result in the need to consult at the political level to ensure that the translated text correctly reflects the intent of the legislator in all languages.

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1. This version of text became applicable law on 1 August 2024.

Linguistic agreement from all member states was reached during March 2024 and formally endorsed on 18 April 2024 by the European Parliament.

At the time of writing this article, the text is expected to be endorsed by the European Council during May 2024 and to become law in June 2024. Twenty days after publication in the Official Journal of the EU, the AI Act will come into effect, and implementation will begin.[2]

2. The European Council adopted the text on 14 June 2024, shortly after the European elections held from 6-9 June 2024, and it was published in the Official Journal of the European Union on 12 July 2024. Finally, the AI Act came into effect on 1 August 2024, with its implementation beginning immediately thereafter.

NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

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INSIGHTS FROM THE DELIBERATION ROOM: NEGOTIATING THE EU'S AI ACT

DRAGOȘ TUDORACHE*

SCOTT PATTERSON:

Thank you for joining us today Mr. Tudorache to discuss the EU's AI Act. Diving right in, can you speak to the negotiations between the committees involved in crafting the AI act? Specifically, the points of emphasis for each party, sticking points, and common themes of agreement.

DRAGOȘ TUDORACHE:

I think what was one of the many things that was special about this AI Act, because there were many things that were somewhat out of the ordinary even for European Standards, was that we've had a record number of committees that were part of this set up at Parliament level. So traditionally you have one committee that's responsible for negotiation with one lead negotiator, one lead rapporteur, for one legislative file; while in this case we had two leading committees. The one on civil

* Dragoș Tudorache is a Member of the European Parliament and Vice-President of the Renew Europe Group. He is the LIBE rapporteur on the AI Act, and he sits on the Committee on Foreign Affairs (AFER), the Committee on Civil Liberties, Justice and Home Affairs (LIBE), the Committee of Inquiry to investigate the use of Pegasus equivalent surveillance spyware (PEGA), the Subcommittee on Security and Defense (SEDE), and the European Parliament's Delegation for relations with the United States (D-US). He was the Chair of the Special Committee on Artificial Intelligence in the Digital Age (AIDA). Disclaimer: The views expressed are his own and do not represent the European Commission or other EU institutions.

liberties[1] and the one on the internal market[2], and plus a plethora of other committees that had bits and pieces of competence for different parts of the text which of course made the preparation and negotiations both inside of Parliament and then with the council even more difficult, more complex, because then inside each of these committees you have all of the political groups, each of them carrying the flavor of that respective committee and the priorities of that respective committee. And that made for a very complex multi-layered negotiation and that's why it also took a bit longer than usual. In terms of sticking points, it is difficult to categorize which were more problematic than others but very quickly we have zeroed in on definitions, which from the beginning we wanted to get right, understanding how important they will be for putting the right framework around what we wanted to be part of the scope of the regulation and what we did not want to make part of the regulation. Then also, with the ambition to keep these definitions as aligned as possible with what was happening in other fora and with other jurisdictions out there, we aimed to align with the definitions of the OECD, and the definitions also on the US side. We also discussed with the National Institute for Science and Technology (NIST) as we wanted to make sure that these definitions will be aligned as much as possible to help for the global conversation, the global convergence that we knew we would need to strive to achieve.

Then there was a very long and complex discussion on how to define the governance around high risks. We knew that we would have a list of contexts of AI applications that we would be labeling as high risk, but how exactly to calibrate the norms, whether it would be for all applications that would be developed in that particular context, or if only for part of them, how do you define the thresholds for those that would be entering the scope and those that would be outside the scope? And eventually we ended up with a number of criteria to determine what represents a significant risk and therefore can see as the need for conformity. Additionally, we had very long and complicated negotiations on some of the prohibited applications, particularly on the use of biometrics in public spaces in real time, where

1. The European Parliament's Committee on Civil Liberties, Justice, and Home Affairs, colloquially known as the "LIBE" Committee.

2. The European Parliament's Committee on the Internal Market and Consumer Protection, colloquially known as the IMCO Committee.

there was a part of the House that wanted from the very beginning an outright ban on the use, employment of this technology, and others who were seeing a need to create an exception for law enforcement and access by law enforcement, to some of this technology in order to ensure an efficient, effective fight against particularly very serious criminality. That remained one of the sticking points all the way until the very end, even in the negotiations between parliament and council.

Then of course, the big discussion on foundation models. The discussion that came in later in the negotiations, there we spent quite a lot of time.

I can go on and on and on, almost all of it was a difficult negotiation in itself, but these were some of the highlights.

Scott Patterson:

One follow on question: did you all settle on the risk framework and determine what was high risk prior to foundational models and general-purpose AI models coming out, or was that a post ChatGPT discussion?

Dragoș Tudorache:

Well, when we started our work, the proposal was a risk-based approach identifying the applications, the areas in which applications of AI would be raising risk. And there was an annex which listed those areas such as recruitment, education, health, banking, insurance, and it's important to note that this started before ChatGPT.

But already in the course of all preparations we were starting to play with what we called back then general-purpose AI, recognizing that it represents a challenge in sticking to the logic of the risk-based approach, with applications that in themselves did not represent a risk or were not allocated a purpose that represented a risk in itself. Because they were, for example, language processors. On the face of it, what's wrong or can be risky about a language processor? But then we realized that by the very nature of how these models are developed, the way they are trained, their versatility, their potency, we realized there is something about them that actually can have quite a significant impact, both in the value chain for other systems that will be developed on top of these models, but also for the customers, for the clients, for the individuals rights themselves. So therefore, we started with a discussion as to whether these models should be put in the category of high risk or not.

We then agreed that putting them in the category of high risk would not actually do justice to them and we also would be affecting the mechanism that we were just preparing for the high-risk applications. That is how and when we decided to craft a special regime for foundational models. This was already autumn of 2022, just maybe a month or so before November when ChatGPT was launched. We had already decided by then that we wanted to deal with foundation models in our text and that we wanted to have a special regime for it. And what we set out to do was to identify what would be the obligations that we considered would be specific for these models.

When ChatGPT came, in a way it proved that it was worth considering a special regime for these models because we could very quickly see how important and how impactful they will be. It also allowed us to then filter through all of the information, and also now having the actual technology in our hands, it was easier, it helped us define exactly how we want to regulate it, what kind of rules we want to put in place. And by Spring 2023, we were able to have this regime fully down, mandate, negotiate, and approve it.

We recognized already that we might need to further work on the text as we would start the negotiation with the council. Our counterpart, the other co-legislator, had nothing in their mandate related to that so we knew that there would be a lot of discussion there, and it proved to be the case. It was one of the open issues up until the very last night of negotiations in December of last year. But that was the journey away from having nothing in the text about foundation models to the point where we are today.

Scott Patterson:

Thank you. Touching on what you spoke briefly about collaborating with NIST and making sure that you were somewhat aligned with what they were also looking at, can you speak a little bit more to the concerns of US stakeholders and what concerns they brought to the table during the negotiations? Both companies and regulatory-wise.

Dragoș Tudorache:

Companies have brought a lot of arguments to the table, and I can't even filter out which were American companies and which were European companies. I never, in fact, categorized them that way. My policy has been one of an open door towards

anyone, any stakeholder that had contributions to make, an argument to bring, because I considered that to be an education for me as a lawmaker, I want to make sure that I hear all possible positions and arguments and learn from them. And I treated companies in the same way – I didn't treat them as lobbyists, I treated them as contributors to the debate.

One of the main arguments coming from some of the bigger players on the US side was that foundation models did not need regulation at all because they were not designed with a particular purpose in mind, a purpose that would be prone to risks, and therefore the responsibility was not theirs. And that the responsibility should be further down the value chain with entities that would be taking their models and developing applications on top that would then raise risks or come in one of the risk categories; and therefore if we were to regulate somehow, we had to regulate the downstream and not the upstream. That was one argument that they brought forward.

Then another argument that they brought was that it was irrelevant and not necessary to require transparency of the data sets used to train the algorithms because well first of all they said it's not necessary, then they moved the cursor and said that would be a problem of trade secrets, and it's part of the recipe of the model and therefore forcing them to be transparent about that would be forcing them to release trade secrets. So, they've used all sorts of arguments to mainly escape altogether responsibility. And then once they realized that that would not happen, that there would be nevertheless a set of obligations, a regime that would be applicable to them, then the discussion moved into trying to make that as flexible as possible with an argument, I think a very good argument and one that we eventually used in our discussions, which is that the technology was still nascent, there was still a lot that we did not know, it was also very fluid, changing all the time.

This is why we chose a model where we listed the obligations in the text to make it clear what we expect out of the developers of these models, but at the same time we recognize that there are no set tools, technologies, or standards yet for how you comply with those obligations. And that is why we accepted the logic of working with a code of practices at the beginning. This is a form of flexible enforcement in the first phase, where the enforcer at the EU level would be interacting with these developers to see how best they can respect the obligations that

they have in terms of risk management, in terms of incident reporting, and in terms of transparency.

Once this Code of Practice is co-designed, then it is going to be fixed in law by virtue of secondary legislation that will be adopted by the European Commission together with the future AI office, until, and this is a placeholder, until standards will be available. So, I think that we've listened and accepted those arguments related to flexibility. And I think we did right, we did justice to where the technology is today. And to the need for working together, for co-generating the standards and the methodologies that will be used to respect these obligations.

And then in terms of the interaction with the US administration, at the level of the European Commission, between the administrations themselves, there was quite a lot of contact and cooperation as part of the TTC framework. But as legislators, we also made sure that we paid attention to what was happening on the US side, also making sure we are informing fellow lawmakers in Congress as to the evolution in our negotiations. I think that helped a lot also in the way the White House has eventually prepared the executive order, and in fact if one unpacks the executive order, there's quite a lot of approaches which are similar, and some of the effects of the executive order would not be very different even if it takes a sectoral approach. So, I think that this coordination, this cooperation, worked well for both sides.

SCOTT PATTERSON:

Thank you for that. Shifting gears to the regulatory framework and the actual implementation and enforcement. How do you envision the AI office working with both companies and Member States to ensure that compliance is met and ensure that the Legislative Act is being followed?

