DOES SOCIAL ENTERPRISE LAW MATTER?

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ABSTRACT

Social enterprise laws are sweeping through the nation. Entrepreneurs can now organize under one of several new legal forms, including the benefit corporation form. In theory, these options will make it easier for socially minded firms to pursue a double bottom line of profit and public benefit—that is, to do well while doing good.

This Article tests that theory. In asking whether social enterprise laws matter, I find that the answer is "yes," but not for the reasons most people think. The standard rationale for social enterprise laws is that they free managers from the "duty" to put profits ahead of social objectives. But that idea misses the point; existing corporate law is already flexible enough to permit most social/economic tradeoffs. Instead, I argue that social enterprise laws add value by creating a new institutional structure that will motivate the development of self-regulatory standards and provide a helpful coordinating mechanism for legal advisors and pro-social investors. The Article thus offers a unique way of thinking about social enterprise laws. Rather than simply provide new off-the-rack legal forms, these laws encourage a process of norm creation and private engagement that ought to drive the social enterprise movement forward. I conclude by offering firms and lawmakers several strategies to reinforce this dynamic.

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INTRODUCTION

Everyone poops.[1] Not everyone turns poop into profit. Sanergy is one company that does. Recognizing that 4.1 billion people lack access to adequate sanitation, which leads to disease causing 1.7 million deaths each year, Sanergy builds and franchises low-cost, pay-per-use sanitation

1. *See generally* TARO GOMI, EVERYONE POOPS (2001).

systems called "Fresh Life Toilets."[2] But Sanergy goes beyond simply providing a new toilet option. In addition to improving sanitation, the proprietary design of Sanergy's system makes it easy to collect waste and convert it to electricity or fertilizer.[3] These are two much-needed commodities in Africa, where Sanergy operates, that the company's franchisees can then take and sell on the open market. This set-up allows Sanergy's model to improve sanitation while strengthening the African agricultural industry and making energy more affordable.

In one sense, Sanergy is just like any other business that has carved out a unique market niche. However, the company is actually something more: a social enterprise.[4] The prototypical social enterprise is a for-profit firm that relies on market-based strategies and techniques to advance a specific social mission. Put another way, it is a company that seeks to do "well" (financially) while doing "good" (socially).

Firms matching this description are not new—and others to receive the social enterprise label include Patagonia, Plum Organics, and TOMS Shoes—but social enterprise as a distinct category of activity has only recently come to the fore. Most notably, within just three years, strong political support on the left and right has led to several new laws meant to assist social enterprises in their dual objectives. My focus is on the most popular of these laws—benefit corporation statutes—that are now on the books in twenty-six states, including Delaware, and on the agenda in eight more.[5]

Benefit corporation statutes differ slightly from state to state, but their primary attributes remain the same: they authorize a new class of corporation that must (1) create a public benefit, (2) direct managers to consider non-financial interests when making business decisions, and (3) comply with specific standards for accountability and transparency.[6] Proponents argue that these provisions enable social enterprises to navigate a legal environment that is often seen as hostile to managers who pursue any goal other than profit maximization.[7] They also believe the form provides branding value that will make it easier to attract the growing

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2. *The Sanergy Model*, SANERGY, http://saner.gy/our-work/the-sanergy-model (last visited Apr. 22, 2014).

3. *See* Jonathan Kalan, *The Silicon Valley of Shit: Nairobi Is Ground Zero for Sanitation Innovation*, GOOD (Nov. 18, 2011, 2:30 AM), http://www.good.is/posts/the-silicon-valley-of-shit-nairobi-is-ground-zero-for-sanitation-innovation.

4. As I note later, so far Sanergy has not chosen to organize as a benefit corporation.

5. *State by State Legislative Status*, BENEFIT CORP INFO. CENTER, http://www.benefitcorp.net/state-by-state-legislative-status (last visited Jan. 13, 2015).

6. Dana Brakman Reiser, *Benefit Corporations—A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591, 597–603 (2011).

7. *See generally* J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*, 2 AM. U. BUS. L. REV. 1 (2012).

number of socially oriented investors, consumers, and employees.[8] The countervailing response has been swift and strong. Critics maintain that benefit corporation laws are either ineffectual or unnecessary, or that they create a false dichotomy that will set back efforts to convince traditional firms to care more about their social footprints.[9]

In this Article, I advance the debate by showing how proponents and critics are both wrong about the import of this species of social enterprise law. Proponents miss the mark when they argue that benefit corporation laws are necessary to enable firms to put social goals on par with profits. Indeed, corporate law already provides entrepreneurs with much of what the benefit corporation form claims to offer. Yet critics are also wrong to portray these laws as inconsequential or harmful. Rather than undermine corporate social responsibility efforts at existing firms, it is just as plausible that the benefit corporation form will fill an important market gap by helping socially oriented entrepreneurs reach a more pro-social investor class.

This Article thus develops a new theory about why benefit corporation laws matter. In keeping with emerging trends in new governance theory—a concept of regulation where law seeks to achieve public goals by encouraging privately shaped standards and rules—I argue that the value of the benefit corporation form comes from its ability to create an important new institutional structure to govern the evolving social enterprise space. For example, the form provides a focal point that ought to make it easier for like-minded actors to cooperate and collaborate on issues ranging from corporate governance practices to capital formation. It is a highly visible archetype that provides common ground and a clear framework for firms and stakeholders to coordinate their activities. In addition, even if social enterprise laws are not legally necessary to allow firms to pursue multiple bottom lines, the imprimatur of the state lends credibility to the social enterprise movement and should influence public expectations about the possibilities of dual-purpose firms. Long term, these factors could change social attitudes about the importance of balancing social and economic concerns in all corporations.[10] More immediately, they combine to raise the

8. Brakman Reiser, *supra* note 6, at 621–624.

9. J. William Callison, *Putting New Sheets on a Procrustean Bed: How Benefit Corporations Address Fiduciary Duties, the Dangers Created, and Suggestions for Change*, 2 AM. U. BUS. L. REV. 85, 104–07 (2012); Mark A. Underberg, *Benefit Corporations vs. "Regular" Corporations: A Harmful Dichotomy*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 13, 2012, 8:31 AM), http://blogs.law.harvard.edu/corpgov/2012/05/13/benefit-corporations-vs-regular-corporations-a-harmful-dichotomy.

10. This claim will likely require future empirical study, but it is at least as plausible as the concern some have expressed that benefit corporations will make it harder for regular corporations to pursue social benefit. *See supra* text accompanying note 9.

profile of individual social enterprises and provide a window into what they value.

My analysis proceeds as follows. Part I defines social enterprise in greater detail and provides examples of firms within this category. Part II outlines the benefit corporation statutes passed to date, and Part III presents a critique of them. Part IV expands upon my thesis by viewing benefit corporation laws through the lens of new governance theory and similar self-regulatory principles. Part V then concludes by describing the implications that my theoretical framework has for the design of benefit corporation legislation and strategies of corporate governance in social-enterprise firms.

I. THE SOCIAL ENTERPRISE MOVEMENT

A. Origins and Definitions

What is "social enterprise" and where did it come from? The historical and descriptive accounts of social enterprise follow several closely linked narratives. First, some argue that an emphasis on profit-making and shareholder wealth within traditional corporations is to blame for the 2008 financial crisis, environmental degradation, and many of the most significant economic scandals in recent memory.[11] To these observers, the time has come to rethink traditional notions of corporate purpose and place greater emphasis on sustainable business practices.[12] Others note that society continues to face a variety of widespread challenges, including the threat of climate change, child labor, rising poverty rates, lack of educational opportunities, and dangerous working conditions.[13] They argue that these issues provide evidence of deeper market failures—irrespective of whatever happens to be the latest corporate scandal of the month—and signal the need for new tools to address them.[14]

For many years the response to these concerns was to note that government and nonprofit organizations are available to pick up the social or environmental slack left by private actors.[15] For example, to reduce

11. 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, 650–62 (2013); Joan MacLeod Heminway, *To Be or Not to Be (A Security): Funding For-Profit Social Enterprises*, 25 REGENT U. L. REV. 299, 299–304 (2013). *See generally* Murray, *supra* note 7.

12. *See generally* Christopher M. Bruner, *Conceptions of Corporate Purpose in Post-Crisis Financial Firms*, 36 SEATTLE U. L. REV. 527 (2013).

13. Robert A. Katz & Antony Page, *The Role of Social Enterprise*, 35 VT. L. REV. 59, 65–67 (2010).

14. *Id.*

15. *Id.* at 60–61.

harms from air pollution, Congress could enact regulations that require lower carbon dioxide emissions from factories. Similarly, many nonprofit charities work to improve health and educational opportunities throughout the world.

Nonetheless, there is a growing consensus that both government and nonprofits suffer from several limitations that restrict their ability to counter the shortcomings of a market economy. The government features an unwieldy bureaucracy and can be slow to act due to political infighting or pressures from special interest groups. Nonprofits present other issues. Though they can earn income from their activities—and indeed this is often necessary to sustain their philanthropic missions—nonprofits do not feature traditional equity investors and face strict restrictions on what they can do with the money they earn. Most notably, nonprofits cannot distribute earnings to directors, managers, trustees, or members without risking their tax-exempt status.[16] This constraint on distributions locks assets into the service of the organization's social objective, but it severely limits the ability to attract capital.

The limitations of government and nonprofits create space for a new category of socially minded business to emerge: the social enterprise. Though it began as a term for nonprofits using commercial activities to support their charitable missions, the social enterprise label now encompasses all private organizations—including for-profit firms—that use business strategies and market tactics to purposefully pursue an explicit combination of economic and social objectives.[17] Companies matching this description occupy a "fourth sector" of the economy that exists alongside the traditional three sectors of government, business, and nonprofits.[18] Like ordinary businesses, social enterprises must attract financing, earn income, install managers, hire employees, and put capital at risk in a competitive market. They can also redistribute profits to their owners. But apart from striving for financial success, these firms also resemble government and many nonprofits in that they seek to mitigate social problems or curtail

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16. Keren G. Raz, *Toward an Improved Legal Form for Social Enterprise*, 36 N.Y.U. REV. L. & SOC. CHANGE 283, 291–94 (2012).

17. Rosemary E. Fei, *A Guide to Social Enterprise Vehicles*, 22 TAX'N OF EXEMPTS 37, 37 (2011) ("In the United States, [social enterprise] broadly encompasses enterprises that seek to achieve their primary social or environmental missions using business methods . . . ."); Alicia E. Plerhoples, *Can an Old Dog Learn New Tricks? Applying Traditional Corporate Law Principles to Social Enterprise Legislation*, 13 TRANSACTIONS: TENN. J. BUS. L. 221, 228–31 (2012); Andrew J. Hoffman et al., *Hybrid Organizations as Agents of Positive Social Change: Bridging the For-Profit & Non-Profit Divide* 4–6 (Univ. of Mich. Ross Sch. of Bus., Working Paper No. 1149, 2010), *available at* http://ssrn.com/abstract=1675069.

18. Thomas Kelley, *Law and Choice of Entity on the Social Enterprise Frontier*, 84 TUL. L. REV. 337, 338–41 (2009).

negative externalities.[19] Founders of social enterprises therefore seek investors looking to earn both financial and social returns and, specifically, those who are comfortable investing in businesses that promote a clear social agenda through their products, services, or practices.[20]

The hope is that the hybrid nature of a social enterprise will allow firms to bypass the structural and financing obstacles that confront government and nonprofits so they can address social issues in innovative ways. Others resist this vision and argue that corporations should focus solely on making money for their shareholders who can then decide how to spend it.[21] In many ways, the descriptive characteristics of social enterprise thus call to mind longstanding debates about corporate social responsibility (CSR) and corporate philanthropy.[22] However, while these concepts share similar themes, they do not capture identical conduct. Proponents of CSR maintain that corporations owe a moral duty to look beyond profits and consider the interests of a variety of stakeholders (including the local community, the environment, and employees).[23] Corporate philanthropy simply refers to corporations donating or contributing to charitable organizations.[24] The principles of both CSR and corporate philanthropy are often evident in a social enterprise, but there remains a crucial distinction. In practice, boards typically see CSR and corporate philanthropy as incidental to the firm's core profit-making purpose.[25] Social enterprises take a stricter approach. These are not oil companies that give annual support to the local art museum. For a social enterprise, social action is the company's overarching

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19. Janelle A. Kerlin & Kirsten Gagnaire, *United States*, *in* SOCIAL ENTERPRISE: A GLOBAL COMPARISON 87, 88 (Janelle A. Kerlin ed., 2009).

20. The models of social enterprise that I describe are often equated to "social entrepreneurship," where a "social entrepreneur" means an "individual who uses earned income strategies to pursue social objectives, simultaneously seeking both a financial and social/environmental return on investment." Elizabeth Bibb et al., *The Blended Value Glossary*, STANFORD GRADUATE SCH. OF BUS., http://www.blendedvalue.org/wp-content/uploads/2004/02/pdf-blendedvalue-glossary.pdf (last visited Jan. 23, 2014).

21. M. Todd Henderson & Anup Malani, *Corporate Philanthropy and the Market for Altruism*, 109 COLUM. L. REV. 571, 571 (2009).

22. David P. Baron, *Corporate Social Responsibility and Social Entrepreneurship*, 16 J. ECON. & MGMT. STRATEGY 683, 683–87 (2007) (describing the debate).

23. John M. Conley & Cynthia A. Williams, *Engage, Embed, and Embellish: Theory Versus Practice in the Corporate Social Responsibility Movement*, 31 J. CORP. L. 1, 1–2 (2005).

24. Roy Shapira, *Corporate Philanthropy as Signaling and Co-optation*, 80 FORDHAM L. REV. 1889, 1891 (2012).

25. Katz & Page, *supra* note 13, at 86–87. Another possible distinction relates to reputational benefits. One criticism is that companies pursuing CSR activities do so mainly for marketing purposes. Plerhoples, *supra* note 17, at 233. By contrast, social enterprises go beyond reputational considerations to directly integrate social concerns into core business activities. *See* Usha Rodrigues, *Entity and Identity*, 60 EMORY L.J. 1257, 1283–84 (2011) ("While for-profit companies may adopt 'feel-good' marketing, branding, or positional strategies, it is understood that those goals are subsidiary to the profit imperative.").

purpose and animates everything it does. Reiser sums up the difference nicely:

> Social enterprises integrate philanthropy into their business models at a more basic level than companies that make corporate contributions or practice CSR. Social entrepreneurs pursue social and business goals together, viewing them as synergistic and mutually reinforcing, as equal partners in their business vision. This deep and particular commitment to philanthropic endeavor is the thrust of the social enterprise ideal.[26]

Of course, traditional for-profit firms also provide important social benefits like jobs and helpful products. They also typically claim to be operating for the public good, even if their only goal is profit, since the capitalist assumes that the pursuit of profit is in the public interest. But as Reiser's description makes clear, social enterprises seek to become something more by uniting social good and profits within a single, unifying strategy.[27] They serve "two 'co-equal' masters (two bottom lines) at once," measuring success in terms of both financial and social performance.[28]

B. Examples

Descriptions of social enterprise like the ones above are admittedly broad. Some even prefer keeping the concept open and ambiguous to place more emphasis on inclusion rather than uniformity.[29] This perspective brings to mind Justice Stewart's famous comment about not being able to define pornography but knowing it when he sees it.[30] Keeping the definition of social enterprise similarly loose allows the focus to stay on a wide range of issues and phenomena with common themes rather than uniform categorization among business associations.

At some point, though, it becomes helpful to take a closer look at how actual social enterprises organize and operate. Doing so helps to guide policy making and provides notice to founders and investors about the availability of business models that will best meet their legal and financial needs. Describing specific categories or attributes of social enterprise also

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26. Dana Brakman Reiser, *For-Profit Philanthropy*, 77 FORDHAM L. REV. 2437, 2450 (2009).

27. Julie Battilana et al., *In Search of the Hybrid Ideal*, STAN. SOC. INNOVATION REV., Summer 2012, at 51, 51.

28. Briana Cummings, Note, *Benefit Corporations: How to Enforce a Mandate to Promote the Public Interest*, 112 COLUM. L. REV. 578, 582 (2012).

29. Declan Jones, *The Trouble with Not Defining Social Enterprise*, GUARDIAN (Jan. 6, 2012, 3:00 PM), http://www.theguardian.com/social-enterprise-network/2012/jan/06/trouble-not-defining-social-enterprise.

30. Jacobellis v. Ohio, 378 U.S. 184, 197 (1964).

facilitates ongoing experimentation and innovation as founders, investors, and legislators assess how the market reacts to different options.

