

HISTORY, HOPE, AND HEALTHY SKEPTICISM

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I appreciate the work Professor Murray does in his symposium essay, *The History and Hope of Social Enterprise Forms*.¹ He has been, and remains, a leading voice on legal forms of business for social enterprises in the United States. By suggesting reforms to the practices and laws governing social enterprise entities in his essay, Professor Murray raises my hackles a bit, as he surely knows. My primary reaction to the initial draft was: "Modify social enterprise entity law? Why bother?" Professor Murray knows I am not a fan of these statutory forms of social enterprise entity—especially the benefit corporation. As a result, I needed to be convinced that amendments to the laws governing these forms are worthwhile.

But before I get back to that thought, I must first confess that I would not likely have begun to conduct research in the social enterprise field if it were not for Professor Murray. He is not only a great leader in social enterprise law (and a good friend), but also the person who convinced me to look into and write on the law as it relates to social enterprise businesses. Specifically, he invited me to a symposium saying (although this is not a direct quote), "We really need someone to impose some securities law wisdom on the social enterprise field. Could you please speak and write about this?" I accepted the entreaty. It was such an enjoyable intellectual exercise to dive into the related research. The article that resulted from Professor Murray's invitation, *To Be or Not to Be (a Security): Funding For-Profit Social Enterprises*,² is one of my better cited pieces. It led to a number of other articles and book chapters and, ultimately, to this comment.

In this comment, I play the role of the two-year-old in the room. Two-year-old children are well known to ask "why," and that is what I do here. Specifically, this comment asks "why" in two aspects. First, I ask why we

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¹ J. Haskell Murray, *The History and Hope of Social Enterprise Forms*, 22 *TRANSACTIONS: TENN. J. BUS. L.* 207 (2021).

² Joan MacLeod Heminway, *To Be or Not to Be (a Security): Funding For-Profit Social Enterprises*, 25 *REGENT U. L. REV.* 299 (2013).

do (or should) care about making modifications to existing social enterprise practices and laws. Second, assuming we do (or should) care, I ask why Professor Murray's changes make sense. My commentary is largely restricted to the benefit corporation form because corporate forms loom large in the debates relevant to Professor Murray's essay and because the benefit corporation is acknowledged to be the most widely adopted corporate form as among the social enterprise forms of entity.³

So why do we care? Why should we care? Professor Murray answers these questions in a general way by noting that social enterprise entities seek to displace shareholder-centric norms and replace them with management-centered decision-making norms focused more broadly on society.⁴ He observes that even if shareholder-focused decision-making norms are not firmly established in and by enforceable legal doctrine, they may hold force as a matter of public belief. He avers: "[D]irectors will often do what is expected of them."⁵ Having formerly been part of teams of lawyers who advised corporate boards, I concur with that observation. As a result, he advises that "if the structure of corporate governance and the incentives are not reconsidered, positive change is likely to be limited."⁶

Indeed, as Professor Murray suggests, corporate law offers governance structures and mandates that may disincentivize or incentivize certain behaviors. Directors will act in accordance with the dominant norms arising from those disincentives and incentives. As he describes, the shareholder wealth maximization norm is a label for a dominant touchstone arising from the existing legal framework applicable to traditional for-profit corporations. As a result, we should expect directors of for-profit corporations to act in accordance with that norm—to do what the applicable norm directs them to do.

Public reinforcement of norms, including the shareholder wealth maximization norm, may play a role in embedding those norms more

³ See, e.g., Ellen Berrey, *Social Enterprise Law in Action: Organizational Characteristics of U.S. Benefit Corporations*, 20 TRANSACTIONS: TENN. J. BUS. L. 21, 25 (2018) ("While those interested in using business strategies to accomplish social or environmental objectives can choose from a growing menu of legal forms of enterprise, the benefit corporation has become the most popular option."); Emily Winston, *Benefit Corporations and the Separation of Benefit and Control*, 39 CARDOZO L. REV. 1783, 1799 (2018) ("[L]egal entities have . . . arisen in the United States to facilitate social enterprise Of the legal forms established to date, the most popular has been the benefit corporation").

