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The Double Bottom Line: Can Constituency Statutes Protect Socially Responsible Corporations Stuck in Revlon Land?

Anthony Bisconti*

Should corporate directors be allowed to sacrifice shareholder returns in an acquisition in order to engage the corporation in socially responsible activity? The traditional model of corporate law, enunciated most influentially by the Delaware courts, emphasizes shareholder benefit. Where a corporation is being sold, this traditional approach limits directors' fiduciary duties to one simple goal: obtaining the highest value possible for shareholders. The constituency statute, a fairly modern advent, operates against this strong tradition and may serve as a mechanism to promote corporate social responsibility in the acquisition context. The current constituency statute framework, however, inadequately protects social responsibility concerns during acquisitions. To help guide courts on this issue, legislatures must adopt a model that explicitly identifies preferred corporate social responsibility policies. Otherwise, corporate social responsibility will remain diluted by the traditional approach.

I. INTRODUCTION

Imagine you are on the board of directors of Healthy Drink, a publicly traded corporation that imports its main product—a health beverage—from the Amazon rainforest.¹ In addition to selling only certified organic products, Healthy Drink sustains and restores 20,000 acres of the Amazon rainforest. Healthy Drink also supports cooperatives and indigenous communities. The corporation is a

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¹ This hypothetical company is based on Guayaki Yerba Mate, a tea business and certified B Corporation. See Guayaki Organic Yerba Mate, http://www.guayaki.com (last visited Feb. 21, 2009).
member of the Fair Trade Federation, which means that the company pays more than market price for its ingredients. This allows Healthy Drink to provide a living wage to growers and suppliers. Additionally, Healthy Drink offsets its carbon emissions by purchasing solar and other green power and by utilizing production processes that limit the volume of emissions that the company creates.

Healthy Drink has been moderately successful, consistently turning out steadily increasing profits from year to year. Healthy Drink is approached by two other companies that are prepared to enter the bidding process to acquire Healthy Drink in an all-cash transaction. The first company ("Bidder 1") sees great earning potential in the Healthy Drink brand by shedding "wasteful" expenses associated with reforestation, the purchasing of green energy, and the use of more expensive (although environmentally-friendly) production processes. Consequently, Bidder 1 offers a substantial premium over the current share price to acquire Healthy Drink.

The second company ("Bidder 2") also sees a large upside to acquiring Healthy Drink. Like Healthy Drink, Bidder 2 prides itself on its own socially responsible initiatives. Bidder 2 will continue Healthy Drink’s socially responsible initiatives but lacks the capital possessed by Bidder 1. Therefore, Bidder 2 can only offer a slight premium over Healthy Drink’s current stock price.

As a board member, you are faced with a dilemma. On the one hand, you could vote to sell Healthy Drink to Bidder 1 and obtain the highest value for the company. However, this requires sacrificing

2. The Fair Trade Federation is an association of businesses committed to creating social and economic opportunities for otherwise marginalized communities of producers and suppliers. Members meet or exceed local, national, or international minimum pay standards, promote equal pay among genders, and ensure prompt payment. Members also provide compensation that reflects the true cost of labor, materials and sustainable growth, and ensure safe working conditions. Fair Trade Federation, About Fair Trade, http://www.fairtradefederation.org/bt/d/sp/i/178/pid/178 (last visited Feb. 21, 2009).

3. The hypothetical involves two all-cash offers at different values to clearly draw attention to the issue faced by the board. Corporate acquisitions can be financed in any number of ways, including various combinations of cash, stock, bonds, and other securities. The valuation of non-cash consideration can greatly impact the true value of a given offer due to the uncertainty of the value of securities at the time of payment versus the time of offer. This means that two offers of equal face value, one all-cash and the other containing securities, may not truly be equal. The comparison of two all-cash offers at disparate values avoids valuation issues beyond the scope of this Note.
the continuation of the company's environmental and supplier-friendly mission. Alternatively, you could vote to sell to Bidder 2 for a lower value and thereby ensure the continuation of Healthy Drink's corporate philosophy. 4

While the story of Healthy Drink is hypothetical, it illustrates a genuine and increasingly frequent dilemma faced by many corporate directors. This is because many corporations, in response to the multitude of environmental and social issues facing our nation and world, have resolved to pursue socially responsible initiatives in addition to profits. Such initiatives include reinvesting profits to develop supplier and producer communities, prohibiting exploitative labor practices, and exceeding minimum environmental requirements. 5

This pursuit of the "double bottom line" 6 is best exemplified by so-called B Corporations. B Corporations are purpose-driven businesses that require adherence to certain social and environmental standards in order to receive B Corporation certification. 7 The B Corporation movement is just one specific example of a growing trend of socially and environmentally aware companies driven by more than the mere desire for profits. 8

This Note explores the extent to which a fairly modern legislative advent—the constituency statute—can provide guidance to a board facing the dilemma presented by the Healthy Drink hypothetical. As this Note describes in greater detail below, the early common law and its subsequent codification in many states requires directors to act solely for the shareholders' benefit. 9 Constituency statutes permit board members to consider nonshareholder interests when exercising their corporate decision-making authority. In terms of general business decisions,

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4. Of course, the third option is for the board to choose not to sell to either bidder. For the purposes of this hypothetical, however, it is assumed that the sale of the company is inevitable.
5. See infra notes 262–266 and accompanying text.
constituency statutes do not present any novel issues because as residual claimants, shareholders have the opportunity to garner indirect benefits from socially responsible corporate activity. Moreover, in the absence of any indirect benefit to the shareholders, the potential negative impact of a social initiative on profits is not typically apparent when the corporation is engaged in numerous activities as a going concern.

In contrast, when a corporation is being sold, the shareholders of the target corporation typically lose their continuing interest in the business. Courts significantly limit the board’s generally broad, decision-making latitude once the company is up for sale. When the sale would result in a change of control of the corporation, courts have found that the board has a duty to seek the maximum shareholder return through the sale of the company. To simplify, “change of control” refers to the mandated sale of the corporation, which leaves the shareholders in a qualitatively different position post-transaction than they were pre-transaction.

Part II of this Note examines the divergence between the traditional view of directors’ duties and the fairly modern constituency statutes. As will be discussed, the traditional-duty analysis generally imposes on directors the duty to act with the shareholders’ best interests in mind. Constituency statutes, adopted by a majority of the states, permit the board to consider the interests of nonshareholder constituencies when exercising decision-making authority.

Part III examines the extent to which the traditional-duty framework prevents directors from engaging the corporation in socially responsible activity. This Note argues that while

10. See infra Part II.B.1.c.
11. See infra notes 97–108 and accompanying text.
12. The circumstances constituting a change of control transaction are fact-intensive and not subject to a concrete definition. See Paramount Comm’ns, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989). The qualitative difference refers to either the shareholders being cashed out, meaning they must sell their shares to the acquiring entity, or the transaction representing the shareholders’ last chance to receive a control premium. See Paramount Comm’ns, Inc. v. QVC Network, 637 A.2d 34, 45 (Del. 1994).
13. As of the writing of this Note, the following states have enacted constituency statutes: Arizona, Connecticut, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Missouri, Nebraska, Nevada, New Jersey, New Mexico, New York, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Vermont, Virginia, Wisconsin, and Wyoming.
constituency statutes do provide a tool that directors may theoretically invoke to circumvent this barrier, ultimately, the statutes do not do enough to protect social initiatives when the corporation is up for sale. This section identifies two main factors contributing to this failure. First, state legislatures have yet to clearly reconcile public policy preferences with respect to the two competing ideals: shareholder primacy and corporate social responsibility. Second, constituency statutes, as presently formulated, do not provide the interpretative guidance required to enable the courts to break from the interpretive framework of the traditional-duty analysis.

Section IV recommends a set of modifications to the current constituency statutes that will enable effective protection of corporate social responsibility in the acquisition setting. While constituency statutes may not always yield an optimal outcome, the economic collapse in the early twenty-first century \(^{14}\) demonstrates that, despite the arguments of some commentators, \(^{15}\) strict profit maximization is not the most efficient long-term business strategy, either. This Note argues that by emphasizing the importance of interests unrelated to profits, constituency statutes may foster more sustainable businesses and a more sustainable economy.

Section V explains the rationale for this proposed model. This section discusses how many socially responsible entrepreneurs are concerned with the reality that, when faced with a takeover, their company may be forced to sacrifice its principles for profits. In addition, this section argues that in many circumstances, corporate social responsibility is preferred over wealth maximization because it permits companies to enhance the interests of a broader range of constituents.

Finally, Section VI concludes that the proposed statutory framework can be a potential tool for administering corporate social responsibility, thereby strengthening corporations by providing long-term benefits.

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15. See infra note 31; see also infra notes 192–194 and accompanying text.
II. STATEMENT OF EXISTING LAW

In the world of corporate governance, the board of directors is responsible for managing the corporation's business affairs. Typically, all corporate powers are exercised at the discretion of the board. This discretion is subject to shareholder approval in certain circumstances.

