Benefit Corporations and the Separation of Benefit and Control

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Scholars, activists, and other observers have expressed concern about the social effects of corporate activity in the United States since as early as the nineteenth century. A recurring theme in this debate has been whether corporations' focus on shareholder interests causes them to neglect and harm the interests of other constituencies affected by corporate activity. A recent and prominent effort to address this concern is the social enterprise movement, which is unique because it has resulted in the creation of entirely new business entities designed specifically for for-profit businesses devoted to pursuing social missions. One of the most widely adopted products of this social enterprise movement is the benefit corporation.

Benefit corporations aim to liberate businesses to do more social good by freeing management from a narrow focus on shareholder value. Scholars have written with restrained hope about benefit corporations, pointing out weaknesses that may inhibit benefit corporations' ability to produce meaningful social returns and highlighting the fact that shareholder primacy is not required under traditional corporate law. Nonetheless, the social enterprise movement exists because modern corporations are generally governed with a narrow focus on share price, even if there is no clear legal mandate to do so.

This Article evaluates the potential success of benefit corporations in light of the absence of a legal mandate to prioritize shareholder interests. First, it analyzes the forces that have led traditional corporations to become narrowly focused on share price maximization. It then systematically evaluates (1) whether benefit corporations will be vulnerable to these forces; and (2) whether benefit corporations will succeed in producing social benefits. By repurposing the traditional agency cost analysis of corporate governance, it concludes that substantial impediments to meaningful social return remain because the beneficiaries of benefit corporations' social missions have no rights to influence corporate decision making—the "separation of benefit and control." Finally, it proposes an ex ante Public Benefit Plan, drafted by the benefit

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corporation and its intended beneficiaries, as a solution to the separation of benefit and control.

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INTRODUCTION

Concern about the social effects of corporations has a long history in the United States, dating at least as far back as the nineteenth century when states began granting corporate shareholders limited liability.[1] A more modern debate about the social effects of corporations arose at the start of the twentieth century, when the trend toward public ownership of corporations began.[2] The contours of the arguments of those pursuing greater corporate social responsibility have varied over time. Nonetheless, while the details may have shifted, the general theme of this concern has persisted: large corporations' focus on pleasing their shareholders may cause harm to others affected by their actions.[3] In spite of the nearly century-long history of this debate, it was not until the recent "social enterprise" movement that legislatures began to amend state corporation law to provide a governance framework specifically designed to make corporations more accountable to the public.[4]

In the early part of the twenty-first century, in the wake of large corporate scandals such as Enron and WorldCom, followed by the 2008 financial crisis, a large constituency of entrepreneurs has arisen who aspire to run profitable businesses that produce a positive social impact.[5] Proponents of this movement define the term "social enterprise" in more than one way, but in this Article it refers broadly to recent efforts to develop for-profit businesses capable of doing more social good and less social harm than corporations have done in the past.

In response to this social enterprise movement, states across the United States have passed legislation enabling special business entity forms that are designed specifically to allow and require these for-profit businesses to pursue social goals. Substantial legal innovation has occurred in this area, and several business forms have been designed and implemented by drawing heavily on existing legal forms, such as corporations and limited liability companies, but with modifications

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1 *See* RALPH NADER ET AL., TAMING THE GIANT CORPORATION 34–35 (1976).

2 *See* C.A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century*, 51 U. KAN. L. REV. 77, 84 (2002).

3 *Id.* at 78.

4 *See* Lyman Johnson, *Law and the History of Corporate Responsibility: Corporate Governance*, 10 U. ST. THOMAS L.J. 974, 990 (2013) ("[T]oday, for the first time since the late nineteenth century, the corporate governance realm itself has been used by state law to address the larger issue of corporate responsibility.").

5 Many social enterprises pursue environmental goals, which are sometimes referenced as a separate concept from social goals, likely because the target of the goal is not human. For simplicity, this Article will use the term "social" when referring to goals, benefits, and related concepts, to mean benefits to people, animals, and the environment.

intended to enable and require the businesses to pursue social goals. Among these new business entity forms, the one that has been most widely adopted by state legislatures and chosen by businesses is the benefit corporation.[6]

The first legislation enabling the formation of a benefit corporation was passed in 2010, and the benefit corporation is currently available as a business entity choice in thirty-four states and Washington, D.C.[7] The stated goal of benefit corporation legislation is to "authorize[] the organization of a form of business corporation . . . that operates with a corporate purpose broader than maximizing shareholder value and that consciously undertakes a responsibility to maximize the benefits of its operations for all stakeholders, not just shareholders."[8]

Many entrepreneurs starting new businesses are choosing the benefit corporation form, and a number of existing socially minded businesses have converted to benefit corporations.[9] Because the benefit

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6 *Status Tool: All*, SOC. ENTERPRISE L. TRACKER, http://socentlawtracker.org/#/map (last visited Apr. 5, 2018) (showing benefit corporation legislation enacted in thirty-one states and Washington, D.C. as of 2017; low-profit limited liability company legislation enacted in eight states; social purpose corporation legislation enacted in four states; and benefit limited liability company legislation enacted in three states). B Lab has tallied 5385 registered benefit corporations, noting that the list is incomplete because not all states track the names and number of benefit corporations. *Find a Benefit Corp*, B LAB, http://benefitcorp.net/businesses/find-a-benefit-corp?field_bcorp_certified_value=&state=&title=&submit2=Go&sort_by=title&sort_order=ASC&op=Go (last visited Apr. 5, 2018).

7 *State by State Status of Legislation*, B LAB, http://benefitcorp.net/policymakers/state-by-state-status (last visited Apr. 5, 2018).

8 MODEL BENEFIT CORPORATION LEGISLATION: WITH EXPLANATORY COMMENTS § 101 cmt. (Apr. 17, 2017) [hereinafter MODEL LEGISLATION], http://benefitcorp.net/sites/default/files/Model%20benefit%20corp%20legislation%20_4_17_17.pdf.

9 Danone, a multinational French corporation, acquired the U.S. organic food producer WhiteWave for $10.4 billion in 2016 and subsequently converted the acquisition to a benefit corporation named DanoneWave. It is now the largest benefit corporation in the United States. Leon Kaye, *Newly Merged DanoneWave Now the Largest U.S. Public Benefit Corporation*, TRIPLEPUNDIT (Apr. 26, 2017), https://www.triplepundit.com/2017/04/newly-merged-danonewave-now-largest-u-s-public-benefit-corporation. Patagonia, an environmentally conscious outdoor clothing retailer, converted to a benefit corporation once benefit corporation legislation was available in California. Mat McDermott, *Patagonia Becomes a California Benefit Corporation*, TREEHUGGER (Jan. 3, 2012), http://www.treehugger.com/corporate-responsibility/patagonia-becomes-california-benefit-corporation.html. Kickstarter, a fundraising platform for creative projects, converted to a Delaware Public Benefit Corporation in 2015. Yancey Strickler et al., *Kickstarter Is Now a Benefit Corporation*, KICKSTARTER: THE KICKSTARTER BLOG (Sept. 21, 2015), https://www.kickstarter.com/blog/kickstarter-is-now-a-benefit-corporation. CiviCore, a technology company serving the nonprofit and public sectors, converted from a Limited Liability Company (LLC) to a Delaware Public Benefit Corporation in January 2017. CiviCore, *CiviCore Becomes a Public Benefit Corporation*, PR NEWSWIRE (Jan. 17, 2017, 8:40 AM), https://www.prnewswire.com/news-releases/civicore-becomes-a-public-benefit-corporation-300391285.html. Philadelphia Media Network, the holding company for *The Philadelphia Inquirer* and other news outlets, converted to a Delaware Public Benefit Corporation in January 2016. Elizabeth K. Babson & Robert T. Esposito, *The Year in Social Enterprise: 2016 Legislative and Policy Review*, DRINKERBIDDLE (Feb. 7, 2017), http://www.drinkerbiddle.com/insights/publications/2017/02/the-year-in-social-enterprise. Virginia Community Capital, a community-based bank, converted to a Virginia Benefit Corporation in

corporation is a potential solution to a long-standing concern and is in high demand among socially minded business leaders, it is worthwhile to closely examine its potential strengths and weaknesses to increase the likelihood that it endures and flourishes as a vehicle for socially responsible business.

Benefit corporations are still too new for any reliable evaluation of their success in practice.[10] Nonetheless, since the enactment of the first benefit corporation legislation in Maryland in 2010, scholars have evaluated this new corporate form's potential with restrained hope, pointing out perceived deficiencies that may hamper benefit corporations' effective pursuit of their social missions.[11] In doing so, several scholars have highlighted that benefit corporations' focus on permitting managers to consider the interests of non-shareholder stakeholders is unnecessary, noting that shareholder value maximization is not legally required for traditional corporations.[12] Nonetheless, observers generally agree that modern corporations are currently governed for the benefit of their shareholders, even if there is no clear legal mandate that they do so.[13] As will be discussed herein, the focus of modern corporations tends to be, more specifically, maximization of share *price* rather than shareholder value more generally, and it is this more specific tendency that benefit corporations strive to overcome.

This Article evaluates the potential success of benefit corporations in light of the absence of a legal mandate to prioritize shareholder interests or share price. First, it analyzes the forces that have led

April 2016, becoming the first regulated bank to do so. *VCC: America's First Benefit Corporation Bank*, VCC (Apr. 3, 2016), http://www.vacommunitycapital.org/news/2016/04/03/vcc-americas-first-benefit-corporation-bank.

10 *See* DANA BRAKMAN REISER & STEVEN A. DEAN, SOCIAL ENTERPRISE LAW: TRUST, PUBLIC BENEFIT AND CAPITAL MARKETS 52 (2017) ("The first-generation hybrid forms remain too novel for empirical study of their uptake to be reliable . . . .").

11 *See, e.g.*, Dana Brakman Reiser, *Benefit Corporations—a Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591, 624 (2011) [hereinafter Brakman Reiser, *Benefit Corporations*] ("Leaving all content to unregulated standard-setters and providing little guidance or enforcement apparatus for midstream decision making, however, does not do enough to ensure benefit corporations can enforce a dual mission over time."); J. Haskell Murray, *An Early Report on Benefit Reports*, 118 W. VA. L. REV. 25, 26 (2015) ("Data from early benefit corporations shows an abysmal benefit report compliance rate (below ten percent), drawing into question the claims about heightened transparency."); Alicia E. Plerhoples, *Nonprofit Displacement and the Pursuit of Charity Through Public Benefit Corporations*, 21 LEWIS & CLARK L. REV. 525, 526 (2017) ("[T]he more pernicious harm is that 'market-based charity' injects individualistic and autocratic business values and methods into charitable work.").

12 *See, e.g.*, Dana Brakman Reiser, *Theorizing Forms for Social Enterprise*, 62 EMORY L.J. 681, 686–88 (2013) [hereinafter Brakman Reiser, *Theorizing Forms*]; Leo E. Strine, Jr., *Making It Easier for Directors to "Do the Right Thing"?*, 4 HARV. BUS. L. REV. 235, 248–49 (2014).

13 *See, e.g.*, LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC 3 (2012); Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907, 1910 (2013); Brakman Reiser, *Benefit Corporations*, *supra* note 11, at 591; Strine, Jr., *supra* note 12, at 241–42.

traditional corporations to become narrowly focused on share price maximization, concluding that the current composition of share ownership combines with other external factors to empower shareholders to effectively advocate for share price maximization, but not other shareholder interests. Then, by repurposing the traditional agency cost analysis of corporate governance for the benefit corporation form, it concludes that substantial impediments to providing meaningful social returns remain due to the "separation of benefit and control." That is, the intended beneficiaries of benefit corporations' social missions have no authority to impact corporate decision making and enforce commitment to social mission. With this framework in place, it then systematically evaluates: (1) whether the benefit corporation form will be vulnerable to the pressures that have driven traditional corporations towards share price maximization, and (2) whether it will succeed in pursuing and producing social benefits, in light of the separation of benefit and control. The result of this analysis is pessimistic because managers and shareholders—the groups tasked with pursuing and enforcing social mission—are faced with the competing incentive of profit maximization. Whether intentionally or not, it is substantially likely that benefit corporation managers' and shareholders' ability to produce meaningful social good will not live up to expectations.

This Article concludes that the weaknesses caused by the separation of benefit and control will not be adequately overcome without engaging beneficiaries directly in the pursuit and enforcement of benefit corporations' social missions. Finally, it proposes as a potential solution for further discussion a requirement that beneficiaries be involved in creating and monitoring a "Public Benefit Plan" as a means to overcome the separation of benefit and control.

This Article proceeds as follows. Part I briefly summarizes the history of debate and advocacy for increased corporate social responsibility, up to and including the current social enterprise movement. Part II describes the legal structure and goals of benefit corporations. Part III traces the theoretical origins of the normative view that corporations should be governed for the benefit of their shareholders. It then describes the forces that have driven modern corporate governance to be narrowly focused on share price. Part IV uses the theoretical framework traditionally associated with shareholder primacy to describe a major obstacle that benefit corporations will face in effectively pursuing social missions—the lack of beneficiary rights. It then recounts the forces that have driven corporate governance toward shareholder primacy and analyzes the effects those forces will have on benefit corporation governance. Part V proposes a "Public Benefit Plan," jointly created and monitored by the benefit corporation and its intended beneficiaries, as a potential solution to the challenges identified herein.

I. HISTORY OF OPPOSITION TO SOCIAL HARM CAUSED BY BUSINESSES

In the nineteenth century, state governments began the trend of limiting the liability of corporate shareholders to encourage incorporations because these governments believed corporations contributed great social utility to the U.S. economy.[14] This gave rise to one of the earliest debates over the social effects of corporations because protecting shareholders from personal liability for the corporation's debts disadvantaged creditors, and was viewed by many as undemocratic because this financial protection was unique to shareholders and not enjoyed by other corporate stakeholders.[15]

Since then, large U.S. corporations have grown steadily in both their size and their influence on the lives of both Americans and others around the world. During this time, scholars have pointed out the great economic success of U.S. corporations and argued that it is socially desirable for corporations to be managed for the benefit of their shareholders.[16] However, throughout this century of ascent for the U.S. corporation and its shareholders, a contingent of scholars and commentators have consistently expressed concern about the effects of shareholder primacy on the corporation's other "stakeholders." Relevant stakeholders include the corporation's employees, customers, and members of the community in which it does business.[17] Concern about the effects of corporate activities on these other stakeholder groups can be generally referred to as concern about corporate social responsibility.[18]

Since the modern debates about corporate social responsibility beginning around 1930, the details of concerns about corporate social responsibility have varied in reaction to changing trends in corporate activity. However, certain aspects of the argument in favor of greater social responsibility have remained constant. The recurring theme, as described by Professor C.A. Harwell Wells, has consistently been

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14 *See* NADER ET AL., *supra* note 1, at 63.

15 *See* Frederick G. Kempin, Jr., *Limited Liability in Historical Perspective*, 4 AM. BUS. L. ASS'N BULL. 11, 15–16 (1960), http://www.bus.umich.edu/KresgeLibrary/resources/abla/abld_4.1.11-33.pdf ("[T]he granting of corporate privilege, with limited liability, was itself considered to be a type of monopoly, by way of legal privilege if not by way of trade or product, that was anti-democratic in nature. If the small, unincorporated businessman was subject to total financial ruin in a business failure, the argument ran, why should the corporate stockholder be exempt from the same risk?" (citing Child v. Boston & Fairhaven Iron Works, 137 Mass. 516 (Mass. 1884))).

16 *See* MILTON FRIEDMAN, CAPITALISM AND FREEDOM 112 (1962).

17 *See* Wells, *supra* note 2, at 78.

18 *Id.*

"whether the directors and managers of large, publicly held corporations should have a legal duty, when making decisions for the corporation, to take into account not only the needs of the shareholders but also other [stakeholders] . . . ."[19] The remainder of this Part traces the history of the modern debate over corporate social responsibility in the United States up to and including the current social enterprise movement.

A. *Prior to Current Movement*

The modern debates over corporate social responsibility were inspired by the changing nature of corporations and the laws governing them at the turn of the twentieth century. In the nineteenth century most firms were managed by their equity holders who were few in number.[20] In this arrangement, the interests of equity owners and management clearly align because they are the same people. At the turn of the twentieth century, however, large firms increasingly had public stockholders who held small fractions of the firm's equity.[21] Moreover, managers were increasingly outside professionals with little ownership interest in the firm.[22] This shift in corporate ownership and management occurred as regulation of corporate governance was becoming more lax.[23] The disappearance of strict regulations of corporations occurred, Justice Brandeis noted, as states competed for the revenue generated by corporate charters—a phenomenon that is now commonly referred to as the "race to the bottom."[24]

The growing prominence of corporations and the increasing independent power of managers set off the early debate over corporate responsibility between Adolf A. Berle and E. Merrick Dodd. Their debate appeared in a pair of articles in the *Harvard Law Review* in 1931 and 1932.[25] Berle and Dodd's disagreement was about to whom

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19 *Id.*

20 *Id.* at 84.

21 *Id.*

22 *Id.*

23 *Id.* (citing JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 43 (2d ed. 1995)); *see also* Johnson, *supra* note 4, at 975 ("Early in the nineteenth century, states had strictly controlled corporate attributes and powers in numerous ways. For example, states typically limited the amount of capital a single corporation could assemble; restricted the scope of corporate powers; limited the duration of a corporation to a period ranging, generally, from twenty to fifty years; placed limits on company indebtedness; prohibited the holding of stock in another corporation; and gave stockholders broad veto powers over proposed transactions." (citing Louis K. Liggett Co. v. Lee, 288 U.S. 517, 542–60 (1933) (Brandeis, J., dissenting))).

24 *See* Johnson, *supra* note 4, at 979 (quoting William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 665–66 (1974)).