To begin, take Starbucks. Starbucks is a classic case of a traditional corporation that produces considerable public benefit but falls short of what most would consider a social enterprise. To its credit, Starbucks uses a third-party valuation and certification system to ensure that it purchases coffee beans through channels that promote social, environmental, and economic value for farmers and local communities.[31] It employs thousands of people and maintains close watch over its suppliers.[32] It will stop working with those who fail to live up to its standards for socially responsible practices. Overall, Starbucks arguably provides more "good" than many social enterprises given its ability to leverage economies of scale.[33] But the company's social focus still remains incidental to its core revenue-generating activity of selling high-end coffee drinks and coffee-related products. Put another way, Starbucks "does not exist first and foremost to solve a social problem,"[34] nor does it have a "deep and particular commitment to philanthropic endeavor" that animates everything it does.[35]

Social enterprises take a different route by starting with a social mission in mind and then scaling up to pursue it. For example, of the 4.4 billion people in the developing world, the United Nations reports that 60% lack access to safe sewers, 33% lack access to clean water, and 30% have no modern health services.[36] Social enterprises take these issues as their cues to offer market-based solutions. Accordingly, we find a company like Sanergy that builds and franchises low-cost sanitation systems for deployment in African slums. Other social enterprises focus less on products that solve social problems and more on how they can generate public good through their everyday operations. Hot Bread Kitchen and Greyston Bakery are both bakeries that sell a wide selection of high-quality breads, but, uniquely, they also adhere to strict workforce development programs. Each company staffs its operations with hard-to-employ individuals, such as low-income immigrants, and actively teaches them skills that they can apply when looking for jobs across the wider

31. *Responsibility*, STARBUCKS, http://www.starbucks.com/responsibility (last visited Apr. 22, 2014).

32. *Ethical Sourcing*, STARBUCKS, http://www.starbucks.com/responsibility/sourcing (last visited Jan. 10, 2015).

33. Anup Malani & Eric Posner, *The Case for For-Profit Charities*, 93 VA. L. REV. 2017, 2048–50 (2007).

34. Raz, *supra* note 16, at 290.

35. Brakman Reiser, *For-Profit Philanthropy*, *supra* note 26, at 2450.

36. Hoffman et al., *supra* note 17, at 4.

foodservices industry.[37] As Greyston's slogan says, they "don't hire people to bake brownies. [They] bake brownies to hire people."[38]

The unifying characteristic among these examples is the use of business methods to pursue both financial and social returns. From there, key distinctions rest on questions of degree when it comes to formal business plans, internal policies, and corporate governance. Alicia Plerhoples thus aptly notes that another way to look at social enterprises is to place them along a spectrum on the basis of what they do, how they do it, or why they do it.[39]

For example, when focusing on the "what" of social enterprise, we see that many for-profit businesses earn income primarily through direct efforts to solve a current social problem. These firms are driven by the specific social problem they seek to address. They typically use profit-making strategies to solve problems that the public is ignoring, or ones that would be candidates for nonprofit support if only nonprofits had access to the resources in the for-profit sector.[40] Others arise simply when founders see a market opportunity in providing direct social impact. For each, "[t]he relevant point is that the organization has an explicit goal to solve a social problem, and that goal guides the organization."[41]

Several firms fitting this description operate in the environmental sector. In addition to Sanergy, a good illustration is Blue River Technology (Blue River). Blue River's founders apply expertise in robotics to develop new technologies in agriculture.[42] Recognizing that $25 billion is spent annually on herbicides that pose environmental risks, Blue River helps farmers reduce chemical use by switching to robots pulled behind tractors that can quickly identify and kill weeds with a blade.[43] Similar examples include Tesla Motor Company (fully electric, clean-emission cars) and Amyris (biofuels).[44]

Other firms, such as Greyston Bakery, focus more on the "how" question of social enterprise by operating in an environmentally friendly

37. Alicia E. Plerhoples, *Representing Social Enterprise*, 20 CLINICAL L. REV. 215, 227 (2013).

38. *Id.*

39. *Id.* at 224.

40. Christine Hurt, *CSR v. Social Entrepreneurship*, CONGLOMERATE (Apr. 16, 2012), http://www.theconglomerate.org/2012/04/csr-v-social-entrepreneurship.html.

41. Raz, *supra* note 16, at 289.

42. *See* BLUE RIVER TECH., http://bluerivert.com/ (last visited Apr. 22, 2014).

43. *March of the Lettuce Bot*, ECONOMIST, Dec. 1, 2012, at 5, *available at* http://www.economist.com/news/technology-quarterly/21567202-robotics-machine-helps-lettuce-farmers-just-one-several-robots.

44. Amyris uses synthetic biology to provide renewable alternatives to the world's finite supply of petroleum-based and environmentally harmful oils and chemicals. Its primary product is Biofene, a renewable hydrocarbon molecule that can be adapted as an alternative to fossil fuels. Amyris went public in 2010 and its shares currently trade on NASDAQ. *History*, AMYRIS INC., https://amyris.com/our-company/history/ (last visited Feb. 4, 2015).

way, employing workers from underserved communities, or sourcing from sustainable materials. Additional examples in this category include Patagonia (sourcing from sustainable materials)[45] and Interface (operating in a 100% environmentally sustainable way).[46] The "why" factor is key for the remaining set of social enterprises, as in the case of companies that operate a core profit-making activity specifically to reinvest in a philanthropic or social endeavor. A prominent example is TOMS Shoes, a corporation that operates pursuant to a buy-one, give-one business model. For every pair of its shoes bought through a traditional retailer, TOMS provides a pair of new shoes to a child in need.[47] Other buy-one, give-one companies include Warby Parker (eyeglasses) and Better World Books (books).

Keep in mind that the foregoing examples are not mutually exclusive. A company like Patagonia focuses on the "how" and "why" factors by operating with an eye toward environmental sustainability through both its sourcing practices and its reinvestment policies.[48] I also do not mean to imply that one model is better than another. There is an occasional reaction that high profit potential means a firm cannot be an authentic social enterprise. Yet, the motives of a firm's managers or investors—whether altruistic or selfish—should not matter if their activities serve first and foremost the public welfare.[49] In fact, trying to find founders of a social enterprise who are completely selfless would be difficult. Entrepreneurs of every stripe, including those who start social enterprises, report strong desires for personal wealth.[50] This realization should not taint their business plans or imply that they are not giving up lucrative options with traditional firms. It simply reflects that even strongly altruistic individuals often desire financial security and the comforts it can bring.[51] Therefore, in the first

45. *Corporate Responsibility*, PATAGONIA, http://www.patagonia.com/us/patagonia.go?assetid=67372 (last visited Apr. 22, 2014).

46. Interface is the world's largest maker of carpet tile. INTERFACE, www.interface.com/US/en-US/global (last visited Apr. 22, 2014).

47. But note that some commentators are critical of TOMS' approach, saying it is only a short-term solution. *See, e.g.*, Joshua Keating, *Is TOMS Shoes Listening to Its Critics?*, SLATE (Oct. 17, 2013, 1:33 PM), http://www.slate.com/blogs/the_world_/2013/10/17/toms_shoes_to_begin_producing_shoes_in_haiti_will_this_be_a_more_effective.html.

48. Patagonia uses sustainable manufacturing techniques and redistributes at least one percent of all revenues to organizations dedicated to environmental protection efforts to offset the pollution caused by its ordinary operations. PATAGONIA, http://www.patagonia.com/ (last visited Apr. 22, 2014).

49. Malani & Posner, *supra* note 33, at 2064. *But cf.* Jill R. Horowitz et al., *The Attack on Nonprofit Status: A Charitable Assessment*, 108 MICH. L. REV. 1179 (2010) (challenging some of Malani and Posner's arguments and assumptions).

50. Jeffrey G. York et al., Selective Incentives, Entrepreneurship, and Identity: Toward a Behavioral Theory of Collective Action, 57 (June 23, 2013) (unpublished manuscript), *available at* http://www.researchgate.net/publication/254934147_Collective_Action_without_Selective_Incentives_The_Entrepreneurial_Creation_of_Public_Goods.

51. Malani & Posner, *supra* note 33, at 2019.

instance, our focus in attempting to define a social enterprise must always come back to whether social impact is embedded in the firm's core agenda.

C. Next Steps

The emergence of dual-purpose, hybrid firms continues to generate considerable interest and engagement. An increasing number of investors now look to invest in companies that produce social or environmental benefits in addition to financial returns. Some estimates suggest that the amount of such "impact investing"—which includes socially oriented investing by mutual funds, venture capitals, and angel investors—runs into the billions of dollars.[52]

Social enterprise theory is also rapidly becoming a dominant paradigm in the curricula of leading business schools, and many now house social enterprise centers and programs.[53] At Harvard Business School, 60% of the class enrolls in social enterprise electives, and nearly half of all students are members of the Social Enterprise Club.[54] Several schools also offer substantial financial aid to alumni who work for social enterprises after graduation.[55] American law schools have been slower to join the social enterprise scene but are starting to catch up through new course and clinical offerings.[56] In addition, newspapers, magazines, and other media are

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52. *Survey Shows Market Growth in Impact Investments and Satisfaction Among Investors*, J.P. MORGAN (Jan. 7, 2013), https://www.jpmorgan.com/pages/detail/1320509594546. Of course, a sense of context is in order. The total market capitalization of all NYSE companies is approximately $16.6 trillion. For NASDAQ, the figure is approximately $5 trillion. The U.S. corporate bond market is another roughly $30 trillion. So, in the United States, just the public securities market totals more than $50 trillion—not to mention all other forms of capital, such as private equity and bank loans. If the "impact investing" sector aggregates to $10 billion, that amounts to about two-tenths of one percent of the value of public securities. Thus, while I argue that impact investing is important in many ways, including morally, it remains a relatively modest force in capital markets.

53. Robert Simons, *The Business of Business Schools: Restoring a Focus on Competing to Win*, 8 CAPITALISM & SOC'Y, no. 1 2013 at 10, *available at* http://capitalism.columbia.edu/volume-8-issue-1 (2013) (recognizing but criticizing this development). Examples include the Harvard Business School's Social Enterprise Initiative, Stanford Business School's Center for Social Innovation, the Social Enterprise Program at Columbia Business School, the Global Social Enterprise Initiative at Georgetown's McDonaugh School of Business, and the Program on Social Enterprise at Yale University's School of Management. *See* John A. Byrne, *Social Entrepreneurship: The Best Schools & Programs*, POETS & QUANTS (Aug. 13, 2010), http://poetsandquants.com/2010/08/13/social-entrepreneurship-the-best-schools-programs/8/.

54. Simons, *supra* note 53, at 14.

55. *See, e.g.*, *Loan Assistance Program*, COLUM. BUS. SCH., http://www8.gsb.columbia.edu/socialenterprise/careers/loanassistance (last visited Jan. 10, 2015).

56. Plerhoples, *supra* note 37, at 239. Social enterprise courses are offered at Harvard Law School, Northwestern University Law School, and Stanford Law School. New York University School of Law offers fellowships in social enterprise to third-year law students and recent graduates.

paying more attention to social enterprise, with many featuring columns, prizes, and blogs to highlight trends in the area.[57]

Advocates maintain that these developments—most of which are less than six years old—show that the demand for and significance of social enterprise will only continue to grow.[58] David Gergen even characterizes social enterprise as a movement that could be as transformative as the Civil Rights Movement given its potential to solve previously intractable social problems through the power of the capital markets.[59]

So, if there is so much passion and growth in this area, what is the problem? What explains the recent push for new legislation? Proponents say the answer is simple: without change, existing corporate law will keep social enterprises from reaching their utmost potential.

II. SOCIAL ENTERPRISE LEGISLATION

A. Arguments for Legal Reform

It is axiomatic that laws affecting corporate America result from significant social, economic, and political events. The federal securities laws came after the market crash of 1929, Sarbanes-Oxley was largely a reaction to the accounting scandals at Enron and WorldCom, and Dodd-Frank was borne out of the 2008 financial crisis. Likewise, shifting market pressures and risks led to new statutory business forms like the limited liability company (LLC).

Similar factors explain calls for new legislation to accommodate social enterprise. Founders of social-enterprise firms argue that existing laws are a poor fit for the hybrid strategies they embody.[60] Several issues shed light on this concern. First, nonprofit law's constraint on distributions makes it unworkable in the case of a for-profit social enterprise that seeks equity ownership.[61] If nonprofits will not work, another option is the traditional corporate form. But here is where the real rub comes for advocates of

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57. Columns and blogs on social enterprise can be found at *Social Enterprise Network*, GUARDIAN, http://www.theguardian.com/social-enterprise-network (last visited Apr. 28, 2014) and *Social Entrepreneurs: Taking on World Problems*, NPR, http://www.npr.org/series/130593764/social-entrepreneurs-taking-on-world-problems (last visited Apr. 28, 2014). For the past two years *Forbes* has also released its "Impact 30," a list of the world's leading social entrepreneurs. *The Impact 30*, FORBES, http://www.forbes.com/impact-30/lander.html (last visited Jan. 10, 2015).

58. David Bornstein, *The Rise of the Social Entrepreneur*, N.Y. TIMES OPINIONATER (Nov. 13 2012, 9:30 PM), http://opinionator.blogs.nytimes.com/2012/11/13/the-rise-of-social-entrepreneur/?_php=true&_type=blogs&_r=0.

59. Mr. Gergen is the Director of the Center for Public Leadership at Harvard University's John F. Kennedy School of Government and a former advisor to Presidents Nixon, Ford, Reagan, and Clinton. James A. Phillis, Jr., *Q&A: David Gergen*, STAN. SOC. INNOVATION REV., Fall 2008, at 19.

60. Katz & Page, *supra* note 13, at 85.

61. *See id.* at 102.

social enterprise. One of their primary concerns is that social enterprises organized as traditional corporations will drift toward maximizing profits for shareholders and away from whatever social objective they were formed to pursue.[62] Many argue that corporate law imposes a duty on directors to maximize profits for the benefit of shareholders.[63] Under this view, any decisions that do not serve to maximize shareholder wealth expose managers and directors to shareholder suits for breach of fiduciary duty or waste.

While the accuracy of this account is subject to much debate—with some arguing that "shareholder wealth maximization" theory is more of a social norm than a legal obligation and others claiming that either characterization overstates the matter—it is still an account with considerable traction.[64] I will refine the discussion in Part III, but for now it suffices to say that backers of social enterprise laws remain adamant that the traditional corporate emphasis on shareholder wealth severely limits managerial discretion to consider stakeholder interests or pursue social objectives.[65]

Once nonprofits and traditional corporations are set aside, the next potential choice of form is the "uncorporation."[66] The thought here is that the contractual flexibility of non-corporate forms like the LLC or

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62. Murray, *supra* note 7, at 25–26.

63. *See* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 736 (2005) (recognizing but criticizing the belief that "traditional fiduciary duties require corporate managers . . . to maximize corporate profits"); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 441 (2001) ("[T]here is today a broad normative consensus that shareholders alone are the parties to whom corporate managers should be accountable . . . .").

64. *See* Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2073 (2001) ("Norms in American business circles, starting with business school education, emphasize the value, appropriateness, and indeed the justice of maximizing shareholder wealth . . . ."); D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 290–91 (1998) (arguing that the influence of the shareholder wealth maximization norm on decision-making by corporate managers is exaggerated); Judd F. Sneirson, *Green Is Good: Sustainability, Profitability, and a New Paradigm for Corporate Governance*, 94 IOWA L. REV. 987, 987 (2009); Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford, 3 VA. L. & BUS. REV. 163, 169 (2008) ("Do [state corporate statutes] . . . limit the corporate purpose to shareholder wealth maximization? . . . '[H]ell no.'").

65. *See* William H. Clark, Jr. & Elizabeth K. Babson, *How Benefit Corporations Are Redefining the Purpose of Business Corporations*, 38 WM. MITCHELL L. REV. 817, 832–33 (2012). The authors are two of the nation's leading proponents of legislation creating the "benefit corporation" form discussed infra. *See* WILLIAM H. CLARK, JR. ET AL., WHITE PAPER: 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 (2013), *available at* http://benefitcorp.net/attorneys/benefit-corp-white-paper.