DRAGOȘ TUDORACHE:

The big challenge, in fact, starts now. Yes, it was very complicated to get to today, to actually have the AI Act in place. But now implementing it is going to be even more difficult.

So, first and foremost, the office will have to get itself ready, and it will have one year to do so. Because in one year's time it will start applying this regime for foundation models, for which the office has exclusive competence.

That means that by that time, the office will have to have the right people in place. The right methodologies for testing,

for evaluations, and for red teaming. So quite a tall order for the office in the next one year, to be ready to take on the likes of ChatGPT, Gemini, Claude, and all the applications that will be making it past the threshold that we have established. And, by the way, another obligation for the office is to always be on the lookout for the evolution of the technology, constantly consult with the scientific community to make sure that those criteria that are supposed to be used for differentiating within models, those are flexible. And they are deliberately flexible in the regulation, understanding that the criteria that we use right now – the FLOPs – might be totally irrelevant in one year's time because in the meantime the use of infrastructure might change with these models.

So the AI office will have this responsibility to keep the regulation in a way adapted to the evolution of the technology. Then the national regulators will also kick in with their part of the competence which relates to the application of the high-risk framework for all other AI applications out there. That is, when an additional layer of complexity comes in. Coherence and uniformity in interpretation, application, will be fundamental to avoid some of the mistakes that we did with the GDPR, for example, where we ended up with quite a lot of fragmentation between the different jurisdictions in the Member States with the GDPR being understood and applied differently between Member States. And that's something we don't want with the Act; it's key that we ensure this coherence. So, this interplay between the EU level governance and the national level governance will be fundamental for good application, good implementation, good enforcement of the law.

Its difficult to predict how it will work because there is no blueprint for it. It's the first time that this sort of governance actually is put into place. A lot of learning and flexibility and adaptability, and an open mind which will have to be kept both by the national regulators and the European Regulator in order to make this work and keep the spirit of the law as we intended it, as legislators, as alive and as true to the cause as possible.

SCOTT PATTERSON:

That makes total sense and thank you for explaining. I know the implementation of the Act hasn't been released or put forth yet so getting insight on how you envision the enforcement of the regulation is pretty key moving forward, especially both for companies and for future lawyers.

Dragoș Tudorache:

One point that I forgot to say, which is also incredibly important for the application, the implementation of the law, is the delivery of the standards. This is the one thing that we did differently from the GDPR. We've given a mandate for technical standards to standard setting bodies at the European level and they have two years to deliver now until the moment when the regulation kicks in also at the national level.

The European Commission delivered a set of guidelines for different parts of the text, where we consider that further technical explanation is necessary for companies to understand how they need to do their self-assessment, how they need to interpret the threshold of significant risk, for example, in the high-risk category. So all of those clarifications will need to come in the next two years until the full entry into force of the legislation, in order to give clarity and predictability of the norm for companies. And also, very importantly, to give this clarity in a technical form not in a legal or legalistic way, which sometimes legislation tends to be, to help companies, particularly the smaller ones, that cannot afford big compliance teams or hire law firms to tell them what they need to do, to allow them to self-assess, looking at the set of technical standards and understanding what it is that they need to do.

Scott Patterson:

It makes total sense. It gives you the flexibility to move forward and adjust as you see how a regulation actually unfolds.

Is the AI office meant to be an independent, regulatory body, or will it be staffed with representatives from the Member States, or just with experts from different particular committees, such as the IMCO or the LIBE committees. How do we look at the future of the AI office staffing?

Dragoș Tudorache:

We meant it, and we mean it as an autonomous structure. We've placed it inside the European Commission in order to achieve synergies, understanding that it's not going to be easy to find the right level expertise, convince them to come and work for the public sector on salaries that are not necessarily on par with what the industry offers. And, knowing that the Commission already has teams in place to implement the DSA or the DMA, we thought it's going to be easier if we also place the AI offices at the Commission, we give it sufficient autonomy to

function and to perform its very different competencies compared to the DSA and the DMA offices. But it has a dedicated structure, it has a dedicated budget line, and we insisted very much on that, and it also has the ability to recruit from inside or from outside the Commission freely, in order to attract talent as flexibly as possible.

What is happening right now is that the Commission has already transferred some staff from the current Directorate General responsible for digital issues inside the European Commission. So they are, in a way, the backbone of the office. They will ensure the policy continuity in terms of understanding what is required, particularly on the regulatory side, the further guidelines that will need to be done, the interaction with the standard setting bodies, what are the adaptations of the regulation and the further secondary legislation that will need to be ensured. Plus, they will be the ones that will be taking care of the governance once the national regulators come together in the Board, because there will also be a Board, with all of the national regulators. And then the creation of the Scientific Committee and the creation of the Advisory Group. Together they will form the governance for the AI Act.

But at the same time the office will have to have technical staff, the ones that will be developing the tools, the methodologies for evaluation and testing the ones that will be interacting on a regular basis with the companies developing the big models, so on and so forth. And for that, the office will have to look outside, because those experts do not exist in the Commission right now. They are now in the process of hiring, they have already issued vacancy notices for technical staff, and they will be on the lookout for the year ahead to try and attract as much talent as possible. Most of that, if not all of that is in the private sector, so it's going to be quite the challenge to bring them in. A challenge that from my contacts with the UK Safety Institute and the US Safety Institute, I think, will be shared across jurisdictions because it's not going to be simple to bring in that kind of talent from the private sector to a public institution. But I remain hopeful that in the next year they'll manage successfully to also bring in such staff.

Scott Patterson:

Thank you for that. Shifting gears to the final topic. We've covered the negotiations and what the interests were. We've covered where the regulatory framework is going, what the regulatory process will look like.

But now, turning to the Act itself. We know that the LIBE committee, which typically handles fundamental rights, and the IMCO committee, which typically handles the internal market and industry, were co-heads.

So, one question we had for each committee is how the core elements of the AI Act protect fundamental rights? And then how do they promote industry and innovation on the other side?

Dragoș Tudorache:

This was from the start; our ambition to achieve the necessary protection of individual rights and societal interests, while at the same time promoting innovation and competitiveness and we constantly worked to blend the two objectives of the text so that they don't appear as a binary choice, as a zero sum game between the two, or that there is some sort of conflict between the objective to protect and the objective to stimulate innovation. I think what we achieved is a good balance between the two.

Now I'll be specific. On the protection side, the regulation was already built from the get-go on the idea of having a human centric focus of the regulation; looking at the risks that are related to individual rights or to the broader interests of society. But even there, in the negotiations, and particularly through amendments and work that was done in the European Parliament, we've added several layers of extra protections.

First of all, we've added to the list of prohibitions, a number of applications that we thought needed to be there. I'll give some examples – predictive policing, or biometric categorization – so things that we thought need to be there because it was fundamental to how we understood privacy or how we understood fundamental rights, and rule of law in the Union. The same thing when it comes to the list of high risks, for example the idea of a fundamental rights impact assessment for all deployment of high-risk applications, particularly in the in the public sector.

Why? Because, history and practice has shown that it is in the public sector where the potential for breaching is, and is the highest risk, and unfortunately, we already had practical examples in Europe. We had the famous case in the Netherlands with the social security system that was using an algorithm to determine potential fraud to the social security schemes and which was completely biased against non-natives, basically, of that particular Member State.

And then similar other cases which showed that, particularly when you apply artificial intelligence in the public sector, you need to have that extra care, and you need to have an active drive as a public institution before you actually decide to deploy such an AI tool in your public service. You have to have an extra duty of care on making sure that that application of artificial intelligence is not breaching rights. So that's why we introduced this impact assessment upon deployment in these sectors.

We've also introduced redress, individual and collective, something that was completely missed in the initial proposal of the text, because we thought that it was also fundamental that consumers and individuals have a way to bring their case before the authority, and eventually before the courts if they would find that one particular application of AI was detrimental to their rights. We chose that path because we thought that with AI becoming such a normally present technology in all walks of life, in almost every sector of human activity or economic activity, it will be quasi-impossible for the regulator to always keep an eye and make sure that they actually know everything that goes on. So, you need these bottom-up reporting mechanisms if you want an alarm system from the consumers themselves to identify potential problems with the interaction between human and machine. So that's why redress was an important mechanism, and I'm proud that it is now in the system.

Now on the innovation side from the beginning, we said, there must be enablers in this text that will be lowering the cost of compliance. So even where compliance will be necessary, we wanted to make sure that compliance does not act as a barrier for innovation or for entry to the market, particularly for smaller companies. So that's why we wanted to make the cost of compliance as low as possible. That's why we went for self-assessment. That's why we went for technical standards to make sure that if you want to go on the market with a product, and you're a startup of two or three people, and you cannot afford to pay a lawyer or a compliance team, you have your technical standards available, you can read and understand them. You do your self-assessment and you can judge for yourself whether you are in one category risk or another, and what you have to do to go on the market.

We've also completely changed the philosophy of sandboxes. The concept of sandboxes existed in the initial provision of the text, but very much like an extraordinary testing ground. Whereas we turned it into almost a pre-compliance enabler,

particularly for smaller businesses, who, are still uncertain after they looked at the technical standards and have done their self-assessment, but let's say they are still not sure – am I actually a significant risk? Am I passing the threshold, or am I not? Well, then, they have the possibility to go into a sandbox; a sandbox that national authorities will be obliged under the AI Act to establish at the national level, but also at the regional and municipal level, so that companies and startups, can go, enter into a sandbox, interact with the regulator, test, validate their assumptions, validate their data sets, and prepare for compliance, achieve pre-compliance in that controlled environment where they can also make mistakes, they can say stupid things, they can check things with the regulator before, achieving certainty that when they go on the market they go in a compliant way.

Many other examples, special provisions for SMEs, special provisions for research and development, special provisions for open source. So we've looked, in a way, at the ecosystem of AI as it is today, a lot of it actually with SMEs, very agile small players, and we wanted to make sure that they will continue to feel stimulated, to remain, to grow, to develop, to innovate without fear that all of a sudden if rules come to town they will have to close shop or they will have to fundamentally change their business model. To the contrary, we gave them tools to continue to do what they do without much hinderance.

SCOTT PATTERSON:

And just to confirm, SMEs are small enterprises?

