

# Benefit Corporations and Public Markets: First Experiments and Next Steps

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## INTRODUCTION

Entrepreneurs and investors, along with employees, customers, and others, have become increasingly interested in social enterprises. The owners of these businesses pursue a dual objective of creating social goods while also achieving profits.<sup>1</sup> Several new legal forms of business associations have evolved recently to attempt to address the challenges that social enterprises face, with benefit corporations so far being the leading new type.<sup>2</sup> Most benefit corporations, and more generally social enterprises to date, are new, small, and closely held businesses. They do not enjoy the benefits or face the challenges of having publicly traded shares and large numbers of shareholders.

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1. See generally Robert A. Katz & Antony Page, *The Role of Social Enterprise*, 35 VT. L. REV. 59 (2010); Heerad Sabeti, *The For-Benefit Enterprise*, HARV. BUS. REV., Nov. 2011, at 98.

2. See generally Dana Brakman Reiser, *Theorizing Forms for Social Enterprise*, 62 EMORY L.J. 681 (2013); Joseph Yockey, *Does Social Enterprise Law Matter?*, 66 ALA. L. REV. 767 (2015).

But there are a few publicly traded social enterprises,<sup>3</sup> and if social enterprises are to succeed on a large scale, some day there will need to be many more. Publicly traded benefit corporations will face unique challenges that do not exist, in the same form, for either ordinary publicly traded corporations or for closely held benefit corporations. In particular, balancing accountability of the managers of the business with a firm, ongoing commitment to both corporate objectives—doing good and making money—may prove extremely difficult.<sup>4</sup> How might publicly traded benefit corporations address these challenges? What sorts of supporting institutions and practices might develop to help? Might stock markets play an important role?

This Article explores those questions. Part I begins by considering the leading benefits and costs for a benefit corporation that chooses to go public.<sup>5</sup> It starts there both to begin gaining an understanding of the challenges public companies will face and also to consider whether going public is likely to actually be an attractive option at all for some set of social enterprises. Some of the benefits and costs of going public are the same for benefit corporations as for ordinary corporations—access to new sources of capital and new accountability mechanisms are benefits, but legal compliance and pressures from shareholders to show quick results are costs. But, there are also special benefits and costs for benefit corporations, or the benefits and costs that other companies face may play out differently for social enterprises. On the benefit side, access to new sources of capital may be even more important for social enterprises, which may find it harder to attract investors given the commitment to doing good. Additionally, founders and early investors may use publicly traded stock as a way of achieving a profitable exit from their investment, though this benefit may be less important to investors in social enterprises whose desire for profit may be tempered by the desire to do good as well. Going public also shifts control from the founders and early investors to the board of directors, which could possibly allow for more commitment to the social mission of the business. But, the shift in control may pose a risk to the social mission. Public shareholders, especially shareholder activists, may create pressures to pursue profit at the expense of the social mission.

Part II considers early experiments in publicly traded social enterprises, or at least arrangements that come close to being such.<sup>6</sup> It

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3. See discussion of Etsy and Laureate Education, *infra* notes 58–70 and accompanying text.

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

5. See *infra* notes 15–27 and accompanying text.

6. See *infra* notes 34–83 and accompanying text.

surveys various public exchanges such as the Social Stock Exchange in the UK,<sup>7</sup> the Social Venture Connection in Canada,<sup>8</sup> and the Impact Exchange in Singapore and Mauritius.<sup>9</sup> It also surveys early experiments in crowdfunding of social enterprises, online sites for impact investing by accredited investors, and a few individual corporations, including Laureate Education, a Delaware public benefit corporation, which (as of the time of writing) has filed an S-1 registration statement<sup>10</sup> in preparation to go public, and Etsy, a B Lab-certified public corporation. Finally, Part II ponders various lessons to be learned from these early experiments.

Part III moves to consider various mechanisms by which benefit corporations, investors, stock markets, and other gatekeepers might be able to realize the benefits of going public while minimizing the costs.<sup>11</sup> Disclosure of actions taken to advance a firm's social mission can give incentives to behave well, to maintain a good reputation, and to provide information to investors that could affect their choice of which firms to invest in. The revised fiduciary duty of benefit corporations may also help ensure that they pursue their dual missions, with a greater chance of suits being brought in public companies with thousands of shareholders (potential plaintiffs) if the corporation fails to pursue their dual mission. Board representation rules and processes could give various stakeholder groups other than shareholders a say in decision making. Relatedly, various stakeholder groups could be given several possible kinds of voting rights. Dual-class share structures may help ensure that control remains with shareholders committed to the social mission. Time-phased or tenure voting may give more power to shareholders with long-term interests in the company. And, investor screening devices may help keep investors that are not committed to a company's mission from investing in that company. Finally, a variety of gatekeepers could help ensure accountability and fidelity to the corporate mission. Possible gatekeepers include certifiers like B Lab, auditors, insurers, lawyers, and exchanges themselves.

Finally, Part IV focuses on the specific role of stock exchanges and similar institutions as ways to help facilitate the various governance and shareholding mechanisms discussed in Part III.<sup>12</sup> Exchanges, through their

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7. SOCIAL STOCK EXCHANGE, <http://socialstockexchange.com/> [<https://perma.cc/YZ5M-RKJR>].

8. SOCIAL VENTURE CONNECTION, <https://svx.ca/en> [<https://perma.cc/7VH9-Z3N3>] [hereinafter SVX].

9. IMPACT EXCHANGE, <http://impactexchange.asiaix.com/> [<https://perma.cc/5V2F-3EDY>].

10. When a company "goes public" it must file a registration statement with the SEC, containing quite an extensive disclosure. The registration statement which companies going public typically use is Form S-1.

11. *See infra* notes 85–132 and accompanying text.

12. *See infra* notes 17–26 and accompanying text.

listing requirements, could require or encourage the mechanisms discussed in Part III. If different exchanges create different requirements, they would allow experimentation as to what works and what doesn't, reducing the challenges that publicly traded benefit corporations will face. Exchange listing could also work as a branding device for companies. Exchanges could provide a focus for the involvement of various corporate gatekeepers, helping to coordinate expectations and best practices for how social enterprises should govern themselves to best pursue their dual missions.

### I. BENEFITS AND COSTS OF GOING PUBLIC

Social enterprises, as I use the term here, are businesses that are committed to both generating economic returns for their investors while also pursuing one more social missions.<sup>13</sup> The benefit corporation is a new legal form created to respond to the perceived needs of social enterprises. Benefit corporations are business corporations, governed by the standard rules of corporation law except for a few characteristics: their corporate purpose includes pursuing a social mission; their fiduciary duties require directors and officers to consider the effect of decisions on stakeholders other than shareholders; and, they must regularly report on what they have done to pursue their social missions.<sup>14</sup> In this Article, I am mostly concerned with the practical and legal issues surrounding benefit corporations that become publicly traded, but much of the discussion of those issues applies to social enterprises more broadly.

We start by exploring the benefits and costs to a benefit corporation of having publicly traded shares. This makes sense as a starting point for (at least) two reasons. First, a core premise of this Article is that if benefit corporations (and social enterprises more generally) are to succeed and become a significant part of the economy, some of the most successful companies will want, and need, to go public. Exploring the benefits and costs of going public will help us understand why that may be so and hence why we need to examine measures to help public markets adapt to the needs of benefit corporations. But it is also worth keeping in mind that the premise may be false; that is, even if benefit corporations become a significant part of the economy, they may rarely—if ever—benefit from

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13. See generally sources cited *supra* note 1.