25 A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932).

corporate managers should be accountable. Berle argued that corporate managers should act as trustees for shareholders and manage the corporation exclusively for their benefit.[26] In contrast, Dodd believed that as corporations grew in size and power, they should be managed with consideration of the interests of non-shareholder stakeholders.[27]

After this initial exchange of views in the *Harvard Law Review*, this debate did not receive significant attention for over two decades.[28] This is attributable, at least in part, to the fact that New Deal legislation addressed many perceived social dangers of large businesses.[29] However, over time Berle and Dodd's views on this question began to converge. By 1934, Dodd was expressing doubt about freeing corporate managers to consider stakeholder interests.[30] His concern was that if fiduciary duties to shareholders were weakened, nothing definitive would replace them, leaving managers too much discretion to pursue their own personal interests at the expense of the corporation.[31] Berle, on the other hand, wrote in 1959 that "[t]he argument has been settled . . . squarely in favor of Professor Dodd's contention."[32] The evolution and convergence of Berle and Dodd's views highlight a prominent tension in this debate. Many will acknowledge that non-shareholder stakeholders are deeply impacted by corporate action and thus it would be good if corporate managers considered all stakeholders in making corporate decisions. However, granting managers such broad discretion runs the risk that they will utilize that discretion to further their own interests at the expense of the corporation. As Frank Easterbrook and Daniel Fischel wrote in 1991, "a manager told to serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither."[33]

After Berle and Dodd's debate, the next appearance of scholarly attention to how corporate governance could improve corporate social

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26 Berle, Jr., *supra* note 25, at 1049 ("It is the thesis of this essay that all powers granted to a corporation or to the management of a corporation, or to any group within the corporation, whether derived from statute or charter or both, are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears.").

27 Dodd, Jr., *supra* note 25, at 1160 ("A sense of social responsibility toward employees, consumers, and the general public may thus come to be regarded as the appropriate attitude to be adopted by those who are engaged in business . . . .").

28 Wells, *supra* note 2, at 99.

29 *Id.*; *see also* BARRY EICHENGREEN, HALL OF MIRRORS: THE GREAT DEPRESSION, THE GREAT RECESSION, AND THE USES—AND MISUSES—OF HISTORY 270 (2015); Katharine V. Jackson, *Towards a Stakeholder-Shareholder Theory of Corporate Governance: A Comparative Analysis*, 7 HASTINGS BUS. L.J. 309, 317–18 (2011).

30 *See* Wells, *supra* note 2, at 98.

31 *Id.*

32 STOUT, *supra* note 13, at 18 (citing ADOLF A. BERLE, THE 20TH CENTURY CAPITALIST REVOLUTION 169 (1954)).

33 FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 38 (1991).

responsibility arose in the 1950s. At that time, many commentators agreed that U.S. corporations had become a great economic success, but worries persisted about their extraordinary and increasing economic, political, and social power.[34] In 1950, corporate analyst Peter Drucker proposed a new conception of the corporate board as a "maker of policy" that would have representatives of all stakeholders.[35] In 1959, Harvard Law Professor Abram Chayes argued that all stakeholders should be involved in corporate decision making, but acknowledged the practical challenges in implementing such an arrangement.[36] Neither of these proposals led to substantial legal changes.

During the social unrest of the 1960s and 1970s, the first modern movement to improve corporate social responsibility arose just as the Chicago School of Economics was emerging. The Chicago School's economic analysis of corporate governance argued forcefully in favor of shareholder primacy.[37] This analytical perspective ultimately achieved great popularity and widely impacted both public perceptions of the role of the corporation and regulation of the corporation. In the meantime, however, those in favor of broader stakeholder protections continued proposing and implementing new strategies to improve corporate social responsibility.

Prominent among the activists pursuing greater corporate responsibility in this era was Ralph Nader. Nader, along with Mark J. Green and Joel Seligman published *Taming the Giant Corporation* in 1976, in which they argued for federal chartering of corporations.[38] Citing an exhaustive list of potential or perceived social and economic costs of big business,[39] and the trend among states to roll back restrictions on corporations,[40] Nader, Green, and Seligman proposed that corporations be chartered at the federal level to bring federal authority to bear on the interstate (and potentially detrimental) actions of corporations.[41] The federally chartered corporations that they envisioned would have had a governance structure that enhanced board review of executive actions and included professional, full-time, and salaried directors.[42] Another trend in the 1970s was for community activists to purchase shares of large corporations in order to attend shareholder meetings and make shareholder proposals for socially

34 *See* Wells, *supra* note 2, at 100.

35 *Id.* at 106 (citing PETER. F. DRUCKER, THE NEW SOCIETY 341–42 (1950)).

36 *See* Johnson, *supra* note 4, at 977–78 (citing Abram Chayes, *The Modern Corporation and the Rule of Law*, *in* THE CORPORATION IN MODERN SOCIETY 25, 41 (Edward S. Mason ed., 1959)).

37 This view of corporate governance is discussed in more detail in Section III.A below.

38 NADER ET AL., *supra* note 1.

39 *Id.* at 17–32.

40 *Id.* at 43–61.

41 *Id.* at 70–71.

42 *Id.* at 120–21.

responsible corporate policies.[43] Overall, these campaigns had mixed success, sometimes succeeding in bringing public attention to the issue even when losing a shareholder vote.[44] This vein of activism and debate continued throughout the 1970s. However, anti-business sentiment began to fade by the end of the decade and the economic boom of the 1980s diffused enthusiasm for these initiatives.[45]

In the 1980s, hostile corporate takeovers became prevalent as corporate "raiders" sought to profit from divesting portions of the large conglomerates that were the product of 1960s and 1970s merger activity.[46] The public widely perceived these takeovers as profiting the acquirer at the public's expense in the form of widespread job losses.[47] These perceptions reignited the debate over whether shareholders should be the sole focus of corporate decision making.[48] One important result of this revived concern was the passage of constituency statutes in many states. Constituency statutes explicitly permit directors to consider the effects of their decisions on a variety of stakeholder interests.[49] Thirty-three states now have constituency statutes, although it remains unclear to what extent they would protect a director against shareholder action in court.[50] Some thought that the advent of

43 Johnson, *supra* note 4, at 982–83.

44 *Id.* at 983. One of the most highly publicized examples of this movement, Campaign GM, is discussed in Section IV.B.3.b.

45 *See* Wells, *supra* note 2, at 120–23.

46 Fabienne Cretin et al., *M&A Activity: Where Are We in the Cycle?*, ALTERNATIVE INV. ANALYST REV. (2015), https://www.caia.org/sites/default/files/AIAR_Q3_2015-07_M&A_CretinDieudonneBoucha.pdf.

47 *See* Robert T. Esposito, *The Social Enterprise Revolution in Corporate Law: A Primer on Emerging Corporate Entities in Europe and the United States and the Case for the Benefit Corporation*, 4 WM. & MARY BUS. L. REV. 639, 660 (2013); Wells, *supra* note 2, at 126.

48 *See* William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 264–65 (1992).

49 *See, e.g.*, 805 ILL. COMP. STAT. § 5/8.85 (2018) (stating that directors "may . . . consider the effects of any action . . . upon employees, suppliers and customers of the corporation or its subsidiaries, communities in which offices or other establishments of the corporation or its subsidiaries are located, and all other pertinent factors"); N.Y. BUS. CORP. LAW §§ 717(b)(2)(i)–(v) (McKinney 2003) (stating that "director[s] shall be entitled to consider . . . the effects that the corporation's actions may have in the short-term or in the long-term upon any of the following: (i) the prospects for potential growth, development, productivity and profitability of the corporation; (ii) the corporation's current employees; (iii) the corporation's retired employees and other beneficiaries receiving or entitled to receive retirement, welfare or similar benefits from or pursuant to any plan sponsored, or agreement entered into, by the corporation; (iv) the corporation's customers and creditors; and (v) the ability of the corporation to provide, as a going concern, goods, services, employment opportunities and employment benefits and otherwise to contribute to the communities in which it does business"); 15 PA. STAT. AND CONS. STAT. ANN. § 1715(a)(1) (West 2013) (stating that directors may consider "[t]he effects of any action upon any or all groups affected by such action, including shareholders, employees, suppliers, customers and creditors of the corporation, and upon communities in which offices or other establishments of the corporation are located").

50 *See* Alicia E. Plerhoples, *Can an Old Dog Learn New Tricks? Applying Traditional Corporate Law Principles to New Social Enterprise Legislation*, 13 TRANSACTIONS: TENN. J. BUS.

constituency statutes would resolve concerns about shareholder primacy, but both share price primacy, and concerns about its negative social effects persist.[51]

The 1980s also saw a global trend of economic liberalization motivated by "Washington Consensus"–inspired thinking.[52] This turn to liberalization accelerated the interconnectedness of nations and businesses.[53] Consequently, corporations were increasingly able to operate abroad, in places where regulation of labor standards, environmental protection, bribery, human rights, and other matters may be less stringent.[54] Beginning in the 1990s, the public became increasingly aware of negative social externalities that had gone unaddressed by multinational corporations.[55] Major brands such as Nike and The Gap were featured in news stories about sweatshop working conditions and other abuses abroad.[56] In response to non-governmental organization advocacy and public pressure, multinational corporations began in the 1990s to draft corporate codes of conduct and issue corporate responsibility reports.[57] Today, most multinational corporations regularly issue corporate responsibility reports.[58] While this development represents some progress toward greater social accountability, the lack of standards for measuring social impact and the lack of any enforceable obligation to comply with these standards makes

L. 221, 237–39 (2012) (describing Ben & Jerry's decision to be acquired by Unilever in spite of being subject to Vermont's constituency statute).

51 *See* Antony Page & Robert A. Katz, *Is Social Enterprise the New Corporate Social Responsibility?*, 34 SEATTLE U. L. REV. 1351, 1383 (2011) ("The 'progressive' corporate law movement advocated structural changes in corporate law itself designed to serve the interests of nonshareholders with a stake in a corporation's activities, such as 'other constituency' statutes that expand directors' discretion. Most would agree, however, that neither movement produced much real change.").

52 3 ENCYCLOPEDIA OF CORPORATE SOCIAL RESPONSIBILITY 1248–49 (Samuel O. Idowu et al. eds., 2013).

53 *Id.*

54 *See Corporate Social Responsibility: The Shape of a History, 1945-2004* 7 (Ctr. for Ethical Bus. Cultures, Working Paper No. 1, 2005), http://www.cebcglobal.org/wp-content/uploads/2015/02/CSR-The_Shape_of_a_History.pdf.

55 *See* ENCYCLOPEDIA OF CORPORATE SOCIAL RESPONSIBILITY, *supra* note 52, at 1249.

56 *See, e.g.*, Bob Herbert, Opinion, *In America; Children of the Dark Ages*, N.Y. TIMES (July 21, 1995), http://www.nytimes.com/1995/07/21/opinion/in-america-children-of-the-dark-ages.html (detailing the terrible working conditions of two Central American teenagers who were employed in factories making clothing for U.S. retailers); Bob Herbert, Opinion, *In America; Nike's Pyramid Scheme*, N.Y. TIMES (June 10, 1996), http://www.nytimes.com/1996/06/10/opinion/in-america-nike-s-pyramid-scheme.html (detailing the abysmal pay and working conditions of Nike factories in Asia).

57 *See* ENCYCLOPEDIA OF CORPORATE SOCIAL RESPONSIBILITY, *supra* note 52, at 1250.

58 *See* ADRIAN KING & WIM BARTELS, CURRENTS OF CHANGE: THE KPMG SURVEY OF CORPORATE RESPONSIBILITY REPORTING 2015 30 (2015), https://assets.kpmg.com/content/dam/kpmg/pdf/2016/02/kpmg-international-survey-of-corporate-responsibility-reporting-2015.pdf (finding that ninety-two percent of Global Fortune 250 companies report on corporate responsibility).

corporate responsibility reporting generally ineffective.[59]

The early 2000s brought the large corporate fraud scandals of Enron, WorldCom, and others, which renewed public concern about the social impact of corporate activities.[60] The largest public reaction to this was the passage of the Sarbanes-Oxley Act, which aimed to avoid corporate fraud through changes to board structures, increased financial reporting requirements, increased penalties for securities violations, and higher standards for conflicts of interest.[61] Most recently came the 2008 financial crisis, public outrage about executive wrongdoing, and the resulting passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The 2000s also brought a marked increase in the ability of shareholders to force corporate managers to act in their interests, a trend that will be discussed further in Part III, below.[62]

Concern about the negative social impacts of shareholder-focused corporate action has therefore existed since the time that corporations began to become the enormous and powerful institutions that they are today. Much of that concern arises from the separation of three groups of people: the managers (directors and officers) who run the corporation; the shareholders who own shares and have limited rights to impact corporate decisions; and other stakeholders who are not involved in corporate governance, such as employees, customers, and community members. Scholars have debated for nearly a century now about how to maximize social benefit and minimize social harms from corporate activities. Regulations have arisen over this time period in an attempt to safeguard the public from the negative externalities of corporate profit-seeking. Prominent examples of the direct regulation of corporate governance include the Securities and Exchange Acts[63] and the Sarbanes-Oxley Act,[64] but many others exist as well. Laws such as the Occupational Safety and Health Act[65] and the National Environmental Policy Act[66] have been directed specifically at the non-shareholder stakeholders affected by corporate action. However, it was not until the current social enterprise movement that legislatures amended state corporation law to provide a governance structure specifically intended to promote stakeholder well-being.

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59 *See* Esposito, *supra* note 47, at 653–59.

60 *See* Johnson, *supra* note 4, at 980; Wells, *supra* note 2, at 77.

61 *See* Johnson, *supra* note 4, at 980–81.

62 *See* Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987 (2010).

63 Securities Act of 1933, 15 U.S.C. §§ 77a–aa (2012); Securities Exchange Act, 15 U.S.C. §§ 78a–qq (2012).

64 Sarbanes-Oxley Act of 2002, 15 U.S.C. §§ 7201–66, 78*o*-6, 78d-3, 18 U.S.C. §§ 1348–50 1519–20, 1514A (2012).

65 Occupational Safety and Health Act of 1970, 29 U.S.C. §§ 651–78, 42 U.S.C. § 3142-1 (2012).

66 National Environmental Policy Act of 1969, 42 U.S.C. §§ 4321–47 (2012).

B. *The Social Enterprise Movement*

The social enterprise movement can be seen as the latest iteration of the long history of debate and activism around holding corporations accountable for the social harm or good they produce. Thus, it can be seen as the most recent response to the "race to the bottom" described by Justice Brandeis—the deregulation of corporate decision making as states compete for corporate charters.[67] The current social enterprise movement began in the mid-2000s,[68] and was likely influenced by the corporate fraud scandals of the early 2000s.[69] The movement has grown much larger since 2008, and was likely accelerated by the widespread negative social effects of the 2008 financial crisis and subsequent Great Recession.[70]

A defining characteristic of the movement is that it does not aim to impose new regulations or requirements on existing businesses. Rather, it consists of a variety of innovations that will allow businesses that independently desire to be more socially responsible or pursue social missions to opt in to greater social accountability. The movement is propelled by a desire among entrepreneurs and investors to operate for-profit businesses that achieve social goals. Social enterprises are therefore often described as dual-purpose organizations that combine

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67 Johnson, *supra* note 4, at 975–76.

68 B Lab, which describes itself as "a nonprofit organization that serves a global movement of people using business as a force for good™[,]" was founded in 2006. *Our History*, CERTIFIED B CORP., https://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps/our-history (last visited Apr. 5, 2018). Vermont adopted the first legislation for Low-Profit Limited Liability Companies (or "L3Cs," a form of social enterprise) in April 2008. Dana Brakman Reiser, *Blended Enterprise and the Dual Mission Dilemma*, 35 VT. L. REV. 105, 108 n.10 (2010).

69 *See* BOB DOHERTY ET AL., MANAGEMENT FOR SOCIAL ENTERPRISE 214 (2009) ("Much has been made in recent times of the problems associated with 'white-collar crime' and the myriad examples of high-profile governance misdemeanours bear testament to this. The most notorious examples are often recounted in newspaper or journal articles as symptomatic of governance failure, including Enron, WorldCom, Parmalat and BAE."); Raymond Horton, *Thoughts on the Meaning and Field of Social Enterprise*, TAMER CTR. SOC. ENTERPRISE, http://www8.gsb.columbia.edu/socialenterprise/about/meaningse (last visited Mar. 19, 2018) ("Any notion that ethical behavior in business is not a public good is dispelled by the devastating social consequences inflicted by the many immoral senior managers we've seen post-Enron."); Entrepreneur Middle East Staff, *Eight Business Schools Around the World That Have a Social Enterprise Focus*, ENTREPRENEUR: MIDDLE EAST (Dec. 3, 2015), https://www.entrepreneur.com/article/253352 (discussing the trend in business schools to include social enterprise curricula in response to students' disenchantment with the social effects of large corporations).

70 *See Status Tool: All*, *supra* note 6 (showing social enterprise entity legislation began to be adopted by states in 2008 and accelerated thereafter); *see also* J. Haskell Murray, *Adopting Stakeholder Advisory Boards*, 54 AM. BUS. L.J. 61, 63 (2017); J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*, 2 AM. U. BUS. L. REV. 1 (2012); *Our History*, *supra* note 68 (describing the history of B Lab's efforts to promote social enterprise and indicating that their mission gained traction in 2008 and accelerated in 2010).

aspects of nonprofit and for-profit businesses.[71]

One of the earliest and most successful projects of the social enterprise movement in the United States was not a legal effort. It was B Lab Company's development of B Corp certification. B Lab is a nonprofit corporation formed in Pennsylvania dedicated to promoting business practices with high levels of social and environmental performance.[72] B Lab created the "Certified B Corporation" designation, which it licenses to businesses that meet its standards of social and environmental accountability.[73] B Lab formed in 2006,[74] certified its first B Corp in 2007,[75] and as of April 5, 2018, reported certifying 2457 B Corporations in more than fifty countries.[76] The choice to become a certified B Corporation and maintain that certification is self-imposed and privately regulated. It is not a legal form, and in the United States, B Corps use existing state law–governed corporate forms. However, B Lab was involved in designing and advocating for benefit corporation legislation.[77]

While B Corp certification has been very successful, advocates of the social enterprise movement, including B Lab itself, have found traditionally available business forms—nonprofit corporations or traditional for-profit entities (corporations, LLCs, partnerships, and sole proprietorships)—insufficient to meet social entrepreneurs' aspirations.[78] Nonprofit corporations are legally prohibited from distributing profits to any individuals that exercise control over them—a concept referred to as the "nondistribution constraint."[79] Therefore, because they cannot offer a return to investors, they must rely on donations for funding and comply with the substantial reporting burdens imposed on nonprofits.[80] For-profit businesses, on the other hand, can raise capital from investors and, in the opinion of many observers, legally pursue social aims.[81] However, for-profit businesses

71 *See, e.g.*, Lloyd Hitoshi Mayer & Joseph R. Ganahl, *Taxing Social Enterprise*, 66 STAN. L. REV. 387, 388 (2014); Page & Katz, *supra* note 51, at 1368; Brakman Reiser, *supra* note 68, 108–09.