According to the traditional corporate governance approach, directors have a duty to exercise corporate powers with the purpose of maximizing the corporation's profits, thereby maximizing shareholder wealth. This approach focuses on the financial benefit to shareholders and is often referred to as the "shareholder primacy" model. Although nonshareholder constituencies do have an interest in the decisions directors make, their interests are generally protected through means other than fiduciary duties, such as contractual provisions. Shareholders, however, are not protected by express contractual provisions. Thus, statutes impose fiduciary duties on directors to prevent the oppression of shareholders by management.

16. See, e.g., CAL. CORP. CODE § 309 (Deering 2008); see also DEL. CODE ANN. tit. 8, § 141 (2008); MODEL BUS. CORP. ACT § 8.01 (2002).
17. See, e.g., CAL. CORP. CODE § 309.
18. See infra notes 50–61 and accompanying text.
20. The phrase "nonshareholder constituencies" typically refers to employees, creditors, and suppliers. See Roberta S. Karmel, Implications of the Stakeholder Model, 61 GEO. WASH. L. REV. 1156, 1163 (1993). For purposes of this Note, the phrase will refer to any entity that has an interest in the corporation other than the shareholders.
21. See FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 24–25 (1991). For example, employees are commonly identified as a nonshareholder constituency which has a vested interest in the decisions the board makes. Employees are able to protect their interest through means such as collective bargaining agreements and employment agreements.
22. See C. A. Harwell Wells, The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century, 51 U. KAN. L. REV. 77, 88 (2002). But see Christopher M. Bruner, The Enduring Ambivalence of Corporate Law, 59 ALA. L. REV. 1385, 1397–1401 (2008) (discussing the nexus of contracts theory, which stands for the proposition that the corporation is at the center of numerous relationships, both with shareholders and stakeholders, and that these relationships essentially hinge on contractual-like obligations even in the absence of any express contract).
23. See Wells, supra note 22.
A. Corporate Social Responsibility

Despite the traditional approach to corporate governance, which focuses on maximizing shareholder wealth, there is a continuing trend among corporations to practice corporate social responsibility ("CSR"). Some corporations engage in socially responsible behavior for the sake of behaving responsibly, while others engage in such behavior as a means to achieve greater profits. Before discussing the ability of a company to engage in CSR, it is helpful to establish the parameters of what CSR means in this analysis. CSR has various potential components, including charitable donations, environmentally friendly initiatives, and enhanced employee benefits, among others. For the purposes of this Note, CSR is defined simply as the sacrifice of corporate profits for the public benefit. This definition highlights the controversy surrounding the extent to which corporations can divert profits from shareholders in order to advance nonshareholder interests.

Corporations are creations of state law. Consequently, the rules of corporate governance are, for the most part, administered by

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25. The term "corporate social responsibility" is fluid and has different meanings depending on the context. See Dow Votaw, Genius Becomes Rare, in THE CORPORATE DILEMMA: TRADITIONAL VALUES VERSUS CONTEMPORARY PROBLEMS 11, 11–12 (Dow Votaw & Prakash Sethi eds., 1973). As Votaw writes:

[It] means something, but not always the same thing, to everybody. To some it conveys the idea of legal responsibility or liability; to others it means socially responsible behavior in an ethical sense; to still others the meaning transmitted is that of "responsible for," in a causal mode; many simply equate it with "charitable contributions"; some take it to mean socially "conscious" or "aware"; many of those who embrace it most fervently see it as a mere synonym for "legitimacy," in the context of "belonging" or being proper or valid; a few see it as a sort of fiduciary duty imposing higher standards of behavior on businessmen than on citizens at large.

Id.

26. See id.


28. It is not necessarily true, however, that shareholder interests and the interests of other constituencies are mutually exclusive. See Daniel J.H. Greenwood, Fictional Shareholders: For Whom Are Corporate Managers Trustees, Revisited, 69 S. CAL. L. REV. 1021 (1996); see also infra notes 243–255 and accompanying text.

As a result, the precise contours of corporate governance vary in certain respects from state to state. Nonetheless, the prevailing view among economists, attorneys, business leaders, and commentators appears to be that corporate directors have a fiduciary duty to maximize profits for the benefit of the shareholders. Moreover, case law supports this duty. On its face, this duty appears to doom CSR, since CSR means sacrificing profits for public benefit. However, judicial deference to the decisions of business people typically allows corporations and directors to avoid otherwise successful legal challenges to their decisions to act in accordance with CSR, at least with respect to general business decisions.

B. The Legality of Corporate Social Responsibility

The common law has shaped the responsibilities that corporate directors have with respect to shareholders and nonshareholder constituencies. The most clearly enunciated of these responsibilities are the fiduciary duties owed by the directors to the corporation and its shareholders.

1. Responsibilities to Shareholders: Fiduciary Duties

Although codified in most states, the fiduciary duties of directors have their origins in the common law. Courts began to impose fiduciary duties on directors to ensure that directors did not

30. See id. While states are generally responsible for formulating corporate governance rules, some aspects are preempted by federal law. See THOMAS LEE HAZEN & JERRY W. MARKHAM, MERGERS, ACQUISITIONS AND OTHER BUSINESS COMBINATIONS: CASES AND MATERIALS 29 (2003) (demonstrating that securities regulations promulgated at the federal level impact certain aspects of corporate governance, particularly with respect to acquisition planning and execution).

31. See, e.g., Milton Friedman, The Social Responsibility of Business is to Increase its Profits, N.Y. TIMES MAG., Sept. 13, 1970, at 126 (arguing that “there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.”).

32. See infra Part II.B.1.

33. See Elhauge, supra note 27, at 744.

34. See infra Part II.B.1.b.


36. See id.

37. See id. Interestingly (but perhaps not surprisingly), Delaware has left the creation and development of directors’ fiduciary duties strictly in the hands of the judiciary. Id.
manage the corporation negligently or for their own benefit. In most states, directors can be held personally liable for breaching their fiduciary duties. 38

Fiduciary duties generally operate to ensure that the board of directors manages the company with the best interests of the shareholders in mind. 39 This obligation to maximize benefit to shareholders is commonly labeled as "shareholder primacy." 40 The shareholder-primacy model is a theory of corporate governance that requires directors to make decisions with the ultimate goal of maximizing shareholder returns. 41 In general terms, directors owe the corporation and the shareholders the fiduciary duties of care and loyalty in their good faith exercise of corporate authority. 42

a. Traditional duties: Loyalty and care

The fiduciary duty of loyalty imposes on directors the obligation to consider and approve only those actions that he or she believes are in the best interest of the corporation. 43 Self-dealing by a corporate director is the quintessential example of a breach of the duty of loyalty. 44 Self-dealing occurs when a director takes a personal benefit to the exclusion or detriment of the corporation and/or its shareholders. 45

38. See, e.g., MODEL BUS. CORP. ACT § 8.31 (2002). Despite potential liability, most states have so-called "rain-coat" provisions, which allow corporate charters to contain provisions limiting or negating the directors' personal liability. See, e.g., DEL. CODE ANN. tit. 8 § 102(b)(7) (2008) (noting that the certificate of incorporation may set forth "[a] provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director . . . ").


40. Rock, supra note 19; Dhir, supra note 19, at 369–70.

41. Rock, supra note 19, at 546.


44. See id. at 510 ("The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest."); see also Remillard Brick Co. v. Remillard-Dandini Co., 241 P.2d 66, 74 (Cal. Ct. App. 1952) ("It is a cardinal principle of corporate law that a director cannot, at the expense of the corporation, make an unfair profit from his position.").

In addition to the duty of loyalty, corporate directors must also adhere to their duty of care. The duty of care obligates a director to handle the corporation's affairs with the level of care of a reasonable director in similar circumstances. Accordingly, a director breaches this duty whenever he or she fails to manage the corporation's affairs with such reasonable care. Perhaps most commonly, directors breach their duty of care by failing to properly inform themselves before making major corporate decisions.

b. Business judgment rule

The discussion so far suggests that fiduciary duties prohibit CSR because sacrificing shareholder profits for public benefit arguably constitutes a breach of these fiduciary duties. In fact, this was precisely the outcome in many early cases. For example, in Dodge v. Ford Motor Co., the Michigan Supreme Court invalidated the authority of the Ford Motor Company to sacrifice profits in the name of social responsibility. Henry Ford and his board of directors exercised their discretion to withhold the distribution of Ford's capital earnings as a shareholder dividend. The funds were instead to be reinvested in the company to benefit its employees. According to Henry Ford, the board withheld the dividend so that the company would be able "to employ still more men; to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes." Despite this apparently benevolent intent, the Dodge court unequivocally

47. See Brehm v. Eisner, 746 A.2d 244, 259 (Del. 2000) (“The Board is responsible for considering only material facts that are reasonably available, not those that are immaterial or out of the Board's reasonable reach.”) (emphasis in original).
49. See infra notes 80–90 and accompanying text.
50. 170 N.W. 668 (Mich. 1919).
51. Id. at 684.
52. Id. at 671.
53. Id.
54. Id.
55. Interestingly, although Henry Ford's stated purpose was to reinvest in the company in order to promote expansion and employee well-being, his true purpose was likely to avoid providing capital to the Dodge brothers—Ford Co. shareholders who had decided in 1913 to begin manufacturing a line of vehicles that would compete with the Ford Model T. D. Gordon Smith, The Shareholder Primacy Norm, 23 IOWA J. CORP. L. 277, 316 (1998).
rejected this business decision by holding that the corporation is to be operated "primarily for the profit of the stockholders," and that directors must exercise their authority solely to that end. Thus, the court decided that the board could not reduce shareholder profits "in order to devote them to other purposes."