66. Larry Ribstein, who coined the term "uncorporation," defined it as "including general and limited partnerships and limited liability companies (LLCs)." Larry E. Ribstein, *The Uncorporation's Domain*, 55 VILL. L. REV. 125, 125 (2010). *See generally* LARRY E. RIBSTEIN, THE RISE OF THE UNCORPORATION (2009).

partnership could provide a workable alternative for dual-purpose firms.[67] And, in fact, several social entrepreneurs have already taken advantage of this flexibility in organizing their businesses.[68] The problem is that many others see uncorporations as second-best. One issue is transaction costs. The same flexibility that makes uncorporations so attractive can also make them more expensive to contract for and organize.[69] Despite the increasing popularity of the LLC form, many founders also find the corporate form easier to understand and more prestigious than the range of non-corporate options available, and they believe potential investors will feel the same.[70]

Thus, while proponents maintain that interest in social enterprise is approaching critical mass, many remain fearful that existing rules and forms will continue to curb the movement's momentum. This concern has not fallen on deaf ears. Social enterprise is a rare issue in today's political discourse to receive strong support from all sides. Observers on the left feel that government is failing to address many pressing social issues, either by refusing to act or by acting only superficially, and they embrace social enterprise as an important supplement.[71] On the right, conservatives and libertarians find the market-focus of social enterprise more attractive than public involvement with social issues.[72]

B. The Benefit Corporation

The political consensus surrounding social enterprise has led to several recent legislative experiments. The most influential efforts so far have come from promoters of the benefit corporation. Twenty-six states enacted benefit corporation laws within the past three years, including Delaware, and eight others are formally considering doing so.[73] Benefit corporations are thought to do two things better than other potential statutory options.

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67. Cassady V. Brewer, *A Novel Approach to Using LLCs for Quasi-Charitable Endeavors (A/K/A "Social Enterprise")*, 38 WM. MITCHELL L. REV. 678, 679–80 (2012).

68. *See id.*; Kelley, *supra* note 18, at 370; Murray, *supra* note 7, at 19. *But see* Brakman Reiser, *supra* note 6, at 608 (agreeing that LLC statutes are flexible enough for social enterprise but noting that "partnership statutes requiring a 'business purpose' may create barriers to social enterprises in that form.").

69. *See* Richard A. Booth, *Form and Function in Business Organizations*, 58 BUS. LAW. 1433, 1442 (2003) ("In the end . . . it may be that investors are simply worried that there may be too many surprises lurking in the customized structure of alternative forms such as LLCs."); Victor Fleischer, *The Rational Exuberance of Structuring Venture Capital Start-Ups*, 57 TAX L. REV. 137, 173 (2003) ("Flexibility brings uncertainty, both in terms of determining what rights LLC agreements confer and whether the agreements will be enforceable in court."). On the other hand, not all LLCs will impose high transaction costs. At the end of the day, it is usually the complexity of the deal, not the legal form, which drives costs—this is true for both uncorporations and corporations.

70. Clark & Babson, *supra* note 65, at 3–4.

71. Phillis, *supra* note 59, at 20.

72. *Id.*

73. BENEFIT CORP INFO. CENTER, http://benefitcorp.net (last visited July 23, 2014).

First, they address perceived legal obstacles in the traditional corporate form by freeing managers from any obligation to pursue profits over social mission. Second, they feature unique accountability mechanisms meant to ensure organizational fidelity to that social mission.

1. Public Benefit Requirements and Decision-Making Standards

Benefit corporations resemble traditional off-the-rack corporations in almost every structural way but begin with a unique premise. Unlike traditional corporations, benefit corporations must expressly advance one or more public benefits in addition to seeking profits.[74] Managers of a benefit corporation must also balance or consider the interests of every firm stakeholder when deciding how to promote the firm's social and financial goals.[75]

To the extent that managers fear exposure to liability under this new framework, benefit corporation laws typically (a) provide that the pursuit of a public benefit is deemed to be in the best interest of the company, (b) clarify that directors do not owe any duties to the third-party beneficiaries of the firm's public benefits, and (c) grant personal immunity to directors for actions taken in pursuit of a public benefit.[76] Other benefit corporation statutes add that directors satisfy their fiduciary duties in advancing social pursuits so long as their decisions are informed and disinterested.[77]

Together, these provisions are meant to enhance managerial discretion and protect managers from claims that they must subordinate social goals in the name of maximizing shareholder profits. Notably, though, benefit corporation statutes do not preclude making substantial profits; they merely provide that firms are not bound to *maximize* profits.[78] However, the broad discretion these statutes create means that enforcement and accountability tools become necessary to ensure that managers use their flexibility to advance the firm's social mission rather than selfish causes.[79]

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74. *See* Clark & Babson, *supra* note 65, at 16.

75. *See* J. Haskell Murray, *Social Enterprise Innovation: Delaware's Public Benefit Corporation Law*, 4 HARV. BUS. L. REV. 345, 355 (2014). Note difference between Model Act and DPBC: Model requires directors to "consider" stakeholder interests; DPBC requires a "balancing" of (1) the pecuniary interests of shareholders, (2) the interests of those materially affected by the corporation's activities, and (3) the firm's identified public benefits.

76. *Id.*

77. *See, e.g.*, DEL. CODE ANN. tit. 8, § 365 (2013). For a thorough overview of Delaware's Public Benefit Corporation statute, see generally Murray, *supra* note 75.

78. Lyman Johnson, *Pluralism in Corporate Form: Corporate Law and Benefit Corps.*, 25 REGENT U. L. REV. 269, 288 (2012).

79. Brakman Reiser, *supra* note 6, at 598–600.

2. *Enforcement Tools*

Benefit corporation laws address enforcement and accountability from both an external and internal perspective. Externally, most require benefit corporations to provide an assessment of how their pursuit of a public benefit holds up against an independent third-party standard. The standard for assessment must be one that is "comprehensive[,] . . . credible,"[80] and "recognized . . . for . . . assessing . . . social and environmental performance."[81]

Benefit corporations must further produce an annual or biennial "benefit report" that describes their progress in meeting their social and financial objectives.[82] Most states specify that these reports should include a narrative description of the firm's public benefit pursuit, any circumstances that hindered its social mission, the process used for selecting a third-party standard, and an analysis of whether the firm's overall social and environmental performance met that standard.[83]

These outward-facing accountability provisions seek to bolster transparency and enhance monitoring efforts by shareholders, stakeholders, and other market actors. Rules that create a new "benefit enforcement proceeding"[84] complement them on the inside. This proceeding closely resembles the standard shareholder derivative suit by creating a right of action against a benefit corporation's directors for the failure to create a

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80. *Criteria for Acceptable Third Party Standards*, BENEFIT CORP INFO. CENTER, http://benefitcorp.net/third-party-standards/criteria-for-acceptable-third-party-standards (last visited Jan. 23, 2014).

81. The relevant standard is said to be "credible" if it is developed by an entity with the "necessary expertise" and one that uses a "balanced multistakeholder approach . . . [that includes] a reasonable public comment period." Dana Brakman Reiser, *Regulating Social Enterprise*, 14 U.C. DAVIS BUS. L. J. 231, 237 (2014).

82. *How Do I Meet Reporting Requirements?*, BENEFIT CORP INFO. CENTER, http://benefitcorp.net/reporting-requirements (last visited Jan. 21, 2015). The report must typically be filed with the state's secretary of state, sent to every shareholder, and appear on a publicly accessible part of the firm's website. Benefit corporation statutes in California, Colorado, Delaware, Illinois, Hawaii, Louisiana, Maryland, Nevada, Oregon, Vermont, and Virginia do not require the report to be filed with the state. *Reporting Requirements by State*, BENEFIT CORP INFO. CENTER, http://benefitcorp.net/storage/documents/State_by_State_Reporting_Requirements.pdf (last visited Jan. 21, 2015).

83. *See How Do I Meet Reporting Requirements?*, *supra* note 82. The report must also disclose the compensation paid to each director, the name of each shareholder holding a 5% or greater equity stake, and the name of the firm's "benefit director." This disclosure of the firm's benefit director follows from the Act's requirement that the board appoint an independent benefit director who is responsible for preparing a statement in the annual benefit report that indicates whether the firm is in compliance with its obligations to create a general and any specific public benefit. If the benefit director believes that the firm's directors or officers did not comply with the Act's requirements she must describe their failures. Benefit corporation statutes in California, Maryland, New York, and Virginia do not require the appointment of a separate benefit director. *Reporting Requirements by State*, *supra* note 82.

84. Brakman Reiser, *supra* note 6, at 605.

public benefit, as well as for violations of any other obligation.[85] The action can be initiated either by shareholders or directors, or anyone else specified in the firm's articles of incorporation, which might include third-party beneficiaries.[86] So far, there is no case law on how courts should analyze benefit enforcement proceedings or how the fiduciary obligations of directors and officers of benefit corporations should be assessed.[87]

3. *Certified "B Corporations" and Similar Statutory Forms*

Confusion occasionally arises between a statutory benefit corporation and something called a "certified B corporation."[88] The latter refers to companies that undergo a process of certification administered by B Lab Company (B Lab), a nonprofit organization that seeks to facilitate social enterprise and social investment. B Lab bases its certification on a review of whether a firm adequately uses "the power of business to solve social and environmental problems."[89] B Lab also conducts periodic audits to ensure compliance with its standards.[90] Accordingly, this process is comparable to other social certifications, such as "fair trade" coffee.[91]

Companies that organize as benefit corporations can also be certified B corporations, but obtaining certification is neither necessary nor sufficient for statutory compliance. Likewise, a certified B corporation may or may not be organized as a statutory benefit corporation. Current estimates put the number of certified B corporations at approximately 1,200, and the total number of benefit corporations at around 780.[92]

Some statutes also feature separate social enterprise provisions that differ from benefit corporation laws.[93] For example, even though it includes

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85. Brakman Reiser, *supra* note 6, at 605. Benefit corporation statutes in Maryland and New York do not expressly allow for benefit enforcement proceedings. *Id.*; *see also* N.Y. BUS. CORP. LAW § 1707(c) (McKinney 2014).

86. Most states impose ownership thresholds on the right to initiate these actions, such as ownership of at least 2% of the firm's outstanding shares.

87. Brakman Reiser, *supra* note 6, at 606.

88. *The Non-Profit Behind B Corps*, B LAB, http://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps (last visited Jan. 21, 2015).

89. *Id.*

90. More specifically, B Lab's process of review involves a point system called the B Impact Assessment. This system uses a 200-point scale to assess issues like corporate employment policies, community relations, environmental performance, corporate accountability, and benefits to consumers. *Performance Requirements*, B LAB, http://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/performance-requirements (last visited Mar. 6, 2015).

91. Murray, *supra* note 7, at 21.

92. *Find a Benefit Corp*, BENEFIT CORP INFO. CENTER, http://benefitcorp.net/find-a-benefit-corp (last visited Apr. 22, 2014); B LAB, http://www.bcorporation.net/ (last visited Mar. 2, 2015).

93. In addition to benefit corporations, California recently authorized the creation of "social purpose corporations" (SPCs). CAL. CORP. CODE § 2500 et seq. SPCs are corporations that (1) expressly pursue profits and at least one charitable purpose activity, or (2) commit to minimizing any

an independent benefit corporation provision, Oregon's corporate code also allows firms to include an instruction in their charters that requires managers to conduct business "in a manner that is environmentally and socially responsible."[94] While these are each significant developments, the statutory benefit corporation remains my central focus since it continues to receive the most attention from lawmakers.

III. CRITIQUE OF BENEFIT CORPORATION LAWS

Like all companies, the success or failure of a social enterprise turns on a combination of factors: its leadership, the existence of accommodating legal rules, access to capital, revenues that exceed expenditures, and the ability to outperform competitors. Firms select business forms on the basis of how well a form's attributes match these needs.[95] Thus, social enterprises will only adopt the benefit corporation form if it gives them an advantage over other options.

The best forms are usually ones that minimize a firm's operating and transaction costs. Proponents believe that the benefit corporation helps on this score by providing managers with the legal discretion to put social objectives ahead of maximizing shareholder wealth.[96] In this way, rather than force firms to handle the balancing of social and financial performance through complex contracts or by departing from the corporate form altogether, now they can rely on the benefit corporation template to give managers the express flexibility to pursue multiple bottom lines.

In other ways, though, the notion that benefit corporation statutes reduce transaction costs might seem counterintuitive. For example, the form's unique disclosure and assessment requirements will likely raise operational costs, and they do not come with countervailing tax breaks like the ones that nonprofits receive. Why would a firm accept these additional costs?

One answer is that founders will avoid the risk of shareholder suits alleging a failure to maximize profits. Another answer is that the benefit corporation's unique framework might create a "brand" that will better

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adverse short- or long-term effects on stakeholders. Unlike benefit corporations, SPCs are not bound to provide a public benefit as assessed against a third-party standard. The state of Washington also recently enacted legislation authorizing the creation of a "social purpose corporation." This is defined as a firm in which directors may consider social purposes in addition to profits "as [they] deem[] relevant" but are not required to evaluate the impact of their decisions on any specific list of firm stakeholders. WASH. REV. CODE § 23B.25.050(2) (2012).

94. OR. REV. STAT. § 60.047(2)(e) (2009).

95. *See generally* Larry E. Ribstein & Bruce H. Kobayashi, *Choice of Form and Network Externalities*, 43 WM. & MARY L. REV. 79 (2001).

96. *See generally* Janine S. Hiller, *The Benefit Corporation and Corporate Social Responsibility*, 118 J. BUS. ETHICS 287 (2013).

enable organizers to attract the interest and trust of an expanding universe of socially motivated investors, employees, and consumers.[97] In the latter sense, the form goes beyond offering a template to reduce transaction costs or expand managerial duties. Those attributes are important, but the form also seeks to provide social enterprises with clear market differentiation and a way to create a new asset class. The next question is how well it does in achieving those objectives.

A. Managerial Discretion

1. Statutory and Case Law

The benefit corporation's focus on expanding managerial discretion assumes that social enterprises will face situations where their social and financial goals become divisible. For example, a social enterprise that sells organic coffee beans might discover that its financial upside will improve by outsourcing jobs to countries with poor records for human rights. If existing corporate law requires managers to maximize shareholder wealth under these circumstances, then the benefit corporation form frees them from that restraint.

The problem with this perception, though, is that it ignores how existing corporate law already provides virtually complete protection to managers who balance stakeholder interests or otherwise make socially motivated decisions. For starters, every state allows corporations to engage in charitable giving.[98] As Henderson and Malani make clear, corporate philanthropy comes in many forms—it may come from direct outlays to support a specific cause, or it may come through stricter-than-necessary environmental controls.[99] That corporate charity statutes even exist casts doubt on a strict rule of shareholder wealth maximization in all situations.[100]

The same is true when one considers that thirty-three states now feature "constituency" statutes.[101] These laws get their name because they authorize corporate controllers to consider the interests of non-shareholder constituents—including employees, creditors, and residents of the local community—when making business decisions. While some constituency statutes only apply to takeovers, the majority do not.

97. Brakman Reiser, *supra* note 6, at 607.

98. Sneirson, *supra* note 64, at 999.

99. Henderson & Malani, *supra* note 21, at 573–74.

100. *See* Sneirson, *supra* note 64, at 999.

101. *See* Cummings, *supra* note 28, at 587–88.

Even more importantly, courts review nearly every type of corporate decision, including ones that seem to favor social goals, pursuant to the business judgment rule. Courts applying this rule presume that directors act with due care, good faith, and in the company's best interests when making decisions.[102] Shareholders can rebut this presumption by showing that the directors acted in bad faith, on an uninformed basis, or were self-interested.[103] If the plaintiffs cannot rebut the presumption, then the directors' decision will stand unless it cannot be attributed to any rational business purpose.[104]

Managers should find plenty of comfort in this framework. It will be "only the most unimaginative board that is unable to show how a 'reasonable' use of resources could plausibly enhance the firm's goodwill."[105] This likely explains why no modern court has overturned an ordinary business decision on the basis that it impermissibly put social goals ahead of shareholder profits.[106] At most, all managers need to do is articulate how decisions like committing to environmental sustainability will serve the best interests of the firm, perhaps by minimizing risks of external regulation, increasing goodwill, or satisfying consumer demand. Therefore, the practical reality is that current law gives managers a "free hand" when it comes to strategic decisions like selecting manufacturing processes, setting prices and wages, hiring employees, and offering particular products or services.[107]

The one situation where matters arguably become more complex is a takeover. Delaware case law holds that directors owe a duty to maximize short-term returns for shareholders in a sale or change-of-control

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102. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

103. *Id.*

104. Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000).

105. Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1470 (2006).

106. *See* Ribstein, *supra* note 105, at 1473; Underberg, *supra* note 9.

