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Making Corporate Social Responsibility Pay

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Abstract

The world is clamoring for corporations to serve society. With the recognition that adequate externality regulation is unlikely to be forthcoming, legal scholars, politicians, major shareholders, and corporate stakeholders have joined in urging companies to practice corporate citizenship. In this Article, I show why much of this advocacy is unlikely to alter corporate decisionmaking to the desired extent. In particular, proponents of corporate social responsibility ask fiduciaries to operate against a deeply-ingrained incentive structure that pushes them to maximize shareholder wealth as a first priority.

Therefore, this Article proposes a way forward that works within the wealth-maximization framework, but could, under certain circumstances, encourage corporations to prioritize stakeholder goals. More specifically, individuals could use “corporate social responsibility bonds” to offset costs associated with prosocial corporate decision-making. The intuition is as follows: if it is welfare-maximizing for individuals to see corporations make public-interested choices, there should be a possible Coasian bargain between those individuals and the corporation. In such situations, an issuer could create a bond to raise funds to support a predetermined public-interested corporate decision. Any investor for whom the choice is welfare-maximizing could support the bond; their loan would be forgiven if the decision was made, and if it is not, the investor would get their money back plus interest.

More broadly, this Article’s motivating insight—the individuals with the strongest interest in seeing corporations pursue corporate social responsibility goals are not always the shareholders—has consequences for corporate law and corporate governance. In particular, it cautions that we should recognize the limits of corporate law and shareholder activism to achieve socially optimal levels of corporate responsibility. The more difficult question is whether and how to reorient our corporate law system away from shareholders and toward other constituencies. As that project forges on, this Article proposes action that could allow corporate outsiders to influence corporate behavior without any delay—one decision at a time.

¹ Thanks to [].

I.	Introduction.....	1
II.	Why Companies Won't Make Public Interested Decisions	9
	A. Takeover Markets.....	11
	B. Shareholder Activism.....	12
	C. Executive Compensation.....	14
III.	Corporate Social Responsibility Bonds.....	15
	A. The Possibilities.....	18
	i. Bonds to Alter an Existing Project.....	18
	ii. Bonds to Avoid a Harmful Project.....	19
	iii. Bonds to Encourage a Beneficial Project.....	21
	B. Nuts and Bolts.....	22
	i. Initiating the Process.....	22
	ii. The Offering Document.....	24
	iii. Purchasers.....	26
	iv. Enforcement.....	29
	C. Analogues.....	30
	i. Impact Bonds.....	30
	ii. Green Bonds.....	31
	iii. Carbon Offsets.....	33
	iv. Legal Analogues.....	35
	D. Unintended Consequences.....	37
	E. Alternatives.....	39
IV.	Broader Implications.....	41
V.	Conclusion.....	44

I. Introduction

The world is clamoring for corporations to serve society. This advocacy is well-directed: some U.S. corporations are as powerful as small countries,² and constraints on their behavior are eroding.³ Not only that, the past few decades have shown how the pursuit of profit can harm society: the financial crisis that brought down the global economy;⁴ the Deepwater Horizon oil spill that polluted 1,100 miles of shoreline,⁵ the social media companies that enabled Russian hackers to meddle in the 2016 presidential election;⁶ the layoffs, wage cuts, and offshoring that have exacerbated economic inequality,⁷ etc.

But herein lies the paradox: Corporations are the source of many problems, but they are also expected to solve them. For example, a popular solution among legal academics is to reconceptualize the purpose of the corporation. These academics contend that it is no longer normatively desirable nor descriptively accurate to say that the law requires corporate fiduciaries to maximize shareholder wealth.⁸ Instead, corporations should adopt a “stakeholder model” and consider how their activities affect employees, consumers, the environment, and the communities that they operate in.⁹

² See, e.g., SARAH ANDERSON & JOHN CAVANAGH, INST. FOR POLICY STUDIES, TOP 200 (2000); Paragh Khanna top 25 by David Francis, These 25 Companies Are More Powerful Than Many Countries, FP, <https://foreignpolicy.com/2016/03/15/these-25-companies-are-more-powerful-than-many-countries-multinational-corporate-wealth-power/> (last visited Oct. 20, 2019).

³ Samantha Gross, The Danger in Deregulation, BROOKINGS: PLANETPOLICY (Jan. 9, 2018), <https://www.brookings.edu/blog/planetpolicy/2018/01/09/the-danger-in-deregulation/>; Mark Lebovitch & Jacob Spaid, Bernstein Litowitz Berger & Grossman LLP, In Corporations We Trust: Ongoing Deregulation and Government Protections, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Feb. 6, 2019), <https://corpgov.law.harvard.edu/2019/02/06/in-corporations-we-trust-ongoing-deregulation-and-government-protections/>.

⁴ William W. Bratton & Michael L. Wachter, The Case Against Shareholder Empowerment, 158 U. PA. L. REV. 653 (2010).

⁵ Cleanup Efforts, ENCYCLOPÆDIA BRITANNICA, <https://www.britannica.com/event/Deepwater-Horizon-oil-spill/Cleanup-efforts> (last visited Oct. 20, 2019).

⁶ Peter Overby, Facebook Acknowledges Russian Ads in 2016 Election. Will Investigations Follow?, npr: NPRPolitics (Sept. 8, 2017), <https://www.npr.org/2017/09/08/549284183/facebook-acknowledges-russian-ads-in-2016-election-will-investigations-follow>.

⁷ THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY (Arthur Goldhammer trans., President and Fellows of Harvard College 2014) (2013).

⁸ See, e.g., LYNN STOUT, THE SHAREHOLDER VALUE MYTH (2012); Margaret M. Blair & Lynn A. Stout, A Team Production Theory of Corporate Law, 85 VA. L. REV. 247, 308 (1999); Einer Elhauge, Sacrificing Corporate Profits in the Public Interest, 80 N.Y.U. L. REV. 733, 763–69 (2005) (arguing that corporate managers have the discretion to sacrifice corporate profits in favor of the public interest under Delaware law); Lyman Johnson, Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose, 38 DEL. J. CORP. L. 405, 432 (2013) (arguing that Delaware law is unsettled on the question of whether corporations are required to advance the long-term interests of stockholders); Lynn A. Stout, Why We Should Stop Teaching *Dodge v. Ford*, 3 VA. L. & BUS. REV. 163 (2008). This advocacy is not limited to legal academics. See, e.g., Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247 (2017).

⁹ Id.

There are signs indicating that this advocacy is beginning to have some traction. For example, in August 2018, Elizabeth Warren introduced the Accountable Capitalism Act, federal legislation that would make clear that corporate fiduciaries have a duty to consider not just shareholder interests, but also the interests of employees, customers, the community, and the environment.¹⁰ Around that same time, Larry Fink, the CEO of BlackRock, one of the largest and most influential institutional shareholders in the world, issued the first of two letters urging CEOs to serve society.¹¹ BlackRock, along with peer institutional investors Vanguard and State Street, has since committed to engaging with companies until they articulate a corporate purpose that benefits the public.¹² In addition, in August 2019, the Business Roundtable announced a new statement on the purpose of the corporation that affirmed that companies should be managed for the benefit of all stakeholders—including customers, employees, suppliers, communities and shareholders.¹³ One hundred and eighty-one CEOs signed the statement.¹⁴

But cynical observers will hesitate before congratulating the legal scholars who have pushed companies to articulate a broader corporate objective. Presumably, the reason for their advocacy was not to provide CEOs with an additional marketing tool; it was to change corporate decisionmaking for the better. And there is very little evidence that the latter phenomenon has occurred. As just one example, days after announcing that Amazon CEO Jeff Bezos had signed the Business Roundtable letter, Whole Foods, a subsidiary of Amazon, announced that it would end medical and health benefits for part time workers.¹⁵

¹⁰ S. 3348, 115th Congress (2018). The former Chief Justice of the Delaware Supreme Court, Leo Strine, Jr., has proposed to require major companies to “have board-level committees charged with ensuring fair treatment of employees” and also using “European-style works’ councils to increase employee voice.” See Leo Strine, Jr., *Toward Fair and Sustainable Capitalism: A Comprehensive Proposal to Help American Workers, Restore Fair Gainsharing between Employees and Shareholders, and Increase American Competitiveness by Reorienting Our Corporate Governance System Toward Sustainable Long-Term Growth and Encouraging Investments in America’s Future*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3461924.

¹¹ Larry Fink, *Larry Fink’s Annual Letter to CEOs A Sense of Purpose*, BLACKROCK [hereinafter Fink, *A Sense of Purpose*] <https://www.blackrock.com/hk/en/insights/larry-fink-ceo-letter> (last visited Oct. 20, 2019); Larry Fink, *Larry Fink’s 2019 Letter to CEOs Purpose & Profit*, BLACKROCK [hereinafter Fink, *Purpose & Profit*], <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter> (last visited Oct. 20, 2019).

¹² Andrew Edgecliffe-Johnson, *Companies under pressure to declare social purpose*, *Financial Times* (Aug. 22, 2019), <https://www.ft.com/content/7ba44ea8-c4f7-11e9-a8e9-296ca66511c9>

¹³ Business Roundtable *Redefines the Purpose of a Corporation To Promote “An Economy That Serves All Americans,”* BUSINESS ROUNDTABLE (Aug. 19, 2019), <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans>.

¹⁴ *Id.* The World Economic Forum has also embraced stakeholder governance. See *Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution* (Dec. 2, 2019), <https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/>.

¹⁵ Bob Bryan, *Amazon-Owned Whole Foods’ Decision To Drop Health Benefits for Hundreds of Part-Time Workers Reveals How Promises to Workers Like CEO Jeff Bezos’ Recent Pledge are Worthless*, *Business Insider* (Sept. 14, 2019, 1:08 AM), <https://www.businessinsider.com/whole-foods-healthcare-amazon-ceo-jeff-bezos-promises-business-roundtable-2019-9>; *see also* Jesse Fried, *Shareholders Always Come First and That’s a Good Thing*, *Financial Times* (Oct. 7, 2009),

<https://www.ft.com/content/fff170a0-e5e0-11e9-b8e0-026e07cbe5b4> (“In reality, the Business Roundtable is merely paying lip service to broader social concerns. I predict that the pledge will not actually affect how they run their companies.”); Aneesh Raghunandan and Shiva Rajgopal, *Is There Real Virtue Behind the Business Roundtable’s Signaling?*, *Wall St. J.* (Dec. 2, 2019) (collecting data showing that the signatories of the Business Roundtable letter were sixteen times more likely to commit at least one federal compliance violation, including labor

Should we be surprised? Of course not: it is naïve to expect corporations to do anything other than maximize profits when corporate law’s incentive structure rewards corporate fiduciaries who maximize shareholder wealth.¹⁶ More concretely, corporate law provides shareholders and only shareholders with control rights, which means that fiduciaries are vulnerable to pressure from takeover markets and hedge fund activists when they sacrifice profits to benefit the public.¹⁷ Moreover, most executives have their pay and reputation tied to the company’s stock price, rendering fiduciaries particularly sensitive to shareholder interests.¹⁸

Put somewhat differently, this wave of stakeholder advocacy does little to change the practical operation of corporate decisionmaking. Corporate fiduciaries already have incentives to engage in prosocial activities when they also maximize profit—and a large and growing literature documents the many ways that corporate social responsibility is wealth maximizing.¹⁹ The difficult question, however, is how to encourage corporations to make public interested choices that are *bad* for business, or at least, not clearly good. And this article explains why corporate fiduciaries are unlikely to voluntarily engage in public interested profit sacrificing very often, regardless of the breadth of their legal discretion: doing so will subject them to shareholder pressure, as well as financial and reputational considerations.²⁰

With that in mind, this Article considers possibilities aimed at encouraging public-interested corporate decisionmaking, which I define to be decisionmaking that shifts profits from shareholders to employees, consumers, the environment, or the broader community. In considering how companies might be encouraged to make public-interested choices, I focus on actions that

and environmental violations, in any given year than peer nonsignatory firms and concluding that the goal of the letter was to preempt regulatory criticism).