14. For an overview of benefit corporations, see generally WILLIAM H. CLARK, JR. ET AL., WHITE PAPER: THE NEED AND RATIONALE FOR THE BENEFIT CORPORATION: WHY IT IS THE LEGAL FORM THAT BEST ADDRESSES THE NEEDS OF SOCIAL ENTREPRENEURS, INVESTORS, AND, ULTIMATELY, THE PUBLIC (Jan. 13, 2013), [http://benefitcorp.net/sites/default/files/Benefit\\_Corporation\\_White\\_Paper.pdf](http://benefitcorp.net/sites/default/files/Benefit_Corporation_White_Paper.pdf) [<https://perma.cc/XV3P-WR3H>]; CORP. LAWS COMM., ABA BUS. L. SECTION, BENEFIT CORPORATION WHITE PAPER, 68 BUS. LAW. 1083 (2013).

going public. In that case, this Article can be taken as a cautionary tale of the problems involved for benefit corporations that go public.

A second reason for starting with an overview of the benefits and costs of going public focuses in particular on the costs. There are certainly challenges facing any social enterprise that chooses to go public. The remaining sections of this Article explore various means by which companies, investors, and markets can try to address and reduce the relevant costs. Therefore, one must then start with an overview of the most important costs.

Let us start with the benefits of going public. Public stock (and bond) markets can provide a significant source of capital for businesses. That point can be overstated—for years, U.S. stock markets have seen a net outflow of funds as dividends and share repurchases exceed the amount of new money invested through share issues.<sup>15</sup> Still, a company listed on a stock exchange has an important way of raising money available to it that other companies lack. This benefit is obviously not unique for benefit corporations—it is a major reason why any company chooses to go public. However, raising money could conceivably be an even bigger consideration for social enterprises than more conventional companies, because social enterprises can find it particularly hard to raise capital due to their dual missions.<sup>16</sup> Because they may choose to prioritize their social mission over profits if the two conflict, investors may fear that social enterprises will earn lower returns, lowering the return on their investments. Thus, social enterprises may need to explore a wider range of potential investors, and public markets could be one option that helps meet their needs. Of course, as I shall soon discuss,<sup>17</sup> one may suspect that investors in publicly traded companies are even more profit-centered than other investors, making them a poor fit for social enterprises. However, perhaps there are some contexts and some pools of potential investors that are more favorable. In Part II, I will discuss crowdfunding as one sort of public or quasi-public fundraising that may be particularly attractive to benefit corporations because already popular forms of nonequity crowdfunding are associated with public good-oriented giving.<sup>18</sup>

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15. Bob Bryan, *The Biggest Force Powering the Stock Market is Starting to Disappear, and It Could Be a Huge Problem*, BUS. INSIDER (Mar. 12, 2016), <http://www.businessinsider.com/buybacks-disappearing-could-mean-recession-2016-3> [https://perma.cc/9CFH-YLYU].

16. See generally Susan N. Gary, *Is It Prudent to Be Responsible? The Legal Rules for Charities That Engage in Socially Responsible Investing and Mission Investing*, 6 NW. J.L. & SOC. POL'Y 106 (2011); Paul Brest & Kelly Born, *When Can Impact Investment Create Real Impact?*, STAN. SOC. INNOVATION REV. (2013); Antony Bugg-Levine et al., *A New Approach to Funding Social Enterprises*, HARV. BUS. REV., Jan.–Feb. 2012, at 118.

17. See *infra* notes 30–33 and accompanying text.

18. See *infra* notes 77–83 and accompanying text.

Another benefit of going public is that it provides a potentially lucrative way for company founders and early investors to exit with big gains on their investments. This is another benefit that is shared with other types of corporations.<sup>19</sup> However, it would seem to be a weaker benefit for benefit corporations than for traditional profit-oriented companies. After all, the founders and investors of benefit corporations will presumably care somewhat less about profit and somewhat more about doing good than the founders and investors of other businesses and so the prospect of a big payout after going public will be less important to them. But less important does not mean totally unimportant; founders and investors of benefit corporations do seek profit (or else they could form as nonprofits and gain tax advantages), so the big payout on going public will matter at least somewhat in some cases.

A final potential benefit of going public is that it typically shifts effective control from the main shareholders (usually the founders and early investors) to the directors and officers of the corporation.<sup>20</sup> There are problems associated with this—the separation of ownership and control and its result agency costs are, after all, the leading concern of American corporate law and governance.<sup>21</sup> But especially in the context of benefit corporations, there is an important potential benefit. When push comes to shove, shareholders—even shareholders who have chosen to invest in a benefit corporation—may push to prioritize profits over social mission. In a closely held corporation, the board will generally be tied to and controlled by a controlling shareholder or group of shareholders.<sup>22</sup> In a public corporation with enough of a dispersed ownership structure, the directors and officers will be less directly subject to effective shareholder control.<sup>23</sup> That may allow them to pursue their own interests, but it also allows them to pursue the interests of other stakeholders and specified public goods. Such is the model of the board as mediating hierarch in the theory of Blair and Stout<sup>24</sup> and, if it ever applies, it applies better in public than in closely held corporations.

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19. Bernard S. Black & Ronald J. Gilson, *Venture Capital and the Structure of Capital Markets: Banks Versus Stock Markets*, 47 J. FIN. ECON. 243, 257–64 (1998).

20. A common, though not universal, feature of U.S. public corporations is that they have no shareholder who owns a high enough percentage of shares to effectively control the business. See Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471, 471 (1999).

21. A point first brought to sustained attention in ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

22. See Cynthia S. Grandfield, *The Reasonable Expectations of Minority Shareholders in Closely Held Corporations: The Morality of Small Businesses*, 14 DEPAUL BUS. L.J. 381, 382–83 (2002).

23. See generally BERLE & MEANS, *supra* note 21.

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

Of course, there are problems with this change in governance structure, which leads us to the costs of going public. One cost for all types of public companies is various compliance costs that come with being public. These have increased in recent years with various provisions of the Sarbanes-Oxley<sup>25</sup> and Dodd-Frank<sup>26</sup> Acts. Some blame the decline in companies going public on these increased costs,<sup>27</sup> although that claim is disputed.<sup>28</sup> This cost is not unique to benefit corporations, though insofar as one contemplates additional rules for benefit corporations (e.g., additional disclosure rules) the costs could be higher for them.

More fundamentally, the change in ownership and governance structure has perils as well as promise. One of these is traditional for any type of public corporation: the separation of ownership and control may make it easier for managers to make decisions that benefit themselves at the expense of shareholders and other stakeholders.<sup>29</sup>

Another problem with the change in ownership structure is that the business loses control over who its shareholders are. This loss of control opens up companies to the possibility of a hostile takeover and, more relevantly, opens them up to the rising number of activist shareholders.<sup>30</sup> Even for ordinary corporations, shareholder activism has led to concern that managers are becoming more short-term in their focus as a way of heading off unwanted shareholder activism.<sup>31</sup> There is much debate over whether this is true, and even if it is, whether that is a bad thing. I have argued elsewhere that the evidence is quite murky, but it does seem plausible that there is at least a somewhat significant problem.<sup>32</sup>

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25. Sarbanes-Oxley Act of 2002, Pub. L. 107-204, 116 Stat. 745.

26. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. 111-203, 124 Stat. 1376.

27. COMM. ON CAPITAL MKTS. REG., INTERIM REPORT x–xi (2006), <http://capmktreg.org/wp-content/uploads/2014/08/Committees-November-2006-Interim-Report.pdf> [<https://perma.cc/657X-KKE4>]; COMM’N ON THE REG. OF U.S. CAPITAL MKTS. IN THE 21ST CENTURY, REPORT AND RECOMMENDATIONS 6 (2007), <http://www.centerforcapitalmarkets.com/wp-content/uploads/2014/06/Commission-on-the-regulation-of-us-cap-markets-report-and-recommendations.pdf> [<https://perma.cc/Z6SN-DALV>].

28. See generally Robert Prentice, *Sarbanes-Oxley: The Evidence Regarding the Impact of SOX 404*, 29 CARDOZO L. REV. 703 (2007).

29. See generally Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); BERLE & MEANS, *supra* note 21.

30. Activist shareholders buy significant shares in a corporation and then pressure the management of that corporation to make organizational or operational changes that they believe will increase the share price. See generally John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545 (2016).