DRAGOȘ TUDORACHE:

Small and medium enterprises, yes. This is the European jargon for small companies.

SCOTT PATTERSON:

We all have our own abbreviations! A quick follow up on the redress capability that you mentioned. Would this be akin to a private right of action on the European side?

DRAGOȘ TUDORACHE:

Yes.

SCOTT PATTERSON:

Okay, I wanted to confirm that as well. That wraps up most of my questions. The next question is on speaking to law

students or future legal professionals. I wanted to confirm, you were a judge previously, right?

Dragoș Tudorache:

Yes, I was. Way back.

Scott Patterson:

Okay. For any lawyers or future lawyers who are looking to either regulate or represent and advise companies, what advice would you have for them in light of where the regulation is moving, based on your experience negotiating the AI Act and shepherding it through the inception of AIDA all the way to now?

Dragoș Tudorache:

I think rules around this technology and generally rules around digital and the online realm, even if right now they seem to be mostly emanating out of the EU, I'm convinced that in the not very distant future, this will become the norm in most other jurisdictions. I think it's inevitable, to a certain extent, at least, for some parts of the online reality. It is late because some of the risks have materialized already. If we look at social media and what it has done to the cohesion of our societies, already we are intervening late by expecting certain responsibility for the platforms, and how they work, and how they optimize and so on and so forth.

So, what I'm trying to say is that I consider rules to now become inevitable for a sector that operated in a vacuum for a very long time, which means that with rules becoming a reality, lawyers will now need to also themselves prepare, adapt and learn. So, the first observation to make is that I consider that every lawyer will need to start understanding technology as well. I know that many universities already started to blend ethics of technology and how it plays out into society and economic relations, into legal studies; I think that's a good approach.

Then companies themselves, as these rules, these norms, these standards, will become more and more present in most jurisdictions, companies themselves will need to understand how they navigate these rules. So, they will be asking lawyers for help.

So, from my point of view, there's a lot of opportunity that actually is opening up right now for lawyers and for how their services will be requested in the future. There is also a

question that I think lawyers need to ask themselves in terms of the impact that AI has on their own job, because lawyering of any kind will also be changed by AI. In fact, if you ask me, it's going to be one of the first jobs that will be quite heavily impacted by AI, because a lot of, for example, clerical work that was done in a law firm right now, a lot of that will be done by AI in the blink of an eye. Whereas now, sifting through ten volumes of jurisprudence might take couple of days for a legal clerk. Well, AI will be doing that for you while you drink your coffee. That is also going to change radically the profession from inside. The same will happen to courts, and how courts will function. And that in itself will require quite a lot of adaptation. Not that I think that lawyers will disappear, on the contrary. I think lawyers, just like many other professions based on intellectual input, they'll have to learn to use AI tools in their work, adapt these tools for their needs, and then use them for a new dawn of the profession.

SCOTT PATTERSON:

Thank you so much for that. Andrew, do you have any questions?

ANDREW LIN:

Sure – thank you so much for the very comprehensive interview, we really appreciate it. I have one question, which is the role of private ordering within the future of the AI Act. So I think until now, one way that companies, at least certainly here in the U.S., and I think European companies as well, take on corporate governance within the AI space is through private ordering, defined as figuring out what works best within that individual company.

Given the AI Act and the rules and the regulations that are coming out of the European Parliament, do you think there's still a world in which private ordering is so important? Or do you see a world in which even if it's important, it's greatly diminished?

DRAGOȘ TUDORACHE:

What is private ordering? I'm not familiar with it.

ANDREW LIN:

It's where an individual company comes in by itself to set its own governance standards.

Dragoș Tudorache:

I don't think that will necessarily die away, disappear, or be rendered unnecessary or irrelevant by regulation. I do think that was an effect of the lack of regulation. I think at some point various companies have started to ask themselves, listen, if no one tells me what I need to do, then I need to figure it out myself and put myself some ethical standards in place.

Which in the absence of rules, they served a purpose, and gave some companies at least, an appearance of respectability, because they could say, listen, we have our own norms, we have our own ethical mechanisms. Nothing will stop them from continuing to have them in parallel with rules, as long as it is clear that the rules have to be respected, particularly where the rules are mandatory, as it happens in the EU market. For a while in the US there won't be the equivalence of that. Therefore, I would say that what you call private ordering will be continuing for a while, but certainly I think it will be on a downward trend as more and more jurisdictions will start fixing in law the expectations, the norms, and the rules.

You know in a way, if you look at any other more mature industrial sector, which has gone through what the digital sector is going right now, maybe eighty to one-hundred years ago, it's the same thing. At the beginning, each car company had to figure out their own standards up until we started to put standards in place on how you build the wheel, how you build an engine, what requirements you expect out of a car company in order to ensure safety from seat belts to ABS, and so on, and so forth. All that started one-hundred years ago by being things that each company was doing on its own, up until as society, we decided that it's important that we have standards that would apply to all the same. It is happening now for digital. It is time for digital companies to realize that now they are grown-ups.

Scott Patterson:

Thank you. To reiterate what Andrew said, thank you so much for taking the time. That wraps up all the questions we had.

NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 20 SUMMER 2024 NUMBER 3

THE EU AI ACT: TOO EARLY AND TOO COMPLEX?

JÉRÔME PHILIPPE*

SEAN URIBE:

I'd like to begin this conversation by asking you to set the scene a little bit for us. Could you please share with us how the most recent AI developments, particularly AI Act, came about in the European Union?

JÉRÔME PHILIPPE:

Thank you, Sean. The AI Act has been under construction for some time, a few years, with quite a number of debates, especially in France but not only. I think there's a relative consensus in Europe on the need to do something.

However, this Act here is a pretty heavy one, maybe too heavy for a nascent industry. It's 272 pages long! It's extremely structured, clearly a bit cumbersome. It's going to create new significant constraints in terms of regulation, debates with regulators, with possible fines in the end.

And, it's also going to create private enforcement activity, I think because it defines many obligations. When you are a client or a subject of AI, you will see that people implementing AI have a number of obligations here. And nothing prevents you, as a third party, a user, or a consumer association, to say:

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"Okay, I consider you did not fully comply with the AI Act, and the regulator is not acting enough, so I'm going to enforce it by myself. Before a court, based on usual tort law and a violation of the AI Act." We expect a lot of private enforcement coming at some point, maybe not immediately, which will create a lot of litigation. And that's one of the issues with those complex and heavy laws such as the AI Act. We see it today with the GDPR as an example, although the GDPR is much simpler than the AI Act.

All this litigation constitutes a cost. Especially when it comes at the very early stages of development of a very new industry. One of the major questions is whether this regulation has come too soon in the development of AI. Many people consider the AI Act to be at risk of hindering innovation and competition. To sum up, when you see that massive regulation with hundreds of pages all setting obligations, you have the feeling that someone has been thinking: "What are all the possible problems that AI could create? Let me regulate all that in advance."

This approach could raise criticism of course. For example, the French government has been working for months to try and alleviate some of the obligations and make them less burdensome for the players, especially the small players. Those could face barriers to entry partly because of the regulation. There's a French actor for example: Mistral AI. It was recently created in 2023, but already has a very high valuation and is seen as a possible competitor to big players for the next stages. That's definitely a good thing to have young competitors like this. We want to have competition, and of course the Government doesn't want AI to be reserved to the big players that are already installed.

It is in this context that we would need to figure out how this regulation would play out. Is it going to favor competition? Or is it going to create too many obligations that end up being so costly that they create significant barriers to entry? These types of regulations are already very difficult to comply with for big, established players with large legal departments. It will be even more difficult for start-ups or mid-size companies to comply with, especially since when you are a newcomer, legal is usually not your first preoccupation amidst your attempts to making your product work and going to investors and markets.

Another feature of the AI Act is that it is extraterritorial, as it applies not only in Europe, but it will cover providers of AI anywhere in the world, provided that their product is used in

Europe, which I guess should be the case for most AI products. So *de facto*, it's a worldwide regulation that can also create a sort of race to regulation if other countries or regions want to do the same. It's like trade barriers, it's always nice to be the first one to create it but then you have to face replies. Here, this creates incentives for other countries to regulate at the same level too and you end up piling up many regulations from many places, all being *de facto* global. That could be a real issue of consistency and of costs.

Of course there are also good things in this regulation. It's clear that when you see some uses of AI, especially generative AI or foundation models, there can be risks associated with that. In particular, there can be an informational risk of being unable to know what is true and what is not true, what has been made with AI and what is natural and made by man.

So of course, having some transparency and some rules is needed. But it is a matter of level. Here, we have two hundred and eighty or so pages of rules, many of which may require clarification. Thus the publishing of the act is not an accomplishment (even if in reality it is in view of the EU decision process) but it is a starting point. The next years will be about implementing all that.

Entry into force should be a matter of a few months. But then, once it enters into force, all the rules do not apply immediately: you start a period between 6 and 36 months for full implementation. Some parts of it, I would say the most sensitive parts, will start to be implemented 6 months after the entry into force. And for other parts, it'll be 12, 24, or even 36 months after implementation. I think this will create a lot of activity because it applies to new AIs, but also to existing ones. For example, you have an obligation of traceability of the data you use for training high-risk AI. This means that when you have already started to train, you need to get back to what you did previously and track it retroactively. A lot of guides are being published everywhere on what you should do to be compliant. But there will be room for a lot of interpretation too: debates will take place because sometimes these obligations are expressed in broad terms, leaving a lot of scope for clarification and implementation… or litigation.

The European Commission is also supposed to adopt a number of implementing regulations. That will all take place in the near future. National authorities should be appointed, one or two per country, depending on how each Member State

wants to organize that. However you will not have massive national implementing regulation as this is not a directive, this is a regulation. It applies directly everywhere in Europe. You don't need national Parliaments to adopt implementing laws except in the specified areas where the AI Act has provided an obligation or a possibility to do so.