The *Dodge* court held that the board was obligated to act in good faith and to maximize shareholder profits. The directors had a certain amount of discretion in their decisions, but that discretion was limited to choosing the appropriate means to maximize shareholder wealth. The directors were not entitled to decide whether or not to pursue the ultimate end of wealth maximization.

Despite the holdings of early cases such as *Dodge*, more recently, courts have shown more deference to board decisions, thanks to the development of the business judgment rule. The business judgment rule operates as a presumption in favor of the board's decisions so long as certain prerequisites are met. In other words, the business judgment rule makes it difficult for shareholders to prevail on a claim against the board for breach of a fiduciary duty because of judicial deference to the judgment of the directors. Under the business judgment rule, a shareholder has the burden of rebutting the presumption that the board's decision was made in good faith and with due care.

The policy underlying the business judgment rule is deference to corporate decision makers. Courts prefer to defer to business people who make legitimate business decisions instead of

57. *Id.*
58. *Id.*
59. See *id.*
60. See *id.*
61. See *id.*
63. See Brehm v. Eisner, 746 A.2d 244, 264 n.66 (Del. 2000) ([D]irectors' decisions will be respected by courts unless the directors are interested or lack independence relative to the decision, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available.); *Aronson*, 473 A.2d at 812 ("It is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.").
retroactively analyzing those decisions with the benefit of 20/20 hindsight.\textsuperscript{65} This, in turn, encourages informed risk-taking,\textsuperscript{66} which is desirable because it promotes innovation and growth.\textsuperscript{67}

Courts have consistently applied the business judgment rule so long as a particular board decision has some rational benefit extending to the shareholders.\textsuperscript{68} \textit{Shlensky v. Wrigley} is a prime example of judicial deference engendered by the business judgment rule. In \textit{Shlensky}, a shareholder of an incorporated professional baseball organization sued the board of directors for refusing to install lights at the baseball field owned by the corporation.\textsuperscript{70} The shareholder contended that the decision to not install lights resulted in lost revenue because the team could not play night games.\textsuperscript{71} Arguably, this refusal caused reduced attendance at weekday games in comparison to weekend home games and weeknight road games.\textsuperscript{72}

The \textit{Shlensky} court, however, held that the board did not breach its duty of care.\textsuperscript{73} The court stated that the board was free to consider the corporation's long-term interest in the property value, which might otherwise be jeopardized by night games that could lead to the deterioration of the surrounding neighborhood.\textsuperscript{74} Because there was no evidence of "fraud, illegality or conflict of interest,"\textsuperscript{75} the board was free to make its decision irrespective of whether or not

\textsuperscript{65}\textit{See} Roselink Investors, L.L.C. v. Shenkman, 386 F. Supp. 2d 209, 224 (S.D.N.Y. 2004) ("[T]he business judgment rule is intended to protect directors against just such attacks because their decisions are not to be second-guessed by courts with the benefit of hindsight."); Air Line Pilots Ass'n, Int'l v. UAL Corp., 717 F. Supp. 575, 582 (N.D. Ill. 1989) ("[T]he judiciary, pursuant to the teachings of the business judgment rule, refrains from judging in hindsight the decisions of directors, who, in any event, are presumably better versed in the operation of the business world.").

\textsuperscript{66}Branson, \textit{supra} note 62, at 632.

\textsuperscript{67}1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01 cmt. c (1994) ("For efficiency reasons, corporate decisionmakers should be permitted to act decisively and with relative freedom from a judge's or jury's subsequent second-guessing. It is desirable to encourage directors and officers to enter new markets, develop new products, innovate, and take other business risks.").

\textsuperscript{68}\textit{See infra} notes 69–77 and accompanying text.

\textsuperscript{69}237 N.E.2d 776 (Ill. App. Ct. 1968).

\textsuperscript{70}Id. at 778.

\textsuperscript{71}Id. at 777–78.

\textsuperscript{72}Id.

\textsuperscript{73}\textit{See} id. at 781.

\textsuperscript{74}Id. at 780.

\textsuperscript{75}Id.
it was "correct." In practical terms, so long as directors can demonstrate that their decision was made with the interests of the corporation in mind, even if those interests are long-term and somewhat tangential or attenuated, the business judgment rule will generally protect the directors from liability.

Despite the presumed validity of board decisions, the business judgment rule will not protect a board whose actions exceed the bounds of rational business judgment. This is likely to occur when a board makes a decision in bad faith or on an uninformed basis. The classic example of a board’s failure to make an informed decision is *Smith v. Van Gorkom*.

In *Van Gorkom*, the court held that the board breached its duty of care by failing to adequately inform itself of all pertinent information prior to approving the sale of the corporation. A group of shareholders sought the rescission of a cash-out merger between two corporations: Trans Union Corporation and a subsidiary of Marmom Group, Inc. The transaction went through at $55 per share of Trans Union stock, but at no point was a formal valuation of Trans Union performed. Rather, management "ran the numbers" at $50 and $60 per share and performed a feasibility study at $55 per share. Trans Union’s CEO, who was also a board member, spearheaded this effort without informing the rest of the board.

76. Id.

78. When a board decision exceeds the bounds of rational business judgment, the presumption in favor of the board no longer applies. This makes it extremely difficult for the board to justify its conduct and enhances the likelihood that the court will find a breach of duty.

79. See Robert F. Blomquist, *Six Thinking Hats for the Lorax: Corporate Responsibility and the Environment*, 18 GEO. INT’L ENVTL. L. REV. 691, 698–99 (2006) (“For corporate officers’ or directors’ decisions to be regarded as ‘irrational,’ and thus not protected by the business judgment rule, the decisions must go so far beyond the bounds of reasonable business judgment that their only explanation is bad faith.”).

80. 488 A.2d 858 (Del. 1985).
81. Id. at 893.
82. Id. at 863.
83. Id. at 869.
84. Id. at 865–66.
85. Id. at 865–68.
When Trans Union's CEO finally presented the idea of the merger to the board in a meeting that lasted two hours, the board voted in favor of the merger based on the limited information orally presented by the CEO. Although the board members were all experienced professionals, the plaintiffs were able to establish that the board did not adequately inform itself of all relevant information. As a consequence, the plaintiffs successfully rebutted the presumption in favor of the board provided by the business judgment rule. Without the defense of the business judgment rule, the board was unable to establish that it did not violate its duty of care.

c. Modified duties in the takeover context

When a corporation is an acquisition target, the business judgment rule is modified so that the board's response to a takeover receives heightened scrutiny. Amid the takeover frenzy of the 1980s, the Delaware Supreme Court decided a series of cases that have come to shape the duties of directors in the acquisition context.

In *Unocal Corp. v. Mesa Petroleum Co.*, the court upheld the board's adoption of a defensive recapitalization in the face of a hostile takeover. The court ruled that where a defensive measure adopted by the board is potentially motivated by entrenchment, the business judgment rule does not automatically apply. Instead, the burden is on the board to establish that there is a reasonably perceived threat to the corporate enterprise and that the measure adopted is "reasonable in relation to the threat posed." In the wake of *Unocal*, the Delaware Supreme Court ruled on another takeover lawsuit in *Revlon, Inc. v. MacAndrews & Forbes*

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86. *Id.* at 874.
87. *Id.* at 880.
88. *Id.* at 874.
89. *See id.* at 878.
90. *See id.* at 881.
92. 493 A.2d 946 (Del. 1985).
93. *See id.* at 949.
94. *Id.* at 953-55.
95. *See id.* at 954.
96. *Id.* at 955.
Holdings, Inc. Revlon involved an unfriendly tender offer to Revlon shareholders by Pantry Pride. In addition to Pantry Pride, a second company, Forstmann, was engaged in the bidding process. The Revlon board had decided to sell the company; the only unresolved issues were to whom and for what value the company would be sold. Ultimately, the board agreed to sell Revlon at a lower price to Forstmann despite receiving a higher offer from Pantry Pride. Among other factors, the Revlon board felt that the Forstmann deal would better protect the interests of certain noteholders (an example of a nonshareholder constituencies) with whom the board was concerned.

The Revlon court held that the board breached its duty to Revlon shareholders by not seeking the highest price possible in the sale of the corporation. The court reasoned:

A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders. However, such concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder.

As the Revlon court makes clear, when a corporation has abandoned its long-term strategies and has entered auction mode (what this Note terms "Revlon land"), the sole fiduciary duty of the board is to maximize immediate shareholder value.

The Revlon decision suggests that a Delaware corporation committed to the double bottom line cannot maintain that commitment once its sale is imminent. This is because once the board puts the company up for sale, Revlon requires that the board

98. For a detailed description of tender offers, see HAZEN & MARKHAM, supra note 30, at 409–12.
99. Revlon, 506 A.2d at 175.
100. Id. at 178.
101. Id. at 178–79.
102. See id.
103. Id.
104. See id. at 185.
105. Id. at 182 (citation omitted).
106. See id. at 182, 184 n.16.
pursue the highest price possible. Just as Revlon could not attempt to protect noteholders' interests to the detriment of shareholders' interests by accepting Forstmann's lower offer, the board of a Delaware corporation may also be barred from accepting a lower purchase price in order to guarantee the continuation of CSR.

