

FROM DUTY AND DISCLOSURE TO POWER AND PARTICIPATION IN SOCIAL ENTERPRISE

Brett H. McDonnell

I.	INTRODUCTION	78
II.	SOCIAL ENTERPRISE	85
III.	NEW LEGAL FORMS FOR SOCIAL ENTERPRISE	92
IV.	REPRESENTATION AND VOTING RIGHTS IN SOCIAL ENTERPRISES	100
	A. <i>Representative versus direct elections.</i>	107
	B. <i>Scope and importance of decisions.</i>	108
	C. <i>Degree of power in vote (from advisory to sole power).</i>	109
	D. <i>Who gets to vote.</i>	110
	E. <i>Restricting shareholder power.</i>	111
V.	PRACTICAL REFORM OPTIONS	112
VI.	LEGAL REFORM OPTIONS	118
VII.	CONCLUSION	123

FROM DUTY AND DISCLOSURE TO POWER AND PARTICIPATION IN SOCIAL ENTERPRISE

*Brett H. McDonnell**

A growing number of businesses are social enterprises with a dual mission of generating profits for investors while also pursuing various social goods. Statutes have created new legal forms of business association to be used by social enterprises, most prominently benefit corporations, but also L3Cs and social purpose corporations. These new forms use purpose, duty, and disclosure as corporate governance mechanisms to enable social enterprises. This Article argues that these forms have some advantages, but ultimately those governance mechanisms are too weak to help social enterprises credibly commit to pursuing their dual missions. Stronger governance mechanisms focus on voting power and participation, allowing stakeholders other than shareholders to vote either directly on some matters or else to elect representatives who in turn are involved in decision-making.

Individual companies can and should adopt voting governance mechanisms in ways tailored to their individual needs and circumstances, and the Article analyzes ways they can do so and what considerations may guide the choice of mechanisms for any given company. Moreover, the positive externalities generated by companies that effectively pursue various stakeholder interests suggest legal interventions beyond simply enabling private contracting. Social enterprises benefit society, and the law should do more to encourage effective enterprises that involve multiple stakeholders. The Article suggests tax and regulatory compliance innovations that could promote more stakeholder representation.

I. INTRODUCTION

A growing number of businesses aspire to be social enterprises, adopting a dual mission of generating profits for investors while also pursuing a greater good. Entrepreneurs and investors, especially younger millennials, want to make a decent living but in an organization they think makes the world a better place. New statutes, especially those creating an entity called the benefit corporation, attempt to help social enterprises credibly commit to this dual mission using the governance tools of fiduciary duty and disclosure.¹ There is much doubt, though, whether those tools are strong enough. This Article advocates the use of different

* Dorsey & Whitney Chair and Professor of Law, University of Minnesota Law School. My thanks to Claire Hill, Bert Kritzer, Bill McGeeveran, Ben Means, Paul Rubin, Dan Schwarcz, and participants at the University of Minnesota Law School Law and Economics Workshop and Faculty Works in Progress Workshop for helpful comments.

1. See *infra* Part III.

governance tools that give various corporate stakeholders other than shareholders voting power to participate in decision-making.² The Article suggests several legal interventions to encourage giving stakeholders more power.³ One suggestion is to create tax benefits for companies that give broad voting power and financial rights to nonshareholder constituencies. A second suggestion is a loosening of regulatory rules for companies that provide for stakeholder representation. But the main focus is less on new legal interventions than on exploring various ways that social enterprises could, on their own initiative within existing law, extend participation to different stakeholders. There is a broad array of options, and different companies will benefit from different combinations of those options.⁴

In recent years, many entrepreneurs, investors, consumers, employees, and scholars have become interested in social enterprise. That term means different things to different people. A broad definition that covers at least most of what anyone might call a social enterprise is “an organization formed to achieve social goals using business methods.”⁵ I will focus more specifically on businesses that have equity investors with a claim to at least some of the profit the business generates, but with an independent commitment to pursuing one or more defined social missions, whether or not that pursuit increases profits.⁶ Those involved in social enterprises hope to do well while also doing good.

Like all businesses, social enterprises face governance challenges, but the dual missions of profit and social good heighten those challenges. They must find ways to systematically balance their sometimes competing goals and to credibly commit to investors and others that they will not prioritize profits over other goals. In the past decade, states have created a variety of new statutory business association forms that try to address the special challenges of social enterprises.⁷ An early innovation was the low-profit limited liability company, or “L3C.” However, a slightly later entrant, the benefit corporation, has become the leading statutory offering for social enterprises so far and has been adopted in over thirty states and by more

2. *See infra* Part IV.

3. *See infra* Part VI.

4. *See infra* Part V.

5. Dana Brakman Reiser, *Theorizing Forms for Social Enterprise*, 62 EMORY L.J. 681, 681 (2013).

6. I have elsewhere called these “[f]or-profit social enterprises.” Brett H. McDonnell, *Three Legislative Paths to Social Enterprise: L3Cs, Benefit Corporations, and Second Generation Cooperatives*, in CAMBRIDGE HANDBOOK ON SOCIAL ENTERPRISE (Benjamin Means and Joseph Yockey eds.) (forthcoming Oct. 2018) (manuscript at 3), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2964018.

7. *See* FREDERICK H. ALEXANDER, BENEFIT CORPORATION LAW AND GOVERNANCE: PURSUING PROFIT WITH PURPOSE 64, 153–56 (2018); DANA BRAKMAN REISER & STEVEN A. DEAN, SOCIAL ENTERPRISE LAW: TRUST, PUBLIC BENEFIT, AND CAPITAL MARKETS 52–66 (2017); Reiser, *supra* note 5, at 681.

than 2,000 companies.⁸ Close cousins of the benefit corporation are the social purpose corporation and the specific benefit corporation.⁹

Benefit corporations and their cousins deploy two main corporate governance mechanisms: duty and disclosure. The directors and officers of a benefit corporation have a duty to consider the impact of their decisions upon the company's social mission and the interests of a variety of groups.¹⁰ They must annually (in most statutes) disclose the effects of their decisions on those groups and their mission.¹¹ There has been much scholarly attention on whether and to what extent these duty and disclosure rules will help address the governance challenges of social enterprises.¹²

As ever, scholars disagree in their analyses of the effectiveness of these new statutes. Some¹³ (myself included¹⁴) think that benefit corporations can potentially accomplish real good in certain cases. However, many¹⁵ (myself included¹⁶) are skeptical that benefit corporation statutes will accomplish a lot in most cases. In this Article, I revisit the reasons for that skepticism and argue that more robust responses to the challenges of social enterprises require using other governance tools that focus on giving nonshareholder constituent groups more power to represent their own interests.¹⁷

A common—and correct—refrain in the criticism of benefit corporations is that in most circumstances, corporate law fiduciary duty suits are quite unlikely to succeed and hence provide only a weak disciplinary device.¹⁸ The business judgment rule protects most decisions not involving a material financial conflict of interest, and various procedural obstacles (such as the demand requirement and director exculpation clauses) stack the deck in favor of defendants. This is likely to be even more true for duty suits under benefit corporation statutes. Most statutes effectively rule out monetary relief for violations, and the profusion of interests that directors and officers must consider means that they can justify almost any decision

8. See *infra* notes 99–100 and accompanying text.

9. See *infra* notes 113–15 and accompanying text.

10. See *infra* notes 107–08 and accompanying text.

11. See *infra* notes 111–12 and accompanying text.

12. See *infra* notes 125–31 and accompanying text.

13. See ALEXANDER, *supra* note 7, at 5.

14. See Brett H. McDonnell, *Committing to Doing Good and Doing Well: Fiduciary Duty in Benefit Corporations*, 20 FORDHAM J. CORP. & FIN. L. 19, 20 (2014).

15. See, e.g., J. William Callison, *Putting New Sheets on a Procrustean Bed: How Benefit Corporations Address Fiduciary Duties, the Dangers Created, and Suggestions for Change*, 2 AM. U. BUS. L. REV. 85, 98–111 (2012); J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*, 2 AM. U. BUS. L. REV. 1, 27–52 (2012); Antony Page, *New Corporate Forms and Green Business*, 37 WM. & MARY ENVTL L. & POL'Y REV. 347, 356–73 (2013).

16. McDonnell, *supra* note 14, at 57–70.

17. See *infra* Part IV.

18. See *infra* note 125 and accompanying text.

as advancing *some* of those interests.¹⁹

As for disclosure, as of now there are no clear, agreed-upon metrics that can force companies to reveal genuinely useful information that will help outside investors and others really understand how well companies are pursuing their social missions and to compare the performance of different companies. Various actors are working on such metrics, but the state of the art leaves much to be desired. The task is daunting, particularly given how many interests are encompassed by the mission of most benefit corporation statutes.²⁰

Beyond these problems lies a deeper question. Benefit corporations are supposed to be run in the interest of a variety of stakeholders—not just shareholders. And yet, directors are elected only by shareholders, and only shareholders have standing to sue for duty violations. The other stakeholders have no governance tools available to try to make directors and officers listen to their concerns and to punish them when they fail to do so. Emily Winston has called this the separation of benefit and control.²¹

Is relying upon shareholders to police how well companies pursue the interests of others good enough? It is problematic. Shareholders lack in two major dimensions: information and motivation.²² They often may not know enough about the details of what a company is doing and how that may affect other stakeholders. And even if they know enough, they may not be strongly motivated to protect other stakeholders if their own direct personal interests are not being harmed. But there is a more fundamental issue here: to what extent social enterprises are (and should be) independently committed to pursuing nonshareholder interests, as opposed to pursuing those interests because their shareholders feel they are important to pursue (either because doing so is good for long-term profitability or because the shareholders believe doing so is independently valuable).

The weakness of duty and disclosure as governance mechanisms and the separation of benefit from control suggest a different set of tools that social enterprises should consider—a point that several recent articles have begun to recognize,²³ which is embodied in the Accountable Capitalism Act recently proposed by Senator Elizabeth Warren²⁴ and which this Article explores in depth. Voting and representation measures could allow

19. See Murray, *supra* note 15, at 27–34; *infra* note 128 and accompanying text.

20. See Brett H. McDonnell, *Benefit Corporations and Public Markets: First Experiments and Next Steps*, 40 SEATTLE U. L. REV. 717, 731–34 (2017).

21. Emily Winston, *Benefit Corporations and the Separation of Benefit and Control*, 39 CARDOZO L. REV. 1783, 1821 (2018).

22. See *infra* notes 149–51 and accompanying text.

23. See J. Haskell Murray, *Adopting Stakeholder Advisory Boards*, 54 AM. BUS. L.J. 61, 64–78 (2017); Alicia E. Plerhoples, *Social Enterprise as Commitment: A Roadmap*, 48 WASH. U. J.L. & POL'Y 89, 93 (2015); Winston, *supra* note 21, at 1822.

24. Accountable Capitalism Act, S. 3348, 115th Cong. (2018).

various stakeholders beyond shareholders to help choose persons who make decisions within companies or to directly vote on matters of importance to them. Such measures address the separation of benefit from control directly. They can also have a stronger impact on decision-making than duty and disclosure rules. They can change who the decision-makers are, putting in place persons more knowledgeable about and committed to the interests of those who selected them. And the selection process changes incentives, as decisions against the interest of a represented group threaten the re-election of the decision-makers.

There are costs as well as benefits to allowing groups other than shareholders to help select company decision-makers. Most critically, the interests or perspectives of different stakeholders may conflict, and most particularly, they may conflict with how shareholders think the business should be run.²⁵ Conflict could lead to longer and less efficient decision-making. Management and shareholders may react to the potential for conflict by keeping decisions away from bodies chosen in part by other groups or by limiting the information that flows to those bodies. Potential investors may be unwilling to become shareholders of businesses where they have less control over what is done with the money they have invested.

Representation of nonshareholders can come in various shapes and sizes and can be designed to balance the benefits and costs of involving groups other than shareholders in decision-making.²⁶ Representation can come through electing directors at the top level of the hierarchy. Or, representation can come through electing members of committees with control over a discrete set of issues. Those committees can have authority to make certain decisions, to veto decisions, or simply to give advice. Nonshareholders can be given a direct collective voice on certain decisions. Communication channels can be set up for formally allowing stakeholders to communicate their views to the company. Different stakeholder groups may be involved using different methods.²⁷

Different social enterprises may benefit from different kinds and degrees of nonshareholder involvement, and the proper balance also depends upon how one understands the proper purpose of social enterprises. This argues against mandating a particular participation structure for all companies of a certain type, my core criticism of the proposed Accountable Capitalism Act.²⁸ One important distinction is between smaller

25. See *infra* notes 165–75 and accompanying text. Different nonshareholder stakeholder groups will sometimes conflict with each other as well.

26. See *infra* notes 180–212 and accompanying text.

27. See *infra* notes 180–212 and accompanying text.

28. See *infra* Part VI.

closely held companies and large publicly-traded companies. Both the conventional corporate governance problems involving shareholders and the social enterprise governance issues involving other stakeholders look differently in these two types of enterprises. Oversimplifying a complicated question, the costs of involving stakeholders may become greater as a company grows, but the benefits may become greater as well. Thus, over the lifespan of a company the mechanisms that work best for it may well evolve.²⁹

In thinking about the possibilities and how their use may vary across companies, it helps to think concretely about what specific social enterprises are doing and how they may differ. This Article does so by comparing and contrasting two exemplars.³⁰ Easier Solar is a company started by an ambitious young entrepreneur, Hank Rockins. He has developed a system that can help homeowners install and operate rooftop solar energy systems much more cheaply than current systems. Easier Solar will install solar systems in houses, then manage the systems and the relationship with their utility company for the consumers. It will take a fair amount of time to get the company up and running profitably. Rockins is very happy to be pursuing a project that could make him rich while helping combat climate change. Easier Solar has attracted the interest of three potential angel investors.³¹ They plan to invest in Easier Solar and want to be sure that it has strong financial prospects. But these investors also want to know that the company will be run in a socially sustainable manner, taking into account the company's impact on climate change and how the company affects the lives of its customers and their communities, making sure that it is a good employer, and so on.