¹⁶ See D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 277 (1998) (“The structure of corporate law ensures that corporations generally operate in the interests of shareholders. Shareholders exercise control over corporations by electing directors”); Leo E. Strine, Jr., *Corporate Power Is Corporate Purpose II: An Encouragement for Future Consideration from Professors Johnson and Millon*, 74 Wash. & Lee L. Rev. 1 (2017); Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, Wake Forest L. Rev. [hereinafter Strine, *The Dangers of Denial*], <https://www.ssrn.com/abstract=2576389> (describing the DGCL’s power structure, which provides rights to shareholders and shareholders only); Leo Strine, Jr., *Corporate Power is Corporate Purpose I*, https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=2724&context=faculty_scholarship

¹⁷ *Id.*; see also *infra* section XX.

¹⁸ See *infra* section XX.

¹⁹ Corporate social responsibility may reduce a company’s cost of capital, see Sudheer Chava, *Environmental Externalities and Cost of Capital*, 60 MGMT. SCI. 2223 (2014); may have a positive impact on a company’s revenue by reducing litigation, sanctions, and boycott risk, and increasing government support ((Thompson and Cowton (2004), Anderson and Sullivan (1993) and Kassinis and Vafeas (2002)); environmental responsibility is associated with a lower cost of debt (Bauer and Hann (2010)). See also Robert G. Eccles et al., *The Impact of Corporate Sustainability on Organizational Processes and Performance*, 60 MGMT. SCI. 2835, 2836 (2014) (describing study finding that companies which voluntarily adopted sustainability policies by 1993 outperformed their counterparts over the long term); Michael E. Porter & Mark R. Kramer, *The Competitive Advantage of Corporate Philanthropy*, HARV. BUS. REV., Dec. 2002, at 1 (arguing that “social and economic goals are not inherently conflicting but integrally connected”); <https://www.institutionalinvestor.com/article/b1hm5ghqtxj9s7/Where-ESG-Fails#.XajIH2RniVc.twitter>.

²⁰ Of course, this is not a novel observation—for many years, people have observed that regulation or taxation is necessary to induce individuals and companies to internalize externalities created by their conduct. See, e.g., William J. Baumol, *On Taxation and the Control of Externalities*, 62 Am. Econ. Rev. 30, 307 (1972).

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corporate stakeholders can take in the absence of regulation. Optimal externality regulation is a first-best solution, but it is unlikely to manifest²¹; therefore, I consider actions stakeholders could take on their own.

Several private ordering solutions are possible,²² but I primarily focus on the use of financial instruments that would create incentives for corporations to act in the public interest. In other words, in the absence of sanctions for bad behavior, private parties could offer inducements for good behavior. Indeed, the past few years have seen ample innovation in this space: investors can now invest in green bonds or impact bonds, for example. However, these instruments simply make money available for profit-maximizing projects that align with investors' prosocial goals; they do not encourage corporations to make profit *sacrificing* decisions.²³

But whenever individuals value a particular course of action more than the costs, it is possible for them to bargain and arrive at the efficient outcome.²⁴ In this vein, this paper considers a "corporate social responsibility bond," a tool that does not exist but that has analogues in law and in finance. This instrument would be a hybrid between a bond and charitable donation, and would essentially support a Coasian bargain between companies and the individuals who desire public interested corporate decisions.²⁵

²¹ Optimal externality regulation is unlikely to be forthcoming for several reasons. For one, gridlock in Washington continues to slow the passage of new laws, and has even sidelined regulation with strong popular support. See Tim Wu, *The Oppression of the Supermajority*, N.Y. TIMES: OPINION (Mar. 5 2019), <https://www.nytimes.com/2019/03/05/opinion/oppression-majority.html>. And even if Congress did manage to pass externality regulation, it would likely be the product of a compromise and subject to interest group dynamics. See Henry N. Butler & Jonathan R. Macey, *Externalities and the Matching Principle: The Case for Reallocating Environmental Regulatory Authority*, 14 YALE L. & POL'Y REV. 23 (1996); See Leo E. Strine, Jr. & Nicholas Walter, *Conservative Collision Course?: The Tension Between Conservative Corporate Law Theory and Citizens United*, 100 CORNELL L. REV. 335, 3342 (2015) (arguing that the Citizens United decision "undermines conservative corporate theory's reliance upon the regulatory process as an adequate safeguard against corporate overreading for non-stockholder constituencies and society generally"); but see Stephen Bainbridge, *Corporate Purpose in a Populist Era* (positing that "resurgent right-wing populism may provide an alternative constraint on corporate political power"). Indeed, corporations are very willing to spend millions of dollars—either on lobbyists, or on direct candidate contributions—to thwart costly legislation. See Tim Wu, *The Goals of the Corporation and the Limits of the Law*, COLUM. L. SCH.: CLS BLUE SKY BLOG (Sept. 3, 2019), <http://clsbluesky.law.columbia.edu/2019/09/03/the-goals-of-the-corporation-and-the-limits-of-the-law/>. This is one reason why advocates of corporate social responsibility have been urging a private sector response. See, e.g., MICHAEL P. VANDENBERGH & JONATHAN M. GILLIGAN, *BEYOND POLITICS* (2017) ("A focus on actions by the private sector is particularly important because climate policy is deeply polarized along liberal and conservative lines, but private sector responses, which we call private climate governance, can bypass "solution aversion" — the resistance to climate change that arises from concerns about a big government response."). Others are more optimistic about the prospect of beneficial regulation. See, e.g., Leo E. Strine, Jr., *Toward Fair and Sustainable Capitalism* (Harvard John M. Olin Ctr. for Law, Econ., and Bus., Discussion Paper No. 1018, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3461924.

²² In Section XX, I discuss changes to corporate governance that could provide management room to sacrifice profits in the public interest.

²³ See supra notes XX and accompanying text.

²⁴ See Ronald Coase, *The Problem of Social Cost*, 3 JOURNAL OF LAW AND ECONOMICS (1960). However, if transaction costs are high, or there is imperfect competition or information, we might not get an efficient allocation of resources. Id.

²⁵ Id. In Section XX, I explore other options that would encourage public-interested decisionmaking, such as offering funding at a lower interest rate.

The concept is as follows: an issuer (likely a non-profit, to increase the likelihood that the investment would be tax deductible²⁶) would create the bond to raise funds that would support a predetermined public interested corporate decision. Any person who valued the choice could contribute. The nonprofit would then work with the corporation to implement the decision; the accumulated funds would offset the cost of the decision if it is successfully made, allowing the company to internalize the Coasian bargain. Any “investor” for whom the choice is welfare-maximizing could contribute; their investment-donation would be forgiven if the decision was made, and if the company fails to take action, the investor would get their money back plus interest.²⁷

Consider the following stylized example of how a corporate social responsibility bond could be used, which illustrates some of the benefits (as well as the drawbacks, which will be discussed in a moment). Suppose a coal-fired power company is facing pressure from environmental advocacy groups to install scrubbers that would reduce air pollution, increasing the life expectancy of employees, as well as people who live near the company’s factories.²⁸ But installing scrubbers would cause the company to incur \$150 million in costs.²⁹ As a result, the electricity company is unlikely to install the scrubbers without regulation, which, as a result of industry lobbying, is not expected to arise. Of course, pressure from environmental advocates, consumers, employees or even shareholders might lead negative reputational repercussions for the company that fails to install scrubbers, but unless those reputational harms exceed the costs from implementation, the choice will not be made. And this reality holds regardless of the company’s legal objective—even if the company’s CEO is permitted to consider the environment or other groups, that leeway will not result in a voluntary decision to sacrifice \$150 million, which will subject her to negative reputational and financial repercussions, as well as a threat of ouster.

The calculus for the company changes, however, if it has the opportunity to work with a non-profit issuer and receive funds to alleviate some of the costs from implementation. Potential donors include individuals for which the choice would be welfare-maximizing; the most likely source of assets, however, would be a foundation, family office, or endowment seeking an opportunity to

²⁶ It is unlikely that a 501(c)(3) could issue the bond and enable the purchaser to claim a charitable contribution if the investor gets the money back. If a person retains a reversionary interest, they cannot claim a charitable contribution deduction. However, the donor might be able to preserve charitable contribution deductibility by having the money roll over to the charity if the bond fails. And if the company did make the decision, the investor could claim a capital loss. See, e.g., Stefan Gottschalk & Sharif Ford, *IRS Addresses Timing of a Worthless Stock Deduction*, RSM (Dec. 15, 2016), <https://rsmus.com/what-we-do/services/tax/federal-tax/corporate-tax-services/irs-addresses-timing-of-a-worthless-stock-deduction.html>.

²⁷ Different versions of this bond are possible and explored *infra* Section XX. One possibility would be to make money available at a lower cost of capital than the company could secure elsewhere. In order to induce the corporation to sacrifice profits, however, the discounted interest payments would need to compensate for the increased costs.

²⁸ For a description of the costs and benefits of coal plant scrubbers, see Maureen L. Cropper et al., *Costs and Benefits of Installing Flue-Gas Desulfurization Units at Coal-Fired Power Plants in India*, in 7 *INJURY PREVENTION AND ENVIRONMENTAL HEALTH* 239 (Charles N. Mock et al. eds., 3rd ed. 2017). Although the Clean Air Act of 1977 essentially mandated that new coal-fired power plants install scrubbers, old companies were grandfathered in. http://www.edf.org/documents/2695_cleanairact.htm. As a result, about 30% of U.S. power plants lack scrubbers. <https://www.nytimes.com/2018/08/24/climate/epa-coal-power-scrubbers.html>.

²⁹ See George W. Sharp, EUCG Inc., *What’s the Scrubber Going To Cost?*, *POWER* (July 15, 2007), <https://www.powermag.com/whats-that-scrubber-going-to-cost/?pagenum=4>.

make a tangible and measurable impact on social welfare. To provide a sense of this pool of funds, consider that U.S. donors give away an amount roughly equivalent to 2% of GDP—or approximately \$300 billion—each year.³⁰ Socially responsible mutual funds might also contribute—indeed, an SRI index fund might promise that, instead of buying and selling companies based on investor ideology (which accomplishes no change in corporate behavior and possibly sacrifices investor returns),³¹ the fund’s fees would support worthy corporate social responsibility bonds.³²

Let’s assume that the total cost to the company of installing scrubbers is estimated to be \$80 million, as the coal company would expect a positive reputational boost and heightened employee productivity worth approximately \$70 million.³³ If a bond was issued, and enough donors contributed, the company would have a difficult time resisting. And if the company installed the scrubbers, the loan would be forgiven; if not, investors would get their money back plus interest.³⁴

In this example, the use of the bond would likely be the only way to encourage the corporation to install the scrubbers. As discussed, externality regulation that would push the company to implement scrubbers or otherwise reduce emissions is unlikely; even if regulation did arise, it would likely be the product of compromise, or distorted by interest group dynamics.³⁵ Moreover, most consumers, many of whom live far away from the factories, might not mind that the coal plant is polluting if it leads to cheaper energy prices. Even socially motivated consumers might not feel compelled to boycott the company if most competing coal companies have not installed scrubbers.³⁶ What about shareholders? Although some prosocial shareholders may be willing to bear a hit to the stock price in service of the public good, it is unlikely that the majority will encourage profit sacrificing decisions even when the welfare benefits are very great.³⁷

³⁰ James Andreoni & A. Abigail Payne, *Charitable Giving*, in 5 HANDBOOK OF PUBLIC ECONOMICS 1 (Alan J. Auerbach et al. eds., 2019).