2. Responsibilities to Nonshareholders: Constituency Statutes

In Revlon, the Delaware Supreme Court articulated a policy requiring the maximization of shareholder returns in the event that the corporation is sold. While the Delaware courts have pursued that policy, many state legislatures pursued an alternative policy embodied in constituency statutes. Constituency statutes essentially permit directors to consider, to varying degrees, nonshareholder interests when making corporate decisions. At least on their face, constituency statutes provide a legislative alternative to the developing case law originating in the ever-influential Delaware courts.

a. Origins

A majority of states have enacted some form of constituency statute. While the true impetus behind early constituency statutes is the subject of debate, most commentators believe that the statutes have been a response to the frenzied hostile takeover.
activity of the 1980s. The increased popularity of unfriendly takeovers left the directors of acquisition targets scrambling to find ways to fend off hostile bidders without breaching the fiduciary duties they owed to shareholders. Consequently, management lobbied state legislatures to adopt constituency statutes as a potential solution to this problem.

In 1983, Pennsylvania became the first state to adopt a constituency statute. Since then, a majority of states have followed suit by enacting some form of constituency statute. Although shareholders of the target company usually stand to benefit financially from a hostile takeover, the nature of a takeover often puts the target's nonshareholder constituencies at risk. Thus, by allowing directors to consider nonshareholder interests, constituency statutes theoretically allow a board to reject a takeover even if it is in the best financial interest of the shareholders.

b. Components of constituency statutes

Although the specific language of the statutes varies from state to state, the unifying principle common to all constituency statutes is that they enable corporate directors to consider interests other than those of their shareholders when exercising their corporate decision-


116. See id. at 489.

117. Hansen, supra note 109, at 1355 n.4.

118. See supra note 13.

119. This is particularly true when the takeover is structured as a leveraged buyout ("LBO"). In an LBO, the target company essentially pays for itself by taking on a large amount of debt secured by the target's assets. This puts employees at risk since the acquiring entity often reduces the number of employees and even eliminates entire divisions to reduce operating costs in order to service the debt load assumed to finance the acquisition. Additionally, the target company's creditors are placed at risk if the company is unable to service its debt. See Bay Plastics, Inc. v. BT Commercial Corp. (In re Bay Plastics, Inc.), 187 B.R. 315 (Bankr. C.D. Cal. 1995) (involving an LBO where the acquired company was forced to file bankruptcy).

An additional risk to stakeholders associated with hostile takeovers is the possibility that the acquiring party intends the takeover to be a "bust-up bid." In bust-up bids, the bidder acquires an underperforming company and sells off its component parts in order to make a profit. Maynard, supra note 113, at 81.
making authority. Some common provisions include the following:

1. The board of directors of a corporation may consider the interests and effects of any action upon nonshareholders.

2. The relevant nonshareholder groups include employees, suppliers, customers, creditors, and communities.

3. The directors may consider both long-term and short-term interests of the corporation.

4. The directors may consider local and national economies.

5. The directors may consider any other relevant social factors.

Most constituency statutes are permissive, as exemplified by the Pennsylvania statute. The Pennsylvania constituency statute reads:

In discharging the duties of their respective positions, the board of directors, committees of the board and individual directors of a domestic corporation may, in considering the best interests of the corporation, consider the effects of any action upon employees, upon suppliers and customers of the corporation and upon communities in which offices or other establishments of the corporation are located, and all other pertinent factors.

As the above statutory language shows, permissive constituency statutes emphasize director discretion. On its face, the permissive

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121. Connecticut’s constituency statute uses mandatory language rather than the permissive language exemplified here. CONN. GEN. STAT. ANN. § 33-756(d) (West 2005).

122. See, e.g., 15 PA. CONS. STAT. ANN. § 516(a); VT. STAT. ANN. tit. 11A, § 8.30(a)(3).

123. See Karmel, supra note 20, at 1163. Recently proposed constituency statutes have included the environment as a relevant nonshareholder interest that may be considered. See infra notes 152-155 and accompanying text.

124. See, e.g., VT. STAT. ANN. tit. 11A, § 8.30(a)(3); WYO. STAT. ANN. § 17-16-830(e)(ii), (iv).

125. See, e.g., WYO. STAT. ANN. § 17-16-830(e)(ii).

126. See, e.g., VT. STAT. ANN. tit. 11A, § 8.30(a)(3); WIS. STAT. ANN. § 180.0827(3) (West 2007).

127. 15 PA. CONS. STAT. ANN. § 516(a).

128. Id. (emphasis added).
language buttresses CSR because the board has the discretion to consider nonshareholder interests, should it choose to do so.

However, the statutes are permissive, not mandatory. This means that while directors have the authority to consider other constituencies, they also have the discretion to not consider other constituencies. In other words, directors are free to focus solely on shareholder returns and to completely ignore the interests of employees and creditors, among others. This point is illustrated by the fact that these statutes do not provide these other constituencies with a cause of action in the event that the board fails to consider nonshareholder interests.

In contrast to Pennsylvania's constituency statute, Connecticut's statute requires the board to consider nonshareholder interests when exercising its decision-making authority. Yet, even Connecticut's mandatory statute does not provide an enforcement mechanism for nonshareholders to protect their interests. In fact, some constituency statutes go so far as to explicitly deny standing to nonshareholder constituencies wishing to sue the board for its failure to adequately consider their interests. Therefore, even in states that require the board to consider nonshareholder constituencies, the failure to do so can only be challenged by a shareholder through a traditional breach of duty claim.

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129. This is not universally true. Connecticut's constituency statute contains mandatory language. See CONN. GEN. STAT. ANN. § 33-756(d) (West 2005).

130. See, e.g., N.Y. BUS. CORP. LAW § 717 (Gould 2008); 15 PA. CONS. STAT. ANN. § 516 (West 1995).

131. CONN. GEN. STAT. ANN. § 33-756. The Connecticut statute provides, in pertinent part, the following:

[A] director of a corporation . . . shall consider, in determining what he reasonably believes to be in the best interests of the corporation . . . (3) the interests of the corporation's employees, customers, creditors and suppliers, and (4) community and societal considerations including those of any community in which any office or other facility of the corporation is located.

Id. (emphasis added).

132. See id.

133. See, e.g., N.Y. BUS. CORP. LAW § 717(b).

134. It is unclear whether the failure to consider nonshareholder interests can be brought as a standalone cause of action or if the shareholder must also assert a breach of duty claim. Regardless, the court is unlikely to uphold any such claim. See infra Part III.
c. Cases

Despite the multiple questions raised by constituency statutes, there exists little relevant case law to provide answers. With respect to the clear policy tension between constituency statutes and the Revlon decision in the ever-persuasive Delaware courts, the landscape is especially sparse. Since their enactment, courts have interpreted constituency statutes in such a way as to fit them into the well-established theoretical and dialectical framework established by the traditional-duty analysis as it was modified by Revlon. Courts are reluctant to interpret constituency statutes as supplanting the shareholder-centric policies enunciated by Revlon. Instead, constituency statutes currently function only to the extent that they do not conflict with shareholder primacy.

One of the early cases that exemplifies this approach comes from Pennsylvania. In Baron v. Strawbridge & Clothier, the defendant corporation’s board of directors adopted a stock reclassification plan to defend against a hostile tender offer. The Pennsylvania court upheld the defensive measure, noting that “[i]t was proper for the company to consider the effects the . . . tender offer would have, if successful, on the Company’s employees, customers and community.” Despite the court’s acknowledgement that the board could consider nonshareholder interests, the court nonetheless emphasized that the board’s fiduciary duty is to act in the best interest of the shareholders. Ultimately, the court’s decision to uphold the company’s anti-takeover measures turned on the board’s consideration of shareholder interests. The outcome would have been identical even without Pennsylvania’s constituency statute.

In Amanda Acquisition Corp. v. Universal Foods Corp., the court ruled that the target board acted properly when it redeemed a

135. See infra Part III.
136. See id.
138. Id. at 692.
139. Id. at 697.
140. Id.
141. See id.
poison pill\textsuperscript{143} in response to a tender offer.\textsuperscript{144} Among other things, the court found that the company acted reasonably when it considered the effect the tender offer would have on the company’s employees, customers, and community.\textsuperscript{145} On appeal, the Seventh Circuit upheld the decision on different grounds. Although Wisconsin law applied, the court relied heavily on Delaware precedent and limited its analysis to equity investors by dismissing the lower court’s “threat” analysis.\textsuperscript{146} The Seventh Circuit further held that “[a] policy denying investors the opportunity to accept a substantial premium, based on remote ‘threats,’ is not easy to square with the law of Delaware.”\textsuperscript{147} Again, the traditional-duty framework sharply limited any force behind the board’s consideration of nonshareholder interests.