Despite this extensive regulation, some of the debates raised by AI are not fully resolved. For example, in France, there is a big debate on how we should apply copyrights. Based on a EU Directive, France was the first in 2019 to implement what we call neighboring rights, which is basically money that platforms like Google, Apple, Meta and others should pay to newspapers when they use their articles, or when their users use such articles in posts, and more generally when they give access to their articles through the platform. There's been big debate on whether those rights were due or not. Lobbying went up to the EU and that gave rise to a Directive that has provided that there should be in some cases a compensation. The Directive does not include AI of course, just social networks platforms. So here now you have a rising debate for AI, and I see that this debate does not only emerge in France and Europe, but also in the US. France has been at the foremost of it to protect the owners of rights on articles, books, and also movies. With a different and older system that also exists for music. Today the new question will be whether they should be paid for the use of their intellectual or artistic production by AI for the purpose of training.

If you think of applying these rules to AI training, the question to ask is what use do you really make of the intellectual or artistic productions when training AI? By using it for training, do you make it available ? Should you pay for that use or not? There is the evanescent idea that this use enables the AI provider to make profit, but how to measure it? There will be litigation and you probably have competition authorities that may want to act also, although I'm not sure they will have such an easy way of acting as they did in neighboring rights. For neighboring rights, the French competition authority was very active. It was the first one to be active in a case against Google. The solution of which was extended to other platforms. So this is something I expect for the future, i.e. debates nationally and at the EU level on compensation for the use of intellectual and artistic data for the training of AI. And this will create another subject within the subject, which is the obligation that will exist on high-risk AI to indicate the data they used for training.

There are two points which I think are problematic for a number of AI providers. One is indicating the data used and sometimes indicating even the source code of it, which is part of the EU regulation. The other is that this will create circumstances that may force you to give indications that are actually your business secrets. Choice and enhancement of training data could be a matter of competition between AI providers. If you have access to better data than others, that's a comparative advantage. In competition law there are very limited cases where you need to give access to essential resources, which sometimes included data but that was not in the context of AI. Apart from those rare cases of data monopolization, if you have a case where there is no dominance nor essential resources and the only thing that data provides is a mere competitive advantage, then its beneficiary should normally not be forced to publish or disclose the data, especially by the government. On the contrary, disclosing in such case could be seen as reducing competition. Therefore these issues of disclosing data and paying for it will most likely fuel a large debate in the future.

If we come back to the AI Act itself, it will cost quite some money to comply with it. It will force all the actors in the chain to take advice, actions and demonstrate at least a minimum degree of compliance with those obligations. This will include a need to precisely define roles.

The AI creates roles: you have the provider, you have the importer, you have the deployer, and the Act gives responsibilities and obligations to all of them. Sometimes it's not very well defined and you may not be able to comply with some obligation. For example, if you are the provider of the AI and you are asked to follow your AI during its life cycle and to provide a number of information. I'm focusing here on what we call high risk AI in the regulation. You have to follow your products and to document a number of things about them, to which you don't always have a direct access. It may be your clients who have access. If there are issues, how do the initial training and the subsequent use of the AI interact, how is the AI amended during its use with, for example, new biases that did not exist at the beginning and that will start to exist during commercial use? This can be so because at some point during use, the system will progressively bias its own output and with the feedback loop will reuse it. What if, similarly, you provide a non-high-risk AI, but your clients amend its use and make it a high-risk AI?

That may make you lose your status of provider but have new duties vis-a-vis the new provider, though you may not even know about it.

Sean Uribe:

Could you explain the concept of "high-risk" within the meaning of the AI Act?

Jérôme Philippe:

The AI Act engages in a risk-based approach. Basically, the heavy constraints are for high-risk AI and foundation models. There is a list of criteria to define high-risk. For example, as soon as the AI performs profiling of persons that has an impact on the persons' rights or duty, you are in high risk. So, it's relatively easy to be considered high risk.

Take, for example, educational AI. That is high-risk in most cases. If the AI is used in an employment relations context, it's very likely high risk too. Moreover, you can very easily fall in the scope of high risk if your AI is embedded in a system that is already regulated.

Reality will certainly show that we need hundreds of additional pages of implementing regulation! I'm obviously not calling for that. But clearly the point is when you want to be so precise in the obligations as the AI Act is, but you're still not 100% precise as to the scope, then you create legal issues.

The regulation is so complex it will create uncertainty. Usually, regulators tend to apply regulations strictly, but they also have to adapt to the situation they face in a clever way. And generally they do it, but it creates significant legal uncertainty for everybody because, you never know how the regulation is going to be interpreted by the regulators especially for a regulation that emerges before the industry has really emerged! And this will be exacerbated by the fact that the regulation is so complex that I expect that no one will be able to entirely comply.

The AI Act is based on the same model as the GDPR in data privacy, but is more complex, and applies to a less developed industry. And yet, when you dig in nearly every company, you always find some degree of GDPR non-compliance. That will be even worse for the AI Act.

So will the regulator understand your situation and take account of it or not? I mean by being benevolent to some extent. That's a big uncertainty, as regulators are not meant to be benevolent.

If one wants to properly comply with the AI Act, he will need to have high degree detailed cooperation with other actors in the chain. As an example, cooperation is requited between the provider of the AI and its deployer. And at some point, there is not a full clarity as to whether the deployer may become provider in turn. Also, it is not clear whether selling a product incorporating AI may impact your role, e.g. by making you a provider.

Additionally, by forcing too much cooperation between the provider and the deployer (i.e. in common terms the user of the AI), you may in some cases end up with competition issues.

For example, if you look at one subject, which is not dealt with here, which is price. As a competition lawyer, when I advise suppliers, I tell them that they are not supposed to know all what their clients do with their own clients: your client buys your products, then they use or resell them and you're not supposed to know to whom and at which price. Once they have bought your product, they are free to use and resell it provided they do not breach the conditions of use and the contract, and you should not try to influence that use. For example, what we call "destination clauses", where the provider attempts to control to whom the product will be resold or with whom it will be used, are often considered to be anti-competitive. Well, with the AI Act, the provider may have no choice but to interact with his client's commercial policy, as that policy may have an impact on the provider's obligations. As an example, although as a provider you did not build your AI product to be a high-risk AI and you did not comply with the additional obligations that this would have imposed, considering your product shall not be high-risk, what if your client starts using is in a way that makes it a high risk AI (e.g. in the areas of education or employment)? Therefore you need to protect yourself from that, but this means interacting with you client's commercial policy. Which, again, you are not supposed to do from a competition law perspective.…

ANDREW LIN:

So, on that point, would you create clean rooms, with different trees within so that they don't touch? What would be your advice?

JÉRÔME PHILIPPE:

You're right, the advice can certainly be to have clean rooms in some situations, in order not to share information that is too sensitive. However, it's not very clear how clean rooms would

interact with the obligations here because at the end of the day, it's an obligation on the deployer or an obligation on the provider, and you may need to really access the information in order to comply with our obligations under the AI Act.

In particular, if I have the relevant information in a clean room, I may need to have it outside of the clean room too in order to make a full regulatory use of it and to be able to discuss if I need to engage with the European Commission or the national regulator. So I think there are some cases where clean rooms will work, and other cases where they won't. In addition, due to the technical complexity of the matters concerned, you will need to often involve engineers and strategy people in those discussion, which may not go along well with the use of a clean room.

SEAN URIBE:

Thank you so much for the background. Getting more granular, could we talk about the intersection between both the new AI Act, GDPR, and some other existing data regulation regimes such as the Data act? I'm curious to know what your thoughts are about the interplay there and, and potential issues that might emerge.

JÉRÔME PHILIPPE:

In principle, it's very simple. They are supposed to all apply in a cumulative way. But in reality it will be much more difficult to do. I will take an example with the GDPR. There are several legal bases for data processing, one of them being consent by the data subject. When you have consent as the legal basis for a processing, one of the particularities of that legal basis is that the data subject has the right to withdraw its consent at any time and with no explanation. In that case the data controller must remove the person's data and stop the processing.

The point is, how are you going to comply with a withdrawal of consent when the data has been used already for training and so has become part of the AI system? One short answer may be it's no longer in the data set so it's fine. However we do not know whether this is sufficient, as the AI is still working on the basis of a training including that personal data, so is there still some use of it and is it still a personal data?

Of course, one of the possibilities that is mentioned in the regulation is to anonymize data when you train an AI. Your set of data used for trainings remains but is no longer

considered to be personal data. However the criteria for valid anonymization is that you cannot infer back and find the person. If you achieve this, then it is no longer personal data and the GDPR is no longer applicable.

However, how sure are you that your data is really anonymized when you are working with AI systems, and are you sure it is not possible, precisely using AI, to infer back who that person is or who that group of persons is?

Indeed, for your model to work well, you generally want the data to be as precise as possible. Thus, even if you remove ID, you will often keep all the "metadata" on the person, e.g. sex, age, region, type of living, tastes, job, family, other characteristics, etc.… How sure are you that you system cannot infer identity back? So, the interplay with GDPR is pretty difficult.

In practice, what we see is that the data protection authorities, although they really enforce GDPR with a strong view to protect data subjects, are also realistic and to some extent may adopt a pragmatic approach, based on what is technically possible and what is not possible. Thus, I would say that at some point we will probably find a point of balance. That will certainly be dealt with soft law. We have hundreds and hundreds of pages of soft law, such as interpretations, guidelines, presentation, and this can give clarity on some points but it also makes the law very difficult to apply without a high level of investment in it.

In relation to soft law, you may have different guidelines from different national data agencies as they don't always fully coordinate with each other to ensure consistency. When you go into the details, you find differences between them. For example, in the way we apply GDPR in various countries, you encounter small differences, which may sometimes become meaningful in the context of a given project.

SEAN URIBE:

It is certainly a very complicated issue. Moving on, I think another question that we are pretty interested in is how you anticipate this new AI regulation to impact the business climate, particularly outside of the European Union.

JÉRÔME PHILIPPE:

Well, first, there will be bad surprises for a number of actors—I'm not speaking about the big players. The big players are already involved in the discussions, and they will be ready for sure. But if you are a smaller player such as a new tech, it will

be much more difficult and costly to comply. I will take again my former example Mistral, the young French startup creating new AI products. How are they going to implement such a tough regulation, I don't know, and I think this is an open question. Generally speaking, what we call the French Tech, i.e. the set of innovating tech start-ups, has spoken negatively on the AI Act, which they see as creating a risk that AI research and development work goes to other parts of the world.

