

NOTE

CONTRACTING FOR GOOD: HOW BENEFIT CORPORATIONS EMPOWER INVESTORS AND REDEFINE SHAREHOLDER VALUE

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INTRODUCTION

SINCE 2010, twenty-six states and the District of Columbia have passed legislation permitting the formation of a new business entity known as a benefit corporation.¹ Under the new entity, directors must balance shareholders' pecuniary interests with the needs of the community, the environment, and non-shareholder constituents, such as employees and consumers.² The American Bar Association's ("ABA") Corporate Laws Committee describes benefit corporation legislation as a shift from a "property model" of corporate law to an "entity model."³ The committee states, "Under the property model, a solvent corporation is viewed as a vehicle with the sole purpose of maximizing the wealth of its owners, the shareholders."⁴ But according to the committee, benefit corporation statutes opt out of this property model and embrace the idea

* J.D. 2014, University of Virginia School of Law. I wish to thank Professor Quinn Curtis for his guidance and encouragement on this Note, the members of the *Virginia Law Review* for their thoughtful and thorough edits, and most importantly, my wife and children for their support.

¹ State by State Legislative Status: Enacted Legislation, Benefit Corp Information Center, <http://benefitcorp.net/state-by-state-legislative-status> (last visited Aug. 18, 2014) (Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Illinois, Louisiana, Maryland, Massachusetts, Minnesota, Nebraska, Nevada, New Hampshire, New Jersey, New York, Oregon, Pennsylvania, Rhode Island, South Carolina, Utah, Vermont, Virginia, Washington, D.C., and West Virginia). Maryland was the first state to pass benefit corporation legislation. Press Release, B Lab, Maryland First State in Union to Pass Benefit Corporation Legislation (Apr. 14, 2010), available at http://www.csrwire.com/press_releases/29332-Maryland-First-State-in-Union-to-Pass-Benefit-Corporation-Legislation.

² See, e.g., Del. Code Ann. tit. 8, § 362 (Supp. 2013).

³ Corporate Laws Committee, ABA Business Law Section, Benefit Corporation White Paper, 68 Bus. Law. 1083, 1083–87 (2013) [hereinafter ABA White Paper] (stating that benefit corporations opt out of the property model and that by creating a model benefit corporation statute, the ABA would be "codifying some form of the entity model").

⁴ Id. at 1083.

that corporations can “simultaneously serve the interests of multiple constituencies, and thus [are] ‘tinged with a public purpose.’”⁵ Put differently, the ABA views benefit corporations as entities that do not maximize shareholder value, but instead sacrifice some of that value in favor of alternate goals, such as creating better working conditions for employees, developing safer products for consumers, or minimizing pollution.

The ABA is not the only one to view benefit corporations through this entity-model lens. Jay Coen Gilbert, former chief executive officer of the AND 1 basketball apparel company and proponent of the model benefit corporation legislation,⁶ recently testified before the Pennsylvania State Senate that adopting the new legislation was necessary because there was not an adequate business structure in the state that allowed corporations to consider goals other than shareholder value maximization.⁷ Professor J. Haskell Murray describes benefit corporations as creating a new paradigm—one that directors can opt into to avoid the “shareholder wealth maximization norm.”⁸ Journalists, too, have followed suit, describing benefit corporations as a legal creation that “lets directors serve three masters instead of one.”⁹ Accordingly, the entity-model description of benefit corporations has been embraced not only by the ABA, but also by those in business, academia, and the media.

Yet even if benefit corporation statutes were intended to embrace an entity model of corporate governance, it does not necessarily follow that

⁵ *Id.* at 1083–84 (quoting William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 *Cardozo L. Rev.* 261, 265 (1992)).

⁶ See Jay Coen Gilbert, *Sustainable Brands*, <http://www.sustainablebrands.com/user/jay-coen-gilbert/bio> (last visited Apr. 19, 2014).

⁷ Jay Coen Gilbert, *Remarks on White/Leach Benefit Corporation Bill upon Introduction to the Pennsylvania State Senate 1–3* (Feb. 7, 2011), *cited in* Kyle Westaway & Dirk Sampsele, *The Benefit Corporation: An Economic Analysis with Recommendations to Courts, Boards, and Legislatures*, 62 *Emory L.J.* 999, 1011–12 & nn.56–59 (2013); see also Jay Coen Gilbert, *Can I Get a Witness?! The Evolution of Capitalism*, *Huffington Post* (Sept. 27, 2011, 7:59 PM), http://www.huffingtonpost.com/jay-coen-gilbert/benefit-corporation-legislation-_b_976650.html (explaining that the belief that profit maximization is the sole purpose of business “constrains our imagination and ability to live to our potential as human beings”).

⁸ J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*, 2 *Am. U. Bus. L. Rev.* 1, 52 (2012).

⁹ Daniel Fisher, *Delaware ‘Public Benefit Corporation’ Lets Directors Serve Three Masters Instead of One*, *Forbes* (July 16, 2013, 2:06 PM), <http://www.forbes.com/sites/danielfisher/2013/07/16/delaware-public-benefit-corporation-lets-directors-serve-three-masters-instead-of-one/>.

the enacted statutes *actually* embrace this model. Instead, the statutes seem to codify a variation of the property model first proposed by Professors Joshua Graff Zivin and Arthur Small.¹⁰ Five years before benefit corporations existed, Graff Zivin and Small observed that many investors held stock in companies that donated corporate funds to charitable or social causes, even though these donations had the potential to diminish shareholder value.¹¹ The two scholars explained that investors were willing to do this because stock in “responsible” companies is effectively a “composite financial product[]—a bundle that blends an investment vehicle together with a charitable giving vehicle.”¹² Shareholders buy into “responsible” corporations because they value both the economic return and the “charitable return” or “warm glow” they feel after contributing to the firm’s non-profit initiative.¹³ Shareholders still expect firm managers to maximize the overall value of their investment, but they purchase the stock knowing the return will take this dual form.

The “responsible” entities observed by Graff Zivin and Small were traditional, publicly traded corporations.¹⁴ Under current law, directors of publicly traded companies are permitted to engage in philanthropic activities, but only to a limited extent.¹⁵ Benefit corporation statutes, on the other hand, actually *require* directors to pursue a social mission. This distinction may explain why so many commentators believe benefit corporations go beyond Graff Zivin and Small’s unique shareholder maximization model and embrace an entity model. But despite the legal mandate to pursue a social good, it is still the shareholders who finance both the for-profit and non-profit missions of benefit corporations. Without shareholder capital, there would be no benefit corporation at all. Thus, just as the Graff Zivin and Small model would suggest, it is the shareholders, not the state, that mandate the so-called “triple bottom line” of “profits, people and the planet.”¹⁶ Ultimately, benefit corporations do not

¹⁰ Joshua Graff Zivin & Arthur Small, A Modigliani-Miller Theory of Altruistic Corporate Social Responsibility, 5 Topics in Econ. Analysis & Pol’y, no. 1, 2005.

¹¹ See *id.* at 1.

¹² *Id.* at 2.

¹³ *Id.*

¹⁴ See *id.* at 1.

¹⁵ See *infra* Section II.B.

¹⁶ Timothy F. Slapper & Tanya J. Hall, The Triple Bottom Line: What Is It and How Does It Work?, *Ind. Bus. Rev.*, Spring 2011, at 4, 4; see also John Elkington, *Cannibals with Forks: The Triple Bottom Line of 21st Century Business* 2 (1998) (providing the original articulation of the “triple bottom line”).

reject the property model; they embrace it, and in so doing, they empower shareholders with greater control over the ends, and to a limited extent the means, of corporate governance.

This Note will proceed in three parts. Part I will review the need for and the legal structure of benefit corporations. Part II will explore the notion of shareholder value maximization and find common ground among the various academics that have commented on the existence and desirability of promoting the shareholder value norm. Part III will use these common findings to explain how benefit corporation statutes embrace the shareholder value norm—a property model of corporate law—rather than an entity model. This Note will conclude by highlighting several implications of viewing benefit corporations as an extension of the shareholder value norm.

I. THE BENEFIT CORPORATION

A. *Before Benefit Corporations*

Before benefit corporations existed, social entrepreneurs could achieve the dual mission of making a profit and pursuing social good in a number of ways. The first and perhaps easiest way was to organize as a limited liability company (“LLC”). LLCs offer tremendous flexibility, permitting social entrepreneurs to mold an operating agreement so that it meets their needs.¹⁷ Another option was to use multiple entities. For example, Chick-fil-A, Starbucks, and Google have long used their profit-making businesses to fund affiliated nonprofit entities.¹⁸ As a third option, social entrepreneurs were able to incorporate in states with constituency statutes. These statutes permit (but do not require) directors of publicly traded corporations to consider certain non-shareholder constituents when fulfilling their fiduciary duties.¹⁹ For example, under the statutes, a director might reject a favorable takeover offer if the acquisition would harm employees or another constituent class.²⁰ A fourth op-

¹⁷ Cassady V. Brewer, A Novel Approach to Using LLCs for Quasi-Charitable Endeavors (A/K/A “Social Enterprise”), 38 *Wm. Mitchell L. Rev.* 678, 680 (2012) (observing the increasing use of LLCs by social entrepreneurs); Murray, *supra* note 8, at 19.

¹⁸ Murray, *supra* note 8, at 19 n.83.

¹⁹ Eric W. Orts, Beyond Shareholders: Interpreting Corporate Constituency Statutes, 61 *Geo. Wash. L. Rev.* 14, 26–31 (1992) (describing varieties of state constituency statutes).

²⁰ See *id.* at 26 (noting the antitakeover motive behind such laws). Permissible constituent groups vary by state but typically “include employees, creditors, suppliers, consumers, and the community at large.” William H. Clark, Jr. & Elizabeth K. Babson, How Benefit Corpo-

tion became available in 2008 when Vermont passed the first social enterprise statute, creating the low-profit limited liability company, or “L3C.”²¹ The L3C operates for profit, generates a return for investors, and exists primarily to further a social mission.²² But because an L3C’s primary purpose is its charitable mission, L3C’s profit potential is small and investor returns are minimal.²³ Nevertheless, the structure has been a good fit for some social entrepreneurs.²⁴

After choosing an appropriate business form, managers and directors could also certify their entity as a B Corporation (“B Corp”).²⁵ This certification process predated,²⁶ and remains distinct from, benefit corporation legislation.²⁷ Rather than creating a new legal entity, B Corp certification provides a business with an assessment that measures the business’s environmental impact, treatment of employees, community relations, and overall transparency and accountability.²⁸ If the business scores well, directors are permitted to use a B Corp insignia on the business’s promotional materials and products. Becoming a B Corp is akin to obtaining LEED (Leadership in Energy and Environmental Design) certification for a construction project or using a fair trade label on a

rations Are Redefining the Purpose of Business Corporations, 38 Wm. Mitchell L. Rev. 817, 830 & n.63 (2012).

²¹ J. William Callison & Allen W. Vestal, *The L3C Illusion: Why Low-Profit Limited Liability Companies Will Not Stimulate Socially Optimal Private Foundation Investment in Entrepreneurial Ventures*, 35 Vt. L. Rev. 273, 273 (2010).

²² See Vt. Stat. Ann. tit. 11, § 3001(27) (2010) (requiring that the company “*significantly* furthers . . . one or more charitable or educational purposes” and that “[n]o significant purpose of the company is the production of income” (emphasis added)).

²³ See, e.g., Malika Zouhali-Worrall, *For L3C Companies, Profit Isn’t the Point*, CNN-Money (Feb. 9, 2010, 10:49 AM), http://money.cnn.com/2010/02/08/smallbusiness/l3c_low_profit_companies/# (explaining how a majority of the profits of one L3C goes back to the farmers the organization is designed to help).

²⁴ See Elizabeth Schmidt, *Vermont’s Social Hybrid Pioneers: Early Observations and Questions to Ponder*, 35 Vt. L. Rev. 163, 179–82 (2010).

²⁵ *What Are B Corps?*, B Lab, <http://www.bcorporation.net/what-are-b-corps> (last visited Apr. 19, 2014) [hereinafter *What Are B Corps?*]; see also *Performance Requirements*, B Lab, <http://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/performance-requirements> (last visited Apr. 19, 2014) (describing how to become B Corp certified).

²⁶ B Corp certifications began in 2007, three years before the first benefit corporation statute was passed. See *Our History*, B Lab, <http://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps/our-history> (last visited Apr. 19, 2014); B Lab, *supra* note 1.

²⁷ *Benefit Corp vs. Certified B Corp*, Benefit Corp Information Center, <http://benefitcorp.net/what-makes-benefit-corp-different/benefit-corp-vs-certified-b-corp> (last visited Apr. 19, 2014).

²⁸ See, e.g., *Method Products, PBC 2013 B Impact Report*, B Lab, <http://www.bcorporation.net/community/method-products-pbc/impact-report/2013-03-18-000000> (last visited Mar. 23, 2014).

package of coffee.²⁹ It offers businesses a way to credibly communicate to the world that they are socially responsible entities.