In another poison pill case, the federal district court in Maine permitted a company to delay a shareholder vote on whether to redeem the pill for 120 days after a tender offer was made.\textsuperscript{148} The court held that 120 days was not an unreasonable amount of time, noting that “[t]his is particularly so when Maine law suggests that the Directors of a corporation, in considering the best interests of the shareholders and corporation, should also consider the interests of the company’s employees, its customers and suppliers, and communities in which offices of the corporation are located.”\textsuperscript{149}

d. Modern trend: Constituency statutes as CSR tools

Notwithstanding the constituency statute’s origin as an anti-takeover device,\textsuperscript{150} the drafters of recently proposed constituency

\textsuperscript{143} A poison pill is a takeover defense mechanism whereby a specified event or set of events automatically triggers a corporate change, usually structural, which makes the company an unattractive target for the prospective acquirer(s). See generally Wachtell, Lipton, Rosen & Katz, The Share Purchase Rights Plan (1996), reprinted in THERESE H. MAYNARD, MERGERS AND ACQUISITIONS: CASES, MATERIALS, AND PROBLEMS 513–18 (2005) (setting forth the terms of a standard poison pill).

\textsuperscript{144} 708 F. Supp. at 1016.

\textsuperscript{145} Id. at 1012–13.

\textsuperscript{146} See Amanda Acquisition Corp. v. Universal Foods Corp., 877 F.2d 496, 499 n.4 (7th Cir. 1989) (“Nothing in this opinion endorses the district court’s rationale concerning these ‘threats,’ which is in tension with recent Delaware cases.”) (applying the law of Wisconsin)).

\textsuperscript{147} Id.


\textsuperscript{149} Id. at 33.

\textsuperscript{150} See Ball, supra note 114.
statutes envision these statutes as tools to enable CSR.151 Most recently, the California legislature passed a bill that would allow directors to consider nonshareholder interests,152 which the governor later vetoed.153 In 2007, a very similar bill made its way through the Washington legislature.154 Each of these proposed statutes listed not only employees, customers, and suppliers as relevant nonshareholder constituencies, but also the environment.155 Moreover, the impetus behind these bills was to encourage socially responsible corporate behavior.156 Some proponents of utilizing constituency statutes as vehicles for CSR suggest that states with these statutes would attract socially responsible businesses.157 This attractive business climate, in turn, would foster innovation and competition among these socially responsible businesses, encourage investment, and produce greater gains, both financially and in terms of social responsibility.158

III. CRITIQUE OF EXISTING LAW

Despite the wide adoption of constituency statutes,159 these statutes do not and cannot protect socially responsible corporations in the competitive acquisition setting following Revlon. The courts’ inability to interpret constituency statutes outside the framework established by Revlon is the consequence of the legislatures’ failure to clearly enunciate the public policy preferences signaled by constituency statutes. This policy failure is itself the product of the inability of constituency statutes to provide adequate interpretive guidance to the courts.

156. See, e.g., Press Release, Mark Leno, supra note 151.
157. See Petra Pasternak, Shielding the Green: Bill Would Let Corporate Directors Consider More ‘Constituencies’, THE RECORDER, Apr. 4, 2008, at 1–2. The author examines a California attorney’s observation that clients fear facing liability for pursuing their corporation’s eco-friendly and socially responsible practices, id. at 1, and further discusses another California attorney who counseled a client with similar concerns to incorporate in a state that had a constituency statute on the books. Id. at 1–2.
158. See id.
159. See supra note 13.
A. More of the Same

With respect to general business decisions, the question is open as to whether a corporation can truly sacrifice profits in the name of social responsibility. Although the business judgment rule seems to give wide latitude to the board in its exercise of corporate powers, the case law developing the business judgment rule “falls short of unambiguously authorizing the pursuit of non-shareholder interests other than instrumentally for the benefit of the shareholders.” If the solitary impact of constituency statutes is that they permit a corporation to engage in socially responsible behavior, but only so long as there is some benefit to the shareholders, then the only fact of substance proven is that shareholder primacy is in fact the sole analytical model guiding corporate fiduciary compliance. This is true even when the benefit to the shareholders is attenuated, such as goodwill for the corporation. Likewise, this is true when the benefit is contemplated and not actualized, as in Shlensky, because directors will not engage the corporation in socially responsible activities without first calculating how to justify the conduct as having some rational benefit to the shareholders.

While philosophically unclear, the business judgment rule allows the board of directors to justify socially responsible activity so long as the board can rationally point to a theoretical benefit that may accrue to the shareholders. In practice, then, constituency statutes appear to be superfluous with respect to general business decisions in light of the common law. The presence of a constituency statute in

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161. Id.
162. See supra notes 69–76 and accompanying text.
163. Admittedly, finding a justification to satisfy the business judgment rule may not be very difficult in the real world, but the requirement does seem to cut against the very principles behind B Corporations and corporate social responsibility, which envision the corporation as being socially responsible for the sake of being socially responsible.
164. The business judgment rule is philosophically unclear. On the one hand, it is driven by a policy favoring deference to business people and a hesitance to pass judgment on business decisions retroactively with the benefit of hindsight. On the other hand, the business judgment rule essentially allows the board to justify any conduct as long as it can produce some rationale for why the decision would potentially benefit the shareholders.
165. In fact, the ABA Committee on Corporate Laws argued that this should represent the full extent of constituency statutes. The Committee wrote:

The Committee believes that the better interpretation of these statutes, and one that avoids [sacrificing shareholder primacy], is that they confirm what the common law
a state lacking a rich body of fiduciary duty case law, at a minimum, makes explicit what was otherwise implicit in the common law developed outside of that state. In other words, constituency statutes at least make clear that a board of directors may consider interests other than those of the shareholders when making corporate decisions. 166

The real weakness of constituency statutes is highlighted when a socially responsible corporation is for sale, as illustrated by the initial Healthy Drink hypothetical. Constituency statutes are essentially rendered impotent in this scenario. 167 As discussed below, even though a few takeover cases in states with constituency statutes have acknowledged the existence of the statutes, the statutes themselves have not been dispositive in these decisions. 168 None of the courts in the cases identified in the following section explicitly confronted the issue of whether, in a multiple-bidder Revlon style acquisition, the board can sacrifice a higher price for promised continuation of socially responsible initiatives. Rather, the courts merely mentioned the constituency statutes and then proceeded to rule on grounds consistent with common law principles that preceded the advent of the constituency statute.

The decision in Baron v. Strawbridge & Clothier 169 evidences the inadequacy of constituency statutes to protect nonshareholder interests during the sale of a company. In Baron, which involved a single-party takeover attempt, 170 the court avoided addressing whether nonshareholder constituency interests could trump shareholder interests. Instead, the court focused on the future success of the company, stating:

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166. Of course, this says nothing as to the appropriate prioritization of these often competing interests.
167. See discussion supra Part II.B.1.c.
168. See infra text accompanying notes 169–178.
170. See id. at 691.
[T]he fiduciary duty of corporate directors "to act in the best interests of the corporation's shareholders . . . requires the directors to attempt to block takeovers that would [in their judgment] be harmful to the target company," and "directors are obliged to oppose tender offers deemed to be 'detrimental to the well-being of the corporation even if that [opposition] is at the expense of the short-term interests of the individual shareholders.'" 171

As this passage reflects, instead of directly addressing whether consideration of nonshareholder interests by itself was sufficient to justify the board's decision, the court fell back on the familiar justification of protecting or benefiting the shareholders. As a result, the court was able to sidestep an analysis of the appropriate weight that should be assigned to constituency statutes relative to other policies.

In Keyser v. Commonwealth National Financial Corp., 172 the court did a similar dance to avoid addressing Pennsylvania's constituency statute. In Keyser, a group of shareholders sued the corporation after the directors "knowingly sacrificed dollars for social issues, refused to hold an auction after the company was in play, stonewalled a willing bidder and finally eliminated that bidder with a lock-up for insufficient consideration." 173 The court noted that Pennsylvania's constituency statute permits directors to consider the effects of any action upon employees, customers of the corporation, and the community. 174 However, the court acknowledged that this consideration is not appropriate under Revlon because Delaware has not adopted a constituency statute. 175 Consequently, the court ruled that "[t]he extent to which price could be sacrificed for these so-called social issues in the factual context of this case is not a proper determination for the court." 176 Again, the court effectively avoided addressing the extent to which constituency statutes permit sacrificing profits for the benefit of nonshareholders in the acquisition setting.

171. Id. at 697 (quoting Enterra Corp. v. SGS Assocs., 600 F. Supp. 678, 686 (E.D. Pa. 1985).
173. Id. at 254.
174. Id. at 265–66.
175. Id. at 265.
176. Id. at 266.
These cases demonstrate the general reluctance of courts to interpret constituency statutes to allow a corporation’s board to sacrifice profits for the benefit of nonshareholder constituencies. This outcome should be expected since the courts routinely couch their evaluative discourse in the terminological and analytical framework established by the traditional-duty analysis.  

In fact, as noted above, some courts have explicitly acknowledged that to the extent the interpretation of constituency statutes contradicts the common law, as established predominantly in Delaware, such interpretation is suspect.

B. Confusion over Policy

These cases present a curious truth. Courts seem to be interpreting constituency statutes to essentially add nothing to the existing law. Yet, both common sense and prevailing theories of statutory interpretation suggest that this could not have been the legislative intent. After all, the process of passing laws can be arduous. Why then do courts seem to hold that legislators passed these constituency statutes with no intention of increasing the board’s authority to consider broader constituencies? Perhaps the answer lies in the result of a debate held seventy years ago.