72 *About B Lab*, CERTIFIED B CORP., https://www.bcorporation.net/what-are-b-corps/about-b-lab (last visited Apr. 5, 2018).

73 Brakman Reiser, *supra* note 68, at 114.

74 *Our History*, *supra* note 68.

75 *Id.*

76 CERTIFIED B CORP., https://www.bcorporation.net (last visited Apr. 5, 2018).

77 *See* Dana Brakman Reiser, *Governing and Financing Blended Enterprise*, 85 CHI.-KENT L. REV. 619, 637 (2010) [hereinafter Brakman Reiser, *Governing and Financing*].

78 *See* Brakman Reiser, *Theorizing Forms*, *supra* note 12, at 683.

79 Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 838 (1980).

80 Nonprofits are permitted to earn income from business activities. So, once a nonprofit is operating, this can also serve as a source of funds. *See, e.g.*, Emily Chan, *The Profitable Side of Nonprofits—Part I: Earned Income*, NEO L. GROUP (May 6, 2011), http://www.nonprofitlawblog.com/the-profitable-side-of-nonprofits-part-i-earned-income.

81 *See infra* Section IV.B.1.

have no enforceable commitment to pursue social good and are likely to succumb to shareholder wealth maximization pressures if they attract dispersed shareholders. Because of these perceived inadequacies, the social enterprise movement has resulted in several new and innovative legal forms for businesses that seek to simultaneously pursue profit and social goals. Each of these novel forms was designed by starting with an existing business entity form and adding a social mission component.[82]

An early experiment with a new legal form for social enterprises is the low profit limited liability company (L3C). The L3C is a dual-purpose entity based on the limited liability company form.[83] The first legislation creating the L3C entity was adopted in Vermont in 2008.[84] As of April 5, 2018, L3C legislation was in force in Vermont, seven other states, and two Native American tribes.[85] A primary goal for the creation of the L3C was to create an entity into which private foundations could make "program related investments" (PRIs), without being subject to excise taxes.[86] However, the Internal Revenue Service (IRS) has not provided clear guidance to confirm that investments into L3Cs would qualify as PRIs.[87] It is likely, at least in part due to the lack of clear guidance from the IRS, that this entity has not been widely used, and L3C legislation has failed to pass in many more jurisdictions than those in which it has succeeded.[88]

Other legal entities have also arisen in the United States to facilitate social enterprise but have not yet been widely adopted. These include the Social Purpose Corporation[89] and the Benefit Limited Liability Company.[90] Of the legal forms established to date, the most popular has been the benefit corporation, which is described in more detail below.[91]

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82 Brakman Reiser, *Theorizing Forms*, *supra* note 12, at 690.

83 Brakman Reiser, *Governing and Financing*, *supra* note 77, at 621.

84 H. Res. 775, 2008 Gen. Assemb., Reg. Sess. (Vt. 2008).

85 *See What Is an L3C?*, INTERSECTOR PARTNERS, L3C, https://www.intersectorl3c.com/l3c (last updated Apr. 1, 2018); *Status Tool: All*, *supra* note 6.

86 Brakman Reiser, *Governing and Financing*, *supra* note 77, at 622; Esposito, *supra* note 47, at 682-83.

87 THOMSON REUTERS FOUND. & MORRISON & FOERSTER, WHICH LEGAL STRUCTURE IS RIGHT FOR MY SOCIAL ENTERPRISE?: A GUIDE TO ESTABLISHING A SOCIAL ENTERPRISE IN THE UNITED STATES 60–61 (May 2013), http://media.mofo.com/files/uploads/Images/Guide-to-Establishing-a-Social-Enterprise.pdf.

88 Businesses continue to form as L3Cs. According to interSector Partners L3C, as of April 5, 2018, 1599 existed. *What Is an L3C?*, *supra* note 85. However, L3C legislation failed in seventeen states and was repealed in North Carolina. *Status Tool: L3Cs*, SOC. ENTERPRISE L. TRACKER, http://socentlawtracker.org/#/l3cs (last visited Apr. 5, 2018).

89 Social Purpose Corporation legislation has been adopted in four states. *Status Tool: SPCs*, SOC. ENTERPRISE L. TRACKER, http://socentlawtracker.org/#/spcs (last visited Apr. 5, 2018).

90 Benefit Limited Liability Company legislation has been adopted in three states, is under consideration in Connecticut, and failed in Virginia. *Status Tool: BLLCs*, SOC. ENTERPRISE L. TRACKER, http://socentlawtracker.org/#/bllcs (last visited Apr. 5, 2018).

91 *See Status Tool: Benefit Corps*, SOC. ENTERPRISE L. TRACKER, http://socentlawtracker.org/#/bcorps (last visited Apr. 5, 2018).

II. Benefit Corporations

A. *Background*

The benefit corporation is the result of efforts by a variety of social enterprise advocates. B Lab was deeply involved in the very successful lobbying efforts to encourage state legislatures to adopt benefit corporation legislation.[92] The Model Benefit Corporation Legislation[93] was drafted by attorneys at Drinker Biddle & Reath LLP.[94]

The comments to the Model Benefit Corporation Legislation describe the benefit corporation as "a form of business corporation that offers entrepreneurs and investors the option to build, and invest in, a business that operates with a corporate purpose broader than maximizing shareholder value and that consciously undertakes a responsibility to maximize the benefits of its operations for all stakeholders, not just shareholders."[95] The benefit corporation form aims to allow businesses to pursue missions other than share price maximization by increasing the board's discretion to consider social goals in making business decisions for the corporation,[96] while also empowering shareholders to monitor the pursuit of those social goals.[97] It is clear how this fits into the longstanding debate over corporate social responsibility. Benefit corporations explicitly inject non-shareholder stakeholder interests into the governance of the entity, thus overcoming the question of whether corporate managers should independently decide to pursue ends other than share price maximization.

States adopt benefit corporation legislation via new statutory provisions in the corporate code, but where benefit corporation statutes are silent, traditional for-profit corporation law controls.[98] Thus, while benefit corporations are correctly conceived of as dual-purpose entities situated somewhere between nonprofit and for-profit corporations, they more closely resemble for-profit corporations. As noted above, the benefit corporation has been the most widely adopted social enterprise entity in the United States to date. The first benefit corporation legislation was enacted in Maryland in 2010.[99] To date, benefit

92 Esposito, *supra* note 47, at 695.

93 MODEL LEGISLATION, *supra* note 8.

94 *The Model Legislation*, BENEFIT CORP., http://benefitcorp.net/attorneys/model-legislation (last visited Apr. 5, 2018).

95 MODEL LEGISLATION, *supra* note 8, § 101 cmt.

96 Esposito, *supra* note 47, at 695.

97 Monitoring is facilitated via benefit reporting and in some jurisdictions, benefit enforcement proceedings, which are discussed in more detail in Section II.B.

98 MODEL LEGISLATION, *supra* note 8, § 101(c); Brakman Reiser, *Benefit Corporations*, *supra* note 11, at 595–96.

99 *See* B Lab, *Maryland First State in Union to Pass Benefit Corporation Legislation*, CSR

corporation legislation has been adopted in thirty-four states and Washington, D.C., and is under consideration in six more.[100]

The benefit corporation's relative popularity among social entrepreneurs is attributable to the fact that it provides a framework to facilitate commitment to social mission using a corporate form that is designed specifically for dual-purpose enterprises. The fact that it is based on the traditional corporate form provides several benefits. First, it is a for-profit form, so it permits raising capital from investors. Second, corporations are more standardized entities than partnerships or LLCs, so social entrepreneurs with little legal expertise or funding for legal assistance may find them a more accessible way to incorporate social mission into their business purpose.[101] Third, corporations provide opportunities for scale. While many examples exist of socially conscious businesses being successfully run as privately held companies,[102] many social entrepreneurs have their sights set higher and prefer a corporate form that will allow their businesses to eventually attract investment from a broad investor base and even go public.[103] Several examples exist of companies that were successfully running social enterprises in existing forms such as traditional corporations or LLCs, but which nonetheless chose to convert to the benefit corporation form so that they would be held more accountable to their social mission.[104]

WIRE (Apr. 14, 2010, 10:57 AM), http://www.csrwire.com/press_releases/29332-Maryland-First-State-in-Union-to-Pass-Benefit-Corporation-Legislation.

100 *State by State Status of Legislation*, *supra* note 7.

101 *See* Brackman Reiser, *Theorizing Forms*, *supra* note 12, at 689. It is worth noting that the LLC remains a very popular entity choice for entrepreneurs, generally.

102 For example, TOMS Shoes is a Delaware LLC; Yogi Tea is an Oregon LLC and certified B Corp; Mission-Hub is a California LLC and certified B Corp.

103 *See* Brakman Reiser, *Theorizing Forms*, *supra* note 12, at 689; *cf.* Mike Isaac & David Gelles, *Kickstarter Focuses Its Mission on Altruism over Profit*, N.Y. TIMES (Sept. 20, 2015), https://www.nytimes.com/2015/09/21/technology/kickstarters-altruistic-vision-profits-as-the-means-not-the-mission.html?_r=1 (quoting Kickstarter's CEO stating that "[w]e don't ever want to sell or go public. . . . That would push the company to make choices that we don't think are in the best interest of the company"); Hannah Miller, *Patagonia Founder Takes Aim: "The Elephant in the Room Is Growth"*, GREENBIZ (Mar. 1, 2013, 7:00 AM), https://www.greenbiz.com/news/2013/03/01/patagonia-founder-takes-aim-elephant-room-growth (conveying Patagonia founder's views that publicly traded companies are incapable of maintaining sustainable practices).

104 *See, e.g.*, Elissa Loughman, *Benefit Corporation Update: Patagonia Passes B Impact Assessment, Improves Score to 116*, PATAGONIA (Oct. 24, 2014), http://www.patagonia.com/blog/2014/10/benefit-corporation-update-patagonia-passes-b-impact-assessment-improves-score-to-116 ("Benefit Corporation legislation creates the legal framework to enable mission-driven companies like Patagonia to stay mission-driven through succession, capital raises, and even changes in ownership, by institutionalizing the values, culture, processes, and high standards put in place by founding entrepreneurs."); *Our Business*, METHOD, http://methodhome.com/beyond-the-bottle/our-business (last visited Apr. 5, 2018) ("[I]n [A]ugust 2013, method reincorporated as a benefit corporation and formally incorporated our mandate for sustainability into the DNA of our company."); Strickler et al., *supra* note 9 ("From Kickstarter's inception, we've focused on serving artists, creators, and audiences to help bring

This Article will argue that, as currently designed, benefit corporations will face challenges that inhibit their ability to produce meaningful social outcomes. Nonetheless, the benefit corporation is a very innovative attempt to solve a long-debated problem, and thus deserves serious consideration to ensure it is effective in creating businesses that successfully pursue social good simultaneously with profit.

B. *How They Work*

The Model Benefit Corporation Legislation reflects the input of private attorneys, state legislatures, state bar associations, Secretaries of State offices, Attorneys General offices, nonprofit groups, and businesses.[105] The details of benefit corporation legislation vary across states. This Article will focus primarily on the aspects of the Model Legislation that are fundamental to the benefit corporation structure and thus are present in the majority of benefit corporation legislation. Key points of divergence among jurisdictions will be pointed out where relevant.

There are three primary legal innovations that are consistent across most states that benefit corporation legislation uses to pursue its goals: (1) stating the social mission in the benefit corporation's corporate purpose; (2) obligating directors to consider the effects of corporate action on non-financial stakeholder groups; and (3) requiring reporting on social impact.[106]

Corporate Purpose. Pursuant to the Model Legislation, benefit corporations must be formed for the purpose of creating a general public benefit,[107] which is defined as a "material positive impact on

creative projects to life. Our new status as a Benefit Corporation hard-codes that mission at the deepest level possible to guide us, and future leaders of Kickstarter."); Press Release, Laureate Educ., Inc., Laureate Education Becomes a Public Benefit Corporation (Feb. 10, 2015), http://www.laureate.net/NewsRoom/PressReleases/2015/10/Laureate-Education-Becomes-a-Public-Benefit-Corporation ("As a Public Benefit Corporation, Laureate is required to balance the financial interests of its stockholders with the best interests of those stakeholders materially affected by its conduct, including particularly those impacted by the specific benefit purpose set forth in its certificate of incorporation.").

105 *The Model Legislation*, *supra* note 94.

106 WILLIAM H. CLARK, JR. & LARRY VRANKA, THE NEED AND RATIONALE FOR THE BENEFIT CORPORATION: WHY IT IS THE LEGAL FORM THAT BEST ADDRESSES THE NEEDS OF SOCIAL ENTREPRENEURS, INVESTORS, AND, ULTIMATELY, THE PUBLIC 15 (Jan. 18, 2013), http://benefitcorp.net/sites/default/files/Benefit_Corporation_White_Paper.pdf.

107 MODEL LEGISLATION, *supra* note 8, § 201(a). The Delaware Public Benefit Corporation (PBC) statute does not require a "general public benefit" purpose, but instead requires that Delaware PBCs identify one or more specific public benefits that will be among the corporation's purposes. DEL. CODE ANN. tit. 8, § 362 (2018). California, Colorado, and Minnesota also require a specific public benefit. J. Haskell Murray, Corporate Forms of Social Enterprise: Comparing the State Statutes (Jan. 15, 2015) (unpublished paper), http://dx.doi.org/

society and the environment, taken as a whole, from the business and operations of [the] benefit corporation assessed taking into account the impacts of the benefit corporation as reported against a third-party standard."[108] The benefit corporation may also choose, but is not required, to specify a specific public benefit purpose. The general public benefit purpose and, if applicable, specific purpose, must be stated in the benefit corporation's articles of incorporation.[109] Because corporate directors owe fiduciary duties to the corporation, the effect of including social mission in the corporate purpose is to clarify that a business decision in furtherance of the social mission is indeed in the best interest of the corporation.[110] This protects corporate directors against claims that the financial interests of the corporation must take precedence over the social mission.

Consideration of Non-Shareholder Stakeholders. The Model Legislation requires that benefit corporation directors consider the effects of their actions on a non-exhaustive, illustrative list of stakeholders that includes shareholders, but also includes employees, customers, the community, the environment, and any other factors or interests they deem appropriate.[111] While the "corporate purpose"

10.2139/ssrn.1988556.

108 MODEL LEGISLATION, *supra* note 8, § 102.

109 *See id.* § 201 (mandating a general public benefit purpose and describing optional specific public benefit purpose); *id.* § 101(c) (stating that except as specified in the Model Legislation, state corporation law is applicable to benefit corporations); *see, e.g.*, DEL. CODE ANN. tit. 8, § 102(a)(3) (requiring Delaware corporations to state their purpose in their certificates of incorporation).

110 CLARK, JR. & VRANKA, *supra* note 106, at 16; MODEL LEGISLATION, *supra* note 8, § 201.

111 MODEL LEGISLATION, *supra* note 8, § 301.

> In discharging the duties of their respective positions and in considering the best interests of the benefit corporation, the board of directors, committees of the board, and individual directors of a benefit corporation:
>
> (1) 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 a specific public benefit purpose of the benefit corporation;
> > (iv) community and societal factors, including those of each community in which offices or facilities of the benefit corporation, its subsidiaries, or its suppliers are located;
> > (v) the local and global environment;
> > (vi) the short-term and long-term interests of the benefit corporation, including benefits that may accrue to the benefit corporation from its long-term plans and the possibility that these interests may be best served by the continued independence 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; and
>
> (2) may consider:

requirement protects directors when they choose to act on behalf of non-shareholder stakeholders, this provision affirmatively requires that they consider the interests of non-shareholder stakeholders. However, the Model Legislation explicitly states that directors need not prioritize any particular stakeholder's interest.[112] So, benefit corporations may not wholly ignore the interests of any stakeholder group, but are required only to *consider* the effects of corporate action on this long list of stakeholders; they are not required to act in furtherance of the interests of any one or more stakeholder groups.

Reporting on Social Impact. Under the Model Legislation, benefit corporations are required to prepare an annual benefit report, distribute it to shareholders, file it with the department of state,[113] and make it publicly available on the benefit corporation's website.[114] Many states with benefit corporation legislation do not require all three methods of dissemination.[115] The report must describe the ways the benefit corporation has pursued the general public benefit and its specific public benefit, if any, and the success it has had in creating these benefits.[116] It must also assess the benefit corporation's overall social performance using an independent, third-party standard.[117] B Lab's "B Impact Assessment"[118] is the most often referred-to source of an independent third-party standard for the annual benefit report. While B Lab's benefitcorp.net website lists several other potential sources of an independent third-party standard,[119] available evidence suggests that the

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> [*(i) the interests referred to in [cite constituencies provision of the business corporation law if it refers to constituencies not listed above]; and*
> *(ii)*] other pertinent factors or the interests of any other group that they deem appropriate; but
>
> (3) need not give priority to a particular interest or factor referred to in paragraph (1) or (2) over any other interest or factor unless the benefit corporation has stated in its articles of incorporation its intention to give priority to certain interests or factors related to the accomplishment of its general public benefit purpose or of a specific public benefit purpose identified in its articles.