One goal of the certification was for it to become “a sort of Moody’s for social and environmental effect,” thereby “unlock[ing] a whole new source of capital.”³⁰ The idea was that investors would look to the B Corp logo and businesses’ impact scores when deciding whether to invest in these companies. But in the first four years B Corp certifications were offered, not one of the 287 companies that took the B Corp pledge was publicly owned.³¹ In 2010, *Forbes* reported that in nineteen states it was legally impossible for publicly held companies to obtain B Corp certification without violating directors’ duty to put shareholders first.³² If directors took the pledge, they would be prioritizing the B Corp mission over profit maximization.

The nonprofit that administered the certification process began working on a solution. What it came up with was model legislation for a new legal entity: the benefit corporation. Since 2010, states have been adopting versions of this model statute with incredible speed.³³ The model’s drafter, William H. Clark, Jr., has argued along with Elizabeth K. Babson that legislation was necessary because existing law did not accommodate for-profit, mission-driven companies.³⁴ For social entrepreneurs looking to make money, the L3C was inadequate because its profit-making potential always took a back seat to the charitable mission.³⁵ LLCs offered greater flexibility, but catered to closely held business models. A traditional corporate form could be publicly owned, but as Clark and Babson put it, “[C]urrent law views shareholder wealth maximization as a duty that directors are prohibited from abandoning.”³⁶ If

²⁹ The Non-Profit Behind B Corps, B Lab, <http://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps> (last visited Apr. 19, 2014).

³⁰ Susan Adams, *Capitalist Monkey Wrench*, *Forbes* (Mar. 25, 2010, 1:20 PM), <http://www.forbes.com/forbes/2010/0412/rebuilding-b-lab-corporate-citizenship-green-incorporation-mixed-motives.html>.

³¹ *Id.*

³² See *id.*

³³ Deborah Sweeney, *Are Benefit Corporations the New Limited Liability Company?*, *Huffington Post Bus. Blog* (Aug. 28, 2013, 5:02 PM), http://www.huffingtonpost.com/deborah-sweeney/are-benefit-corporations_b_3819590.html (“Compared to the 20-odd years it took LLC legislation to catch on, the B-Corp is absolutely blazing through the states.”).

³⁴ Clark & Babson, *supra* note 20, at 832–33, 838.

³⁵ See Vt. Stat. Ann. tit. 11, § 3001(27) (2010).

³⁶ Clark & Babson, *supra* note 20, at 828 (citing *eBay Domestic Holdings v. Newmark*, 16 A.3d 1, 34 (Del. Ch. 2010)).

directors were to pursue a corporate mission, it could conflict with shareholder wealth maximization.

Contradicting Clark and Babson, Professor Einer Elhauge has argued that the traditional corporate form in fact does provide flexibility for boards of directors to pursue goals other than increasing shareholder value.³⁷ However, Elhauge and many others acknowledge that even if traditional corporate laws provide legal flexibility to pursue non-profit-maximizing goals, in practice, the shareholder value norm remains widely accepted and religiously observed.³⁸ It seems that the adoption of constituency statutes in several states might have changed this by giving directors authority to consider non-shareholder interests, but even as these statutes were passed, the shareholder value norm remained dominant.³⁹ Part of the problem was and is that constituency statutes are missing in several states, including Delaware—the legal home of more than half of all U.S. publicly traded companies.⁴⁰ Directors also cannot tell from reading the statutes “how, when, and to what extent they can consider [the constituents’] interests.”⁴¹ Indeed, “courts seem reluctant to wade into these issues and often fall back on shareholder primacy.”⁴² Without clear authority to pursue a social mission, directors are likely to protect themselves by maximizing shareholder value.⁴³ Thus, before benefit corporations existed, it did not matter whether corporate statutes actually allowed directors to consider non-shareholder interests. Instead, what mattered was that directors did not feel comfortable using the traditional corporate form to pursue social missions unless those missions somehow

³⁷ Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. Rev. 733, 738 (2005).

³⁸ *Id.* at 736–38, 743–45; see also Lynn Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public* 3 (2012) (stating that “[s]hareholder value thinking is endemic in the business world today”); Murray, *supra* note 8, at 17–19. For further discussion on this point, see *infra* Section II.B.

³⁹ Clark & Babson, *supra* note 20, at 831–33.

⁴⁰ *Id.* at 830, 833.

⁴¹ *Id.* at 831.

⁴² *Id.* (citing *Baron v. Strawbridge & Clothier*, 646 F. Supp. 690, 697 (E.D. Pa. 1986) (holding that while directors facing tender offers can consider the effect on “employees, customers and community,” ultimately their fiduciary duty is “to act in the best interests of the corporation’s shareholders” (internal quotation marks omitted))).

⁴³ Clark & Babson, *supra* note 20, at 831–32; see also Constance L. Hays, *Ben & Jerry’s to Unilever, With Attitude*, N.Y. Times, Apr. 13, 2000, at C1 (reporting that the directors of Ben & Jerry’s ice cream company felt compelled to accept a lucrative takeover offer). For an argument that Ben & Jerry’s could have turned down the takeover bid because of its incorporation in a state with a constituency statute, see Murray, *supra* note 8, at 16.

increased share price as well. Ultimately, the business community needed more than a legal entity that permitted a dual mission; they needed an entity that required it.

B. A New Corporate Form

Benefit corporations now fill the missing gap. Rather than creating a new body of law, the statutes “tweak” existing corporate law to permit the creation of this new hybrid entity.⁴⁴ Though the statutes differ from state to state, they share three major provisions:

A benefit corporation: (1) has the corporate purpose to create a material, positive impact on society and the environment; (2) expands fiduciary duty to require consideration of nonfinancial interests; and (3) reports on its overall social and environmental performance as assessed against a comprehensive, credible, independent, and transparent third-party standard.⁴⁵

Regarding the first point, benefit corporations modify the traditional purpose of the corporation. Typically, corporations are *allowed* to form for any lawful purpose. Benefit corporations, on the other hand, *must* “have a purpose of creating general public benefit and are *allowed* to identify one or more specific public benefit purposes.”⁴⁶ They also exist to make a profit.⁴⁷ The general public benefit requirement ensures that directors run the corporation “in a responsible and sustainable manner.”⁴⁸ Having a specific public benefit allows the corporation to pursue a personally selected mission, which could be anything. Delaware, for example, defines “public benefit” as “a positive effect (or reduction of negative effects) on 1 or more categories of persons, entities, communities or interests (other than stockholders in their capacities as stockholders).”⁴⁹ The specific public benefit could be charitable, educational, artistic, or even religious.⁵⁰

⁴⁴ Clark & Babson, *supra* note 20, at 851.

⁴⁵ *Id.* at 838–39. Note that Delaware does not require the use of a third-party standard when generating these reports. Del. Code Ann. tit. 8, § 366 (Supp. 2013). Delaware also requires the corporation to identify in its certificate of incorporation “1 or more specific public benefits to be promoted by the corporation.” *Id.* § 362.

⁴⁶ Clark & Babson, *supra* note 20, at 839 (internal quotation marks omitted).

⁴⁷ Del. Code Ann. tit. 8, § 362(a) (Supp. 2013).

⁴⁸ *Id.*

⁴⁹ *Id.* § 362(b).

⁵⁰ *Id.*

Directors of benefit corporations are required to balance the general public benefit and the specific public benefit with the “shareholders’ pecuniary interests.”⁵¹ In Delaware, directors are deemed to have satisfied their “fiduciary duties to stockholders and the corporation” if their decisions are “both informed and disinterested and not such that no person of ordinary, sound judgment would approve.”⁵² Even though directors are charged with considering non-shareholder interests, the statutes do not create any duties between directors and non-shareholder constituents, including constituents affected by a specific public benefit.⁵³ Additionally, only the shareholders have standing to enforce the general and specific public benefit missions.⁵⁴ Thus, directors enjoy significant discretion regarding how the balancing act plays out.

To assist shareholders, the statutes also call for regular reporting on directors’ performance. Unlike the financial world where uniform conventions for reporting have developed, a uniform standard for reporting on social and environmental performance does not yet exist. The statutes, therefore, allow directors to pick their own standard.⁵⁵ Nearly all benefit corporation states require that the standard be created by a third party, but Delaware permits directors to craft their own rubric.⁵⁶ Regardless, these reports document how directors have pursued both general and specific public benefits, explain the standard against which corporate performance is being measured, and assess the corporation’s success in meeting its chartered objectives.⁵⁷

Aside from a few provisions that affect how changes are made to the corporate purpose, benefit corporation statutes rely on existing law to regulate the remaining aspects of corporate governance. Thus, from a textual standpoint, the difference between benefit corporations and traditional corporations is quite small.

After reading the statutes, one might believe benefit corporations truly “let[] directors serve three masters instead of one.”⁵⁸ Indeed, this is how

⁵¹ See, e.g., *id.* § 362(a).

⁵² *Id.* § 365(b).

⁵³ See, e.g., *id.*

⁵⁴ See, e.g., *id.* § 367.

⁵⁵ Clark & Babson, *supra* note 20, at 842, 845–46 (listing several organizations that provide qualifying third-party standards, including The Global Reporting Initiative, GreenSeal, Underwriters Laboratories, ISO2600, Green America, and B Lab).

⁵⁶ Del. Code Ann. tit. 8, § 366 (Supp. 2013).

⁵⁷ *Id.*; Clark & Babson, *supra* note 20, at 842–43, 845.

⁵⁸ Fisher, *supra* note 9.

the ABA and many academics interpret the legislation, referring to benefit corporations as a shift toward the entity model.⁵⁹ Under that model, directors are expected to consider all corporate constituencies and not focus exclusively on shareholders' pecuniary interests. Thus, where shareholders once had directors' undivided attention, the entity model posits that they must now compete with other constituencies for directors' time and for corporate resources.⁶⁰ Directors, on the other hand, have no new duties toward non-shareholder constituents but can pursue a new, broader set of goals that may harm shareholder value. Reading the statutes this way, it is as if legislatures were liberating directors from the duty to maximize profits and imposing a requirement that corporations act responsibly, simply because they are publicly traded entities.⁶¹ This Note will argue, however, that something very different has happened. Instead of replacing shareholder value, the statutes embrace it. As a result, benefit corporations do not weaken shareholders; they empower them, leaving directors with not three masters but one.

II. THE SHAREHOLDER PRIMACY NORM

A. Shareholders as Owners and Controllers

To understand how benefit corporation statutes empower shareholders, it is essential to first review the rights shareholders currently enjoy in traditional corporations. "Shareholder primacy" is a term that is widely used to describe the control shareholders have over the corporation and its directors.⁶² Primacy exists where a single constituent or class of constituents controls the corporate purpose and the right to carry out that purpose. To determine which constituents hold these powers, Professor Steven Bainbridge asks two questions: "First, which constituency's interests will prevail when the ultimate decision maker is presented with a zero sum game? Second, in which organ of the corporation is that ulti-

⁵⁹ See ABA White Paper, *supra* note 3, at 1083–84; see also Murray, *supra* note 8, at 52 (explaining that the "beauty of social enterprise" is that it allows investors "their choice of entity or choice of corporate objective").

⁶⁰ The interests of shareholders and other corporate constituents will not always be at odds. Sometimes promoting a benefit mission builds long-term value for the shareholders or serves as a form of advertising. See, e.g., Profiting for a Good Cause, *Fast Company* (Sept. 19, 2005, 5:00 AM), <http://www.fastcompany.com/919050/profitting-good-cause>.

⁶¹ See *supra* notes 3–5, 7–9 (providing examples from law, business, academia, and media where this view has been adopted).

⁶² D. Gordon Smith, *The Shareholder Primacy Norm*, 23 *J. Corp. L.* 277, 278 n.1 (1998).

mate power of decision vested?”⁶³ Primacy theorists of the 1970s believed that the answer to these questions was simple. Shareholders collectively own the stock of the corporation; therefore, decisions should be made in the shareholders’ interests, and directors should manage corporate affairs on the shareholders’ behalf.⁶⁴ In practice this meant that directors had to maximize stock value to benefit the shareholders. When asked whether corporations might pursue alternative goals, Professor Milton Friedman famously replied, “[T]here is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits.”⁶⁵

Professors Michael Jensen and William Meckling provided further support for the shareholder primacy theory when they compared the shareholder-director relationship to that of principal and agent. Their model suggests that directors (acting as agents) have a duty to maximize the wealth of the principals for whom they work: the firm’s residual claimants, or shareholders.⁶⁶ Interpreting shareholder primacy theory in this light provided the media with a “simple, easy-to-understand, sound-bite description of what corporations are and what they are supposed to do.”⁶⁷ It meant that corporate performance could be measured by share price alone. And it provided clear advice for corporate management: “(1) give boards of directors less power, (2) give shareholders more power, and (3) ‘incentivize’ executives and directors by tying their pay to share price.”⁶⁸

In 2001, Professors Reinier Kraakman and Henry Hansmann declared the overwhelming triumph of shareholder value thinking.⁶⁹ In particular, they found wide consensus on the following principles:

⁶³ Steven M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 *Vand. L. Rev.* 83, 85 (2004).