But even abroad, as soon as your AI is supposed to interact with European citizens, a first obligation will be to appoint a representative in the EU if you don't already have one. And then, you start piling up obligations, especially if you provide a high risk AI. That is going to make development more costly from the outset. What we should hope is that it'll not create too many barriers to entry with products that you cannot sell simply because you need more money to both develop your product and comply with all this and that again.

This is the first and foremost question – is it going to make it too difficult to develop AI, and thus hinder innovation, or not? Is it going to concentrate innovation on the big players that are already established?

The French Competition authority (the FCA) has rendered an opinion on the AI sector a few weeks ago, in which it expresses concerns about the risk of major digital players engaging in strategies to consolidate their market power upstream of the generative AI value chain and to extend any market power into existing and new downstream markets. In particular, the FCA identifies several risks of abuse, many of which relate to access to key inputs (such as computer/chips, data, talent and capital) as potential high barriers to entry. In light of these concerns, the FCA has put forth a series of recommendations aimed at fostering competitive dynamics within the sector. These include ensuring that the implementation of the AI Act does not slow down the emergence or expansion of smaller operators, and that the largest players do not divert the AI Act to consolidate their market power, though a so-called AI Act "washing", notably through the AI Act exemption applicable to open general purpose AI models.

When you look at the communication by the French competition authority at the time of the launch of that sector investigation, its Chairman said in substance, if I may sum up, we are doing that because we don't want AI to be monopolized by a handful of already established US players. This is the role

of a competition authority obviously to ensure that access to the market is maintained, including for newcomers, but the question is whether such a complex regulation on an emerging industry is really the right way to do so.

Additionally, one should always be careful when putting in place such extraterritorial regulation because other countries may respond as well. To some extent it works like protectionism. You are happy for some time when you're the first one to move, but you are less happy when others replicate. Here, I hope this is not going to trigger similar extraterritorial laws in other regions but I fear it will, as this would or will result in piles of competing legislations applying altogether and making innovation even more difficult.

This is an issue of such a complex and extensive regulatory approach at an early stage of the industry. I'm a bit afraid, I must say, and our clients are a bit afraid, that it may well make business more difficult, and at some point, it may slow or hinder innovation.

SEAN URIBE:

Right. Well, fingers crossed those risks don't materialize. We may have touched on this slightly, but can you speak a little more about what you think boards need to be doing right now in order to ensure that their compliance programs take into account these advances?

JÉRÔME PHILIPPE:

All these issues are more and more subjects for Boards of directors, as they are really structuring ones.

It makes me think of cyber risk. Ten years ago, cyber was not a Board level subject. Now it is definitely a Board subject because the risk you face is an existential one. It is the same here, in terms of compliance first, but also in terms of reputation. Reputation and trust are important in the AI world, because AI is at the same time exciting and worrying. If tomorrow you get a name and shame decision saying you did something wrong and that your company is not compliant with the regulation, this may have a cost much higher than the fine, which by the way may already be high.

So compliance will have a high cost for sure, but non-compliance is likely to have an even higher one. That makes it a matter for the Board. This is not only a subject for the regulatory department, or for the public relations one, or for legal. This

is a real subject that needs to go up to the Board of Directors and involve the whole company. It is a cultural matter. There is a need to develop and maintain a culture of compliance, and AI will be part of it.

Thus I think the Boards should anticipate the AI Act as much as possible. Now that it is adopted, implementation will be progressive for a long period of time. This gives time to anticipate and start preparing for it. That work should start right now if it hasn't started yet, as implementation will take time. As an example, it is not limited to internal measures, but it will induce changes in contracts with partners, clients, suppliers, etc… All this need to be anticipated and negotiated in advance.

In practice, the Board should appoint an AI Act coordinator, who will be specifically in charge of ensuring compliance, will interact will all the departments that are concerned, will have authority to make the compliance plan progress, and will report directly to the Board.

I would say those persons who will be appointed should be at the right level in the company in order to make sure compliance is warranted in the end, so you'd want someone sufficiently senior in the organization to be able to shape the way the organization will work, because that will have an impact on how the whole organization will work. There will be internal reluctance of course, as compliance with the new act will change ways of working and will add constraints That should be organized with clear Board level indications, on the basis of a strategy endorsed by the Board.

Indeed, it will be essential for an AI to be compliant. For all the high risk AIs, you will have a "CE" marking on the product. Technically I don't know how you mark "CE" on an AI, but joke apart, that will be obviously key for commercialization, and also embedded in other products in Europe.

In particular, if that "CE" marking is removed, it will mean big issues for the product because it will immediately be barred from the European territory. If it's embedded in third parties' products, then you face even bigger legal issues with your clients, with potentially high levels of liability. Needless to say, contracts will need to address that issue very cautiously.

You just have to look at the issues that a company like Boeing is facing at the moment, not in relation to AI though. Just imagine your AI is marked on 10 million cars in Europe in view of ensuring their safety, and from one day to other, it has to be removed what would be the consequences of that ? There

is no doubt such issues can become enormous and vital for a company. So, it's a clearly very important subject. Boards should really as soon as possible organize themselves to be able to implement that and reduce risk.

Regarding companies that will embed third parties AI in their products, such as car makers for examples, AI due diligence will be a major subject for safety and quality. When you look at it from a supply chain perspective, it is actually very close to cyber issues. You need to make sure your providers will be compliant and you need to develop you own due diligence ability. At some point you may need to be able to audit what you are going to embark. Either you can do this yourself, but this means developing the ability, or you need to select trusted third parties to do so.

To this extent, it is a sort of "know your supplier" approach, as you could be the first victim of a non-compliance of your supplier. In itself, this may make entry on the AI markets much more difficult, as you will need to be able to prove strong track-records and comfort to your clients about compliance.

And at the end of the day, it may be that the biggest barrier to entry in that industry is how to obtain the trust of your clients. You need to have track records, you need to have a lot of accountability, transparency, and that means it's something difficult when you are a new company. There will be a barrier to entry here.

This is where I come back to my first point on regulation. Is it too early? Is it good here to be ahead of the curve, or could it create a bad situation because, even if there are legitimate reasons for regulating, it comes too soon and you face issues of bias against entry and bias against development.

Finally, we should anticipate complex business relationships and complex liability issues. For example, take a car manufacturer – say it decides that it will integrate some AI into its product, which by the way is or will be a strong market constraint. It may also buy components which themselves may have AI in them. As an example, the radars that certain cars use which are used to safeguard against accidents, these might include AI and are not usually components which are developed by car manufacturers themselves. You will have AI that will reconstitute the environment using data coming from all the (sometimes AI-powered) sensors. And you may have central AI that will manage the vehicle. So, you have several layers of AI products: some developed by the car manufacturer, some

procured from third parties for specific tasks, and some already embedded in components that are separately procured. This means multiple stages of AI incorporation in the product, and communication buses between them. And when you are the car maker, you are at the end of the chain. The point is, you need to get visibility not only into your direct suppliers, but sometimes the suppliers of your suppliers. This is something difficult because when that visibility includes how that AI was trained, which kind of data it trained on, et cetera, that makes it exceedingly difficult. And this will be key not only for compliance, but also for the proper functioning of the vehicle and for the determination of liabilities in case of technical issue.

ANDREW LIN:

So, Jérôme, could we dive in a little bit more on the different layers and the lack of visibility. Let's say you are a plane maker, and you're using all these AI technologies. Assume the AI uses data that violates the AI Act but improves safety by ten times. So, here, you have a tradeoff. Do you think in these contexts where the benefits the AI brings are substantial that there will be exceptions to these rules? Where do you think it'll be a per se rule? If you don't meet the guidelines, you're out of the game?

JÉRÔME PHILIPPE:

In theory you don't have such a balance in the regulation. The concept of balance between pros and cons is not in itself visible in the regulation. Thus the short answer should be, if it's not compliant, it cannot be used. If it's on a plane as in your example, it means the plane using that cannot take an EU passenger on board or fly into the EU.

Now I'm an optimistic person and I strongly believe regulators feel a strong duty to protect the people. Thus I tend to think they would agree in principle to work out a legal solution, though within the limitations set out by the AI Act, which they will not be able to move or to evade.

In practice, in such case, you would first need to assess your own risk. You have a self-assessment to make in the form of an impact assessment. Once done, you would have to engage with the regulator and share it with the regulator. That impact assessment is typically the place where you would create yourself the latitude to make the pros and cons balance. What will my AI bring in terms of added security and what are the reason

why it may create risks? There may be some risks I can control to some extent, and then I should take steps to control those risks. There might also be risks which I'm not able to control, at least not now. Based on this, a discussion will take place with the regulator, hopefully ending with the possibility to deploy the product while taking all possible steps to ensure its safety. This way, the system would be deemed compliant.

Take as another example the data privacy impact assessments in the GDPR field. The notion there is that it is a self-assessed impact assessment, and this is something that works well in the GDPR context. Essentially, this boils down to making sure you are asking yourself the right kind of questions. What are the benefits, what are the risks? How do I control the risks? Can I remove all the risks or can I mitigate them? Are there other risks I cannot control? Why can't I control those risks? All of this is part of your assessment. If the assessment is properly done, then when it's reviewed by an authority, you have a possibility to reach a consensus and have it approved by the authority.

Apart from the risk control itself, there are other components of compliance: you need transparency, you need traceability of training data, etc.… Those are mainly processual and will be seen as obligations of means for compliance.

Therefore you distinguish two parts for compliance: a processual part that will not be subject to negotiation, and a substantive part where an impact assessment will be the tool for a discussion with the regulator.

As you can see, there is still a lot to build and limited time to do so. This is why compliance work should start now with strong Board involvement and support. On the regulators' side, once they are appointed by the Member States, there will be a huge amount of work to get to a level of in depth understanding of that regulation that will enable them to apply it rightly while still finding the degrees of flexibility that will be necessary to adapt to an evolving and still nascent industry without impeding innovation.

NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 20 SUMMER 2024 NUMBER 3

NAVIGATING RECENT EU REGULATIONS ON AI: AN ADVISORS PERSPECTIVE

NICK WOLFE*

DANIEL VENETUCCI:

In a very broad sense, what are some of the considerations you have been looking at from the antitrust perspective, especially in the most recent AI regulations that have come out?