Id.

112 CLARK, JR. & VRANKA, *supra* note 106, at 17.

113 MODEL LEGISLATION, *supra* note 8, § 401.

114 *Id.* § 402.

115 Only about half of benefit corporation states require that the report be filed with the state. *See* Murray, *supra* note 107. Most states require public posting and distribution to shareholders, but there are a few states that do not require one or both. Minnesota and Delaware do not require public posting. Minnesota and Washington do not require distribution of the reports directly to shareholders. *Id.*

116 MODEL LEGISLATION, *supra* note 8, § 401(a)(1).

117 CLARK, JR. & VRANKA, *supra* note 106, at 17–20; MODEL LEGISLATION, *supra* note 8, § 401.

118 *Performance Requirements*, CERTIFIED B CORP., https://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/performance-requirements (last visited Apr. 5, 2018).

119 *How Do I Pick a Third Party Standard?*, BENEFIT CORP., http://benefitcorp.net/businesses/how-do-i-pick-third-party-standard (last visited Apr. 5, 2018).

B Impact Assessment is the most often used standard for this purpose.[120] The annual benefit report is intended to keep shareholders and the public informed about the benefit corporation's pursuit of and success in achieving its social mission.

Under the Model Legislation, shareholders holding two percent of the benefit corporation's shares may derivatively bring a benefit enforcement proceeding against the benefit corporation or its directors.[121] Most, but not all, benefit corporation statutes provide for benefit enforcement proceedings.[122] Benefit enforcement proceedings may be brought for failure by the corporation to pursue its general or specific public benefit, or for the violation of any obligation under the benefit corporation law.[123] The benefit enforcement proceeding grants shareholders an explicit right to legally enforce the corporation's commitment to social mission. While the Model Legislation does not specify what remedies are available in a benefit enforcement proceeding,[124] several states have clarified in their adopting legislation that monetary damages are not available and the only remedy is injunctive relief.[125] No benefit enforcement proceedings have gone to court to date,[126] so the standard for these proceedings remains untested.

Finally, once a business has chosen the benefit corporation form and thereby committed to the mechanisms described above, the Model Legislation seeks to ensure the business cannot easily choose to abandon its benefit corporation status. The Model Legislation requires a supermajority (two-thirds) shareholder vote to terminate benefit corporation status.[127]

Individual state statutes have introduced additional statutory innovations,[128] including requiring a "benefit director" on the board to oversee the preparation of the annual benefit report,[129] allowing for the

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120 Murray, *supra* note 11, at 56 (finding that of the eight benefit reports reviewed in this study, seven relied on the B Impact Assessment as their independent third party standard; the eighth listed an individual's name).

121 MODEL LEGISLATION, *supra* note 8, § 305(c).

122 There is no benefit enforcement proceeding in California, Colorado, Delaware, Hawaii, Maryland, Minnesota, New York, Oregon, and Washington. Murray, *supra* note 107.

123 MODEL LEGISLATION, *supra* note 8, § 102.

124 Prior versions of the Model Legislation available online provided explicitly that monetary damages were not available for benefit enforcement proceedings. *See, e.g.*, MODEL BENEFIT CORPORATION LEGISLATION: WITH EXPLANATORY COMMENTS § 305(b) (Apr. 4, 2016), http://benefitcorp.net/sites/default/files/Model%20Benefit%20Corp%20Legislation_4_16.pdf. The most recent, April 17, 2017 version, however, has no such limitation. MODEL LEGISLATION, *supra* note 8.

125 *See, e.g.*, CAL. CORP. CODE § 14623(c) (West 2018); MASS. GEN. LAWS ANN. ch. 156E, § 14(3) (West 2018); NEV. REV. STAT. ANN. § 78B.190(3) (West 2017).

126 To the author's knowledge.

127 MODEL LEGISLATION, *supra* note 8, § 105.

128 *See* Esposito, *supra* note 47, at 702–06.

129 Several states require a public benefit director for publicly traded benefit corporations. Others always require a public benefit director. Murray, *supra* note 107.

appointment of "benefit officers" charged with managing the benefit corporation's pursuit of its social mission,[130] requiring public comment on the annual benefit report,[131] and automatic forfeiture of benefit corporation status for failure to file the annual benefit report.[132]

The statutory provisions described above are intended to make it easier for, and thus more likely that, benefit corporations will be managed in a way that considers the impact of the corporation's actions on a broad array of stakeholders. The corresponding enforcement mechanisms are intended to hold benefit corporations to these commitments.

C. *Goal of Benefit Corporations*

The principal goal of benefit corporations is to permit businesses to pursue profits simultaneously with social goals (social mission).[133] The creators and advocates of benefit corporations believe that shareholder primacy is the primary impediment to traditional corporations' pursuit of social mission.[134] Though, as will be discussed in Part III below, it is more accurate to say that it is a narrow focus on share *price* that impedes corporations' pursuit of social goals, not a focus on shareholder interests more generally. Benefit corporation proponents also generally believe that shareholder primacy is enshrined in traditional corporation law.[135]

On this basis, to liberate businesses to pursue social missions, the benefit corporation form aims to overcome shareholder primacy by making explicit in the benefit corporation's formative documents that the benefit corporation was formed with the purpose of pursuing a social mission, and that directors are required to consider a wide range of stakeholder interests in pursuit of that purpose. With the aim of ensuring that benefit corporations are, in fact, operated in pursuit of their social missions, shareholders are granted a distinct form of action—the benefit enforcement proceeding—to enforce commitment to social mission.

130 The Model Legislation permits a benefit officer. MODEL LEGISLATION, *supra* note 8, § 304.

131 Public comment on the annual benefit report is required in Hawaii. Esposito, *supra* note 47, at 706.

132 Automatic forfeiture of benefit corporation status for failure to file the annual benefit report is required in New Jersey. *Id.* And also in Minnesota. MINN. STAT. ANN. § 304A.301(5) (West 2017).

133 *See* BENEFIT CORP., http://benefitcorp.net (last visited Apr. 5, 2018); *see also* CLARK, JR. & VRANKA, *supra* note 106, at 2; MODEL LEGISLATION § 101 cmt.

134 *See* CLARK, JR. & VRANKA, *supra* note 106, at 14.

135 *See id.*; *FAQ*, BENEFIT CORP., http://benefitcorp.net/faq (last visited Apr. 5, 2018) ("Traditional Corporate Law Requires that Directors Place Profit Above All Else . . . .").

While these are novel and important innovations, it is still only the shareholders who are granted rights to enforce the pursuit of social mission if management fails to do so. Shareholders are entrusted to act as proxies to represent non-shareholder stakeholder interests.[136] The success of this enforcement mechanism depends upon the willingness of shareholders to act to enforce the social mission.[137] The benefit corporation structure therefore relies on a reasonable assumption that those who choose to invest in benefit corporation equity will do so because of their commitment to public benefit. What is yet to be seen is whether that commitment to social mission will translate into shareholder action to protect the public benefit.[138]

Given benefit corporations' focus on overcoming share price primacy, it will be useful to understand the origin and evolution of share price primacy in U.S. corporations before assessing whether benefit corporations will be successful in overcoming this corporate tendency.

III. Shareholder Primacy

A. *Theoretical Underpinnings of Shareholder Primacy*

As discussed above, since Berle and Dodd's exchange in the 1930s, the debate over whether corporations have responsibilities to society beyond share price maximization has persisted.[139] This debate between shareholder preferences and other stakeholder preferences is grounded in larger theoretical questions about the nature of corporations and their appropriate purpose.

Scholars have put forth theories that conceive of the corporation in a variety of ways[140]; however, the theories most closely associated with shareholder primacy are the property theory and the nexus of contracts theory. The property theory conceives of corporations as aggregations of shareholders' property.[141] Under this theory, shareholders' shares represent a fractional ownership of the corporation, and the shareholders, as owners, hire managers to run their corporation.[142] This

136 *See* Esposito, *supra* note 47, at 700.

137 *See* Strine, Jr., *supra* note 12, at 245.

138 *Id.* at 250.

139 *See* STOUT, *supra* note 13, at 17; Wells, *supra* note 2, at 82.

140 These include theories that the corporation is an independent, artificially created entity, an aggregation of natural persons, an entity formed to facilitate collective effort by many parties, and an extension of the political state. *See* Lynn Stout, *Corporate Entities: Their Ownership, Control, and Purpose* §§ 3.1–.2, 3.5–.6 (Cornell Law Sch. Legal Research Paper Series, Paper No. 16-38, 2016), http://dx.doi.org/10.2139/ssrn.2841875.

141 *Id.* § 3.3.

142 *Id.*

theory, which was the basis of Berle and Gardiner Means's famous 1934 book *The Modern Corporation and Private Property*,[143] clearly advocates in favor of shareholder primacy. If shareholders "own" the corporation, then it should operate in furtherance of their preferences. The nexus of contracts theory better accounts for the myriad individuals involved in corporate production, while still favoring shareholder primacy. The nexus of contracts theory has its origins in Ronald Coase's work in which he conceived of the firm as a range of exchanges that took place within the firm rather than in the marketplace.[144] Coase's ideas were adapted by business professors Michael C. Jensen and William H. Meckling into a theory of firms as "legal fictions which serve as a nexus for a set of contracting relationships among individuals . . . ."[145] The theory has evolved since Jensen and Meckling's writing, and the modern nexus of contracts theory conceives of the corporation as a web of reciprocal agreements (not, in all cases, actual contracts)[146] among the many parties associated with the corporation, including shareholders, directors, officers, employees, and creditors.[147] Thus, the nexus of contracts theory takes into account the variety of stakeholders who are deeply tied to and affected by corporate action. However, while the nexus of contracts theory denies that shareholders own the corporation, it perceives them as having a reciprocal agreement with the corporation that shares many characteristics of ownership.[148] It is on this basis that the traditional nexus of contracts theory reaches a similar conclusion as that of the property theory—that corporations should be managed for the benefit of their shareholders.

As discussed in Part I above, the debate that Berle and Dodd began in the 1930s remained stagnant for several decades.[149] During this time, managers were able to freely conceive of their role as that of trustees for

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143 ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

144 *See* Melvin A. Eisenberg, *The Conception That the Corporation Is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819, 820–21 (1999) (citing Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937)); *see also* Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972) (discussing an early conception of the firm as a nexus of contracts).

145 Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305, 310–11 (1976); Eisenberg, *supra* note 144, at 822 (concluding that Jensen and Meckling adapted Coase's theory).

146 *See* Stephen M. Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 IOWA L. REV. 1, 10–11 (2002) ("As used by contractarians, however, the term is not limited to relationships constituting legal contracts. Instead, contractarians use the word 'contract' to refer generally to long-term relationships characterized by asymmetric information, bilateral monopoly, and opportunism. The relationship between shareholders and creditors of a corporation is contractual in this sense, even though there is no single document we could identify as a legally binding contract through which they are in privity." (footnote omitted)).

147 Stout, *supra* note 140, § 3.4.

148 *See* Bainbridge, *supra* note 146, at 6.

149 *See* STOUT, *supra* note 13, at 17.

a wider array of stakeholders because shareholders were dispersed and passive.[150] In the 1960s and 1970s, the Chicago School of thinking about law and economics reignited the argument for shareholder value maximization on the basis of the property and nexus of contracts conceptions of the corporation.

Milton Friedman wrote in 1962 that "there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud."[151] Based on the property theory of the corporation, Friedman's position was both economic and moral. While he believed that management for non-shareholder constituencies would cause economic inefficiencies, he also believed that shareholders were the owners of corporations who had contributed capital to allow their corporations to operate, and therefore, it would be improper to manage them in anyone else's interests.[152]

In 1976, Jensen and Meckling formalized shareholder primacy in an economic "theory of the firm."[153] Their theory explained in economic terms how when unorganized and dispersed shareholders call upon managers to run the businesses in which they own shares, managers may not act in a way that maximizes shareholder welfare.[154] In their analysis, Jensen and Meckling began to develop the nexus of contract theory but also continued to conceive of shareholders as "owners" of the firm.[155] They therefore viewed shareholders as "principals" who hire managers as "agents" to manage the corporation. Because the managers will not bear the financial consequences of their decisions in managing the corporation, they are incentivized to make decisions that benefit the managers at the shareholders' expense.[156] This scenario results in "agency costs" due to what Berle and Means had termed the "separation of ownership and control."[157] Jensen and Meckling's paper added the weight of formal economic analysis to an argument that had been made in more general terms for some time.

Following Jensen and Meckling's paper, concern began to grow

150 *See* Rock, *supra* note 13, at 1912–13.

151 FRIEDMAN, *supra* note 16, at 112.

152 *See* Wells, *supra* note 2, at 123–24.

153 Jensen & Meckling, *supra* note 145.

154 *Id.*

155 *Id.* at 308 ("We focus in this paper on the behavioral implications of the property rights specified in the contracts between the owners and managers of the firm.").

156 *Id.*

157 BERLE & MEANS, *supra* note 143, at 6, 116 ("[I]t is therefore evident that we are dealing not only with distinct but often with opposing groups, ownership on the one side, control on the other—a control which tends to move further and further away from ownership and ultimately to lie in the hands of the management itself, a management capable of perpetuating its own position.").

about the inefficiencies of agency costs, and an extraordinary amount of scholarship has been dedicated to this topic.[158] Some of the potential detrimental effects of these agency costs that have been identified in this scholarship include: managers preferring less risk than diversified investors[159]; managers retaining higher than optimal amounts of cash to avoid having to attract new investment[160]; engaging in mergers and acquisitions without attention to the effect on shareholder returns[161]; and retaining earnings to build corporate "empires."[162] While material decisions that corporate officers make about a corporation are subject to review by the board of directors, the CEO appoints the directors. So, when shareholders are dispersed and passive, the argument goes, managers will be unrestrained in furthering their own interests at the expense of shareholders because the board members will align themselves with the management that appointed them.[163]

The dispersed and passive nature of public shareholders is a key aspect of this analysis because shareholders do have limited rights to control or monitor corporate action. Shareholders have the right to elect directors to the board, vote on major transactions, inspect corporate books and records, and file derivative suits.[164] However, a shareholder vote against corporate action requires a majority vote, directors are elected by a plurality,[165] and derivative suits may only be brought by shareholders representing at least two percent of the corporation's outstanding stock.[166] So, utilizing these shareholder rights requires coordination among shareholders. Agency costs arise when shareholders cannot, or do not, organize to use these rights to ensure

158 *See, e.g.*, ROBERTA ROMANO, FOUNDATIONS OF CORPORATE LAW (2d ed. 2012); Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435 (1992); Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520 (1990); Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403 (1985); Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); Hideki Kanda & Saul Levmore, *Taxes, Agency Costs, and the Price of Incorporation*, 77 VA. L. REV. 211 (1991); Eric A. Posner & E. Glen Weyl, *Quadratic Voting as Efficient Corporate Governance*, 81 U. CHI. L. REV. 251 (2014); *see also* EASTERBROOK & FISCHEL, *supra* note 33.

159 *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 306–07 (1999); Rock, *supra* note 13, at 1913.

160 *See* Rock, *supra* note 13, at 1914.

161 *Id.* at 1915.

162 Blair & Stout, *supra* note 159, at 306.

163 *See* Rock, *supra* note 13, at 1916.

164 *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 211–12, 220, 251(c), 327 (West 2018).

165 *See, e.g.*, DEL. CODE ANN. tit. 8, § 215. *But see, e.g.*, COUNCIL OF INSTITUTIONAL INV'RS, FAQ: MAJORITY VOTING FOR DIRECTORS (Jan. 4, 2017), http://www.cii.org/files/issues_and_advocacy/board_accountability/majority_voting_directors/CII%20Majority%20Voting%20FAQ%201-4-17.pdf (noting that many large-cap companies have recently adopted majority voting policies for director elections even though it is not legally required).

166 *See, e.g.*, DEL. CODE ANN. tit. 8, § 367.

the firm is managed for their benefit.

B. *Current Status of the Agency Cost Problem: Solved*

In a 2013 article, Professor Edward B. Rock concluded that the agency cost problem arising from the separation of ownership and control had been resolved.[167] That is to say, U.S. public corporations are now being managed primarily for the benefit of their shareholders, a phenomenon that began to emerge in the 1980s just as the academic discussion of agency costs arising from the separation of ownership and control was gaining steam.[168] Rock observed that currently, "[c]ompanies, shareholders, business schools, corporate law professors, and judges all seem to believe that the primary responsibility of directors is to maximize shareholder value."[169] This view is shared widely by other commentators.[170] To those narrowly concerned about shareholder agency costs arising from the separation of ownership and control, this is indeed a solution to a problem. On the other hand, for proponents of corporate social responsibility, this state of affairs is instead a problem to be overcome. Indeed, this turn to a narrow focus on shareholder value has caused concern among both legal and business scholars about the potential negative effects of corporations focused on actions that increase share price in the short-term at the expense of long-term firm value creation.[171] Rock himself notes, "[i]n a world in which managers' high-powered equity incentives make them think and act like shareholders, it is important to remind managers and directors that the goal of the exercise is to create valuable firms, not to maximize shareholder value as an end in itself."[172]

Benefit corporations aim to overcome this trend toward

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167 *See* Rock, *supra* note 13, at 1988.

168 *See id.* at 1910.

169 *Id.* at 1923.

170 *See, e.g.*, Arthur R. Pinto & Franklin A. Gevurtz, *United States: Corporate Governance for Publicly Traded Corporations*, *in* COMPARATIVE CORPORATE GOVERNANCE: A FUNCTIONAL AND INTERNATIONAL ANALYSIS 1042, 1045 (Andreas Fleckner & Klaus Hopt eds., 2013); STOUT, *supra* note 13, at 3; Brakman Reiser, *Benefit Corporations*, *supra* note 11, at 591 ("[F]or-profit forms will create practical, if not legal, pressure to favor profit maximization over social good . . . ."); Strine, Jr., *supra* note 12, at 241.