⁶⁴ See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 *J. Fin. Econ.* 305, 309 (1976) (stating that “the relationship between the stockholders and manager of a corporation fit[s] the definition of a pure agency relationship” and that the principal (the shareholders collectively) must “induc[e] [the] ‘agent’ to behave as if he were maximizing the ‘principal’s’ welfare”).

⁶⁵ Milton Friedman, *Capitalism and Freedom* 133 (40th anniversary ed. 2002).

⁶⁶ See Jensen & Meckling, *supra* note 64, at 308–10.

⁶⁷ Stout, *supra* note 38, at 18–19.

⁶⁸ *Id.* at 20.

⁶⁹ Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 *Geo. L.J.* 439, 468 (2001).

[U]ltimate control over the corporation should rest with the shareholder class; the managers of the corporation should be charged with the obligation to manage the corporation in the interests of its shareholders; other corporate constituencies, such as creditors, employees, suppliers, and customers, should have their interests protected by contractual and regulatory means rather than through participation in corporate governance; . . . and the market value of the publicly traded corporation's shares is the principal measure of its shareholders' interests.⁷⁰

Despite its appeal, the shareholder primacy movement lacked an essential element: clear legal support. That is not to say it was without merit, but nothing in U.S. corporate law unequivocally declares that the shareholders are entitled to control publicly traded companies or that the purpose of the corporation is to maximize shareholder value.⁷¹ As this truth came to the forefront in the early 2000s, it added nuance to the debate over shareholder primacy. The first development was an acknowledgement from most scholars that shareholders lack control of publicly traded corporations. Professor Lynn Stout explains:

[F]rom a legal perspective, shareholders do not, and cannot, own corporations. *Corporations are independent legal entities that own themselves*, just as human beings own themselves.

. . . .

What, then, do shareholders own? The labels "shareholder" and "stockholder" give the answer. Shareholders *own shares of stock*. A share of stock, in turn, is simply a contract between the shareholder and the corporation, a contract that gives the shareholder very limited rights under limited circumstances.⁷²

Professor Stephen Bainbridge still refers to shareholders as the firm's "nominal owners," as do many scholars, but Bainbridge agrees with Stout that shareholders "exercise virtually no control over either day-to-day operations or long-term policy."⁷³ In fact, Bainbridge argues that

⁷⁰ Id. at 440–41.

⁷¹ Stout, *supra* note 38, at 23.

⁷² Id. at 37.

⁷³ Stephen M. Bainbridge, *Director Primacy*, in *Research Handbook on the Economics of Corporate Law* 17, 17 (Claire A. Hill & Brett H. McDonnell eds., 2012); cf. Stout, *supra* note 38, at 42–44 (noting the weakness of shareholder control).

disclosure requirements for large shareholders, insider trading rules, and even shareholder voting communication rules discourage shareholders from obtaining or coordinating control blocks that might otherwise give shareholders meaningful control.⁷⁴ The scholars further agree that shareholders have no property rights in the corporation's assets.⁷⁵ In sum, shareholders cannot be owners in a legal sense. And despite their status as "nominal owners," the rights shareholders do have to vote, sue, or sell their shares are rough tools at best to get directors and corporate managers to do their bidding.⁷⁶ Without more legal support, Jensen and Meckling's principal-agent model falters.⁷⁷ Indeed, even scholars who argue that shareholders should be entitled to control concede that control is not granted to shareholders under current law.⁷⁸

B. The Shareholder Value Debate

Despite recent consensus regarding the lack of *shareholder control*, opinions still differ as to whether *shareholder wealth maximization* is (or should be) the purpose of the corporation. The new question is not whether the law permits corporate directors to pursue shareholder value—it clearly does.⁷⁹ Instead, the question is whether the law requires it. According to Professor Ian Lee, advocates from both sides of the debate exaggerate their claims about "the state of corporate law" when, in fact, the situation is "persistently ambiguous."⁸⁰ Nowhere in the Delaware General Corporate Law does it explicitly require that directors maximize shareholder value.⁸¹ Instead, Delaware relies on case law that ties a di-

⁷⁴ Bainbridge, *supra* note 73, at 17–18.

⁷⁵ *Id.* at 18; Ian B. Lee, Corporate Law, Profit Maximization, and the "Responsible" Shareholder, 10 *Stan. J.L. Bus. & Fin.* 31, 41 (2005); Stout, *supra* note 38, at 37 ("Owning shares in Apple doesn't entitle you to help yourself to the wares in the Apple store.").

⁷⁶ Stout, *supra* note 38, at 42; Bainbridge, *supra* note 73, at 17–18.

⁷⁷ Stout, *supra* note 38, at 42–44.

⁷⁸ See, e.g., Lucian Arye Bebchuk, The Case for Increasing Shareholder Power, 118 *Harv. L. Rev.* 833, 836, 843–47 (2005).

⁷⁹ Del. Code Ann. tit. 8, § 101(b) (2011) ("A corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes, except as may otherwise be provided by the Constitution or other law of this State.").

⁸⁰ Lee, *supra* note 75, at 33; accord Allen, *supra* note 5.

⁸¹ See Lee, *supra* note 75, at 34 n.118 ("In the all-important state of Delaware, there remains no statutory statement of the entity or individuals to whom directors owe their duty of loyalty.").

rector's duty to "the corporation."⁸² Most other state statutes mandate that directors seek "the best interests of the corporation and its shareholders."⁸³ Though the "best interests of the corporation" could be synonymous with maximizing shareholder value, it is by no means the only interpretation of the statutes.⁸⁴

Many cases discuss directors' duties but add only partial clarity to the ambiguous situation. The 1919 Michigan case, *Dodge v. Ford Motor Co.*,⁸⁵ is frequently cited as the seminal authority on shareholder value.⁸⁶ In that case, Henry Ford, the founder and majority shareholder of the Ford Motor Company, stopped paying dividends when he learned that two minority shareholders, Horace and John Dodge, wanted to use the dividends to fund their own rival business, the Dodge Brothers Company. Ford openly rejected the shareholder value norm, claiming he needed the cash to offer cheaper cars and pay higher wages. When the Dodges sued, the Michigan Supreme Court ordered Ford to pay the dividend.⁸⁷ In its holding, the court wrote:

There should be no confusion A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself.⁸⁸

Though this language is clear, its impact is not. *Dodge* has been dismissed by commentators as "a mistake,"⁸⁹ applicable only in the context of minority shareholder oppression,⁹⁰ and largely irrelevant since it is nearly one hundred years old and from a "state court that plays only a

⁸² *Guth v. Loft*, 5 A.2d 503, 510 (Del. 1939) (explaining that Delaware requires "undivided and unselfish loyalty to the corporation").

⁸³ See, e.g., Cal. Corp. Code § 309(a) (West 2013); see also 805 Ill. Comp. Stat. 5/8.85 (2012) ("best long term and short term interests of the corporation"); Nev. Rev. Stat. Ann. § 78.138(1) (Lexis-Nexis 2010) ("interests of the corporation"); N.J. Stat. Ann. § 14A:6-1 (West 2003) ("best interest of the corporation"); N.Y. Bus. Corp. Law § 717(b) (McKinney 2013) ("the long-term and the short-term interests of the corporation and its shareholders").

⁸⁴ Lee, *supra* note 75, at 33–34.

⁸⁵ 170 N.W. 668 (Mich. 1919).

⁸⁶ See, e.g., Jeffrey D. Bauman, Alan R. Palmiter & Frank Partnoy, *Corporations: Law and Policy* 87 (6th ed. 2007).

⁸⁷ *Dodge*, 170 N.W. at 671–73, 683–85; see also Stout, *supra* note 38, at 25–26.

⁸⁸ *Dodge*, 170 N.W. at 684.

⁸⁹ Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford*, 3 Va. L. & Bus. Rev. 163, 166, 176 (2008).

⁹⁰ Smith, *supra* note 62, at 278, 323.

marginal role in the corporate law arena.”⁹¹ Even more, the outcome of *Dodge* is rare. Courts almost never intervene in the day-to-day decisions of directors and managers thanks to the discretion granted under the abstention-style business judgment rule.⁹²

But just because the norm is infrequently enforced does not mean it is a fiction.⁹³ In a 2012 law review essay, Chancellor Leo Strine suggested that the Michigan Supreme Court was unable to grant Henry Ford business judgment deference because Ford confessed “he was placing his altruistic interest in helping workers and consumers over his duty to stockholders.”⁹⁴ Had Ford claimed his decision to withhold dividends was actually calculated to build long-term value for shareholders by fostering customer and employee loyalty, he may have won the case.⁹⁵

Most directors follow this advice and talk about their altruistic decisions as being motivated by long-term value.⁹⁶ But in some instances, even shareholders’ long-term interests cannot be reconciled with those of non-shareholder constituents. For example, a corporation in financial distress has an incentive to take risks that might produce wealth for shareholders if successful, but if unsuccessful, would leave creditors unpaid.⁹⁷ What then is a director to do? According to Chancellor Strine, it would seem the director is obligated to place shareholder value above the interests of other constituents (the creditors in this scenario), but the case law disagrees. In *Credit Lyonnais Bank Nederland v. Pathe Communications Corp.*, the court held that “a board of directors is not merely the agent of the residue risk bearers, but owes its duty to the corporate enterprise.”⁹⁸ Thus, the directors, who were managing a corporation in financial distress, were not liable to shareholders for turning down a

⁹¹ Stout, *supra* note 89, at 168.

⁹² See Bainbridge, *supra* note 63, at 109 (explaining that “the business judgment rule is justified precisely because judicial review threatens the board’s authority”).

⁹³ See Murray, *supra* note 8, at 12 (“Cases like *Dodge v. Ford* are rare because the business judgment rule is so powerful, and defendants are not generally so open about eschewing shareholder interests.”).

⁹⁴ Leo E. Strine, Jr., Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit, 47 *Wake Forest L. Rev.* 135, 148 (2012).

⁹⁵ Jonathan R. Macey, A Close Read of an Excellent Commentary on *Dodge v. Ford*, 3 *Va. L. & Bus. Rev.* 177, 189–90 (2008).

⁹⁶ See Murray, *supra* note 8, at 13; see also Macey, *supra* note 95, at 180–81 (stating that there is no way for courts to adequately discern *ex post* when directors are only pretending to act in the shareholder’s best interests).

⁹⁷ Lee, *supra* note 75, at 35.

⁹⁸ No. Civ.A.12150, 1991 WL 277613, at *34 (Del. Ch. Dec. 30, 1991).

chancy venture that was in the best interests of shareholders but exposed the corporation's creditors to significant risk.⁹⁹ The case law is therefore mixed—sometimes supporting the shareholder value norm, sometimes abandoning it—but usually the issue never comes up because directors can justify their altruistic actions using the rhetoric of long-term value.

More recently, the Delaware Chancery Court reviewed the shareholder value norm in the narrow context of takeover defenses. In *eBay Domestic Holdings v. Newmark*, a series of disagreements between Craigslist and its minority shareholder, eBay, led directors to adopt numerous defensive measures, including a shareholder rights plan (also known as a poison pill), to protect the company's community-focused culture.¹⁰⁰ Ultimately, the court ordered the rights plan to be removed. Chancellor William B. Chandler III stated:

Promoting, protecting, or pursuing non-stockholder considerations must lead at some point to value for stockholders. When director decisions are reviewed under the business judgment rule, this Court will not question rational judgments about how promoting non-stockholder interests—be it through making a charitable contribution, paying employees higher salaries and benefits, or more general norms like promoting a particular corporate culture—ultimately promote stockholder value. Under the *Unocal* standard, however, the directors must act within the range of reasonableness.

....

... Directors of a for-profit corporation cannot deploy a rights plan to defend a business strategy that openly eschews stockholder wealth maximization—at least not consistently with the directors' fiduciary duties under Delaware law.¹⁰¹

The holding tends to confirm Chancellor Strine's interpretation of *Dodge*, at least in the narrow context of takeover cases: Where directors fail to link their altruistic decisions to shareholder value, the court will intervene on behalf of shareholders if the directors' actions are subject to heightened scrutiny. This is consistent with the holdings in Delaware's major takeover cases, which permit directors to consider non-

⁹⁹ *Id.*

¹⁰⁰ 16 A.3d 1, 6–8 (Del. Ch. 2010).

¹⁰¹ *Id.* at 33–35.

shareholder constituents,¹⁰² but only if “there [is] some rationally related benefit accruing to the stockholders.”¹⁰³ Nevertheless, the requirement to favor shareholders has typically only been enforced by the Delaware Chancery Court in situations of enhanced scrutiny—when the directors adopt defensive measures in response to a takeover threat (think *eBay*¹⁰⁴) or when directors elect to sell the corporation or pursue a change of control.¹⁰⁵

Collectively, the cases suggest that in the limited situation of takeovers, directors have a duty to justify altruistic actions by linking those actions to shareholder value. But it remains unclear whether that same duty exists in day-to-day decision making.¹⁰⁶ From this ambiguous legal backdrop, scholars derive conflicting theories about shareholder value. Professors Margaret Blair and Lynn Stout, for example, propose a team production theory in which shareholders are viewed as members of a collaborative team rather than the corporation’s residual claimants.¹⁰⁷ Under their model, the corporation itself is the residual claimant,¹⁰⁸ and directors act as neutral “mediating hierarchs,” allocating profits and losses among constituents in a manner that rewards constituents’ contributions to the firm (such as labor and capital) and prevents any one class

¹⁰² See, e.g., *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985).