Our other exemplar social enterprise is Community Solar. Community Solar was formed by a group of three community organizers, Xerxes Cervenka, Jane Roe, and Billie Zounds. Similar to Easier Solar, Community Solar will install and then manage rooftop solar systems for homeowners in the neighborhood in which Cervenka, Roe, and Zounds have been organizing. The three founders are very tied to the neighborhood and want to help its residents, and they are excited about helping address climate change while also hopefully making a good living. Through their contacts in the nonprofit world, they have found several organizations with a focus on climate change, community development, or both that would like to help finance Community Solar, seeing the project as a way to invest

29. See *infra* notes 245–52 and accompanying text.

30. All characters and events in this Article—even those based on real people—are entirely fictional.

31. See Darian M. Ibrahim, *The (Not So) Puzzling Behavior of Angel Investors*, 61 VAND. L. REV. 1405, 1406 (2008) (defining “angel investors” as “wealthy individuals who personally finance the same high-risk, high-growth start-ups as venture capitalists but at an earlier stage”).

that advances their charitable purposes while still earning some financial returns.

Easier Solar and Community Solar, along with the goals of their founders and potential investors, will help to illustrate the governance issues that arise for social enterprises. I will use them to think through various ways in which the law may address those issues. Even though they are similar in many ways, the two companies may prefer using different governance mechanisms.³² Community Solar's founders and investors are more strongly committed to the community and environment, so they may use strong, board-level voting rights. Easier Solar's founder and investors have weaker commitments, so they may use lower-level methods of representation with less power for various stakeholders (e.g., using advisory panels for community and environmental representatives).

This example illustrates the main point of this Article. Individual companies can and should adopt representational governance mechanisms in ways tailored to their individual needs and circumstances, and the Article analyzes ways they can do so and what considerations may guide the choice of mechanisms for any given company. However, the positive externalities generated by companies that effectively pursue various stakeholder interests suggest legal interventions beyond simply enabling private contracting. Social enterprises benefit society, and the law should do more to encourage effective enterprises that involve multiple stakeholders. I suggest tax and regulatory compliance innovations that could promote more stakeholder representation.³³ I argue that this approach could improve the proposed Accountable Capitalism Act.³⁴

This Article proceeds as follows. Part II analyzes what social enterprises are; the potential advantages they offer to founders, other groups, and society; and the particular governance challenges they face. Part III analyzes the leading new statutory forms that have been created to address the needs of social enterprises and their limitations. Part IV argues that voting and representation mechanisms allowing various stakeholders to participate in decision-making may overcome the limitations of existing statutory forms. It analyzes potential benefits and costs of such representation tools and outlines different types of representation that are possible. Part V considers various ways that representation mechanisms could be advanced and implemented within existing law. Part VI considers legal reforms that could further encourage representation mechanisms for stakeholders, including new statutory forms of business association, tax rules subsidizing forms of stakeholder representation, and innovations in various

32. See *infra* notes 214–52 and accompanying text.

33. See *infra* Part VI.

34. See *infra* Part VI.

areas of substantive regulation that would weaken or waive some legal rules in companies that allow adequately vigorous forms of stakeholder representation. Part VII concludes.

II. SOCIAL ENTERPRISE

I start by considering what social enterprises are, why they might be attractive, and a few significant challenges they face.³⁵ We can situate social enterprises on a continuum between pure nonprofits and pure for-profits.³⁶ A pure nonprofit is devoted solely to achieving social goals, and creating financial returns for those who control or provide funds to the organization is not an independent goal at all (although some financial return, especially to those who work for the organization, may be a necessary means for being able to effectively pursue the organization's social goals).³⁷ No equity participation—giving a right to a share of profits generated—is allowed.³⁸ Choosing to be a pure nonprofit may limit the incentive of those running an organization to neglect their social goal in order to make higher profits. On the other hand, highly limited financial returns may make it quite hard for pure nonprofits to attract human or financial capital.

A pure for-profit is devoted solely to creating profits that can be passed on (through distributions or capital gains) to those who run, or have invested equity in, the business.³⁹ The product or service it produces may well generate some social good—after all, some people must be willing to pay for it in order to generate revenue (although consider the case of businesses with “repugnant business models,” which may thrive by covertly taking advantage of their customers).⁴⁰ But if ever there is a perceived conflict between increasing profits and doing good, the owners choose to increase profits. Pure for-profits will generally find it easier to attract money than pure nonprofits. However, they may find themselves cut off from the patronage of investors, consumers, and employees who care about the social virtue of an organization. Also, as a matter of public policy, we may worry that pure for-profits may cause harms of various sorts.⁴¹

35. See ALEXANDER, *supra* note 7, at 47–48; REISER & DEAN, *supra* note 7; Robert A. Katz & Antony Page, *The Role of Social Enterprise*, 35 VT. L. REV. 59 (2010).

36. McDonnell, *supra* note 6 (manuscript at 3).

37. See *id.* (manuscript at 3–4).

38. See *id.* (manuscript at 3).

39. See *id.* (manuscript at 1). “Pure for-profit” here is a conceptual construct; it does not necessarily describe all companies incorporated under standard business corporation statutes.

40. Claire A. Hill, *Repugnant Business Models: Preliminary Thoughts on a Research and Policy Agenda*, 74 WASH. & LEE L. REV. 973, 981 (2017).

41. Of course, we have known, at least since Adam Smith, that the profit motive may induce business people to indirectly pursue the public interest. See *generally* ADAM SMITH, *THE WEALTH OF*

Social enterprises sit somewhere along a spectrum between these two extremes. The term has been defined in many ways. A broad definition of social enterprise is “an organization formed to achieve social goals using business methods.”⁴² I have divided this broad category into two parts: nonprofit and for-profit social enterprises.

Nonprofit social enterprises have an exclusive social purpose and do not distribute profit to equity investors, but they use business methods (e.g., generating revenue by selling goods or services) to achieve their social purposes. For-profit social enterprises have equity investors with a claim to at least some of the profit the organization generates, and thus have a dual mission of making a profit for their investors while also pursuing one or more social purposes.⁴³

Both kinds of social enterprises will be relevant in this essay, with a stronger focus on for-profit social enterprises.

Another distinction I will use in considering social enterprises concerns the ways in which they care about social goals.⁴⁴ In some enterprises, the social focus shows up only in how the business disposes of its profits. Some businesses commit to giving at least a significant share of their profits for designated charitable purposes. Of course, even ordinary businesses may donate some profits to charities. There is no clear dividing line for determining when doing so makes a business a social enterprise, but two important criteria are (1) how high the percentage of profits a business donates is and (2) how firmly committed a business is to donating that percentage.

In some enterprises, the social focus comes through mainly in the good or service the business produces. As already noted, this does not clearly distinguish social enterprises from pure for-profits because most businesses must generate some sort of positive value for their customers or else they will not be willing to pay. But in social enterprises, achieving that social good is independently significant.⁴⁵ In making investment, production, and marketing decisions, the business will be willing to do things that advance its social values even if they do not generate more profits or even if they lead to lower profits. Both of our two example companies, Easier Solar and Community Solar,⁴⁶ are social enterprises in this sense: their founders and investors both care strongly about spreading the use of solar energy as a

NATIONS (Edwin Cannan ed., Random House 1937) (1776). Modern economists have tried to analyze the conditions under which Smith’s “invisible hand” is likely to succeed. The answer is complex: roughly, there is much truth to his idea, but many ways in which it can and does go wrong. *See generally* KENNETH J. ARROW & F. H. HAHN, GENERAL COMPETITIVE ANALYSIS (1971).

42. Reiser, *supra* note 5, at 681.

43. McDonnell, *supra* note 6 (manuscript at 3).

44. *See* Katz & Page, *supra* note 35, at 90–92.

45. *See id.*

46. *See* text accompanying *supra* note 30.

way of combating climate change, and advancing that social goal is a major driving force in their decisions to found or invest in the companies. For Community Solar, advancing economic development in the community of its consumers is also a significant goal.⁴⁷

Finally, in some social enterprises, those running and funding them care strongly and independently about the social benefits and costs of the inputs they use. They want to provide a good environment for their employees, buy from suppliers whose products are themselves socially responsible, and impose as few negative effects on their surrounding communities and environments as possible. In our examples,⁴⁸ this is clearly part of the conception of Community Solar. The angel investors in Easier Solar also care about the general impacts of the business, although it is less clear that founder Rockins shares that vision.

It is fairly obvious how social enterprises may avoid some of the problems experienced by organizations on the far ends of the nonprofit/for-profit spectrum. The advantages over pure nonprofits are clear. The ability to offer a share in profits allows social enterprises to attract major sources of money unavailable to nonprofits⁴⁹ (although they also lose out on tax-advantaged charitable contributions). It also attracts entrepreneurial energy and vision—some entrepreneurs are willing to work for nonprofits with no path to riches, but many are not.⁵⁰

A more subtle advantage over nonprofits is the addition of some accountability mechanisms.⁵¹ Shareholders (or partners or members, in noncorporate legal forms) can monitor and, if necessary, discipline or remove those in control of a business enterprise and have strong personal motivations (the desire not to lose their investments) to keep a close eye on the business. Also, profits and other financial measures provide a visible, clear-cut taskmaster, making poor performance harder to hide. And subjecting a business to market discipline (including capital and product markets) provides another strong check on managerial self-dealing or incompetence.

These advantages over pure nonprofit organizations help explain why most social enterprises will find unattractive one of the leading traditional legal forms of association: the nonprofit corporation. Such entities face what has been called the “nondistribution constraint.”⁵² State law defining the entity forbids equity ownership.⁵³ Employees can still be given a

47. See text accompanying *supra* note 30.

48. See text accompanying *supra* note 30.

49. Katz & Page, *supra* note 35, at 94.

50. See *id.* at 93.

51. See *id.* at 95.

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

53. See MODEL NONPROFIT CORP. ACT §§ 6.40, 6.41, 14.05(d) (AM. BAR ASS'N 2008).

significant financial return, but both state fiduciary law and federal tax law⁵⁴ (assuming an organization wants to be tax-exempt and eligible to receive deductible donations) limit how much they can be paid. Outside investors can profit by lending to a nonprofit corporation, but lending has limited upside and is thus particularly unattractive to newer or more risky organizations, particularly those with high costs and low liquidation values.⁵⁵ In our two exemplar enterprises,⁵⁶ the founders of and investors in both Easier Solar and Community Solar want to make equity investments with a right to share in profits generated. The nonprofit corporate form is thus not viable for them.

The advantages over pure for-profits are also significant. From the point of view of socially conscious investors, consumers, and employees, pure for-profits may talk a good game about being socially responsible as a way to lure them to participate. However, they should worry that, when push comes to shove, such businesses will choose profits over other goals. That is particularly true if that choice is hard for others to observe.⁵⁷ Moreover, choosing profits over responsibility may not happen all at once or deliberately. Businesses may drift from their social missions over time. Decision-makers may think of themselves as behaving virtuously but may ultimately be unconsciously pursuing a financial bottom line that makes them well off and does less to help others than they wishfully believe.⁵⁸

These advantages over pure for-profits help explain why the traditional business corporation can be problematic as a legal vehicle for social enterprises, although the legal obstacles are less decisive than in the case of nonprofit corporations. The point is much disputed,⁵⁹ but at least in some states under some circumstances, the directors and officers of a corporation may have a legal duty to put profits above all other goals.⁶⁰ That is most likely not true in all states (in particular, in those states with corporate

54. I.R.C. § 501(c)(3) (2012).

55. See generally Paroma Sanyal & Catherine L. Mann, *The Financial Structure of Startup Firms: The Role of Assets, Information, and Entrepreneur Characteristics* (Fed. Reserve Bank of Bos., Working Paper No. 10–17, 2010), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1768099.

56. See text accompanying *supra* note 30.

57. See McDonnell, *supra* note 6 (manuscript at 14–15).

58. On fiduciary duties in benefit corporations as a commitment device to avoid this sort of mission drift, see McDonnell, *supra* note 14, at 40–49; Joseph W. Yockey, *Does Social Enterprise Law Matter?*, 66 ALA. L. REV. 767, 788–92 (2015).

59. Compare LYNN STOUT, *THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC* 2–4 (1st ed. 2012), with Leo E. Strine, Jr., *Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 136 (2012).

60. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986); *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 34 (Del. Ch. 2010).

constituency statutes),⁶¹ and even where true, the business judgment rule gives managers much flexibility in deciding how much to favor the interests of other stakeholders as a way of pursuing long-term profits. But even if it usually has little strictly legal bite, the shareholder maximization norm may have a real effect in setting norms and expectations.⁶² And even in states where directors and officers *may* consider the interests of groups other than shareholders, there is no law that says they *must* do so,⁶³ and thus, corporate law does not help managers credibly commit to considering the interests of other stakeholders. Nor does it do anything to stop the managers of for-profit corporations from imposing legally allowable harms on third parties and the environment if they so choose.⁶⁴

In our two exemplars,⁶⁵ Easier Solar and Community Solar could both be legally organized as standard business corporations. However, they would then need to consider contractual or other ways to credibly commit to avoiding mission-drift, and nothing in corporate law specifically helps companies do so (although we shall discuss some ways that founders and investors could use standard tools of the corporate form to achieve their aims).

While their advantages are real, social enterprises face corresponding challenges. Nonprofits lack the benefits that sharing profits bring, while for-profits may overemphasize profits at the expense of other social goods. Social enterprises try to strike a balance on a tightrope in the middle. However, they run the risk of falling off the tightrope in either direction.

This is often discussed as the “two masters” problem.⁶⁶ If social enterprises attempt to pursue multiple, sometimes conflicting, sometimes vaguely defined and hard-to-measure goals, that can raise both informational and incentive problems. As for information, managers must try to estimate the effects of their decisions not just on future profits (that is quite hard in itself) but also on whatever stakeholders and other goals they have identified as mattering to the business. The demands of gathering information and predicting the effects of different choices become much greater.