107. *See* Underberg, *supra* note 9. Additionally, Section 102(b)(7) of the DGCL allows the corporation to eliminate director liability for breaches of the duty of care, and virtually every Delaware corporation has opted into this provision. To the extent that shareholder suits alleging that a director has placed mission ahead of maximizing profits sound in the duty of care, a 102(b)(7) provision would be a powerful shield to such suits. Furthermore, Section 102(b)(1) of the DGCL authorizes a Delaware corporation to include in its charter "[a]ny provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders, or any class of the stockholders, or the governing body, members, or any class or group of members of a nonstock corporation; if such provisions are not contrary to the laws of this State." This section arguably authorizes a charter provision stating, for example, "In managing the business and affairs of the corporation, the directors may consider the interests of all corporate constituencies, need not regard the interests of shareholders as paramount, and may also consider the social mission of the corporation." However, there is at least some anecdotal evidence that the Delaware Secretary of State might reject such a charter provision. *See* Brakman Reiser, *supra* note 6, at 608.

scenario.[108] However, Delaware courts also allow directors of target companies to execute a range of takeover defenses to preserve the corporation's long-term business plan, even if doing so goes against shareholder wishes.[109] Prominent scholars accordingly find a reminder in Delaware's takeover jurisprudence that, "[w]hen push comes to shove, sustaining the enterprise for the good of all stakeholders has been deemed more important than generating premiums for shareholders."[110]

2. *Profits vs. Public Good*

In addition to mischaracterizing the scope of managerial discretion, the benefit corporation narrative also frequently overstates the degree to which corporate managers of social enterprises even need or want to make tradeoffs between social and financial objectives.

First, consider again the strategies of Sanergy and Blue River. The more "Fresh Life Toilets" or pesticide-replacing robots that these companies sell the more profits they will take in—and the more public good they will perform.[111] In these situations there is no clear tension between profit maximization and social performance. Some describe this as the "hybrid ideal," a phenomenon that comes when everything a firm does generates social value and commercial revenue.[112] Managers in the hybrid ideal "do not face a choice between mission and profit, because these aims are integrated in the same strategy."[113] Even companies like Patagonia and TOMS that take a less direct approach to producing social impact show

108. Revlon v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). But see Jones Apparel Grp., Inc. v. Maxwell Shoe Co., Inc., 883 A.2d 837 (Del. Ch. 2004), which opens the possibility that a charter provision under 102(b)(1) could allow the parties to contract even around *Revlon*.

109. Bruner, *supra* note 12, at 531.

110. *Id.* at 532. Benefit corporation supporters often cite the recent *eBay v. Newmark* case for the proposition that directors of traditional corporations must always prioritize shareholder returns. eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010). But while a generous reading of the court's holding might support that view, a closer look reveals that *eBay* is likely limited to situations of minority shareholder oppression. *See* J. Haskell Murray, *Defending Patagonia: Mergers and Acquisitions with Benefit Corporations*, 9 HASTINGS BUS. L.J. 485, 493 (2013) (describing scholarship supporting this view). The court noted that this was the first case where a closely held corporation with only three shareholders sought to use defensive measures to resist a takeover that were ordinarily used to protect "dispersed, disempowered, or vulnerable stockholders." *eBay*, 16 A.3d at 31. Outside of Delaware, the thirty-three states with constituency statutes afford directors enough flexibility to consider non-monetary interests when responding to takeover bids.

111. Of course, the situation may not be this simple for all social enterprises. For example, all companies have some degree of market power, and perhaps a company could make more money by selling fewer products at a higher price, which would also imply doing less social good. In this way, even for a social enterprise, profits and social good might collide.

112. *See generally* Battilana et al., *supra* note 27.

113. *Id.* at 52.

how difficult it is to try to separate philanthropic behavior from purely strategic, market-driven activity.[114]

Second, a key issue is whether a company is private or goes public. If a social enterprise remains private, with the vast majority of the shares (or at least the votes), in the hands of the founders, their families, their hand-picked successors, or loyal employees, then there would be but small incentives to shift towards maximizing profits and away from the social goals of the business. Moreover, with all shareholders on board for the social mission, there is less of a practical danger that shareholders will sue directors for breach of fiduciary duty, regardless of what the relevant law may be: indeed, most of the shares would likely be controlled by the directors themselves. If the company goes public, matters become very different. At that point, the shares will be purchased by a cross-section of investors generally, and if the company does not produce a competitive risk-adjusted return, its share price could decline until the risk-adjusted return reaches the competitive rate. This might indeed put pressure on managers to increase profits.

There will, however, be a partial brake on this possibility to the extent that there are investors who will accept a lower risk-adjusted return in order to invest in a company of whose activities they approve morally.[115] Similarly, regardless of how one feels about the influence of the shareholder wealth maximization theory, not even its strictest adherents object when firms are open and honest about their social agendas.[116] When that happens, there should be an implicit understanding among all parties that managers may give preference to social objectives. This realization will then be reflected in equity prices.[117] Social decisions that reduce profitability may lead to lower share prices in the market, but shareholders hardly bear any costs if they expected those decisions and were still willing to invest.[118] They would be making the conscious decision to preference altruism and the warm glow of social investing in exchange for monetary

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114. Plerhoples, *supra* note 37, at 235; Ribstein, *supra* note 105, at 1147. Plum Organics provides a particularly telling anecdote on this point: when the company chose to give away a free nutrition supplement to children who chronically miss meals, the extensive positive media feedback that the company received turned a donation into a revenue-enhancing marketing score—and this came despite the fact that some investors openly questioned the "profitability" of such an act. Ariel Schwartz, *Inside Plum Organics, The First Benefit Corporation Owned by a Public Company*, FAST COMPANY (Jan. 22, 2014, 8:08 AM), http://www.fastcoexist.com/3024991/world-changing-ideas/inside-plum-organics-the-first-benefit-corporation-owned-by-a-public-co.

115. Robert T. Miller, *The Coasean Dissolution of Corporate Social Responsibility*, 17 CHAP. L. REV. 381, 400 (2014).

116. Baron, *supra* note 22, at 685.

117. *Id.*

118. FRANK EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 35–36 (1991).

gain. If anyone takes a financial hit, it will be the founders who do so through a social "discount" in the price of capital.[119]

These considerations ultimately highlight the importance of investor preference. Some investors will make investment decisions based on the firm's social impact rather than, or in addition to, its ability to generate financial returns. They might hope to make lots of money and believe that the best way to do so is through investment in clean energy, or they might see themselves more as quasi-donors.[120] Others might be totally agnostic about a firm's social mission and simply see a market opportunity.[121] And, of course, profit-maximizing investors who believe that social enterprises will only generate below-market returns can stay away.

To comment even more broadly, social enterprises are growing at a time when notions of shareholder prioritization continue to evolve. While it is true that courts, including those in Delaware, generally hold that directors must act for the benefit of the "corporation," what this means as a practical matter remains in flux.[122] Some managers probably do see the singular pursuit of wealth as their primary goal—likely because it provides a straightforward reference point for corporate decision-making. But many others, and perhaps most, now see a strong relationship between a firm's social footprint and its impact on shareholder value.[123] This realization has led commentators to suggest that the days of the "profit-only" business are over.[124] Stakeholder-centric governance is increasingly seen as the most accurate descriptive account of corporate behavior,[125] as well as a maturing normative theory among business scholars.[126] Profits still matter under this view, but there is growing recognition of the interplay between corporate

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119. Baron, *supra* note 22, at 715.

120. Steven Russolillo, *Man Who Bet It All on Tesla Answers Critics*, WALL ST. J. (May 20, 2013, 11:55 AM), http://blogs.wsj.com/moneybeat/2013/05/20/the-man-who-bet-it-all-on-tesla-answers-his-critics/.

121. John Tozzi, *More 'Patient Capital' for Social Ventures*, BLOOMBERG BUSINESSWEEK (Apr. 3, 2009), http://www.businessweek.com/stories/2009-04-03/more-patient-capital-for-social-venturesbusinessweek-business-news-stock-market-and-financial-advice.

122. Martin Gelter & Geneviève Helleringer, *Constituency Directors and Corporate Fiduciary Duties*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 302, 303 (Andrew Gold & Paul Miller eds., 2014).

123. *See, e.g.*, Ribstein, *supra* note 105, at 1444–45.

124. *Muhammad Yunus: 'Be Clear What You Want When Mixing Profit and Social'*, GUARDIAN (May 30, 2013), http://www.theguardian.com/social-enterprise-network/small-business-blog/video/2013/may/30/muhammad-yunus-video.

125. *See* Justin Fox & Jay W. Lorsch, *What Good Are Shareholders?*, HARV. BUS. REV., July-Aug. 2012, at 57.

126. Simons, *supra* note 53, at 9 (recognizing but criticizing the business academy's shift toward stakeholder theory); Lumen N. Mulligan, *What's Good for the Goose Is Not Good for the Gander: Sarbanes-Oxley-Style Nonprofit Reforms*, 105 MICH. L. REV. 1981, 2004 (2007).

value and sustainability within the profit calculus.[127] Indeed, considerable empirical work in this area shows that firms with a stakeholder-centric approach tend to outperform their counterparts economically over the long run.[128]

These results and the move toward sustainable business practices should hardly be surprising. The number of shareholders, consumers, and employees who seek to associate with firms that act in socially responsible ways only continues to grow.[129] Some managers recognize that they must consider societal interests for public relations purposes, if for no other reason. Others see opportunities to satisfy specific market demands, tap new streams of funding, or improve worker productivity through their attention to social issues.[130] Still others take a broader view and believe that problems like diminishing natural resources, corruption, and economic disparity will limit their ability to prosper if nothing is done to address them.[131]

Ultimately, contemporary corporate governance increasingly reflects Michael Jensen's view that "we cannot maximize the long-term market value of an organization if we ignore or mistreat any important constituency."[132] Corporate managers are now best understood to function as "mediating hierarchs" who weigh the needs and interests of every corporate constituent instead of serving solely to advance the interests of shareholders.[133] Companies are also beginning to supplement this model by integrating sustainability into their marketing, accounting, financing, and research and development practices.[134] The majority of firms on the Fortune 500 now publish "sustainability reports" and many feature Chief Sustainability Officers.[135] As competitors add new social and environmental programs, firms are responding with initiatives of their own

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127. Judd F. Sneirson, *The Sustainable Corporation and Shareholder Profits*, 46 WAKE FOREST L. REV. 541, 542 (2011).

128. Fox & Lorsch, *supra* note 125, at 57 ("There's a growing body of evidence . . . that the companies that are most successful at maximizing shareholder value over time are those that aim toward goals other than maximizing shareholder value."); Sneirson, *supra* note 64, at 1009–10; Robert G. Eccles et al., *The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance* (Harv. Bus. Sch., Working Paper No. 12-035, 2011).

129. *See, e.g.*, Tozzi, *supra* note 121 (discussing the increase of venture capitalist (shareholder) investment in socially responsible firms).

130. *Muhammad Yunus: 'Be Clear What You Want When Mixing Profit and Social'*, *supra* note 124.

131. Plerhoples, *supra* note 37, at 217–18.

132. Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, J. APP. CORP. FIN. Fall 2001, at 8, 16.

133. Ribstein, *supra* note 105, at 1465.

134. Andrew J. Hoffman & John R. Ehrenfeld, *The Fourth Wave: Management Science and Practice in the Age of the Anthropocene* 5 (Ross Sch. of Bus., Univ. of Mich., Working Paper No. 1196, 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2317423##.

135. *Id.* at 2.

to keep pace with market trends. Insurance companies also increasingly pressure managers to integrate social impact into their general risk management strategy.[136] One prominent practitioner even sees the link between corporate behavior and shareholder value as evidence that directors must consider stakeholder interests as part of their standard fiduciary duties.[137]

None of this is to say that corporate misconduct is history. There are still plenty of examples of firms and managers behaving badly. Agency costs will always be an issue. Nevertheless, the substantial harm to a firm's bottom line and reputation that can come from anti-social actions should incentivize every shareholder—including those who care only about profits—to care about attention to stakeholder interests and sustainability.[138]

The more immediate concern for social enterprises is how to address the practical governance challenge of managing potential conflicts between duties owed to both social and financial pursuits. Similarly, what happens if the preferences of shareholders or managers shift over time, either toward or away from the firm's social mission, and thus conflict with the initial expectations of other corporate constituents? Finally, there is the separate issue of attracting the right mix of capital, something of particular importance to social enterprises that generate lower profits—often because they serve consumers who are very poor—and thus must compete for the admittedly smaller universe of investors willing to accept below-market returns. Even for social enterprises that do not face this problem, investors might still find it difficult to assess risk or put a price on firms that pursue multiple bottom lines. These concerns are taken up below.

B. Accountability

The threshold accountability challenges in a social enterprise are fundamentally the same ones that every business must address. They relate to uncertainty, information asymmetry, and agency costs.[139] At an enterprise's early stages, uncertainty concerns arise because the firm has no meaningful performance record.[140] Information asymmetry is similar. As with all firms, an organization's controllers boast a significant informational advantage over outside investors because they know more

136. *Id.* at 5.

137. Underberg, *supra* note 9.

138. Derek Bok, *Comment on "The Business of Business Schools" (by Robert Simons)*, CAPITALISM & SOC. Jan. 2013, at 3; Ribstein, *supra* note 105, at 1444–45.

139. Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067, 1076 (2003).

140. *Id.* at 1076–77.

about the business and what they intend to do. They are also privy to confidential and proprietary information.

Matters can become more complex in a social enterprise because the quality of social performance is often difficult for outsiders to measure, predict, and evaluate, especially in the short term.[141] Of course, this is not always the case. Mission drift is relatively easy to monitor in social enterprises that pursue direct and clear social objectives. If Tesla starts producing gasoline-powered cars, it will be difficult for the company to hide that change from investors.[142] By contrast, information asymmetries are more extreme in firms that organize to pursue complex and less-quantifiable social missions. For these firms, rather than being defined by what they sell, they are defined primarily by what *else* they do beyond selling goods. If Tesla stops selling electric cars, that will be difficult to hide, but if Patagonia makes discrete changes to manufacturing policies, those decisions will be easier to keep under wraps. Departure from mission is therefore harder to detect in this context.

Social enterprises also are not immune to agency risks like managerial shirking. The wide discretion the law affords managers means that a firm's actions are generally the result of their personal choices. Some managers will selflessly work to advance the firm's social mission. Others, though, might use their discretion to pursue pet projects, focus on short-term gains to trigger compensation incentives, or rely on greenwashing tactics.

Finally, a social enterprise might start out at or near the hybrid ideal but then move away from its social objective toward greater pursuit of profits. This departure might follow from something as straightforward as changes in ownership or leadership, described as the "legacy problem," or it could be more nuanced, as when managers consciously or unconsciously start to leave poorer customers behind to expand sales to wealthier ones.[143] There is the additional possibility that some shareholders who began committed to the mission could eventually pressure management to prioritize profits. Benefit corporation statutes respond to these concerns with several requirements meant to help investors make informed decisions and provide them with confidence that a social enterprise will maintain fidelity to its mission over time. In theory, these requirements will better enable market actors to identify and support companies that commit to positive social impact. In practice, though, they warrant considerable skepticism.

141. Cummings, *supra* note 28, at 603–05.

142. This is particularly true in light of existing securities and consumer anti-fraud laws.

143. Battilana et al., *supra* note 27, at 54.

1. Public Benefit and Stakeholder Mandate

The benefit corporation's opening accountability salvo comes via the stakeholder mandate and public benefit requirements. Both are meant to orient managers toward the dual purpose of benefit corporations by requiring a specific mode of governance and decision-making. For example, in a Delaware benefit corporation, managers must "balance" (1) the pecuniary interests of shareholders, (2) the best interests of the firm's stakeholders, and (3) the public benefits specified in the firm's organizational documents.[144]

Despite their good intentions, provisions along these lines are arguably both too broad and too narrow. The ability to justify decisions by citing vague public benefit requirements or stakeholder interests could give managers "broad cover" to act selfishly or with less commitment to social impact than investors prefer.[145] Some investors might also worry *not* that managers will use their discretion to produce too little social impact, but that they will focus too much on public benefit and neglect financial goals. In either case, the wide range of interests that directors must consider arguably makes them answerable to none.[146]

Social enterprises might also be reluctant to restrict their flexibility in ways that benefit corporation laws require. Corporations rarely impose specific decision-making standards upon directors. The reason is simple. Just as the business judgment rule reflects the wisdom of granting broad discretion to managers, so too do corporate bylaws reflect the need to give managers considerable flexibility.[147] All firms depend on adaptive decision-making structures so they can proactively respond to new challenges.[148] This is especially true for startups. Firms entering or creating new industries frequently encounter roadblocks that require them to adapt. New competitors or regulations might emerge, or new technological or economic developments might occur. There will also be times when even the most strictly socially oriented investors should want their managers to focus more on profits than social impact. For example, managers might need to sacrifice the pursuit of a public benefit in the short term to pave the way for greater social impact in the long run.