In a series of law review articles published in the 1930s, Professors Adolf Berle and Merrick Dodd debated the appropriate role of the corporation. Professor Berle was an early proponent of the shareholder primacy model and believed strongly that all

177. For example, in Baron v. Strawbridge & Clothier, the court discussed the reasonableness of the board’s response to a hostile takeover in relation to the threat posed. 646 F. Supp. 690, 697 (E.D. Pa. 1986). This analysis tracks the framework laid out by the Delaware Supreme Court in the Unocal decision. See Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).


180. Even if a proposed law survives numerous amendments and anticipated attacks, and passes through the legislature, it is still subject to the executive’s veto.

181. Compare Adolf Berle, Corporate Powers as Powers in Trust, 44 HARV. L. REV. 1049, 1049 (1931) (arguing that “all powers granted to a corporation or to the management of a corporation . . . are necessarily and at all times exercisable only for the ratable benefit of all shareholders as their interest appears”) with E. Merrick Dodd, For Whom are Corporate Managers Trustees?, 45 HARV. L. REV. 1145, 1148 (1932) (warning against emphasizing “the view that business corporations exist for the sole purpose of making profits for their stockholders,” and instead promoting a view of the corporation “as an economic institution which has a social service as well as a profit-making function . . .”).
corporate activity should be evaluated in terms of the extent to which it benefits the company’s shareholders. Berle was concerned with the evolving corporate structure that gave opportunistic corporate managers the power to engage in self-dealing to the detriment of relatively unorganized shareholders. In Berle’s view, although a particular exercise of corporate power may be motivated by a self-interested management, if the exercise of corporate power benefits the shareholders, then shareholder oppression is avoided. Wealth maximization, therefore, serves as an objective measurement of shareholder benefit.

Professor Dodd offered an alternative view of the corporation. Whereas Berle was concerned with the ability of self-interested management to oppress shareholders, Dodd was concerned with protecting society from oppressive corporations. Professor Dodd viewed “all business as affected with a public interest.” In other words, Dodd believed that corporations serve a public utility beyond furnishing shareholders with profit and maximizing wealth. Unlike Berle, who believed that the separation of ownership and management allowed management to exploit shareholders, Dodd perceived this separation as providing an opportunity for management to use their governance authority for the good of society.

Most commentators seem to agree that the shareholder primacy model derived from Professor Berle’s position has prevailed as the more persuasive and predominant form of corporate governance. In fact, one need not look far beyond the title of Nobel Laureate and economist Milton Friedman’s 1970 article The Social Responsibility

182. Berle, supra note 181, at 1049.
183. Wells, supra note 22.
184. Id.
185. Berle, supra note 181, at 1049.
186. Dodd, supra note 181, at 1148.
187. Id. at 1147–48.
188. Id. at 1149.
189. See id.
190. Berle, supra note 181, at 1049.
191. Dodd, supra note 181, at 1148.
of Business is to Increase its Profits\textsuperscript{193} to see the persuasiveness of Berle's position. Scholars have echoed this view.\textsuperscript{194}

Despite the far-reaching support for the shareholder primacy model,\textsuperscript{195} the current CSR movement and the recent wave of proposed constituency statutes revive and embody Professor Dodd's position.\textsuperscript{196} However, the predominance of the shareholder primacy view has resulted in the courts' inability to address the validity of constituency statutes without falling back on the shareholder primacy paradigm.\textsuperscript{197} It is this failure to break with the traditional shareholder wealth maximization principles that prevents constituency statutes from adequately protecting CSR in the acquisition context in light of Revlon.

The inability of the courts to interpret constituency statutes as distinct from the traditional-duty framework is predicated not only on the courts' adherence to the traditional framework, but also on their uncertainty over how to apply constituency statutes independently. The traditional framework fosters a system of adjudicatory rationality by simplifying the board's duty—maximizing shareholder return.\textsuperscript{198} In other words, the law has developed in the acquisition context by identifying profit maximization as the normative ideal and articulating norms (i.e., fiduciary duties) in terms of the minimum acceptable conduct that directors must follow.\textsuperscript{199}

The alternative system, which constituency statutes strive for, acknowledges the relevant interests of multiple constituencies and allows corporate directors to seek preference maximization in the aggregate.\textsuperscript{200} The choice of adjudicative rationality allows the courts

\textsuperscript{193} Friedman, supra note 31.
\textsuperscript{194} See David C. Bayne, S.J., THE PHILOSOPHY OF CORPORATE CONTROL: A TREATISE ON THE LAW OF FIDUCIARY DUTY 126 (1986) ("The overarching objective of the corporate entity is its own common good, which is generally to make profits.").
\textsuperscript{195} Henry Hansmann & Reinier Kraakman, The End of History for Corporate Law, 89 Geo. L.J. 439, 439 (2001) (arguing that not only has the shareholder primacy model proven to be the dominant model in American corporate law, but that all economies are converging toward this model).
\textsuperscript{196} See supra text accompanying notes 150–158.
\textsuperscript{197} See supra Part III.A.
\textsuperscript{199} See id. at 429.
\textsuperscript{200} See id. at 430.
to avoid confronting the complex decision matrix, which a board must necessarily analyze when trying to prioritize competing preferences. Instead, the directors are able to focus on a strict set of well-established normative principles to frame the proper course of conduct for a company faced with the prospect of being acquired. Consequently, the interpretation of constituency statutes can be explained as the product of administrative convenience, even though its policies compete with the traditional-duty analysis.

C. Lack of Guidance

The traditional view is that the legislature is responsible for formulating rules to achieve public policy. However, the courts’ inability to break from the normative, analytically convenient framework suggests that constituency statutes fail to provide adequate guidance for their application. This indicates that the legislatures have failed to clearly articulate the policies underpinning these statutes. As a result, judges are left to make the statutes fit within the pre-existing duty framework.

Moreover, the lack of case law interpreting constituency statutes in the acquisition context almost certainly guarantees that management will be counseled to choose a topping bid over a bid promising the continuation of CSR. This is because there is no legal authority protecting a board that rejects a higher value bid out of consideration for nonshareholder interests. Instead, Revlon and its far-reaching precedent provide authority for punishing management...

201. Admittedly, preferences are not necessarily in competition. See Greenwood, supra note 28, at 1061. However, the point is that the decision-making process becomes exponentially more difficult when the board must consider the interests of more and more groups.


203. This may be explained in part by the fact that despite the recent attempt to use constituency statutes to support corporate social responsibility, a majority of currently enacted constituency statutes were designed to be anti-takeover devices. See Ball, supra note 114.

204. William W. Bratton, Confronting the Ethical Case Against the Ethical Case for Constituency Rights, 50 WASH. & LEE L. REV. 1449, 1468 (1993). Bratton argues that as a result of constituency statutes being adopted at the behest of management as an anti-takeover tool, “enactment did not force the implications of constituency empowerment forward as matter for legislative consideration. These facts invite an ordinarily cautious interpreting judge to fit the statutes into corporate law’s inherited framework of management empowerment: Since constituency rights disempower managers, the statutes do not imply them.” Id.

205. See supra Part II.B.2.c.
for not accepting the higher bid. 206 Since constituency statutes are merely permissive 207 and lack an enforcement mechanism, they do little more than give boards the legislative permission to consider the effects of an acquisition on nonshareholder constituencies. Consequently, a board can disregard these interests without fearing shareholder backlash.

Furthermore, constituency statutes in their current form apply to all corporations, not only to corporations interested in pursuing the double bottom line. 208 Because not all corporations have socially responsible agendas, the courts are rightfully hesitant to apply constituency statutes in a way that permits sacrificing profits for the public benefit. Apprehension over setting questionable precedent for strictly profit-maximizing firms arguably prevents courts from applying constituency statutes to corporations that are truly committed to the double bottom line.

Finally, constituency statutes do not provide any guidance as to the relevant weight directors should afford to nonshareholder interests. 209 Even Connecticut’s mandatory constituency statute 210 does not indicate what weight, if any, nonshareholder interests should receive relative to shareholder interests. 211 Consequently, the courts refer back to the traditional framework where shareholder interests receive top priority, often to the exclusion of any nonshareholder interests.

IV. PROPOSAL

The inability of constituency statutes to adequately safeguard CSR in the acquisition setting cannot be remedied solely by an internal restructuring of the statutes themselves. Constituency statutes can only allow CSR to survive Revlon land if the legislature


208. Each currently enacted constituency statute appears to apply to all corporations in the state where the statute is in force, although in some states the statutes only apply in the takeover context. James J. Hanks, Jr., Playing with Fire: Nonshareholder Constituency Statutes in the 1990s, 21 Stetson L. Rev. 97, 106 (1991).


211. Id.
clearly understands the public policy it is promoting. Therefore, legislatures must then clearly articulate this policy in the language of the statutes and give the statutes the requisite force necessary to guide the courts in enforcing this public policy.