NICK WOLFE:

First, I would place it in context and note that over the last decade, there has been a change to a harder enforcement environment. Particularly in the area of merger control, where there has been both legislative change and more assertive enforcement.

There were many transactions over the years involving the high-tech industry that were largely not captured by the merger control thresholds at the time. An exception was the UK, where the Competition and Markets Authority (CMA) has always had scope to assert jurisdiction under UK legislation even if the parties had little revenue in the UK. It really started to flex that capability in the late 2010s. With Brexit, that held particular importance because the CMA also acquired the vires to review deals which had fell to the European Commission to review on the UK's behalf when the UK was an EU Member State. Before

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then, most regulators weren't really looking into these deals or if they did, they did not object to them or they got comfortable with them based on market feedback and remedies or commitments offered by the parties. I'm sure you've heard people refer to Facebook-Instagram or Facebook-WhatsApp as examples of mergers that did not elicit much regulatory interest at the time, but which regulators have since said they should have reviewed more carefully.

Greater regulatory monitoring has subsequently come about in all sorts of ways. Here in Europe, the European Commission has tried to make greater use of Article 22 of the EU Merger Regulation. This was originally conceived of in 1989, when the EU Merger Regulation was introduced. Not all members of the EU had their own merger control framework, and Article 22 was there to allow Member States to refer deals to the European Commission for review. The idea was to address situations where a Member State wasn't able to review something by itself because it lacked the relevant local legal basis, and at the same time the transaction didn't meet the technical financial thresholds to be subject to review at the EU level.

But Article 22 withered on the vine because most Member States did develop their own domestic regimes. The Commission controversially pressed it into service again in recent years as a route to review these deals where the parties didn't meet the EU level thresholds for review.[1]

Separately, the European Commission has ramped up enforcement, particularly of what they view as large tech platforms. And so has the CMA in the UK – I worked on a case, PayPal-Zettle in 2018, which the CMA reviewed (and cleared), even though the target had very small revenues in the UK. Over the last five or six years, you've seen an enforcement environment where the regulators have said, "we need to scrutinize more closely large tech companies, and we're going to make sure that we can get the jurisdiction to do that, or we will assert our jurisdiction if we weren't really doing so before." As I mentioned earlier, Brexit had an effect here, because the CMA became an additional significant regulator with the flexibility

1. In September of this year, however, the European Court of Justice in the *Ilumina/Grail* case held that the EC cannot review a transaction if the member state making the referral request has national merger control rules but its national thresholds are not met. Joined Cases C-611 & C-625/22 P, Ilumina v. Comm'n, ECLI:EU:C:2024:677.

to review deals, even ones that involved companies with very modest turnovers.

Looking now at AI, the thing that's really prompted a lot of regulatory activity in the last six months is generative AI. Because clearly AI has been with us for a while, and it's really this ability to generate novel content and provide it via an accessible and user-friendly interface that has excited people, led to rapid adoption and generated a lot of regulatory scrutiny as a result. The European Commission has sought information from companies who have foundation models or use those models to enhance an existing product.

So, the Commission – and also the CMA in the UK over the past year – has already been approaching many companies to ask them: what agreements do you have in place with foundation model providers? What are you thinking to do with generative AI? How is that going to feed into the products and services you offer? What are your ambitions for using generative AI or AI more generally? What are your concerns? These questions relate to the various issues the regulators are looking into, in particular things like whether certain inputs are critical and who controls access to them, what roles do new versus established players play and will existing positions be reinforced, and will there be choice, transparency and accountability that will reinforce the competitive process.

The regulators are at a fact-finding stage at this point, seeking to figure out what the landscape looks like. Of course, the ability to fact find is a valuable part of their toolkit.

Moving away from fact finding, another item in the EU's regulatory toolkit is Regulation 1/2003 Article 8(1). This enables the Commission to apply "interim measures". If the Commission has evidence of a prima facie case of a competition law infringement that will cause irreparable damage – for example, the Commission alleges that there has been an abuse and a market is about to tip, and as a consequence others will struggle to compete – the Commission has this Article 8(1) interim measures ability to approach a company and say they're imposing interim measures. The Commission must open proceedings under Article 2 Regulation 773/2004 and send what is called a statement of objections ("SO") to the prospective addressee of the interim measures, and grant access to the Commission's case file. The recipient of the SO has a right to be heard in an oral hearing and reply in writing. The views of third parties who show sufficient interest to be heard should also be considered.

The Commission made use of interim measures in the Broadcom case in 2019. Broadcom produced chips for television set top boxes. The Commission investigated exclusivity provisions in Broadcom's contracts. The Commission also used interim measures more recently in Illumina-Grail, because Illumina and Grail closed their merger without having received merger clearance from the European Commission. The Commission doesn't use interim measures very often, but I mention it as an example of something that is definitely at its disposal as an enforcement tool.

Another significant development came in February and March of this year. We've seen the Digital Services Act and the Digital Markets Act come into force. I worked as a financial services regulator before I became a lawyer, back in the 2000s. We're very familiar with a world where large systemic banks are supervised closely by regulators who every day get reports from these banks or large insurance firms. And they talk to these banks and insurers about their capital position and whether they're at risk of a run or somehow not being able to do what their policyholders or their customers expect.

What we've seen with the Digital Services Act (DSA) and Digital Markets Act (DMA) in Europe is a world where the European Commission is moving to close supervision of what it deems to be systemically important platforms, referred to as "gatekeepers" under the legislation. The Commission identified six companies. If you're a gatekeeper, you're now subject to a degree of supervision and also reporting obligations – having to send compliance reports to the Commission.

The DMA and DSA oblige those subject to them to give the Commission information on a regular basis, such as annual reports on compliance with conduct obligations relating to things such as use of end user data and terms and conditions imposed on business users, and for DMA gatekeepers an independently audited description of changes made to their core platform services that could affect things such as interoperability. All of this can help the Commission understand what they are doing including in the AI space.

They also have to notify the Commission of M&A in the digital sector, including acquisitions that may give access to new sources of data. This may not ultimately lead to a formal antitrust filing, but the Commission gets a view of the activity that these companies are engaged in, in the M&A space as well as

their day-to-day ongoing business, and may require a filing for example pursuant to Article 22 of the EUMR.

There's also the Digital Services Act, which is not really so competition focused. It's more about protecting end users – making sure that harmful content is regulated. That applies to significant platforms or search engines, and there are seventeen large platforms that are covered by it. So, that casts the net more widely and is another way in which the Commission can gather information. In particular, companies must prepare risk mitigation strategies for their platforms.

You mentioned the AI Act, and that hasn't entered into force yet. It's still to go through the legislative process, but the Commission is trying to encourage people to already voluntarily comply with it through the "AI Pact" initiative. The AI Act, as I understand it, is really speaking to the big picture concerns that are talked about in the news – such as "is AI going to take over", this kind of concern that one sees being expressed. The Commission has said that the goal is to support the development of trustworthy AI, to ensure that AI systems respect fundamental rights, safety, and ethical principles.

So, overall, I think the Commission is pretty well equipped to regulate and potentially enforce to address its concerns. But I will also say – to make an obvious point of course – that this is clearly an area where there's a lot of uncertainty and nobody has a crystal ball as to how things will unfold.

Generative AI is a new and dynamic kind of space, and when you have that kind of uncertainty – well, even when you don't have uncertainty – it's difficult for a regulator to reach the perfect biting point for its regulation and figure out that this is exactly how it should regulate something. A regulator wants to avoid under regulating; wants to avoid over regulating; wants to get it just right. Even in normal circumstances when dealing with very familiar territory, it's difficult for a regulator to do that, I think. With generative AI, it's uncertain territory. It's new, and people are still figuring out what it can do, so it's very hard for regulators to get it right and to pitch regulation at just the right point.

That's why they're doing all this fact gathering that I mentioned; that's why they're sending out information requests. That's why they are issuing reports, such as reports the CMA issued in September last year and April this year. They're doing all of that to inform themselves and then make sense of the situation.

DANIEL VENETUCCI:

You've mentioned all these different tools that regulators have to help regulate AI. I'm wondering if you have any sense for how the regulators themselves are utilizing AI to perhaps aid in their enforcements, or simply monitor companies.

NICK WOLFE:

I have fairly limited insight into that. What I will say is they have ramped up their capabilities in the area of forensic science and document review. I guess that's particularly pertinent in a world where companies generate very large numbers of documents, and nobody can humanely go through those. So, the use of technology to bring that to a more manageable state of affairs is obviously very useful, and it is clear that the regulators have invested in this area.

The European Commission has in the past used patent analytics software in order to assess innovation in an industry and take a view on the impact of a proposed merger on innovation, based on patent analysis.

When Brexit happened, the CMA talked about the resources it was spending to prepare itself for an increased work-load. That ranged from hiring fifty more people, to beefing up the technology used by its forensics unit. The EC has also spoken of its use of algorithms to detect where markets may be performing sub-optimally and to investigate whether this may be the result of anticompetitive practices. Recently, the European Ombudsman, which holds the Commission and other EU institutions to account, has written to the Commission to ask how it decides on and uses artificial intelligence (AI) in its decision making. It has specifically asked about the automation of tasks, decision making concerning the use of AI, transparency of how the Commission takes decisions on AI use, and accountability.

DANIEL VENETUCCI:

I want to turn now to more of the business side and perspective. Maybe just in a broad sense, what are some issues that clients or businesses in general are thinking about in terms of AI? For example, implementing that into their own business and potential pitfalls such as driving anti-competitive behavior with the AI.

NICK WOLFE:

A number are looking at how they can use foundation models to enhance existing products or services. And I would say in terms of pitfalls, businesses are very conscious that this is a hot topic for regulators. Even if they haven't been a recipient of an information request themselves, they're aware of the high degree of regulatory interest. So, I think they look to us for guidance on what may or may not be acceptable from a compliance perspective, what good practice looks like and how to approach compliance so that you are doing the best you can from a regulatory compliance standpoint.

Arguably, AI doesn't really change what the concerns might be from an antitrust perspective. Things like foreclosure provide a framework for regulatory analysis – if you take for example a particularly powerful foundation model and someone is also active in providing services downstream that interface with users. The question becomes "What might be the concern if we have a foundation model, and we also have products downstream? What might the concerns be from a regulatory perspective?"