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144. DEL. CODE ANN. tit. 8, § 365 (West 2013).

145. Liam Pleven, *When Doing Good Meets Investing*, WALL ST. J., July 13, 2013, at B9, *available at* http://online.wsj.com/news/articles/SB10001424127887324694904578598231690128560.

146. Dana Brakman Reiser & Steven A. Dean, *Hunting Stag with FLY Paper: A Hybrid Financial Instrument for Social Enterprise*, 54 B.C. L. REV. 1495, 1510 (2013).

147. Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1417–18 (1989). Similar issues would complicate any attempt by founders and investors to contract over how much social impact a firm will provide in relation to a range of financial objectives.

148. James Austin et al., *Social and Commercial Entrepreneurship: Same, Different, or Both*, 30 ENTREPRENEURSHIP THEORY & PRAC. 1, 10–11 (2006).

Therefore, the risk of imposing specific decision-making standards is that they will be unworkable.[149] How should managers balance their fiduciary duties if they face multiple potentially conflicting interests while working to serve the benefit of "the corporation?" Whose interests should win out when managers must choose between closing a factory, running it at a loss, or taking on additional debt to preserve a social mission?[150] Benefit corporation laws eliminate the risk of damages in this scenario, but depending on shareholders' motives for investing, they may not alleviate worries that some will be dissuaded from investing, or that others will demand a higher risk premium. Managers can thus look forward to the unenviable task of sorting the needs and wants of a potentially diverse (and competing) group of stakeholders that includes social investors, market-rate investors, lenders, employees, and consumers.[151]

A final difficulty relates to the definition of "general public benefit." Most benefit corporation statutes define it as something that creates "'a material, positive impact on society and the environment.'"[152] But what are we to make of a social enterprise that provides positive social impact but arguably does not impact both society *and* the environment? The statutory language implies that benefit corporations must adhere to a triple rather than double bottom line.[153] However, imagine a social enterprise that sells inexpensive eyeglasses to at-risk populations but otherwise does not use particularly environmentally friendly manufacturing processes. Such a company might be profitable, provide a significant and previously unmet public good, and yet fail to satisfy the benefit corporation's purpose requirement—thereby turning it off from the form altogether.

2. *Transparency and Third-Party Standards*

The benefit corporation's disclosure requirements shift the focus toward reducing information asymmetry. They come in addition to any disclosure obligations under the federal securities laws.[154] The expectation is that they will create sufficient legal and market pressures on firms to provide meaningful disclosure so that investors, consumers, and other stakeholders can assess the quantity and quality of their social impact and differentiate between firms on these grounds. They further save individual investors the need to spend money and time trying to gather the necessary information on their own.

149. Murray, *supra* note 7, at 32.
150. Raz, *supra* note 16, at 293.
151. *Id.* at 295–97.
152. *Id.* at 301.
153. Katz & Page, *supra* note 13, at 86.
154. *See, e.g.*, Securities Act of 1933, 15 U.S.C. §§ 77e, 77g, 77j, 77o (2012).

The problem is that these goals assume market actors can process disclosures effectively and have the incentive to follow them closely, neither of which is certain. Individual investors in firms with diffuse ownership face a collective action problem that discourages them from closely monitoring corporate disclosures. This is why most pursue a diversification strategy and invest through financial intermediaries. Financial intermediaries have the expertise, incentives, and leverage to process firm-specific information and demand more when necessary, but, unfortunately, they are not always available in the social enterprise sector.

Furthermore, mandatory disclosure does not eliminate the difficulty of interpreting social information in firms with complex missions. Benefit corporation statutes routinely instruct firms to provide a narrative description of how their public benefit pursuits are progressing.[155] They also often require an assessment of how a social enterprise's efforts stack up against whatever third-party standard it chooses to implement.[156] These requirements pose several challenges. First, some social performance information is relatively easy to quantify and report (e.g., Blue River sold X number of weed-killing robots, thereby eliminating the need for Y number of farmers to use pesticides). But other types are less verifiable, such as promoting environmental stewardship or employing "at-risk" employees.[157] This dynamic creates a risk that managers will drift toward activities that generate the former type of information at the expense of the latter.[158] For example, since it is easier to show improvement in areas with easily quantifiable metrics, managers might neglect to invest in "softer" social pursuits.

The challenge of credibly disclosing information about complex or non-quantifiable social performance also suggests that firms might prepare only vague and generic disclosures—or fail to disclose anything at all. There are no statutory penalties for noncompliance with benefit corporation reporting obligations, meaning that firms with negative or hard-to-express information might simply withhold disclosure or release only partial information. Shareholders can certainly initiate derivative suits or benefit enforcement proceedings to encourage compliance, but as I show in the next section, both options are of little practical value.

Finally, if transparency and third-party assessment are so important, it is unclear why statutory disclosure requirements are even necessary. Companies can voluntarily pursue "B Corporation" certification or hire an

155. Cummings, *supra* note 28, at 594–95.

156. *Id.* at 594.

157. *Id.* at 603–04.

158. Edmans et al., *The Real Costs of Disclosure* 1 (Oct. 8, 2013) (unpublished manuscript) (on file with author).

independent social auditor if they wish to distinguish themselves on the basis of social performance. Indeed, some commentators question whether states should serve as branding agents by offering the benefit corporation option, especially when the benefit reporting requirement does not appear to be truly "mandatory" and managers can pick the standard of assessment they want to follow.[159]

3. *Enforcement and Shareholder Activism*

Provisions that emphasize direct shareholder action on accountability raise additional issues. First, the benefit enforcement proceeding is fairly toothless. Others have shown that the traditional shareholder derivative suit is largely ineffectual—particularly in light of the business judgment rule—and nothing about the benefit enforcement proceeding changes that.[160] Standing is limited to directors and shareholders, meaning that the firm's intended public beneficiaries are left out, and there is no opportunity for money damages. Also, depending on a firm's size and ownership characteristics, most individual shareholders lack the incentive to spend any meaningful time on monitoring efforts. Even if shareholders litigate issues bearing on a benefit corporation's social pursuits, courts confronting this new and unique space will likely resist substituting their judgment for that of management so long as managers appear to be making a good faith effort.[161]

Traditional methods of shareholder activism are similarly weak. Shareholders face well-documented challenges in corporate elections, proxy fights, and requests to inspect corporate records.[162] Shareholders may further stand to gain financially from mission drift, suggesting that those who try to closely monitor management might be tempted to quit as their wealth starts to grow.[163] Finally, nothing about benefit corporation legislation prevents changes in ownership or legal status. Shareholders can vote to convert the firm to a traditional corporation through a two-thirds majority vote, or they can simply exit by selling their shares. Benefit corporation laws thus appear unable to fully guarantee a singular or lasting social focus on their own. Something else becomes necessary.

159. Raz, *supra* note 16, at 305.

160. Ribstein, *supra* note 105, at 1473.

161. Clark & Babson, *supra* note 65, at 28.

162. Brakman Reiser, *supra* note 6, at 612–13.

163. *Id.* at 613.

IV. THE BENEFIT CORPORATION AS EXPERIMENT IN NEW GOVERNANCE

The discussion up to this point presents a puzzle. We know that benefit corporation laws are unnecessary to expand the discretion of a social enterprise's managers in the day-to-day running of the firm. We also see several reasons to be skeptical about how they approach accountability and enforcement, which would seem to harm their branding potential. Yet, if the benefit corporation form is negligible, why are states continuing to enact new benefit corporation statutes at an increasingly rapid pace? And what explains the many firms that keep adopting the form?

One answer is that perhaps these actors are mistaken. Entrepreneurs might be selecting the form based on false assumptions or a misreading of corporate fiduciary duties. The same goes for legislators. They might want to help social enterprises but could be getting it wrong by focusing on enabling statutes rather than, say, changes to tax policy. Another possibility is that benefit corporation legislation is simply an attempt by lawyers and other professionals to create a new business form so they will have a new product to "sell."[164] For example, B Lab lobbied to get versions of its Model Act passed in most of the states that now feature benefit corporation legislation.[165] A cynic might note that B Lab also happens to be in a position to gain reputational benefits by providing firms with the assessment standards that the Model Act requires.[166]

Any of these possibilities could be true. But there is also another plausible explanation: that many rational people know exactly what they are doing in promoting or adopting the benefit corporation form. After all, founders of benefit corporations were presumably guided by counsel when selecting the form.[167] Furthermore, not every state has blindly followed B Lab's model, and the push for a new business form was largely organic within the social enterprise community.[168] The question thus remains: what value do benefit corporation laws add in light of their apparent limitations?

A. *Insights from New Governance*

It's tempting to view benefit corporation laws as though they function just like traditional enabling statutes. However, much of the criticism surrounding them exposes a misunderstanding about the breadth of their

164. Ribstein & Kobayashi, *supra* note 95, at 112.

165. J. William Callison, *Benefit Corporations, Innovation, and Statutory Design*, 26 REGENT U. L. REV. 143, 146 (2013).

166. *Id.* at 148.

167. Fleischer, *supra* note 69, at 174.

168. For example, Delaware's Public Benefit Corporation Act was an independent product of the Delaware corporate laws committee. Callison, *supra* note 165, at 163.

design. Traditional corporate enabling statutes provide templates for specific business forms. Under the contractarian model, they are thought to lower transaction costs by providing managers and investors with default terms that reflect the likely hypothetical private bargain they would strike on their own.

Benefit corporation statutes also provide default rules for a corporate form but combine them with provisions that are more public or regulatory in nature. Some provisions are distinctly regulatory, like mandatory disclosure requirements, and others are quasi-regulatory, like mandatory assessments against third-party standards. These hybrid public/private characteristics make benefit corporation laws unique among corporate enabling statutes, which typically lack reporting or external engagement requirements like those found in the federal securities or environmental laws. Moreover, and most importantly for my purposes, they also call to mind several aspects of contemporary new governance theory.

1. What Is New Governance?

New governance defies easy definition, but it typically refers to a collection of ideas for governance where law serves as a launching point for a multi-dimensional approach to addressing complex social and economic challenges. Like the social enterprise movement itself, new governance seeks mainly to "'harness [] private capacity to serve public goals.'"[169] It does so through two general strategies. First, recognizing that the state as a sole locus of rulemaking is usually one step behind private actors, new governance encourages dialogue and collaboration among multiple stakeholders—including firms, regulators, and professional groups—to develop meaningful tools for self-regulation.[170] Throughout this process, the state is understood to act mainly as a facilitator rather than a top-down regulator.[171] It provides a general legal framework by virtue of its position and authority, but policy implementation is left to the people closest to the ground and who possess the most expertise on a given topic. Help in this regard comes when static rules give way to reflexive rules that allow for flexibility and adaptability in the face of new or changing phenomena.[172]

169. Saule T. Omarova, *Wall Street as Community of Fate: Toward Financial Industry Self-Regulation*, 159 U. PA. L. REV. 411, 428 (2011) (alteration in original).

170. *Id.* at 426.

171. Orly Lobel, *The Renew Deal: The Fall of Regulation and the Rise of Governance in Contemporary Legal Thought*, 89 MINN. L. REV. 342, 377 (2004).

172. Bridget M. Hutter, *Understanding the New Regulatory Governance: Business Perspectives*, 33 LAW & POL'Y 459, 461 (2011) (alteration in original) (quoting Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543, 549 (2000)).

Second, new governance principles of accountability often prioritize soft law in place of, or in addition to, hard law. For example, rather than rely solely on punitive sanctions to boost compliance, new governance emphasizes public-private partnerships, the importance of internalizing values within firms, and the development of industry standards and best practices to guide behavior.[173] Similar strategies focus on harnessing both legal and market pressures to achieve policy goals—including reliance on mandatory disclosure requirements and third-party assessment programs—as well as regulatory principles that reflect insights from behavioral economics and the expressive power of law.

In the end, as I will continue to unpack, new governance sees law as going beyond the enforcement of contract rights or the provision of default rules for business associations. Law becomes an important "coordinative mechanism" for creating a diverse array of policy solutions beyond the broadly contractual conception of the firm.[174] Situating benefit corporation laws within this paradigm does not resolve every challenge facing dual-purpose firms, but it goes a long way toward explaining why the concerns described in Part III should not be taken as reasons to abandon the form.

2. *Signals and Shocks*

Initially, looking at benefit corporation laws from the perspective of new governance offers a new way to think about their role in the market. For example, some maintain that benefit corporations statutes actually create a harmful dichotomy between "profit-only" corporations and "responsible" corporations.[175] The argument is that, by resting on the false premise that managers of traditional corporations must prioritize profits above all else, the benefit corporation form undermines efforts to convince *all* corporate managers that CSR-driven activities are consistent with their fiduciary duties. Similarly, there is a fear that the form will prompt courts to redefine the obligations of corporate directors in traditional firms by adding a shareholder wealth maximization requirement where one does not currently apply.[176] In either case, proponents of benefit corporation laws

173. Deborah E. Rupp & Cynthia A. Williams, *The Efficacy of Regulation as a Function of Psychological Fit: Reexamining the Hard Law/Soft Law Contiuum*, 12 THEORETICAL INQUIRIES L. 581, 586 (2011); William H. Simon, *Afterward—Part II: New Governance Anxieties: A Deweyan Response*, 2010 WIS. L. REV. 727, 729–30 (2010) ("[W]e can think of [new governance] horizontally—say from the point of view of a group of peers (individuals, firms, states) who want to commit themselves to joint action but, because of uncertainty, cannot contractually specify their mutual obligations and must thus set up a regime for ongoing adaptation.").

174. Robert A. Kagan et al., *Explaining Corporate Environmental Performance: How Does Regulation Matter?*, 37 LAW & SOC'Y REV. 51, 84 (2003).

175. Callison, *supra* note 9, at 102; Underberg, *supra* note 9.

176. Callison, *Benefit Corporations, supra* note 165, at 153; Callison, *supra* note 9, at 105.

could be seen as acting contrary to their own interests by attempting to carve out their own statutory space.

But this perspective takes an overly narrow view of the qualities of the benefit corporation form. As Hoffman puts it, there is a difference between reducing unsustainability—the classic domain of CSR—and creating sustainability—the promise of social enterprise.[177] While it is true that managers of traditional corporations increasingly see sustainability and social impact as important strategic considerations, the worry is that this recognition is not translating into widespread positive change.[178] Sustainability is still proving elusive, and in many corners, there remains a "visceral distrust" of traditional for-profit entities.[179] Movements such as "Occupy Wall Street" and post-financial crisis populism reflect a continuing lack of faith in managers' ability to avoid excessive risk-taking. More broadly, sociologists find that many among the post-Baby Boom generations of entrepreneurs, investors, and consumers are idealistic, seek greater authenticity in their commitments, and desire to see corporations as instruments of change or reflections of their own values.[180]

With these considerations in mind, a key lesson of new governance is that legal forms and structures can send important signals that help to form a consensus around particular norms. In the case of benefit corporation laws, they are meant to facilitate the formation of private social enterprises, which in turn, are meant to promote the public good. They therefore reflect a legislative judgment about the desirability of firms that actively seek to solve social problems. Their reliance on an intertwining of public and private law characteristics also gives them something in common with classic public laws like the ones found in environmental or securities regulation: they reflect a public determination about how certain private actors should behave.[181] And, like the laws in those fields, they rely heavily on disclosure and transparency rules to protect public interests and elicit public engagement.

The notion that benefit corporation laws make a statement about the social value of hybrid firms provides strong evidence for why so many entrepreneurs find them attractive. Under an expressive theory of law, one of the most important functions of law is to express beliefs about societal

177. Hoffman & Ehrenfeld, *supra* note 134, at 1.

178. *Id*.

179. Yuan Ji, *Burning Man: A Case Study of Altruism Thriving in a For-Profit Organizational Form and the Rationales for LLC-to-Nonprofit Conversion*, 9 HASTINGS BUS. L.J. 449, 459–60 (2013).

180. Beth Cousens et al., *Using the Contextual Orientation to Facilitate the Study of Bible with Generation X*, 74 J. JEWISH EDUC. 6, 12 (2008); Kaylene C. Williams et al., *Multi-Generational Marketing: Descriptions, Characteristics, Lifestyles, and Attitudes*, 11 J. APP. BUS. & ECON. 2 (2012).