³¹ Paul Brest et al., *How Investors Can (and Can’t) Create Social Value*, 44 J. Corp. L. 205 (2018).

³² In the beginning of 2018, \$11.6 trillion of all professionally managed assets were in ESG investment strategies. Adam Connaker & Saadia Madsbjerg, *The State of Socially Responsible Investing*, HARV. BUS. REV. (Jan. 17, 2019), <https://hbr.org/2019/01/the-state-of-socially-responsible-investing>.

Assuming investors were willing to pay an additional fee of 10 basis points each year, that would amount to over a billion dollars available to incentivize good corporate behavior. This does not include the money spent on charitable donations each year, estimated to be 2% of GDP (or approximately \$380 billion) in the U.S. alone.

³³ The company would likely have to pay tax on the money that it gets, however, it might be possible to structure the transaction to reduce the tax burden (such as claiming depreciation for fixed assets).

³⁴ Again, to preserve deductibility, the investors could choose to have the money roll over into a donation to the nonprofit. See *supra* note XX.

³⁵ See note XX *supra*.

³⁶ *To Boycott or Not To Boycott: The Consequences of a Protest*, WHARTON U. PA.: KNOWLEDGE @ WHARTON (June 9, 2010), <https://knowledge.wharton.upenn.edu/article/to-boycott-or-not-the-consequences-of-a-protest/>.

³⁷ Madison Condon posits that diversified investors have an incentive to push for action that will sacrifice profits at a single firm if doing so will maximize the value of the entire portfolio. She contends that this explains environmental initiatives undertaken by institutional investors. *Externalities and the Common Owner*, WASH. L. REV. (forthcoming 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3378783. But the paradigmatic universal owner is the index fund, which for reasons I explain in Section XX, lacks a financial incentive to invest in the kind of research and engagement necessary to effectively implement this kind of strategy, which would require knowledge about climate science, as well as firm-specific information about companies that are most likely to contribute to climate change and the tradeoffs between profit sacrificing today and profit maximizing tomorrow.

Therefore, the bond might be the only way for stakeholders to affect corporate decisionmaking. And under certain circumstances, funding a bond could have a big effect. Indeed, by advertising that it has installed scrubbers, the company's choice could cause consumers to focus on rival companies that have not followed suit, increasing the costs of non-compliance with the developing norm. The social responsibility bond could also alter industry-wide standards in another way: by forcing a company to reduce pollution, the bond removes an incentive for the company to lobby against regulation that would impose the same requirement on other companies. Indeed, the power company might now lobby in favor of regulation.³⁸

As this example reveals, the social responsibility bond resembles a private Pigouvian subsidy³⁹ that could be used to alter corporate decisionmaking by changing the set of decisions that are wealth-maximizing. It does this without requiring any change in the law or corporate governance. Indeed, one of the advantages of the bond is that it works within the wealth-maximization framework, and therefore, does not run a risk of eroding managerial accountability and other inefficiencies associated with a stakeholder model.⁴⁰ In addition, the use of social responsibility bonds avoids the collateral consequences that flow from consumer boycotts and employee strikes—by targeting individual decisions and offering incentives for corporations to make them, the bond rewards good behavior, rather than punishing corporate actors and the guiltless individual employees that populate them.

Not only that, even these long-term investors are operated by managers who are unlikely to sacrifice profits to safeguard the portfolio several decades into the future—even if this is the correct long-term strategy, the fund will suffer from poor performance for the manager's tenure, affecting the amount of fees the manager earns. See Rock and Kahan, *supra* note XX. In fact, as Condon concedes, these diversified investors maintain that their actions are in fact profit maximizing for the underlying firm. Therefore, it is unlikely that shareholder pushing—even by universal owners—will lead to routine profit sacrificing in the public interest.

³⁸ As an analogy, consider Amazon's changed lobbying position on laws requiring online retailers to pay sales tax. Amazon initially opposed such laws, but once the Supreme Court ruled that state and local governments could require online merchants to levy sales tax, even when that retailer had no physical presence in the state, Amazon switched gears and began lobbying in favor of laws that would require sales taxes on all internet purchases. Kyung M. Song, *Amazon Lobbies Heavily for Internet Sales Tax*, SEATTLE TIMES (Sept. 7, 2013, 7:45 PM), <https://www.seattletimes.com/seattle-news/amazon-lobbies-heavily-for-internet-sales-tax/>.

³⁹ Pigouvian subsidies are direct payments from the government to firms to encourage beneficial activities (e.g., research and development for clean energy technologies) so that corporate decisions coincide with socially optimal allocations. See Garth Heutel, *Subsidies*, Economics Faculty Publications Paper 20 (2014). But note that the corporate social responsibility bond is not calibrated to maximize public welfare, but rather private welfare. And because individuals might also fail to internalize all of the costs of corporate harm, it is likely that relying on bonds alone will not result in an optimal level of corporate social responsibility from a public welfare perspective. This is why this instrument is intended to be a complement to regulation, rather than a substitute.

⁴⁰ See Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001) (“[A] stakeholder measure of managerial accountability could leave managers so much discretion that managers could easily pursue their own agenda, one that might maximize neither shareholder, employee, consumer, nor national wealth, but only their own.”); Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 SOUTHERN CAL. L. REV. 1189 (2002) (opining that the prospect of increased agency costs is the least-bad argument for shareholder primacy); Strine, *The Dangers of Denial*, *supra* note 16, at (describing how constituency statutes “largely shift[] power to the directors to couch their own actions in whatever guise they find convenient, without making them more accountable to any interest”); Jean Tirole, *Corporate Governance*, 69 *Econometrica* 1 (“the implementation of the stakeholder society strikes three rocks: dearth of pledgeable income, deadlocks in decision-making, and lack of clear mission for management”).

But the devil is in the details. As this article explains, the use of corporate social responsibility bonds is fraught with complications that would render the use of a bond not useful at best, or harmful at worst. For example, the bonds could be impossible to price because of information asymmetries, lead to moral hazard for companies, and could result in harmful distributive consequences, to name just a few possibilities. In addition, companies might not be receptive to accepting funds when doing so will focus attention on their harmful practices. (I discuss these and other possible pitfalls in Section XX). Therefore, corporate social responsibility bonds should not be seen as a cure for every instance of corporate irresponsibility, but a complement to action taken on other grounds: pushing from long-term shareholders, consumer input, employee strikes, and externality regulation.

More broadly, the insight at the core of this Article—that the individuals with the strongest interest in seeing corporations pursue corporate social responsibility goals are not necessarily the shareholders—has consequences for corporate law and corporate governance. In particular, we should recognize the limits of corporate law and shareholder activism to achieve socially optimal levels of corporate responsibility. We should also be skeptical about the growing enthusiasm about shareholders, and specifically, the long-term “universal owners,” as the solution to wide-ranging problems, like climate change and systemic risk.⁴¹ The paradigmatic universal owner is the index fund, which offers investors market returns for a low cost.⁴² To keep costs low, index funds minimize overall expenditures, including market research.⁴³ For this reason, index funds focus on governance reforms that can be implemented at scale.⁴⁴ They are not well positioned to identify and solve problems that have generated substantial debate among informed researchers, such as how companies can minimize risks from climate change.

From the observation that shareholder control is unlikely to lead to an optimal level of corporate social responsibility emerges the difficult question: whether and how to reorient corporate law away from shareholders and toward a broader set of constituents. Even though shareholder primacy offers many efficiencies, the costs of prioritizing one group at the expense of others may ultimately outweigh the benefits. But a move to a new paradigm is fraught with complications, which may explain the lasting power of the shareholder primacy norm. As that

⁴¹ See note 38, *supra*; see also Yesha Yadav, *Too-Big-To-Fail Shareholders*, 103 Minn. L. Rev. 587 (2018); Gordon, *supra* note 64; Strine, *Toward Fair and Sustainable Capitalism*, *supra* note XX. Strine recognizes that it may be necessary to implement reforms that would increase the ability of large institutional investors to focus on “the human realities of their worker-investors.” He suggests broadening their fiduciary duties to free those institutions to move beyond wealth maximization, and focus on their investors interests “as human beings.” But the problem is not that institutional investors lack discretion to focus on investor welfare, even broadly construed. The larger issue is that these institutions lack incentives to invest resources in determining how to satisfy the increasingly complex desires of their constituents. Beyond the complexity of determining what might be welfare-maximizing for heterogeneous investors exists an additional complication—the fact that these institutions tend to be subject to conflicts of interest that make them wary to challenge management. See Dorothy Lund, *The Case Against Passive Shareholder Voting*, 43 J. Corp. Law (2017); Lucian Bebchuk and Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 Columbia L. Rev. (2019).

⁴² Dorothy Lund, *The Case Against Passive Shareholder Voting*, 43 J. Corp. Law (2017).

⁴³ *Id.*; Lucian Bebchuk and Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 Columbia L. Rev. (2019).

⁴⁴ *Id.*; Ed Rock and Marcel Kahan, *Index Funds and Corporate Governance, Let Shareholders Be Shareholders*, Working Paper.

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discussion forges on, the bond mechanism could allow corporate outsiders to influence corporate behavior right away.

There is at this moment a massive appetite for corporate social responsibility.⁴⁵ Impact investing opportunities are everywhere—and most of these opportunities are less influential than they first appear.⁴⁶ This Article explores a possibility that would allow individual donors to make a concrete and tangible impact on corporate behavior—one decision at a time.

This article proceeds as follows: Part II explains why corporations are unlikely to make public interested decisions, even if they have the legal discretion to do so (as many contend they do). Part III discusses more promising avenues for proponents of corporate social responsibility. It introduces the concept of corporate social responsibility bonds and describes several examples of where they could be used to alter corporate decisionmaking to serve the public interest. It describes analogous concepts in law and finance, including green bonds, carbon offsets, impact bonds, and tax breaks for companies that act in the public interest. And it describes the substantial limitations and complications that limit the usefulness of this tool. Part IV discusses broader implications for corporate law and corporate governance. Part V concludes.