A. Clarifying the Role of Corporations

The debate over the appropriate role for corporations in society is just as lively and unresolved today as it was for Berle and Dodd nearly three-quarters of a century ago. As entities created by state authority, corporations should be governed in accordance with policy choices promulgated by the state legislatures. This governance, in turn, will allow corporations to help further the ends of the states' public policies.

Constituency statutes embody one such public policy choice. For example, California's most recently proposed constituency statute was prompted by a desire to encourage socially responsible corporations to incorporate in California. The motivation behind the bill is in line with the developing socially and environmentally aware policy vision taking shape in the state. Although the constituency statute was ultimately vetoed, this is the type of convergence of policy and law that is necessary for constituency statutes to effectively protect CSR in the acquisition context.


When we begin to understand the true role of corporations in our modern society, we are able to see corporate law not just as a tool to help businesses govern their internal affairs but also as a mechanism to bring about needed changes in other areas of public policy. Corporate law can be a powerful tool of public policy . . .

Id.

214. See Press Release, Mark Leno, supra note 151 (“AB 2944 is important to help attract and retain these leading-edge companies . . .”).


216. See Veto Message, supra note 153.
In fact, the failed passage of California's constituency statute is symptomatic of the policy confusion perpetuating the general inability of constituency statutes as currently formulated to protect CSR in the acquisition setting. California certainly prides itself in taking the initiative and "lead[ing] the nation" in environmentally friendly policies.\textsuperscript{217} As a consequence of the executive veto of the proposed statute, however, corporations can only engage in these initiatives to the extent that "shareholder protections" are maintained.\textsuperscript{218}

This apparent schizophrenia may be due to the fact that, as noted above, a majority of currently enacted constituency statutes were not initially motivated by CSR.\textsuperscript{219} This helps explain the courts' failure to analyze the relevance of constituency statutes in the acquisition context without referencing the traditional fiduciary duty framework.\textsuperscript{220} Regardless, the states are free to reshape the constituency statutes in light of the developing public policy that is more responsive to socially responsible businesses.\textsuperscript{221}

\textbf{B. Statutory Guidance}

In conjunction with the clarification of public policy preferences, legislatures must retool constituency statutes in order to ensure that corporations devoted to the pursuit of the double bottom line will be adequately protected in the acquisition setting. The statutes must contain language that clearly signals analytical independence from the traditional-duty framework. Specifically, the statutes would be more effective if the corporation were required to elect coverage. Once the corporation opts in, the statutes must require consideration of nonshareholder interests, grant the board the authority to assign varying weight to constituent interests, and set forth an enforcement mechanism. The rationale for each of these provisions is explained in turn below.


\textsuperscript{218} Veto Message, \textit{supra} note 153.

\textsuperscript{219} See \textit{Ball, supra} note 114.

\textsuperscript{220} See \textit{supra} Part III.

\textsuperscript{221} See Eric W. Orts, \textit{Beyond Shareholders: Interpreting Corporate Constituency Statutes}, 61 GEO. WASH. L. REV. 14, 49 (1992) ("States have primary authority over questions of corporate governance.").
1. Opt In for Mandatory Consideration of Other Constituencies

Constituency statutes will be more effective if corporations are required to elect statutory coverage in their corporate charters. In the early stages of entity formation, entrepreneurs and business owners must decide whether to make the business a corporation, partnership, or some form of limited liability entity.\(^{222}\) They must also determine the company’s capital structure and how investors will realize returns.\(^{223}\) Requiring the corporation to affirmatively elect to be covered by the constituency statute permits the traditional framework to apply where election is not made in the corporate charter. This allows corporations that wish to be governed by the well-established traditional principles to choose to do so. Simultaneously, it requires a corporation that wishes to pursue the double bottom line to actively protect itself through such an election.

Requiring corporations to elect coverage ensures that investors will be on notice of the fact that the investors’ preferences, at least in terms of strict wealth maximization, will not necessarily have priority over the interests of other constituencies. This requirement has the potential added benefit of allowing a corporation to attract investors who would prefer to invest in socially responsible businesses as opposed to companies that do not elect statutory coverage.

Additionally, requiring a corporation to opt in protects shareholders of corporations that have not elected statutory coverage. Shareholders in non-electing companies are protected from directors who might abuse the statute by attempting to retroactively justify a board decision by citing the interests of other constituencies, since directors must first obtain shareholder approval to amend the charter and elect statutory coverage.\(^{224}\) As a result, nonshareholder preferences may consequently receive higher priority than shareholder interests, but shareholders have the authority to permit or deny such an outcome. This allows the retention of some balance to protect the shareholders, while ultimately permitting the directors to

\(^{222}\) See generally HAZEN & MARKHAM, supra note 30, at 1–23.

\(^{223}\) Id.

\(^{224}\) Shareholder approval is generally required for any fundamental changes to the corporation, including amending the document of incorporation. E.g., CAL. CORP. CODE § 902 (West 1990); DEL. CODE ANN. tit. 8, § 242 (2008); MODEL BUS. CORP. ACT § 10.03(e) (2002).
sacrifice shareholder profits for the public benefit in an acquisition so long as the shareholders had already approved statutory coverage.

Although coverage by the proposed constituency statute is initially elective, once election is made, the consideration of nonshareholder interests must be mandatory. Making the consideration of nonshareholder interests mandatory in the statute, as illustrated in Connecticut, provides a clear signal to the courts that the consideration of nonshareholder interests must be more than just an afterthought. Mandatory consideration of nonshareholder interests differentiates the proposed language from the majority of constituency statutes currently enacted, as well as the recently failed California constituency statute. It also enables the proposed statute to more efficiently promote CSR. Mandatory consideration ensures that the propriety of socially responsible corporate activity can be evaluated irrespective of the traditional benefit-to-the-shareholder analysis because the board is no longer free to completely disregard nonshareholder interests in the name of profit maximization.

2. Weight of Constituent Interests and Enforcement

Constituency statutes must also provide guidance as to the appropriate weight the board may assign to nonshareholder interests. The constituency statutes will continue to ineffectively protect CSR in the acquisition context if they do not expressly indicate the weight directors may assign to potentially competing interests. In weighing the interests of various constituents, the interests of the shareholders must not necessarily hold any priority over the interests of nonshareholder constituencies. In fact, given the right circumstances, it may be appropriate to assign more weight to nonshareholder interests than to the interests of the shareholders. The express legislative grant of discretion in this regard clearly indicates to the courts that, depending on the nature of the transaction, CSR is a legitimate end sought by directors.

Additionally, the absence of an enforcement mechanism in constituency statutes in their current form contributes to their

225. CONN. GEN. STAT. ANN. § 33-756(d) (West 2005).
226. Connecticut's constituency statute does not require mandatory consideration of nonshareholder interests. Id.
impotence when it comes to protecting CSR for companies in situations like Healthy Drink.\textsuperscript{228} Even the CSR-minded statute proposed in California contained a provision expressly denying a cause of action for failure to consider non-constituent interests.\textsuperscript{229} The lack of an enforcement mechanism leaves directors little choice but to fall back on the traditional framework because there is only the risk of a breach of duty claim. Therefore, constituency statutes need to impose upon the board a duty to consider nonshareholder interests, attribute the appropriate weight to them, and expressly state that this duty is enforceable.\textsuperscript{230}

V. JUSTIFICATIONS

The proposed paradigm will likely be attacked on the grounds that the suggested legislative action encourages self-interested behavior among management.\textsuperscript{231} Arguably, the proffered model engenders unaccountability of the board by permitting directors to justify self-interested conduct by claiming consideration of nonshareholder constituencies.\textsuperscript{232} Despite these concerns, the proposed statute creates a presumption in favor of the validity of the board’s decision in the absence of bad faith, breach of fiduciary duty, and self-dealing. This continues the policy rationale supporting the business judgment rule,\textsuperscript{233} while simultaneously ensuring that directors will not be able to successfully invoke the proposed statute as a means to protect themselves against breach of duty claims. While directors certainly may attempt to justify self-dealing in this way, fact-finders and courts will be no less equipped to evaluate the legitimacy of such claims merely because of the presence of the proposed measures.