171 *See, e.g.*, *Panel Transcripts from 2014 National Lawyers Convention: Millennials, Equity, and the Rule of Law: Corporations: The Short-Termism Debate*, 85 MISS. L.J. 697 (2016); ASPEN INST. BUS. & SOC'Y PROGRAM, OVERCOMING SHORT-TERMISM: A CALL FOR A MORE RESPONSIBLE APPROACH TO INVESTMENT AND BUSINESS MANAGEMENT (Sept. 9, 2009) [hereinafter ASPEN INSTITUTE], https://assets.aspeninstitute.org/content/uploads/files/content/docs/pubs/overcome_short_state0909_0.pdf. Professors Margaret Blair and Lynn Stout argued that the increase in institutional share ownership has tipped the political balance of power toward shareholders, which "allows them to capture a larger share of the rents from the corporate enterprise." Blair & Stout, *supra* note 159, at 326.

172 Rock, *supra* note 13, at 1911.

shareholder wealth maximization and allow their managers to consider not only the well-being of shareholders and the firm, but also a variety of other stakeholder interests. In order to evaluate whether they will succeed in doing this, it is necessary to understand the forces that have caused the trend toward shareholder primacy in traditional corporations.

1. Legal Requirements

a. State Corporate Law

Directors of U.S. corporations are charged with managing or directing the affairs of the corporation.[173] The directors typically appoint officers who manage the day-to-day operations of the corporation while the directors play a supervisory role. In carrying out this responsibility, directors owe a duty of care and a duty of loyalty to both the corporation itself and its shareholders.[174] Director decisions are scrutinized under the very lenient business judgment rule, which presumes that the board of directors acted on an informed basis and in the honest belief that the action was taken in the best interest of the corporation.[175]

A debate among scholars and practitioners persists about whether directors' fiduciary duties, which flow to both the corporation and its shareholders, include an obligation to maximize shareholder value. However, numerous scholars and commentators argue that no such legal obligation exists.[176] The case most often cited by those who believe shareholder primacy is enshrined in law is *Dodge v. Ford Motor Co.*[177] The case was brought by the Dodge brothers, who were minority shareholders in Ford Motor Company.[178] The Dodge brothers were

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173 *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (West 2018). Director duties are substantially, but not perfectly, consistent across states. This discussion focuses on Delaware laws because most large corporations are incorporated in Delaware.

174 *See, e.g.*, Arnold v. Soc'y for Sav. Bancorp, Inc., 678 A.2d 533, 539 (Del. 1996). The duty of care is the duty to "use that amount of care which ordinarily careful and prudent men would use in similar circumstances." Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963). It is a duty not to act negligently. The duty of loyalty is a duty to avoid conflicts of interest and therefore to always pursue the interests of the corporation and its shareholders, not the interests of any director. *See* Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

175 *See, e.g.*, *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 746–47 (Del. Ch. 2005).

176 *See, e.g.*, MIGUEL PADRÓ, ASPEN INST. BUS. & SOC'Y PROGRAM, UNREALIZED POTENTIAL: MISCONCEPTIONS ABOUT CORPORATE PURPOSE AND NEW OPPORTUNITIES FOR BUSINESS EDUCATION (May 28, 2014), https://assets.aspeninstitute.org/content/uploads/files/content/docs/pubs/Aspen%20BSP%20Unrealized%20Potential%20May2014v.2.pdf; Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 783–96 (2005); Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford, 3 VA. L. & BUS. REV. 163 (2008).

177 Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919).

178 *Id.* at 670–71.

displeased by Ford's recent decision to suspend dividends in order to reinvest its profits into the company and thus allow Ford's success to be shared more widely in the community.[179] They sued to demand that Ford pay the usual dividend.[180] The court ordered Ford to pay the dividend and commented that "[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."[181]

This case has never been overturned and is, therefore, technically "good law."[182] Nonetheless, there are many reasons to doubt the relevance of this decision and its proclamation that businesses are organized solely for the benefit of their shareholders. As Professor Lynn Stout pointed out: the case is nearly one hundred years old (and therefore preceded the debate between Berle and Dodd about corporate responsibility)[183]; the statement about shareholder primacy is likely dicta; the decision turned on the rights of minority shareholders, not shareholders generally; and it is the decision of a jurisdiction (Michigan) that is not the epicenter of contemporary corporate activity.[184] More recent cases have stood much more clearly for the proposition that corporate directors have flexibility to consider non-shareholder interests,[185] though there do appear to be limits to how far the courts will permit management to de-emphasize shareholder value.[186]

179 *Id.* at 671 ("'My ambition,' declared Mr. Ford, 'is to employ still more men; to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes. To do this, we are putting the greatest share of our profits back into the business.'").

180 *Id.* at 673.

181 *Id.* at 684.

182 *See, e.g.*, CLARK, JR. & VRANKA, *supra* note 106, at 8 ("*Dodge v. Ford* remains good law and many still maintain that its 'theory of shareholder wealth maximization has been widely accepted by courts over an extended period of time.'"); Jonathan R. Macey, *A Close Read of an Excellent Commentary on* Dodge v. Ford, 3 VA. L. & BUS. REV. 177, 190 (2008) ("[T]he rule of wealth maximization for shareholders is virtually impossible to enforce as a practical matter."); Brakman Reiser, *Benefit Corporations*, *supra* note 11, at 608 ("At inception, it appears permissible to include charitable or social goals as part of a corporation's purposes. Yet, anecdotal reports suggest that in some states, inclusion of such goals as a major component of corporate purposes may stall or block acceptance of articles by the secretary of state." (footnote omitted)); Stout, *supra* note 176, at 174 ("Not only is Dodge v. Ford bad law from a positive perspective, but it is also bad law from a normative perspective.").

183 *See supra* Section I.A.

184 *See* Stout, *supra* note 176, at 166–67.

185 *See, e.g.*, Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989) (finding that directors acted within their fiduciary duties when rejecting a merger that would have provided substantial returns to shareholders on the basis that it did not comport with corporate strategy); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) (finding that directors' defensive measures against a takeover enjoy the protection of the business judgement rule when the directors hold a reasonable belief that the transaction is a threat to corporate policy and the response is proportionate); Shlensky v. Wrigley, 237 N.E.2d 776 (Ill. App. Ct. 1968) (finding that shareholders did not state a cause of action in claiming mismanagement by directors where the directors' decisions did not hint at fraud, illegality, or a conflict of interest).

186 *See, e.g.*, eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010)

Nonetheless, to the extent there remains some uncertainty about when and to what extent corporate managers can consider non-shareholder interests, it is conceivable that a corporation could find itself confronted with a court willing to enforce an affirmative duty to maximize shareholder value. However, this scenario seems increasingly unlikely, and following the advent of constituency statutes, directors of corporations in constituency states are statutorily authorized to consider the effects of their decisions on non-shareholder interests.[187] The lack of a clear legal mandate to maximize shareholder value demonstrates that state corporate law is not the driving force behind U.S. corporations' focus on shareholder wealth maximization.

b. Other Legal Measures That Encourage Shareholder Primacy

While state corporation law does not appear to enshrine a requirement of shareholder primacy, since the 1990s a variety of federal regulations have had the effect of encouraging corporate managers to manage corporations in furtherance of shareholder preferences,[188] either as their explicit goal or as a secondary consequence. Summaries of prominent examples follow.

1992 Proxy Rule Changes. Rule 14a-8 of the Securities and Exchange Act of 1934 requires that companies include shareholder proposals in their proxy statements if certain requirements are met.[189] However, some of the communications that shareholders might make in discussing potential shareholder proposals among themselves could be considered "proxy solicitations" under Securities and Exchange Commission (SEC) rules, and thus, be subject to substantial filing requirements and restrictions.[190] The 1992 reforms limited the types of shareholder communications that could be considered proxy solicitations, allowing shareholders to more effectively coordinate to make shareholder proposals.[191] This reform facilitates shareholder activism and thereby increases shareholders' ability to hold management accountable.

(distinguishing *Paramount* by clarifying that corporate culture is not an end automatically protected by the business judgment rule, but rather that the judgment that the promotion of a non-stockholder interest will eventually lead to stockholder gain is protected by the business judgment rule).

187 The first state to adopt a constituency statute was Pennsylvania in 1983. Esposito, *supra* note 47, at 660. Notably, Delaware, where sixty-three percent of Fortune 500 firms were incorporated in 2014, has no constituency statute. CLARK, JR. & VRANKA, *supra* note 106, at 9–10.

188 *See* STOUT, *supra* note 13, at 111–12.

189 17 C.F.R. § 240.14a-8 (2018).

190 *See* Stephen Choi, *Proxy Issue Proposals: Impact of the 1992 SEC Proxy Reforms*, 16 J.L. ECON. & ORG. 233, 236 (2000).

191 *See* U.S. SEC. & EXCH. COMM'N, 1992 ANNUAL REPORT viii (1993), https://www.sec.gov/about/annual_report/1992.pdf.

1993 Tax Code Changes. Section 162(m) of the Internal Revenue Code as enacted in 1993 limited the amount of executive pay that was deductible against corporate profits to one million dollars for pay not tied to performance.[192] Stock options were considered performance-based, and thus, not subject to the limit.[193] Executives who are compensated in stock options have very strong incentives to manage the corporation so as to maximize share price. As has been widely noted in the aftermath of the 2008 financial collapse, compensating executives with stock options also often creates perverse incentives that allow executives to be substantially enriched by share price increases, while bearing little to none of the risk of a share price collapse.[194] Section 162(m) was amended by the 2017 Tax Act such that performance-based pay will no longer be exempt from the one million dollar deductibility limit for tax years beginning after December 31, 2017.[195]

2002 Rule on Mutual Fund Voting. In 2002, the SEC adopted rules requiring mutual funds and other "management investment companies" to publicly disclose how they vote the shares that they hold as well as the policies and procedures they use to determine how to vote these shares.[196] This additional disclosure allows individual investors to determine how a mutual fund votes before making a decision whether to invest, which would be expected to encourage mutual funds to vote in the interests of their investors. While not necessarily the intended effect, this rule works to make mutual funds more attuned to share price.

2010 Elimination of Broker Discretionary Voting. In 2010, New York Stock Exchange Rule 452 was amended to prohibit brokers from voting shares in director elections when they have not received instructions from their customers as to how to vote (uninstructed shares). Prior to this amendment, brokers could vote uninstructed shares at their discretion. Because brokers usually vote for the board's nominees, this amendment reduced the number of shares voted in favor of management, thus increasing the power of votes against management.[197]

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192 Brian J. Hall & Jeffrey B. Liebman, *The Taxation of Executive Compensation*, 14 TAX POL'Y & ECON. 1, 3 (2000).

193 *Id.* at 7.

194 *See* Lucian A. Bebchuk et al., *The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000–2008*, 27 YALE J. ON REG. 257 (2010).

195 Act of Dec. 22, 2017, Pub. L. No. 115–97, 131 Stat. 2054; I.R.C. § 162(m) (West 2017); *see also The New Tax Rules for Executive Compensation and Employee Benefits*, MCGUIREWOODS (Dec. 29, 2017), https://www.mcguirewoods.com/Client-Resources/Alerts/2017/12/New-Tax-Rules-Executive-Compensation-Employee-Benefits.aspx.

196 U.S. Sec. & Exch. Comm'n, *Final Rule: Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies*, https://www.sec.gov/rules/final/33-8188.htm (last updated Sept. 23, 2003).

197 *See* WEIL, GOTSHAL & MANGES LLP, WEIL BRIEFING: SEC DISCLOSURE AND CORPORATE GOVERNANCE 1–3 (July 9, 2009), http://www.weil.com/~/media/files/pdfs/Weil_Briefing_SEC_CG_July_9.pdf.

2011 Say on Pay Rules. The "Say on Pay" rules were a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act and require an advisory (non-binding) shareholder vote on compensation packages for executives.[198] The Say on Pay rules are intended to allow shareholders to put management on notice if they are displeased with the compensation provided to executives. This rule gives corporate executives yet another incentive to please shareholders.

None of these rules require corporate management to prioritize shareholder interests; however, they do incentivize managers to do so. They also empower shareholders to act when they are displeased with management. These rules demonstrate a concern among policymakers about manager-shareholder agency costs and thereby indirectly promote share price primacy. While they have likely contributed to the trend toward share price primacy, as the next Section will demonstrate, they are not the defining force.

2. Shareholder Identity Has Changed

In his article describing the problem of the separation of ownership and control as "resolved," Rock emphasized that the shift to a shareholder-centric system of corporate governance has occurred primarily through non-legal changes.[199] Rather than laws promoting shareholder primacy, other forces have caused shifts in the balance of power between corporate management (executives and directors) and shareholders.[200] Recall that agency costs arise in the relationship between shareholders and management when shareholders are dispersed and passive, thus inhibiting their ability to use their shareholder rights to defend their interests. Over the past several decades, shareholders have become more concentrated and more active.

The increased concentration of share ownership is the result of the rise of institutional investors. The percentage of institutional holdings of publicly traded stock has steadily increased since 1980.[201] Because institutional investors purchase shares on behalf of a large number of individual human investors, their ownership stakes tend to be significantly larger than those of individual investors. The result is that

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198 *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Rules for Say-on-Pay and Golden Parachute Compensation as Required Under Dodd-Frank Act (Jan. 25, 2011), https://www.sec.gov/news/press/2011/2011-25.htm.

199 Rock, *supra* note 13, at 1910.

200 *Id.* at 1922; *see also* Kahan & Rock, *supra* note 62, at 995–1007.

201 *See* Kahan & Rock, *supra* note 62, at 995–98; Serdar Çelik & Mats Isaksson, *Institutional Investors and Ownership Engagement*, 2013 OECD J. 93, https://www.oecd.org/corporate/Institutional-investors-ownership-engagement.pdf; Marshall E. Blume & Donald B. Keim, Institutional Investors and Stock Market Liquidity: Trends and Relationships (Aug. 21, 2012) (unpublished paper), http://dx.doi.org/10.2139/ssrn.2147757.

the coordination of a smaller number of shareholders is required for successful shareholder advocacy.

Not only have institutional investors become more prevalent, they are also increasingly inclined toward activism. Mutual funds represent an increasingly large proportion of institutional investors.[202] Mutual funds traditionally did not engage in strong investor activism, but this is no longer always the case.[203] The rise of hedge funds is also a very important contributor to the increasing power of shareholders. While hedge funds may not be the largest owners of publicly traded shares, certain hedge funds are particularly inclined toward engaging in activist campaigns to change the business strategies of the corporations in which they invest.[204] Moreover, pension funds, which do not often engage in strong shareholder activism, sometimes affiliate themselves with activist hedge funds that do.[205]

Concurrent with this rise of institutional investors who are concentrated and active, proxy advisory firms have arisen that further facilitate investor activism. Proxy advisory firms make recommendations to their institutional investor clients about how to vote their shares on any number of corporate issues.[206] Thus, they assist shareholders in coordinating and unifying their votes.

The trends of increased institutional holdings, more active institutional investors, and the rise and assistance of proxy advisory firms have converged to create a landscape of share ownership that does not look anything like the dispersed, unorganized, and passive shareholders described by the extensive scholarship dedicated to agency costs and the separation of ownership and control. An important result of this development is that active institutional investors may not simply be focused on shareholder value generally. Rather, there is evidence to suggest that they more specifically tend to focus their activism on maximizing short-term shareholder value.[207] Institutional investors are generally strongly incentivized to purchase shares and increase the share price as quickly as possible. They can then either sell the shares at a

202 *See* Kahan and Rock, *supra* note 62, at 998.

203 *Id.* at 1001 (footnote omitted); *see also* ASPEN INSTITUTE, *supra* note 171, at 4 ("Presently, however, many college savings, 401(k), and related retirement funds engage in behavior that is inconsistent with their investors' goals, as they trade securities, pay their managers, and engage in (or support) activism in pursuit of short-term financial objectives at the expense of long-term performance and careful analysis of fundamental risk.").

204 *See* Thomas W. Briggs, *Corporate Governance and the New Hedge Fund Activism: An Empirical Analysis*, 32 J. CORP. L. 681 (2007); John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545 (2016); Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021 (2007); Kahan & Rock, *supra* note 62, at 998.

205 *See* Kahan & Rock, *supra* note 62, at 1004–05.

206 *Id.* at 1005–06; *see also* Coffee, Jr. & Palia, *supra* note 204, at 557–59.

207 *See* STOUT, *supra* note 13, at 69–71.

profit, or report to their clients and potential clients on the successful investments they have made, or both.[208] Because share prices cannot increase infinitely, it is far from clear that this trend is beneficial to the long-term interests of the corporation or the economy.[209] In recent years, some institutional investors have publicly announced that they make investments with a long-term focus.[210] It is too soon to know the force of this trend and how it will affect corporate decision making.

The rise in active institutional investors has changed the landscape of public share ownership such that a fundamental premise on which the agency cost analysis is based—dispersed and passive shareholders—is no longer true. Therefore, this non-legal development is arguably the most consequential force that has solved the agency cost problem.

3. Human Shareholder Limitations

A final and important force that drives shareholder primacy is the inability of investors to advocate on behalf of outcomes other than maximizing share price. The trends discussed so far have overcome agency costs associated with maximizing share price, particularly short-term share price. However, to the extent shareholders would like the corporations in which they have invested to pursue other ends, obstacles still exist in promoting those other interests.

Jensen and Meckling based their theory of the firm on a number of assumptions, one of which was that "[n]o outside owner gains utility from ownership in a firm in any way other than through its effect on his wealth or cash flows."[211] This assumption, however, does not accurately represent reality. Even where investors are institutional, the investment is usually held on behalf of one or more humans. Most of us can likely reflect on our experiences being and living among humans to observe that humans derive value from other sources besides wealth and cash flows. There are both selfish and altruistic dimensions to individual investors' non-share price interests.