II. Why Companies Won't Make Public Interested Decisions

The world is ready for corporations to serve society: Legal scholars defend a view of fiduciary obligation that would allow directors and officers to make public interested choices, even those that sacrifice corporate profits.⁴⁷ Nearly every state has adopted constituency statutes that allow management teams to consider stakeholder interests, as well as their shareholders.⁴⁸ Prominent shareholders have made public statements urging CEOs to serve the public interest;⁴⁹ prominent CEOs have voiced an increased commitment to doing so.⁵⁰ Likewise, researchers in economics and finance continue to advance a view that profit-maximizing and corporate social responsibility are linked.⁵¹

In this section, I show why much of this advocacy is unlikely to have a dramatic effect on corporate decision-making. The reason is that these advocates of corporate social responsibility either ask corporate fiduciaries to do something they already have incentives to do, or they operate against a deeply-ingrained incentive structure that pushes corporate fiduciaries to maximize shareholder wealth as a first priority. And without an attempt to change that incentive structure, the effect of this pushing will be little more than symbolic. In other words, the problem with much of this advocacy is that it neither requires nor encourages corporations to make different choices than they would otherwise make.

⁴⁵ Jon Hale, *Bucking the Trends, Flows into ESG Funds Set Another Record in 2018*, MORNINGSTAR: SUSTAINABILITY MATTERS (Jan. 24, 2019), <https://www.morningstar.com/articles/908665/bucking-the-trend-flows-into-esg-funds-set-another-record-in-2018>.

⁴⁶ Brest et al, *supra* note 31.

⁴⁷ See *supra* note X.

⁴⁸ Elhauge, *supra* note 8.

⁴⁹ Fink, *A Sense of Purpose*, *supra* note 11; Fink, *Purpose & Profit*, *supra* note 11.

⁵⁰ Business Roundtable Letter, *supra* note XX.

⁵¹ See *supra* note XX.

To make this more concrete, assume that the world of corporate decisionmaking can be divided into two categories: those decisions that maximize shareholder wealth, and those that do not. Quite obviously, corporations already have incentives to make choices that maximize shareholder wealth. Of course, this easy answer elides many difficulties: for example, some long-term wealth-maximizing choices may be wealth-sacrificing over a shorter time horizon, or some prosocial projects may be NPV uncertain.⁵² If there is a risk that an investment in corporate social responsibility will not pay off at all, or that it will pay off years after the management team has departed, management may not make the choice voluntarily. However, long-term holders of company shares have tools available to push management to consider a longer time horizon if that is the problem. In addition, diversified shareholders may be willing to use these tools to push companies to take risks on NPV uncertain decisions—so long as more than 50% pay off, they will be better off.

We can see this happening already. In particular, long-term shareholders claim that they use voting and engagement to push companies to pursue environmental and social initiatives that are in the company's long-term interest.⁵³ These proponents of social responsibility not only include so-called permanent capital—mutual funds and pension funds—but also investors with more limited time horizons. As an example of the latter, the hedge fund Jana has raised capital for a fund that will focus on environmental and social activism that also creates value for shareholders.⁵⁴ The fund's first initiative pushed Apple to develop tools to minimize the harm to children from using iPhones and iPads.⁵⁵

In sum, corporate law already provides incentives for companies to make wealth-maximizing choices; if management is operating under the wrong time horizon or risk profile, shareholders can use voting and engagement to influence management decisionmaking.⁵⁶ The more interesting

⁵² There is a long literature discussing the supposed problem of market short termism. See Mark Roe, *Stock Market Short-Termism's Impact*, ECGI Working Paper, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3171090 (citing papers).

⁵³ Condon, *supra* note 37; Michal Barzuza et al., *Shareholder Value(s): Index Fund Activism and the New Millennial Corporate Governance*, 93 SOUTHERN CAL. L. REV. (forthcoming 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3439516.

⁵⁴ David Benoit, *Wall Street Fighters, Do-Gooders—and Sting—Converge in New Jana Fund*, WALL STREET J., <https://www.wsj.com/articles/wall-street-fighters-do-goodersand-stingconverge-in-new-jana-fund-1515358929> (last updated Jan. 7, 2018, 4:10 PM). Jana has since delayed the opening of its social impact fund and instead announced that it will raise socially responsible co-investments in three to five target companies. See <https://www.barrons.com/articles/jana-partners-activist-investor-fund-51559837142>. This co-investment model indicates that the activism that the hedge fund intends to engage in is consistent with a profit maximizing strategy. As another example, activist hedge fund TCI Fund Management has sent letters to a number of portfolio companies stating that the fund would vote against directors if they did not disclose carbon dioxide emissions. http://www.shareholderforum.com/access/Library/20191202_Deal.htm. The move is largely viewed as an attempt to court investors who are interested in ESG initiatives. Id.

⁵⁵ Id.

⁵⁶ That is not to say that more should not be done to encourage a long-term perspective. For one, the SEC could mandate sustainability disclosure, as Jill Fisch and Cindy Williams, and separately, Ann Lipton, have urged it to do. Letter from Cynthia A. Williams, Osler Chair in Bus. Law, York Univ., & Jill E. Fisch, Saul A. Fox Distinguished Professor of Bus. Law, Univ. of Pa. Law Sch., to Brent J. Fields, Sec'y, Sec. and Exch. Comm'n (Oct. 1, 2018), <https://www.sec.gov/rules/petitions/2018/petn4-730.pdf>; see also Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 GEO. L. REV. 923 (2019); Ann M. Lipton, *Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure*, YALE J. ON REG. (forthcoming),

DRAFT

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question is whether corporate fiduciaries will make “public-interested” decisions. By public interested, I mean decisions that are clearly not wealth-maximizing; in other words, choices that would shift profits from shareholders toward employees, consumers, the environment, or the broader community. In the sections that follow, I show why the typical corporation will very rarely, if ever, make public-interested choices, even if this is what a large portion of their shareholders desire.⁵⁷ And this reality holds regardless of what the law requires of corporate fiduciaries:⁵⁸ market forces, bolstered by state corporate law and the good governance movement, push corporations to maximize shareholder wealth regardless of the legal default. In the sections that follow, I’ll highlight three of these market forces: 1) takeover markets, 2) shareholder activism, and 3) executive compensation.

A. Takeover Markets

If management routinely sacrifices profits for prosocial goals, the company may become a takeover target by an acquirer who can shift the direction of the company and monetize those profits for themselves. The logic is straightforward: Routine profit sacrificing will dampen the company’s share price, providing an opportunity for a hostile acquirer to purchase control. By changing the direction of the company, the hostile acquirer can monetize those gains.

This is not a novel observation. Andrei Schleifer and Larry Summers, Oliver Hart and Luigi Zingales, and Einer Elhauge all discuss the role of takeover markets in incentivizing management to make antisocial choices. Specifically, Schleifer and Summers show how a hostile bidder can take control of a company and profit by shifting value away from employees by renegotiating employment contracts.⁵⁹ Elhauge,⁶⁰ as well as Hart and Zingales,⁶¹ show how collective action problems encourage even prosocial shareholders to tender to hostile acquirers with antisocial goals. Even if a shareholder prefers not to tender to the hostile acquirer that plans to convert a public interested company into a profit maximizing one, that shareholder will understand that other shareholders are likely to tender. Therefore, even that prosocial shareholder will be compelled to tender for fear of losing out on the takeover premium offered by the hostile acquirer.

However, the risk of a hostile takeover is more limited than it once was. Most states offer antitakeover statutes which provide companies the ability to protect themselves from the risk of a hostile acquisition.⁶² Not only that, hostile takeovers are an expensive, and so not every instance

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3435578. Such disclosure would better enable investors and academics “to evaluate the sustainability practices of issuers and to analyze the relationship between sustainable practices and economic performance.” *Id.* at 927. Companies could also be required to disclose practices that affect employees. *See* Strine, *supra* note 21.

⁵⁷ *Cf.* Lance Moir & Richard J. Taffler, *Does Corporate Philanthropy Exist? Business Giving in the Arts in the U.K.*, 54 J. BUS. ETHICS 149, 156 (2004) (analyzing gifts to the arts by 60 firms and finding that they were justified almost entirely by profit maximization).

⁵⁸ *See* Gordon Smith, *supra* note 16 (arguing that “the shareholder primacy norm is nearly irrelevant to the ordinary business decisions of modern corporations” and that the norm is “one of the most overrated doctrines in corporate law”).

⁵⁹ Andrei Shleifer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers*, in CORPORATE TAKEOVERS 33 (Alan J. Auerbach ed., paperback ed. 1991).

⁶⁰ Einer Elhauge, *Sacrificing Profits in the Public Interest*, 80 N.Y.U. L. Rev. 733, 809–10 (2005).

⁶¹ Hart and Zingales, *supra* note XX.

⁶² *See* Elhauge, *supra* note XX.

of profit sacrificing is likely to subject the company to takeover risk.⁶³ However, hedge fund activism is a more potent threat, as will be discussed in the next section.

B. Hedge Fund Activism

For companies that are unlikely to become takeover targets, hedge fund activists pose a more substantial threat to management teams that sacrifice profits.⁶⁴ In other words, shareholders need not tender shares to a hostile acquirer; they can simply support a hedge fund that aims to boost the stock price by pushing the company in a different direction.⁶⁵ The draw for the hedge fund activist is the prospect of high returns: agitating for changes that will result in gains to shareholders will benefit the hedge fund that has taken a large stake in the company. Although the gains are shared, the risk is also lessened as the hedge fund need not take a controlling stake to succeed. All they will need to do is convince shareholders to support the campaign.

Will prosocial shareholders follow suit? The calculus for them is a little different in this context, as they won't be coerced into supporting the hedge fund out of a fear of losing out on a takeover premium. Indeed, if enough shareholders are concerned about the activist investor's plans, they can freely vote no at the annual meeting. However, it is likely that many shareholders would support a plan that would result in a boost to the stock price.⁶⁶ This risk has contributed to the phenomenon of companies succumbing to pressure from activists without putting the issue to

⁶³ Monika Schnitzer, *Hostile versus Friendly Takeovers*, 63 *Economica* 37 (1996) (“[T]he empirical evidence suggests that hostile tender offers are not very attractive. The raider has to pay for expensive advertisements and mailings to shareholders in addition to high-cost services of merchant banks and lawyers. To succeed with his offer, he often has to overcome costly takeover defenses....Furthermore, the raider typically ends up paying a high premium to shareholders.”).

⁶⁴ See Jeffrey N. Gordon, *Addressing Economic Insecurity: Why Social Insurance Is Better Than Corporate Governance Reform*, COLUM. L. SCH.: CLS BLUE SKY BLOG (Aug. 21, 2019), <http://clsbluesky.law.columbia.edu/2019/08/21/addressing-economic-insecurity-why-social-insurance-is-better-than-corporate-governance-reform/> (“Today’s reconcentration of ownership has invigorated the proxy battle, which can be pursued at much lower cost than a hostile bid and for which a shareholder activist bears only the risk of its toehold stake, not 100 percent ownership. The consequence is that companies have much less margin for what is perceived as strategic or operational shortfalls.”).

⁶⁵ See Jeff Schwartz, *De Facto Shareholder Primacy*, 79 MD. L. REV. (forthcoming 2020) (describing how hedge fund activism pushes companies to maximize shareholder wealth).