So, one can think about the risk of a regulator investigating potential foreclosure of others who might want to use your foundation model, and questions that may be raised about the contracts you have with customers who use your foundation model (and whether you have overly restrictive clauses in them). More broadly, I think people are aware that if you really boil it down to what the regulators are concerned about, they're concerned about contestability.

If you are active in AI, you may be on the receiving end of a lot of attention from the Commission because the Commission is asking itself questions about the position that those developing foundation models might occupy in future years. I think the CMA said that in an ideal world, we'd probably have multiple foundation models that compete. There are a lot of foundation models out there, and the regulatory query is whether and when they will consolidate.

In Europe, there is a consciousness that we don't really have an equivalent of Silicon Valley, and that some European startups have been acquired by US companies. There's an awareness of that amongst regulators, and they're considering whether there's a way to perhaps prevent that from happening in the AI space. And that explains, for example, the fact that the Commission publicly said that it was interested in partnerships in

the AI space, including where an existing tech company enters into a partnership with a newer / startup company.

With the DMA really coming into force earlier this year, we've seen a reaction and it has been in the news, for example, that some companies have made changes to terms or product offerings. So, in case of doubt businesses will look to take advice on whether there are likely to be antitrust or other regulatory issues with their business proposals. The CMA has identified as potential concerns things such as control of critical inputs, bundling potentially distorting consumer choice, and partnerships or investments reinforcing market positions.

Daniel Venetucci:

I wanted to follow up on something you said earlier. You mentioned some ways that it's very easy to apply traditional antitrust principles and analysis to AI. I was wondering if you perhaps thought there was any way in which AI is new and antitrust may have to adjust and adapt to this new kind of industry that's popping up now.

Nick Wolfe:

What I would say to that is that in recent years, the concept of ecosystems has been at the forefront of regulatory analysis in a number of cases. People debate how you define an ecosystem, but an ecosystem boils down to having some allegedly very important assets or dominant product or service. I would emphasize *potentially* – it's for the regulator to determine. But being perceived to have that and then having other services that are within the hinterland of the allegedly very important or very successful product or service. What I've seen in cases I've worked on in recent years is that regulators haven't just reached for traditional foreclosure theories or horizontal concerns, but they've also tested ecosystem theories.

In the AI space one could imagine a regulator pursuing an ecosystem theory of harm, alleging that a strong foundation model could advantage other areas of a business.

There is also potential for regulatory concerns about walled gardens. The DMA seeks to address such a concern by requiring portability of data and so on.

The so-called ecosystem theory of harm has been on the agenda for a few years now. It's been applied in merger cases by the CMA in the UK, by the European Commission in Brussels,

and I think by the DOJ and the FTC. And it seems very likely that regulators could apply it in respect of AI.

Daniel Venetucci:

Does anyone else have a question they'd like to ask before we start to wrap up?

Scott Patterson:

I can ask a question in relation to that topic. If clients are concerned about foreclosure, are they also concerned about having to export or send out their data in order to help train other AI models based on the regulations?

Nick Wolfe:

I've not been on the receiving end of a request about something related to this, but it is clear that there are questions about the use of data in training foundation models. Note that the DMA also has obligations on data portability for business and end users, as does certain provisions of the GDPR.

Scott Patterson:

Is portability similar to making it available to everyone?

Nick Wolfe:

So, with foundation models there are both open and closed models. There's a lot of regulatory scrutiny and regulators are asking questions about both. Regulators surely understand that closed models have a lot of benefits. With the closed models, part of the incentive of those who develop them is surely to earn a return on the engagement and investment that they are making. Regulators may seek to set some parameters around how data is used. There are also consumer welfare concerns about data, so I can see that from a non-competition perspective that there will be scrutiny of this. The Digital Services Act in the EU is something that may be useful in tackling that, because that's also about regulating potentially harmful content and also enabling users to understand what their data is being used towards.

Daniel Venetucci:

I wanted to start to wrap things up. Europe has been one of the first major movers on this, and specifically in the antitrust

space, so many of these companies are large multinational corporations. And I was wondering with Europe being the first to move, do you think other countries are going to also move to adopt something similar, or maybe something more restrictive? How do you see this playing out going into the future?

NICK WOLFE:

I do think it's inevitable that regulators and other competition regulators in other parts of the world will look at what's happening in Europe and then think about how to develop their own law and their own regime in this space, if they're not already doing something. We've seen this happen before with the increased scrutiny of platforms. That is an example where once it started, other regulators started looking into these cases as well. Within Europe, the Commission really started to scrutinize large tech deals and so did the Austrian regulator, the German regulator, and so on, all essentially looking to exert greater scrutiny either at the EU level or a Member State level.

In my day-to-day work, I think of the major regulators as the FTC and the DOJ, and SAMR in China. And then here in Europe, you have the European Commission here in Brussels and there's the Competition and Markets Authority in London. These are the most active regulators and one expects that what they do is picked up by others around the world, and we may see other antitrust regulators taking an increased degree of interest and governments legislating to provide for new powers for authorities throughout the world.

Ultimately AI is fundamentally a global phenomenon, of course. The shift in economies over the last 40 years or more has been towards transferring bits of information across the globe. That was not the lion's share of economic activity and not what the most geographically spread companies were doing before. They might have exported raw materials or manufactured goods, and mostly they weren't transmitting information across borders, which can happen very quickly. You know, it happens in a second. It would be surprising in such a world if you only have a subset of regulators who were really interested in key aspects of this economy, including AI, because it's part of this very global, very easily transmitted kind of activity. So, it's incumbent on all of the regulators to ultimately get up to speed in this area.

NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 20 SUMMER 2024 NUMBER 3

THE EU'S APPROACH TO ARTIFICIAL INTELLIGENCE REGULATION

LAUREN CUYVERS* & TONI PITESA**

Note: This interview took place in March 2024 before finalization of the EU AI Act and other potentially relevant legislation mentioned in this Article and any comments by interviewees should be interpreted accordingly.

ANDREW LIN:

To orient ourselves with everything that's going on, could you begin by talking about what was happening two or three years ago? There has been a lot of legislation coming out of Europe. To name just a few, we have seen the Data Act, the Data Governance Act, and then the AI Act. There's a lot going on here. What do you think was the precursor to the AI Act? And what are some of the concerns the European Commission was trying to address with the AI Act?

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* Lauren Cuyvers is a senior managing associate in the Brussels office of Sidley Austin LLP. She focuses her practice on compliance, regulatory enforcement and litigation related to EU data privacy and cybersecurity laws, including the EU GDPR, EUDPR, ePrivacy Directive, NIS2 Directive, CER and DORA.

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Lauren Cuyvers:

The AI Act was proposed April 21, 2021, by the European Commission. The EU has always been a more regulation-heavy region and jurisdiction. Looking at all of the different technologies that are coming out, especially AI, the EU was seeing risks to values it holds as important, such as democracy and the democratic process, the rule of law, and fundamental rights privacy. They felt it necessary to issue more regulation to protect those values. The AI Act is a cornerstone piece of regulation for that purpose.

That said, I don't know that we necessarily expected for them to issue this much regulation. As you mentioned, we have the Data Act, the Data Governance Act, and the European Health Data Space Regulation Act. Some of the regulations have been modeled after the GDPR, and the EU is trying to leverage the same Brussels Effect for the laws that the GDPR has had. The GDPR has influenced a number of other data protection laws in other jurisdictions, South America in particular. The GDPR is an important cornerstone because of the importance of data for AI systems—they live and breathe data.

Andrew Lin:

The AI Act itself is quite comprehensive. There's a lot going on, and it tries to anticipate a lot of different use cases with AI, generative AI, etc. Do you think that the timing in which the AI Act has come out is appropriate? Do you think the law is ahead or behind the technology?

Lauren Cuyvers:

A law that's trying to regulate technology, like AI, will always be behind the technology, because the legislative process, especially in the EU and perhaps similar to in the US, takes time. When the Commission proposal came out in 2021, generative AI didn't really exist. It started with ChatGPT around November, 2022. As a result, the EU modified the Act to take into account generative AI.That goes to show how important the AI Act is for the EU. The EU also wanted to show the world that they are a pioneer in this space and in a prominent position in regulating it all.

However, some commentators say that the AI Act is actually going against innovation and that the EU will not be able to attract the AI companies that it wants to attract because of the heavy regulation. So, it is a bit of a balancing exercise.

Generally, I think regulation will always be a bit behind technology. But the Commission has been putting in a lot of effort to making sure the regulation comes out at the right time. The adoption was originally planned for April, but they moved it up to March 13, just last week. I think it really shows that they wanted to get this out as soon as possible.

Andrew Lin:

I want to dive deeper on the competition issue. If the purpose of the AI Act is in part to make sure there's enough competition, how do you think a startup or smaller company without the large legal team will fare given that they might find it harder to comply with the regulations? That seems like an additional hurdle to competition.

Lauren Cuyvers:

The AI Act cuts both ways. On the one hand, the regulations are trying to incentivize competition by making sure that everyone is on a more level playing field in terms of access to data because currently the big data pools are with the big tech companies. The Digital Markets Act is a good example of that. On the other hand, the regulations lead to the inevitable consequence that startups will be a bit disincentivized and disadvantaged because they will have to seek legal counsel to comply with the new regulations.

Toni Pitesa:

It also depends on what the startup does. If it's not high risk, then the level of regulation companies have to face is lower. The regulatory burden is not the same for every company.

Andrew Lin:

The wording in the Act is quite broad, so if you're using personal data, you can be high risk. Anything that touches PII or impacts financial wellbeing can be high risk. So how do you think about the legislation as it relates to risk and risk-levels?

Lauren Cuyvers:

The PII processing and access to that data will still be regulated by the GDPR. The AI Act doesn't directly say that if you use PII, it's automatically high risk. It assesses things more on

a use case basis. For example, you could be high risk if you use AI in the context of a medical device or to assess someone's credit scores for financial purposes. Another example is that if you use AI in employee recruitment, it can affect whether someone gets a job or not. So in that context, it may be high risk.