¹⁰³ *Revlon, Inc. v. MacAndrews & Forbes Holdings*, 506 A.2d 173, 176 (Del. 1986).

¹⁰⁴ 16 A.3d at 33–35.

¹⁰⁵ See *Arnold v. Soc’y for Sav. Bancorp.*, 650 A.2d 1270, 1289–90 (Del. 1994); Lee, *supra* note 75, at 36.

¹⁰⁶ Consider, for example, *Theodora Holding Corp. v. Henderson*, 257 A.2d 398 (Del. Ch. 1969). The court suggested that corporations may donate to charity without providing any shareholder value justifications. *Id.* at 404 (“The recognized obligation of corporations towards philanthropic, educational and artistic causes is reflected in the statutory law of all of the states, other than the states of Arizona and Idaho.”). But in doing so, the court implied the donation was permitted because it created shareholder value, stating:

[T]he relatively small loss of immediate income otherwise payable to [the shareholders] . . . is far out-weighted by the overall benefits flowing from the placing of such gift in channels where it serves to benefit those in need of philanthropic or educational support, thus providing justification for large private holdings, thereby benefiting plaintiff in the long run.

Id. at 405; see also Kyle Westaway & Dirk Sampselle, *The Benefit Corporation: An Economic Analysis with Recommendations to Courts, Boards, and Legislatures*, 62 *Emory L.J.* 999, 1027 (2013) (discussing that, because of the doctrine of waste, charitable contributions may be permitted only to a certain extent).

¹⁰⁷ Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 *Va. L. Rev.* 247, 269–70, 276–79 (1999).

¹⁰⁸ See *id.* at 250–51, 269.

of constituents from dominating the rest.¹⁰⁹ Shareholders still agree to exchange their capital for voting and stock ownership rights, but those rights are limited.¹¹⁰ The directors are left to control the firm and to determine (within the scope permitted by the charter) the purpose of the corporation—whether that is focusing primarily on shareholder value or rewarding other constituent classes as well.¹¹¹

Steven Bainbridge takes a different approach in his “director primacy” model.¹¹² He agrees that in large publicly traded corporations, shareholders cede to directors control of managerial decisions.¹¹³ But he believes that maximizing shareholder value remains a contractual obligation for directors.¹¹⁴ Shareholders contract to determine the purpose of the corporation (the ends), but directors retain control over how that purpose is achieved (the means).¹¹⁵

Professor Lucian Bebchuk agrees that shareholders lack managerial control of the company,¹¹⁶ but he argues that the balance should be tilted in the shareholders’ favor.¹¹⁷ He contends that the law should grant shareholders greater power in the corporate election process and in amending corporate documents.¹¹⁸ Nevertheless, Bebchuk concedes that

¹⁰⁹ See *id.* at 250–51, 272, 279–81, 291–92; see also Forest L. Reinhardt et al., *Corporate Social Responsibility Through an Economic Lens*, 2 *Rev. Envtl. Econ. & Pol’y* 219, 221 (2008).

¹¹⁰ Blair & Stout, *supra* note 107, at 250–52 (explaining that shareholder rights are limited, and that shareholders give up important ownership interests so there can be a “mediating hierarchy”); see also Stout, *supra* note 38, at 42 (explaining that shareholders have very little “practical” ability to exercise control).

¹¹¹ See Blair & Stout, *supra* note 107, at 303 (emphasizing that “case law interpreting the business judgment rule often explicitly authorizes directors to sacrifice shareholders’ interests to protect other constituencies”); see also Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 *Nw. U. L. Rev.* 547, 551–52 (2003) (summarizing Blair and Stout’s view that directors are not subject to shareholder supervision or control).

¹¹² See Bainbridge, *supra* note 111, at 551–52 (summarizing the differences between a team production theory and director primacy).

¹¹³ Bainbridge, *supra* note 73, at 17–18; Bainbridge, *supra* note 111, at 559–60, 569.

¹¹⁴ Bainbridge, *supra* note 73, at 18; Bainbridge, *supra* note 111, at 606.

¹¹⁵ See Bainbridge, *supra* note 111, at 550–51, 605.

¹¹⁶ Bebchuk, *supra* note 78, at 844–47.

¹¹⁷ *Id.* at 837–43.

¹¹⁸ *Id.* at 837, 840; see also Jennifer G. Hill, *The Rising Tension etween Shareholder and Director Power in the Common Law World*, 18 *Corp. Governance: Int’l Rev.* 344, 346 (2010) (explaining Bebchuk’s argument).

until things change, directors control *how* the corporation will maximize shareholder value.¹¹⁹

Despite their disagreements, the commentators appear united on two points. First, they agree that shareholders do not control corporations—directors do. Second, regardless of whether they believe shareholder value maximization is the law,¹²⁰ an economic imperative,¹²¹ or a recipe for disaster,¹²² they acknowledge that the business world, the media, and the public continue to embrace shareholder value as the norm.¹²³

It might seem odd that shareholder value has become so entrenched, knowing the doctrine lacks clear legal support,¹²⁴ but there are several reasons for this phenomenon. First, shareholder value offers a clear, simple mandate that is easy for shareholders to track, for directors to follow, and for the media to report on.¹²⁵ Second, if society were to abandon the shareholder value norm, it is not clear what would replace it. The most likely candidate is a team production regime in which directors would have to balance the interests of multiple constituents. But as Michael Jensen points out, “telling a manager to maximize [multiple priorities] will leave that manager with no way to make a reasoned decision. In effect, it leaves the manager with no objective.”¹²⁶ Though Lynn Stout accurately contends that humans balance priorities all the time, even she concedes that balancing is hard,¹²⁷ and shareholder-value thinking may be an *easier* method that managers prefer to follow.

¹¹⁹ Bebchuk, *supra* note 78, at 844 (“The basic and longstanding principle of U.S. corporate law is that the power to manage the corporation is conferred on the board of directors.”); see also *id.* at 847 (claiming that the authority to make “scaling-down” decisions “rests fully with the board”).

¹²⁰ Bainbridge, *supra* note 111, at 574–76.

¹²¹ See *id.* at 574, 576–77.

¹²² Stout, *supra* note 38, at 51–56.

¹²³ See, e.g., *id.* at 33.

¹²⁴ See *supra* Section II.A (discussing the ambiguous legal state of the shareholder value norm).

¹²⁵ See Michael C. Jensen, Value Maximization, Stakeholder Theory, and the Corporate Objective Function, 12 *Bus. Ethics Q.* 235, 238 (2002) (explaining that telling directors to maximize “multiple objectives” results in “confusion and lack of purpose”). But see Stout, *supra* note 38, at 107–09 (arguing that Jensen “ignores the obvious human capacity to balance . . . competing interests”).

¹²⁶ Jensen, *supra* note 125, at 238; see also Frank H. Easterbrook & Daniel R. Fischel, *The Economic Structure of Corporate Law* 38 (1991) (“[A] manager told to serve two masters . . . has been freed of both and is answerable to neither.”).

¹²⁷ See Stout, *supra* note 38, at 108.

This highlights a third reason that the shareholder value norm is prevalent: Society may see little incentive to change the norm. Granted, some commentators blame shareholder-value thinking as a catalyst for accounting fraud, inflated executive salaries, and poor business practices that harm employees, communities, and the environment.¹²⁸ But the negative consequences are often one step removed. And in the forefront, directors see handsome salaries, investors track growing stock value, and employees and communities may feel adequately protected by laws that regulate wages, pollution, product quality, and the like.¹²⁹ If directors pursue goals other than shareholder value, they risk upsetting shareholders, face a foreseeable decline in stock price, and may even turn the company into a takeover target, thereby jeopardizing their own jobs.¹³⁰ Rather than risk these consequences, directors protect themselves by sticking to shareholder value.

A fourth reason shareholder-value thinking persists is that the federal government has embraced the norm. Lynn Stout points out that “the Securities Exchange Commission (SEC) changed its shareholder proxy voting rules in 1992 to make it easier for shareholders to work together to challenge incumbent boards,” and “Congress amended the tax code in 1993 to encourage public companies to tie executive pay to objective performance metrics.”¹³¹ Both of these changes incentivize directors (one with a stick and the other with a carrot) to maximize shareholder value.

Despite wide acceptance, society recognizes that shareholder-value thinking needs limits. Even though maximizing profits often furthers the social good,¹³² there are many instances when it does not. When profit margins start incentivizing managers to engage in accounting fraud, to pollute, or to forego safety inspections, just about everyone agrees there should be some constraint.¹³³ These constraints are typically external.

¹²⁸ See, e.g., *id.* at 5–6, 53, 104–06, 111–13.

¹²⁹ See Hansmann & Kraakman, *supra* note 69, at 440–42 (stating that non-shareholder constituents traditionally protect themselves from corporations through private contracting and legal rules).

¹³⁰ Lee, *supra* note 75, at 37.

¹³¹ Stout, *supra* note 38, at 20.

¹³² Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* 485 (Edwin Cannan ed., Random House 1994) (1776) (“By pursuing his own interest [an individual] frequently promotes that of the society more effectually than when he really intends to promote it.”).

¹³³ Even Milton Freidman acknowledged that corporate conduct should conform to the “basic rules of the society, both those embodied in law and those embodied in ethical cus-

They take the form of laws that prohibit objectionable practices and of private contracts between directors and non-shareholder constituents.¹³⁴ Product quality standards, employment laws, and union contracts, for example, limit a director's ability to maximize shareholder value. In theory, directors and shareholders could also place internal constraints in the charter or bylaws to achieve the same results.¹³⁵ Ian Lee argues that at least some internal constraint is desirable; otherwise, managers have a perverse incentive to lobby for deregulation and reduce constraints on the pursuit of profits.¹³⁶ Unfortunately, it is rarely in directors' or shareholders' immediate interest to impose internal constraints that would limit the shareholder value norm.¹³⁷

C. Shareholder Value Maximization and Benefit Corporations

The shareholder value norm, its prevalence, and the legal uncertainty surrounding it are at the heart of benefit corporation legislation. Commentators justify the existence of benefit corporations by claiming that these entities offer an alternative to the shareholder value norm.¹³⁸ For instance, benefit corporation supporters frequently cite the takeover of Ben & Jerry's ice cream company as an example of the shareholder value dilemma that could be avoided by benefit corporations.¹³⁹ In 2000, Unilever made an attractive bid for the socially driven ice cream company. Though the bid maximized shareholder value, the founders of Ben & Jerry's preferred not to sell, fearing a takeover would compromise their

tom." Milton Friedman, *A Friedman Doctrine—The Social Responsibility of Business Is to Increase Its Profits*, N.Y. Times, Sept. 13, 1970, § 6 (Magazine), at 32.

¹³⁴ Bainbridge, *supra* note 111, at 588 & n.196; see also Hansmann & Kraakman, *supra* note 69, at 442 (discussing the protections that labor, health, and antidiscrimination laws provide to non-shareholder constituents).

¹³⁵ See Lee, *supra* note 75, at 43–45.

¹³⁶ *Id.* at 44.

¹³⁷ See *infra* Subsection III.A.3.

¹³⁸ See, e.g., Clark & Babson, *supra* note 20, at 838 (stating that benefit corporation statutes were drafted “against the paradigm of shareholder primacy” and “address . . . the need for a new corporate form that changes the paradigm of shareholder primacy”); Jack Markell, *A New Kind of Corporation to Harness the Power of Private Enterprise for Public Benefit*, Huffington Post Bus. Blog (July 22, 2013, 2:06 PM), http://www.huffingtonpost.com/gov-jack-markell/public-benefit-corporation_b_3635752.html (explaining that businesses are considering this corporate structure as an alternative to “existing corporate law that recognizes only one legitimate corporate purpose—to maximize value for stockholders”); see also ABA White Paper, *supra* note 3, at 1083 (explaining that benefit corporations opt out of a “property model” of corporate law which maximizes the wealth of shareholders).