31. See generally 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).

32. *Id.*

This short-termism problem is worse for benefit corporations. The shareholder activists seek profits, not doing good. Moreover, insofar as doing good has reputational benefits that increase profits in the long run, pressure to increase profits in the short term may make companies less sensitive to those benefits.<sup>33</sup> Thus, the pressure of effective shareholder activism raises a major concern that benefit corporations that go public will face mission drift and, over time, come to prioritize profits over social benefits, thereby challenging their core defining feature and purpose.

Do the benefits of going public outweigh the costs for benefit corporations? That is hard to answer in the abstract, and it may well differ for different companies. Indeed, for most benefit corporations the costs will continue to outweigh the benefits as is the case for most businesses of all sorts. The more precise question is whether a significant number of successful benefit corporations will find the benefits of going public outweigh the costs.

One should not quickly jump to conclude that the answer is yes. The costs are real and the benefits are uncertain, and maybe benefit corporations should and will remain limited to closely held entities. But the answer may depend in part upon what can be done to control the costs identified above. The rest of this Article is devoted to exploring mechanisms that may control the costs. For those skeptical about whether public benefit corporations will ever make sense, consider this an exploration of the difficulty of reducing the costs of going public. For those more optimistic about the prospects of public benefit corporations, the following parts will explore possible practices that could develop to help support those corporations.

As one considers the leading unique benefits and costs of going public for benefit corporations, one sees that they must strike a difficult balance between maintaining the accountability of officers and directors (and thus avoiding self-dealing); reducing pressures to follow the dictates of profit-focused activist shareholders (and thus avoiding mission drift); while overall leaving managers the discretion to make difficult choices while still credibly committing to achieve both profits and social good.

## II. EARLY EXPERIMENTS

Rather than speculate in a vacuum about how benefit corporations should handle the challenges of becoming publicly traded, let us start by looking at early experiments that may shed light on what might work. As of this writing, there is no company organized legally as a benefit corporation that has shares listed on a public stock exchange, much less

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33. *Id.*



any stock exchange that particularly focuses on listing benefit corporations. However, there are various exchanges and online portals that are in the neighborhood of being such exchanges as well as individual companies that are close to being publicly traded benefit corporations. To consider the experiences of some of these institutions is a useful first step.

Sarah Dadush's *Regulating Social Finance*<sup>34</sup> is a valuable article that reviews three early experiments in public exchanges for social enterprises that were all formed in 2013. One of those public exchange experiments is the Social Stock Exchange (SSX) based in the United Kingdom.<sup>35</sup> At the time of Dadush's article, the SSX was simply an online information portal for social enterprises that were already listed on a traditional exchange.<sup>36</sup> The idea of the portal is to inform interested investors about these companies so that they can then buy their shares if they are suitably impressed. The SSX has now partnered with the ICAP Securities and Derivatives Exchange (ISDX) to create a market-trading segment on ISDX for SSX member companies.<sup>37</sup>

To join the SSX (and thereby gain access to investors in the ISDX), companies must be approved by an Admissions Panel and prepare an Impact Report. The Impact Report both provides the core information on which an admissions decision is based, and provides disclosure to investors and the general public about what social goals a company is pursuing, and what it does to pursue those goals. The Impact Report is prepared with the assistance of an independent analyst and must be updated annually.<sup>38</sup> As Dadush emphasizes, the guidance as to what Impact Reports must contain is broad, and hence Reports vary considerably.<sup>39</sup> Listed companies are not required to report any specific quantitative metrics. There is also little to nothing in the way of governance standards that companies must follow.<sup>40</sup> Also, as Dadush rather critically emphasizes, SSX does nothing to explicitly screen investors in SSX-listed companies (indeed, investors purchase on a different platform, ISDX or some other traditional exchange, not through SSX itself).<sup>41</sup>

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

35. SOCIAL STOCK EXCHANGE, <http://socialstockexchange.com/> [https://perma.cc/YZ5M-RKJR].

36. Dadush, *supra* note 34, at 193.

37. *Our Markets*, ISDX, <http://www.isdx.com/about-us/our-markets/> [https://perma.cc/N5MH-TXTU].

38. Dadush, *supra* note 34, at 195–97.

39. *Id.* at 194–97.

40. *Id.*

41. *Id.* at 198.

The second institution Dadush examines is the Social Venture Connection (SVX) in Canada.<sup>42</sup> SVX is a platform for accredited investors to find and connect with social enterprises that list share offerings on it. Thus, SVX is not a full-fledged exchange because buyers are limited to accredited investors and because it is a platform for initial offerings by companies to investors, not for reselling shares on a secondary market. In order to be listed on SVX, issuers must either self-report a score of at least 100 on the Global Impact Investing Rating System (GIIRS) or get B Lab certified (which requires a GIIRS rating of at least 80, audited by B Lab).<sup>43</sup> Once listed, these scores must be regularly updated.<sup>44</sup> Therefore, in contrast with the broad qualitative standards of the SSX Impact Reports, SVX relies on the detailed quantitative metrics embodied in the GIIRS ratings.

SVX also makes an effort to screen its investors. The Investors Agreement contains the following warning:

Investing in issuers whose offerings are posted on the SVX online platform has significant risk. The main objective of these issuers is not to maximize returns to the investors and you should invest in issuers whose offerings are posted on the SVX online platform only if you are prepared not to receive any return on your investment and to lose your investment in its entirety.<sup>45</sup>

The Investors Manual states that its investors are “[i]mpact-first investors with a focus on achieving positive social and/or environmental outcomes with patient capital investments.”<sup>46</sup> SVX retains the right to terminate investor access to the platform. Dadush approvingly notes these efforts to screen out impatient investors who are not focused on social impact—SVX is the only one of the three exchanges she examines that does so.<sup>47</sup>

Dadush’s third subject is the Impact Exchange (IX), a joint project of the Stock Exchange of Mauritius and the Impact Investment Exchange Asia, based in Singapore.<sup>48</sup> IX aims to be a full-fledged public exchange for social enterprises, with secondary trading occurring on its platform and

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42. SVX, *supra* note 8.

43. SVX, SVX ISSUER MANUAL, 15, [http://s3.amazonaws.com/svx.staging/comfy/cms/files/files/000/000/173/SVX\\_Issuer\\_Manual-original.pdf](http://s3.amazonaws.com/svx.staging/comfy/cms/files/files/000/000/173/SVX_Issuer_Manual-original.pdf) [<https://perma.cc/B5QE-EZB4>].

44. *Id.*

45. SVX, SVX INVESTOR MANUAL 19, [http://s3.amazonaws.com/svx.staging/comfy/cms/files/files/000/000/178/SVX\\_Investor\\_Manual-original.pdf](http://s3.amazonaws.com/svx.staging/comfy/cms/files/files/000/000/178/SVX_Investor_Manual-original.pdf) [<https://perma.cc/BDH9-KZ9Z>].

46. *Id.* at 13.

47. Dadush, *supra* note 34, at 205–06.

48. IMPACT EXCHANGE, <http://impactexchange.asiaiiix.com/> [<https://perma.cc/5V2F-3EDY>].

not limited to accredited investors. So far, no companies are listed, only a few impact bonds.<sup>49</sup>

For a company to be listed on IX, it must meet a variety of requirements. It must specifically state that a positive social or environmental impact is “its primary reason for existence.”<sup>50</sup> It must commit to “ongoing monitoring and evaluation of impact performance using clearly defined impact indicators for performance assessment and reporting.”<sup>51</sup> It must prepare annual reports on its social impact “in accordance with Impact Exchange reporting principles”<sup>52</sup> (These principles are not clearly spelled out, at least not in publicly available documents.). And, it must have been certified by an independent social or environmental ratings body.<sup>53</sup> To help ensure applicant companies adequately comply with these standards, applicants are assigned an Authorized Impact Representative to help them complete the process.<sup>54</sup> There appear to be no restrictions on who can invest and less attempt to weed out unwelcome investors than at the SVX.