⁶⁶ See Hart & Zingales, *supra* note 8 (“The support that activists rely on often comes from institutional investors who may believe that they have a fiduciary duty to their shareholders to vote for value-maximizing actions. Thus institutions may support an activist who wants to turn a clean company into a dirty one even if most shareholders are against this.”). Hart & Zingales believe that a broader articulation of institutional investor fiduciary duty—one that allowed them to maximize investor welfare not wealth—would enable institutional investors to stand up to activists. *Id.* But I doubt this would make a difference. For one, institutional investors are bound to act in the best interests of their investors. See SEC rules/DOL rules. That duty could be construed as supporting a course of action that is not wealth-maximizing but that a majority of investors prefer. That is especially true because management often provides a rationale for a vote against: that the plan is not wealth-maximizing in the long term, to take an example. Therefore, it is unlikely that an institutional investor that refused to support a hedge fund activist would run into any legal trouble, and no broader articulation of their duty is necessary to incentivize them to support management when doing so would maximize investor welfare. Indeed, studies of mutual fund voting show that they are already very likely to support management in proxy contests. See Alon Brav et al., *Picking Friends Before Picking (Proxy) Fights: How Mutual Fund Voting Shapes Proxy Contests* (ECGI Working Paper Series in Fin., Working Paper No. 601/2019, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3101473.

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a shareholder vote.⁶⁷ In the face of an activist campaign, directors will likely find it easier to agree to make changes that would move the company in a new, profit-maximizing direction rather than to fight and take the risk of an unfavorable shareholder vote.

Etsy provides an example of this dynamic at work. Etsy was founded in 2005 and from the start advertised that it sought to benefit “buyers, sellers, staff and the planet.”⁶⁸ The company prided itself on treating employees well, offering generous parental leave, as well as free organic food and yoga classes. The company also prioritized the well-being of the artisans who sold goods through the site, without pushing them to maximize revenue or sales. As a result of these practices, the company was certified by non-profit B Lab as a company that met particularly high social and environmental standards.⁶⁹

But the company needed money to grow, and so it accepted millions of dollars from venture capitalists. In exchange, those venture capitalists secured board seats to ensure that they would be able to influence the company’s direction.⁷⁰ Seeking an exit, the venture capitalist investors pushed Etsy to go public. Immediately following the company’s IPO, the company’s failure to turn a profit became a focus for some of the company’s new investors. Despite the company’s B Corp status, a hedge fund activist bought a large stake in the company and began to agitate for changes.⁷¹ Before long, private equity firms also amassed stakes in the company. As the conflict grew, the board of directors decided to fire the company’s CEO and replace him with someone who would better carry out the activist investors’ goals: increased operational efficiency and profitability.⁷² The new CEO allowed the company’s B Corp certification to lapse, began putting pressure on sellers, and eliminated many of the generous workplace perks.⁷³

In this example, the company didn’t wait to take the temperature of its shareholders before changing directions. The pressure from activist investors was enough. This example also shows that having legal discretion to sacrifice profits is not dispositive. Etsy had advertised to investors that it planned to look out for its employees and the sellers that utilized the online marketplace. But having discretion to make even profit sacrificing choices is irrelevant if vocal investors are unhappy about that course of action. In this situation, the board of directors realized that in order to avoid a costly and distracting proxy fight, it would need to accede to investor demands and put their interests first.⁷⁴

⁶⁷See generally Melissa Sawyer et al., Sullivan & Cromwell LLP, *Review and Analysis of 2018 U.S. Shareholder Activism*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Apr. 5, 2019), <https://corpgov.law.harvard.edu/2019/04/05/review-and-analysis-of-2018-u-s-shareholder-activism/> (showing the frequency with which activist hedge fund campaigns are settled).

⁶⁸ David Gelles, *Inside the Revolution at Etsy*, N.Y. TIMES (Nov. 25, 2017), <https://www.nytimes.com/2017/11/25/business/etsy-josh-silverman.html>.

⁶⁹ Id. For an overview of the B Corp certification process, see <http://digitalcommons.law.seattleu.edu/cgi/viewcontent.cgi?article=2398&context=sulr>.

⁷⁰ Id.

⁷¹ Id.

⁷² Id.

⁷³ Id.

⁷⁴ A similar phenomenon took place at Warby Parker—when it went public, it let its B corp certification lapse rather than comply with a requirement that it reincorporate as a benefit corporation under state law.

This and the previous section show what is likely in store for management that routinely sacrifices corporate profits. It is not that they are likely to go out of business, as others have claimed.⁷⁵ Instead, they are likely to remain in business, but under someone else's control. As such, they will not routinely engage in profit sacrificing to benefit the public, even if this is what some—or many—shareholders desire.

C. Executive Compensation

Not every firm is a potential takeover target, and not every profit-sacrificing decision will attract attention from hedge fund activists. But another market force operates to keep management focused on shareholder value—executive compensation.

Most executives have their pay tied to the company's stock price. A so-called “equity-based” compensation strategy is thought to align management and shareholder incentives and usually comes in the form of stock options or stock grants.⁷⁶ But equity compensation can distort incentives, such as by motivating stock buy-backs and a short-term mindset. A related problem is that compensating executives primarily with stock options means they will be unlikely to take action that will sacrifice profits and thus reduce their salary. Therefore, whenever compensation strategies tie executives' incentives to stock price, management will have incentives to boost the company's value rather than make public interested decisions.

Compounding this reality is the fact that a dampened stock price is also likely to negatively affect executive reputation and advancement. In theory, making public-interested choices could improve executive reputation. For example, the CEO that engages in profit sacrificing might get favorable attention from the media, stakeholders, and the surrounding community.⁷⁷ That attention could help insulate the CEO from removal.⁷⁸ On the other hand, the CEO who sacrifices profits for social good will have to account to shareholders and the board of directors for the decline in stock price or slower rate of growth. This could cause the board of directors to suffer negative consequences, too.⁷⁹ As such, the CEO is unlikely to sacrifice profits, and if she does, she is likely to be removed. In fact, recent study shows that CEOs that invest in social responsibility initiatives that correspond with a fall in stock price⁸⁰ are 84% more likely to be fired than their counterpart CEOs that do not invest in social responsibility initiatives.⁸¹

⁷⁵ See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 436 (9th ed. 2014); J.B. Heaton, Leo Strine's Corporate Decline Problem, *The CLS Blue Sky Blog* (Nov. 8, 2019), <http://clsbluesky.law.columbia.edu/2019/11/08/leo-strines-corporate-decline-problem/>.

⁷⁶ See Lucian Bebchuk & Jesse Fried, *PAY WITHOUT PERFORMANCE* (2004).

⁷⁷ Diego Prior et al., *Are Socially Responsible Managers Really Ethical? Exploring the Relationship Between Earnings Management and Corporate Social Responsibility*, 16 *CORP. GOVERNANCE* 160 (2008).

⁷⁸ *Id.*

⁷⁹ Cf. Eugene F. Fama & Michael C. Jensen, Separation of Ownership and Control, 26 *J. L. & Econ.* 301, 315 (1983) (“outside directors will monitor the management that chooses them because outside directors have incentives to develop reputations as experts in decision control”).

⁸⁰ Tim Hubbard, Higher Highs and Lower Lows: The Role of Corporate Social Responsibility in CEO Dismissal, *Strategic Management Journal* (2019).

⁸¹ However, engaging in profit-maximizing CSR helps insulate the CEO. *Id.*

In sum, the CEO that makes public-interested decisions will not make less money,⁸² but will be at a greater risk of displacement—at the hand of their investors, or even their own board of directors.

* * *

The previous three sections demonstrated why the typical widely held public company is very unlikely to sacrifice profits in the public interest. Doing so would subject management to takeover threats, shareholder activism, and reputational and financial consequences. As the Etsy example reveals, this is true even if the company takes steps to advertise its alignment with a broader set of stakeholders: regardless of the extent of the company’s legal discretion, market pressures push management to maximize shareholder wealth. Put simply, giving management the discretion to prioritize prosocial goals that sacrifice shareholder wealth will not change the practical operation of most companies so long as the incentive structure remains the same. If we want to see companies making public interested decisions, more would need to change. The next section explores possibilities.

III. Corporate Social Responsibility Bonds

What possibilities remain for proponents of corporate social responsibility, in a world of imperfect regulation? One course of action would be to borrow from the activist investor playbook, but with a different endgame. Instead of agitating for structural changes that would improve accountability to shareholders—dismantling poison pills and de-staggering boards, to take two examples—activists seeking to further stakeholder objectives could push for structural changes that would insulate fiduciaries and therefore give them greater ability to sacrifice profits in pursuit of social goals. For example, stakeholder activists could push companies to adopt anti-takeover provisions, staggered boards, anti-activist poison pills,⁸³ and dual class voting structures.⁸⁴ Stakeholder activists could also demand governance changes that would render fiduciaries sensitive to a broader set of interests, such as by benchmarking compensation to environmental hurdles.⁸⁵

Another approach for stakeholder activists would be to seek governance rights for corporate constituents other than shareholders. For example, a company could issue preferred stock with super voting shares to employees, or give employees the right to elect a minority slate of directors.⁸⁶ Providing employees with a right to elect directors would force fiduciaries to take their

⁸² Some companies are beginning to tailor executive compensation to encourage prosocial goals. See note XX supra.

⁸³ Marcel Kahan & Edward Rock, *Anti-activist Poison Pills*, 99 B.U. L. REV. 915 (2019).

⁸⁴ Marty Lipton has pushed for such reforms for decades, and continues to do so today. See, e.g., Martin Lipton et al., *It’s Time to Adopt the New Paradigm*, <https://corpgov.law.harvard.edu/2019/02/11/its-time-to-adopt-the-new-paradigm/>; Martin Lipton, *Takeover Bids in the Target’s Boardroom*, 35 BUS. LAW. 101, 104 (1979).

⁸⁵ Robert Newbury et al., Willis Tower Watson, *Compensation Committees & ESG*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Aug. 31, 2019), <https://corpgov.law.harvard.edu/2019/08/31/compensation-committees-and-esg/>; <https://corpgov.law.harvard.edu/2019/11/29/performance-metrics-accelerating-the-stakeholder-model/#more-124425>.

⁸⁶ This is the sentiment behind Elizabeth Warren’s proposed legislation that would give employees the right to elect two out of five directors. S. 3348, 115th Congress (2018), as well as Leo Strine’s proposed legislation that would implement European-style workers’ councils. See note XX. But a company could achieve the same result by compensating employees with a separate class of stock with special voting rights.

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interests into consideration.⁸⁷ However, this solution would only encourage decisionmaking along one additional dimension; environmental concerns, or other issues affecting broader community, might not be addressed. Not only that, studies of co-determination systems in other countries have identified problems with allowing employees control rights, including less fluid decisionmaking.⁸⁸ This may be why no U.S. firms have initiated these specific changes⁸⁹ (although the U.S. does have a large and growing population of worker-owned companies⁹⁰).

Given the growth of social responsibility investing, it is somewhat puzzling that investor activism about environmental and social (E&S) issues has been so limited. Yes, investors have brought non-binding shareholder proposals in an attempt to nudge companies to improve their disclosure of environmental risks or disclose corporate political spending payments, to take two examples.⁹¹ Other investors have done more. For example, State Street has promised to withhold votes for nominating directors that serve on all-male boards.⁹² Likewise, BlackRock has promised to engage with companies until they produce a clearly defined purpose that serves society.⁹³ The hedge fund Jana at one point even promised to launch a fund focused on socially responsible investing (it has since delayed the launch).⁹⁴ These are all laudable efforts, but are far less radical and influential than initially appears. For one, all justify their advocacy as maximizing long-term shareholder wealth.⁹⁵ More important, none move the power structure of the corporation away from shareholders and toward other groups—management or even employees—in the way that is necessary to encourage public-interested decisions.