¹³⁹ See, e.g., Clark & Babson, *supra* note 20, at 837–38.

corporate mission.¹⁴⁰ Yet, “[t]he board felt they had no choice but to let all three [bidders] put their best offers on the table,” and eventually Unilever won.¹⁴¹ Had Ben & Jerry’s been a benefit corporation, there is no question that the directors could have turned down the offers in order to protect the corporate mission.¹⁴² Indeed, the directors would have not only been permitted to consider non-shareholder interests, but they also would have been required to do so.¹⁴³

Other authors question whether directors actually need benefit corporation statutes to further a social mission. Professors Antony Page and Robert Katz, for example, argue that under traditional corporate law, Ben & Jerry’s had no obligation to sell to Unilever.¹⁴⁴ J. Haskell Murray also points out that even if traditional corporate law would have required the sale, Vermont had a constituency statute that specifically permitted the Ben & Jerry’s directors to consider the interests of non-shareholders.¹⁴⁵ Given that many states already have similar constituency statutes,¹⁴⁶ Murray believes the legal need for benefit corporations may be “overstated.”¹⁴⁷ Nevertheless, he recognizes that benefit corporations serve another purpose: They combat public acceptance of the shareholder value norm.¹⁴⁸ The legal uncertainty and wide public acceptance surrounding shareholder value can drive risk-averse directors to favor shareholder value, even when they might not have to. Benefit corporation statutes provide the legal certainty directors need to pursue a broader set of goals—especially when those goals come at the expense of delaying a dividend or turning down a lucrative bid. As Murray puts it, “The beauty of social enterprise lies in the fact that managers and investors can choose which side of the well-worn shareholder wealth max-

¹⁴⁰ Constance L. Hays, *Ben & Jerry’s to Unilever, with Attitude*, N.Y. Times, Apr. 13, 2000, at C1, available at <http://www.nytimes.com/2000/04/13/business/ben-jerry-s-to-unilever-with-attitude.html>.

¹⁴¹ *Id.* at C20.

¹⁴² See Fisher, *supra* note 9.

¹⁴³ See Del. Code Ann. tit. 8, § 362(a) (Supp. 2013) (“[A] public benefit corporation *shall be managed* in a manner that balances the stockholders’ pecuniary interests, the best interests of those materially affected by the corporation’s conduct, and the public benefit or public benefits identified in its certificate of incorporation.” (emphasis added)).

¹⁴⁴ Antony Page & Robert A. Katz, *Freezing Out Ben & Jerry: Corporate Law and the Sale of a Social Enterprise Icon*, 35 Vt. L. Rev. 211, 230–31 (2010).

¹⁴⁵ Murray, *supra* note 8, at 16.

¹⁴⁶ Delaware is not one of them, however. Clark & Babson, *supra* note 20, at 830–31.

¹⁴⁷ Murray, *supra* note 8, at 16.

¹⁴⁸ *Id.* at 25–26.

imization argument they favor through their choice of entity or choice of corporate objective. They can choose their own master.”¹⁴⁹

Murray’s observation raises a critical point. Commentators like those from the ABA, who see benefit corporation legislation as embracing an entity theory,¹⁵⁰ ignore the fact that becoming a benefit corporation is optional. If state legislators had required all corporations to operate in a socially responsible manner when they passed benefit corporation legislation, then the entity argument would make sense. An across-the-board requirement would signal that all corporations, because they are quasi-public entities, have an innate duty to act responsibly. But the optional nature of benefit corporation statutes sends a different message. It says that benefit corporations have added responsibility not because governments require it, but because the directors and shareholders want it. If these statutes are to make economic sense, they must be seen as facilitating a contract between shareholders and directors with mutually agreeable terms. Shareholders with the option of investing in traditional corporations would not forego their right to maximized value unless the alternative deal was more appealing. To make that deal more appealing, benefit corporations do not abandon the shareholder value norm; they merely redefine what it means to maximize shareholder wealth.

III. BENEFIT CORPORATION STATUTES EMPOWER SHAREHOLDERS

This Part will introduce a theory describing both the reasons and extent to which benefit corporations embrace the shareholder value norm. The Note will defend this theory as the appropriate interpretation of benefit corporation legislation and conclude by explaining various implications of viewing benefit corporations as entities that promote shareholder value.

A. A Contract Model for Benefit Corporations

1. The Contract Analogy

Recall that commentators in the shareholder value debate agree on two items: (1) shareholders are not in control of corporations (directors hold that power); and (2) irrespective of any legal or economic support for the shareholder value doctrine, the public has by and large accepted

¹⁴⁹ Id. at 52.

¹⁵⁰ ABA White Paper, supra note 3, at 1085–86.

the doctrine as the norm. There is a third point of consensus, which is now relevant. Regardless of which theories they support, all of these scholars attempt to understand corporate law by breaking the statutes down into hypothetical contracts among corporate constituents.

Take, for instance, Bainbridge, whose director primacy model is “grounded in the prevailing contractarian theory of the firm.”¹⁵¹ Blair and Stout describe their team production model as one in which “hierarchs [that is, directors] work for team members (including employees) who ‘hire’ them to control shirking and rent-seeking among team members.”¹⁵² Indeed the contract model of firms has become the “dominant legal academic view.”¹⁵³ Why? “The role of corporate law,” explain Judge Frank Easterbrook and Professor Daniel Fischel, “is to adopt a background term that prevails unless varied by contract. And the background term should be the one that is either picked by contract expressly when people get around to it or is the operational assumption of successful firms.”¹⁵⁴ Viewing corporate statutes as default contracts is useful because that is exactly what the statutes are intended to be.

Notably, statutes allow the directors, shareholders, and other constituents to avoid most, if not all, of the transaction costs they would have encountered by creating a corporation through private contracting.¹⁵⁵ Indeed, corporate statutes bypass so many transaction costs that they facilitate agreements that could not exist but for the statutes.¹⁵⁶ Henry Hansmann and Reinier Kraakman, for example, convincingly argue that in publicly traded corporations with thousands of shareholders, it would be impossible to mimic limited liability through private contracts.¹⁵⁷ Nevertheless, general corporate statutes make limited liability a reality. Though it may have seemed odd to compare a corporate statute to a set of contracts that would never exist on their own, it was precisely be-

¹⁵¹ Bainbridge, *supra* note 111, at 550.

¹⁵² Blair & Stout, *supra* note 107, at 280 (emphasis omitted).

¹⁵³ William T. Allen, *Contracts and Communities in Corporation Law*, 50 *Wash. & Lee L. Rev.* 1395, 1400 (1993); see also Bainbridge, *supra* note 111, at 552 (describing the nexus of contracts model as “standard”).

¹⁵⁴ Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 *Colum. L. Rev.* 1416, 1446 (1989).

¹⁵⁵ See Larry E. Ribstein, *The Rise of the Uncorporation* 26–27 (2010).

¹⁵⁶ Cf. Bainbridge, *supra* note 111, at 578 (“In high transaction cost settings, we cannot depend on private contracting to achieve efficient outcomes. Instead, in such settings, statutes must function as a substitute for private bargaining.”).

¹⁵⁷ See Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 *Yale L.J.* 387, 390 (2000).

cause Hansmann and Kraakman made this comparison that they discovered the essential role organizational law played in facilitating limited liability.¹⁵⁸

Relying on the general consensus that corporate law may be best understood through a contract metaphor, this Note will analyze benefit corporation statutes as though they represent a collection of private contracts.

2. Applying the Contract Analogy to Benefit Corporations

The first step in building a contract model for benefit corporations is to understand the starting point for each of the contracting parties. Easterbrook and Fischel observe that in traditional corporations, shareholders “have contracted [with directors] for a promise to maximize long-run profits of the firm, which in turn maximizes the value of their stock.”¹⁵⁹ There is nothing in contract theory that mandates these specific terms, though. Shareholders and directors can agree to terms other than wealth maximization if they so choose.¹⁶⁰ But in the main, directors assume that either for legal reasons or for economic efficiency, maximizing shareholder value is the best course. Thus, shareholders who invest in corporations expect that directors will maximize profits.

Certain shareholders, however, who place high subjective value on specific social causes (such as supporting local merchants, fighting AIDS, educating impoverished children, etc.), might independently choose to take some of the wealth the corporation produces on their behalf and donate to these causes. Shareholders do this because the feeling of goodwill they receive from that transaction outweighs the economic utility of spending those dollars on something else.¹⁶¹ At some point, the benefit of donating the tenth or hundredth or millionth dollar will be less than the marginal utility of making other purchases. At that point the

¹⁵⁸ See *id.*

¹⁵⁹ Easterbrook & Fischel, *supra* note 154, at 1446.

¹⁶⁰ Cf. Lee, *supra* note 75, at 47–48 (explaining that default terms in corporate statutes are most beneficial when they are not mandatory).

¹⁶¹ See Rubén Hernández-Murillo & Deborah Roisman, *The Economics of Charitable Giving: What Gives?*, *The Regional Economist*, Oct. 2005, at 12–13 (“Although some people may be altruistic when giving, economics tells us that the dominant motivation is the internal satisfaction that individuals derive from the act of giving itself. Individuals derive utility from giving much in the same way they obtain satisfaction from buying a new car or eating at a restaurant.”).

shareholder will stop making donations and instead spend money on other items—so long as those purchases make the shareholder happier than donating the money would.¹⁶² Thus, shareholders with sufficient funds to meet their own needs will have an optimal level of purchases and donations that they engage in over a period of time—a combination of gift giving and personal spending that maximizes their subjective happiness and wellbeing. Importantly, when shareholders donate, they are paying for something they value. For example, individual shareholders might pay for the feeling they get when they help someone in need, when they make a child happy, or when they see their name on a donor's plaque.¹⁶³ Even institutional shareholders are willing to allocate funds to charitable causes if donations boost their public image, improve employee morale, or build long-term value in other ways.¹⁶⁴ This feeling of satisfaction (or, for institutional investors, the long-term benefit) can be thought of as an “in-kind” return.

In the same way that shareholders essentially pay to receive personal benefits when they make donations, they might also be willing to forego (that is, pay) some amount of shareholder value to ensure that the corporation whose stock they own operates in a responsible manner. Treating employees well, taking care of the environment, and fostering good community relations require time, money, and resources. Certainly, there is a middle ground where operating responsibly also increases shareholder value.¹⁶⁵ However, the more ambitious a corporation's social mission becomes, the more likely it is that shareholders will have to give up some of this value to fund the mission.¹⁶⁶ By foregoing some

¹⁶² See, e.g., Stout, *supra* note 38, at 97 (observing that “we are more likely to be nice when it only takes a little, not a lot, of skin off our own noses”).

¹⁶³ See Hernández-Murillo & Roisman, *supra* note 161, at 12–13.

¹⁶⁴ See Murray, *supra* note 8, at 19 n.83 (discussing how Chick-fil-A, Starbucks, and Google have established nonprofit charitable foundations). This point is important because even now some of the early Delaware public benefit corporations are owned by publicly traded companies. See, e.g., Ariel Schwartz, Inside Plum Organics, The First Benefit Corporation Owned by a Public Company, *Fast Company* (Jan. 22, 2014, 8:08 AM), <http://www.fastcoexist.com/3024991/world-changing-ideas/inside-plum-organics-the-first-benefit-corporation-owned-by-a-public-co> (stating that Campbell's Soup “embraced” the idea of its subsidiary, Plum Organics, becoming a benefit corporation because it would positively affect Plum's relationship with consumers).

¹⁶⁵ For examples of businesses taking that middle ground, see *Fast Company*, *supra* note 60.

¹⁶⁶ See Thomas Lys et al., Pinpointing the Value in CSR, *Kellogg Insight* (Mar. 4, 2013), http://insight.kellogg.northwestern.edu/article/pinpointing_the_value_in_csr (reporting that

profits, though, the employees are left with better wages, dangerous chemicals are not polluting the environment, and the local manufacturing plant will not be shipped overseas. If these are things individual shareholders value, their decisions to accept smaller returns on their investments would look a lot like charitable contributions. In essence, the shareholders would be paying for the social mission with shareholder value to which they were otherwise entitled. And they would do it because sacrificing that portion of their shareholder value would make them subjectively better off than retaining those funds.¹⁶⁷ Put simply, the shareholders would be better off receiving a part-monetary, part-“in-kind” return than receiving a pure monetary return.¹⁶⁸

All of this presupposes a world without transaction costs, where individual shareholders could express their subjective motivations and agree on a corporate mission that balances each shareholder’s pecuniary and altruistic goals. Because shareholders have unique subjective motivations, though, no single corporate mission would ever be ideal to every shareholder. One shareholder might prefer that the company donate to cancer research; another might prefer giving employees generous health benefits. Shareholders might also prefer to contribute in different amounts.¹⁶⁹ However, if stockholders have sufficiently similar interests, a corporate mission that averages the collective desires of the shareholder class could still make the entire class better off. That is to say, the shareholder who prefers donating to cancer research might still think a

corporate social responsibility initiatives tend to harm economic performance and reduce shareholder value).

¹⁶⁷ Shareholders may also feel obligated to support a social mission if maximizing shareholder value inevitably harms employees, communities, or the environment. See, e.g., Lee, *supra* note 75, at 32 (“[S]hareholders have a degree of responsibility for the conduct of incorporated business, because they are the people for whose benefit the conduct occurs, and no one forces them to invest.”).

¹⁶⁸ Dana Brackman Reiser, *Benefit Corporations—A Sustainable Form of Organization?*, 46 *Wake Forest L. Rev.* 591, 619 (2011) (stating that benefit corporations “may attract potential investors or lenders who are interested in combining their financial contributions with a purchase of social good”).