⁴ Murray, *supra* note 1, at 218.

⁵ *Id.*

⁶ *Id.* at 219.

widely and deeply. Corporate directors may fear challenging norms that have become part of public awareness and understanding. Legal advisors to corporate board also may be impacted by this infiltration and entrenchment process, causing them to elevate norms to the status of legal rules in their reasoning.

Benefit corporations and other social enterprise corporate forms, as Professor Murray explains, are designed to “disrupt” those processes as they relate to the shareholder wealth maximization norm and its professed (if not actual) unitary focus on shareholder financial wealth as the key driver of corporate decision-making.⁷ As he indicates in his essay, these corporate forms offer signals to the public and, through those signals, a sense of hope—a warm glow of sorts that social or environmental concerns will be valued in some form of corporation. Ultimately, it is hard to substantiate or refute this premise. A lot of the information that we have is anecdotal.

Paradoxically, valid concerns also have been raised about a distinctly negative signaling effect of benefit corporation law.

The PBC [public benefit corporation] innovation may lead judges to conclude that if corporate promoters want to deviate from shareholder primacy, they must do so by using the Public Benefit Corporation. The organizational and governance requirements of the PBC are highly particular, and most of its important features are mandatory. Thus, the Public Benefit Corporation may inadvertently have narrowed flexibility in the creation of corporations that alter the shareholder primacy norm, rather than expanded it, as the PBC's proponents and many commentators have presumed.⁸

⁷ *Id.* at 218 (“Social enterprise forms seek to disrupt the norm. Just names like ‘benefit corporations’ and ‘social purpose corporations’ suggest that these forms are not shareholder-focused, but rather focused on the broader society.”).

⁸ David G. Yosifon, *Opting Out of Shareholder Primacy: Is the Public Benefit Corporation Trivial?*, 41 DEL. J. CORP. L. 461, 463 (2017) (internal citations omitted); *see also, e.g.*, Joan MacLeod Heminway, *Let's Not Give Up on Traditional For-Profit Corporations for Sustainable Social Enterprise*, 86 UMKC L. REV. 779, 799 (2018) [hereinafter Heminway, *Let's Not Give Up*] (“[L]aw scholars have begun to raise concerns that social enterprise legal forms may be undesirable because they reinforce the doctrinal application of shareholder wealth maximization norms well beyond the factual scenario presented in the *eBay* decision, both in and outside the State of Delaware.”); Joan MacLeod Heminway, *Shareholder Wealth*

This negative signaling effect persists despite relatively clear statutory directives to the contrary. Specifically, benefit corporation legislation typically instructs that its existence has no effect on corporate law outside the benefit corporation context.⁹ These provisions have not yet been tested in judicial adjudications, however. It is therefore possible that, rather than affording us hope, benefit corporation law offers us a substandard, narrow way to achieve social enterprise objectives—one that shuts off or limits the inherent flexibility of traditional for-profit corporations by restricting the discretion of the board of directors. I have argued elsewhere that the statutory framework of benefit corporation law may serve to constrain board authority to act in the interest of society and the environment.¹⁰

Maximization as a Function of Statutes, Decisional Law, and Organic Documents, 74 WASH. & LEE L. REV. 939, 964 (2017) (“[L]egislatures are ‘sold’ on the existence of a shareholder wealth maximization norm that may not be legal doctrine but may, by the legislature’s tacit endorsement, become public policy.”); Kevin V. Tu, *Socially Conscious Corporations and Shareholder Profit*, 84 GEO. WASH. L. REV. 121, 173 (2016) (“[T]he existence of Benefit Corporations may reinforce the profit maximization norm.”). In an October 2020 weblog post, Professor Stephen Bainbridge articulates his view that, “[i]f somebody wants a Delaware corporation that has a purpose other than shareholder wealth maximization, they have to go the . . . [benefit corporation] route.” Stephen M. Bainbridge, *A Delaware Business Corporation Cannot Opt Out of the Shareholder Wealth Maximization Norm in its Certificate of Incorporation*, PROFESSOR BAINBRIDGE.COM (Oct. 8, 2020, 4:41 PM), <https://www.professorbainbridge.com/professorbainbridgecom/> (follow “Archives” hyperlink; then follow “October 2020” hyperlink).