Beyond these three examples analyzed by Dadush, a variety of other institutions exist, at least within the neighborhood of being public exchanges for social enterprises. Many of these institutions are online investing platforms for accredited investors focused on impact investments (indeed, SVX is an example). Another example is Mission Markets (MMX).<sup>55</sup> Investments offered on MMX include “funds, project finance, structured debt products and later stage private and public companies in addition to earlier stage offerings that we may, from time-to-time, also list.”<sup>56</sup> Investors are mostly limited to accredited investors—there does not appear to be an explicit attempt to weed out nonimpact investors. All listed entities must include their performance under an approved third-party sustainability metric, such as GIIRS. They also require an Impact Reporting and Investment Standards (IRIS) indicated result metric.<sup>57</sup>

The experience of some individual companies, rather than exchanges or portals, also may yield some insight. As of now, there is not a single

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49. These are pooled investments of bonds issued to various enterprises.

50. IMPACT EXCH., IMPACT EXCHANGE BOARD LISTING GUIDE 10, [http://impactexchange.asiaix.com/wpcontent/uploads/2014/03/Impact\\_Exchange\\_Listing\\_Guide\\_Feb2014\\_FINAL.pdf](http://impactexchange.asiaix.com/wpcontent/uploads/2014/03/Impact_Exchange_Listing_Guide_Feb2014_FINAL.pdf) [<https://perma.cc/N7UX-Q2NF>].

51. *Id.*

52. *Id.*

53. *Id.*

54. *Id.* at 14–15.

55. MISSION MARKETS, <http://www.missionmarkets.com/> [<https://perma.cc/B4UY-B3SV>].

56. *Frequently Asked Questions*, MISSION MARKETS, <http://www.missionmarkets.com/#!faq/c1r2k> [<https://perma.cc/H7TX-4M9D>].

57. *Id.*

company legally organized as a benefit corporation that is publicly traded. However, there are some close calls. Laureate Education is a Delaware public benefit corporation that has filed an S-1 registration statement in preparation for going public; although, it has not yet completed its Initial Public Offering (IPO).<sup>58</sup> Laureate is a leading for-profit provider of higher education with its business mostly concentrated in Latin America.<sup>59</sup> For-profit higher education is a controversial field with concerns that such providers make profits at the expense of quality, often relying on government-subsidized student loans.<sup>60</sup> Benefit corporation status may be a way for Laureate to try to commit to maintaining a focus on its public educational mission despite its for-profit status. As such, the difficulty of maintaining such a dual commitment is a major question mark surrounding Laureate, and the effectiveness of its mechanisms for avoiding mission drift is a significant question for the company.

Laureate uses dual-class stock to allow founders and early investors to maintain control over the business while bringing in more equity investors.<sup>61</sup> We will discuss dual-class stock more below.<sup>62</sup> Suffice to say, it is controversial, and many academic commentators have complained that dual-class stock splits control from a financial stake in a company's success.<sup>63</sup> Still, it could be an effective way to prevent mission drift driven by shareholder activism in social enterprises. Laureate also has a high debt level.<sup>64</sup> This could create a potential incentive to take on too much risk, but for a social enterprise, it may also be a way to gain additional financing without issuing shares that could relinquish control to shareholders who lack adequate commitment to the mission. Laureate states that it plans to become a B Lab certified corporation,<sup>65</sup> adding B Lab as an outside certifier of Laureate's commitment to pursuing the public good.

Another notable company is Etsy. Etsy is a B Lab certified company that went public in 2015.<sup>66</sup> It is not a benefit corporation, but under B Lab's current rules, it will eventually need to become one if it wishes to remain

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58. Laureate Education, Inc., Registration Statement Under the Securities Act of 1933 (Form S-1) (Oct. 2, 2015), <https://www.sec.gov/Archives/edgar/data/912766/000104746915007679/a2209311zs-1.htm> [<https://perma.cc/9N8K-M46N>] [hereinafter Laureate S-1].

59. *Id.* at 1–3.

60. See generally Amanda Harmon Cooley & Aaron Cooley, *From Diploma Mills to For-Profit Colleges and Universities: Business Opportunities, Regulatory Challenges, and Consumer Responsibility in Higher Education*, 18 S. CAL. INTERDISC. L.J. 505 (2009).

61. Laureate S-1, *supra* note 58, at 68–69.

62. See *infra* notes 113–116 and accompanying text.

63. See, e.g., Paul Gompers et al., *Incentives vs. Control: an Analysis of U.S. Dual-Class Companies* (Nat'l Bureau of Econ. Research, Working Paper No. 10240, 2004), <http://www.nber.org/papers/w10240.pdf> [<https://perma.cc/3G63-64K4>].

64. Laureate S-1, *supra* note 58, at 61–62.

65. *Id.* at 64.

66. *Mission & Values*, ETSY, <https://www.etsy.com/mission> [<https://perma.cc/GX3N-PGPJ>].

certified. Etsy is an eBay-like online craft market. Its brand revolves around a focus on independent artisanship, explaining its desire to identify as a social enterprise.<sup>67</sup> Since going public, its performance raises some questions about both sides of the dual mission. On the for-profit side of the ledger, Etsy's stock price since going public has dropped precipitously,<sup>68</sup> even more than the large drop that is typical for newly public companies.<sup>69</sup> On the social mission side of the ledger, Etsy has generated significant controversy when it transferred much of its intellectual property to an Irish subsidiary because of Ireland's status as a tax haven.<sup>70</sup> The use of Ireland and other jurisdictions to avoid U.S. taxes has been a major political controversy for some time, and Etsy's action has raised awkward questions about whether a commitment to doing good is consistent with aggressive techniques to avoid paying taxes.<sup>71</sup>

More loosely related to our topic, many significant public companies are like Laureate in that they use dual-class stock.<sup>72</sup> These are not benefit corporations or B Lab certified, but might some of them qualify more informally as social enterprises? As noted above in discussing Laureate, though dual-class stock creates serious concerns, it can potentially be justified as a way to retain control in the hands of early shareholders strongly committed to the dual mission while still bringing in new public shareholders who provide additional equity.<sup>73</sup> There are at least two distinct classes of public companies using dual-class stock. The first class is media companies, including the New York Times and the Washington Post.<sup>74</sup> Their use of dual class stock is justified on a quite plausible social enterprise-like ground. Newspapers, after all, do profess to advance the public good by providing reporting and information that is essential to deliberative decision making in a democracy. Serious investigative

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67. *Id.*

68. Greg DePersio, *Etsy: How It's Fared Since Its 2015 IPO (ETSY)*, INVESTOPEDIA (Jan. 27, 2016), <http://www.investopedia.com/articles/markets/012716/etsy-how-its-fared-its-2015-ipo-etsy.asp> [https://perma.cc/Q5PT-AG5J].

69. Roger G. Ibbotson et al., *The Market's Problems With the Pricing of Initial Public Offerings*, 7 J. APP. CORP. FIN. 66, 73–74 (1994).

70. Alex Barinka & Jesse Drucker, *Etsy Taps Secret Irish Tax Haven and Brags About Transparency at Home*, BLOOMBERG (Aug. 13, 2015), <http://www.bloomberg.com/news/articles/2015-08-14/etsy-taps-secret-irish-tax-haven-and-touts-transparency-at-home> [https://perma.cc/582Q-5MBD].

71. Rob Davies & Dominic Rush, *Pfizer Takeover: What Is a Tax Inversion Deal and Why Are They So Controversial?*, GUARDIAN (Nov. 23, 2015), <https://www.theguardian.com/business/2015/nov/23/pfizer-takeover-tax-inversion-questions> [https://perma.cc/RKY7-T6R7].