181. *See generally* MARC T. MOORE, CORPORATE GOVERNANCE IN THE SHADOW OF THE STATE (2013).

values.[182] For example, anti-discrimination laws can be understood as expressing the view that racial discrimination is morally wrong. This message, and the social norm it conveys, can help shape individual behaviors and preferences independently of any separate punitive sanctions. In a similar vein, benefit corporations represent a potential shock to the system. Because laws send powerful signals about the importance of particular phenomena,[183] the benefit corporation form can add value for a new wave of entrepreneurs simply by offering a systematic alternative to the old guard. The form offers something new, exciting, and unconventional to shake up the corporate landscape and displace "core beliefs" about the traditional corporate model.[184] It goes beyond efforts to enact narrow reforms to existing corporate practice by offering a new corporate architecture that embodies the goal of generating positive impact within a profit-making framework.

Therefore, even if they are not legally necessary to accomplish what social enterprises desire, state-sponsored benefit corporation laws provide important information to the market that options like private certification cannot match.[185] The state's backing lends legitimacy to the social enterprise movement, influences public expectations about the possibilities of dual-purpose firms, and provides an outlet with the force of law for firms to demonstrate their commitment to multiple bottom lines. It is plausible that these factors could, in the long run, change social attitudes about the importance of balancing social and economic concerns in all corporations. For now, they combine to raise the profile of hybrid firms and provide a window into what they value.

3. Self-Regulation and External Engagement

In keeping with the question of why an entrepreneur might want to organize her business as a benefit corporation, a second factor is the form's potential to drive a process of self-regulation within the social enterprise sector. The term "self-regulation" can refer to a wide range of activities, but I use it primarily in the way that scholars of new governance use it. A new governance gloss on self-regulation posits that the state should allow private actors in specific industries or sectors to shape the standards and

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182. Susanna Kim Ripken, *Corporate First Amendment Rights After* Citizens United*: An Analysis of the Popular Movement to End the Constitutional Personhood of Corporations,* 14 U. PA. J. BUS. L. 209, 248–54 (2011).

183. Ruth V. Aguilera et al., *Putting the S Back in Corporate Social Responsibility: A Multilevel Theory of Social Change in Organizations*, 32 ACAD. MGMT. REV. 836, 848–50 (2007).

184. Hoffman et al., *supra* note 17, at 5–7.

185. *See* Aguilera et al., *supra* note 183, at 836.

practices that govern their affairs.[186] This idea came about as a way to manage market complexity. Unlike states, which suffer from several well-known structural, informational, and temporal limitations, private firms get a first-hand view of the underlying trends and obstacles they face on a daily basis. Self-regulation allows firms to take advantage of this "on the ground" knowledge to develop context-specific strategies for responding to new or changing circumstances.[187]

Not only is this approach more flexible than traditional top-down rule-making, it can also be cheaper and more effective. For example, proponents of self-regulation stress that it often leads to greater levels of collaboration among firms, stakeholders, and policy groups on matters ranging from corporate best practices to market benchmarks and performance standards.[188] External engagement along these lines, in turn, has the "potential to foster shared values among industry actors, a stronger sense of participation in the process of rulemaking reflecting such common values, and voluntary compliance with the resulting rules."[189] This does not mean that there is no role for state involvement in self-regulation. However, by recasting its focus from enforcement to facilitation, the state's primary role becomes promoting collaborative policy development through tools such as legislative ambiguity, market-based certification or assessment requirements, and transparency rules that create additional market pressures for compliance.

In seeking to apply these principles to benefit corporations, we see first that social enterprise is nothing if not complex. The primary issues identified earlier relate to mission drift, the legacy problem, information asymmetry, agency costs, the difficulty of assessing social performance, and the governance challenge of managing competing stakeholder interests. These concerns make the task of lawmakers hoping to promote benefit corporations increasingly difficult. For benefit corporation legislation to facilitate growth, it must improve upon existing law and be both comprehensive and flexible enough to meet the needs of founders, investors, and other relevant stakeholders who occupy such a dynamic field. But the infancy of the social enterprise movement and the new combination of activities it entails means that few people can speak with certainty about what entrepreneurs or investors need to best protect and advance their interests. Accordingly, rather than rely on static legislative pronouncements that cannot keep pace with this evolving sector, the

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186. Omarova, *supra* note 169, at 427–30.

187. *See* Kenneth A. Bamberger & Deirdre K. Mulligan, *New Governance, Chief Privacy Officers, and the Corporate Management of Information Privacy in the United States: An Initial Inquiry,* 33 LAW & POL'Y 477, 480 (2011).

188. Omarova, *supra* note 169, at 427–30.

189. *Id.* at 423.

complexity facing social enterprises suggests that a self-regulatory structure built around industry participation and reflexive policy development offers a valuable way forward.

Matters become slightly more complicated, though, when moving from the potential normative value of self-regulation to its practical execution. Fortunately, most benefit corporation laws feature several characteristics that ought to promote the type of self-regulatory regime I describe. One example relates to flexibility and ambiguity in key statutory provisions. While definitions of the stakeholder mandate and public benefit requirement are often criticized as vague and ambiguous, these attributes can go from a negative to a positive when the group targeted by a statute consists of many diverse actors who operate in dynamic environments. For instance, since every social enterprise features a unique stakeholder profile, a broad stakeholder mandate errs on the side of inclusion and flexibility to allow for context-specific approaches to governance. By the same token, when firms must engage with flexible legislative provisions it forces them to develop a more thorough understanding of legislative goals, industry trends, and their own circumstances if they are to avoid the paralysis that ambiguity might otherwise bring. Managers and employees must consider multiple perspectives, debate the meaning of broad terms, and reflect on myriad issues—all of which can trigger deeper knowledge and greater internalization of the values behind the standards and practices that emerge from their efforts to manage uncertainty.[190]

Likewise, by instructing managers to balance stakeholder interests, benefit corporation laws raise awareness about issues that should inform their behavior.[191] Stakeholder governance means little if there is no discussion about implementation. While it is possible that some managers might find a broad stakeholder mandate to be confusing or paralyzing, others will see it as a prompt to engage with corporate constituents to better determine how to incorporate their concerns into strategic decisions.[192] This is an important strategy for all firms hoping to boost their legitimacy. Employees and stakeholders who feel included in the corporate decision-making process demonstrate higher levels of emotional investment and commitment to the firm's mission.[193] They are more likely to accept and abide by organizational directives and norms, and to resist pressures to go

190. Bamberger & Mulligan, *supra* note 187, at 489–91.

191. *See generally* Louis Lowenstein, *Financial Transparency and Corporate Governance: You Manage What You Measure*, 96 COLUM. L. REV. 1335 (1996).

192. Aguilera et al., *supra* note 183, at 844–47.

193. E. ALLAN LIND & TOM R. TYLER, THE SOCIAL PSYCHOLOGY OF PROCEDURAL JUSTICE 179, 194, 196, 207–08 (1988); Rupp & Williams, *supra* note 173, at 587–88; Hoffman, *supra* note 17, at 12.

against them, when they have a thorough understanding of the reasons behind them and feel they play a meaningful part in their development.[194]

Other features of benefit corporation laws also come into clearer focus once we examine them from the perspective of self-regulation. The most obvious examples are mandatory disclosure and assessment requirements. The classic understanding of mandatory disclosure rules are that they mitigate information asymmetry.[195] However, they also make it easier for market actors to monitor firm behavior and apply legal or market pressure when necessary to encourage compliance. On this theory, benefit corporations that fail to adhere to their public disclosure obligations should suffer reputational consequences that will hinder their ability to attract investors, talent, or consumers, thereby allowing their more compliant counterparts to use that distinction to their competitive advantage.[196]

The benefit corporation's third-party assessment requirements are similarly outward facing, but they fulfill a slightly different role than mandatory disclosure. Success and failure are relatively easy to evaluate when profitability is the only metric for managers and investors to follow.[197] However, different social enterprises produce different social outputs and weigh them against different financial goals. Social enterprise leaders agree that the movement's growth will depend on developing consistent, meaningful standards to measure and report social and financial performance in multiple contexts.[198] There is a particular need for baseline and universal metrics to reduce information asymmetry so that all firms and investors can use the same tools, compare results, and revise tests as necessary for evaluative purposes.[199]

Consequently, benefit corporation statutes put the onus on the market to determine what it means for third-party standards to be "comprehensive,

194. LIND & TYLER, *supra* note 193, at 199–200; Rupp & Williams, *supra* note 173, at 588.

195. *See* Paul M. Healy & Krishna G. Palepu, *Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literature*, 31 J. ACCT. & ECON. 405, 408 (2001).

196. Encouraging external pressure is certainly a key part of self-regulation, but transparency rules provide additional benefits, too. Though not strictly a new governance strategy, when managers must gather and analyze information in anticipation of disclosure, they ought to gain greater awareness about firm performance and the steps necessary to improve or maintain it. Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L. Q. 417, 465 (2003). For example, managers who must provide a narrative description about their pursuit of social and financial objectives ought to be more prone to engage in a process of self-reflection to determine how well they are living up to their own and others' expectations. Of course, managers might do this even without legal compulsion, but it's plausible that disclosure rules provide an important extra incentive.

197. Ribstein, *supra* note 105, at 1463–64.

198. Battilana et al., *supra* note 27, at 55.

199. Tamara Schweitzer, *Interview: Acumen Fund's Sasha Dichter on Trends to Look for in 2011*, ACUMEN (Feb. 24, 2011), http://acumen.org/blog/our-world/interview-acumen-funds-sasha-dichter-on-trends-to-look-for-in-2011/.

credible, and recognized for assessing social and environmental performance."[200] This allows the relevant parties—including firms, investors, professional groups, and standard-setting organizations—to experiment and apply their own inputs when formulating standards to fit the changing needs of all social enterprises. The third-party evaluation process is thus best seen, not as a static framework, but as a way of moving toward a greater understanding of what the goals of social enterprise should be. The benefit corporation structure provides a way of deliberating on and experimenting with socially constructive action over time.

4. Building a Bridge to Self-Regulation

Collectively, the benefit corporation's self-regulatory characteristics offer a "structure through which private commercial exchange may be regulated for essentially public purposes" without any direct government oversight.[201] The potential upside of this structure makes it easy to see why individual benefit corporations would engage with it. Self-regulation promises to temper concerns about transaction costs, mission drift, and information asymmetry by helping benefit corporations develop governance solutions for managing competing interests and encouraging them to put more higher-quality, social-enterprise-specific information into the market. These factors should provide a much-needed boost to the form's credibility among investors, consumers, and other groups.

And yet, despite the spirit of optimism that self-regulation often generates, there are a variety of issues that warrant further attention. The first is whether a new governance form of self-regulation will prove attractive or useful to every social enterprise that might be thinking of becoming a benefit corporation. The answer, I believe, is yes and no. In every sector, the active engagement of firms in the regulatory process can help overcome the limitations that traditional forms of top-down legislative rulemaking present. For all firms, self-regulation is more responsive and flexible, and it shows great promise in leading to higher rates of compliance.

However, for present purposes, it seems likely that the social enterprises that stand to benefit the most from a self-regulatory process are those with broader social missions or less profit potential. With respect to firms at or near the hybrid ideal, such as Sanergy or Blue River, their social objectives are direct and market driven. There is little tension between

200. *See* Brakman Reiser, *Regulating Social Enterprise*, *supra* note 81, at 237; *Criteria for Acceptable Third Party Standards*, *supra* note 80.

201. Margaret M. Blair et al., *The New Role for Assurance Services in Global Commerce*, 33 J. CORP. L. 325, 329 (2008).

profits and impact, and in any case, mission drift is relatively easy to monitor. This likely explains why neither Sanergy nor Blue River has chosen to become a benefit corporation yet.

In contrast, as firms like Greyston Bakery—which has become a statutory benefit corporation—pursue broader social missions or missions that result in lower revenues, the governance challenge of managing heterogeneous interests among a potentially discordant group of shareholders and stakeholders takes on greater significance. The cost of capital will also likely increase as risk becomes harder to quantify. It is in these situations where self-regulation offers the most potential for managing complexity.

This leads to another, larger issue: even if they would benefit from self-regulation, can we necessarily expect social enterprises to use the benefit corporation form as their framework for doing so? Social enterprise is a diverse space, and becoming a benefit corporation is not cheap. Some firms might balk at adhering to its transparency and assessment requirements, particularly if they fear that competitors will skimp on compliance to save costs.[202] A similar but more general risk of self-regulation is that it will lead to cosmetic and self-serving standards, or that it will suffer from intractable free-rider problems.[203] For example, one worry is that benefit corporations will use the form only as a vehicle for "cheap talk" or greenwashing.[204] This concern highlights the fundamental challenge of giving firms more leeway and shared responsibility for finding policy solutions. Meaningful self-regulation depends on firms being willing to participate in a process that seeks to advance the collective good even if that means avoiding actions that might otherwise be in their individual self-interest.[205] Is it safe to assume that this will happen in the case of benefit corporations?

a. Focal Points

Most commentators agree that successful self-regulation can only occur in the shadow of the law.[206] That is, for firms to meaningfully engage with

202. Another potential objection is that much of what the benefit corporation form offers by way of self-regulation could arguably be handled through a private certifying regime rather than by statute. For example, some suggest that because social enterprise is evolving so quickly, it would be better to rely on private organizations like B Lab to drive the standard-setting process forward rather than give the job to less flexible state governments. Murray, *supra* note 7, at 19–27. Of course, arguably this is what states are already trying to do. By providing an initial framework that utilizes open-ended terminology rather than prescriptive rules, most benefit corporation laws leave the details of standard-setting and implementation to market actors.

203. Omarova, *supra* note 169, at 423.

204. *See, e.g.*, Thomas P. Lyon & John W. Maxwell, *Greenwash: Corporate Environmental Disclosure Under Threat of Audit*, 20 J. ECON. & MGMT. STRATEGY 3, 5 (2011).

205. Omarova, *supra* note 169, at 420–21.

206. *Id.*

it, the state must provide a formal legal framework that guides the self-regulatory process. One way states do this is by offering statutory provisions that "nudge" self-regulation forward.[207] The benefit corporation's mandatory assessment and disclosure rules are two examples of this strategy. They both encourage external engagement and market-based collaboration by forcing firms to take an outward-facing view of their responsibilities.

Law can further assist self-regulation in another important respect. Similar to its expressive power, law establishes "focal points" that facilitate group interaction and influence collective behavior without resort to sanctions to induce compliance. This is another example of law's ability to minimize complexity and facilitate private ordering. Individuals often gravitate toward specific laws and the rules they embody because of law's perceived legitimacy and its ability to rise above other forms of expression.[208] States that enact subject-specific laws thus help to guide behavior *ex ante* by signaling that certain outcomes are more preferable than others. Put another way, by making one outcome salient or "focal," legal rules "guide expectations toward that outcome" and create "self-fulfilling expectations that [the] outcome will occur."[209]

The idea of law as a focal point is relevant to social enterprise for several reasons. Even though firms might benefit from self-regulation and external engagement, the social enterprise space is so diverse that it may be difficult for collaboration to occur organically. However, widespread state sponsorship of benefit corporation legislation directs social enterprises toward a desired starting point for structuring their behavior. Seeing benefit corporation laws as focal in this way does not mean they will dictate particular standards. Rather, they simply incentivize firms and stakeholders to participate in a self-regulatory process by providing a locus for networking that facilitates coordination, communication, and standards development.[210] The laws help to attract social enterprises by pointing to a preferred organizational form, and from there, their salience makes it more likely that firms will engage with each other since doing so is expected of them and supported by the coordinative framework that the law provides.[211]

Furthermore, legal focal points can also focus the attention of other market actors, including consumers, NGOs, and stakeholders, toward

207. *Id.*

208. *See* Richard H. McAdams & Janice Nadler, *Testing the Focal Point Theory of Legal Compliance: The Effect of Third-Party Expression in an Experimental Hawk/Dove Game*, 2 J. EMPIRICAL LEGAL STUD. 87 (2005).

209. *Id.* at 88, 93.

210. *See* Robert B. Ahdieh, *Law's Signal: A Cueing Theory of Law in Market Transition*, 77 S. CAL. L. REV. 215, 287 (2004).