61. Brett H. McDonnell, *Corporate Constituency Statutes and Employee Governance*, 30 WM. MITCHELL L. REV. 1227, 1233–34 (2004).

62. McDonnell, *supra* note 14, at 67–69; Yockey, *supra* note 58, at 780.

63. McDonnell, *supra* note 61, at 1231.

64. This disadvantage of for-profit corporations also explains why many investors concerned with advancing social purposes may not want to simply earn returns from for-profit investments and then donate to their preferred nonprofits. For-profit corporations may do much harm to the environment, their employees, the local community, or other groups or values that investors may care about. Using their gains to do good elsewhere may not make up for the harm caused by such use of their invested money.

65. See text accompanying *supra* note 30.

66. See Mark J. Loewenstein, *Benefit Corporations: A Challenge in Corporate Governance*, 68 BUS. LAW. 1007, 1027–34 (2013); Dana Brakman Reiser, *The Next Big Thing: Flexible Purpose Corporations*, 2 AM. U. BUS. L. REV. 55, 78 n.106 (2012).

And even once information is gathered and predictions are made, different decisions may lead to tradeoffs among different stated goals. Even well-intentioned decision-makers may not have a good idea of how to balance competing interests. Some argue that the resulting psychological ambiguity leads to poor decisions.⁶⁷

Perhaps worse, others may not be able to adequately monitor how well managers balance competing interests. That may lead to managers making decisions that benefit themselves, as they can justify a self-serving decision for the positive effect it will have on a stakeholder group—almost any decision will help *some* group other than just the managers. Or managers may systematically prioritize some interests over others in unannounced ways. Companies may, for instance, engage in “greenwashing,” claiming to be environmentally sensitive while really focusing on making profits. This is a form of fraud upon investors and consumers who choose to participate in social enterprises because of their social commitments.⁶⁸ Even where greenwashing does not occur, fear of it may prevent investors and consumers from becoming involved even in companies that are in fact genuinely committed to socially responsible behavior.⁶⁹ Note that both of these agency problems are likely to worsen as companies become larger with a more dispersed shareholder base. The greater scope for managers in public corporations to make decisions that benefit themselves is the standard separation-of-ownership-and-control concern that has dominated corporate law policymaking since Berle and Means.⁷⁰ The drift towards a shareholder focus after a company goes public may follow from greater pressure to focus on short-term results.⁷¹

Like any social enterprise, Easier Solar and Community Solar face these questions.⁷² Even in balancing profits and spreading the use of solar energy, both companies may face tradeoffs in making investment and marketing decisions. The founders of each would appreciate some clarity as to their goals in making those decisions, and the investors will demand at least some ability to ensure that the founders will make decisions consistent with their understanding of the organizations’ purposes. In considering other interests (employees, customers, the local community, etc.), further potential quandaries and conflicts arise. For Easier Solar, the potential

67. See Loewenstein, *supra* note 66, at 1029–30.

68. Tina H. Ho, Note, *Social Purpose Corporations: The Next Targets for Greenwashing Practices and Crowdfunding Scams*, 13 SEATTLE J. FOR SOC. JUST. 935, 939 (2015).

69. McDonnell, *supra* note 14, at 58.

70. See generally ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

71. See Claire A. Hill & Brett H. McDonnell, *Short- and Long-Term Investors (And Other Stakeholders Too): Must (and Do) Their Interests Conflict?*, in RESEARCH HANDBOOK ON MERGERS AND ACQUISITIONS 396 (Claire A. Hill & Steven Davidoff Solomon eds., 2016).

72. See text accompanying *supra* note 30.

investors seem to have stronger expectations of a social mission beyond creating more solar energy than does the founder. For Community Solar, the founders and investors all have a large number of interests in mind. How are all of them to be balanced? To what extent do the founders and investors think they are in the end the ones who should do the balancing, as opposed to giving those whose interests are at stake a role in deciding how the balance should be struck?

In focusing on the informational and incentive effects of how governance structures balance power between different stakeholders, I have implicitly begun to generalize an important new approach to understanding corporate law and governance. That is principal-cost theory, created by Zohar Goshen and Richard Squire.⁷³ That theory in turn generalizes the traditionally dominant approach of agency-cost theory.⁷⁴ Goshen and Squire focus on the choice between how much control to allocate to shareholders, treated as the sole principals of a corporation, and managers, the agents.⁷⁵ For whomever is given control, there are two kinds of costs. Competence costs arise from honest mistakes—the informational and flawed decision-making concerns I discuss above.⁷⁶ Conflict costs arise from disloyal conduct—the incentive concerns I discuss above.⁷⁷ Where agents have control, conflict costs arise from agents pursuing their own interests rather than those of shareholders. Where principals have control, conflict costs arise from some shareholders putting their interests above those of others. Different ownership and governance structures can balance shareholder and manager control in different ways, leading to different levels of competence and conflict costs.

As we consider social enterprise, we see there are multiple principals—not just shareholders, but also employees, customers, and others as well. Arguably at least, this is true even for ordinary corporations, but it is certainly so for social enterprises. The introduction of multiple principals increases both competence costs and conflict costs. As for competence costs, there are more interests to consider and balance. More information is required to understand the effect of decisions on various stakeholders, and balancing the different interests requires more difficult judgments in using that information.⁷⁸ As for conflict costs, agents can act disloyally not merely by pursuing their own interests but also by putting the interests of

73. Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 767 (2017).

74. See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976).

75. Goshen & Squire, *supra* note 73, at 771.

76. *Id.* at 785–90.

77. *Id.* at 790–95.

78. See *supra* notes 65–69 and accompanying text.

some stakeholders (most notably shareholders) unduly far above the interests of others, while empowered shareholders can act disloyally by putting the interests of all shareholders above those of other stakeholders.⁷⁹ Empowering other stakeholders creates a different set of conflict costs.

Goshen and Squire, in their normative analysis, conclude that different companies face a different mix of competence and conflict costs, and so the optimal governance structure differs across enterprises.⁸⁰ Rather than prescribing one-size-fits-all governance solutions, the law should make a menu of options available.⁸¹ As we move to multiple principals, we see a more complex array of costs and even more diversity across companies. A greater menu of options would seem to be called for, which brings us to the new legal forms being created for social enterprises.

III. NEW LEGAL FORMS FOR SOCIAL ENTERPRISE

We have already started to see⁸² that two old existing legal forms, the business (for-profit) corporation and the nonprofit corporation, are imperfect vehicles for helping social enterprises address their challenges. The nonprofit corporation affirmatively blocks enterprises from sharing profits with founders and investors. The business corporation is not so clearly hostile to social enterprise, but its profit maximization norm is at least concerning. There are no governance tools specifically created to help social enterprises address their governance challenges. In response, new forms of legal business association have been created. We now turn to them.

A variety of statutory innovations in the past decade or two have created new legal forms of business association intended to enable social enterprises. These include L3Cs, benefit corporations, social purpose corporations, benefit LLCs, and new generation cooperatives. Each of these (except perhaps the first, L3Cs) responds to weaknesses in existing forms and tweaks those forms to create a new vehicle better suited for use by social enterprises.⁸³ Each of them (except perhaps the last, new generation cooperatives) falls significantly short of providing a truly effective vehicle. In this Part, I briefly review each of these forms, the ways in which they improve the legal environment for social enterprises, and the ways in which they fall short of transforming that environment.⁸⁴

The low-profit limited liability company (“L3C”) was the first widely

79. See *supra* note 68 and accompanying text.

80. Goshen & Squire, *supra* note 73, at 767.

81. *Id.* at 825–29.

82. See *supra* notes 39–61 and accompanying text.

83. See McDonnell, *supra* note 6 (manuscript at 1).

84. See *id.*

discussed legal form adopted for social enterprises. The first L3C statute was adopted by Vermont in 2008,⁸⁵ and there are now eight states with L3C statutes.⁸⁶ An L3C is a limited liability company (“LLC”) governed by LLC law in all matters except for the required provision on purpose discussed here.⁸⁷ LLCs have become the leading form of business association for new businesses in the U.S. because they provide limited liability for all investors, pass-through taxation, and great flexibility along with plausible default rules.⁸⁸ Since most social enterprises are small businesses, the LLC is a useful starting point.

On top of this LLC base, L3C statutes impose three requirements. The company must “significantly further[] the accomplishment of one or more charitable or educational purposes.”⁸⁹ It must be the case that “[n]o significant purpose of the company is the production of income or the appreciation of property.”⁹⁰ And, “[n]o purpose of the company is to accomplish one or more political or legislative purposes”⁹¹ This language is taken from the Internal Revenue Code provisions defining program-related investments (“PRI”).⁹² Investments by charitable foundations that qualify as PRI are exempt from a variety of rules and taxes.⁹³ L3Cs were conceived as vehicles to encourage such investments, but so far that has not happened, in part because the IRS has not provided assurance that equity investments in L3Cs would satisfy the PRI requirements.⁹⁴

Nonetheless, more than 1,600 businesses have chosen to become L3Cs.⁹⁵ The reason seems to be that the L3C label has some branding benefits, signaling a business’s commitment to pursuing social purposes. And signaling a commitment to pursuing social purposes is one of the challenges facing the founders of social enterprises: they want to convince socially responsible investors and others that they are not your ordinary for-profit business.⁹⁶ However, simply choosing to be an L3C does not seem to

85. See VT. STAT. ANN. tit. 11, § 4163 (2016).

86. Rob Esposito & Shawn Pelsinger, SOCIAL ENTERPRISE LAW TRACKER, <http://socentlawtracker.org/#/l3cs> (last visited Aug. 16, 2018).

87. McDonnell, *supra* note 6 (manuscript at 1).

88. See LARRY E. RIBSTEIN, THE RISE OF THE UNINCORPORATION 153–56 (2010).

89. VT. STAT. ANN. tit. 11, § 4162(1)(A).

90. *Id.* § 4162(2).

91. *Id.* § 4162(3).

92. I.R.C. § 4944(c) (2012).

93. MARION R. FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION 278 (2004).

94. Examples of Program-Related Investments, 81 Fed. Reg. 24,014 (Apr. 25, 2016) (to be codified at 26 C.F.R. pt. 53); John A. Pearce II & Jamie Patrick Hopkins, *Regulation of L3Cs for Social Entrepreneurship: A Prerequisite to Increased Utilization*, 92 NEB. L. REV. 259, 272–73 (2013).

95. INTERSECTOR PARTNERS, L3C, <http://www.intersectorl3c.com> (last visited Aug. 24, 2018).

96. McDonnell, *supra* note 6 (manuscript at 5); Elizabeth Schmidt, *Vermont’s Social Hybrid Pioneers: Early Observations and Questions to Ponder*, 35 VT. L. REV. 163, 187, 199 (2010).

send a very strong signal. It's just a name, and there is no enforcement mechanism underlying it. What happens if a business chooses to be an L3C but then does not truly attempt to further any charitable purposes? The statutes give no answer. Perhaps the business might lose its L3C status, but there is no stated mechanism for how that would happen (who would have the power to remove the status?), and even if the business lost its L3C status, no further legal consequences follow from that. This vacuous quality of the L3C statutes probably explains why adoption at both the state and entity level has slowed, and attention has turned to other forms.⁹⁷

Most of that attention has focused on the benefit corporation. The first benefit corporation statute was enacted in Maryland in 2010;⁹⁸ thirty-three states now have benefit-corporation legislation.⁹⁹ There are more than 2,000 individual benefit corporations.¹⁰⁰ B Lab, a company that certifies the social responsibility of companies along a variety of metrics using a detailed survey, promotes model legislation which forms the basis of most of these statutes.¹⁰¹ Unlike L3Cs, benefit corporations are corporations subject to the business corporation statute of their state of incorporation in all respects other than those set out in the benefit corporation statute.¹⁰² Like L3Cs, benefit corporation statutes address the purpose of the company. Under the model legislation, a benefit corporation must have as a purpose the creation of a “[g]eneral public benefit,”¹⁰³ defined as “[a] material positive impact on society and the environment, taken as a whole.”¹⁰⁴ They may, but need not,¹⁰⁵ also have one or more specific public benefits that they set out in their charter as goals of the company.¹⁰⁶

Unlike L3Cs, benefit corporations go beyond fiddling with purpose to impose fiduciary duty and disclosure requirements. The directors and officers of a benefit corporation must consider the effects of their actions¹⁰⁷ on a variety of specified interests, including employees, customers, the

97. See McDonnell, *supra* note 6 (manuscript at 2).

98. *Id.* (manuscript at 9).

99. Esposito & Pelsinger, *supra* note 86.

100. Ellen Berrey, *How Many Benefit Corporations are There?*, SSRN (May 14, 2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2602781.

101. See *The Model Legislation*, BENEFIT CORP., <http://benefitcorp.net/attorneys/model-legislation> (last visited Sep. 16, 2018).

102. MODEL BENEFIT CORP. LEGISLATION § 101 (B LAB 2017), http://benefitcorp.net/sites/default/files/Model%20Benefit%20Corp%20Legislation_4_16.pdf.

103. *Id.* § 102.

104. *Id.*

105. This is the case with most statutes. The structure of Delaware's public benefit corporation statute is rather different and does require a specific public purpose. DEL. CODE ANN. tit. 8, § 362(a) (Supp. 2016).