72. Gompers et al., *supra* note 63 and accompanying text.

73. *Id.*

74. Gregory Zuckerman & Chris Reiter, *New York Times Faces Share-Class Challenge*, WALL ST. J. (Apr. 19, 2006 12:01 AM), <http://www.wsj.com/articles/SB114540837862029468> [https://perma.cc/4PJT-U365].

reporting can be quite expensive with an uncertain payoff, so a pure for-profit company may not invest as much money in such reporting as a social enterprise with a dual mission. The second prominent class of public companies with dual-class stock consists of high tech companies, most famously Google and Facebook.<sup>75</sup> Can these plausibly be portrayed as social enterprises? Google does, after all, proclaim a motto of “[d]on’t be evil,”<sup>76</sup> but one can perhaps be excused for having some skepticism on this point.

A final emerging example of something resembling a public market for benefit corporations is the new field of equity crowdfunding.<sup>77</sup> Crowdfunding for pure donations, or in return for rewards, has been around for some time and has become a significant source of financing for many small businesses. However, equity crowdfunding (going online to raise money in return for issuing equity interests) has, until recently, been essentially impossible under federal securities law. Congress attempted to change this with the CROWDFUND Act, part of the JOBS Act passed in 2012.<sup>78</sup> However, the Securities Exchange Commission (SEC) rules needed to implement the crowdfunding provisions did not take effect until May 2016.<sup>79</sup> So, there is still little data for equity crowdfunding.

It seems plausible that crowdfunding may become a major source of funding for benefit corporations.<sup>80</sup> Indeed, it may be the most probable route by which benefit corporations will become a major part of the economy. Older and quite successful forms of crowdfunding are focused on enterprises that seem socially attractive, and crowdfunding is attractive to younger generations raised online.<sup>81</sup> Additionally, this demographic also seems more likely to be interested in social enterprise.<sup>82</sup> Very early

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75. Matt Orsagh, *Dual-Class Shares: From Google to Alibaba, Is It a Troubling Trend for Investors?*, CFA INST. (Apr. 1, 2014), <https://blogs.cfainstitute.org/marketintegrity/2014/04/01/dual-class-shares-from-google-to-alibaba-is-it-a-troubling-trend-for-investors/> [https://perma.cc/44C4-JQ32].

76. Or at least it did—now it proclaims “do the right thing.” Alistair Barr, *Google’s “Don’t Be Evil” Becomes Alphabet’s “Do the Right Thing,”* WALL ST. J.: DIGITS (Oct. 2, 2015), <http://blogs.wsj.com/digits/2015/10/02/as-google-becomes-alphabet-dont-be-evil-vanishes/> [https://perma.cc/X4EU-LEE4].

77. See, e.g., Laura A Farley, *Knowledge Is Power: How Implementing Affirmative Disclosures Under the JOBS Act Could Promote and Protect Benefit Corporations and Their Investors*, 99 MINN. L. REV. 1507 (2015); Joan McLeod Heminway, *To Be or Not to Be (A Security): Funding For-Profit Social Enterprises*, 25 REGENT U. L. REV. 299 (2013); Christine Hurt, *Pricing Disintermediation: Crowdfunding and Online Auction IPOs*, 2015 U. ILL. L. REV. 217 .

78. Pub. L. No. 112-106, 126 Stat. 306, §§ 301–305 (2012).

79. *Regulation Crowdfunding: A Small Entity Compliance Guide for Issuers*, SEC (May 13, 2016), <https://www.sec.gov/info/smallbus/secg/rccomplianceguide-051316.htm> [https://perma.cc/M8C8-25NH].

80. Hurt, *supra* note 77, at 258–60.

81. *Id.*

82. *Id.*

evidence suggests there may indeed be a connection between equity crowdfunding and social enterprises. DrinkerBiddle collected data on the first fifty company filings under the new crowdfunding regulations. Seven of these filings were by benefit corporations, benefit LLCs, or B Lab certified companies. That is 14% of the filings—quite disproportionately high given the still tiny number of benefit corporations relative to all new businesses in the country.<sup>83</sup>

Thus, though there is not yet a true public exchange devoted to benefit corporations, or social enterprises more generally, there are a variety of institutions and individual companies that are providing early experiments in how an ecosystem for publicly traded benefit corporations might evolve. Disclosure is an important element across most of these experiments; although, standards are still in flux and emerging. There has not been a lot of focus on governance mechanisms at the exchange level, but individual companies are experimenting with at least one such mechanism: dual-class stock. Exchanges and companies seem to be focusing on attracting a new type of impact investor interested in a dual mission of profit and social good. However, not a lot has been done yet in finding ways to keep out investors who may focus too much on short-term profits at the expense of social mission. We explore these issues and mechanisms more in Part III.

### III. GOVERNANCE MECHANISMS

The challenges facing benefit corporations, and social enterprises generally, are different from those facing other companies but not radically new. The various corporate governance mechanisms used for traditional for-profits are also available to benefit corporations and starting to be used by them. We can see many of them at work in the early experiments discussed in Part II. Part III will be a discussion of the most significant types of corporate governance mechanisms, and how they are already being adapted to benefit corporations and potentially could be further adapted.

Disclosure is a central element in the experiments described above, which should come as no surprise. Disclosure is of course the central strategy of U.S. securities law and the leading way in which we regulate public companies.<sup>84</sup> Disclosure is also a central element in the new state

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83. Marc A. Leaf et al., *Leading the Crowd: An Analysis of the First 50 Crowdfunding Offerings*, DRINKER BIDDLE (July 14, 2016), <http://www.drinkerbiddle.com/insights/publications/2016/07/leading-the-crowd-first-50-crowdfunding-offerings?noredirect=true> [https://perma.cc/6BFL-Q852].

84. In the SEC's own words, "The laws and rules that govern the securities industry in the United States derive from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it,

laws creating benefit corporations. Those statutes have two main elements that distinguish benefit corporations from others. One is the new fiduciary duties (discussed next in our list of governance mechanisms).<sup>85</sup> The other is regular benefit reports, which benefit corporations must produce and give or make available to their shareholders.<sup>86</sup> Most of the statutes (though notably not Delaware) require that companies use an independent, third-party standard with which to measure themselves in these reports; although, they do not require using third-party *auditors* to certify the accuracy of their reporting.<sup>87</sup>

The exchanges discussed in Part II feature disclosure as their shared central regulatory strategy. They handle their disclosure requirements in differing ways. The SSX Social Impact Report rules set out a vague set of qualitative standards.<sup>88</sup> By contrast, SVX requires use of the detailed quantitative rules of the GIIRS rating system.<sup>89</sup> Third-party auditing is not required by SVX, but B Lab certification is encouraged insofar as a company can be listed with a lower rating if it is B Lab certified as opposed to self-reporting.<sup>90</sup> The IX reporting standards are not yet clear (at least not in public), but they do require use of an outside Authorized Impact Representative to ensure compliance.<sup>91</sup> MMX requires use of a third-party quantitative metric, such as GIIRS.<sup>92</sup>

Going forward, there are a variety of issues and options for benefit corporations and social enterprises. For example, do we need more uniformity in reporting by benefit corporations? Uniformity helps make comparisons across companies easier—a leading justification for securities regulation.<sup>93</sup> On the other hand, as the social missions of benefit corporations may vary wildly, information that matters to investors may vary correspondingly. Moreover, at this stage, social impact measures are still evolving, and companies and investors are still learning what

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and so long as they hold it. To achieve this, the SEC requires public companies to disclose meaningful financial and other information to the public.” *What We Do*, U.S. SEC. & EXCHANGE COMMISSION (June 10, 2013), <https://www.sec.gov/about/whatwedo.shtml> [<https://perma.cc/R6Y7-JFVU>].

85. MODEL BENEFIT CORP. LEGIS., subch. 3 (2016).

86. *Id.* subch. 4.

87. *Id.* § 401(a)(2).

88. *See* text accompanying *supra* note 34.

89. *SVX Issuer Manual*, *supra* note 43.