First, humans interact with corporations in many ways other than by investing in their stock. "They are also consumers who buy products, citizens who pay taxes, and organisms that breathe air and drink water."[212] So, if corporations are advancing short-term share price at the

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208 *Id.* at 66–67.

209 *Id.* at 71–73.

210 *See, e.g.*, Larry Fink, *Larry Fink's Annual Letter to CEOs: A Sense of Purpose*, BLACKROCK (2018), https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter ("As a fiduciary, BlackRock engages with companies to drive the sustainable, long-term growth that our clients need to meet their goals.").

211 Jensen & Meckling, *supra* note 145, at 13.

212 STOUT, *supra* note 13, at 87.

expense of engaging in research and development for the products that shareholders purchase or protecting the environment in which shareholders live, shareholders will be negatively affected by these actions. Second, human shareholders often care about corporate actions that do not directly affect them. Ample evidence exists to confirm that the vast majority of humans are what Professor Lynn Stout referred to as "prosocial."[213] This is to say, we are often willing to make modest personal sacrifices to be ethical and avoid harming others.[214] The significant demand among entrepreneurs and investors for a corporate form that will allow them to "do well while doing good" is evidence of this tendency.

So, most humans who ultimately own shares in corporations would likely be willing, at times, to sacrifice an increase in share price for the benefit of other stakeholders—whether or not they are in that "other stakeholder" group. In spite of this, as discussed above, modern public shareholders narrowly use their increased leverage to promote increases in share price and often in the short term at the expense of the long term.

There are a number of factors that combine to create this phenomenon. First, institutional investors are fiduciaries for their clients, and that fiduciary duty is generally understood to mean that these funds are obligated to protect only their clients' financial interests.[215] Fund managers therefore have both legal and business reasons to prefer a high share price. It fulfills their legal duties to their clients, but also demonstrates to existing and future clients that the fund is a profitable investment. Second, the same forces that make dispersed shareholders passive—lack of information and rational apathy—work to make the individuals who invest in mutual and pension funds passive.[216] Individuals invest in funds precisely because they do not want to monitor and manage a diverse portfolio of investments. They pay to delegate this task to fund managers and thus a new set of "agency costs" arises. Most individual investors do not likely consider it cost-effective to closely monitor their fund investments. Finally, stock price is an easily understood and comparable piece of data. Higher is better, and it is reasonable to assume that higher is better for all investors, whether individuals or funds. Shareholders' non-financial preferences are likely much more diverse and more difficult to measure. It is therefore much more practical for either corporate management or a fund manager to focus on the one metric—share price—that will please every

213 *Id.* at 96; *see also* LYNN A. STOUT, CULTIVATING CONSCIENCE: HOW GOOD LAWS MAKE GOOD PEOPLE (2011).

214 *See* STOUT, *supra* note 13, at 96.

215 *Id.* at 91.

216 *Id.*

shareholder.

The result of these forces is that "fund managers have little to lose and much to gain from supporting corporate strategies that raise the stock prices of the firms they hold in their portfolios, even when those same strategies harm their beneficiaries' outside interests."[217] So, share price maximization continues to be pursued even when the individual shareholders themselves may have other preferences.

With these observations in mind, we can clarify that when the leaders of the social enterprise movement and the creators of benefit corporations say they aim to move away from "shareholder value maximization," what they are really concerned about is share *price* maximization. Because, it turns out, even shareholders in traditional corporations place value on outputs that could be considered part of a social mission.

C. *Conclusion*

Several forces have combined to cause publicly traded U.S. corporations to be very narrowly focused on maximizing share price. As we have seen, state corporation law is not the driving force behind this trend. Instead, the growing prominence of institutional investors means there are fewer shareholders owning larger shares of corporations. Shareholders have been further empowered by federal regulations and the advent of proxy advisory services. These changes all work together to make it easier for shareholders to overcome the collective action problems associated with utilizing shareholder rights to impact corporate decision making. Structural and practical limitations cause modern shareholders to use this power to promote share price maximization at the expense of human shareholders' more "prosocial" concerns.

IV. WILL BENEFIT CORPORATIONS OVERCOME SHAREHOLDER PRIMACY?

The explicit goal of benefit corporations is to allow businesses to operate in pursuit of social mission by freeing them from the pressures to maximize share price. The extent to which they will succeed in doing this will depend, first, on the extent to which the forces that have led traditional corporations to become narrowly focused on share price will similarly impact benefit corporations and, second, whether the benefit corporation form will instead allow businesses to operate in a way that

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217 *Id.*

effectively provides social return.[218] This Part analyzes how those forces will affect benefit corporations.

A. *The Separation of Benefit and Control*

The problem of agency costs arising from the separation of corporate ownership and control is premised on the belief, articulated by Berle, Friedman, and others, that the proper purpose of a corporation is to maximize profits for shareholders.[219] You must start with the premise that shareholder preferences are the proper focus of corporate action in order for the inability of shareholders to control management to be a problem.

As we have seen, benefit corporations do not take this view. Instead, benefit corporations make clear that their purpose goes beyond maximizing shareholder return.[220] They explicitly pledge to pursue social mission simultaneously with shareholder financial return.

With this very clear statement of benefit corporations' aims, we can repurpose the traditional separation of ownership and control analysis for benefit corporations by altering the premise to include social mission beneficiaries together with shareholders as the proper foci of corporate action. Doing this, we have two distinct groups whose interests we have decided are the purpose of the benefit corporation. Both groups are, to differing extents, separated from the management that controls the benefit corporation.

Using this revised analytic framework, the analysis with respect to the shareholders is the same as it was in the traditional analysis of corporations. Shareholders have some limited rights, but if they are unwilling or unable to coordinate to use their shareholder rights to control management, then management may act in ways that are contrary to shareholder interests. Applying this analysis to the social mission beneficiaries, however, we see that the likelihood that their interests will not be adequately protected is even greater. For shareholders, the problem arises because they may have difficulty or lack incentive to *utilize* their shareholder rights to control management. The beneficiaries have no control rights. If they are receiving inadequate or no public benefit, they must rely on the shareholders to be aware of the problem, know how to solve it, and take action to protect their interests.

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218 *See* BRAKMAN REISER & DEAN, *supra* note 10, at 27 ("For a specialized form to be a meaningful brand to social enterprise stakeholders, it must convince them to trust that the new entity will avoid the problems caused by existing products . . . .").

219 *See supra* Section III.A.

220 *See* MODEL LEGISLATION, *supra* note 8, § 201.

Shareholders can overcome the separation of ownership and control if they can organize to overcome the collective action problem of utilizing their shareholder rights. As we have seen, modern shareholders in traditional public corporations have done just that. However, no amount of coordination or commitment by beneficiaries will give them the power to impact corporate decision making because they have no rights to do so. Thus, the separation of benefit and control is a much larger obstacle than the separation of ownership and control.

Shareholders must act as proxies for beneficiaries and they are given an additional tool to do this—the benefit enforcement proceeding. However, using the benefit enforcement proceeding would be very costly, as any litigation is. Using other shareholder rights to pressure management would also involve substantial transaction costs and could result in a lower financial return on investment for the shareholders. As Professor Sarah Dadush describes, this places beneficiaries in the "precarious position" of being both the intended beneficiaries of social good, but also possible sources of profit for shareholders.[221] Nonetheless, the success of benefit corporations in pursuing their social missions will depend on shareholders' ability not only to engage in activism when management action is inadequate, but to do so on behalf of the beneficiaries rather than, or in addition to, themselves.

B. *Evaluating Each Trend That "Solved" the Agency Problem*

1. Legal Requirements

Benefit corporation statutes are unequivocal in their intent to eliminate any legal requirement that officers and directors focus solely on share price. Benefit corporations must state in their articles of incorporation that their purpose is to pursue social mission.[222] The Model Legislation explicitly states that pursuit of social mission is in the best interest of the corporation.[223] Further, benefit corporation directors are obligated to consider the interests of non-shareholder stakeholders.[224]

Thus, to the extent that managers' duties under state corporation law were a catalyst of corporations' focus on share price maximization, benefit corporations clearly overcome that hurdle. However, as we saw above, if corporation law was a contributor to share price maximization

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[221] Sarah Dadush, *Regulating Social Finance: Can Social Stock Exchanges Meet the Challenge?*, 37 U. PA. J. INT'L L. 139, 168 (2015).

[222] *See* MODEL LEGISLATION, *supra* note 8, §§ 201(a)–(b).

[223] *Id.* §201(c).

[224] *Id.* §301(a).

at all, it was not a primary or decisive one. Nonetheless, any ambiguity in the law creates risk for businesses. So, even if state corporation law was not the driving force in the path toward share price primacy, it is still of some value to benefit corporations to have eliminated this source of ambiguity.

Most of the federal rules and regulations promoting shareholder rights and share price maximization discussed in Section III.B.1.b above are not currently relevant for the vast majority of benefit corporations. They are primarily directed at publicly traded companies. To date, there is only one publicly traded benefit corporation, Laureate Education, which completed its initial public offering on February 6, 2017. For Laureate and any future publicly traded benefit corporations, the SEC rules will likely encourage shareholder activity the same way they do for traditional corporations. Whether this increased shareholder activity results in social goods to beneficiaries will depend on the extent to which shareholders choose to use their influence to promote beneficiaries' interests. However, public shareholders will continue to have the option to use their influence to promote their own financial interests, which they may do because benefit corporation investors expect a financial return. Because we currently have only one example of a publicly traded benefit corporation, and Laureate has only been trading publicly for just over one year, it is not yet possible to draw conclusions about how these rules will affect benefit corporation decision making. Moreover, it is not clear whether a trend of publicly traded benefit corporations will develop.

2. Shareholder Identity

Likewise, because only one benefit corporation is currently publicly traded, information about the ownership composition of all but one benefit corporation is not publicly available. Therefore, it is not possible to draw conclusions about trends in the composition of investors in benefit corporations.[225] However, hypotheses based on available information are possible. At one end of the private-public spectrum, some benefit corporations may exist as small, private, and closely held

225 As of February 28, 2018, a group of private equity investors who initially purchased shares of Laureate in a 2007 leveraged buyout (well before Laureate became a benefit corporation) owned a majority of both classes of Laureate's outstanding stock and controlled 91.5% of the voting power. U.S. SEC. & EXCH. COMM'N, SCHEDULE 14A FOR LAUREATE EDUCATION INC. (Apr. 13, 2018), https://www.sec.gov/Archives/edgar/data/912766/0001047469 18002781/a2235277zdef14a.htm. Thus, in the case of Laureate, so long as these investors hold their shares, the public investors who purchased shares in the IPO will have substantially diminished (if any) power to influence corporate behavior, whether in furtherance of their own or the beneficiaries' interests.

companies. In this case, the ability of shareholders to influence management will be largely irrelevant because shareholders will be few and will often be the same individuals as management. Beyond that scenario, benefit corporations may be private companies that seek outside equity investors, or even go public as Laureate did.

A driving force behind the creation of benefit corporations was the increasing popularity of socially responsible investing (SRI).[226] There were $8.72 trillion of assets under management using SRI techniques at the start of 2016, accounting for one out of every five dollars under professional management in the United States.[227] Thus, there is reason to believe that benefit corporations that seek external capital will attract investments from professionally managed, socially responsible investment vehicles. If this is true, then share ownership of benefit corporations will be less dispersed than is imagined by the traditional separation of ownership and control analysis because investments will be made by SRI vehicles that pool individual capital.[228] SRI investments pursue long-term financial returns,[229] so the pressure to create short-term gains in share price will likely be less for benefit corporations than it is for traditional corporations. Beyond that observation, it is difficult to know the exact profile of investors in benefit corporations and the extent to which any future trends will mirror those observed in traditional public corporations. However, given available information it is reasonable to predict they will not be entirely dispersed, and will have a longer-term focus than traditional public company equity investors.

The reduced focus on short-term returns should empower benefit corporations to further their social missions because management will be freed from a focus on short-term results, granting them more leeway to pursue social mission even if that sometimes comes at the expense of short-term financial gain. The effects of ownership concentration are much less clear. This is in part because we do not yet have an accurate profile of benefit corporation shareholders, or information about how their concentration will develop in the future.

However, even if we knew exactly what benefit corporation share ownership looked like, that information would be insufficient to make meaningful predictions about their relative commitments to social mission and share price. This is because protection of both these aims

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226 *See* CLARK, JR. & VRANKA, *supra* note 106, at 3–4.

227 US SIF, REPORT ON US SUSTAINABLE, RESPONSIBLE AND IMPACT INVESTING TRENDS 2016 12 (2016), http://www.ussif.org/files/SIF_Trends_16_Executive_Summary(1).pdf.

228 *Id.* at 14 (citing $206 billion AUM in alternative investment vehicles that "include a number of private equity funds focused on themes such as clean technology and social enterprise, and property funds focused on green building and smart growth").

229 *Id.* at 12 ("The individuals, institutions, investment companies, money managers and financial institutions that practice SRI investing seek to achieve long-term competitive financial returns.").

falls to the shareholders. If shareholders are uncoordinated and inactive, then neither share price nor social mission will be defended. If shareholders are coordinated and active, we cannot be certain how they will divide their efforts between promoting share price and promoting social mission. Though, the human fallacies described in the next Section give reason for doubt that social mission will be adequately protected.

3. Human Shareholder (and Management) Limitations

The ability of benefit corporations to create real social good will depend heavily on the commitment of their directors, officers, and shareholders. As demonstrated above, the intended beneficiaries of benefit corporations' social missions lack any input in the operation of the corporation, so the attainment of social mission will depend entirely on the commitment of the corporate management in the first instance, and then the commitment of shareholders to enforce the social mission if management fails to do so. This Section analyzes the extent to which we should expect such commitment.

a. Management Commitment

There is reason to believe that directors and officers of benefit corporations will have, ex ante, greater commitment to social mission than those of traditional corporations. Benefit corporation law ensures that directors and officers will be on notice that a purpose of the benefit corporation is to pursue public benefit. So, benefit corporation managers will be aware of this goal and will ideally only choose to manage the corporation if they are committed to pursuing this goal. Moreover, initially, many benefit corporations will be managed by their founders who explicitly chose the benefit corporation form for their enterprise. The founders will likely be significantly committed to social mission. As the benefit corporation grows and management changes, this commitment could erode.

Nonetheless, consideration of nonprofit corporation governance gives reason to believe that benefit corporation managers may not always maintain unwavering commitment to social mission. Like benefit corporations, nonprofits also face a separation of benefit and control; the intended beneficiaries of nonprofits' social missions have no legal rights to impact decision making in the nonprofit.[230] Unlike benefit

[230] Nonprofits do not have shareholders. They may have "members," which are in many ways analogous to shareholders, but the nonprofit may choose who those members are and they need not represent the intended beneficiaries. *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(a)(4) (West 2006) (stating that a Delaware nonstock corporation (the corporate form for Delaware

corporations, nonprofits are formed solely for the purpose of pursuing a social mission and may not pursue private profit.[231] Employees of nonprofit corporations are prohibited from being compensated based on the profits of the organization,[232] and the IRS requires that nonprofit executive compensation be "reasonable and not excessive."[233] Managers of nonprofit firms are therefore expected to be more altruistic than managers of for-profit firms because the possibility of large compensation is eliminated, but they are incentivized by the knowledge that they are doing good.[234] Those seeking large financial compensation are disincentivized from managing nonprofit organizations. Nonetheless, extensive regulations exist to monitor the acts of nonprofit management and ensure that their financial resources are devoted to the nonprofit's mission.[235] This extensive regulation would not be necessary if nonprofit managers' altruistic tendencies were sufficient to ensure sustained commitment to the nonprofit's mission. Indeed, nonprofits are not infrequently found in violation of these regulations[236] and the total incidence of such violations is difficult to know given the limited enforcement resources available to police nonprofits.[237]

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nonprofits) must have members, but failing to have members will not adversely affect the existence of the corporation or the validity of its actions, and stating further that if the nonstock corporation's formative documents do not specify who the members are, those who elected the governing body will be deemed to be the members); N.Y. NOT-FOR-PROFIT CORP. LAW § 601(a) (McKinney 2015) ("A corporation shall have one or more classes of members, or, in the case of a charitable corporation, may have no members . . . .").

231 *See* I.R.C. § 501(c)(3) (2012).

232 *See* Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 838 (1980) ("A nonprofit organization is, in essence, an organization that is barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees.").

233 *See* 26 C.F.R. § 1.162-7(b)(3) (2018).

234 *See* Anup Malani & Erick A. Posner, *The Case for For-Profit Charities*, 93 VA. L. REV. 2017 (2007).

235 This regulation exists in the form of both IRS regulations and state nonprofit law.

236 *See, e.g.*, Karen W. Arenson, *Ex-United Way Leader Gets 7 Years for Embezzlement*, N.Y. TIMES (June 23, 1995), http://www.nytimes.com/1995/06/23/us/ex-united-way-leader-gets-7-years-for-embezzlement.html (describing conviction of the president of the United Way of America for fraudulently diverting $1.2 million of the charity's assets to himself); Sean Gardiner, *Charity's Former Chief Sentenced to Prison for Fraud*, WALL ST. J. (July 23, 2014, 9:10 PM), https://www.wsj.com/articles/charitys-former-chief-sentenced-for-fraud-1406132735 (describing the conviction of the former executive director of the Metropolitan Council on Jewish Poverty for stealing $3 million from the organization); John M. Goshko, *New York Regents Oust Board over Adelphi President's Role*, WASH. POST (Feb. 11, 1997), https://www.washingtonpost.com/archive/politics/1997/02/11/new-york-regents-oust-board-over-adelphi-presidents-role/c0beddf3-b9a6-477c-ad53-e4cafaf83352/?utm_term=.8c8d0459a48a (describing the New York Board of Regents' decision to remove the entire Board of Trustees of Adelphi University in reaction to the extraordinary compensation it had approved for the University's president).