We should not be surprised that major investors—most of whom are investment intermediaries that are fiduciary duty bound to act in their investors’ best interests⁹⁶—aren’t using activism to move companies away from a shareholder wealth-maximization viewpoint. In fact, they have been

⁸⁷ See Gary Gorton & Frank Schmid, *Class Struggles Inside the Firm: A Study of German Codetermination* (NBRE Working Paper Series, Working Paper No. 7945, 2000), <https://www.nber.org/papers/w7945.pdf> (“We find, in fact, that co-determination does empower employees, and that they use their power in ways that contradict the desires of shareholders, that is, they change the objective function of the firm.”)

⁸⁸ Id.; Elmar Gerum & Helmut Wagner, *Economics of Labor Co-determination of Corporate Governance* (unpublished manuscript), https://www.researchgate.net/publication/228322896_Economics_of_Labor_Co-Determination_in_View_of_Corporate_Governance (summarizing other empirical findings, including inefficient decision-making). Unsurprisingly, scholars also show that companies with co-determination have reduced profitability. Id.; Gary Gorton & Frank A. Schmid, *Capital, Labor, and the Firm: A Study of German Codetermination*, 2 J. EUR. ECON. ASS’N 863 (2004).

⁸⁹ Michael C. Jensen & William H. Meckling, *Rights and Production Functions: An Application to Labor-managed Firms and Codetermination*, 52 J. BUS. 469 (1979).

⁹⁰ *The Employee Ownership 100: America’s Largest Majority Employee-Owned Companies*, NCEO (July 24, 2019), <https://www.nceo.org/articles/employee-ownership-100>; Peter Walsh et al., *Why the U.S. Needs More Worker-Owned Companies*, HARVARD BUS. REVIEW (Aug. 8, 2019), <https://hbr.org/2018/08/why-the-u-s-needs-more-worker-owned-companies>.

⁹¹ See Subodh Mishra, Institutional Shareholder Services, Inc., *An Early Look at 2019 US Shareholder Proposals*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Mar. 5, 2019), <https://corpgov.law.harvard.edu/2019/03/05/an-early-look-at-2019-us-shareholder-proposals/>.

⁹² See Barzuza et al., *supra* note 53.

⁹³ Fink, *A Sense of Purpose*, *supra* note 11.

⁹⁴ See *supra* note XX.

⁹⁵ Id.

⁹⁶ SEC Rule/DOL rule; see also Hart & Zingales *supra* note XX.

most influential in taking steps to increase management’s focus on shareholder interests, including by demanding equity-based compensation, unified boards, and single-class equity structures.⁹⁷

In other words, radical change is unlikely to come from shareholders themselves. In addition, were companies to enact the changes necessary to allow fiduciaries to freely make public interested decisions, the ensuing lack of accountability could lead to other problems—most notably, increased managerial agency costs.⁹⁸ Indeed, governance reforms of this kind cut against decades of good governance advocacy designed to empower shareholders and ensure that management teams remain accountable to them.⁹⁹ And it is possible that some management teams would use their discretion to slack or maximize their private benefits, leading to economic harm—if not now, then at some time in the future.¹⁰⁰

Is there any hope for people who hope to encourage corporations to make public interested decisions? This article proposes a way forward that works within the wealth maximization framework, and yet could result in dramatic social change. The idea is simple: use private markets to provide incentives for corporations to make public interested decisions. One promising option, which the remainder of this article will focus on, would be to issue “corporate social responsibility bonds.”¹⁰¹ These pseudo-bonds, pseudo-donations would allow people to “invest” in the company’s pro-social future. The intuition is as follows: if it is welfare-maximizing for individuals to see corporations make public interested choices, there should be a possible Coasian bargain between the individuals who desire the public interested choice and the corporation. Note that these individuals might include the company’s shareholders, but more likely, they will be entities or individuals external to the corporation, such as pension funds, other institutional investors, charitable organizations, foundations, university endowments, and nonprofits.

⁹⁷ BLACKROCK, PROXY VOTING GUIDELINES FOR U.S. SECURITIES (2019), <https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf> (embracing shareholder responsiveness, unitary boards, majority voting, equal voting rights, and opposing poison pills); <https://www.ssga.com/our-insights/viewpoints/2019-proxy-voting-and-engagement-guidelines-north-america.html> (embracing shareholder rights, majority voting, annual elections, proxy access for shareholders, and opposing poison pills); VANGUARD, VANGUARD FUNDS PROXY VOTING GUIDELINES FOR U.S. PORTFOLIO COMPANIES (2019), https://about.vanguard.com/investment-stewardship/portfolio-company-resources/proxy_voting_guidelines.pdf (opposing limited shareholder rights, unequal voting rights, and defensive structures, embracing pay-for-performance equity compensation, unified boards, majority voting); see also Ian Appel et al, *Passive Investors, Not Passive Owners*, *Journal of Financial Economics* (2016) (showing that a higher percentage of passive fund ownership is associated with a firm being less likely to have unequal voting rights, takeover defenses, and classified boards); Eli Kasargod-Staub, *Majority Action, Climate in the Boardroom*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG (Oct. 7, 2019), <https://corpgov.law.harvard.edu/2019/10/07/climate-in-the-boardroom/> (showing that the Big Three rarely support ESG shareholder proposals).

⁹⁸ See supra note XX.

⁹⁹ See Lund and Pollman, supra note **Error! Bookmark not defined.**

¹⁰⁰ See Fried, supra note 14 (“If the Business Roundtable CEOs really were able unilaterally to disempower shareholders, the economy would suffer. Excess capital would be trapped inside their companies because managers prefer to play with more money. Resources would be mis-invested. If payouts from public companies declined, unlisted firms would have less access to capital. Furthermore, investors might think twice before investing in a small, growing company. If it fails or goes sideways, they lose. If it goes public, its CEO might decide to use its assets to serve all manner of stakeholders, with shareholder returns as an afterthought. Heads they lose, tails they don’t really win.”).

¹⁰¹ Other possibilities exist – these are explored infra Section XX.

How would these corporate social responsibility bonds work? The issuer (likely a non-profit) would first identify a public interested corporate decision—something that would have a large positive impact on employees, consumers, communities, or the environment—that is not wealth-maximizing for the company. The issuer would then raise money to support that decision by issuing a bond, describing in a detailed offering document how the company would use funds to implement the decision and why they would not otherwise make it without investment. Individuals could invest, earning interest for as long as they waited for the project to be implemented. If the company agreed to implement the decision, the bond money would be loaned to the company using a promissory note. If the project was implemented according to the offering document, the loan would be forgiven. If it was not, for whatever reason, the investors would get their money back.¹⁰²

Therefore, the corporate social responsibility bond is a tool that could motivate real corporate change, without any government intervention. It would provide an opportunity for philanthropic individuals who dedicate 2% of GDP to charitable giving each year to use their money to direct corporate decisionmaking.¹⁰³ And by working within the existing wealth maximization framework, the corporate social responsibility bond would avoid the risks to managerial accountability that would come from abandoning shareholder primacy altogether.

In the sections that follow, I describe in further detail the concept of a social responsibility bond. I begin by exploring examples of how they might be used, and then set forth some of the attenuating issues and difficulties. I conclude by demonstrating that this instrument, although novel, has its origins in recently developed financial instruments aimed at uniting prosocial investors and profit-maximizing companies.

A. Corporate Social Responsibility Bonds: The Possibilities

This section provides examples of where corporate social responsibility bonds could be used. Note that in each example, a bond is used to push the company to make a choice that is not-wealth maximizing (and therefore will not be made without external pressure), but that would result in major societal benefits. In addition, these examples are unlikely to be addressed by government regulation, nor are they likely to be the subject of pressure from consumers, shareholders, and employees. In the sub-sections that follow, I describe examples that fit within each of the three categories of decisionmaking that a corporate social responsibility bond could encourage: 1) altering an existing project, 2) avoiding a harmful project, and 3) taking on a new beneficial project.

i. Bonds to Alter an Existing Project

First, a bond could be used to convince a company to alter an existing project to benefit society. The introduction considered the example of the power plant and scrubbers that would cost \$150 million, but would result in major societal benefits—including by easing the prospect of industry-wide regulation. As another example, consider how a bond could be used to transform supply

¹⁰² In order to preserve deductibility, the investors would need to specify that the donation would roll-over if the bond fails. See *supra* note XX.

¹⁰³ James Andreoni & A. Abigail Payne, *Charitable Giving*, in 5 HANDBOOK OF PUBLIC ECONOMICS 1 (Alan J. Auerbach et al. eds., 2019).

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chains for the better. Every year, McDonalds buys 3.4 billion pounds of potatoes—approximately 7% of U.S. production.¹⁰⁴ Therefore, the company has the ability to alter supply chain dynamics as a buyer. Suppose that the cheapest option for the company is a potato farmed using pesticides that harms the environment and consumers, but is nonetheless legal. In addition, consumers are not sufficiently aware of or bothered by the risks to alter their consumption. The cost of an organic pound of potatoes would be 7 cents, or 10% more than the non-organic pound – for an annual total of \$240 million. Of course, McDonalds will not buy the organic potatoes, even though doing so would benefit consumers and the environment.

What would happen if a corporate social responsibility bond was used to push McDonalds to buy organic potatoes? Because McDonalds is such a large buyer, the increased demand could further drive up prices for organic potatoes temporarily, inducing other farmers to grow them. If this happened, prices could eventually fall—perhaps not to the level of non-organic potatoes, but below the initial price of 7 cents per pound. These price effects could induce other companies to buy organic potatoes. Indeed, McDonalds’ compliance with the developing norm could encourage other companies to follow suit in another way: McDonalds would likely advertise that it is using organic potatoes, which could put pressure on other fast-food restaurants to change course. Eventually, therefore, the bond could cause the equilibrium to shift by increasing both supply and demand for organic potatoes.

Corporate social responsibility bonds could also be used to benefit workers. Take the following example: Nike, like many global retailers, utilizes overseas sweatshops to produce sneakers. As a result of consumer boycotts, Nike has improved conditions somewhat, but overall conditions remain dismal. Let’s assume that the cost of bringing these overseas factories into compliance with OSHA standards would be \$100 million; therefore, Nike is unlikely to do so. Consumer pressure is unlikely to move the needle; indeed, consumers might not even be aware of the conditions in overseas factories. Not only that, regulation addressing overseas factory conditions is unlikely to be forthcoming, and even if a country was to adopt more stringent regulation, Nike could move its factory elsewhere. In this situation, the use of a corporate social responsibility bond might be the only way to incentivize the company to improve worker conditions. And as in these other examples, were Nike to participate and advertise its compliance, it would focus attention on other companies that failed to enact the same changes.¹⁰⁵

ii. Bonds to Avoid a Harmful Project

Instead of encouraging a company to perform an existing project differently, a bond could be used to encourage a company to cease a project altogether.

¹⁰⁴ John Miller, *McDonald’s Fries the Holy Grail for Potato Farmers*, SPOKESMAN-REV. (Sept. 23, 2009, 9:44 AM), <https://www.spokesman.com/stories/2009/sep/23/mcdonalds-fries-holy-grail-potato-farmers/>.