¹⁶⁹ As with personal gifts, there would be an optimal level of corporate responsibility. At some point a shareholder’s desire to make money would outweigh the desire to pay employees generously or to prevent harm to the environment. Cf. Yvon Chouinard, *Let My People Go Surfing: The Education of a Reluctant Businessman* 78, 228 (2006) (admitting, as the founder of Patagonia, that it is impossible to operate the company without causing “some waste and pollution,” so Patagonia attempts to “cause no *unnecessary* harm”) (emphasis added).

generous employee health plan is better than pocketing a few more dollars in cash.

Assuming such a contract could be agreed upon, the corporation would become a hybrid entity that allows shareholders to simultaneously invest and donate. Shareholders might actually prefer this structure to donating independently because it could avoid harms in the first instance. Rather than donating to the local food bank to help the unemployed, shareholders of hybrid corporations would choose to forgo some value up front to ensure employees were not laid off in the first place. Similar arguments could be made for avoiding environmental harms, fostering good community relations, etc.

In the real world, benefit corporation statutes mimic this hypothetical agreement for “in-kind” returns. By allowing directors to charter as a benefit entity, states facilitate an off-the-rack contract that shareholders can opt into without having to negotiate this deal independently. Because only those shareholders that value in-kind returns (to the degree and of the kind offered by benefit corporation statutes) will purchase stock in these companies, benefit stock will be owned by a self-selected, ideologically similar group of shareholders. As long as enough people opt in, there will be a healthy market for social enterprise and investment.

Notably, this contract model is the same as the economic model developed by Professors Joshua Graff Zivin and Arthur Small.¹⁷⁰ They proposed that when public companies sacrifice shareholder value to make charitable or social contributions they are effectively offering investors a composite financial product—monetary returns via stock value and charitable returns via the “warm glow” investors feel for contributing to a social initiative.¹⁷¹ Under both the contract model and the economic model, however, directors retain only one loyalty—to the shareholders.¹⁷² That loyalty is the same as it always has been—to maximize residual value—but in benefit corporations shareholders tell directors how the directors can maximize their subjective wealth preferences by delivering both monetary and “in-kind” returns. Directors manage the corporation in a socially responsible way not because the company owes

¹⁷⁰ Graff Zivin & Small, *supra* note 10, at 1–2.

¹⁷¹ *Id.* at 2.

¹⁷² *Id.* (describing directors as investors’ “agents”).

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any unique duty to society or to non-shareholder constituents, but because the shareholders have contracted for such actions.

3. The Contract Between Shareholders and Directors

If this model is accurate, one might ask whether there are examples of shareholders who have explicitly contracted with directors for responsible, charitable actions. The answer is yes; shareholders have made these contracts. But it has usually been in closely held companies. The absence of similar contracts in large, publicly traded corporations is likely due to high transaction costs that make negotiating such agreements impossible.

In closely held companies, however, the examples of private contracting for public benefits probably occur with greater frequency than most people recognize. A firm owned by a handful of individuals creates an ideal environment for considering, negotiating, and carrying out a social mission. The investor-owners can communicate easily with each other and with management about their investment goals, their preference for in-kind returns, and so on. When there are disagreements about how corporate funds should be allocated, a small group of investors can usually agree on a single path forward. The fewer owners there are, the fewer transaction costs there will be.

A famous example can be found on the salad dressing aisle of almost any grocery store. Among the brands, the face of actor Paul Newman appears on many of the labels. Thirty years ago, Newman and his pal A.E. Hotchner bottled homemade dressing in old wine bottles to give away as holiday gifts. When friends came back asking for refills, Newman decided the dressing was good enough to sell. From the start, Newman determined that all after-tax profits should be given to charities. In the thirty years since, Newman's Own has grown to become a household brand, and the company has donated over \$380 million to charities worldwide.¹⁷³ For a wealthy actor like Paul Newman, the decision to donate everything may not have been that hard. But that is exactly why his story is a great example. As the sole owner,¹⁷⁴ he faced no negotiating costs about how profits should be used, and he directed funds to what he thought would produce the most value. Being as

¹⁷³ History, Newman's Own Foundation, <http://newmansownfoundation.org/about-us/history> (last visited Dec. 5, 2013).

¹⁷⁴ Fast Company, *supra* note 60.

wealthy as he was, the benefit of pocketing the profits was not worth as much as the satisfaction he received giving the money away.¹⁷⁵ Indeed the satisfaction was substantial enough that he was not only willing to give the profits away, but he was also willing to put in long hours to ensure the donations were made.¹⁷⁶

Newman's example is not isolated. Just last year, Etsy, the online marketplace for handmade and vintage items, became a certified B Corporation.¹⁷⁷ As discussed above, becoming a certified "B Corp" is not the same as becoming a legally recognized benefit corporation. Instead, it is akin to obtaining LEED certification for a construction project or selling coffee under the fair trade standards, except the B Corp label certifies that a company is committed to operating in a socially and environmentally responsible manner.¹⁷⁸ Etsy's decision to obtain B Corp certification is a perfect example of shareholders agreeing to pursue a social mission. As a closely held company, Etsy has received significant funding from several venture capital firms.¹⁷⁹ Typically, venture capitalists take large stock holdings in the companies they fund and actively participate in corporate decision making.¹⁸⁰ The evidence suggests that Etsy's venture capital investors have done just that.¹⁸¹ Thus, any decision as

¹⁷⁵ Mike Allen, *Making His Own Charity an Acquired Taste*, N.Y. Times, Nov. 18, 1998, at G2, available at <http://www.nytimes.com/1998/11/18/giving/making-his-own-charity-an-acquired-taste.html?src=pm> (stating that Newman donated all profits because "he had no need or desire to make money from it").

¹⁷⁶ Newman's daughter once commented, "Dad jokes that it takes a lot of time to give away all that money." *Id.*

¹⁷⁷ Michelle Traub, *Etsy Joins the B Corporation Movement*, Etsy News Blog (May 9, 2012), <http://www.etsy.com/blog/news/2012/etsy-joins-the-b-corporation-movement>.

¹⁷⁸ *Id.*; see also *What are B Corps?*, *supra* note 25 (explaining that B Corp certification is equivalent to fair trade or organic certifications).

¹⁷⁹ Joseph Cafariello, *Etsy IPO: Entering the IPO Planning Stages?*, *Wealth Daily* (Nov. 20, 2013), <http://www.wealthdaily.com/articles/etsy-ipo/4818> (stating that several venture capital firms have invested \$91 million in Etsy since its creation); see also Ki Mae Heussner, *Amid Growing Pains, Etsy Raises \$40 Million*, *Gigaom* (May 9, 2012, 11:19 AM), <http://gigaom.com/2012/05/09/amid-growing-pains-etsy-raises-40-million> (listing five venture capital firms that had recently invested in Etsy).

¹⁸⁰ VC Industry Overview, National Venture Capital Association, http://www.nvca.org/index.php?option=com_content&view=article&id=141&Itemid=589 (last visited Aug. 19, 2014) ("Typically, [venture capitalists] take seats on the boards of directors and participate actively in company operations and management personnel. This commitment often includes providing strategic counsel regarding development and production, making connections to aid sales and marketing efforts, and assisting in hiring key management.").

¹⁸¹ Cafariello, *supra* note 179 (discussing how venture capital investors influence decisions that affect Etsy's growth); Heussner, *supra* note 179 (announcing that after a recent round of

significant as committing to a social mission must have been supported by these investors. And it was. Regarding the company's decision to become certified, Etsy investor Albert Wenger commented on behalf of the shareholders, "We believe that the best long-term stewards of Internet-based networks and marketplaces will focus on value creation for all participants instead of solely on shareholders."¹⁸² Granted, the investors may have had multiple and differing reasons for supporting the initiative—some of which may not have been altruistic.¹⁸³ Nevertheless, Etsy demonstrates that small groups of active shareholders can and do agree to social missions, and that some of those shareholders do so for non-pecuniary reasons.¹⁸⁴

The prosocial initiatives pursued by Newman's Own and Etsy occurred because investor-owners agreed on a single course of action and were able to communicate their desires to management. In closely held companies, shareholders can do both of these things with relative ease. Indeed, for Paul Newman, who was both the owner and the manager of his company, the negotiations were no more than a moment of self-deliberation.¹⁸⁵ But in a widely held public corporation, it is a different story.

Lynn Stout points out that "[t]he structure of modern stock markets, combined with the rhetoric of shareholder primacy, creates almost insurmountable obstacles to prosocial investing behavior."¹⁸⁶ The first challenge shareholders face in large, publicly traded companies is purely administrative. Stephen Bainbridge notes, "At the most basic level, the

fundraising, the general partner from one of Etsy's venture capital investors would join the Etsy board).

¹⁸² Traub, *supra* note 177; see also Cafariello, *supra* note 179 (reading Wenger's quotation to mean the venture capital investors collectively supported B Corp certification).

¹⁸³ Investors may perceive certification as something that creates both short-term and long-term value. Short-term value may be created because the Etsy brand caters to buyers and sellers that prefer handmade and vintage items. A corporate mission that emphasizes sustainability, thrift, and social awareness will likely resonate with the client base. Sustainable practices may also produce long-term value by fostering customer loyalty and good relationships with corporate constituents and by avoiding litigation. For a discussion of the short- and long-term benefits of corporate social responsibility, see Business Case for CSR, Industry Canada (Aug. 15, 2013), http://www.ic.gc.ca/eic/site/csr-rse.nsf/eng/h_rs00100.html.

¹⁸⁴ Traub, *supra* note 177 (quoting Wenger's reference to the Etsy shareholders being "stewards" while suggesting that Etsy has social obligations as a corporate entity, and that by becoming certified, Etsy is furthering that non-pecuniary mission).

¹⁸⁵ Allen, *supra* note 175 (describing Newman's decision to donate after-tax profits to charity as "an afterthought").

¹⁸⁶ Stout, *supra* note 38, at 101.

sheer mechanical difficulties of achieving consensus amongst thousands of decision-makers impede shareholders from taking an active role. Just as cities get too big to be run by New England-style town meetings, so do corporations.”¹⁸⁷

Assuming prosocial shareholders could overcome these administrative challenges, perhaps by piggybacking on a proxy ballot¹⁸⁸ or by holding a large percentage of stock, they must then convince fellow shareholders that their proposed mission is worthwhile. Not all investors, however, share the same interests.¹⁸⁹ The optimal level of donating is different for each. For some, like Paul Newman, the optimal amount is in the millions. For the debt-ridden college graduate, the amount may be close to zero. Even investors who share an interest in philanthropy might prefer donating their funds to different causes. For example, one might prefer donating to the Ronald McDonald House, and another might prefer subsidizing operating costs to keep a manufacturing plant from going overseas. If only like-minded investors owned the shares in a company, then those shareholders probably could agree on a specific social mission. But without a way to homogenize the shareholder base, few if any proposals would generate wide support.

Indeed, going prosocial is often perceived as harmful if shareholders do not agree on the terms and conditions of the corporate mission. Daniel Fischel explains why:

[L]et us assume a corporation decides to modify its behavior—say, discontinuing investment in South Africa or ceasing manufacture of war munitions—in direct response to a defeated [shareholder] proposal. While reformers would no doubt be ecstatic about this result,

¹⁸⁷ Bainbridge, *supra* note 73, at 22; see also *id.* at 19 (citing Committee on Corporate Laws, ABA Section of Business Law, Report on the Roles of Boards of Directors and Shareholders of Publicly Owned Corporations and Changes to the Model Business Corporation Act—Adoption of Shareholder Proxy Access Amendments to Chapters 2 and 10, 65 Bus. Law. 1105, 1108–09 (2010)) (explaining that it would be impractical to have shareholders vote on every management decision in a large public company).

¹⁸⁸ Shareholder proxy access is permitted in certain situations under 17 C.F.R. § 240.14a-8 (2014).

¹⁸⁹ Lynn Stout observes that even shareholders in traditional corporations who share a common investment objective are not homogenous. Investors tend to invest for different reasons and as a result have different views about whether directors should seek short- or long-term gains. For example, consider the long-term buy and hold strategy of mom and pop investors versus the quick buy and sell strategies of arbitragers or hedge funds. Stout, *supra* note 38, at 66–69 (explaining that individuals invest for the long term but mutual funds and hedge funds push for short-term gains—because that is how they are evaluated).

shareholders as a class have little to be excited about. What has occurred is that a tiny minority, subsidized by the vast majority of shareholders, has caused the corporation to abandon a wealth-maximizing strategy favored by the very majority of shareholders who are forced to provide the subsidy. A less “democratic” result or one more inconsistent with the goal of maximizing shareholders’ welfare is hard to imagine.¹⁹⁰

Aside from these concerns, the prosocial investor also faces internal challenges. Stout observes that “diversified shareholders who are uninvolved in and ignorant of a company’s day-to-day business decisions are in no position to police against, or even know about, antisocial corporate behavior.”¹⁹¹ Instead, their incentive is to focus on something simple, like the stock price, and to evaluate directors’ performance on this single metric (ignorant of the fact that increasing stock price might harm employees, the environment, or the community).¹⁹² Because most shareholders—even those with prosocial intentions—diversify their investments and lack the time to effectively follow the companies they invest in, Stout’s observation is probably closer to describing the norm for shareholder behavior than an exception.