⁹ See, e.g., DEL. CODE ANN. tit. 8, § 368 (2020) (“This subchapter shall not affect a statute or rule of law that is applicable to a corporation that is not a public benefit corporation, except as provided in § 363 of this title.”). Tennessee law specifically provides that: “[N]o implication is made by, and no inference may be drawn from, the enactment of this chapter as to whether, in exercising their duties, the officers or directors of a domestic business corporation that is not a for-profit benefit corporation may consider the impact of the corporation’s transactions or other conduct on: (1) The interests of those materially affected by the corporation’s conduct, including the pecuniary interests of shareholders; or (2) Any public benefit or public benefits identified in its charter.” TENN. CODE ANN. § 48-28-109 (2020).

¹⁰ See Heminway, *Let’s Not Give Up*, *supra* note 8, at 800 (“[T]he stringent application of shareholder wealth maximization doctrine in the TFPC and the nature of benefit corporation doctrine conspire to decrease director discretion within the overall bounds of the board’s authority and, in turn, negatively impact the significance of the board decision-making process under corporate law.”). Others have come to similar conclusions. See Amy Klemm Verbos & Stephanie L. Black, *Benefit Corporations as a Distraction: An Overview and Critique*, 36 BUS. & PRO. ETHICS J. 229, 258 (2017)

For the sake of argument, however, let us assume that Professor Murray's hopeful vision of benefit corporation statutes prevails over more negative conceptions of those legislated corporate frameworks. That allows us to approach my second "why"—why Professor Murray's proposed enhancements to benefit corporations and the statutory law governing them make sense. Said another way, why do the recommended changes he offers work to ensure that benefit corporations can better serve the ostensibly noble purposes for which they are designed?

Professor Murray's suggestions include both changes in financial compensation incentives (providing for an exercise date for director stock options that extends out twenty-five or more years after the date of grant—rather than more customary near-term exercise dates—to encourage fealty to “the stakeholders who are necessary to carry the corporation that far”¹¹) and changes in corporate governance and related operations (to “elevate nonshareholder stakeholders rights”).¹² He notes that these latter governance and operational modifications might include:

- affording more stakeholders standing to sue;
- giving more stakeholders the ability to elect members of the corporation's board;
- involving stakeholders in creating and monitoring the corporation's public benefit plans;
- giving long-term shareholders increased voting rights;
- clarifying and enforcing statutory social reporting mandates;
- limiting social enterprise status to firms operating in specific industries or using specified hiring practices or compensation metrics;
- capping executive compensation; and
- paying employees a living wage or better.¹³

(“concluding that benefit corporations are legally unnecessary or [un]desirable” and offering “cautions about unintended potential to change corporate law, legal uncertainty for directors, and . . . the wisdom of including a third party standard in entity formation legislation.”); Yosifon, *supra* note 8, at 506 (finding that “[t]he benefit corporation model . . . threatens to create a social policy ‘mirage’ of responsiveness to the problems attendant to shareholder-primacy firms. . . . In this sense, creating benefit corporations is worse than doing nothing, because at least if nothing had been done nobody could think that something significant had been done.” (footnote omitted)).

¹¹ See Murray, *supra* note 1, at 219-20.

¹² *Id.* at 220-21.

¹³ *Id.*

Overall, Professor Murray's ideas posit a move away from the shareholder-centric rules that govern traditional for-profit corporations. In theory, by relaxing shareholder-focused constraints associated with for-profit corporate legal rules and traditions, benefit corporations can be better held accountable to broader stakeholder interests.