¹⁰⁵ However, Nike might be concerned that the bond would have the opposite effect—shine a spotlight on the company’s harmful practices, which would hurt its brand and reputation. That concern might chill Nike from accepting to work with a bond issuer in the first instance. For a discussion of this concern, see Section XX *supra*.

For example, Harley Davidson plans to move plants overseas to avoid new tariffs imposed on U.S. manufacturers.¹⁰⁶ The company estimates that the new tariffs would cost the company \$90 million each year, but the move overseas is predicted to cost 10,000 American workers their jobs. Let us also assume that most of those workers would not find new jobs and would therefore become unemployed.

In such case, a workers' rights nonprofit, such as Jobs for Justice,¹⁰⁷ could solicit a bond that would offset the costs of the tariffs for the company. It could negotiate with the company on the ultimate price, ultimately arriving at a sum less than \$90 million because taking the expensive course of action would result in offsetting reputational benefits and save on costs associated with moving production.¹⁰⁸ Perhaps they would split the difference and the company would agree that an investment of \$45 million would be enough to keep the jobs in the United States. The nonprofit would then solicit investment for the bond—from philanthropic shareholders and other individuals, foundations, and workers' rights groups. If the bond was funded, the company would be required to keep the jobs domestically or lose the money, and the optics of turning down the money would make the latter approach particularly unappealing.

Corporate social responsibility bonds could also be used to push companies to stop selling harmful products. For example, Wal-Mart is one of the biggest sellers of guns in the world.¹⁰⁹ Let's suppose that the company does not generate much revenue from these sales, but it expects that were it to stop selling guns, it would be subject to boycotts that would reduce revenue by 1%-for a total of \$5 billion, or \$300 million in lost EBITDA.¹¹⁰ Assume also that there would be a boost in sales from anti-gun consumers, but that this boost would only result in \$150 million in additional earnings. Therefore, Wal-Mart continues to sell guns and ammunition, even in the face of pressure from consumers and anti-weapons activists.¹¹¹ But what if those activists were to use a corporate social responsibility bond to change the calculus for the company? By paying Wal-Mart to stop selling guns, Wal-Mart would have a much tougher time saying no.¹¹² And altering the practices of this major gun retailer would likely have a big effect. For one, Wal-Mart's decision could change influence other big-box weapons retailers to stop offering guns. And even if Wal-

¹⁰⁶ Carson Kessler, *Why Harley-Davidson Is Moving Production Overseas*, FORTUNE (June 26, 2018), <https://fortune.com/2018/06/26/harley-davidson-moving-production-overseas/>.

¹⁰⁷ JOBS WITH JUSTICE, <https://www.jwj.org/> (last visited Nov. 11, 2019).

¹⁰⁸ The introduction of a monetary payment for the decision could somewhat reduce the altruistic signal and corresponding reputational boost from the decision, but it is unlikely to eliminate it. Roland Bénabou, & Jean Tirole, *Incentives and Prosocial Behavior*. 96 AM. ECON. REV. 1652, 1652–78.

¹⁰⁹ Chris Isadore, *What Would Happen if Walmart Stopped Selling Guns*, CNN: BUS., <https://www.cnn.com/2019/08/05/business/walmart-gun-sales/index.html> (last updated Aug. 6 2019, 11:30 AM).

¹¹⁰ Walmart 10K

¹¹¹ Note that Dick's Sporting Goods stopped selling guns and faced similar boycotts. But those boycotts were offset by a rise in sales from customers who approved of this decision. *Id.*; Joe Williams, *Dick's Sporting Goods Admits Suffering Gun Policy Backlash as Sales Slide*, WASH. EXAMINER (Nov. 28, 2018, 10:56 AM), <https://www.washingtonexaminer.com/business/dicks-sporting-goods-admits-suffering-gun-policy-backlash-as-sales-slide>.

¹¹² A weaker version of the bond would require Wal-Mart to implement background checks and stop selling certain types of weapons. These decisions would be unlikely to generate the same blowback, so would be cheaper for investors to implement. However, they might not be as effective at reducing gun sales; therefore, it could be more difficult to raise money to fund the bond.

Mart was the only retailer to change course, the reduced availability of guns could decrease the risk of gun violence.¹¹³

iii. Bonds to Encourage a Beneficial Project

Finally, a bond could be used to encourage a company to move in a completely new direction, and tackle a new project that would have large social benefits. Consider Bombay Dyeing,¹¹⁴ one of the largest global textile manufacturers, which primarily uses polyester and cotton yarns used by clothing manufactures. These fabrics have increasingly come under scrutiny from researchers and non-profits for their harmful environmental impact.¹¹⁵ A corporate social responsibility bond could be used to push Bombay Dyeing to instead produce new sustainable fabrics. As one example, consider fabric made from banana fiber, which is nearly carbon neutral.¹¹⁶ But assume that the cost of producing this fabric is prohibitively expensive without economies of scale and expertise in the textile industry. Imagine that it would cost \$500 million dollars for Bombay Dyeing to launch a new fabric line using banana fiber technology, and that customers would be unwilling to bear the costs in the form of higher prices for banana fiber clothing. As such, the company will not move from the status quo. However, were it to do so, and invest in the infrastructure necessary to produce banana leaf fabric at scale (which would include investments in suppliers and marketing), the cost would be the same for the company as producing cotton in future years. By encouraging an investment in sustainable fabric production and kickstarting a green fabric market, the corporate social responsibility bond could transform the textile industry.

* * *

These examples show how corporate social responsibility bonds could be used to alter corporate decisionmaking when the social welfare benefits are great. And it does this without requiring any legal change; we need not wait for Congress, or even the states, to alter the legal obligation of corporate fiduciaries, adopt corporate externality regulation, or provide new legal rights to third parties. The corporate social responsibility bond could be used to affect corporate decisionmaking without delay.

Not only that, the corporate social responsibility bond works within the wealth-maximization framework. Therefore, it induces prosocial decisions without leading to the problems that economists and legal scholars predict would manifest if fiduciaries were no longer bound to maximize shareholder wealth, including increased agency problems.¹¹⁷ There are good reasons

¹¹³ There is a clear link between availability of guns and the incidence of mass shootings. Paul M. Reeping et al., *State Gun Laws, Gun Ownership, and Mass Shootings in the U.S.: Cross Sectional Time Series*, THEBMJ (Mar. 6, 2019), <https://www.bmj.com/content/364/bmj.l542>.

¹¹⁴ BOMBAY DYEING, <https://bombaydyeing.com/> (last visited Nov. 11, 2019).

¹¹⁵ *Environmental Impacts*, Green Choices, <https://www.greenchoices.org/green-living/clothes/environmental-impacts> (last visited Nov. 11, 2019).

¹¹⁶ FASHIONUNITED, <https://fashionunited.uk/news/fashion/sustainable-textile-innovations-banana-fibre/2017082825623> (last visited Nov. 11, 2019).

¹¹⁷ A.A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365, 1367 (1932) (“When the fiduciary obligation of the corporate management and ‘control’ to stockholders is weakened or eliminated, the management and ‘control’ become for all practical purposes absolute.”).

why shareholder rights advocates have spent the better part of the last fifty years agitating for increased accountability to shareholders.¹¹⁸

Another main advantage of a corporate social responsibility bond is that it accomplishes a wealth transfer from the people who believe that the action is welfare maximizing; individuals that do not want to pay for it don't have to. Compare this to mandating corporations to make public interested decisions, which taxes all shareholders equally, even those that disagree with the decision.¹¹⁹ But this reality leads to a limitation, too. Because these bonds entail a privately provided public good, free riding is very likely. If others will pay for it, why should I?

The same concern is true of all charitable giving, and yet, most households give to charity.¹²⁰ Indeed, 2% of U.S. GDP, or nearly \$300 billion, is devoted to charitable giving each year.¹²¹ This means that there is a sizable pool of money available from individuals interested in seeing social change. Moreover, there is a palpable interest in seeing corporations change their behavior. Inflows to social responsibility investment vehicles have reached all-time highs;¹²² institutional investors compete by advertising their prowess on environmental, social and governance (“ESG”) issues.¹²³ People understand that corporations are powerful actors, and yet are frustrated by a lack of tools to effect change. The corporate social responsibility bond would offer donors a chance to influence corporate decisionmaking for the better, and could therefore appeal to a broad swath of individuals.

B. Nuts and Bolts

How would these bonds be issued? Who would issue them? Who would buy them? The following sub-sections answer these questions.

i. Initiating the Process

A corporate social responsibility bond could be issued in many different ways. In theory, the company could proactively issue a bond. But more likely, a third-party entity or several third-party entities would issue the bond and then work with the company to implement it. A useful third-party collaborator could be a non-profit with experience dealing with the bond's ultimate goal: as an example, the Environmental Defense Fund could work with the coal-fired power company to issue the scrubber bond discussed in the introduction. One advantage of having a non-profit issue the bond is the contributions would likely be tax deductible, meaning that a \$1 of investment would cost much less.¹²⁴ Public interested banking groups or family foundations could also assist: Goldman Sachs' urban development group¹²⁵ provides one example. In all likelihood, the issuance of the bond would involve several sophisticated entities.

¹¹⁸ See, e.g., Lucian Bebchuk, *The Case For Increasing Shareholder Power*, Harv. L. Rev. (2004).

¹¹⁹ These shareholders include not only the wealthy, but a large swath of ordinary Americans saving for retirement. INV. CO, INST., *supra* note 37 (showing that 44.8% of U.S. households invest in mutual funds).

¹²⁰ Andreoni & Payne, *supra* note 103.

¹²¹ *Id.*

¹²² See <https://www.wsj.com/articles/top-esg-funds-are-all-still-invested-in-oil-and-gas-companies-11573468200>.

¹²³ See Barzuza et al., *supra* note XX.

¹²⁴ See note XX *infra*.

¹²⁵ *Impact Investing*, GOLDMAN SACHS, <https://www.goldmansachs.com/what-we-do/investing-and-lending/impact-investing/> (last visited Nov. 11, 2019).

Under certain circumstances, the third-parties might issue the bond without any involvement from the company in question. If the bond was successfully funded, the third-parties would then negotiate the loan to the company in question. The advantage of this approach is that it would increase the third-parties' leverage in negotiations: when the company is involved with creating the terms of the bond, it can more easily push for more favorable terms. By contrast, if the company is presented with the opportunity to get a loan and the ensuing terms, it will have a harder time saying no or influencing the terms in a way that is overly favorable to it. This approach would only work, however, where there are not insurmountable information asymmetries between the company and the third-parties.¹²⁶ Where outsiders cannot easily estimate the cost of the decision, as well as the course of action that would correct it and the ensuing benefits, they would not be able to issue a bond without input from the company.

Assuming that the idea for the bond did not originate with the company, and was instead brought to the company's attention, would the company be receptive? On the one hand, the prospect of receiving money in the form of a forgivable loan should be attractive. On the other hand, the company might worry about agreeing to take a course of action that is patently not wealth maximizing. Although the bond purports to offset the costs associated with the decision, the company could be concerned that it will be difficult to shift gears in the future, or that the costs will be greater than estimated.

The company might also worry about the optics of being paid to avoid harm. In the Nike example mentioned above, the existence of the bond would be an advertisement to the world that Nike does not treat its workers fairly, and that it will only make changes if it is paid to do so. But this optics effect depends on how the public views the corporation and its conduct. If the public perceives that the bond induces heroic behavior—like the bounty for a whistleblower who takes great risk to report a crime—there is no shame in rewarding it. Put differently, if the public perceives that the company is departing from behavior that it has every right to engage in, the bond will appear to be just compensation for the decision to sacrifice profits. The problem, however, is that there is a growing consensus among the public that wealth-maximization is not a desirable objective function for the firm. This may render the optics of accepting bond money unpalatable to many companies.