211. McAdams & Nadler, *supra* note 208, at 88.

pressuring firms to participate in self-regulatory activities.[212] Though it occurs in a different context, scholars often point to the creation of the Extractive Industry Transparency Initiative (EITI) as an example of this phenomenon.[213] With the goal of improving government accountability and political stability in developing countries, the United Kingdom became a leader in the EITI in an effort to encourage all companies in the petroleum industry to disclose the payments they make to foreign governments.[214] By doing so, the government was able to use the EITI as a focal point within the larger CSR space to marshal the support of NGOs and socially conscious institutional investors so that both groups could concentrate their efforts on pressuring firms to comply with the EITI's voluntary disclosure guidelines.[215] This approach did not solve every problem with illegal foreign payments, but it made it easier for a diverse group of values-based entities to accomplish a positive result.

b. Leadership, Community, and Cooperation

It is certainly possible that some firms will not buy in to the coordinating aspect of benefit corporation laws and may instead be drawn to alternative business forms. Only time and greater empirical study will tell. However, there is reason for optimism. The benefit corporation form continues to hold the most traction among state lawmakers and leading figures within the social enterprise sector. Publicity and industry leadership are two key conditions for creating strong legal focal points.[216] Before founders will elect to organize as a benefit corporation, they will need to develop expectations about how the market will view the form and whether others will adopt and engage with it. Accordingly, the support of high-profile figures like Patagonia, Ben & Jerry's, and B Lab can convince social enterprises that the benefit corporation form is, or will become, the new market standard. When competent leaders express a preference in this way and then commit to it, their conduct influences others to do the same because of the added credibility that a leadership presence provides.[217] In addition, given B Lab's longstanding history of promoting socially oriented investment and businesses, its role in shaping benefit corporation legislation should make the form appear more organic to the social

212. Aguilera et al., *supra* note 183, at 844–45.
213. *Id.* at 854.
214. *Id.*
215. *Id.*
216. *See* McAdams & Nadler, *supra* note 208, at 97.
217. *Id.* at 115.

enterprise community.[218] This perception ought to engender greater support for and acceptance of it within that community.

Another important condition for incentivizing successful self-regulation and external engagement is a spirit of mutual dependence and cooperation within the relevant sector.[219] Similar to the concept of building an industry "ecosystem" or "community of fate," the central idea is this: self-regulation works best when firms within a specific sector or industry realize that their futures hinge largely on how well they interact with each other, their stakeholders, legislators, policy groups, and industry professionals.[220] If firms believe that collaboration and the creation of a common normative framework are precursors for their collective survival, they are more likely to take the self-regulatory steps necessary to accomplish those results. Of course, this does not mean that firms will stop competing for funding, consumers, or talent. But along with competition, they must also come to appreciate that their relevance and impact depends on systemic action rather than the activities of one or two individual companies.[221]

How do we know if such an ecosystem exists, or is likely to exist, for benefit corporations? The first clue is that many within the broader social enterprise space already speak of its importance. Among social entrepreneurs, many see themselves as part of a "movement" to achieve significant and lasting positive impact.[222] The mentality that they are part of something bigger than just one person or company should, in turn, prompt individual social enterprises to consider the benefits of taking steps to establish a self-regulatory framework.

A second factor in developing an ecosystem or community of fate mentality is the presence of industry interconnectedness and cooperation. Even though social enterprises come in different sizes and offer a wide variety of products and services, the sector exhibits a high degree of homogeneity and "intrasectoral" cooperation. Hoffman finds that social enterprises often "seek a leadership role within their industry," noting that, "while other companies seek to influence institutions to reduce regulations and external costs to protect their competitive advantage, [social enterprises] seek to influence institutions to draw other companies into emulating them."[223] In these ways, social enterprises act as "institutional entrepreneurs; changing the rules of the game for all

218. Omarova, *supra* note 169, at 474.

219. Ahdieh, *supra* note 210, at 287; Omarova, *supra* note 169, at 456.

220. Omarova, *supra* note 169, at 446.

221. PAUL C. LIGHT, THE SEARCH FOR SOCIAL ENTREPRENEURSHIP 62 (2008).

222. Phillis, *supra* note 59, at 19.

223. Hoffman et al., *supra* note 17, at 15.

organizations . . . [and] promoting sustainable products and practices that will eventually become established as industry norms that all must follow."[224] Many social enterprises also work with industry groups, government agencies, and other stakeholders to develop standards for sustainable production and industry practices.[225] For example, in an effort to facilitate transparency and information sharing, Seventh Generation, a social enterprise that manufactures ecologically friendly cleaning products, now publicly discloses its product formulations so that competitors can learn from its advances.[226] Other social enterprises interact extensively with their suppliers and communities to establish mutually beneficial arrangements on practices ranging from price and wage structures to employee training programs.[227]

Corollary to its ability to create a focal point, the benefit corporation form offers a promising structure for facilitating such collective interaction. The form is a highly visible archetype within a complex space that provides common ground for firms and other market actors to coordinate their activities.[228] Moreover, along with the examples set by leading benefit corporations, the form's explicit mandate to consider multiple interests should make cooperation more palatable. Firms that prioritize profits above other objectives often lack the incentive to share information with their competitors.[229] In that case, first-movers will see their profits slip if information sharing allows others to easily replicate their techniques or strategies. However, by definition, the benefit corporation form means that profits are not the overriding organizational focus. Its hybrid nature thus creates more room for cooperation within a business model that still requires a degree of competition to be successful. Indeed, this is likely one reason why benefit corporations often cooperate to take advantage of group discounts and gain better access to service providers.[230] As I will explain in Part V, the challenge now becomes finding ways to nurture these and similar cooperative efforts.

c. *Internal Dynamics*

A final reason to be confident in the ability of the benefit corporation form to drive a meaningful process of self-regulation goes back to the form's expressive power. Specifically, an important step in addressing

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224. *Id.* (citation omitted).

225. *Id.*; LIGHT, *supra* note 221, at 62.

226. Hoffman et al., *supra* note 17, at 14–15.

227. *Id.* at 11–12.

228. *See generally* ASPEN INSTITUTE, THE EMERGING FOURTH SECTOR (2009).

229. Peter Molk, *The Puzzling Lack of Cooperatives*, 88 TUL. L. REV. 899, 915 (2014).

230. Murray, *supra* note 7, at 44.

issues like mission drift, the legacy problem, and the corporate governance challenges facing hybrid firms is to recognize that, just as they send broader signals about values to the market, legal forms also influence internal corporate behavior and compliance. Individuals who associate with a social enterprise can come and go or alter their preferences. Yet since the people within an organization are the most significant determinants of its commitment to social mission, taking steps to ensure the "right" people (or their replacements) remain in place is crucial.[231] When organizations are small, it may be enough if a small group of dedicated founders or controllers remains to describe the values and behaviors that are expected of all employees.[232] However, as firms grow and monitoring becomes more difficult, they usually need to look beyond the influence of individual managers to address the company's overall culture.[233]

With respect to the benefit corporation, organizational forms that reflect a specific ideological commitment influence internal culture and attitudes by signaling the values that should inform employee decision-making.[234] Patagonia cited this belief as a motivating factor in its decision to become a benefit corporation. Its founder hopes to use the form as a framework to preserve the company's current culture of sustainability long after he departs.[235] The founder of Plum Organics adds: "When [social enterprise] ideas become inscribed in your corporate bylaws [as part of being a benefit corporation], it becomes the compass of the company. . . . Every new employee that comes in to this company understands that we're a public benefit corporation."[236]

Of course, much still depends on a firm's ability to educate employees on the importance of balancing social and economic goals and then rewarding them for doing so. But provisions like the benefit corporation's

231. Robert A. Katz & Antony Page, *Sustainable Business*, 62 EMORY L.J. 851, 872 (2013).

232. Battilana et al., *supra* note 27, at 52. An alternative approach to managing mission drift, uncertainty, information asymmetry, and agency costs in a social enterprise is to keep the firm closely held. Doing so would allow founders to preserve control while minimizing the risk of activism from other shareholders. Monitoring and information costs are lowest when owners are few in number, share the same goals, and transact with each other on a regular basis. Consensus building becomes easier under these conditions. A similar strategy would be to rely primarily on debt rather than equity financing. However, not every social enterprise wants to be closely held. Founders with large ambitions, a desire to scale up quickly, or agendas that involve intensive research might find that reliance on personal wealth or a small group of investors hinders their ability to grow. Debt also has its limits. Most firms cannot survive on debt financing alone, and risk-averse lenders might be reluctant to fund social enterprise given that hybrid firms are still relatively new and present unfamiliar issues.

233. *Id.*

234. *See* Katz & Page, *supra* note 231, at 870; Rupp & Williams, *supra* note 173, at 584; Anne E. Tenbrunsel et al., *Building Houses on Rocks: The Role of Ethical Infrastructure in Organizations*, 16 SOC. JUST. RES. 285, 294–95 (2003).

235. *B Corps: Firms with Benefits*, ECONOMIST (Jan. 17, 2012), http://www.economist.com/node/21542432.

236. Schwartz, *supra* note 114.

public benefit requirement or stakeholder governance mandate signal what actions are expected and reinforce the importance of taking the organization's core principles into account when acting on its behalf.[237] The benefit corporation form thus provides a framework that managers and employees can turn to when facing difficult decisions such as whether to relocate, pay a bribe to ease customs duties, or distribute earnings rather than expand distribution capacity.[238] Uncertainty is often unbearable, which is why many prefer the "clean" guidance that comes with the shareholder profit-maximization theory. However, by telling them, structurally, that profits are not the firm's overriding focus, a benefit corporation's managers and employees can filter their actions through that reference point in situations where they might be tempted to act in their self-interest at the expense of mission. This may give founders more confidence about encouraging compliance than leaving the job to internal guidelines that can easily change if there is no cohesive culture within the firm.

Finally, establishing a culture that leads to the internalization of values is easier when organizational goals match employees' personal beliefs and were important factors in drawing them to the enterprise.[239] The benefit corporation's formal emphasis on dual objectives should attract socially minded employees by signaling that they will find a supportive structure in place if they join. In turn, when employees enter organizations that reflect their own values, they exhibit greater motivation to act consistently with those values.[240] This dynamic provides them with a sense of autonomy, attachment, and identity that will enhance their feelings of responsibility and make compliance more likely.[241]

V. CONCLUSION: LESSONS AND IMPLICATIONS

While the infancy of the benefit corporation form makes it difficult to predict its full impact on the corporate landscape, social enterprises are becoming so popular that they need a normative structure to build around. I show above how the underlying dynamics of benefit corporation laws can advance this effort by virtue of their consistency with new governance ideas. The laws help observers move past a preoccupation with managerial discretion in order to advance a more general framework for developing a corporate community disposed to caring about social goals and equipped with self-regulatory tools to facilitate those goals. I will conclude by

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237. Battilana et al., *supra* note 27, at 52.

238. Aguilera et al., *supra* note 183, at 857.

239. Rupp & Williams, *supra* note 173, at 588.

240. Tom R. Tyler, *Legitimacy and Criminal Justice: The Benefits of Self-Regulation*, 7 OHIO ST. J. CRIM. L. 307, 329 (2009).

241. Rupp & Williams, *supra* note 173, at 599–600.

describing the practical lessons and implications that we can draw from this result, paying particular attention to issues of professionalization, corporate governance, legislative design, and education.

A. Professionalization

Facilitating legal and other professional involvement in the benefit corporation sector is of threshold importance if new governance strategies for self-regulation are to take hold. First, lawyers who develop an expertise with a particular business form often go on to participate in a variety of networking activities. They teach continuing legal education programs, lobby state lawmakers, and participate in industry conferences and other outreach events.[242] When professionals interact in these ways, no matter how informally, they spread and reinforce norms within the relevant industry on a national rather than just local basis.[243]

Cooperation on issues like standards and best practices should then become easier as the players gain more familiarity with each other and come to understand what is expected of them. This is especially likely if an institutional group of actors working within the benefit corporation sector emerges to coordinate and "regularize" such interaction. Policy groups made up of representatives from business, government, NGOs, and academia often play a leadership role in prompting collaboration within a specialized industry by establishing workshops, training programs, and other systems for information sharing.[244] A group like B Lab might be able to fill this role, but that would require a slight shift in its purpose. An "institutional intermediary" like the one I describe is "less about 'checking compliance with rules'" and more about fostering "professional accountability by pooling knowledge between members of an industry and 'developing a community of practice to sustain . . . inquiry and learning.'"[245]

In addition to their role in shaping norms within the larger sector, attorneys and other professionals also have an important function to play in mitigating potential information asymmetry problems and designing corporate governance solutions.[246] Traditional for-profit firms already operate within a well-developed ecosystem. Support from lawyers,

242. Mark C. Suchman & Mia L. Cahill, *The Hired Gun as Facilitator: Lawyers and the Suppression of Business Disputes in Silicon Valley*, 21 LAW & SOC. INQUIRY 679, 683 (1996).

243. *Id*. at 690–91.

244. Joseph W. Yockey, *Choosing Governance in the FCPA Reform Debate*, 38 J. CORP. L. 325, 362 (2013).

245. Cummings, *supra* note 28, at 622.

246. Darian M. Ibrahim, *The (Not So) Puzzling Behavior of Angel Investors*, 61 VAND. L. REV. 1405, 1431–32 (2008).

consultants, and accountants who understand and offer services tailored to their needs is readily available. For social enterprises to solve previously neglected social problems through the application of sophisticated business strategies, they too will need the same type of infrastructure. A recent report on social enterprise from the Aspen Institute emphasizes that entrepreneurs, investors, and policymakers engaged in this sector must start to "speak the same language" and "harmonize" their activities in order for meaningful development to occur.[247] The report adds that the creation of common funding vehicles, social assessment tools, and other examples of interoperability will "reduce redundancy, enhance competition for the best tools and solutions, increase market demand for infrastructure services, and align individual and incremental efforts toward a systematic solution."[248]

The newness and uniqueness of social enterprise makes achievement of these objectives a challenge, but recognition of their importance within the social enterprise community is a step in the right direction. Lawyers on the investor side can share information about what their clients need to feel secure, which over time, should lead lawyers on the enterprise side to develop expectations and strategies for ameliorating their concerns. Parties on both sides should also start to understand what requests are seen as reasonable within the community, and how they can respond to specific demands for information or contractual rights. Shareholders will then obtain a better sense of what they are getting in their investment, and their attorneys can help convince them that tools are in place to mitigate concerns about mission drift or other problems. These developments should make deals simpler, faster, and cheaper by reducing the amount of due diligence required and by leading to the creation of industry standards for benefit corporation financing.[249]

B. Capital Formation

Establishing a strong community of attorneys and professionals with benefit corporation expertise is also important for capital formation. On one hand, investor interest in the social enterprise sector is clearly growing.[250] On the other, many founders claim that securing capital remains difficult despite having more options for finance.[251] The non-traditional nature of a dual-purpose firm might scare away some investors who, rightfully or

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247. ASPEN INSTITUTE, *supra* note 228, at 12.

248. *Id.*

249. Ibrahim, *supra* note 246, at 1433–35.

250. *What Is Social Investment?*, BIG SOC. CAP., http://bigsocietycapital.com/what-social-investment-0 (last visited Jan. 20, 2015).

251. Joan MacLeod Heminway, *To Be or Not to Be (A Security): Funding For-Profit Social Enterprises*, 25 REGENT U. L. REV. 299, 308 (2013).

wrongfully, worry that socially oriented firms will only generate below-market rates of return. Similar issues can complicate efforts to obtain other forms of supplemental financing, like debt.[252] These concerns leave many social enterprise startups with the daunting prospect of attracting the attention of a growing but still relatively small universe of socially oriented sources of private equity.

To help address this challenge, lawyers and other professionals can play an important "sorting" role in linking benefit corporations with potential investors.[253] Over time, these professionals will start to become more familiar with the interests and demands of socially oriented firms and investors. They should then be able to help simplify the capital formation process by serving as go-betweens in matching suitable partners from within their network of contacts.[254] Many private equity investors already rely on a network of lawyers, consultants, and accountants to help them locate and sort potential investments.[255] Nurturing a similar dynamic within the benefit corporation community is vital. For example, venture capitalists ("VCs") and angel investors offer several unique advantages to social enterprise.[256] First, both can be good sources of "patient" capital. One argument in favor of the benefit corporation's stakeholder mandate is that without it, managers might ignore social impact due to shareholder pressure to focus on short-term profits. However, VCs and angels are often more willing to welcome longer-term business plans.[257] Some find that patient capital is even *more* patient in social enterprise since the goal is creating social impact rather than immediate profit, and the former can be difficult to measure in the short-term.[258] Angels in particular often share founders' non-financial objectives, and, since they invest their own money rather than that of a fund investor, are more likely to be comfortable investing for the warm glow and community benefits that social enterprises provide.[259]

Second, VCs and angels are important sources of business expertise. Founders of social enterprises often have good ideas about solving social problems but little experience in running a company. Many will need professional managerial knowledge if they hope to attract customers and

252. Brakman Reiser, *supra* note 6, at 618 (noting lenders will likely insist that social enterprises pay higher interest rates).