Professor Murray's observation that shareholder governance rights are fundamental to benefit corporation accountability mechanisms and enforcement is unassailable. His footnotes include citations to the work of others who share his observations about specific shareholder-dominant accountability practices and processes.¹⁴ Benefit corporation statutes—which are built into existing statutes governing traditional for-profit corporations—allow shareholders to bring derivative litigation and elect the directors who constitute the governing body of the firm.¹⁵ That accountability to shareholders is a core value of the traditional for-profit corporate form. As Professor Murray notes, shareholders possess all of

¹⁴ *Id.* at 219 n.73 (noting in the parenthetical “ultimate accountability in the hands of the shareholders in the form of voting rights and the benefit enforcement proceeding”).

¹⁵ Typically, benefit corporation acts include special qualifications for shareholder derivative litigation that layer onto more general derivative litigation authorizations under state corporate law. *See, e.g.*, DEL. CODE ANN. tit. 8, § 367 (2020) (providing specific requirements for shareholder derivative actions and other litigation to enforce benefit corporation director fiduciary duties); TENN. CODE ANN. § 48-28-108 (2020) (providing specific requirements for derivative actions to enforce benefit corporation director fiduciary duties). However, general corporate law statutes alone normally govern benefit corporation director elections in the same way that they govern all other corporate director elections. *See, e.g.*, DEL. CODE ANN. tit. 8, § 216(3) (2020) (“Directors shall be elected by a plurality of the votes of the shares present in person or represented by proxy at the meeting and entitled to vote on the election of directors”); TENN. CODE ANN. § 48-17-209(a) (2020) (“Unless otherwise provided in the charter, directors are elected by a plurality of the votes cast by the shares entitled to vote in the election at a meeting at which a quorum is present.”). As a general matter, benefit corporation acts expressly outline the relationship of their contents to those of the corporate law. *See, e.g.*, DEL. CODE ANN. tit. 8, § 361 (2020) (“If a corporation elects to become a public benefit corporation under this subchapter in the manner prescribed in this subchapter, it shall be subject in all respects to the provisions of this chapter, except to the extent this subchapter imposes additional or different requirements, in which case such requirements shall apply.”); TENN. CODE ANN. § 48-28-102 (2020) (“If a corporation, organized under the Tennessee Business Corporation Act . . . elects to become a for-profit benefit corporation under this chapter in the manner prescribed in this chapter, the corporation shall continue to be subject in all respects to the Tennessee Business Corporation Act, except to the extent that this chapter imposes additional or different requirements, in which case the requirements of this chapter shall apply.”).

the key legal means of holding directors accountable under current corporate law (including benefit corporation law).¹⁶ I agree that this aspect of benefit corporation legislation is something we need to alter if benefit corporations are to best serve their intended public policy goals.

I might add that the focus of management fiduciary duties in the benefit corporation also deserves attention. In an earlier work, I noted that some benefit corporation statutes require directors, in exercising their fiduciary duties, to consider constituencies not expressly served by the corporation's explicit chartered purpose.¹⁷ I also noted in that same work that some statutes seem to better connect a benefit corporation's expressed statutory purpose to director fiduciary duties.¹⁸ Consistency in the content and application of managerial fiduciary duties in benefit corporations is lacking. Appropriately tailored, standardized fiduciary duties, consistently applied, should enhance the overall value of the benefit corporation as a form of business association for social enterprises.

If benefit corporation managers are not held accountable to the stakeholders expressly called out to be served by the corporation's public purpose—if those stakeholders cannot hold management's feet to the fire (including as beneficiaries and enforcement agents of managerial fiduciary duties)—then benefit corporations are unlikely to get more than superficial traction as instruments for social enterprise. The relative lack of success of “other constituency” statutes has proven that to us; the relative lack of legal force enjoyed by corporate social responsibility practices also has proven that to us. If managers do not owe duties to those who are intended to benefit from them and if those intended beneficiaries cannot enforce any duties intended for their benefit, accountability is not assured, compliance with those duties may be barely more than voluntary, and systemic shifts necessary to real change are unlikely to occur.

¹⁶ Murray, *supra* note 1, at 219 (“In benefit corporations and similar social enterprise forms, shareholders—not other stakeholders—hold the accountability tools.”).