Einer Elhauge also believes that the choice to invest in socially responsible companies presents an unfortunate scenario, which Stout describes as a “Tragedy of the Commons.”¹⁹³ If mission-driven companies produce less shareholder value than their purely for-profit counterparts, investors incur a pecuniary cost for their prosociality.¹⁹⁴ Prosocial shareholders might view this cost as the tradeoff for producing social good. But it is often unclear how or if the sacrificed profits actually translate

¹⁹⁰ Daniel R. Fischel, *The Corporate Governance Movement*, 35 *Vand. L. Rev.* 1259, 1279 (1982); see also Friedman, *supra* note 65, at 133 (explaining that viewing corporations as having a “social responsibility” to groups beyond their shareholders is a “fundamental misconception”).

¹⁹¹ Stout, *supra* note 38, at 99 (citing Elhauge, *supra* note 37, at 733).

¹⁹² *Id.*

¹⁹³ See Elhauge, *supra* note 37, at 792 (explaining the collection problem that may keep shareholders from individually voting for socially responsible measures in the hopes that others will support them); Stout, *supra* note 38, at 99 (formulating Elhauge’s description of the collective action problem as a “Tragedy of the Commons”).

¹⁹⁴ See Elhauge, *supra* note 37, at 792; Stout, *supra* note 38, at 99. Note, however, that shareholders invest in prosocial companies by choice, believing the social mission of the corporations will produce greater subjective value than the marginal increase in stock value. See discussion *supra* Subsection III.A.2.

into increased corporate responsibility.¹⁹⁵ Without tangible evidence of how the foregone shareholder value makes the world a better place, investors may have a difficult time “put[ting] [their] money where [their] conscience is.”¹⁹⁶

Given these considerations, it is entirely possible that shareholders have always wanted something like the benefit corporation, but because of these “insurmountable obstacles”¹⁹⁷ they simply have not been able to make it happen in widely held firms. With the arrival of benefit corporations, however, many of the obstacles that once inhibited private contracting for corporate missions have now been addressed. The administrative burdens of negotiating for a mutually agreed upon social mission are avoided thanks to benefit corporation statutes that represent the default terms prosocial shareholders and directors would likely have established in a world without transaction costs. Rather than negotiating these terms, directors and shareholders simply choose whether to opt into the benefit corporate form. If investors do not like the idea of sacrificing shareholder value for a charitable cause or if they do not like the public benefit mission of a specific company, they do not have to invest. But if those things appeal to them, they can opt in. This process of self-selection produces a group of shareholders with homogenous interests who agree on a specific mission and will not consider themselves harmed if the corporation sacrifices some shareholder value to further that mission.

The statutes also serve as a broad platform that many shareholders can agree with—thus increasing the number of investors that self-select into owning benefit corporation stock. Like a purposefully vague political platform, benefit corporation statutes approximate shareholder interests much better than any one shareholder could through a specific initiative. Even though shareholders know directors might allocate funds in a manner that differs from what they personally prefer, shareholders in benefit corporations are nevertheless confident that directors’ decisions will be good enough. In essence, every shareholder in a benefit corpora-

¹⁹⁵ See Elhauge, *supra* note 37, at 792.

¹⁹⁶ Stout, *supra* note 38, at 99; see also *id.* at 89 (“Most [shareholders] have relatively small, diversified investment portfolios, meaning they are likely to hold only very small amounts of stock in any particular corporation. This makes most retail investors rationally apathetic.”); Lee, *supra* note 75, at 63–64 (arguing that shareholders are rationally apathetic in proxy contests because they “have no expectation that their vote will be pivotal”).

¹⁹⁷ Stout, *supra* note 38, at 101.

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tion would rather promote some social mission than none at all. The broad parameters established by benefit corporation statutes allow this to occur.

Finally, benefit corporations provide shareholders with a simple, concrete way to measure the good that their capital is doing. Depending on the state, benefit corporations must issue an annual or biannual report that discloses how the company furthered its social and environmental initiatives.¹⁹⁸ These reports convey information about social value the company is creating just as stock prices convey information about shareholder value. Though the reports are not as current as stock prices, they are a step in the right direction and provide shareholders with an easy way to track and justify the charitable portion of their investment.

It is not enough, though, to say that benefit corporations overcome barriers that inhibit private contracting for socially driven companies. Benefit corporation statutes only make sense under the contract model if there are also enough prosocial investors in the marketplace to justify the creation of the statutes. Studies suggest that most individuals are willing to make small personal sacrifices to avoid harming others.¹⁹⁹ Lynn Stout reports:

In one common experiment called a “social dilemma,” for example, anonymous subjects are asked to choose between a defection strategy that maximizes their own personal payoffs, and a cooperation strategy in which they individually receive slightly less but the other members of the group receive more. As many as 97 percent of subjects choose to cooperate in some social dilemma games. . . . Not surprisingly, researchers have found that the incidence of such behaviors declines as the personal cost of prosocial action rises: we are more likely to be nice when it only takes a little, not a lot of skin off our own noses. Nevertheless, the evidence overwhelmingly demonstrates that the vast majority of people are willing to make at least small personal sacrifices to follow their conscience.²⁰⁰

Consumer habits support this finding. For example, shoppers typically pay a premium when they “buy local” or purchase organic certified

¹⁹⁸ See, e.g., Del. Code Ann. tit. 8, § 366(b) (Supp. 2013) (requiring a biannual report); 15 Pa. Cons. Stat. Ann. § 3331 (West Supp. 2013) (requiring an annual report).

¹⁹⁹ Stout, *supra* note 38, at 97.

²⁰⁰ *Id.*

products. These consumers could pay less for standard or national brand products, but they choose not to, partly because their purchase supports the local economy or helps the environment.²⁰¹ Investors face a similar trade off when purchasing regular stock versus stock in benefit corporations. By purchasing benefit stock even though they pay a little more, investors feel as though they are bolstering the economy or helping the environment. Because many consumers are willing to pay extra for products that deliver a social good, it seems at least some investors would be willing to do the same.

This is being confirmed as the market for socially responsible investment opportunities expands. “Socially responsible investing,” as it is called, has grown over the past thirty years and was recently estimated to represent 11.3% of U.S. assets under management, or roughly \$3.74 trillion.²⁰² Socially responsible investing can involve screening stocks of companies whose businesses or products shareholders disagree with (such as firearm or tobacco companies) or buying stock in mission-driven companies.²⁰³ The latter practice is known as impact investing. “Impact investments are investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return.”²⁰⁴ A 2010 survey by Hope Consulting reports that 87% of investors are open to the idea of impact investing, suggesting a market opportunity of \$120 billion.²⁰⁵ Another study by J.P. Morgan found that impact investments have the potential to generate profit from \$183 billion to \$667 billion by 2020.²⁰⁶ Ian Potter ex-

²⁰¹ See, e.g., Stacey Mitchell, Top 10 Reasons to Support Locally Owned Businesses, Institute for Local Self-Reliance (Dec. 10, 2012), <http://www.ilsr.org/why-support-locally-owned-businesses>.

²⁰² U.S. Soc. Inv. Forum Found., Report on Sustainable and Responsible Investing Trends in the United States 11 (2012), available at http://www.ussif.org/files/Publications/12_Trends_Exec_Summary.pdf; Clark & Babson, *supra* note 20, at 822 (citing data from U.S. Soc. Inv. Forum Found., Report on Socially Responsible Investing Trends in the United States (2010)).

²⁰³ Clark & Babson, *supra* note 20, at 822.

²⁰⁴ About Impact Investing, Global Impact Investing Network, <http://www.thegiin.org/cgi-bin/iowa/resources/about/index.html> (last visited Dec. 3, 2013).

²⁰⁵ Hope Consulting, Money for Good: The US Market for Impact Investments and Charitable Gifts from Individual Donors and Investors 61–62 (2010), available at http://www.hopeconsulting.us/pdf/Money%20for%20Good_Final.pdf.

²⁰⁶ J.P. Morgan Global Research, Impact Investments: An Emerging Asset Class 6, 11 (2010), available at http://www.jpmorgan.com/cm/BlobServer/impact_investments_nov2010.pdf?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1158611333228&blobheader=application%2Fpdf.

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plains that impact investing is poised for substantial growth largely because institutional investors are starting to consider these assets as profitable investment opportunities.²⁰⁷ In sum, benefit corporations appear to have an initial market they can target, and it is reasonable to believe that investor demand will grow.

4. Contracts Between Directors and Non-Shareholder Constituents

Though it is likely that state legislatures recognized the demand for socially responsible investment opportunities, it is possible that they were also responding to demands from other corporate constituents. In the traditional contract model of corporate law, directors are presumed to contract not only with shareholders, but also with employees, creditors, governments, suppliers, customers, and a host of other non-shareholder constituents.²⁰⁸ If, as some argue, the shareholder value norm prevents corporations from considering environmental standards, employee safety, and the like,²⁰⁹ perhaps benefit corporation statutes were created to make directors more accountable to the injured parties. After all, the typical statute requires directors to consider “the best interests of those materially affected by the corporation’s conduct.”²¹⁰ A closer reading of benefit corporation statutes, however, reveals that benefit corporations only modify the traditional contract between directors and shareholders and do not represent an expanded contract between directors and non-shareholder constituents.

If benefit corporation statutes were intended to modify the contracts between directors and non-shareholder constituents, the legislatures would have imposed new duties on directors towards these constituents and would have provided a way for the constituents to enforce those duties. But the legislatures did neither. In Delaware, for example, the public benefit corporation statute explicitly states that it imposes *no* duties on directors toward non-shareholder constituents—even those constituents that benefit from a corporation’s specific, chartered public mis-

²⁰⁷ Ian Potter, *Impact Investing: Unleashing Institutional Capital*, *Forbes* (Oct. 22, 2013, 9:34 PM), <http://www.forbes.com/sites/insead/2013/10/22/impact-investing-unleashing-institutional-capital>.

²⁰⁸ Bainbridge, *supra* note 111, at 559–60.

²⁰⁹ See Joel Bakan, *The Corporation: The Pathological Pursuit of Profit and Power* 28, 35, 45, 49, 60 (2004).

²¹⁰ See, e.g., Del. Code Ann. tit. 8, § 362 (Supp. 2013).

sion.²¹¹ Furthermore, under the statute, only shareholders can sue directors for failing to pursue a company's benefit mission.²¹²

It is possible that legislatures assigned the enforcement responsibility to shareholders, thinking shareholders would adequately protect the other constituents' interests. But this is unlikely given that shareholders owe no fiduciary obligation to the other constituents. Furthermore, shareholders' economic incentives could easily be at odds with non-shareholder interests.²¹³ Rather than assuming legislatures believed shareholders would act on behalf of their fellow constituents, it makes more sense to assume that legislatures provided shareholders the enforcement right to protect the shareholders' own interests. Under this reading, shareholders have the enforcement right because they contracted with directors to exchange shareholder value for a social good, and if directors do not deliver on their promise, under the statute, it is the *shareholders* who have been harmed.²¹⁴ If benefit corporation statutes were intended to facilitate a contract between directors and non-shareholder constituents, the statutes would provide a more direct enforcement mechanism.

²¹¹ See Del. Code Ann. tit. 8, § 365(b) (Supp. 2013). This provision specifies:

A director of a public benefit corporation shall not, by virtue of the public benefit provisions or § 362(a) of this title, have any duty to any person on account of any interest of such person in the public benefit or public benefits identified in the certificate of incorporation or on account of any interest materially affected by the corporation's conduct and, with respect to a decision implicating the balance requirement in subsection (a) of this section, will be deemed to satisfy such director's fiduciary duties to stockholders and the corporation if such director's decision is both informed and disinterested and not such that no person of ordinary, sound judgment would approve.

When benefit corporation legislation was first passed in Maryland, one law student argued that fiduciary duties should be established between a board of directors and outside stakeholders. Michael R. Deskins, Comment, Benefit Corporation Legislation, Version 1.0—A Breakthrough in Stakeholder Rights?, 15 Lewis & Clark L. Rev. 1047, 1048–51, 1067–68, 1070–72, 1076 (2012).

²¹² See Del. Code Ann. tit. 8, § 367 (Supp. 2013).

²¹³ See Westaway & Sampselle, *supra* note 7, at 1040–41.

²¹⁴ Other constituents may have a private cause of action against the directors, depending on how they were affected by the directors' decisions. See Hansmann & Kraakman, *supra* note 69, at 442 (observing that constituent interests are typically protected by contract or by laws concerning health, safety, antidiscrimination, etc.).

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*B. Implications**1. Shareholder Power*

Having discussed the evidentiary and logical support for the contract model of benefit corporations, this Note will next review several implications of the theory. The first and perhaps most important implication is that benefit corporation statutes empower shareholders with control over the ends and to some extent the means of corporate governance. Despite significant debate over what the balance of power should look like, scholars tend to agree that, in practice, directors manage companies for the purpose of creating shareholder value.²¹⁵ This effectively gives shareholders control of the ends of corporate governance, but directors enjoy significant freedom when deciding what means they will use to maximize shareholder value.