ANDREW LIN:

Thinking about the interactions between the GDPR and the AI Act, AI runs on data, and data is regulated by the GDPR. If someone doesn't want their data to be used, but that data is already being used on the algorithm, how would the AI Act address that? Does it consider the technical complexities of rolling back data?

LAUREN CUYVERS:

What you're talking about is if an individual were to ask for all his or her data to be deleted, or object to the processing of their data by AI, how would that trickle down because the data is already being used. This is regulated by the GDPR, in the form of data subject rights requests. Dealing with data subject access, data subject deletions, right to be forgotten and all those rights in our GDPR and other laws is a struggle for many companies.

If the data is fully anonymized, within the meaning of the GDPR, it would no longer be subject to the GDPR and therefore companies may prefer using fully anonymized data for AI processing only.

ANDREW LIN:

But even if you anonymize the data to the point where individuals cannot be re-identified, if the model has enough attributes (as models often have many) such as gender, race, occupation, income, neighborhood, you may have enough datapoints to still triangulate a specific individual. How is that addressed?

LAUREN CUYVERS:

The GDPR has a very high threshold for regarding data as "anonymized". If there's even the slightest possibility that someone is re-identifiable based on linking attributes, then it is considered identifiable and not anonymized.

The issue is that the GDPR doesn't define what anonymization is, so it's largely being interpreted by courts and regulators. We, lawyers, have to look at all of the guidance and core decisions to advise and argue what is considered fully anonymized because it's not very clear at the moment.

ANDREW LIN:

Shifting gears, let us turn to the effects of AI in shaping the competitive dynamics. What roles do you see the different AI and especially generative AI regulations have in driving competitive behaviors?

TONI PITESA:

There's a lot going on in this field right now—in particular regarding the interaction between AI, competitive dynamics and EU competition law.

Depending on who possesses the technology and how they use it, AI can spark pro-competitive effects or anti-competitive effects. The AI Act captures the dichotomy of pro-competitive effects vs anti-competitive effects quite well. Recitals n. (3) and n. (4) explain how AI can contribute to a wide array of economic, environmental and societal benefits across industries and social activities. But at the same time, depending on the application, AI may generate risks and cause harm to public interests, like competition.

In terms of pro-competitive effects, we can look at AI in terms of increased competition, transparency in markets, and better quality of products. For example, when you are looking for flights or hotels, you already have websites relying on AI that can give you a hyper-personalized offer showing you the best time to book your flight or hotel at the best price. This has a significant impact on competitive dynamics and ultimately benefits consumers.

In terms of anticompetitive effects, the malicious use of AI technologies can lead to competition distortions and consumer harm. In the EU, we categorize anticompetitive conduct through two main provisions: Article 101 of the Treaty on the Functioning of the European Union (TFEU) which regulates collusive agreements, and Article 102 of the TFEU which regulates abuse of dominant position.

As regards the application of Article 101 TFEU, one of the main issues is so-called "algorithmic collusion". It is currently still more of an academic topic in the EU. So far, we haven't seen

cases concerning algorithmic collusion in the proper sense of the term, i.e. algorithms *autonomously deciding and implementing* an anti-competitive agreement. What we have seen however are algorithms being used to *facilitate* anti-competitive conduct. For example, in a cartel, brands decide the prices they want to collude on and they can use an AI-powered price tracking tool to implement or monitor deviations from the cartel arrangement. We already have examples of this type of cases. Already back in 2016, the UK Competition Authority imposed fines on two online retailers of posters and frames who used an automated re-pricing software to implement an agreement not to undercut each other's prices when selling on Amazon.co.uk. Similar cases have been pursued by the EU Commission as well.

Proper algorithm collusion is still a dystopic scenario that will probably emerge sometime in the future. But this does raise some interesting questions: can you actually attribute liability for what the algorithm is doing to the company that is using it? Can you have an anti-competitive agreement, often requiring the existence of concurrent wills, between machines? For example, if two algorithms adjust prices with no point of contact or interaction among themselves, it would be very hard to prove the existence of an "agreement" within the meaning of EU case law. Because AI acts autonomously, there would be only independent price adjustment, which, in principle, would not fall within the scope of Article 101 TFEU.

In relation to Article 102 TFEU which regulates abuse of dominant position, AI-related infringements could result from the control of key AI inputs (e.g., data, computing hardware, foundation models) by a handful of powerful (i.e. dominant) companies that may decide to, e.g., refuse to supply such input to their competitors, or to provide it under discriminatory terms or for an excessive price. In the EU, we have not seen thus far abuse of dominance cases concerning AI markets (e.g. market for foundation models) but we have seen cases in which the abuse of dominance was perpetrated in non-AI markets (e.g. general internet search) through the use of an AI tool, e.g., a ranking algorithm.

ANDREW LIN:

Since AI collects data from a wide variety of sources, could taking data be considered communicating with one another? Either by the algorithms exchanging data or a third-party exchanging data?

Toni Pitesa:

That's an interesting question. Under EU competition law, an exchange of competitively sensitive information leading to parallel market conduct is likely to be unlawful. It's hard to say if this would happen in the context of algorithms, but if we suppose that two algorithms, because of the way they are programmed, "decide" to exchange competitively sensitive information with each other (e.g. prices) and, as a result, they end up applying the same prices, that could potentially constitute an infringement of EU competition rules. So, the exchange of sensitive data can play an important role.

Andrew Lin:

Here is a hypothetical—suppose an AI algorithm has gotten so smart that it observes behaviors, prices, and histories from public information you can Google. There is no direct exchange or communication, but you could say it's interacting with the public. How do you think that scenario would pan out?

Toni Pitesa:

It's difficult to answer this question given the novelty of the issues brought up by AI. I would say that we would have to go back to the traditional framework of application of EU competition law. The exchange or collection of information is unlawful to the extent that this information is competitively sensitive, is provided in individualized form and, most importantly, is not in the public domain. If the information is genuinely public, it is equally accessible to competitors and customers and thus it does not normally trigger the application of competition law.

Andrew Lin:

What if the algorithm makers market the software as a way to collude on prices—so there is no contact involved in buying the software but the effect of using the software is price convergence while bypassing infringement?

Toni Pitesa:

The present EU Commissioner for Competition, Margrethe Vestager, stated that companies must be held liable for the tools they use. If the software is calibrated in a way that leads to an infringement of EU competition rules, companies may be held liable for the damage caused. But it's difficult to predict

how things will unfold in practice because this is a highly technical area and there are no precedents that we can rely on at the moment.

ANDREW LIN:

In terms of liability, which is what corporate clients ultimately care about, do you think it would be a per se rule or determined case-by-case? For example, if a company did their due diligence, but their AI system is still in violation of the AI Act, what results?

LAUREN CUYVERS:

One has to distinguish (civil) liability from regulatory enforcement. The AI Act as such only regulates regulatory enforcement and action - not civil liability or consumer redress, for example (although there currently is an AI Liability Directive in the making that does harmonize civil redress in relation to AI in the EU). The AI Act is not fault-based, meaning that if a company did its diligence, but their AI system is still found infringing under the AI Act, that is a basis for a regulator to take enforcement action under the Act.

One would first have to determine whether the AI system one is providing or using falls in scope of the AI Act and then whether that AI system is considered an unacceptable, high or low risk AI system. Based on the level of risk the AI system is presumed to have, the AI Act prescribes certain requirements. If one objectively fails to meet those requirements, then one can be faced with regulatory action under the AI Act. Noncompliance with the AI Act can expose a company to fines of up to 7% of global worldwide turnover.

ANDREW LIN:

With all the liabilities and risks that AI can bring, there are obviously benefits as well, such as making consumer products safer. If AI improves product safety by a meaningful magnitude, but is undisputedly in violation of the AI Act, how do you think courts would balance between product safety and the violation?

LAUREN CUYVERS:

First, one thing to note is that the requirements within the AI Act are based on EU product safety legislation. The

requirements (for high-risk systems) include monitoring the quality of the AI system after it's been marketed and after it's been placed in the market. You also need conformity assessments and to have a CE marking, so it needs to be checked by EU authorities. Then you need to affix the CE marking on the AI system. These are all requirements stemming from concepts under product safety.

Second, the AI Act does not undo existing EU Product Safety Laws, but instead is actually meant to work in tandem with those laws. Given the AI Act is very new, there are no precedents yet on how national EU Member State and EU courts would tend to adjudicate this.

Andrew Lin:

From a politics perspective, countries compete for business. Are there concerns that other governments might come up with similar AI acts that might make it very difficult for companies to comply with everything? Alternatively, do you think companies may lobby their governments to come up with their own rules?

Lauren Cuyvers:

Companies that operate worldwide will obviously have to comply with different regulations. There are rumors that other countries will look to the EU AI Act to develop their own laws. It will be difficult for companies to navigate that very complex landscape. To ensure a workable solution that is somewhat future proof, the approach we try to take is to identify a number of core principles in the AI Act (and other laws and regulations such as those in the UK, US and APAC), such as transparency, human oversight, privacy principles, and cybersecurity that can be actioned and incorporated by companies into compliance programs.

We advise clients to stick to the basic core principles and if necessary, adjust these principles and their underlying requirements in the jurisdictions that they need to.

Andrew Lin:

Thank you, everyone, for the thorough and thoughtful responses to an incredibly complex issue. Could you provide some parting thoughts?

Lauren Cuyvers:

To wrap up, in terms of themes, the main theme is that there's a lot of regulation and more regulation will be issued moving forward (not just on AI, but other (related) themes as well such as cybersecurity).

Toni Pitesa:

As for the application of EU competition law to AI, it's important to remember that AI, depending on how it is used, can give rise to pro-competitive effects or anti-competitive effects. The latter will normally stem from anticompetitive agreements or abuse of dominance.

What is also important to remember is that, in the EU, we don't have precedents concerning competition infringement in AI markets, like for instance in generative AI or foundation models. We have, however, cases concerning more traditional industries or digital markets where AI already plays an important role and where it has been used to facilitate competition law infringements.

Lastly, it must be noted that AI can also be used to detect competition infringements. The EU Commission and national competition authorities are arming themselves with AI technologies, such as price monitoring software, capable of detecting anticompetitive conduct.