Another likely criticism of this proposal is that constituency statutes further limit already minimal protections afforded to

\begin{itemize}
\item \textsuperscript{228} See supra Part I.
\item \textsuperscript{229} Assem. B. 2944, 2007–2008 Leg., Reg. Sess. (Cal. 2008) (“Nothing in this section shall create any duties owed by any director to any person or entity to consider or afford any particular weight to any interest or factor described [in this section] . . .”).
\item \textsuperscript{230} This will necessarily be a fact-sensitive determination.
\item \textsuperscript{231} Letter from Greg Hines, Legislative Dir. of Cal. Mfrs. & Tech. Ass’n., to Arnold Schwarzenegger, Cal. Governor (Sept. 11, 2008), available at http://www.cmta.net/pdfs/AB%202944.pdf.
\item \textsuperscript{232} von Stange, supra note 115, at 483; see also Wells, supra note 22, at 88–89.
\item \textsuperscript{233} Branson, supra note 62, at 632.
\end{itemize}
shareholders through the board’s fiduciary duties.\textsuperscript{234} Nonshareholder constituencies, such as employees, creditors, and suppliers, are able to protect themselves through contractual relationships by negotiating contract terms that reduce their exposure to potential risks.\textsuperscript{235} For example, a supplier can require payment of any outstanding balance before shipping new goods. Similarly, employees can demand higher compensation in response to a reduction of fringe benefits.\textsuperscript{236} In contrast, shareholders are only protected by the board’s obligation to adhere to its fiduciary duties. As residual claimants, shareholders are not afforded the opportunity of upfront negotiation, which is often accessible to nonshareholder constituencies.\textsuperscript{237} Arguably, when it comes to determining the appropriate weight of nonshareholder interests, the board should not have complete discretion to subvert shareholder interests in favor of the interests of other constituencies.\textsuperscript{238}

Admittedly, constituency statutes can only do so much. As noted previously, corporate law often involves a fact-intensive analysis.\textsuperscript{239} For instance, sometimes management itself is involved in the acquisition of the company.\textsuperscript{240} In such a situation, shareholder value should be maximized in order to avoid the appearance of impropriety, even if management has nothing but benevolent intentions. Otherwise, constituency statutes would appear to permit a board’s self-interested conduct. Additionally, where the bidding entities offer equal prospects for the continuation of the target’s CSR, the target’s board would not be justified in failing to maximize shareholder returns.\textsuperscript{241}

\begin{itemize}
\item \textsuperscript{235} Id. at 666.
\item \textsuperscript{236} Id.
\item \textsuperscript{237} Id. at 666–67.
\item \textsuperscript{238} See id. at 664–65.
\item \textsuperscript{240} For example, in 1988 the management group of RJR Nabisco attempted a leveraged buyout of the company before ultimately being outbid by the private equity group Kohlberg Kravis Roberts & Co. See BRYAN BURROUGH & JOHN HELYAR, \textit{Barbarians at the Gate: The Fall of RJR Nabisco} (Harper & Row 1990), for an in-depth case study of this failed management acquisition.
\item \textsuperscript{241} Again, these examples are not exhaustive. The appropriateness of a board’s decision is a complex factual determination that does not lend itself to a simple formulaic analysis.
\end{itemize}
Moreover, the board must weigh the interests of shareholders and nonshareholders in light of the acquiring entity's ability to further the company's CSR mission. As with the board's duty to fully inform itself of all relevant information in the traditional-duty analysis, the board must be fully informed and carefully scrutinize the acquirer's vow to continue the company's CSR initiatives. This is because if the board ultimately decides to accept a lower bid based on the continuation of the company's CSR initiatives, the board must perform a valuation of those initiatives. In other words, the board is responsible for making sure that the furtherance of nonshareholder interests is actually worth the particular difference between the rejected higher-priced offer and the accepted lower-priced offer.

Most arguments opposing constituency statutes are premised on an unrealistic conception of the "shareholder." Under the traditional-duty analysis, the notion of the shareholder is in some sense a legal fiction. In other words, the traditional framework has developed in a way that strips the shareholder of all the complexity of a human being and instead understands the shareholder as having the solitary aim of maximizing wealth. This dehumanization of the shareholder rationalizes the conflict between shareholders and nonshareholder constituencies, and treats the interests of the two groups as divergent.

Very frequently, however, there is a confluence of these interests. Employees are often shareholders. Shareholders often reside in the communities affected by corporate activity, and so on. Therefore, the proposed statutory framework allows the board to acknowledge the very real possibility that in many situations, the actual human beings owning the company's shares may prefer that the corporation take actions that diminish the value of the shares or reduce their returns. The ancillary benefits of CSR may be more valuable to the shareholder as human than strict profit maximization

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243. See, e.g., Greenwood, supra note 28, at 1025–27 (discussing the problems associated with a simplistic notion of "shareholder").

244. Id. at 1025.

245. Id. at 1025–26.

246. See id. at 1063–64.

247. Id.
is to the shareholder qua shareholder. In some cases, sacrificing shareholder profits can have a rational benefit to the shareholder even where there is no continuing interest, as in the mandated sale of a corporation.

A. Real Concerns

For companies that wish to pursue the double bottom line, the inability of constituency statutes to uphold CSR values in the takeover context is a true concern. The Healthy Drink hypothetical describes a very real problem. Large corporations frequently acquire smaller, socially conscious brands. As a B Corporation founder, Ahmed Rahim has said, "The biggest fear of any company like ours is that if we merge with a strategic partner, will they try to strip our values away just to save on the cost of goods?" Moreover, socially responsible entrepreneurs may be hesitant to incorporate in states that lack effective constituency statutes.

B. Desirability of Corporate Social Responsibility

Although some opponents staunchly argue against the prudence of CSR no matter the circumstances, the claim that socially responsible corporations are desirable is not entirely controversial. However, when CSR functions to limit shareholder returns in the acquisition context, where there is no chance for long-term shareholder benefit, the desirability of CSR comes into question. But, from the perspective of social interests, while CSR entails

248. See id.
249. See supra Part I.
251. Id.
252. See Pasternak, supra note 157; see also SEN. R. COMM., ASSEM. B. 2944-BILL ANALYSIS, at *5-6 (Aug. 25, 2008) available at http://info.sen.ca.gov/pub/07-08/bill/asm/ab_2901-2950/ab_2944_cfa_20080825_160055_sen_floor.html (arguing that amending California's corporation code to allow directors to consider nonshareholder interests would restore California's competitive advantage).
253. See Friedman, supra note 31.
254. But see Greenwood, supra note 28, at 1063 (arguing that actual shareholders have real interests other than maximizing the value of shares).
sacrificing shareholder profits, it directly benefits a broader range of individuals. In the Healthy Drink hypothetical, permitting the board to enter into the transaction with Bidder 2 will benefit the communities who harvest the ingredients, supplier communities, and the environment. Permitting Healthy Drink to accept Bidder 2's offer allows the corporation to internalize externalities that would otherwise be created in a transaction with Bidder 1. In turn, this allows for the potential of a more efficient allocation of preferences. Although shareholders receive reduced financial returns, informed investors are free to make the decision for themselves as to whether they wish to invest in firms with express double bottom lines or to invest in more traditional, profit-maximizing firms.

Furthermore, moving away from a strictly normative view of directors' duties encourages aspiration beyond mere compliance with minimal acceptable conduct. The board of directors is traditionally viewed as being in the best position to assess the business needs of the company. Directors are generally more qualified to determine optimal policies with respect to pollution, employee management, environmental impact, and creditor and supplier relationships, among other aspects of the corporation. By allowing directors to make these assessments and make decisions that may optimize preferences on a broader scale, albeit by potentially sacrificing some profits, the policy encourages over-compliance with regulatory standards. As part of CSR, many corporations adopt their own standards with respect to the

255. Testy, supra note 24, at 1238.
256. See supra Part I.
257. For example, the increased volume of pollution that would result from abandoning the more expensive, low-emission production processes is a burden that would be borne by society at large and not internally by the company.
258. Biancalana, supra note 198, at 430.
259. Moreover, it is often the case that the board is comprised of some of the corporation's biggest shareholders. If these board members are willing to sacrifice their own shareholder returns in order to ensure continuation of the company's CSR agenda, then the legislature should want to encourage this behavior.
263. Id.
environment, labor conditions, and other concerns, which go beyond the minimal standards set by law.\(^{264}\) Often, this over-compliance sets standards across industries.\(^{265}\) This phenomenon is, at least, partly responsible for such advances as improved health and safety conditions in factories, reduced deforestation, decreased greenhouse gas emissions, and enhanced pressure on protecting human rights.\(^{266}\) These gains are jeopardized by the adherence to strict profit maximization, which encourages bare compliance with legal standards, since to do otherwise risks reduced output at higher costs, thereby reducing profits.

**VI. CONCLUSION**

Although not originally envisioned as such, constituency statutes provide a potential tool for administering CSR even in the acquisition setting. The statutory framework suggested by this Note seeks to remedy identified inadequacies common to currently enacted constituency statutes. The proposed model seeks to explicitly identify preferred policies and clearly enunciate those policies to guide the courts in their enforcement.

Just as the courts have had difficulty breaking from the traditional-duty analysis, it is likely that the proposals contained in this Note may prove troubling to the practitioner. Like the courts, the corporate lawyer is accustomed to counseling the corporation in the shadow of the traditional analytical framework. Disrupting this principle may create uncertainty over which interests the attorney should advise the directors to prefer with respect to a particular decision. One possible solution to this problem is to require the corporate charter to clearly lay out the priority of interests that must be considered in corporate decision making. The wisdom of such a requirement is unclear, however, because ultimately this would amount to a substitution of shareholder primacy for the primacy of another single group over all others. More likely, the practitioner will be required to confront the more complex framework faced by the board and the courts as well.

\(^{264}\) Id.

\(^{265}\) Id.

\(^{266}\) Id.
Clearly, the difficulty lies in striking the appropriate balance between shareholder interests and the interests of other constituencies. With the growing movement of socially responsible businesses and entrepreneurs, it is vital that the legislatures provide clear guidance to the courts and validate these concerns. Shifting the balance to enable corporations to increase social welfare at the expense of profits can strengthen corporations by enhancing the long-term viability of businesses and industries. A decision that invalidates a board’s decision that has a positive impact reaching beyond attaining top dollar for shareholders risks hindering the growth and sustainability of the economy as a whole.