Benefit corporation statutes disrupt this balance. The contract model clarifies that just like traditional corporations, benefit corporations are set up to maximize shareholder value.²¹⁶ But benefit corporations go one step further and require directors to maximize shareholders' *subjective* value. Once shareholders are able to tell directors not only to maximize their investment, but also *how* to do so, they obtain some control over the means of corporate governance. Indeed, the day-to-day operations will look noticeably different between a traditional corporation and benefit corporation *because* shareholders have requested the dual return.

Commentators like J. Haskell Murray argue that benefit corporation statutes are redundant because the law already permits directors to consider non-shareholder constituents.²¹⁷ It may be true that the statutes are superfluous from a director's perspective, but the contract model suggests the statutes are critical from a shareholder's perspective. Without the statute, shareholders could only accept pure monetary returns; they would be stuck with the old definition of "shareholder value." There would be no effective option to request a return of capital and public benefits. Because benefit corporations redefine shareholder value to include investors' subjective wealth preferences, they empower sharehold-

²¹⁵ See *supra* Section II.B.

²¹⁶ See *supra* Subsection III.A.2.

²¹⁷ Murray, *supra* note 8, at 16 (stating that "existing corporate law . . . already provides significant protection to directors who choose to favor or consider non-shareholder stakeholders in their decisions").

ers with control the shareholders could not otherwise obtain and, therefore, serve a material purpose.²¹⁸

2. *Shareholder Value*

The second implication has practical consequences. The contract theory suggests that benefit corporations actually create economic value. An example is in order: In 2010, Kraft Foods acquired Cadbury, the British candy manufacturer.²¹⁹ Eighteen months later, directors announced they would split the companies into a snack foods operation selling Oreos and Cadbury chocolate and a grocery business selling Oscar Mayer meats and Kraft Macaroni and Cheese.²²⁰ Why? Because “executives can reasonably hope that splitting the company in two will ‘unlock shareholder value’ by allowing the price for a [sic] one business to be set only by investors who are optimistic about the future of sugar-laden snack foods, while the other is set by investors bullish on basic groceries.”²²¹ Benefit corporations offer the same potential. By creating a tailored investment option that prosocial shareholders are excited about, states can “unlock” more capital than was previously in the market. Additionally, if prosocial shareholders are better off receiving a dual return, they should be willing to pay a premium for stock that caters to their preferences. Though this premium has yet to be measured empirically, an entity-model view of benefit corporations would not account for this phenomenon.

3. *Director Accountability*

The contract model also shows how benefit corporations offer a new structure for corporate accountability. After scandals like Enron, the

²¹⁸ It is true that some public companies support social initiatives by donating funds to charity or other causes. See, e.g., Graff Zivin & Small, *supra* note 10, at 1. To some extent this provides shareholders with a dual return. However, in traditional corporations, the extent to which directors may forego pecuniary shareholder value in favor of a social mission is limited. See *supra* Section II.B. Benefit corporation statutes, therefore, are valuable because they increase the amount of “in-kind” returns shareholders can expect to receive.

²¹⁹ David Jones & Brad Dorfman, *Kraft Snares Cadbury for \$19.6 Billion*, Reuters (Jan. 19, 2010, 3:24 PM), <http://www.reuters.com/article/2010/01/19/us-cadbury-idUSTRE60H1N020100119>.

²²⁰ Aaron Smith, *Kraft to Split into Two Companies*, CNNMoney (Aug. 4, 2011, 10:50 AM), <http://money.cnn.com/2011/08/04/news/companies/kraft>.

²²¹ Stout, *supra* note 38, at 73.

public called for tightening the leash on directors.²²² Academics have naturally debated whether this is a good thing,²²³ and the contract model brings benefit corporations into that debate. Benefit corporations offer a somewhat unique solution. Rather than relying on external constraints, like laws, to keep directors in check, the benefit corporation imposes internal constraints. These consist of shareholder demands that directors operate within certain parameters and spend a portion of their time furthering a social mission. Because shareholders are a self-selected class intrinsically motivated to further the social mission, they are given the right to enforce these internal parameters, holding directors to an unusually high standard.²²⁴ Shareholders can enforce director compliance in a number of ways: by initiating a benefit enforcement proceeding, by starting a proxy contest, or by voting for governance terms that require regular auditing of directors' actions, as in certified B Corps. Though all of these options are available in traditional corporations, the difference is that social investors will be more willing to hold directors accountable because their stock purchase was conditioned on a promise that directors would act in a socially responsible manner. Shareholder activism is the only way to guarantee that directors live up to this promise.

Some academics propose more intrusive control rights for shareholders as a solution to director accountability.²²⁵ Others advocate removing the pressure on directors to maximize shareholder value so that directors may consider non-shareholder constituents and act ethically without fear of litigation.²²⁶ The contract model of benefit corporations offers a third option, showing that if the shareholders are altruistically motivated and pay a premium for their shares, it may be possible to remove the profit

²²² See Mark Rogers, *Sarbanes-Oxley 10 Years Later: Boards Are Still the Problem*, *Forbes* (July 29, 2012, 1:56 PM), <http://www.forbes.com/sites/frederickallen/2012/07/29/sarbanes-oxley-10-years-later-boards-are-still-the-problem>; see also Stout, *supra* note 38, at 19–21, 45–46 (explaining that the shareholder primacy model placed blame for corporate failures on the boards of directors).

²²³ See *supra* Section II.B (noting arguments that shareholders should exercise more control over directors).

²²⁴ Prosocial shareholders may also be better monitors of directors' actions than the typical diversified investor. Cf. Sullivan & Cromwell LLP, *2012 Proxy Season Review 1*, 12–13 (July 9, 2012), available at http://www.sullcrom.com/files/Publication/fdd28332-7b79-4d37-9ada-89da9bc111a9/Presentation/PublicationAttachment/d546858a-ee4a-43af-b379-170d4995e41c/2012_Proxy_Season_Review-7-20-2012.pdf (indicating that approximately one quarter of all shareholder proposals during 2011 and 2012 concerned social policy issues).

²²⁵ See Hill, *supra* note 118, at 346–47.

²²⁶ See Stout, *supra* note 38, at 111–12.

maximization requirement and provide for shareholder oversight—a solution that accomplishes accountability and efficiency, goals that often seem mutually exclusive.²²⁷

4. *Statutory Interpretation*

Finally, the contract model provides a framework for interpreting and revising benefit corporation statutes. There are at least two instances in which the contract model could be useful. First, commentators repeatedly express concern that benefit corporation statutes do not prioritize a corporation's multiple purposes.²²⁸ In a zero-sum transaction, it is unclear on the face of the statutes if directors should favor the shareholders' pecuniary interests, the general public benefit, or the specific public benefit (if any).²²⁹ Under the contract model, however, there is only one body of corporate constituents for whom benevolent actions are taken: the shareholders.²³⁰ Thus, the natural solution might be to ask, hypothetically or even literally, what shareholders want. It would be a mistake to look anywhere else, because directors should only pursue non-profit maximizing ends to the extent that shareholders collectively want directors to pursue such ends. Framing the issue in these terms should help judges prioritize the three corporate purposes. Viewing the three purpos-

²²⁷ The need for oversight may be minimal, though. Just as prosocial investors opt into this corporate form, so too do prosocial directors. Directors that want to further a social mission are arguably less likely to commit financial fraud, forego safety checks, etc.

²²⁸ See, e.g., Murray, *supra* note 8, at 27–33; see also William H. Clark, Jr. & Elizabeth K. Babson, Delaware Is Considering “Public Benefit Corporation” Legislation, *Drinker Biddle* (May 3, 2013), <http://www.drinkerbiddle.com/resources/publications/2013/delaware-considering-public-benefit-corporation-legislation> (stating that the Delaware legislation does not specifically require directors to prioritize the interests of the various corporate constituents).

²²⁹ See Del. Code Ann. tit. 8, § 362(a) (Supp. 2013). See also Model Benefit Corporation Legislation § 301(a), Benefit Corp Information Center, <http://benefitcorp.net/attorneys/model-legislation> (last visited Aug. 18, 2014), which states:

[D]irectors . . . shall consider the effects of any action or inaction upon: (i) the shareholders of the benefit corporation; (ii) the employees and work force of the benefit corporation, its subsidiaries, and its suppliers; (iii) the interests of customers as beneficiaries of the general public benefit or specific public benefit purposes of the benefit corporation; (iv) community and societal factors . . . ; (v) the local and global environment; (vi) the short-term and long-term interests of the benefit corporation . . . ; and (vii) the ability of the benefit corporation to accomplish its general public benefit purpose and any specific public benefit purpose.

²³⁰ See *supra* Subsection III.A.4 (arguing that benefit corporations only modify the contractual agreement between directors and shareholders, not between directors and other constituents).

es as shareholder requests rather than government mandates should also help directors make wise choices as they manage the company.

Delaware's public benefit corporation statute poses another possible concern: It does not require directors to use a third-party standard when reporting on social performance.²³¹ Every other benefit corporation statute requires a third-party standard.²³² Without a third-party standard, it is conceivable that Delaware directors will choose easy-to-meet criteria by which they will measure their work.²³³ This, critics argue, could make directors appear artificially productive and dilute the value of being a benefit corporation—something they refer to as “greenwashing.”²³⁴ The contract model sets this concern to rest. Under a contract-model approach, if a third-party standard is truly necessary, investors will fund only those companies that use a third-party standard in their reporting. If shareholders are concerned that directors' reports rely on internally created rubrics (as is permitted in Delaware), they can invest in other benefit corporations with more transparent reporting. The decision to fund or not to fund requires no negotiations among shareholders or with directors, so investors can express their preferences by not investing in the first instance.²³⁵ Perhaps the only cost to a new investor is the time it takes to discover whether directors are using an adequate standard. Though the typical shareholder might not care to make this inquiry, pro-social investors might, since they have a unique interest in obtaining an “in-kind” return. Thus, as they do with credit ratings, directors—even in Delaware—may actually seek out rigorous third-party standards when reporting on corporate social initiatives in order to attract capital.²³⁶ The

²³¹ See Del. Code Ann. tit. 8, § 366 (Supp. 2013).

²³² See, e.g., Md. Code Ann., Corps. & Ass'ns § 5-6C-08(a) (LexisNexis Supp. 2013); N.J. Stat. Ann. § 14A:18-11a(2) (West Supp. 2013); Vt. Stat. Ann. tit. 11A, § 21.14(a)(2) (Supp. 2013).

²³³ See, e.g., Model Benefit Corporation Legislation § 102 cmt. (Third Party Standard), Benefit Corp Information Center, <http://benefitcorp.net/attorneys/model-legislation> (last visited Aug. 18, 2014) (stating that “a third party standard provides an important protection against the abuse of benefit corporation status” and is “intended to reduce ‘greenwashing’ (the phenomenon of businesses seeking to portray themselves as being more environmentally and socially responsible than they actually are)”).

²³⁴ *Id.*; Clark & Babson, *supra* note 20, at 845–46.

²³⁵ It is more difficult for investors to “vote with their feet” once their capital is locked in. Nevertheless, Delaware benefit corporation directors have an incentive to commit to a third-party reporting requirement prior to any public offering.

²³⁶ See Moody's History: A Century of Market Leadership, Moody's Corp., <https://www.moody.com/Pages/atc001.aspx> (last visited Dec. 5, 2013) (stating that

contract model, therefore, makes it clear that statutes need not require third-party standards as long as investors can communicate their desires effectively.

CONCLUSION

Benefit corporations are something of an irony. On the surface, they seem to empower directors and marginalize shareholders by aspiring to an entity model of corporate law. They grant directors discretion to pursue social missions and give non-shareholder constituents a piece of the residual earnings that would have otherwise gone to the investors. A closer look at the statutes, though, reveals a different story.

In traditional corporations, shareholders are presumed to exchange capital for a promise that directors will maximize the value of their investment. In theory, shareholders could modify the terms of this contract to fund a social mission as well, but the costs of doing so are prohibitive—at least in widely held corporations. Nevertheless, an interest among certain shareholders to invest in publicly traded companies that further social missions exists, and benefit corporation statutes match the preferences of those shareholders. The statutes represent the contract shareholders would have reached with directors in a world without transaction costs. Shareholders who opt into benefit corporations communicate to directors that they are subjectively better off if some of their pecuniary returns are instead spent on charitable or ethical causes. By giving voice to prosocial investors, benefit corporations empower shareholders with greater control over the management of corporate affairs. Thus, while it appears shareholders must compete with other constituents for management's attention, they have actually chosen to share some economic value to which they were otherwise entitled. And though it seems directors enjoy new discretion, the social mission may actually be a tighter leash. Despite being an entity that discredits pure profit maximization, the benefit corporation embraces shareholder primacy more than the traditional corporate form itself.

Moody's began charging issuers, as well as investors, for their credit rating services because the ratings provided greater market access).