237 *See* U.S. GOV'T ACCOUNTABILITY OFF., GAO-15-164, TAX-EXEMPT ORGANIZATIONS: BETTER COMPLIANCE INDICATORS AND DATA, AND MORE COLLABORATION WITH STATE REGULATORS WOULD STRENGTHEN OVERSIGHT OF CHARITABLE ORGANIZATIONS 20 (2014), http://www.gao.gov/assets/670/667595.pdf (citing declining funding for IRS oversight of tax

Benefit corporation managers have no similar restraints on their ability to financially benefit from the success of the firm and they also lack outside regulation to ensure commitment to social mission. Thus, while benefit corporation managers may be committed to social mission and derive utility from creating social good, the fact that they can potentially increase their financial returns by focusing instead on profit can be expected to offset their commitment to social good to some degree. This problem of competing incentives is exacerbated by the great flexibility granted to benefit corporation management in balancing the interests of their shareholder and non-shareholder stakeholders. The mandatory "general public benefit"[238] is extremely broad, as is the list of stakeholder interests that directors must consider.[239] Moreover, there is no requirement that managers prioritize social mission or non-shareholder stakeholder interests, and some states expressly state that prioritization is not required.[240]

The extraordinary flexibility afforded to benefit corporation management in determining how to simultaneously consider profit and social interests insufficiently distinguishes them from traditional corporations.[241] It gives them substantial leeway to focus on profit, or even their own narrower interests, without running afoul of their legal duties. The current benefit corporation structure creates a state of affairs that looks like the one that existed before the rise of institutional investors and the corresponding empowerment of shareholders—a state of affairs that caused scholars to worry that corporate managers were serving too many masters.[242] Professors Antony Page and Robert A. Katz commented on the great leeway afforded to benefit corporation boards saying, "[t]he early Berle might have characterized this as handing over power, 'with a pious wish that something nice will come

exempt organizations and its 2013 audit rate of 0.71% of tax exempt organizations); CINDY M. LOTT ET AL., URBAN INST., RESEARCH REPORT: STATE REGULATION AND ENFORCEMENT IN THE CHARITABLE SECTOR 33 (Sept. 2016), http://www.urban.org/sites/default/files/publication/84161/2000925-State-Regulation-and-Enforcement-in-the-Charitable-Sector.pdf (concluding that "resources devoted to charities oversight [at the state level] are minuscule compared with the oversight they are expected to provide").

238 Delaware Public Benefit Corporation Law does not include this concept and requires Delaware PBCs to choose a specific public benefit. DEL. CODE ANN. tit. 8, § 362(a) (West 2006).

239 *See* MODEL LEGISLATION, *supra* note 8, §§ 102, 301(a).

240 *See* Brakman Reiser, *Theorizing Forms*, *supra* note 12, at 697.

241 *Id.* at 692 ("This generic command to 'do both' insufficiently distinguishes specialized forms from ordinary for-profit entities."). Professor Sarah Dadush has written on the dangers of "blueprinting" in the social enterprise context, which she defines as "when a new market, such as the market for social finance, is created based on a template that is set by an already-existing market, such as the market for conventional finance." Dadush, *supra* note 221, at 173. Blueprinting has arguably hindered benefit corporations' efficacy by borrowing too directly from the traditional shareholder-focused corporate structure. *Id.* at 173–74.

242 *See supra* Section I.A.

out of it all.'"[243] Past efforts at corporate social responsibility reform have failed because they insufficiently resolved how corporate managers should simultaneously fulfill legal obligations to multiple stakeholders.[244] Benefit corporation legislation liberates managers to consider a wide array of stakeholder interests, but provides no additional guidance on how to manage or prioritize the various groups.

b. Shareholder Commitment

Consistent with the traditional corporate governance structure, the enforcement of benefit corporation management's duties falls to the shareholders. They are empowered with all the rights that shareholders enjoy in traditional corporations—electing directors, voting on major transactions, inspecting books and records, and filing derivative suits.[245] However, distinct from traditional corporations, benefit corporation managers are obligated to consider the impact of their actions not only on the corporation and its shareholders, but also on an array of other stakeholders who are intended to be the beneficiaries of the benefit corporation's social mission.[246] The discussion above highlights the competing incentives that could diminish a manager's commitment to social mission. If management commitment is insufficient, it then falls to the shareholders to enforce this commitment. To empower them to do so, benefit corporation shareholders have an additional right to bring a "benefit enforcement proceeding" against the corporation if they believe the business has failed to pursue or achieve its social mission, though to do so, shareholders would incur substantial costs.[247]

As noted above, most benefit corporations are currently small companies that are privately owned, and therefore their ownership and management structures are not publicly available information. In a small, privately owned benefit corporation, it may well be the case that there is substantial overlap among the officers, directors, and shareholders. That is, the founders of the benefit corporation may run the company as executives, serve on the board, and own substantial proportions of stock. In that scenario, the shareholders cannot be effective enforcers of mission because they are the same people as the management they are supposed to be monitoring. So as a preliminary matter, in small, closely held benefit corporations, where management and shareholders are the same individuals, shareholders will not effectively enforce commitment to social mission where management's

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243 Page & Katz, *supra* note 51, at 1369 (quoting A.A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365, 1368 (1932)).

244 Wells, *supra* note 2, at 122–23.

245 *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 211–12, 220, 251(c), 327 (West 2006).

246 *See* MODEL LEGISLATION, *supra* note 8, § 301.

247 Brakman Reiser, *Theorizing Forms*, *supra* note 12, at 715–16.

commitment lags. However, in granting shareholders rights as "social mission enforcers," the Model Legislation clearly contemplates benefit corporations seeking equity capital from outside the corporation.

As discussed in Section III.B.3 above, even in traditional corporations, most shareholders do care about outcomes other than share price. They care about how corporate actions affect their own lives and they are prosocial, meaning that, to an extent, they care about how corporate actions affect others. In spite of this, shareholders in traditional corporations regularly act to promote share price maximization. Much like benefit corporation managers, benefit corporation shareholders will be aware that they are investing in an entity that counts its social mission among its corporate purposes. It is likely that they will often be investors who are specifically seeking to invest in organizations with a commitment to the greater good. The likely result is that benefit corporation shareholders will have a somewhat greater willingness to act to promote non-share price outcomes as compared to traditional shareholders.[248]

Nonetheless, benefit corporation shareholders will face the same obstacles as their traditional counterparts in identifying and measuring public benefit.[249] They will have the advantage of receiving an annual benefit report from management.[250] While this report must include "[a]n assessment of the overall social and environmental performance of the benefit corporation . . . reported against a third-party standard[,]"[251] there is no one standard for measuring public benefit, and the benefit corporation is responsible for applying the standard to its own actions. The Model Legislation specifically states that no third party needs to audit or certify the benefit corporation's assessment of its social performance.[252] While profit and share price can always be easily measured and compared, social contribution is much more subjective. Moreover, an initial study showed that less than ten percent of a sample of benefit corporations actually complied with this requirement and produced a benefit report.[253] It is easy to imagine shareholders being satisfied by a situation where profits are high and a minimal level of social good is being provided even when sacrificing some amount of revenue could result in substantially greater public benefit, especially when social mission enforcement is costly. Indeed, evidence suggests that benefit corporation shareholders do not even demand compliance

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248 *Id.* at 716.

249 *See id.* at 716–17.

250 MODEL LEGISLATION, *supra* note 8, § 401(a).

251 *Id.* § 401(a)(2).

252 *Id.* § 401(c) ("Neither the benefit report nor the assessment of the performance of the benefit corporation in the benefit report required by subsection (a)(2) needs to be audited or certified by a third party.").

253 *See* Murray, *supra* note 11, at 34–35.

with basic reporting requirements on social impact.

Moreover, while benefit corporation shareholders can be expected to have a higher-than-average commitment to social mission, so will the managers, as pointed out above. There is no reason to believe that the additional social commitment of shareholders will be greater than that of officers or directors. If both management and shareholders are, on average, equally committed to social mission, it is difficult to see how shareholders will be effective enforcers.

Campaign GM from the 1970s is a telling example of presumably socially minded shareholders failing to promote corporate social accountability. Inspired by Ralph Nader's writing about GM's lax safety standards,[254] a group of activists purchased shares of GM and put forth several shareholder proposals intended to reorient GM's corporate mission toward greater social welfare.[255] To counter these proposals, GM distributed brochures highlighting the corporation's existing commitment to social involvement.[256] Campaign GM's shareholder proposals were decisively rejected by shareholders. A number of socially motivated shareholders voted against these proposals, including Harvard University, Columbia University, and the Rockefeller and Carnegie Foundations.[257] These shareholders were presumably investing in GM for financial return, but they were also social mission–driven organizations. Nonetheless, faced with Campaign GM's proposals for increased social accountability, they declined to vote for additional steps to make GM more socially responsible. Thus, in this example, a handful of activist shareholders willing to take on the high costs of social activism, and a shareholder base that included social mission–driven shareholders, was insufficient to overcome the status quo level of corporate commitment (or lack thereof) to social responsibility.

Benefit corporations will face the same obstacles confronted by Campaign GM, and they may not have activist shareholders willing to incur the costs of an enforcement campaign. Thus, while benefit corporation shareholders can be expected to exhibit a greater commitment to social mission than traditional shareholders, on balance, it is unlikely that that additional commitment will translate into meaningful promotion of social mission.

c. Lack of Beneficiary Input

In light of the conflicting interests of benefit corporation managers and shareholders described above, the most significant impediment to

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254 *See* Wells, *supra* note 2, at 115 (citing RALPH NADER, UNSAFE AT ANY SPEED: THE DESIGNED-IN DANGERS OF THE AMERICAN AUTOMOBILE (1965)).

255 *Id.* at 115–16.

256 *Id.* at 116.

257 *Id.* at 116–17.

benefit corporations' pursuit of social mission is the lack of input from the intended beneficiaries of benefit corporations' social missions.[258] As noted above, beneficiaries' separation from "control" is much greater than that of shareholders because they have no rights to influence corporate action. The lack of input from beneficiaries to hold benefit corporations accountable to their commitments will increase the likelihood that the benefit corporations and their shareholder watchdogs will not prioritize commitment to social mission. Even a sincere commitment to doing good is often not sufficient to create that good.

Benefit corporation managers and shareholders can be expected to have varying degrees of commitment to social mission. In the seemingly likely cases where that commitment level results in a suboptimal level of social good, the failure by managers to pursue and shareholders to effectively enforce social mission would fall into one of three broad categories, listed from most pessimistic to most optimistic:

1. Managers and shareholders are simply selfish. Managers pursue their own interests and shareholders only use their shareholder rights to promote their own financial interests.
2. Managers and shareholders monitor social outcomes but are only willing to act to pursue or enforce social mission if it would cost them very little.
3. Managers and shareholders diligently pursue, monitor, and enforce social commitment but do so ineffectively because they are not aware that the benefit corporation's mission-driven actions are not actually producing meaningful social good.

The managers and shareholders of a given benefit corporation could fall into more than one of these categories. However, any one of these categories or any combination of them would result in a suboptimal social return, regardless of the intentions of the managers and shareholders. Meaningful input from the benefit corporation's intended beneficiaries, if implemented properly, could improve social outcomes in each of these scenarios.

Beneficiary input would improve social outcomes when managers and shareholders are in categories one and two by reducing the "social distance" between the beneficiaries and the people who are making decisions for the benefit corporation. As noted in Section III.B.3 above,

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258 This problem is exacerbated by the exceedingly broad mandate that benefit corporations pursue "general public benefit." MODEL LEGISLATION, *supra* note 8, § 201(a). This level of generality makes it nearly impossible to identify who should be benefitting from the benefit corporation's actions. However, for the purposes of this analysis, we will assume that benefit corporations choose an identifiable specific beneficiary whom they intend to help through their corporate action.

the vast majority of humans are to some extent, prosocial. Reducing the social distance between people can encourage prosociality. For instance, research demonstrates that people are more likely to cooperate with each other when they are able to see, speak with, or even just learn the names of the people with whom they are asked to cooperate.[259] Particularly relevant to benefit corporations, reducing social distance has also been shown to promote "volunteering," where this term is defined as individuals bearing a cost so that a public good can be provided.[260] People have been shown to be more likely to "volunteer" on behalf of others who are socially or psychologically close to them.[261] In benefit corporations, managers and shareholders are asked to "volunteer"[262] their efforts on behalf of beneficiaries who are left entirely outside of the decision making process. If beneficiaries were involved directly in the affairs of the benefit corporation, they would be more socially and psychologically close to the managers and shareholders. This could increase the willingness of managers and shareholders in categories one and two to expend more effort to promote social mission.

Beneficiary input would similarly improve social outcomes in category three because the benefit corporation would quickly become aware that its efforts at producing social good were not effective. Managers and shareholders in category three are willing to help in spite of cost and social distance, but lack adequate information about the effectiveness of their efforts.

A widely publicized example of a category three problem is the controversy surrounding TOMS Shoes' social impact. One of the earliest and most well-known social enterprises, TOMS Shoes is a Delaware LLC[263] with a public commitment to a "one for one" model whereby products purchased from TOMS result in the donation of a related product or service to people in need. Initially, this was one pair of shoes donated for each pair purchased.[264] Concerns eventually arose about these donations displacing local shoemakers in the communities where

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259 *See* STOUT, *supra* note 213, at 101.

260 Joachim I. Krueger et al., *Expectations and Decisions in the Volunteer's Dilemma: Effects of Social Distance and Social Projection*, 7 FRONTIERS PSYCHOL. 1 (2016), https://www.frontiersin.org/articles/10.3389/fpsyg.2016.01909/pdf.

261 *Id.* at 4.

262 Managers and shareholders are, of course, not volunteering in the most conventional sense since managers are compensated and shareholders stand to receive a financial return from their status as shareholders. However, when benefit corporations ask these individuals to expend effort or costs to benefit others, they would likely suffer no adverse consequences from *not* expending that effort or cost; they are, in the sense described here, "volunteering" to promote a social mission.

263 *Toms Shoes, LLC*, OPENCORPORATES, https://opencorporates.com/companies/us_de/4918922 (last updated Feb. 23, 2018) (citing the Delaware Department of State: Division of Corporations).

264 *Improving Lives*, TOMS, http://www.toms.com/improving-lives (last visited Apr. 5, 2018).

the donations are made.[265] TOMS responded by sourcing its shoes from Haiti.[266] Since its founding, TOMS has expanded to offer additional products, and thus additional donations, such as a free eye exam for a person in need with the purchase of a pair of sunglasses.[267] However, concerns persist about whether TOMS is really addressing the most important needs of the recipients of their donations.[268]

Ultimately, a company cannot be certain of how its actions are affecting its beneficiaries without the beneficiaries' input. The sooner and more effectively a benefit corporation can receive this input, the sooner they can adjust their activities to do more good. This is why involving beneficiaries in corporate decision making would both reduce social distance and increase social returns.[269] A proposal for how benefit corporations can effectively receive and use beneficiary input is the topic of the next Part.

V. A PROPOSED SOLUTION: PUBLIC BENEFIT PLANS

To ensure benefit corporations effectively pursue their social missions and create real social good, they must overcome the separation of benefit and control. To do this, the intended beneficiaries of benefit corporations' social missions must have some rights to influence the decision making that affects social mission commitment. With such rights, control over the provision of social good is no longer entirely separate from the beneficiaries who are intended to receive the social good, and the resulting agency costs are reduced.

In developing a theory of social enterprise forms, Professor Dana Brakman Reiser argues that in order for any stakeholder (shareholder or otherwise) to enforce a social enterprise's commitment to social mission the stakeholder must have three things: (1) access to information about the provision of the benefit; (2) rights to challenge the decisions made that affect the provision of the benefit; and (3) incentives to use those rights to enforce the enterprise's commitment to the benefit.[270]

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265 *See* Jonathan Favini, *Some Bad News About Tom's Shoes*, WORDPRESS.COM: HONEST IMPRESSIONS (Mar. 22, 2013), https://johnfavini.wordpress.com/2013/03/22/some-bad-news-about-toms-shoes; *Free Two Shoes*, ECONOMIST (Nov. 5, 2016), http://www.economist.com/news/finance-and-economics/21709563-new-studies-should-cool-warm-glow-surrounding-shoe-donations-free-two-shoes.

266 *See* Amy Costello, Opinion, *Toms Shoes a Hit at Oscars, but Does Shoe Giveaway Hit the Mark?*, NPR (Mar. 3, 2016, 11:08 AM), http://www.npr.org/sections/goatsandsoda/2016/03/03/468955265/toms-shoes-is-a-hit-at-oscars-but-does-its-shoe-giveaway-hit-the-mark.

267 *Id.*

268 *Id.*

269 *See* Dadush, *supra* note 221, at 176–77 ("[I]t makes little sense to rate or assess the social impact of a business without taking the feedback from those whose lives are supposed to be positively impacted into account.").

270 Brakman Reiser, *Theorizing Forms*, *supra* note 12, at 718.

The intended beneficiaries of benefit corporations' social missions inherently have the first and third requirements. Beneficiaries know better than anyone whether and how well the benefit is being provided. Moreover, they need not be given artificial incentives to enforce the commitment because they are naturally incentivized by the fact that they are the intended recipients of the benefit. Thus, under Professor Brakman Reiser's framework, the only change that needs to be made for beneficiaries to effectively enforce commitment is to give them the rights to challenge the decisions made that affect the provision of the benefit. Benefit corporations can effectively empower beneficiaries to challenge decisions about social commitment if they are required to work with their beneficiaries to produce an ex ante Public Benefit Plan. A broad outline of how a Public Benefit Plan requirement would work is presented below. It is followed by a more detailed assessment of the advantages of the Plan and several important issues that would benefit from further debate and consideration.

Creation of the Public Benefit Plan. A benefit corporation's Public Benefit Plan would be co-authored by its management and representatives of the beneficiary class. It would then be subject to shareholder approval. It would lay out either concrete steps that the benefit corporation will take or guidelines that it will follow to ensure that in the operation of its business, it is contributing adequate social good for its beneficiaries. The result should be a Plan that is satisfactory to both the benefit corporation and the beneficiary representatives.