106. See MODEL BENEFIT CORP. LEGISLATION § 102.

107. They must also consider the effects of their inaction, *id.* § 301(a)(1), which has always struck me as quite a broad requirement indeed.

community, the environment, and the ability of the company to generate a general public benefit.¹⁰⁸ Shareholders may sue if they believe a company's directors and officers have violated this duty, although their remedies are limited.¹⁰⁹ Nonshareholder constituencies (e.g. employees or customers) do not have the right to sue to enforce the duty to consider their interests, although companies may grant standing by agreement.¹¹⁰

The final element of benefit corporation statutes is disclosure via an annual benefit report.¹¹¹ In these reports, companies must say what they have done to pursue general public benefit, along with any specific public purpose they may have. This must be measured against an independent third-party standard, such as the standard B Lab has created.¹¹²

Several other new statutory forms of business association are similar to benefit corporations, using a corporate base and imposing modifications in purpose, duty, and reporting on top of that base.¹¹³ However, these alternative forms eschew the extremely broad commitment to pursuing general public benefit, which encompasses all aspects of what a business does and how it affects the world. Several states have enacted social purpose corporation statutes.¹¹⁴ These entities must specify one or more specific public purposes they intend to pursue. Their officers and directors then have a duty to consider the effects of their actions on that purpose, and the companies must annually report on what they have done to advance the purpose. The purpose, duty, and reporting requirements are thus more narrowly focused than in benefit corporations. The Minnesota benefit corporation statute creates two types of entities—the general benefit corporation has the broad focus of benefit corporations in other states, while the specific benefit corporation has the more narrow focus of social purpose corporations.¹¹⁵

A proposed statute at the federal level borrows from the benefit corporation statutes for one of its main provisions. The Accountable Capitalism Act¹¹⁶ would create a federal charter that all corporations with gross receipts over \$1 billion would be required to adopt.¹¹⁷ That charter would require those corporations to have a purpose of pursuing general

108. *Id.* §§ 301, 303.

109. *Id.* § 305(a), (c) (limiting such a right of action to only “benefit enforcement proceedings”).

110. *Id.* § 305(c).

111. Here, too, Delaware differs, requiring reports only every other year. DEL. CODE ANN. tit. 8, § 366(b) (Supp. 2016).

112. MODEL BENEFIT CORP. LEGISLATION § 401.

113. *See* Reiser, *supra* note 66, at 57.

114. *See, e.g.*, CAL. CORP. CODE §§ 2500–4808 (West 2016 & Supp. 2018); WASH. REV. CODE ANN. §§ 23B.25.005–150 (West 2013).

115. MINN. STAT. § 304A.021(2), (8) (Supp. 2018).

116. *See supra* note 24 and accompanying text.

117. Accountable Capitalism Act, S. 3348 §§ 2, 4(a), 115th Cong. (2018).

public benefit¹¹⁸ and to consider the types of stakeholder interests included in the benefit corporation statutes.¹¹⁹

How well do benefit corporations, or social purpose corporations, serve to help social enterprises address the challenges they face? They should provide at least some additional structures that help businesses cope. Consider, for instance, the informational (or competence) challenges facing our first hypothetical business, Easier Solar, in identifying the interests of concern to the company and predicting how a contemplated decision may affect those concerns.¹²⁰ Rockins, the founder, may have a more narrow focus on public interests than do his potential investors. If Easier Solar was located in Minnesota, deciding whether to be a general or a specific benefit corporation might bring this potential disagreement to the fore and force the founders to address and resolve the issue early on. The duty requirement might force the board and its legal advisors to have a list of affected interests at hand and to make sure that before making a major decision they have put evidence on the record showing that they have considered those interests.¹²¹ The reporting requirement requires that they annually collect information on what they have done to advance affected interests.

It is true that both the duty and reporting requirements leave it quite vague regarding how to measure the impact on the various interests, and even more vague as to how companies should balance the impacts on differing, and sometimes competing, interests.¹²² But, the requirement to use independent third-party standards may lead to a competition among standard developers to come up with standards that provide more detailed guidance in measuring impacts. Someday, case law on the duty requirements may provide further guidance. Best practice advice developed by lawyers and others as to how to comply with the legal rules may provide more help.¹²³

The statutes also may provide at least some support in addressing the incentive (or conflict) problems, including the temptation to engage in greenwashing.¹²⁴ Suppose Rockins runs Easier Solar (assume it has been formed as a general benefit corporation) in a way that persistently and substantially hurts its employees, and disputes over this arise with the more woke angel investors. They may sue Rockins for violating his duty to

118. *Id.* § 5(b).

119. *Id.* § 5(c).

120. *See supra* notes 65–68 and accompanying text.

121. For a suggestion as to board procedure on the B Lab website, see B Lab, *Board Procedures for Public Benefit Corporations*, BENEFIT CORP., <http://benefitcorp.net/sites/default/files/Board%20Procedures%20for%20Public%20Benefit%20Corporations.pdf> (last visited Aug. 21, 2018).

122. *See* MODEL BENEFIT CORP. LEGISLATION §§ 301, 401 (B LAB 2017).

123. McDonnell, *supra* note 14, at 67.

124. *See supra* note 68 and accompanying text.

consider the interests of employees. Even if the chances of success are low, and the available remedies meager in the unlikely event a violation was found, the threat of suit alone may improve the bargaining power of the shareholders. Furthermore, the annual benefit report will need to say something about the company's treatment of workers. That disclosure may reveal the problem to shareholders, or if it does not do so because it is seriously misleading, that may become the basis for a securities fraud claim—again improving shareholder bargaining power even if the chances of litigation success are low.

But as many have complained, these legal tools may not have much bite.¹²⁵ The statutory duties provide no real guidance as to how to measure and balance the effects on different interests—they merely list the interests that directors and officers must consider.¹²⁶ Even if the legal advisors force boards to put in the record that they have considered each of these interests before making a decision, those records could easily become pro forma checklists. Case law could ultimately provide more detailed and nuanced guidance, but so far, there are no cases, and the limited chances of success may mean that the case law never develops (as has been the case, for instance, with constituency statutes). Private party disclosure standards may provide more guidance, but so far, measurement of broad social benefits is proving a tough nut to crack. And the first study of benefit reports found that most companies did not even file a required report,¹²⁷ suggesting serious skepticism that we should expect too much from the reporting requirement.

These weaknesses also suggest that the statutes may offer little protection against greenwashing. Directors and officers who want to paint a pretty, green picture of how they are benefiting the planet will probably be able to evade legal liability for either violating their duties or for securities fraud in their misleading disclosures.¹²⁸ More subtly, directors and officers of benefit corporations are likely to strongly believe that they are doing good, and the vague standards of the statutes will not provide a strong reality check against the power of self-belief.

Also worth noting is that the statutes rely upon shareholders to keep directors and officers in check, even though the interests of other groups are also at stake.¹²⁹ Are the nonmanaging shareholders likely to know how well a company is pursuing the interests of, say, employees or customers? Will they evaluate the pursuit of those interests in the way that employees

125. See Callison, *supra* note 15, at 109–10; McDonnell, *supra* note 14, at 62–64; Murray, *supra* note 15, at 33; Page, *supra* note 15, at 364.

126. MODEL BENEFIT CORP. LEGISLATION §§ 301, 303.

127. J. Haskell Murray, *An Early Report on Benefit Reports*, 118 W. VA. L. REV. 25, 34 (2015).

128. See *supra* note 125.

129. See *supra* notes 107–08 and accompanying text.

and customers do? Even if the original shareholders are genuinely well-meaning and well enough informed in a small business whose limited activities are easy enough to monitor and evaluate, what will happen in a successful business when new shareholders enter and the company's activities become more complex and hard to evaluate?¹³⁰ And how much, really, can we rely upon directors, officers, and shareholders to deeply internalize the interests and perspectives of other groups of stakeholders? Human beings are ultimately stuck with their own worldview shaped by their own interests. We can struggle to open ourselves up to the needs and desires of others, but we are likely to face severe limits in our efforts to become better people.¹³¹

These significant limits in the likely effectiveness of the corporate governance tools relied upon by benefit corporation statutes and related new entity types raise the question as to whether other corporate governance tools might be more effective. Part IV turns to that question and suggests that voting by and representation of stakeholder groups is a more powerful option worth exploring. As a transition to that discussion, I finish this exploration of recent statutory innovations by considering a new statutory option, and an even newer proposal, that have not yet been a significant part of the conversation surrounding social enterprises but deserves to become part of that conversation.¹³²

That statutory innovation is second-generation cooperative statutes, which I have called elsewhere "C2Gs."¹³³ First generation cooperatives (or "coops") are themselves in some sense an old vehicle for social enterprise. In cooperatives, members representing one of the stakeholders of an enterprise own the business, electing the board members who control it. The members are often customers (e.g., in credit unions or retail coops), but they may instead be suppliers of inputs (as in many agricultural coops) or employees.¹³⁴ Coops are thus plausible ways to promote the interests of the group that constitutes the members, and they also traditionally proclaim pro-social values.¹³⁵

However, the members of traditional cooperatives have limited claims to the profits generated by the business. Furthermore, financial equity interests are not allowed. That is, coops cannot issue interests with a claim

130. For some speculation on this question, see McDonnell, *supra* note 20.

131. Brett H. McDonnell, *Between Sin and Redemption: Duty, Purpose, and Regulation in Religious Corporations*, 74 WASH. & LEE L. REV. 1043, 1086 (2017).

132. See McDonnell, *supra* note 6 (manuscript at 11–13).

133. See *id.* (manuscript at 1).

134. For more on the law of cooperatives, see CHARLES T. AUTRY & ROLAND F. HALL, *THE LAW OF COOPERATIVES* (2009).

135. *Id.* at 9.

to a share of profits in return for money invested in the business.¹³⁶ They are thus not really a vehicle for the type of social enterprise discussed here, which combines equity investment for a financial return with a commitment to social purposes. The inability to issue equity interests also significantly limits the ability of coops to raise money, limiting the number and size of coops.¹³⁷

That limit on the ability to raise money has led some coops to experiment with ways to create interests that resemble equity shares. This led a few states to create the C2G statutes.¹³⁸ The key features of those statutes were included in a new uniform act, the Uniform Limited Cooperative Association Act, which has been adopted in six states.¹³⁹ These C2G statutes allow for two classes of members. One class is the traditional patron members—customers, employees, etc. The other class is the equity investors. Both voting power and the right to receive profit distributions are split between the two classes.¹⁴⁰

The C2G statutes thus provide for equity investors with a share of control and profits rights, a key feature of social enterprises. But they provide for another class of members who also have voting and financial rights. Thus, at least one other stakeholder group is represented in such a new-generation cooperative. The governance features protecting and empowering that group of stakeholder members go beyond the purpose, duty, and disclosure elements of more prominent social enterprise statutes. The members of cooperatives have voting rights—they help elect the directors who run the business and vote on other major decisions as well.

Consider, for instance, the second of our two exemplar enterprises, Community Solar.¹⁴¹ The founders of the company, while wanting to have equity stakes for themselves and other investors, are also very concerned to advance the interests of the community members who will be using their service. If they truly want to empower those community members, they could create a second-generation cooperative, in which the affected community members are the patron class, while also having a class of interests for equity investors. The split of voting and financial rights between the two groups can be determined by agreement, within statutory limits.¹⁴²

136. *Id.* at 20.

137. Peter Molk, *The Puzzling Lack of Cooperatives*, 88 TUL. L. REV. 899, 929–35 (2014).

138. See McDonnell, *supra* note 6 (manuscript at 10).

139. *Limited Cooperative Association Act*, UNIF. LAW COMM'N (last visited Sept. 16, 2018), [http://www.uniformlaws.org/Act.aspx?title=Limited%20Cooperative%20Association%20Act%20\(2007\)%20\(Last%20Amended%202013\)](http://www.uniformlaws.org/Act.aspx?title=Limited%20Cooperative%20Association%20Act%20(2007)%20(Last%20Amended%202013)).

140. James B. Dean & Thomas Earl Geu, *The Uniform Limited Cooperative Association Act: An Introduction*, 13 DRAKE J. AGRIC. L. 63, 85–86, 98 (2008).

141. See text accompanying *supra* note 30.

142. The statutes vary as to the severity of those limits. The Uniform Act requires that patron members as a class retain a majority share of voting and financial rights, whereas some states, e.g.

A very recent proposal, the Accountable Capitalism Act, also features a turn to participation. Recall that the Act requires all corporations with enough revenue to adopt a federal charter.¹⁴³ In addition to adopting the purpose and duty provisions of a benefit corporation, companies subject to the proposed charter would have to provide that at least 40% of their boards of directors are elected by their employees.¹⁴⁴

What are the benefits and costs of this turn to voting and representation as a governance strategy in social enterprises? Are there other ways to use voting and representation than the voting rights used in the C2G statutes? What are the options available conceptually, and how might the benefits and costs vary depending upon the precise forms of rights granted? I turn to these questions in Part IV.

IV. REPRESENTATION AND VOTING RIGHTS IN SOCIAL ENTERPRISES

C2G cooperatives (“co-ops”) build voting rights into the enterprise at a basic structural level: members choose the directors who control the conduct of the business as a whole, as well as vote directly on certain fundamental transactions, such as mergers and dissolution.¹⁴⁵ For most decisions, this is representative, not direct, democracy—an even more basic distribution of structural power would have members voting on all decisions.¹⁴⁶ However, direct democracy on all matters quickly becomes unwieldy as the number of members increases,¹⁴⁷ so I will mainly (but not exclusively) focus on representative—rather than direct—democracy. As we shall see,¹⁴⁸ there are a variety of ways to give stakeholders more limited voting and representational rights than electing those who control all elements of a company’s operations, and many companies will want to consider less powerful forms of representation and voting to avoid significant costs. But let us first consider granting broad-ranging representa-

Minnesota, only require that the patron member share be at least fifteen percent. MINN. STAT. ANN. § 308B.545(1), 308B.721 (West 2011); UNIF. LTD. COOP. ASS’N ACT §§ 514, 1004(c) (UNIF. LAW COMM’N 2013).