¹⁷ See Joan MacLeod Heminway, *Corporate Purpose and Litigation Risk in Publicly Held U.S. Benefit Corporations*, 40 SEATTLE U. L. REV. 611, 623 (2017) (citing Lyman Johnson, *Pluralism in Corporate Form: Corporate Law and Benefit Corps.*, 25 REGENT U. L. REV. 269, 289 (2013)) (“[M]any benefit corporation statutes . . . require the board to consider, along with that public benefit, constituencies other than those related to the public benefit.”).

¹⁸ *Id.* at 623–24.

These governance and related operational considerations are at the heart of the challenges addressed by Professor Murray in his essay. However, before closing, it seems important to come back to—and call out for specific attention—the equity compensation aspects of the benefit corporation conundrum, which he also raises. Specifically, Professor Murray notes that “[d]irectors are often paid in stock options and are publicly commended for rises in stock price.”¹⁹ Compensating directors with equity and equity-based derivatives is likely to keep the focus of those directors on market prices and, as a result, investor financial wealth gratification. Thus, equity and equity-based compensation (which collectively comprise “equity incentives”) is undoubtedly an important factor for consideration in the benefit corporation context, alongside corporate governance and operations.

Indeed, this entire area at the intersection of corporate finance and management compensation (and the related suggestion to push back the exercise date on director stock options) deserves more attention as a matter of both thought and research, including through contextual legal analyses (under, e.g., federal and state income tax law and securities regulation) and empirical study. For example, as to legal analyses, it seems fair to note that incentive stock options qualified under federal income tax law must expire no later than ten years after the date of grant.²⁰ No such restriction exists for nonqualified stock options. Moreover, in terms of empirical research, we have little understanding of the investor base for social enterprise entities. There may or may not be a different kind of person that invests in social enterprise—one that may not care as much about stock price, especially in the short term. It remains unclear whether changing the prototypical terms of stock options could shift the dominant focus of directors away from shareholder wealth generation.

Having said that, compensation structures generally may hold some promise in counterbalancing director fixation on stock price as a key marker in shareholder value generation and maximization. Equity and non-equity incentives—including bonus programs—may be built partially

¹⁹ Murray, *supra* note 1, at 219.

²⁰ See 26 U.S.C. § 422(b)(3) (2018) (“For purposes of this part, the term ‘incentive stock option’ means an option granted to an individual for any reason connected with his employment by a corporation, if granted by the employer corporation or its parent or subsidiary corporation, to purchase stock of any of such corporations, but only if . . . such option by its terms is not exercisable after the expiration of 10 years from the date such option is granted . . .”).

or exclusively around performance measures other than stock price. Equity incentives based on the achievement of internal corporate goals—performance metrics centered on the social enterprise’s corporate purpose as expressed in its charter or other corporate aims communicated through a charter, bylaw, or policy provision that expresses the ethos and value of the firm—may be more appropriate in the benefit corporation context. I appreciate the fact that Professor Murray’s essay called out director compensation as an area worthy of consideration in strengthening the efficacy of social enterprise firms, including benefit corporations. It deserves more thought and study.

In conclusion, having asked why we do or should care about modifying benefit corporation practices and law, I am satisfied—even if not wholly persuaded—that there is a reason to care. Benefit corporations may alter mindsets in a positive way, even if they do not positively or meaningfully alter applicable legal principles.²¹ And having asked (assuming a reason to care) why Professor Murray’s ideas for practical and legal change may make sense, I am convinced that Professor Murray generally has the right idea in calling for more accountability to a broader base of stakeholders—beyond just shareholders. However, the details of that shift in accountability remain to be fleshed out in detail. He highlights “increasing stakeholder rights, realigning director incentives, and strengthening social reporting.”²² I can agree with at least the first two ideas. I remain uncertain about the third, however, merely because the utility and expense of social reporting are a much larger question mark for me. In any event, I hope that in future work Professor Murray will develop a specific set of proposals to reform benefit corporation practices and laws for the betterment of social enterprise.

²¹ See Murray, *supra* note 1, at 208 (“[I]t is the possibility of shifting norms, not law, that is the true hope of social enterprise forms”).

²² *Id.*