253. Suchman & Cahill, *supra* note 242, 702–03.

254. *Id.*

255. *Id.*

256. The term "angel investor" can apply to anyone who invests personal wealth in a new business, but it typically refers to individual accredited investors who invest in several early-stage startups. Ibrahim, *supra* note 246, at 1406.

257. *See, e.g.*, Mark J. Roe, *Corporate Short-Termism—In the Boardroom and in the Courtroom*, 68 BUS. LAW. 977 (2013).

258. Austin et al., *supra* note 148, at 13–15.

259. Ibrahim, *supra* note 246, at 1440.

capital. VCs and angels with in-kind expertise can assist in this regard through their connections and personnel.[260] Ibrahim also reports that many angels invest in startups because they miss the excitement of running a business and relish the chance to help new entrepreneurs.[261] This explains why angels often invest at earlier stages than venture capitalists, as well as why they are more likely to fund smaller companies that VCs tend to avoid.[262]

VCs and angels are also well-suited to invest in social enterprise because of their proficiency in guarding against information asymmetry and opportunism. VCs routinely negotiate complex contracts that provide them with considerable control and oversight in portfolio firms.[263] Specific strategies include staged financing arrangements,[264] the taking of convertible preferred stock,[265] guaranteed seats on the board, and non-transferability provisions.[266] For their part, angels typically obtain comparable protection through informal mechanisms that avoid the high transaction costs of negotiating comprehensive investment contracts. They do so first by taking common stock rather than the more complex preferred stock that VCs favor. Secondly, angels prefer to invest in companies where they know the industry. For instance, in social enterprise, many angels come from industries where hybrid firms are the most active.[267] This experience provides them with an edge in judging a firm's prospects. Angels also offer the same expertise as VCs but usually take an even greater hands-on role with the firm.[268] Their close relationship with management enables them to actively monitor for opportunism, mission drift, and other risks, in addition to simply helping the business grow.

C. Corporate Governance Strategies

The application of new governance ideas to benefit corporation laws also has implications for corporate governance practices. Fiduciary duties

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260. Alan Hirzel, *To Grow, Social Enterprises Must Play by Business Rules*, HARV. BUS. REV. (Jan. 9, 2013, 2:07 PM), http://blogs.hbr.org/2013/01/to-grow-social-enterprises-mus/; *see also* Ibrahim, *supra* note 246, at 1431–32.

261. Ibrahim, *supra* note 246, at 1408–09.

262. *Id.* at 1416–18.

263. *Id.* at 1434.

264. *Id*. at 1413.

265. Preferred stock offers downside protection because it is paid first in the event of a liquidation or sale. *Id.* at 1414.

266. Katz & Page, *supra* note 13, at 97; D. Gordon Smith & Masako Ueda, *Law & Entrepreneurship: Do Courts Matter?*, 1 ENTREPRENEURIAL BUS. L. J. 353, 362–63 (2006).

267. David Floyd, *Social Investment: Guidance and Guardian Angels,* GUARDIAN (Sept. 13, 2013, 1:59 AM), http://www.theguardian.com/social-enterprise-network/2013/sep/13/social-investment-angel-investors.

268. Ibrahim, *supra* note 246, at 1419.

are fundamental to reducing the agency cost risks that come from the separation of ownership and control, but questions of duty often become more complex in benefit corporations because of their explicit dual purpose. Shareholders who worry that directors will be unable or unwilling to balance hybrid pursuits in the way they prefer will likely demand a discount in the price of equity or simply avoid investment.

As we've seen, self-regulatory strategies for managing the potential for competing, heterogeneous interests include the development of standards and best practices for governance. Going forward, a promising way to supplement these strategies involves a push for greater diversity on the board of directors. Homogeneous boards work well for firms with singular pursuits because directors who share the same viewpoints typically find it easier to reach a consensus. Thus, uniform boards should operate effectively for benefit corporations that approach the hybrid ideal, although even in that case there remains a risk of "groupthink" and the suppression of debate and alternative ideas.[269] The same is true for smaller benefit corporations that have founders available to articulate a clear message about organizational goals.

Board composition takes on more significance for larger benefit corporations, as well as for those with social and economic goals that are more divisible. For these companies, board heterogeneity would augment available enforcement remedies by serving to keep the benefit corporation's multiple objectives in view at a structural level. Directors with an interest and expertise in a specific corporate pursuit (e.g. sustainability) are better able to affect the board's decision-making process by acting as a credible "moderating influence" during deliberations.[270] A specialist on the board can help to ensure that specific issues like social mission feature in every high-level discussion about organizational objectives. She will have the ear of key executives and can apprise them of matters that bear on mission in the face of potential pressure to focus exclusively on profits.[271]

Importantly, this strategy is not about dictating or guaranteeing specific outcomes. The broad discretion that the business judgment rule affords to directors means that their decisions will generally stand if the board is informed, acting in good faith, and free of a conflicted majority. Rather, the purpose of heterogeneity is to promote the consideration of multiple viewpoints during the *process* that leads to each outcome.[272] The entire board sets corporate policy, but specialist directors are present to introduce

269. Gelter & Helleringer, *supra* note 122, at 311–12, 318–20.

270. *Id.* at 314–18.

271. Bamberger & Mulligan, *supra* note 187, at 502.

272. Gelter & Helleringer, *supra* note 122, at 316–17.

specific interests into the discussion and guard against misunderstood messages.[273] Several states already appear to recognize the advantage of this approach by requiring benefit corporations to appoint a "benefit director" to oversee issues relating to the pursuit of social benefits.[274]

In addition to improving the quality of board deliberations, new governance research further shows that specialist directors or officers play a useful role in coordinating external self-regulatory activities and integrating them into internal corporate governance practices.[275] For one, assigning someone the task of overseeing benefit issues and social assessment will encourage her to become an expert in those areas. Individuals who are made responsible for tasks of high importance are more likely to exercise greater care and analytic rigor in performing them.[276] Grappling with the uncertainty of the benefit corporation environment also paves the way for the type of stakeholder collaboration and deep-seated knowledge discussed above. A director or officer in this role will then be in a position to apply that knowledge in developing firm policies and overseeing their implementation.[277] She can also become a singular conduit for communicating a cohesive message about policy goals throughout the firm, as well as a point of contact for employees to share their granular knowledge about the challenges they face in the hybrid setting. When coupled with the information and standards that emerge from external engagement with stakeholders and peers, the resulting feedback loop should prove valuable in designing employee training programs and monitoring systems capable of mitigating mission drift. The end goal of this strategy is to embed the desired norms, culture, and expertise at every level of the firm so that the consideration of mission becomes part of standard operating procedure.[278]

D. Statutory Changes

A third important aspect of new governance theory is its emphasis on responsive statutory revision. This suggests two key lessons for the design of benefit corporation statutes. The first concerns flexibility. By defining public benefit as requiring firms to follow a triple bottom line, many states undercut the benefits that legislative flexibility offers to the range of social

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273. *Id.* at 318–20.

274. *See* Brakman Reiser, *supra* note 6, at 605.

275. *See* Bamberger & Mulligan, *supra* note 187, at 500.

276. *Id.* at 503.

277. Admittedly, a potential drawback of this approach is that the presence of a specialist could cause other directors to "switch off" from caring about social issues. Caution is therefore necessary to ensure that the specialist is seen as a supplement, rather than a replacement.

278. Aguilera et al., *supra* note 183, at 838.

enterprises. To remedy this problem, states should reframe the public benefit requirement in accord with comparable statutes that leave more room for experimentation. Delaware is the best example to follow. Eschewing a mandatory triple bottom line, Delaware's Public Benefit Corporation statute requires benefit corporations to identify the public benefits that they will promote and to operate in a responsible and sustainable manner.[279] "Public benefits" are broadly defined as any positive effects, or the mitigation of negative effects, on persons, entities, communities, or interests of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific, or technological nature.[280] This definition puts social enterprises in the more flexible confines of the double bottom line. They are certainly free to focus on the environment in addition to social impact, if that is their specific mission or if that is how they or the market interprets sustainability, but neither is expressly dictated by statute.

Secondly, new governance's emphasis on self-regulation should not be confused with deregulation. For new governance strategies to operate successfully, the state must reserve enforcement power to encourage collaboration and minimize the risks of backsliding or free riding.[281] Benefit corporation statutes frequently come under fire in this respect as a result of their lack of enforcement bite. Regardless of whether our focus is on industry standards or statutory mandates, market actors will demand that the benefit corporation form credibly commits individual firms to their dual social and economic pursuits. Firms must show that compliance with rules or standards is real and costly; otherwise, market actors will discount the value of the brand that comes from being a benefit corporation.

Similar themes appear in other situations. The nondistribution constraint that unites nonprofit law gives confidence to the market that managers cannot divert resources for personal gain.[282] Similarly, because it is costly for firms to opt-in to the mandatory disclosure requirements of the federal securities laws, doing so credibly signals to investors that a company is honest and transparent.[283] If the benefit corporation form likewise requires firms to take burdensome and meaningful steps that not every company is willing to take, that too will help market actors separate the wheat from the chaff when evaluating different social enterprises.[284]

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279. DEL. CODE ANN. tit. 8, § 362 (2013).

280. *Id.*

281. Omarova, *supra* note 169, at 419.

282. Ji, *supra* note 179, at 467–70.

283. Edward Rock, *Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure*, 23 CARDOZO L. REV. 675, 686–87 (2002).

284. *See* Paredes, *supra* note 196, at 471.

Proponents of benefit corporation legislation appear unwilling to introduce statutory asset locks or other constraints on financial distributions for fear of turning off would-be investors or triggering the inefficiencies that can plague nonprofits. But for this strategy to work, the transparency and accountability provisions found in benefit corporation laws must signal that compliance is costly and meaningful in a manner akin to what the constraint on distributions accomplishes in the nonprofit setting. The reason that the federal securities laws send credible signals is because disclosure is mandatory and burdensome.[285] There are negative consequences for failure to comply. However, the benefit corporation laws to date do not include penalties for non-compliance. They leave enforcement to flawed and inefficient shareholder derivative procedures. As a result, benefit corporations are relatively free to ride on the coattails of well-meaning peer firms that thoroughly comply with statutory requirements and engage in the self-regulatory process that those requirements trigger. Firms in the former group can obtain some of the positive "aura" of being a benefit corporation without facing any real downside from practicing greenwashing or for playing fast-and-loose with the timing and content of the disclosures they provide.

Of course, market discipline and reputational sanctions should mitigate this failure to some extent. Benefit corporations that fail to comply with legal rules or industry standards may face challenges in attracting investors, talent, or consumers as their more compliant counterparts use that distinction to their advantage. "Good" benefit corporations can also hire social auditors to report on their pursuit of the double or triple bottom line and rely on the auditors' reputations for honesty as a separate signaling device. As helpful as these options might be, though, they will never offer the same credibility or signaling power of statutory requirements that allow for sanctions.[286] Statutes that rely largely on self-regulatory strategies must provide firms with the assurance that their peers will engage with the collaborative and standard-setting processes that are built into the legislation. Mandatory requirements must actually be mandatory, and, given the challenges with shareholder monitoring, they must therefore present a risk of state-backed penalties for non-compliance.

In addition, states should also require an independent social audit rather than leave it to benefit corporations to provide their own assessments against a third-party standard. The recent rise of the social auditing industry has already led to a proliferation of social and environmental auditing standards developed through the type of multi-stakeholder collaboration

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285. *See* Rock, *supra* note 283, at 687.

286. Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 605 (1984).

that new governance envisions.[287] An audit requirement in benefit corporation legislation would provide an additional boost to these efforts since more firms and investors will come to rely on them. Professional social auditors should also be more capable and efficient than firms acting independently given their experience and expertise in gathering, analyzing, and presenting social impact information.[288]

Admittedly, shifting from an assessment model to one requiring an independent audit will introduce a new agent to the mix, the auditor, and thus raise agency costs.[289] But the significance of this problem is often overstated. Auditors trade mainly on their reputations. They are not invested in the outcomes of their audits other than to show they are honest, competent, and fair.[290] Auditors are not infallible, but this practical reality suggests they present a lower risk of cheating because they need to protect their reputations in the market. Another potential worry is that an audit requirement could raise costs in ways that will disproportionately affect smaller firms. However, many free social auditing services already exist, and, in any event, cost concerns must be weighed against the potential for an audit requirement to fuel the development of standards that will make benefit corporations more effective in achieving their social and economic goals.

E. Training, Education, and Experimentation

William Cary Jones, the first Dean of the University of California, Berkeley, School of Law, described law as "'a living principle . . . in process of constant becoming.'"[291] Today, one of the most exciting things about applying new governance theory to benefit corporation legislation is the way in which both trends reflect a willingness to think creatively about traditional corporate law, norms, and behavior. However, for new governance ideas to firmly take root in this context, current and future market participants will need to develop the capacity to understand and apply them.

Fortunately, several important strides are already being made. I mentioned earlier how many leading business and law schools now feature specific courses and clinical opportunities in the social enterprise field. For example, Alicia Plerhoples directs a social enterprise clinic at Georgetown

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287. Blair et al., *supra* note 201, at 342.

288. *Id.* at 355.

289. *Id.*

290. *Id.* at 356.

291. Christopher Edley, Jr., *Fiat Flux: Evolving Purposes and Ideals of the Great American Public Law School*, 100 CALIF. L. REV. 313, 315 (2012).

Law that provides students with hands-on experience in addressing the novel theoretical and practical issues that dual-purpose firms present.[292] The next step is to integrate these approaches with the strategies of new governance that offer the most potential for bolstering the social enterprise sector. Thus, in addition to a strong emphasis on traditional topics like corporate finance, fiduciary duties, and shareholder litigation, students in law and business schools would also benefit from exposure to general problem-solving techniques, collaboration with parties from multiple disciplines, negotiation theory, and the formation of public-private partnerships. This does not mean that professional schools should abandon or neglect traditional skills and practices, only that they learn to integrate them with new governance ideals.

In fact, pedagogical approaches that incorporate new governance theory and its emphasis on collaborative problem-solving would arguably be more consistent with the responsibilities that many professionals now perform. To take the example of lawyers working in Silicon Valley, most no longer define their roles in terms of being either litigation or transactional attorneys. Instead, they describe themselves as "key players in an informal apparatus of socialization, coordination, and normalization that serves to avert potential disputes between members of the local business community."[293] If we extend this idea to professionals who represent social enterprises, many will need to work with a wide range of entrepreneurs who come from backgrounds in human rights, clean energy, education, medicine, and finance.[294] Developing the capacity to collaborate and communicate with individuals from diverse disciplines will be of central importance to adequately serving their interests.

Finally, beyond its relation to new governance theory, maintaining a strong focus on the benefit corporation in academic and professional circles has the potential to generate a subtle but significant shift in debates about corporate law. Benefit corporations, and social enterprises more generally, cannot solve every social problem. There will always be critical roles for nonprofits, government, and traditional corporations to play. However, discussions about CSR and the "proper" roles of nonprofits and government remain highly contentious. By contrast, conversations about social enterprises often take a constructive tone in keeping with the virtually universal support they receive from the right and the left. This dynamic is important. It calls to mind the concept of "bracketing," where

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292. Plerhoples, *supra* note 37, at 218 n.5.

293. Suchman & Cahill, *supra* note 242, at 683.

294. Lisa T. Alexander, *Part III*: *Reflections on Success and Failure in New Governance and the Role of the Lawyer*, 2010 WIS. L. REV. 737, 747 (2010).

the most intractable issues in an area are set to one side so that the focus can stay on matters of common agreement.[295]

Using the benefit corporation as an archetype for social enterprise can perform a similar function. If actors who share a normative consensus come together to discuss how to support the benefit corporation form, the resulting dialogue may prompt them to re-conceptualize how they approach more controversial issues. The discussions that emerge could even render the form obsolete, if, for example, they reframe ideological disputes surrounding corporate purpose in ways that cause social entrepreneurs to feel less dependent on a separate statutory regime. In this way, founders and investors might come to see corporate law as reaching a point where distinctions between "regular" corporations and benefit corporations appear unthinkable—thanks in large part to the transformative power of social enterprise law.

295. *See* Simon, *supra* note 173, at 733.