143. See *supra* note 117 and accompanying text.

144. Accountable Capitalism Act, S. 3348 § 6, 115th Cong. (2018).

145. See *supra* notes 133–42 and accompanying text.

146. An example of such distribution is the structure of a partnership or a member-managed LLC. REVISED UNIF. LTD. LIAB. CO. ACT § 407(b) (UNIF. LAW COMM’N 2006); REVISED UNIF. P’SHP ACT § 401 (UNIF. LAW COMM’N 1994). Members in LLCs are standardly conceived of as contributors of equity capital, but that is not actually inherent in the law—membership can be founded on any basis the company may choose by agreement. See, e.g., REVISED UNIF. LTD. LIAB. CO. ACT §§ 102(11), 401 (UNIF. LAW COMM’N 2006).

147. Oscar Wilde is thought to have said that “the trouble with socialism is that it takes up too many evenings,” although tracking down that attribution is not a trivial exercise. Paul Thomas, *Critical Reception: Marx Then and Now*, in THE CAMBRIDGE COMPANION TO MARX 23, 48 (Terrell Carver ed., 1991); see also KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 60–74 (1st ed. 1974).

148. See *infra* notes 180–212 and accompanying text.

tional rights to one notable stakeholder group, employees, in order to understand the benefits and costs of this governance strategy at its strongest.

There are several powerful benefits to allowing stakeholder groups whose interests are important to an enterprise to help elect the body that controls the company, or to help elect less powerful bodies instead, a point that several scholars have made recently in considering the weaknesses of current versions of social enterprise.¹⁴⁹ We can think of those benefits as improving both information/competence and incentives/control.¹⁵⁰ As for information, suppose that an enterprise is explicitly committed to advancing the interests of its employees as a core element of its purpose. Employees have many varied interests, both individually and collectively. Working-life affects those interests in many ways. Understanding all these many ways that company decisions and activities affect employees is a daunting informational task.¹⁵¹ Even well-meaning officers, directors, and shareholders may often just not fully understand how some elements of what their businesses are doing may be hurting (or helping) their employees.

You know who does understand how a business is hurting or helping its employees? Those employees. Moreover, employees are well-placed to know what is going on within a business.¹⁵² If the managers are incompetent or corrupt, employees will often be aware of it. Employees are thus potentially effective monitors even as to decisions that are not directly concerned with their personal interests. On such matters, other stakeholders, including shareholders, should be happy to benefit from this information that employees naturally possess. If the employees are directly voting on a matter, their knowledge as to how that matter affects them will be directly incorporated into their votes.¹⁵³ The link is less direct where employees vote to elect persons who then make decisions. However, if employees vote to elect representatives from among themselves, then those representatives will have direct personal knowledge of how decisions affect their interests, and they are likely to have a good sense of how other employees are affected as well through their interactions with fellow

149. See generally Murray, *supra* note 23; Plerhoples, *supra* note 23; Winston, *supra* note 21.

150. See *supra* notes 73–80 and accompanying text.

151. See generally HENRY HANSMANN, *THE OWNERSHIP OF ENTERPRISE* (1996); Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003).

152. See, e.g., Matthew T. Bodie, *Workers, Information, and Corporate Combinations: The Case for Nonbinding Employee Referenda in Transformative Transactions*, 85 WASH. U. L. REV. 871, 873 (2007); Brett H. McDonnell, *Employee Primacy, or Economics Meets Civic Republicanism at Work*, 13 STAN. J.L. BUS. & FIN. 334, 355 (2008); Joseph E. Stiglitz, *Credit Markets and the Control of Capital*, 17 J. MONEY, CREDIT & BANKING 133, 149 (1985); Margit Osterloh & Bruno S. Frey, *Shareholders Should Welcome Knowledge Workers as Directors* 10 (Univ. of Zurich Inst. for Empirical Research in Econ., Working Paper No. 283, 2006).

153. See Bodie, *supra* note 152, at 874.

employees.¹⁵⁴ The election process is also likely to transmit information; insofar as a matter is of major concern to many employees, it is likely to be made known to those seeking their votes.

I have made these points on the informational benefits of voting with the example of employee voting, but the same basic arguments apply to other stakeholder groups as well. When we turn to the costs of voting and representation, though, we will see that the benefits will typically be weaker (or the costs of achieving the benefits will be greater) for some groups than they are for employees.¹⁵⁵

As for incentive benefits of employee voting, even if the decision-makers are aware of how their decisions will affect various stakeholder interests, one may not trust that, when push comes to shove and different interests conflict, those decision-makers will not prefer their personal interests or those of shareholders above other interests. But if the affected stakeholders are themselves involved in making the relevant decisions, they will be motivated to fully take into account their own interests. Even if the stakeholders themselves are not making the decisions, if those who do are chosen by the stakeholders, at least in part, then their motivation to account for the interests of those stakeholders becomes much stronger. Note also that the incentive benefits of stakeholder participation are likely to be greater in public corporations, which are likely to face stronger pressure to produce short-term profits,¹⁵⁶ and so there is more need for a countervailing force to counter that pressure.

Because of both the informational and the incentive advantages, we can expect that in a company that gives a stakeholder group the right to participate in electing the members of the board that controls the company, that company will more effectively and consistently consider and give weight to the interests of that group in making decisions. That is obviously more true the more voting power that group members have, a dimension of variation in power that I will discuss below.¹⁵⁷ As a result, either shareholders or members of the relevant stakeholder group will be better able to trust that company to act as it promises if the group has voting rights to select members of the board. The stakeholders will, as a result, be more willing to associate with the company, or to do so on more favorable terms.

So there are clear benefits to allowing stakeholders other than shareholders to help select board members. But there are costs as well. Two particularly significant types of costs concern collective action and con-

154. See Osterloh & Frey, *supra* note 152, at 19–20.

155. See *infra* notes 161–65 and accompanying text.

156. McDonnell, *supra* note 20, at 737.

157. See *infra* notes 198–203 and accompanying text.

flicts. As for collective action, to actually realize the informational and incentive benefits discussed above, the members of a stakeholder group have to organize to choose representatives who will indeed effectively pursue their interests, or in the case of direct democracy, they must figure out what voting option best advances those interests.¹⁵⁸ Each individual member of the group may not be strongly motivated to expend much effort figuring out how to cast their vote. There is much well known research on such collective action costs, and we have some good understanding as to features that may increase or decrease those costs.¹⁵⁹ For instance, bigger groups will face larger costs as the effective power of each individual vote decreases, and each individual has less reason to vote or to expend resources on informing themselves if they do vote. More dispersed groups will also face larger costs, as they find it harder to communicate with each other. Also, the less each individual member has at stake personally, the greater the costs of collective action. Furthermore, the more costly it is for each individual member to evaluate the likely effects of a proposed action, the higher the costs of action.¹⁶⁰

These considerations suggest that some stakeholder groups will be harder to effectively organize than others. Consider, for instance, a comparison of employees and customers. The comparison of course varies for different companies and industries. In general, though, the factors just noted will tend to suggest higher costs in organizing customers than employees.¹⁶¹ A typical company will have many more customers than employees, and the customers are more dispersed. Also, customers generally have less at stake in the activities of any given company whose product or services they use than do the employees of that company. Because customers are more removed from the activities of a business, they may also find it harder to evaluate how a company's decisions are affecting their interests than do the employees, and they may be less able than employees to detect managerial incompetence or self-dealing. Thus, all of the identified factors suggest that, in many cases, a company's customers will be a less effective voting block than its employees. A lower percentage of customers are likely to vote at all, and their votes are likely to be less informed and more random. This is not to say that customers are typically not worth

158. See generally ARROW, *supra* note 147; MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* (1977).

159. The foundational reference is OLSON, *supra* note 158.

160. See generally *id.*

161. For instance, analyses of customer-owned mutual banks, credit unions, and insurance companies often suggest weak corporate governance as a result of the limited interest of those customers in becoming involved. See, e.g., Henry Hansmann, *The Organization of Insurance Companies: Mutual Versus Stock*, 1 J.L. ECON. & ORG. 125, 134–35 (1985); Eric Rasmusen, *Mutual Banks and Stock Banks*, 31 J.L. & ECON. 395, 396–99 (1988); Robert F. Hoel, *Power and Governance: Who Really Owns Credit Unions?*, FILENE (2011).

giving the vote because they are too costly to organize—in many cases, giving them the vote may still be worthwhile. Nor is it to say that employees are generally worth giving the vote—even they may be too costly to organize, or the conflict costs we will turn to next may be too high. And in some companies, the relative collective action costs may flip from the norm. The claim is simply that in most companies, the collective action costs for customers will be higher than for employees.

Some commonly cited stakeholder interests¹⁶² may be even harder to organize than customers. Consider, for instance, the environment—a major concern of many social enterprises, including our two fictional exemplars.¹⁶³ This is not even a “stakeholder” in some sense—it is a more abstract, nonhuman concern, though many different human beings are affected by environmental harms. Everyone in the world is affected by carbon emissions that worsen climate change, for instance, as are unborn future generations. Giving voting rights to every living human being would be obviously absurd, and giving voting rights to human beings not yet born would be downright impossible. Giving voting rights to all affected “members” of an interest group such as this would not work. Still, there are potential workarounds. For instance, a company could give voting rights to one or several environmental advocacy organizations or nonprofits.¹⁶⁴ The question would then become how well those groups actually reflect the underlying interest the company intends to promote and whether the groups can be trusted to honestly and diligently use their voting rights to promote those interests.

The other main type of cost from giving stakeholder groups voting rights stems from conflicts that may generate.¹⁶⁵ Let us return to the example of giving employees the right to elect some members of the board of directors, with shareholders electing the other directors. On some matters, the interests of employees and shareholders will clash, creating conflict on the board. Such conflicts will lead to direct costs. Decisions will take longer, and each side may expend resources to buttress their side. Quality of decisions may sometimes suffer as a result of the conflict. Resentment arising from conflicts may tarnish relations between directors going forward. Time spent on conflicts will detract from other valuable activities directors and officers should be engaged in.¹⁶⁶

162. These include the interests often cited in corporate constituency statutes. *See* McDonnell, *supra* note 61, at 1231.

163. *See supra* notes 30–31 and accompanying text.

164. Murray, *supra* note 23, at 98.

165. *See generally* HANSMANN, *supra* note 151, at 42–43; Bainbridge, *supra* note 151, at 42–43.

166. A frequent criticism of employee codetermination in Germany, for instance, is that it creates such effects. *See* Katharina Pistor, *Codetermination: A Sociopolitical Model with Governance Externalities*, in *EMPLOYEES AND CORPORATE GOVERNANCE* 163, 177–79 (Margaret M. Blair & Mark

Costs of conflict go beyond these sorts of direct costs. Directors on either side may take costly steps to avoid conflicts from obscuring or limiting the influence of the other side. Critics of co-determined boards in Germany, for instance, claim that the shareholder-directors withhold information from the employee-directors or covertly take some decisions outside of board meetings.¹⁶⁷ They limit the flow of information to the board out of concern that the information will be misused by the employee-directors.¹⁶⁸ If these direct and indirect costs are serious concerns, shareholders may avoid investing in the company in the first place, or they may be willing to invest only on less favorable terms for the company, thus increasing its costs of raising capital. Again, just as the incentive benefits of stakeholder participation are likely to be greater in public corporations,¹⁶⁹ so are the costs of conflict and for the same reason: with a dispersed, transient shareholder base, there is greater pressure to maximize short-run profits, putting more of a wedge between the interests of shareholders and other stakeholders.¹⁷⁰

In the quite influential theory of Henry Hansmann,¹⁷¹ these sorts of considerations are a major explanation as to why employee ownership of businesses is relatively uncommon. There is much dispute over this story, particularly in the case of employee co-determination in Germany.¹⁷² However, there is something to it. A similar logic applies to potential conflict arising from giving voting rights to other stakeholder groups as well.

But when it comes to the costs of conflicts, the case of social enterprises differs importantly from the case of co-determined German companies. The German companies are required to have employee representatives on their boards by dint of reaching a certain size of operation under governing national law.¹⁷³ They do not choose to involve employees beyond allowing themselves to grow large enough to be subject to the law. It thus makes sense that the shareholders and their representatives are not happy if the employee representatives forced upon them are leading the company to make decisions they may not like. Of course, the shareholders need not buy shares in companies subject to these laws. However, since all

J. Roe eds., 1999). See generally Stefan Prigge, *A Survey of German Corporate Governance*, in *COMPARATIVE CORPORATE GOVERNANCE: THE STATE OF THE ART AND EMERGING RESEARCH* 943, 943–1044 (Klaus J. Hopt et al. eds., 1998).

167. See Pistor, *supra* note 166, at 177–92.

168. See *id.*

169. See *supra* note 156 and accompanying text.

170. See *supra* note 156 and accompanying text.

171. HANSMANN, *supra* note 151, at 87–92.

172. See generally Pistor, *supra* note 166; Prigge, *supra* note 166, at 163–93.

173. Lionel Fulton, *Board-Level Representation*, WORKER-PARTICIPATION.EDU (2015), <https://www.worker-participation.eu/National-Industrial-Relations/Countries/Germany/Board-level-Representation>.

large German companies are subject to them, choosing not to invest in such companies would exclude investors from a large set of investment choices. Note that this same point would apply to corporations subject to the proposed Accountable Capitalism Act, which imposes a federal charter on all corporations with income above a given amount.¹⁷⁴

By contrast, shareholders in social enterprises choose to invest in businesses that are committed to considering interests beyond those of shareholders. Why should they be upset if the representatives of those other interested groups actually succeed in getting the company to act upon those interests? This should reduce the degree of conflict. However, there could still be some conflict. Shareholders may agree with employees that the company should give real, independent weight to the interests of both shareholders and employees. They may disagree on how much weight to give employee interests, though. Moreover, it may be that the shareholders want to decide how to make the necessary trade-offs themselves or have their own representatives make those decisions, rather than sharing control with the affected groups. Like many do-gooders, there may well be limits to how far social enterprise investors are willing to go in subordinating their own interests¹⁷⁵—they want to help others, but on their own terms, with assurances that those terms will be followed, even where the intended beneficiaries disagree.