90. *Id.*

91. *Impact Exchange Board Listing Guide*, *supra* note 50; *see* text accompanying *supra* note 54.

92. *Frequently Asked Questions*, MISSION MARKETS, *supra* note 56; *see* text accompanying *supra* note 56.

93. Business and Financial Disclosure Required by Regulation S-K Release No. 33-10064, 18 SEC Docket 113, at 14 (Apr. 13, 2016). (disclosure requirements “can facilitate the coordination of registrants around consistent disclosure standards, increasing the efficiency with which investors can process the information.”), <https://www.sec.gov/rules/concept/2016/33-10064.pdf> [<https://perma.cc/W4BS-C8LU>].



information really matters, as well as how to collect, measure, and report that information.<sup>94</sup> Premature uniform regulation may cut short a valuable learning process. As will be discussed below,<sup>95</sup> one benefit of regulation through exchanges is that it allows some significant uniformity (across companies listed on a given exchange) while still allowing for diversity and learning across exchanges.

Beyond the content of disclosure, important questions remain concerning the process by which disclosure is created. Most importantly, should third-party auditing and certification be required? B Lab<sup>96</sup> is the main actor here so far, though there are others. As summarized above, some of the new exchanges require a third-party certifier, while others do not. Outside certifiers can obviously increase the reliability of the content in the disclosure. However, they increase compliance costs. Also, insofar as the issuers pay for certification, the problems that traditional ratings agencies have faced in recent years suggest challenges that could become an issue for social enterprise rating agencies should their ratings come to have significant value in public markets.<sup>97</sup> Thus, who watches the watchers is a serious question. This is another area where exchanges could play a useful role. Is there a need for new government regulation, either of individual benefit corporation reporting, of third-party certifiers, or of exchanges focused on social enterprises? At this stage, given how new and evolving the field is, new specific regulation seems premature. After all, public companies will be subject to traditional securities fraud rules. But should public social enterprises and possibly exchanges for them become much more widespread, the SEC will presumably want to study how those entities are handling disclosure.

In this era of online offerings and trading, one form of airing information that may deserve more exploration is social media. People today are quite used to using sites like Yelp and TripAdvisor to rate businesses. This could be a very useful way of airing information about the performance of public social enterprises. Of course, such online sites are also clear targets for securities fraud. This is another area where exchanges could play a role in creating and policing bulletin boards about

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94. See generally Alnoor Ebrahim & V. Kasturi Rangan, *What Impact? A Framework for Measuring the Scale and Scope of Social Performance*, 56 CAL. MGMT. REV. 118 (2014), [http://www.hbs.edu/faculty/Publication%20Files/CMR5603\\_07\\_Ebrahim\\_e3316477-8965-4287-be95-04642982b638.pdf](http://www.hbs.edu/faculty/Publication%20Files/CMR5603_07_Ebrahim_e3316477-8965-4287-be95-04642982b638.pdf) [<https://perma.cc/MGA4-S4JQ>].

95. Mahoney, *infra* note 134 and accompanying text.

96. B LAB, <https://www.bcorporation.net/> [<https://perma.cc/5BRQ-2M3P>].

97. See generally Aline Darbellay & Frank Partnoy, *Credit Rating Agencies Under the Dodd-Frank Act*, 30 BANKING & FIN. SERVICES POL'Y REP. 1 (Dec. 2011); Claire A. Hill, *Limits of Dodd-Frank Rating Agency Reform*, 15 CHAP. L. REV. 133 (2011).

listed companies (and if that happens, it is another area I am sure that the SEC will want to monitor).

Another traditional corporate governance mechanism is fiduciary duty.<sup>98</sup> The directors and officers of a corporation have a duty to make decisions that they reasonably believe are in the best interests of the corporation. Of course, what counts as the best interests of a corporation is a long-standing debate.<sup>99</sup> The central legal innovation of benefit corporations is the statutory formulation of fiduciary duties to explicitly require that directors and officers consider not just the financial interests of shareholders, but also the interests of a wide range of corporate stakeholders, typically including employees, creditors, customers, the community, and the environment.<sup>100</sup> However, many commentators fear that the statutes build in so many limits to potential lawsuits for violation of these duties that the new duties are basically toothless.<sup>101</sup> There is a tough balancing act—making the duties too strong and easily enforceable risks scaring off anyone from founding benefit corporations because any decision risks hurting some set of stakeholders.<sup>102</sup>

The early experiments in public exchanges discussed above do little or nothing to explicitly address fiduciary duty. As far as duties are concerned, legally publicly traded benefit corporations are no different from those that are closely held. However, there is a practical effect of going public that could be crucial: public companies have many more shareholders and thus, many more potential plaintiffs in a fiduciary duty lawsuit.<sup>103</sup> Moreover, public companies will generally lose control over whom owns their shares. If they underperform financially, they may find activist shareholders buying up shares in order to try to force the board to take actions that raise the share price.<sup>104</sup> These actions may be in conflict with a company's social mission. Thus, the expansion of the shareholder base that comes with going public may make the duty lawsuit a stronger accountability device but may also create more pressure to move away

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98. See generally Claire A. Hill & Brett H. McDonnell, *Fiduciary Duties: The Emerging Jurisprudence*, in RESEARCH HANDBOOK ON THE ECONOMICS OF CORPORATE LAW 133 (Claire A. Hill & Brett H. McDonnell eds., 2012).

99. See generally Ian B. Lee, *The Role of the Public Interest in Corporate Law*, in RESEARCH HANDBOOK ON THE ECONOMICS OF CORPORATE LAW 106 (Claire A. Hill & Brett H. McDonnell eds., 2012).

100. MODEL BENEFIT CORP. LEGIS., subch. 3 (2016).

101. McDonnell, *supra* note 4, at 62–65.

102. *Id.*, at 65–70.

103. Joan MacLeod Heminway, *Corporate Purpose and Litigation Risk in Publicly Held U.S. Benefit Corporations*, 40 SEATTLE U. L. REV. 611, 625–26 (2017). Note, however, that the model legislation limits standing to bring a suit to holders collectively of at least 2% of the outstanding shares. MODEL BENEFIT CORP. LEGIS. § 305(c)(2)(i) (2016).

104. Coffee & Palia, *supra* note 30, at 553.

from social mission. Counterbalancing this: under the benefit corporation duty rules, shareholders themselves may sue if they think the company has drifted away from its social mission.<sup>105</sup> Thus, directors and officers face possible lawsuits for overemphasizing either side of their dual mission, and with more shareholders, whose composition they may not be able to control, their exposure to such lawsuits may be a concern.

Rules and practices concerning board representation (or representation at other levels of decision-making) are another potential governance mechanism. For traditional public corporations, the move to requiring independent directors for various board committees and boards overall has been a leading governance development in recent decades.<sup>106</sup> The Model Benefit Corporation Act provides for the possibility of appointing benefit directors, who would be responsible for specifically focusing on how a company is pursuing and achieving its social mission.<sup>107</sup> The exchanges discussed in Part II do not appear to have focused much on this type of mechanism. One exception to that statement is the IX requirement that listed companies must commit to “ongoing monitoring and evaluation of impact performance using clearly defined impact indicators for performance assessment and reporting.”<sup>108</sup>

More could be done with board representation. One could have constituency directors actually elected by the members of stakeholder groups other than shareholders. In some countries, most notably Germany, co-determination via employee representatives on boards is an important instance of that strategy.<sup>109</sup> Germany also illustrates another possible mechanism: a two-tier board structure.<sup>110</sup> The management board is composed of insiders, but the supervisory boards of public companies are composed of representatives elected by shareholders and employees. The supervisory board structure, focused on monitoring and setting broad

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105. The model benefit corporation statutes appear to forestall damages for violations of the duty to consider nonshareholder interests, limiting the pressure of potential suits from that direction. However, I have argued elsewhere that those appearances may be deceiving—it is far from clear to me that the model statute forecloses damages where a plaintiff successfully argues that managers have failed to *consider* other stakeholder interests. See McDonnell, *supra* note 4, at 41–42.