Timing Requirements. The benefit corporation would be required to have a Plan in force within a certain time period after incorporation as or conversion to a benefit corporation. The Plan would remain in force for a set period of time—one to several years—though while the Plan is in force, the parties could renegotiate provisions that are not working well in practice. At the end of the term, the parties could renew or renegotiate the Plan for an additional term, or they could choose not to do so if the partnership has not been fruitful. If the Plan is not renewed, the benefit corporation would be required to find a new beneficiary class or representative and produce a new Public Benefit Plan within a set time frame. A failure to have a Plan in place at the required times would cause the company to lose its benefit corporation status.

Enforcement. The representative beneficiaries would be entitled to some enforcement mechanism if they believe that the benefit corporation is not complying with the Plan. Options for such a mechanism are discussed in more detail below.

It is important to note that in order to implement this proposal, it will be necessary for benefit corporations to choose a "specific public benefit" and not only pursue the "general public benefit" required by the Model Legislation. When Delaware implemented its Public Benefit

Corporation Law in 2013, it independently introduced this change on the reasoning that it would provide more clarity and focus to benefit corporation leaders.[271] This is a positive development.[272] While pursuing a general public benefit is admirable, as discussed above, it leaves management with too much discretion and blurs the distinction between benefit corporations and traditional corporations. Under this Public Benefit Plan proposal, benefit corporations would specify a specific public benefit and then locate a representative beneficiary of that specific social mission to participate in drafting and monitoring the Public Benefit Plan.

A. *Creation of the Public Benefit Plan*

The Public Benefit Plan's most fundamental contribution is that it would drastically reduce the separation of benefit and control because it would give beneficiaries a measure of control over corporate decision making that affects them. At the same time, it ameliorates an important ambiguity that has likely made direct beneficiary involvement unattractive to social entrepreneurs to date.

The most plausible explanation for why non-shareholder stakeholders currently do not have governance rights in benefit corporations is the risk it would create for the benefit corporation, its management, and potentially its shareholders.[273] If beneficiaries were

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271 *See* J. Haskell Murray, *Social Enterprise Innovation: Delaware's Public Benefit Corporation Law*, 4 HARV. BUS. L. REV. 345, 355 (2014). The Delaware statute requires that the specific public benefit be pursued, but that it be balanced against stockholders' pecuniary interests and the interests of those affected by the benefit corporation's conduct. DEL. CODE ANN. tit. 8, § 365(a) (West 2006) ("The board of directors shall manage or direct the business and affairs of the public benefit corporation in a manner that balances the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct, and the specific public benefit or public benefits identified in its certificate of incorporation."). The social purpose corporation, which is an alternate social enterprise corporate form adopted by a few states, also requires that the corporation choose one or more specific purposes to pursue. *See* BRAKMAN REISER & DEAN, *supra* note 10, at 64–65.

272 *See* Murray, *supra* note 271, at 356 ("[R]equiring PBCs to identify a specific public benefit purpose is a positive change, which will likely aid directors in decision-making and may allow shareholders and courts to create some level of accountability for directors.").

273 Alicia E. Plerhoples, *Social Enterprise as Commitment: A Roadmap*, 48 WASH. U. J.L. & POL'Y 89, 128 (2015) ("[T]here are risks in granting enforcement rights to non-stockholder stakeholders. Stakeholders consist of heterogeneous groups with their own agendas to advance. For example, employees' interests in living wages and health benefits may be in conflict with customers' interests in keeping prices low. Each stakeholder group will have their own agendas to advance. The directors of a hybrid corporation must carefully consider whether to grant enforcement proceeding rights to representatives from all or particular groups of stakeholders."). Nonetheless, some scholars are continuing to work on formulating ways to make stakeholder representation on governance boards work. *See generally* Dadush, *supra* note 221, at 218 (discussing the implementation of a "social director"); Murray, *supra* note 70, at 64 (discussing the creation of stakeholder advisory boards).

granted governance rights that conveyed real, meaningful power to influence corporate decision making, they might do so in a way that negatively affects or displeases the benefit corporation's leaders or shareholders.[274] Because the benefit corporation statutory language is very broad and the fiduciary duties of benefit corporation managers have not been addressed in court, substantial ambiguity exists about the extent to which benefit corporation management must work to pursue social mission. If beneficiaries were empowered to initiate benefit enforcement proceedings, this ambiguity would create a great deal of risk of litigation by either disgruntled or opportunistic beneficiaries.[275] If, instead, the beneficiaries' governance rights are more cosmetic, they would not be effective in improving social outcomes. With these considerations in mind, it is unsurprising that social entrepreneurs have not been eager to put forth requirements that beneficiaries be directly involved in day-to-day governance or enforcement of mission.

The Public Benefit Plan proposal ameliorates this concern because it forces management and the beneficiaries to elucidate their mutual expectations ex ante, reducing the likelihood of unforeseen conflict in the future.[276] While benefit corporation leaders may lack clear statutory language or common law precedent to clarify exactly what their duties to beneficiaries are, they can provide that clarity privately by creating a Public Benefit Plan that lays out both parties' expectations. Moreover, the Plan would not be mutually exclusive with beneficiary representation on the board or as shareholders. So, while the Public Benefit Plan allows for beneficiary input without granting day-to-day governance rights to beneficiaries, it also does not foreclose the possibility of simultaneously granting beneficiaries additional rights.

In addition to providing clarity about management's obligations, the Public Benefit Plan would also resolve the challenges that benefit corporations have faced in measuring their social impact. The Model Legislation requires that benefit corporations report on the ways in which they have pursued their social mission, and the extent to which they succeeded in providing social good.[277] However, social enterprise scholars have highlighted the weaknesses of benefit corporations' current reporting requirements, pointing to the lack of an objective

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274 *See* Murray, *supra* note 70, at 89 (acknowledging that having stakeholder interests represented directly on the board "may cause internal discord and fighting among the firms' directors.").

275 *Id.* at 84 ("Individual stakeholder enforcement rights, however, could lead to excessively expensive litigation and could disrupt the functioning of firms by encouraging peripheral stakeholders to adopt an adversarial stance against their firms.").

276 Admittedly, the Plan would not eliminate the possibility of future conflicts. However, as transactional attorneys are well aware, while a written agreement may never represent an ironclad "meeting of the minds," a thoughtful written agreement provides a great deal more certainty than an unwritten "understanding" between parties.

277 MODEL LEGISLATION, *supra* note 8, § 401(a).

standard to measure social good.[278] Moreover, the sheer diversity of social missions that benefit corporations may pursue exacerbates the challenge of developing an adequate standard. The Public Benefit Plan could serve as a metric, customized to the particular benefit corporation, against which the benefit corporation and its various stakeholders could measure its success. Benefit corporations could report on the extent to which they have met the goals of their Public Benefit Plans. Shareholders and other observers would then review the report with increased confidence that the goals set forth are ones that are valued by the beneficiaries.

An important question that warrants further discussion is who would constitute an adequate beneficiary representative? This question would be particularly difficult where the social mission involves the environment. In that case, a representative from an environmental organization would likely need to be involved. Where the intended beneficiaries are human, further consideration is required as to how to define "representative" and whether a nonprofit serving the beneficiaries' interests would suffice. A tension arises in considering this question between accountability and social distance. A nonprofit would have the benefit of both institutionalized processes for providing and measuring social benefits, and a legal purpose and obligation to pursue those benefits. Nonetheless, inserting another intermediary between the beneficiaries and the benefit corporation increases social distance and could make the benefit corporation less aware of the ultimate effect of its actions on its intended beneficiaries. Choosing one or more individual beneficiaries as representatives would substantially reduce or eliminate social distance. However, the selected individuals may not be able to adequately represent the entire group, and could be more susceptible to information asymmetries and influence by the benefit corporation's preferences. Fortunately, scholars have already given attention to this question, pointing out the need for a contextual analysis depending on the benefit provided.[279]

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278 *See, e.g.*, Brakman Reiser, *Benefit Corporations*, *supra* note 11, at 617 ("[T]he delegation to third-party standard-setters to vet this public benefit and the lack of a statutory floor for what counts as public benefit make low standards and greenwashing particular concerns for the benefit corporation."); Murray, *supra* note 11, at 48 ("[T]he benefit reporting requirements are quite general and vague, merely requiring a narrative description of the ways the public benefit was pursued, created, and hindered.").

279 *See* Plerhoples, *supra* note 273, at 128 ("Who comprises the group of stakeholders would be entirely context dependent. The stakeholders empowered with enforcement rights might be the individual, community, or nonprofit beneficiaries that the social enterprise seeks to help. Directors might also look outside of stakeholder groups to subject-matter experts, such as representatives of independent nonprofits working in the same field."); *see also* Murray, *supra* note 70, at 99 ("[R]epresentatives could be nominated and elected by the groups they represent. Employees or customers could elect community and environmental representatives, or one or more appropriate nonprofits could provide an identifiable voting group."); BRAKMAN REISER & DEAN, *supra* note 10, at 41 (describing the role of charities in their proposed "Mission

B. *Timing Requirements*

Mandating strict timing requirements for having a Plan in place, coupled with the automatic forfeiture of benefit corporation status, serve to improve beneficiaries' bargaining power while requiring very limited additional government oversight.[280]

Without a requirement that benefit corporations always have a Plan in place, beneficiaries would have very little, if any, bargaining power in drafting the Plan because they are essentially receiving free benefits from the benefit corporation. However, it would be costly and inconvenient for the benefit corporation if negotiations broke down and they had to identify new representative beneficiaries and negotiate a new Plan before the deadline to have one in place. Once the benefit corporation has identified its representative beneficiaries and begun negotiations, they have sunk costs in the process and are incentivized to bargain meaningfully with the beneficiaries for a mutually beneficial Plan. Moreover, a breakdown of negotiations very close to the deadline would put the benefit corporation at risk of losing its benefit corporation status. Status as a benefit corporation is presumably meaningful to a company that chooses that form over the traditional corporate form, and therefore, loss of the status can be expected to serve as a deterrent.

Moreover, benefit corporation statutes have been widely adopted by state legislatures in large part because they impose no additional costs on the government.[281] Some commentators have proposed government oversight of benefit corporations, but simultaneously acknowledge that this route to improved enforcement is not feasible because states do not have the additional resources to devote to a new regulatory role.[282] The Public Benefit Plan is an enforcement mechanism that imposes very minimal additional costs on the government and should therefore not substantially interfere with states' enthusiasm for making this entity available to social entrepreneurs.

The automatic forfeiture of benefit corporation status raises important questions about how best to protect shareholders' rights to avoid this result. The Model Legislation consciously sets a high bar to abandon a company's benefit corporation status, requiring a two-thirds

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Protected Hybrid" organizations).

280 This method has seen some success in the United Kingdom, where the government regulator of Community Interest Corporations (CIC) regularly removes organizations from the CIC register for failure to file. *See* Dadush, *supra* note 221, at 160–61.

281 *See* Haskell Murray, *Benefit Corporations: What Am I Missing—Seriously?*, LPB NETWORK: BUS. L. PROF BLOG (Feb. 23, 2015, 1:16 PM), http://www.lawprofessors.typepad.com/business_law/2015/02/benefit-corporations-what-am-i-missing-seriously.html.

282 Brakman Reiser, *Theorizing Forms*, *supra* note 12, at 720–22; *see also* Plerhoples, *supra* note 11, at 566–68.

supermajority shareholder vote to terminate benefit corporation status.[283] Automatic forfeiture of benefit corporation status for failure to comply with the Public Benefit Plan requirements would, in effect, allow management to terminate benefit corporation status without the requisite shareholder vote. Further consideration is required to devise adequate rights or remedies for shareholders to avoid this outcome.

C. *Enforcement*

Another key question for further discussion is how beneficiaries will be empowered to enforce the terms of the Plan.

The first step in enforcement is enforcing the requirement that the benefit corporation engage beneficiaries to create the Plan. Evidence collected to date indicates that benefit corporation shareholders do not effectively enforce the obligation to prepare thorough annual benefit reports,[284] so they cannot be expected to enforce the obligation to prepare a Public Benefit Plan. It will therefore likely be necessary to require that the Public Benefit Plan be filed with a state authority since benefit corporation shareholders have demonstrated very little will to enforce benefit corporations' existing reporting requirements. Nonetheless, the state's role could be limited to ensuring that it is faithfully prepared and filed in a timely manner.

Once the Plan is in place, the beneficiaries would be empowered to monitor compliance with the Plan. If the beneficiaries do not believe the Plan is being adequately implemented and the benefit corporation fails to remedy the situation, several possible enforcement mechanisms warrant discussion:

1. The beneficiaries could simply be entitled to walk away if they are displeased, either during the term of the Plan or at the end of the term. This would impose costs on the benefit corporation because they would be required to find new beneficiary representatives within a statutorily mandated time frame or risk losing their benefit corporation status.
2. The Public Benefit Plan could be an enforceable contract, and the beneficiaries would therefore have a right to sue to enforce its terms. This would likely only be effective if the beneficiary representative were an organization, as individuals would often lack the resources to bring such a suit.
3. Under the existing framework, shareholders would have the right to bring a benefit enforcement action in the event the

283 MODEL LEGISLATION, *supra* note 8, § 105(a).
284 *See* Murray, *supra* note 11, at 44.

beneficiaries are not satisfied with the relationship. It is worth further consideration whether the beneficiaries themselves should also have this right, but with the realm of possible claims limited to a failure to abide by the Plan.

For the second and third options, additional consideration is required as to the remedies available to the beneficiaries. Injunctive relief would appear a judicious option as the goal of this proposal is to ensure that benefit corporations do, in fact, act in a way that provides social good. Thus, a remedy that forces them to take such actions seems particularly fitting. Large monetary rewards should be avoided in this instance because, again, the goal is to influence the actions of benefit corporations so that they provide meaningful social good. Financially strained or bankrupt benefit corporations will not be able to provide social good.[285] Nonetheless, fee-shifting of the beneficiaries' legal costs, or the reimbursement of clear, measurable costs to the beneficiaries seem appropriate.

D. *Concluding Thoughts: In Furtherance of the Relevance of Benefit Corporations*

This Article seeks only to present the broad outline of the Public Benefit Plan as a starting point for further discussion. The description above highlights several substantial issues that will need to be resolved before this proposal could be functional, though it offers several options for resolving each. Further discussion and consideration of this proposal would surely bring forth additional questions and ideas, and the ensuing discussions would serve to improve and strengthen the proposal. Moreover, individual states would be free to implement a Public Benefit Plan requirement in the manner they think will be most effective, and states could thereby act as laboratories to test different formulations of the Public Benefit Plan requirement. Nonetheless, in spite of its preliminary status, this proposal has the potential to increase benefit corporations' effectiveness and therefore their long-term relevance.

Benefit corporations exist because of a desire to create businesses that deliver real positive social contributions. If they cannot do this, the purpose of the entity disappears. Engaging benefit corporations directly with their intended beneficiaries reduces the social distance between the benefit corporation and those they aim to serve, which will increase accountability and efficacy. Feedback directly from beneficiaries will provide the benefit corporation with a direct and accurate evaluation of their success that cannot be matched by third party enforcers.

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285 *See* BRAKMAN REISER & DEAN, *supra* note 10, at 46 (describing the many reasons that stakeholders have to avoid litigation).

Requiring a Public Benefit Plan would undoubtedly place additional burdens on benefit corporation managers, but this additional burden would serve as a useful screen to ensure that those choosing to operate benefit corporations have sufficient willingness to do the work required to balance social mission and financial return. If a minority of benefit corporation states requires the Plan, prospective benefit corporation leaders may forum shop and incorporate in a jurisdiction that does not require the Plan. Similarly, under the current proposal, a benefit corporation that was not willing to devote resources to meeting the Plan requirements could let the Plan lapse and revert to a traditional corporation, thereby abandoning its benefit corporation status. However, these opportunities for managers to avoid the Plan requirement are a strength rather than a weakness of the proposal. Business leaders who are unwilling to engage with their beneficiaries to ensure they are accomplishing their social missions are unlikely to exhibit the necessary level of commitment to actually provide meaningful social benefit. The long-term relevance of benefit corporations depends on their ability to produce real social returns and thus distinguish themselves from traditional corporations. If benefit corporations are managed by people unwilling to commit to ensuring they are providing social returns, they will not do so. Therefore, requiring beneficiary input via a Public Benefit Plan will increase the likelihood that benefit corporations succeed in their goals and persist as a relevant and effective form of social enterprise.

CONCLUSION

The creation of benefit corporations is an important and admirable experiment in creating businesses committed to doing good and avoiding the negative social effects of share price primacy. It is the product of the first successful effort to amend state corporation law to include a governance framework intended to promote corporate social responsibility. Because it is a meaningful legal innovation, it is worthwhile to closely examine the structure and ensure it has the maximum beneficial effect and that it survives as an entity that distinguishes itself from traditional corporations by its successful promotion and accomplishment of social mission.

The incremental nature of the benefit corporation form has assisted it in becoming the most popular dual-purpose entity available to social entrepreneurs, but it also results in a structure that is unlikely to ensure meaningful commitment to and accomplishment of social mission. Benefit corporations rely heavily on shareholders to enforce their commitment to social mission, which is counterintuitive given benefit corporations' stated aim to overcome shareholder primacy.

Benefit corporation shareholders will face many of the same impediments to socially beneficial action that traditional shareholders face, and the intended beneficiaries of the social mission created by the benefit corporation are left out of the decision making process.

Benefit corporations will be more likely to succeed in producing substantial social good if they require participation by beneficiaries in corporate decision making. Beneficiaries can effectively be involved in corporate decision making, at little to no additional cost to the government, through their role in developing and monitoring a Public Benefit Plan. This arrangement will usefully clarify the expectations of both the benefit corporation and its beneficiaries with respect to how and to what extent the benefit corporation will pursue social mission. It will reduce the social distance between the benefit corporation and its beneficiaries, and therefore result in the more effective provision of social benefits.