This raises a fundamental question as to the genuine core purpose of social enterprises. If they are truly committed—as a matter of purpose and legal duty—to pursuing interests beyond those of shareholders, then why should only shareholders be able to determine (more precisely, to choose who determines) how the company pursues those interests? For investors who resist giving any actual power to other groups, what does that tell us about their degree of commitment to the interests of others?

Our two exemplar companies differ here.¹⁷⁶ Cervenka, Roe, and Zounds, the three founders of Community Solar, are all community organizers. They are closely tied to the neighborhood and have deep experience working with those neighbors to help them advance their interests. Their potential investors are nonprofits. Though those nonprofits want to earn a financial return, their core focus on charitable purposes makes them more willing to risk putting control in decision-makers who are beholden to groups other than shareholders. Community Solar, then, is a plausible target for a social enterprise that grants board voting rights to persons other than shareholders. By contrast, Hank Rockins, the founder of Easier Solar, has a more narrow focus, with his main social purpose turning upon the

174. See *supra* notes 143–45 and accompanying text.

175. McDonnell, *supra* note 131, at 1051.

176. See *supra* notes 30–31 and accompanying text.

very product that the company is offering. His potential investors have broader concerns, but perhaps they too would find granting voting rights to other groups a step beyond where they are willing to go.

Thus, it may be that when it comes to the strongest of voting rights tools, Community Solar, but not Easier Solar, would be willing to have nonshareholder members involved in choosing board members. However, there are less expansive ways of granting some rights of participation to other groups. Insofar as Rockins and his investors do truly care about advancing the interests of others, the informational advantages of participation matter to them.¹⁷⁷ Moreover, insofar as the angel investors care more about a range of interests than Rockins does, those angel investors may see some advantage to the incentive effects of participation,¹⁷⁸ giving Rockins more motivation to consider other interests. Let us then consider other ways in which constituent groups may participate in enterprise decision-making without voting on representation at the highest level of the company. We can identify several dimensions of variation in the degree and kinds of participation.¹⁷⁹

A. *Representative versus direct elections*

As I have noted at various points,¹⁸⁰ members of a stakeholder group may either vote directly on a particular decision or vote to elect representatives who then engage in decision-making. This distinction is familiar for shareholders in standard corporations. Most decisions are under the authority of the board of directors (though the board will delegate many decisions to officers), and the role of shareholders for these decisions is to elect the board. Thus, for most decisions, shareholders have representative authority.¹⁸¹ However, in a handful of fundamental decisions, including mergers,¹⁸² sales of substantially all assets,¹⁸³ dissolution,¹⁸⁴ and charter amendments,¹⁸⁵ shareholders get a direct vote, typically after the board has voted in favor of them. On these matters, shareholders have direct authority. If a company is contemplating giving some voting rights to other stake-

177. See *supra* notes 151–55 and accompanying text.

178. See *supra* notes 156–57 and accompanying text.

179. For a related analysis, see Heiko Spitzack & Erik G. Hansen, *Stakeholder Governance: How Stakeholders Influence Corporate Decision Making*, 10 CORP. GOVERNANCE: INT'L J. BUS. SOC'Y 378, 381 (2010).

180. See *supra* notes 146–48 and accompanying text.

181. See, e.g., DEL. CODE ANN. tit. 8, § 141(a) (2011); MODEL BUS. CORP. ACT § 8.01(b) (AM. BAR. ASS'N 2016).

182. See, e.g., DEL. CODE tit. 8, § 251(c); MODEL BUS. § 11.02(c).

183. See, e.g., DEL. CODE tit. 8, § 271(a); MODEL BUS. § 12.02.

184. See, e.g., DEL. CODE tit. 8, § 275(b); MODEL BUS. § 14.02(b).

185. See, e.g., DEL. CODE tit. 8, § 242(b); MODEL BUS. § 10.03(b).

holders, for them, too, those rights could be either direct or representative.

As noted above,¹⁸⁶ unless a company has only a small number of members of a group given voting rights for most decisions, it will be more effective to give representative—rather than direct—voting rights because of the costs of having a large group vote on too many matters. With small enough membership, direct voting could apply to most or all decisions—that is, after all, the partnership¹⁸⁷ and member-managed LLC¹⁸⁸ model of governance.

B. *Scope and importance of decisions*

Voting authority—both direct and representative—may vary as to the scope and importance of the decisions covered.¹⁸⁹ For representative voting, the power to elect members to the board (or comparable body) represents the widest scope and greatest importance of voting authority. Boards are the central decision-making body in a corporation, with authority over all decisions. As noted,¹⁹⁰ on a few fundamental matters, boards share their authority with shareholders voting directly, and on many matters, especially routine ones, boards will delegate primary decision-making authority, although such delegation is subject to board oversight and the authority to change decisions the board does not like (to the extent that the company has not become bound to those decisions).¹⁹¹

Cooperatives provide numerous examples of organizations that give various stakeholders the power to elect boards. They give members of a particular stakeholder class the same powers that shareholders possess in business corporations, such as the power to elect the board of directors and to vote directly on fundamental matters.¹⁹² Cooperative ownership structures have been common in a variety of industries, including agricultural services, consumer-owned food stores, mutual insurance companies, and credit unions.¹⁹³ Rural electrical cooperatives provide one interesting cautionary note. Such cooperatives are an important source of low-cost electricity for rural residents. However, they often tend to have old, coal-based plants and little capital to modernize, so from an environmentalist

186. See *supra* notes 145–46 and accompanying text.

187. UNIF. P'SHIP ACT § 401 (1997) (UNIF. LAW COMM'N, amended 2013).

188. REVISED UNIF. LTD. LIAB. CO. ACT § 407(b) (UNIF. LAW COMM'N 2006).

189. Spitzack & Hansen, *supra* note 179, at 382–86.

190. See *supra* notes 180–85 and accompanying text.

191. See, e.g., DEL. CODE ANN. tit. 8, § 141(a)–(c)(2) (2011); MODEL BUS. CORP. ACT § 8.01(b) (AM. BAR ASS'N 2016).

192. AUTRY & HALL, *supra* note 134, at 55–56.

193. *Id.* at 44–49.

point of view, they can be problematic.¹⁹⁴ The general lesson here is that different nonshareholder stakeholder interests may compete with each other, even where no shareholders are involved.

However, voting authority can be more limited in scope. Consider, for instance, work councils in Germany.¹⁹⁵ These have rights over most or all decisions relating to issues that directly affect employees. Those rights are broad, but they are far from all-encompassing. Another example involving direct democracy is Matthew Bodie's suggestion for giving employees a vote on business combinations.¹⁹⁶ This is a vote on an important matter, but with narrow scope in the sense that it only covers one class of decisions.

Limiting the scope of voting rights limits the informational benefits to only those decisions on which the relevant group has voting rights. However, if a company designs its voting rights well, it will grant rights to groups over decisions on which the information their members have is particularly useful, as is the case with the work councils example.¹⁹⁷ Limiting the scope of rights may help to limit the degree of conflict between groups. However, the informational and conflict effects of limiting voting scope may often be in tension. Employees may be most likely to disagree strongly with shareholders precisely on the matters that most affect their personal welfare, on which they are both well-informed and highly motivated.

C. *Degree of power in vote (from advisory to sole power)*

Whatever matter a group's members may vote on, their degree of power over that decision may vary. At one extreme, the group's vote may be only advisory, so that the board (or other relevant decision-maker) is not legally bound to follow the outcome of the vote. That is the case, for instance, with Bodie's suggestion on employee voting on business combinations.¹⁹⁸ It also applies to most shareholder votes under the rules of the Rule 14a-8 shareholder proposal system¹⁹⁹ as well as shareholder say-on-

194. National Rural Electric Cooperative Association, Comments on Proposed Repeal of Carbon Pollution Emissions Guidelines for Existing Stationary Sources: Electric Utility Generating Units (Apr. 26, 2018), <https://www.regulations.gov/document?D=EPA-HQ-OAR-2017-0355-19875>. Rural electricity co-ops also turn out to be an interesting—and discouraging—case study in the corporate governance problems of governance by consumers. See generally Debra C. Jeter, Randall S. Thomas, & Harwell Wells, *Democracy and Dysfunction: Rural Electrical Cooperatives and the Surprising Persistence of the Separation of Ownership and Control*, 70 ALA. L. REV. (forthcoming 2018).

195. Pistor, *supra* note 166, at 165; Prigge, *supra* note 166, at 1011–12.

196. See Bodie, *supra* note 152, at 878–79. In the proposal, the employee vote would be nonbinding, thus making it a weak form of voting power on the next dimension we shall consider.

197. See, e.g., Stephen F. Befort, *A New Voice for the Workplace: A Proposal for an American Works Councils Act*, 69 MO. L. REV. 607 (2004).

198. See Bodie, *supra* note 152, at 878–79.

199. 17 C.F.R. § 240.14a-8(i)(1) (2018).

pay votes on executive compensation.²⁰⁰ At the other extreme, a group may have the sole authority to make a decision. For instance, shareholders, on their own, may enact corporate bylaws.²⁰¹ In between, members of one group may split authority with members of another group or groups. In that case, it could be that the approval of each group is required, as is often the case where class voting among different groups of shareholders occurs.²⁰² Alternatively, votes from different groups could be aggregated with each group receiving a set percentage of the total vote.²⁰³

In many cases, even an advisory-only vote may achieve most of the attainable informational benefits from allowing a group to vote. However, the incentive benefits are typically much less for advisory votes. At the other end of the spectrum, giving a group sole voting power over a decision gives the fully available informational and incentive benefits, but it also may raise serious concerns over a loss of control for other groups. The direct conflict costs may not be great, insofar as other groups have no authority over the matter, but indirect conflict costs may be high, as concerned excluded groups take actions to avoid a situation if they are unhappy with it.²⁰⁴

D. *Who gets to vote*

A final dimension of variation in the assignment of voting rights is which stakeholder groups are assigned voting rights over a particular matter. In a standard corporation, the only group with voting rights is the shareholders, who are equity investors.²⁰⁵ In most of the discussion so far, I have focused on employees as an alternative stakeholder group that could receive voting rights.²⁰⁶ Customers are another group that receives rights in a range of decently common enterprises, e.g., retail coops, insurance

200. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899–1900 (2010).

201. The board may also enact bylaws on its own. *See, e.g.*, DEL. CODE ANN. tit. 8, § 109(a) (2011).

202. *See, e.g., id.* § 242(b)(2).

203. Giving some stakeholders standing to sue to enforce the fiduciary duties within a benefit corporation could be conceptualized as extending a form of participatory power. Those with standing to sue have been given the power to affect corporate decisions that violate the duty of directors and officers, if they can convince the court such a violation has occurred. Perhaps that is a stretched conceptualization, but at any rate, granting standing to sue to specified stakeholders should be included as part of the available governance toolkit.

204. *See supra* note 165 and accompanying text.

205. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 211–33 (2011 & Supp. 2016). As we shall discuss below, *see infra* notes 227–28 and accompanying text, as a matter of law, shareholders need not be equity investors—the law is very flexible as to what consideration is allowed in return for the issuance of shares.

206. *See* McDonnell, *supra* note 152, at 355.

mutuals, and credit unions.²⁰⁷ Other groups are possible as well, though as the defining interest becomes more widespread and abstract, representation will typically get more costly. Even among a particular defined group, only a subset of members may get a voting right. For instance, rights may go only to full-time employees or to those who have been employed longer than a minimum length of time. Also, different classes within a stakeholder group may vote separately, a well-known phenomenon with shareholder class voting.²⁰⁸

Extending voting rights to more stakeholder groups—and more fully to members within a group—will tend to increase the informational benefit of voting and give stronger incentives to consider the interests of each group represented than if that group were not represented. On the other hand, each group will tend to find its relative power reduced as other groups are added, another way of noting that conflict costs will tend to increase as more groups are given voting rights.

E. Restricting shareholder power

The above techniques all look to improve the relative power of stakeholders other than shareholders by expanding the voting power of one or more nonshareholder groups. An alternative method would be to restrict the effective voting power of shareholders. An extreme way of doing this is through dual-class voting shares, with top managers retaining a controlling number of shares so that other shareholders have little effective voting power.²⁰⁹ An even more extreme way occurs for nonprofit corporations with no members, whose boards are self-perpetuating.²¹⁰ A less extreme form of diluting shareholder power is a public corporation with highly dispersed shareholding, where collective action problems make shareholder votes a relatively ineffective constraint on managers.²¹¹

Restricting shareholder power without expanding the power of other stakeholders in effect vests power exclusively in the hands of managers. This can reduce informational flow in the voting process and make it easier for managers to pursue their own self-interests. However, it may reduce conflict costs between shareholders and other stakeholders by making managers more unbiased arbiters of differing interests. This strategy is at

207. ATRY & HALL, *supra* note 134, at 45.

208. *See, e.g.*, DEL. CODE ANN. tit. 8, § 242(b)(2).

209. *See* Lynne L. Dallas & Jordan M. Barry, *Long-Term Shareholders and Time-Phased Voting*, 40 DEL. J. CORP. L. 541, 549 (2016); Christopher C. McKinnon, *Dual-Class Capital Structures: A Legal, Theoretical & Empirical Buy-Side Analysis*, 5 MICH. BUS. & ENTREPRENEURIAL L. REV. 81, 82 (2015).

210. *See* FREMONT-SMITH, *supra* note 93, at 159.

211. Goshen & Squires, *supra* note 73, at 808–10.

the heart of Blair and Stout's mediating hierarchical model of public companies.²¹²

I have analyzed a number of dimensions along which voting rights may vary, with many degrees or levels of choices within several of the dimensions. That leaves an extremely wide array of options open to companies interested in giving some kind of voting rights to groups other than shareholders. In Part V, we shall explore how companies may choose among those options depending upon their particular situations, using Easier Solar and Community Solar to help guide our thinking. In Part VI, we shall consider whether any kinds of legal reform might help companies develop options more effectively.