106. See generally Lisa M. Fairfax, *The Elusive Quest for Director Independence*, in RESEARCH HANDBOOK ON THE ECONOMICS OF CORPORATE LAW 170 (Claire A. Hill & Brett H. McDonnell eds., 2012).

107. MODEL BENEFIT CORP. LEGIS. § 302 (2016).

108. *Impact Exchange Board Listing Guide*, *supra* note 50, at 10.

109. Brett H. McDonnell, *Employee Primacy, or Economics Meets Civic Republicanism at Work*, 13 STAN J.L. BUS. & FIN. 334, 379–80 (2008).

110. See generally Klaus J. Hopt, *The German Law of and Experience with the Supervisory Board* (Eur. Corp. Governance Inst., Working Paper No. 305, 2016), [http://papers.ssrn.com/sol3/Papers.cfm?abstract\\_id=2722702](http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2722702).

strategy rather than more detailed decision-making, may be an appropriate place to focus on representing the interests of various stakeholders.<sup>111</sup>

Below the full board level, stakeholders could be represented on committees of various kinds. These could be board or sub-board level committees.<sup>112</sup> The committees could focus on various topics, with different stakeholder groups represented on different committees depending upon the nature of their interests. Committees could be merely advisory or could have more significant decision-making authority. There are many variants possible, depending upon which stakeholder interests one would like to see represented, and who might have the authority to appoint representatives of those interests. To date, exploration of representative strategies to advance stakeholder interests has been an underexplored mechanism in the social enterprise movement.

These representation mechanisms focus on ways in which nonshareholder constituencies might be given an indirect voice in decision-making. Another set of mechanisms concerns voting by shareholders, for which the standard is one share/one vote.<sup>113</sup> NYSE and Nasdaq rules<sup>114</sup> limit the ability of listed companies to deviate from one share/one vote after they have gone public, but allow deviations from this rule at the time of going public.<sup>115</sup> The main example of such a deviation is dual-class shares. With dual-class shares, one class of shares has more voting power than another class. Depending upon the numbers, this can allow a small group of shareholders to retain voting control over the board even though others hold a majority of the financial interest in the company. As noted above, Laureate Education, looking to become the first publicly traded benefit corporation, has dual-class shares. Leading media and high tech companies also use this structure.

As noted above,<sup>116</sup> dual-class shares are highly controversial. The conventional wisdom among corporate law scholars and economists is that the structure creates rotten incentives.<sup>117</sup> Those with control of the company do not have a corresponding financial stake in the company, and may thus be tempted to make decisions that help them while hurting the share value. On the other hand, dual-class shares may be a way of

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111. COLIN MAYER, *FIRM COMMITMENT: WHY THE CORPORATION IS FAILING US AND HOW TO RESTORE TRUST IN IT* 267–68 (2013).

112. McDonnell, *supra* note 109, at 380–81.

113. *See* text accompanying *supra* note 63.

114. NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 313.00 (2013), <http://nysemanual.nyse.com>; NASDAQ STOCK MARKET RULES, R. 5640 (2006), <http://nasdaq.cchwallstreet.com/NASDAQ/>.

115. *See id.*

116. *Supra* note 63 and accompanying text.

117. Christopher C. McKinnon, *Dual-Class Capital Structures: A Legal, Theoretical, & Empirical Buy-Side Analysis*, 5 MICH. BUS. & ENTREPRENEURIAL L. REV. 81, 87–88 (2016).

protecting against the pressures of mission drift that can come with public share ownership. If one seeks financial investment by public shareholders but fears that those shareholders, or their successor purchasers, will seek high share values at the expense of social mission, dual-class shares are a way of bringing those shareholders on board while limiting their influence. These competing effects illustrate the competing considerations facing publicly traded social enterprises.

Other shareholder voting mechanisms are also possible. One mechanism that has received some attention is time-phased or tenure voting.<sup>118</sup> With this system, shareholders receive more per-share voting rights the longer they hold their shares. This is meant to reduce the pressures to overemphasize short-term profits. A short-term focus may hurt nonshareholder constituents insofar as keeping groups such as employees and customers happy may result in better long-term performance. It is debated whether short-termism is really a problem in current American public companies, but I have argued elsewhere that it could well be.<sup>119</sup> There is limited experience to date with tenure voting and the empirical evidence surrounding it is uncertain (as empirical evidence so often is). However, the theoretical and empirical arguments in favor of tenure voting are real enough that they at least suggest that further experimentation should be allowed.<sup>120</sup>

A related but different proposal comes from Colin Mayer.<sup>121</sup> Under his proposal, shareholders would register their shares for a set period of years. The voting power of the shares would decrease with the time remaining for their registration. Unlike tenure voting, instead of rewarding past long-term holding, this system would directly tie voting power to the length of time the shareholders are committed to ownership.

Another possible shareholder-focused mechanism is shareholder screening. In closely held companies, the founders and early investors are generally able to control who the shareholders are: by careful selection of initial investors, by the lack of a market for shares, and by contractual mechanisms such as rights of first refusal. Going public generally entails the loss of that control. Might there yet be ways to screen out investors with inappropriate goals, especially those with an inadequate commitment to a company's social mission? Dadush emphasizes this question, and is generally critical of the exchanges she examines for their lack of any such

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118. See generally Lynne L. Dallas & Jordan M. Barry, *Long-Term Shareholders and Time-Phased Voting*, 40 DEL. J. CORP. L. 541 (2016).

119. See generally Hill & McDonnell, *supra* note 31.

120. Dallas & Barry, *supra* note 118, at 645–46.

121. MAYER, *supra* note 111, at 264–67.

screening device.<sup>122</sup> She approvingly points to the SVX for its clear warnings to investors that listed companies may have lower financial returns than more traditional businesses.<sup>123</sup> Might there be other ways of screening beyond warnings and clear disclosure of the dual mission nature of benefit corporations? For more quasi-public type markets, exchanges or portals may retain some control over who is allowed to trade on the exchange. Investors who demonstrate a lack of commitment to the goals of the exchange could be excluded, as suggested in the rules of the SVX.<sup>124</sup> However, how one would determine when such a remedy is appropriate seems rather murky.

A final type of governance device relies on gatekeepers.<sup>125</sup> Corporate gatekeepers are outside professionals who help monitor the behavior of corporate managers and certify to investors and others that their behavior is appropriate. Gatekeepers include ratings agencies, auditors, insurers, lawyers, investment banks, and stock exchanges, among others. For traditional for-profit companies, the governance role of gatekeepers has received increased attention in recent years.<sup>126</sup> As with all governance mechanisms considered here, the gatekeeping role can be adapted to the needs of social enterprises, and that adaptation is already happening.

B Lab is the most obvious and important gatekeeper in the benefit corporation field so far.<sup>127</sup> B Lab plays a central role in both creating disclosure standards and also in certifying how well specific companies satisfy those standards. Several of the new exchanges rely upon disclosure rules generated by others, like the GIIRS.<sup>128</sup> Crucial to the success of benefit corporations is convincing interested investors, as well as employees and customers, that the companies are credibly committed to their dual missions.<sup>129</sup> Certifiers like B Lab help create credibility, although as noted above, the issuer pays model could threaten that credibility, as has happened with the ratings agencies' scandals of recent years.

Corporate lawyers are another potential set of gatekeepers. Law firms may play a leading role in helping bring more reputable companies public, and investors could look to the involvement of such companies for

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122. Dadush, *supra* note 34, at 222–26.

123. *Id.* at 223.

124. *Id.* at 206.

125. *See generally* JOHN C. COFFEE JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE (2006).

126. *See id.*

127. *See* Brett McDonnell, *Benefit Corporations and Strategic Action Fields or (The Existential Failing of Delaware)*, 39 SEATTLE U. L. REV. 263, 281 (2016).

128. *See supra* notes 43 and 57 and accompanying text.

129. Joseph W. Yockey, *Does Social Enterprise Law Matter?*, 66 ALA. L. REV. 767, 799–800 (2015).

assurance.<sup>130</sup> Such firms also play a major role in guiding companies and in spreading best practices concerning good corporate governance. Might law firms arise specializing in benefit corporations? If so, they could play a significant role in helping encourage more such companies and more widespread investment in them.<sup>131</sup>

Another related set of corporate gatekeepers consists of investment banks, broker-dealers, and the sponsors of investment funds. These securities firms are financial intermediaries that gather information about potential prospects for investment and then help inform would-be investors about attractive target investments. Some securities firms now offer funds or other products that focus on social enterprises. The Impact Bonds mentioned above that are sold on IX are an example.<sup>132</sup> MX also offers managed funds.<sup>133</sup> There are plenty of other examples.

Finally, stock exchanges are themselves important gatekeepers, as are similar institutions, such as portals for crowdfunding. Because these are the main focus of this Article, Part IV looks more closely at the role that they can play in light of the existing experiments discussed in Part II and the various governance mechanisms discussed in this Part III.

#### IV. THE ROLES OF EXCHANGES

As we explore what sorts of practices and institutions may help publicly traded benefit corporations thrive, exchanges present a useful intermediate level of institution. As compared with legal regulatory reforms, certainly at the level of federal securities law and to a lesser extent also at the level of state business association law, exchanges provide an opportunity for experimentation and diversity. Experimentation is important because it is still early in the development of social enterprises, and we do not have a good sense as to what sorts of governance practices are likely to work. As to diversity, the concept of “social enterprise” covers a wide range of types of enterprises. Practices that work well for some businesses within that range may not work as well for others. If a range of exchanges or similar market places for public social enterprises develops, different exchanges can provide an infrastructure for different kinds of enterprises.<sup>134</sup>

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130. Richard W. Painter, *Transactions Cost Engineers, Loophole Engineers, or Gatekeepers: The Role of Business Lawyers After the Financial Meltdown*, in RESEARCH HANDBOOK ON THE ECONOMICS OF CORPORATE LAW 255, 263–70 (Claire A. Hill & Brett H. McDonnell eds., 2012).

131. McDonnell, *supra* note 127, at 286.

132. See *supra* note 49.

133. See *Frequently Asked Questions*, *supra* note 56.

134. For extended arguments in favor of stock exchanges as primary regulators, see generally Paul G. Mahoney, *The Exchange as Regulator*, 83 VA. L. REV. 1453 (1997).

Much experimentation can, and will, of course, occur at the level of individual businesses. However, to succeed, especially at the level of larger, publicly traded entities, businesses must attract and retain investors, creditors, employees, customers, and other stakeholders. They need to coordinate the expectations of those various groups, credibly conveying information about how they are pursuing their dual missions while developing practices and routines for effectively balancing sometimes competing aims.<sup>135</sup> Gatekeepers of the sort discussed at the end of Part III<sup>136</sup> may help in this emerging coordination of expectations, and exchanges could be an effective locus for some of this coordination. Let us consider how that might develop for the various governance mechanisms discussed in Part III.

Disclosure will be a major concern of exchanges focused on benefit corporations, or social enterprises more broadly. Although disclosure by public companies is now heavily regulated under federal securities law, much of the early development of that disclosure occurred within the exchanges.<sup>137</sup> Publicly traded benefit corporations will, of course, be subject to the securities rules that govern all public companies, but for the specific concerns of disclosure related to social enterprise status, regulation through exchanges, rather than through the law, presently appears more attractive. As noted above, exchanges face a variety of questions about disclosure. How detailed and quantitative should they require disclosure to be, and should they require certification by outside companies like B Lab? If exchanges do choose to require specific and quantitative disclosure, should they write their own rules or require compliance with standards devised by other organizations, and if the latter, should they settle on one set of standards or allow listed companies to choose from a range of options? There are some tough tradeoffs and those tradeoffs may change over time. For instance, prematurely settling on just one detailed standard may cut off useful experimentation and learning. On the other hand, as we come to get a better sense of what disclosure is useful, early diversity may be pared down as investors look for more uniform disclosure so that they can more easily compare companies.

Looking at other governance mechanisms, exchanges seem unlikely to play much of a role in the development of fiduciary duty rules. However, they could play a significant role in shaping rules surrounding board representation and shareholder voting. After all, traditional exchanges have played a major role in shaping such rules for traditional

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135. Yockey, *supra* note 129.

136. *Supra* notes 125–133 and accompanying text.

137. Mahoney, *supra* note 134, at 1466–69.



companies.<sup>138</sup> Should exchanges for social enterprise require or encourage some form of representation or voting by nonshareholder constituencies? Should they allow, or even encourage, deviations from the one share/one vote rule for shareholders? Online bulletin boards for investors are one mechanism that exchanges (and similar institutions, such as portals for crowdfunding and other sorts of online investing) may be particularly well-placed to foster and regulate. As noted above, younger investors in particular are quite familiar with these sorts of online sites in other contexts, and they could prove a highly valuable governance device for publicly traded enterprises. They could also prove a locus for securities fraud. Striking a balance between allowing such sites to achieve their potential for good while limiting their potential for harm will be challenging. Exchanges and similar institutions should get a first shot at attempting such regulation, although the SEC is unlikely to allow them to do so without oversight.

Finally, exchanges may serve as a locus for coordinating the involvement of the other gatekeepers discussed above. The exchanges, in creating and modifying their corporate governance listing rules, will both draw upon and help shape practices developed by other gatekeepers. We have just discussed how this can work in setting disclosure rules and Part II discussed how new exchanges have drawn upon the rules of standard setters like GIIRS and B Lab.<sup>139</sup>

Lawyers will play a major role in advising and drafting rules for representation and voting, as well as disclosure, and will also play a role in helping choose and manage relationships with exchanges. Thus, if one or a few exchanges come to play a major role in listing publicly traded benefit corporations (or other kinds of social enterprises), corporate lawyers working with such companies will both pay attention to and help disseminate the rules and practices of those exchanges, while also helping to shape them.

Investment banks, broker-dealers, and the promoters of social enterprise stock and bond funds are other potentially significant gatekeepers as discussed above. These securities firms and professionals will frequently work with and through exchanges if they are available and well-used. Some of the new social enterprise exchanges are already creating space for stock and bond funds.<sup>140</sup> Indeed, even some traditional exchanges are working to create spaces for socially responsible companies, e.g., with sustainability indices.

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138. Fairfax, *supra* note 106, at 138.

139. *Supra* notes 43 and 56 and accompanying text.

140. *Supra* notes 49 and 56 and accompanying text.

## CONCLUSION

Social enterprise is a new concept, and benefit corporations are an even newer attempt to provide a legal instrument for carrying out social enterprises. So far, there are not many benefit corporations and almost all of them are small, closely held businesses. This particular social experiment may never go much further than this. However, the concept of benefit corporations may become widely adopted. If so, we may face a time when a number of benefit corporations are or want to become publicly traded.

Publicly traded benefit corporations will face some unique corporate governance questions, related to but distinct from the questions that face both closely held benefit corporations and publicly traded traditional corporations. Addressing those questions will require new variations on corporate governance mechanisms. Many new practices will need to be developed, requiring the input of many different kinds of institutions.

Stock exchanges, or similar trading platforms for widely held corporations, could play a significant role in these developments. Some experiments have already begun that begin to suggest what such exchanges might look like. We surveyed some of those developments in Part II. Part III looked more closely at some of the main categories of corporate governance mechanisms: disclosure, duty, representation, voting, and gatekeepers. Would-be promoters of future exchanges aimed at benefit corporations would do well to consider the kind of roles and supporting guidance such exchanges might provide to help shape those governance mechanisms.