V. PRACTICAL REFORM OPTIONS

How might social enterprises give voting or participation rights to some stakeholder groups beyond shareholders as a way to more firmly and effectively commit to furthering their chosen purposes?²¹³ We shall use our two fictional exemplar companies²¹⁴ to work through some of the possibilities in a more applied way. We have seen that Community Solar is more deeply bound to the interests of some stakeholders, particularly the community residents to whom it hopes to provide services. Let us then start with that company.

If the company plans to balance several types of groups in governance, it may find that a board structure along corporate lines is useful as a way to involve representatives of the different groups.²¹⁵ The organizations interested in providing financing to Community Solar will need to decide if they prefer debt or equity interests. Suppose they prefer equity interests, either because they view debt to the untested company as too risky or because they want a share in upside profits. They could be issued equity interests that entitle them to a specified share of profits whenever profits are distributed. Those interests will also entitle the equity holders to elect a specified number of directors to the board.

Resident users of the company's services are of deep interest to Community Solar's founders, who are community organizers closely tied to the neighborhood. A separate class of user interests could be issued to them. These interests would be entitled to a share of profits and to the right

212. See generally Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999).

213. For related suggestions, see Murray, *supra* note 23; Plerhoples, *supra* note 23; Winston, *supra* note 21.

214. See *supra* notes 30–31 and accompanying text.

215. As we shall see, *infra* notes 233–34 and accompanying text, other legal forms beside corporations allow this as an option.

to elect a specified number of directors. Since Community Solar's users are clustered in one area and already have existing ties to the founders, the costs of involving the company's customers should be less than for companies with a more widely distributed base of customers.²¹⁶ Also, the number of users will not be too high, and since the financial stakes for each user are decently big and their relationship with the company is ongoing, each user has an incentive to pay attention.²¹⁷ These factors should also reduce the costs of involving the users. Of course, if the company succeeds and expands to other areas, organizing costs will increase, but that will be a problem down the road—a welcome one insofar as it will happen only if the company does well.

Another potential stakeholder group that could be given voting rights is the company's employees, once it has some. Above, we have seen various reasons why in many cases the benefits and costs particularly favor giving representational rights to employees as a group,²¹⁸ and that could be true for Community Solar as well. The nature of the company would not entail hiring a very large number of employees, which makes the costs more manageable. Employees, too, could thus be given interests entitling them to a share in profits and the ability to elect some directors.

Community Solar's three founders—Cervenka, Roe, and Zounds—also need to be included somewhere in the scheme. Presumably, they will be officers or managers of the business, involved in both making major decisions and running daily operations. However, they will also want to have both some say in electing the board and a share of profits. This could be accomplished by giving them some of the equity interests (particularly insofar as they contribute money to the enterprise), giving them employee interests, or creating a separate class of founder interests.

If Community Solar does go so far as to create four sets of interests with financial and voting rights—equity, user, employee, and founder—it will be following an interesting governance model being promoted by a European organization, the FairShares model.²¹⁹ This model advocates enterprises with the four classes of interests just mentioned. Organized thus, Community Solar would give serious representation to the core groups of persons most interested in and vital to its success. Of course, with four classes of interests, the company would also face higher conflict costs than if it were an ordinary corporation with only shareholders who have invested money (the angel investors and presumably the three founders)

216. See *supra* notes 159–61 and accompanying text.

217. See *supra* notes 150–52 and accompanying text.

218. See *supra* notes 159–64 and accompanying text.

219. See *What Is FairShares?*, FAIRSHARES, <http://www.fairshares.coop/what-is-fairshares/> (last visited Aug. 17, 2018).

electing its board—though even there, the angels and the founders may conflict, as anyone familiar with the venture capital startup world will tell you.²²⁰ Perhaps, then, Community Solar’s founders will not want to go quite so far, at least at first. Maybe they will not want to give employees the right to elect directors, for instance. If so, there are other ways to give employees some participation rights. They could create a work council, with some members elected by employees and others selected by the board, which has authority over employment-related issues.²²¹ Or they could create an employee advisory council, elected by employees, that has no formal authority, but that could be consulted regularly for suggestions and advice on a range of issues.²²² Similarly, employees could elect a nonvoting board representative. These options would give some assurance to employees and provide useful information to the company while reducing potential conflict costs.²²³

Alternatively, Community Solar could expand the circle of representation even more widely to include another interest: the environment and sustainability. After all, its core product focuses on promoting clean energy, and that is presumably a core value for those attracted to the company. Ensuring that the company’s operations do in fact promote that value effectively should matter to all of Community Solar’s key constituents. As noted above,²²⁴ representing an abstract interest like environmental sustainability is not a straightforward task, but there are a variety of possible ways to do it. The company could appoint a director or officer with specific responsibility to pay attention to environmental concerns. It could empower a specific environmental organization—or several organizations—to appoint a director. It could establish an advisory panel of environmentalists to monitor the company and give suggestions.²²⁵

Could Community Solar achieve the suggested allocations of voting rights within existing legal forms? It could, in a variety of ways. The sub-board representation mechanisms, such as a work council or an environmental advisory panel, operate largely outside business association law and are unaffected by it, though other areas of law may potentially create obstacles (which I would suggest should be addressed with legal re-

220. See Ibrahim, *supra* note 31, at 1412 n.19. Another concern of building in stakeholder power at such a foundational level is that, should the costs prove too high, it may prove hard to undo the structure, as such participation will probably be reflected in the corporate charter or similar governing document. Lower level forms of participation need not be as hard-wired, and hence are easier to amend or drop if they prove to be a failure.

221. Cf. *supra* note 189 and accompanying text.

222. Befort, *supra* note 197, at 635–36.

223. See *supra* notes 185–202 and accompanying text.

224. See *supra* notes 162–63 and accompanying text.

225. See *supra* notes 185–95 and accompanying text.

forms).²²⁶ For board-level representation, the company could be established as a corporation, either as an ordinary for-profit or as a benefit corporation, if the founders want to take on the duty and disclosure obligations of the latter. The consumers and employees could be issued separate classes of shares. Shares can be issued, at the board's discretion, in return for "any tangible or intangible property or benefit to the corporation"²²⁷ or "for such consideration . . . as determined from time to time by the board of directors."²²⁸ Both employees and customers are providing value to the company, so these broad provisions allow the board to issue shares in return. The use of classes of shares is common and well-understood, and corporation law gives plenty of flexibility to design the allocation of voting and financial rights between classes of shares so as to receive any division of board voting and financial rights desired. If Community Solar organized as a corporation, though, it would face a tax disadvantage, as it would have to be organized as a C corporation and not benefit from pass-through taxation, since an S corporation can have only one class of shares.²²⁹

Community Solar could also organize as an LLC, with different classes of membership for founders, equity providers, customers, and employees. Under the RULLCA, an LLC member "means a person that has become a member of a limited liability company under Section 401."²³⁰ Section 401 in turn provides that a person becomes a member as provided in the operating agreement,²³¹ and that "[a] person may become a member without acquiring a transferable interest [basically, the right to receive profit distributions] and without making or being obligated to make a contribution to the limited liability company."²³² Most states do not provide for a board within their LLC statutory governance rules, but they provide enough flexibility that a company's operating agreement may create a board.²³³ And the Minnesota LLC Act does provide for a board-managed LLC option.²³⁴ An LLC benefits from favorable check-the-box taxation rules, and can thus be taxed as a pass-through entity.²³⁵ Community Solar's lawyers would have to do a lot of heavy lifting in writing these governance rules—LLC statutes do not provide off-the-rack rules that a company can adopt at low cost to

226. For instance, under section 8(a)(2) of the National Labor Relations Act, 29 U.S.C. § 158(a)(2), a work council may constitute an unfair labor practice. *See* McDonnell, *supra* note 152, at 375.

227. MODEL BUS. CORP. ACT § 6.21(b) (AM. BAR. ASS'N 2016).

228. DEL. CODE ANN. tit. 8, § 153(a) (2011).

229. 26 U.S.C. § 1361(b)(1)(D) (2012).

230. REVISED UNIF. LTD. LIAB. CO. ACT § 102(11) (UNIF. LAW. COMM'N 2006).

231. *Id.* § 401(d).

232. *Id.* § 401(e).

233. *See id.* § 110(b).

234. MINN. STAT. § 322C.0407(4) (Supp. 2018).

235. Treas. Reg. § 301.7701-02 (as amended in 2016).

achieve this governance structure. But the statutes do give the freedom to set up the desired structure if the lawyers have the competence and creativity to do so (and the company is willing to pay for those lawyers).²³⁶

Community Solar might also be able to use a new second-generation cooperative statute.²³⁷ Those statutes provide for two classes of members: those who provide equity capital and those who are patrons. The trick here is that Community Solar contemplates two classes of patron members: customers and employees. Could the patron members be split into two classes under the statutes? The statutes are somewhat unclear on this point.

Thus, existing business association law gives Community Solar a variety of ways to provide for board representation (and participation in profits, too, if desired) by a variety of groups beyond equity investors. However, several of those ways do involve fitting the structure into statutes not really designed for it. After all, we typically use the word “shareholder” to be synonymous with equity investors in a corporation. The law is actually broader than that, but the term does come with a set of social expectations. The same is true, to a lesser extent, for members in an LLC, though the term “member” may have a broader social meaning. The statutes do not provide built-in ways to address the many unique problems that will arise in multi-stakeholder organizations—the founders and lawyers must come up with their own solutions at no little cost.²³⁸ It may also be that, in operation, the company will discover that some of the default statutory provisions designed with equity investors in mind do not work well for different classes of stakeholders, requiring further contractual solutions and perhaps causing conflict where the statutory default structure does not work well. When we turn to considering potential statutory reforms, we will need to consider not only the flexibility of existing forms but also their limits in providing governance solutions tailored to the needs of social enterprises.

Before turning to potential statutory reforms, though, we should consider possible governance structures for Easier Solar. As we have seen,²³⁹ Hank Rockins, the company’s founder, has a less selfless focus on promoting the interests of others than the founders of Community Solar. He does care about advancing the transition to clean energy, which is at the heart of his business model. His three investors care more about a broader range of interests. However, even they are not as tied to any particular stakeholders as the three community organizers who are founding Community Solar. Suppose, then, that they organize Easier Solar as a corpora-

236. REVISED UNIF. LTD. LIAB. CO. ACT § 110(b) (UNIF. LAW. COMM’N 2006).

237. See *supra* notes 131–40 and accompanying text.

238. McDonnell, *supra* note 6 (manuscript at 4–5).

239. See *supra* notes 30–31 and accompanying text.

tion—either a traditional or benefit corporation—or as an LLC. Even if it is an LLC, a board structure would be useful. Rockins would be the CEO, with control over daily decisions, but the investors would be directors, giving them the ability to monitor and intervene with decisions where they care to. They could also give shareholders voting power over specific matters of concern to them. This balance of power between founders and investors is a common pattern observed in many start-up companies, although perhaps more common in later venture capital financing than in earlier angel financing.²⁴⁰ The investors would have enough authority to ensure that customers, employees, and other stakeholders are protected to the extent that they envision them being protected.

Of course, that degree of protection might not be what the customers or employees themselves are hoping for. And Rockins and the investors would quite possibly benefit from a structure that gives a flow of information concerning how customers and employees feel about the company.²⁴¹ Some of the alternatives from above that fall short of giving power to elect directors or vote directly on specified matters may be helpful in providing more information to the board and officers, while also providing some degree of assurance to other stakeholders that their concerns will at least be heard and considered.²⁴² Customers or employees could have the power to elect representatives to advisory boards with no power to bind, but the ability to get information and give advice.²⁴³ As long as the boards are just advisory, there would be little harm to giving them scope to give advice on any matters they choose, although the company may want to limit what information they have access to. In addition, or as an alternative, customers or employees could be given direct advisory voting power over specific matters, such as with Bodie's suggestion of an employee advisory vote on business combinations.²⁴⁴

If Easier Solar succeeds and funds growth in part by selling shares to new investors, the governance preferences of its early shareholders may evolve. That is particularly true if the company is successful enough to go public and become traded on national stock markets. As we have seen, both the benefits and the costs of stakeholder participation may well increase in public corporations.²⁴⁵ Two possibilities may concern the old shareholders. One is that with more diffuse shareholding, managers may become less

240. Ibrahim, *supra* note 31, at 1420–25.

241. See *supra* notes 148–53 and accompanying text.

242. See *supra* notes 189–91 and accompanying text.

243. Murray, *supra* note 23, at 99–100.

244. Bodie, *supra* note 152, at 873.

245. See *supra* notes 69–71 and accompanying text.

subject to shareholder control.²⁴⁶ Shareholders will know less about what is going on in the company and will have less incentive to monitor, as they each individually own smaller and smaller percentages of the outstanding shares. Managers may become freer to pursue their own self-interests and less committed to the proclaimed purposes of the company. The second possibility is that new public shareholders may be more focused on profits and less concerned about the other goals that the company proclaims. This may create pressure on management to pursue profits at the expense of other interests.²⁴⁷

Giving more power to other stakeholders might be a plausible response to either of these developments. Some stakeholders, particularly employees, may have natural access to information about the company's functioning, and they might have incentive to ensure that managerial incompetence or self-dealing are not damaging the business.²⁴⁸ Stakeholder empowerment would also serve as a counterweight to newer shareholders pushing for more of a focus on profits.²⁴⁹ Of course, this will also increase conflict costs between shareholders and stakeholders, but that may be better than simply going along with pressure from public markets to maximize short-term profits at the expense of other interests.

There are a variety of ways that Easier Solar could give stakeholders more power. It could set up advisory stakeholder boards,²⁵⁰ if not already present, or give those boards some degree of actual authority over some decisions so that they are no longer purely advisory. Representatives elected by stakeholders could be added at the board level, with or without voting power. New ways for stakeholders to communicate with officers or the board could be created.²⁵¹ Stakeholders could be given standing to sue to enforce fiduciary duties.²⁵² These structures could be set up in a way to leave shareholders and managers still firmly in ultimate control of the company, while giving various stakeholders some voice and a little power.

VI. LEGAL REFORM OPTIONS

All of the practical options considered within the previous Part can be implemented within existing legal forms of business association. Is there any need for further legal experimentation in statutory forms or other legal

246. This is the classic concern in large public corporations, recognized since BERLE & MEANS, *supra* note 70, at 84–90.

247. Hill & McDonnell, *supra* note 71, at 396; McDonnell, *supra* note 20, at 723–24.

248. McDonnell, *supra* note 152, at 355–56.

249. McDonnell, *supra* note 20, at 734–35.

250. See generally Murray, *supra* note 23.

251. See generally Plerhoples, *supra* note 23; Winston, *supra* note 21.

252. *Id.*

ways of encouraging social enterprise?

Even if current legal forms allow the types of experimentation in voting power discussed here, at least two reasons could support further legal reforms. First, forms of business association can provide off-the-rack governance solutions at a low cost, making it easier for businesses to adopt useful techniques.²⁵³ Second, giving more power to stakeholders may reduce externalities that purely shareholder-focused companies are likely to generate. Society may then have reason to promote stakeholder empowerment beyond what the managers and shareholders of a business may choose if left to their own devices.²⁵⁴ Statutory forms or subsidies may serve as a prod to externality-reducing governance structures.

The first reason, providing off-the-rack governance solutions, suggests that we consider expanding the arrays of statutory forms of business association available to social enterprises. However, the number and variety of forms already available is considerable. Among traditional forms not created with social enterprises in mind, but adaptable to social enterprises, are corporations, partnerships, limited liability partnerships, limited partnerships, and limited liability companies, which can be member-managed, manager-managed, or board-managed.²⁵⁵ Specifically for social enterprises, we find low-profit LLCs, benefit corporations, social-purpose corporations, and cooperatives, both traditional and new generation.²⁵⁶ There are significant variations among these forms across states, further increasing the variety available. We have seen that many of these forms can be adapted to the needs of social enterprises that want to incorporate forms of stakeholder participation and voting, even if the statutes do not specifically contemplate and encourage such adaptations.²⁵⁷

Do we need more new forms that more explicitly provide mechanisms for stakeholder voting? What would those look like? For now, I would say we do not really know what experiments in governance are likely to work well and satisfy the needs of many companies. I suggest innovation at the level of individual businesses. Let us see what works there. The proliferation of new forms may well have outstripped our understanding of what social enterprises need. Waiting and learning from experience on the ground seems the best strategy for now, insofar as the justification for possible new legal forms is to better help businesses solve perceived governance challenges.

253. See generally FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991); McDonnell, *supra* note 6.

254. Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 802–05 (2005); McDonnell, *supra* note 152, at 379.

255. See RIBSTEIN, *supra* note 88.

256. See *supra* Part III.

257. See generally *supra* notes 216–26 and accompanying text.

If the time does come for new legal business association forms, they may well involve add-ons to or variations on existing forms, as we have seen with benefit corporation and L3C statutes.²⁵⁸ New forms would provide statutory structures designed to provide classes of governance and financial rights for different stakeholder groups. One possible statutory form could start with the new generation of cooperatives and provide greater flexibility with multiple classes of members and fewer restrictions on how voting and financial rights can be allocated. Elsewhere I have described this possible legal evolution as third-generation cooperatives, or “C3Gs.”²⁵⁹ Another possible statutory form would use the LLC statute as a base. LLCs are extremely flexible, and the check-the-box taxation rules may make them a better base for tax purposes than cooperatives, though as we shall soon discuss, cooperatives can also have tax advantages.²⁶⁰

The second reason supporting legal reform may suggest a different answer as to whether social enterprises require further legal reform and perhaps a different kind of reform. That reason, recall, suggests that stakeholder voting power may reduce externalities created by existing company governance structures.²⁶¹ If such externalities are strong, we may not be able to rely upon individual experiments and adoptions within the marketplace. Founders and investors—even those with a real commitment to advancing social goods beyond their own financial gains—may not choose to adopt as much stakeholder voting power as is socially optimal. Of course, there are many other ways, through many other areas of the law, that we try to reduce externalities.²⁶² But those other areas of the law may have serious enough limits that addressing externalities through company governance makes sense.²⁶³

This justification gives an additional reason to make more readily available legal forms that encourage stakeholder voting and participation. However, this justification suggests other sorts of interventions as well. If we do not trust entrepreneurs and investors to fully internalize the externalities they impose on various stakeholders, then we should not necessarily trust them to choose the socially optimal form of governance, even if we have made that form legally easy to set up. Stronger incentives to

258. See *supra* notes 97–140 and accompanying text.

259. McDonnell, *supra* note 6 (manuscript at 2).

260. *Id.* (manuscript at 5–6).

261. See *supra* note 253–254 and accompanying text.

262. A central part of Milton Friedman’s argument against corporate social responsibility is that we should use other areas of the law to prevent corporations from imposing harms. Milton Friedman, *A Friedman Doctrine—The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAGAZINE, Sept. 13, 1970, at 32, <https://timesmachine.nytimes.com/timesmachine/1970/09/13/issue.html?action=click&contentCollection=Archives&module=LedeAsset®ion=ArchiveBody&ppgtyp=article>.

263. See generally ARROW & HAHN, *supra* note 41.

encourage stakeholder voting and participation may be justified.

Stronger incentives could entail either subsidizing stakeholder voting or outright requiring some forms of it.²⁶⁴ The latter—requiring stakeholder empowerment—goes beyond what I am willing to advocate. It seems quite politically unrealistic, at least in the U.S., and the various costs of stakeholder empowerment, discussed above,²⁶⁵ suggest that we should be cautious in imposing it. Even if empowerment would reduce significant externalities,²⁶⁶ there is no assurance that those benefits would exceed the costs that come with such a change. Absent a much stronger empirical case for the need for stakeholder empowerment than I have made here, and given the political obstacles, requiring such empowerment seems like a non-starter. Senator Warren does not seem to agree, as her proposed Accountable Capitalism Act would apply to all high-revenue corporations.²⁶⁷ I doubt the political realism of that proposal, even assuming a Democratic President and Congress, and putting political feasibility aside, the potential costs just noted suggest a more cautious approach.

Subsidies, rather than legal requirements, may be both more feasible and more justifiable. The leading way we subsidize different forms of business associations is through tax treatment of different legal structures. Nonprofits that satisfy the strict rules of the Internal Revenue Code are exempt from the corporate tax, and contributions made to nonprofits are tax deductible because we want to encourage people to devote money and other resources to social goals, even where doing so does not yield personal financial gains.²⁶⁸ Closely held businesses are allowed generally favorable pass-through taxation, rather than the corporate tax,²⁶⁹ because we believe there are various social benefits—e.g., in job creation and innovation—to encouraging the formation of new small businesses.²⁷⁰ Cooperatives also can get some tax advantages, e.g., through the deduction of dividends paid to patrons.²⁷¹

So far, new legal forms for social enterprises have not been granted much, if anything, in the way of tax advantages. The externality justification for stakeholder voting and participation suggests that perhaps companies that grant stakeholders governance rights should receive tax advantages. What might that look like? Consider the FairShares governance

264. McDonnell, *supra* note 152, at 380.

265. See *supra* notes 157–72 and accompanying text.

266. And for stakeholders, where voting mechanisms are likely to be weak due to collective action problems, empowerment may have little to no effect in reducing externalities.

267. See *supra* note 117 and accompanying text.

268. See FREMONT-SMITH, *supra* note 93, at 238–41.

269. See I.R.C. §§ 1361–79 (2012).

270. See RIBSTEIN, *supra* note 88, at 112–13.

271. ATRY & HALL, *supra* note 134, at 106–10.

structure described above in light of existing tax rules.²⁷² Imagine a social enterprise with three different classes of interests, with voting and financial rights assigned to each class. One class applies to equity investors, which may include both the initial investors and subsequent providers of equity capital. A second class applies to a specified group of other patrons with interests in the company. There could be multiple subclasses of such patrons. This could include, for instance, employees and customers of the business. A third class applies to more abstract social interests, not pertaining to any well-defined set of individuals. This could include the environment, with one or more environmental organizations being granted voting and financial rights to represent this abstract interest.

How should such an organization be taxed? Perhaps each class of interests should be taxed differently. The equity class could be taxed like an ordinary business, either with C corporation double taxation or with a pass-through partnership-like tax. That is, a percentage of company profits equal to that which is distributed to the equity class in the company's ownership structure would get corporate tax treatment. The cooperative-like patron classes could either be taxed as pass-throughs or perhaps have no tax at the entity level and tax the patrons only when they receive their distributions. The social class could be tax exempt, with the distributions to their non-profit holders also not taxed. To some extent, tax treatment close to this might be achievable within existing tax law, although it would involve the interaction of several different, and fiendishly complicated, areas of tax law, creating hard planning problems, which would generate hefty legal fees. If such fair-share governance structures start to be adopted, a new set of tax rules adapted to them, which simplifies the tax planning issues, would encourage further experimentation.

A different way of subsidizing voting rights in social enterprises would be through regulatory innovations in various areas of substantive law. Consider as an example a way that we might encourage employee involvement in governance. We could offer deals to companies and their employees along the following lines: certain employment and labor-law rules could be relaxed or waived for employers who have adopted an adequately vigorous form of employee representation and whose employees have voted in favor of this exchange of rights.²⁷³ Not only would this encourage greater employee participation, but it would also recognize that employment and labor law may have grown overly complex and rigid, with rules that do not necessarily work well for all sorts of businesses. Employers

272. See *supra* notes 219–23 and accompanying text.

273. See CYNTHIA ESTLUND, *REGOVERNING THE WORKPLACE: FROM SELF-REGULATION TO CO-REGULATION* 215–25 (2010); Orly Lobel, *The Renew Deal: The Fall of Regulation and the Rise of Governance in Contemporary Legal Thought*, 89 *MINN. L. REV.* 342, 417–18 (2004).

who give enough control rights to their employees would be allowed to find a different balance of rights within their businesses that better calibrates the interests of the business and its employees. Similar deals could be offered in environmental law for businesses that empower environmental representatives or in consumer law for businesses that empower their consumers, and so on. Elements of such a strategy already exist, and this strategy fits within the emerging responsive-regulation approach to the regulatory state.²⁷⁴

Either or both of these forms of subsidization—tax or employment law forbearance—could be used to improve the Accountable Capitalism Act. Rather than requiring the purpose, duty, and employee representation provisions for all large-enough corporations, one could create the proposed charter and make it available to all corporations. Those that adopted it would get tax cuts, employment law forbearance, or both, as discussed above. Not only would such a change make the Act more politically achievable, it would also lower its potential costs. Moreover, insofar as the purpose, duty, and participation provisions are ways for companies to commit to considering the interests of groups beyond shareholders, requiring all large corporations to adopt the provisions may actually backfire, as unwilling companies with no desire to make that commitment will find ways to comply in form but not in spirit.

VII. CONCLUSION

Social enterprises pursue a dual mission, founded to both generate profits for their founders and investors while also independently pursuing other social goals. Many investors, employees, and customers want to be involved in such companies, and their founders and managers would like to commit to these groups of persons that they will not put profits ahead of their stated social missions. However, effectively achieving such commitment can be hard.²⁷⁵

Policymakers have devised new statutory forms of business associations to address the special needs of social enterprises, above all the benefit corporation. The main corporate governance tools the benefit corporation uses to help companies commit to pursuing stakeholder interests are fiduciary duty and disclosure. However, as a number of persons have

274. See generally IAN AYRES & JOHN BRAITHWAITE, *RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE* (Donald R. Harris et al. eds., 1992); Christine Parker, *Twenty Years of Responsive Regulation: An Appreciation and Appraisal*, 7 *REG. & GOVERNANCE* 2 (2013).

275. See *supra* Part II.

argued, these tools are generally pretty weak—not useless, but not all that useful either.²⁷⁶

Various forms of representative and direct voting, or participation by interested stakeholders, provide potentially much stronger commitment devices. Stakeholders and their representatives are often both better informed about how company actions affect their interests and also more strongly motivated to make sure those interests are well considered than are company managers or shareholders. To be sure, stakeholder representation can come at a cost, particularly in generating conflicts with shareholders and among various stakeholders.²⁷⁷

This Article has considered a variety of ways to help represent stakeholders within company decision-making. It has categorized those mechanisms along a variety of dimensions: representative versus direct elections, scope and importance of decisions, degree of power over a decision, and who gets to vote. By tailoring mechanisms along these dimensions, companies can adjust benefits and costs to achieve stakeholder representation in ways that work best for their particular needs and circumstances.²⁷⁸ Our two exemplar companies, Easier Solar and Community Solar, illustrate some possible choices. Community Solar's founders have a stronger commitment to stakeholder interests, especially the interests of customers and the local community, and hence would benefit from stronger forms of representation than Easier Solar. However, at least informational forms of participation might help Easier Solar, and if the company succeeds and grows, it may find that stronger forms of participation might help address the governance challenges that arise with a larger and more dispersed set of shareholders.²⁷⁹

At a policy level, my core emphasis has been analyzing how companies can achieve stakeholder involvement through contractual mechanisms. However, the positive externalities generated by companies that effectively pursue stakeholder interests suggest that more aggressive legal intervention may be justified. Here, I suggest two options. One proposes a mixed tax regime for companies that have voting and financial rights for differing types of stakeholders. The other proposes regulatory forbearance in various policy areas for companies that effectively grant stakeholder participation rights for the stakeholders relevant to that policy area.²⁸⁰ Further work is needed to add details to these proposals. Stay tuned for sequels.

276. *See supra* Part III.

277. *See supra* Part IV.

278. *See supra* Part IV.

279. *See supra* Part V.

280. *See supra* Part VI.