Although this optics problem is a hurdle for bond proponents, the refusal to work with a non-profit that is offering a bond could result in a different sort of optics problem. In the latter situation, Nike is not just treating its overseas workers badly, but is refusing a large sum of money intended to correct the problem. In sum, corporate reputational effects cut in both directions.

There is also the opposite concern: not that the company would hesitate, but that it would be too willing to accept the money. Perhaps the company would be worried that if it doesn't accept the bond, a rival company will, which would increase the likelihood that the company would face pressure to make the change in the absence of a bond. Worse, a company could attempt to seek funds for decisions that are really wealth-maximizing. This risk is especially likely for bonds that

¹²⁶ Proposals to increase ESG disclosure would help reduce information asymmetries about corporate social responsibility. See Fish and Williams, *infra* note XX, Lipton, *infra* note XX.

aim to encourage companies to take on NPV uncertain projects. For Dick's Sporting Goods, for example, the decision to stop selling firearms ended up boosting revenue.¹²⁷ Ex ante, outside observers might have guessed that the decision would have the opposite effect. Given the market pressures that corporate executives face, however, the fact that these decisions are not being made indicate that they are not wealth-maximizing, at least in the near term. But this possibility makes a sophisticated third-party's role in deciding when to issue the bond and negotiating terms all the more important.

Assuming that the corporation is a good candidate for a bond, and that the corporation is willing to issue a bond or accept the proceeds, the third-party has an additional role to play in creating the terms and monitoring the process.¹²⁸ Most important, the third-party could also negotiate with the company to bring down the cost of the bond. Finally, the third party would be charged with monitoring the company's compliance with the bond, easing the burden on donors. The following sections contain more details about the offering terms and enforcement.

ii. The Offering Document

As the previous section indicated, the offering document would entail significant disclosure. It would describe in detail the decision that investing in the bond would encourage. The company (likely in conjunction with the third-party entity) would need to certify that, to the knowledge of the corporation, the decision is not wealth-maximizing, and therefore, that the company would not make the choice absent the investment. The offering document would also describe how the company would use the funds to implement the decision and how success would be measured. It would attempt to quantify the social benefits of the bond. And it would inform donors that if the company successfully implements the decision, the loan would be forgiven—in the meantime, the company would pay interest on the funds. The offering document would also describe the third-party's involvement—including the negotiations and monitoring role that it would play going forward.¹²⁹

What about pricing? In theory, the total amount of money raised would offset the lost profits that would result from making the public interested decision.¹³⁰ But in reality, the price could and probably should be much lower. For one, the loss in profits would likely be offset by benefits—increased worker productivity, fewer lawsuits, reputational benefits, etc. The total amount would be difficult to quantify, and would likely vary from company to company. Second, the company that refuses to work with the non-profit could suffer a negative reputational effect. For that reason, a company may need to accept less money than it would otherwise need to offset the costs of making the decision to avoid a hit to its reputation.

¹²⁷ See *supra* note XX.

¹²⁸ Without a sophisticated third party, disaggregated investors would have trouble monitoring the company and negotiating the terms. This might make investors wary to invest in the bond.

¹²⁹ An additional advantage of issuing the bond, from the nonprofit's perspective, is that the offering document could force disclosure that would benefit the public. See Lipton, *supra* note XX.

¹³⁰ Note that the donation would likely be taxable to the company, which would somewhat increase the cost. However, the company's tax planners could help it structure the transaction to reduce the overall tax burden.

To see where the pricing negotiation might end up, consider again the Wal-Mart example in Section XX. Recall that the expected cost of eliminating guns from stores was \$300 million. But the bond would not need to recoup that amount because the policy change would have an offsetting benefit of \$150 million. In addition, the non-profit might determine that Wal-Mart would be willing to accept a smaller amount, as it would suffer reputational consequences if it turned down a vast sum of money to end its gun sales. Indeed, the corporation could advertise the discounted bond as a form of corporate giving: it is partnering with the non-profit in question to alter its practices to benefit society. The ultimate price of the bond, consequently, might be only \$100 million.

The pricing issue is likely the most difficult hurdle that issuers of corporate social responsibility bonds will face: it will be very difficult to quantify the precise cost and benefit from any decision or set of decisions, and especially difficult for outsiders to monitor. One strategy to reduce the risk of error would be to employ a pseudo-earn-out.¹³¹ Taking the Wal-Mart example again, the company might over-estimate the cost and under-estimate the benefit ex ante. Knowing that, the third-party negotiating with the company could specify that if the cost is less and the benefit greater, donors would get a portion of their money back. In this situation, the donors would be splitting the risk created by implementing the decision with the company. This arrangement would lessen the third-party's task of estimating the cost and benefit ex ante. The problem with an earn-out, of course, is the prospect of costly negotiations later on.¹³² A clear description of how the earn-out would be calculated would lessen some of this burden, as it does in M&A transactions.¹³³

Another pricing complication is that some decisions do not need to be made only once, but are recurring. In the example involving McDonald's potato purchases, the bond would only offset expenses for a single calendar year. The parties could handle this issue in various ways. They could increase the price of the bond in order to induce McDonalds to promise to change behavior into future years. Perhaps McDonalds would be required to pay damages to the donors if it reverted during the period of time contemplated by the parties. Or, the third-party may foresee that if McDonalds makes the change for a single year, it will be difficult for it to go back to its old practices in a subsequent year. Another possibility is that if McDonalds makes the change, it will make the decision to source organic potatoes cheaper going forward. As with the previous issue, this complication will need to be handled on a case-by-case basis.

Another possibility for issuers to consider is that the activity subject to the bond could be subject to regulation after the company receives the bond proceeds. The offering document should specify in advance what would happen to the proceeds if this eventuality were to occur. But, under most circumstances, I anticipate that the company would be permitted to keep the money, even if it were later required to implement the same choice. At its best use, the corporate social responsibility bond would be used to alter industry standards and the regulatory environment. It

¹³¹ See Stefano Caselli et al., *Managing M&A Risk with Collars, Earn-outs, and CVRs*, J. APPLIED CORP. FIN., Fall 2006, at 91 (describing the asymmetric information and moral hazard in M&A transactions and how earn-outs can limit the effects of uncertainty and risk).

¹³² Jonathan I. Handler & Jillian B. Hirsch, *Developments in the World of Earn-Outs*, 19 *Corporate Finance Review* (2014).

¹³³ *Id.*

would target industry leaders who would otherwise not have an incentive to choose the prosocial course of action. And offsetting the costs of compliance for the industry leader would remove a major source of opposition to the regulation, increasing the likelihood that it would occur. Indeed, the prospect of regulation would also encourage industry leaders to participate in the offering; if regulation was very likely, the company might make the decision for far less than the total cost.

As discussed, the offering document would need to certify that the decision is not wealth maximizing. But what about decisions that are wealth-maximizing in the very long-term, but profit-sacrificing in the short term? In theory, a bond could be issued to encourage these choices, too. Imagine, for example, that an investment in clean energy is likely to pay off for a coal company sixty years into the future, well beyond the current management team's tenure. Even though this choice could eventually be profitable, it is unlikely that management will make it now.¹³⁴ Therefore, a corporate social responsibility bond could be used to encourage the company to make the choice today. Perhaps the bond could also provide for some donor repayment in the future, whenever the course of action becomes profitable, again using an earn-out mechanism.

Similarly, a bond could be used to nudge a company that is unwilling to take on a project that is NPV uncertain. Take the Wal-Mart example once again. The decision to stop selling guns is fraught with risk for the company, which would likely result in boycotts and negative press from pro-gun groups. On the other hand, if enough shareholders and consumers rewarded the company for eliminating gun sales, the decision could ultimately increase profits. Given the uncertainty, the CEO might be wary to rock the boat without encouragement in the form of a corporate social responsibility bond. However, the prospect of moral hazard would be very great—it would be difficult for the outsider to evaluate whether the CEO was simply feigning disinterest in order to solicit bond funds. To alleviate that risk, the offering document could provide for repayment if the decision ends up being less costly than anticipated. Section XX explores other financing possibilities for NPV uncertain projects.

iii. Purchasers

Possible purchasers of these bonds include any individual or entity for which the decision would be welfare-maximizing. According to Oliver Hart and Luigi Zingales, corporations should maximize shareholder welfare, and not wealth.¹³⁵ But if welfare is the right lens, why limit welfare to that of shareholders? Again, this is because administering a standard that encompasses multiple

¹³⁴ Although in theory, a company's stock price could go up in anticipation of future profitability, the more salient effect on stock price will be many years of lower profits in the near future. See generally, Charles Wang, Short-Term and Long-Term Market Inefficiencies and Their Implications, <https://www.northinfo.com/documents/30.pdf>. In addition, shareholders should be particularly skeptical of a plan that is predicted to manifest many years into the future, beyond the tenure of the current management team. Much can go wrong during that time, and the first manager will not be there to bear the burden. This same problem compromises the government's ability to invest in climate defenses now.

¹³⁵ See Hart & Zingales, *supra* note 8. They recognize that it would be difficult for companies to determine which activities are welfare maximizing for shareholders, and proposed shareholder votes as a preference aggregation mechanism. But shareholder voting is a crude method for aggregating preferences along multiple dimensions. The corporate social responsibility bond would allow corporations to more easily determine when certain choices are welfare maximizing. And once we recognize that corporations should calibrate decisions based on welfare, rather than wealth, there is no reason to exclude other stakeholders from the calculus.

points of view is complex and prone to error or bias.¹³⁶ The corporate social responsibility bond solves that problem, however. Indeed, whenever stakeholders value the effects of a corporate decision more than its cost, there should be a possible Coasian bargain between the corporation and the stakeholders that would maximize overall welfare. The bond simply serves as a coordinating device for stakeholders and a way to clearly express preferences.

These stakeholders could include shareholders, employees, and even outsiders, such as nonprofits, family foundations, sovereign wealth funds, mutual funds, and pension funds. Although the latter set of entities is realistically best positioned to pay the large sums of money necessary to fund these bonds, they may be concerned about the optics of paying corporations to avoid harm. An environmental non-profit or family foundation might be wary of giving money to ExxonMobil, for example. Perhaps the decision to pay money to ExxonMobil will alienate other donors, or at the very least, mean that there is less money available for other worthy causes. Although the possibility of alienating donors is a real one, the non-profit could advance a narrative that would be appealing: rarely do donors have such clear opportunities to make a concrete difference in the world as they would by directing corporate decisionmaking for the better.

Not only that, family foundations and nonprofits already partner with corporations in various ways. Often, the goal of the alliance is to raise money for the nonprofit, but not always. For example, nonprofits will sometimes license their names to consumer product companies, giving the underlying product a competitive advantage in the marketplace in exchange for publicity.¹³⁷ Critics of this practice contend that this practice represents a sort of quid pro quo: the nonprofit gives the corporation a reputational boost to offset its wrongdoing elsewhere, and the nonprofit benefits from the increased exposure.¹³⁸ By contrast, the use of corporate social responsibility bond is not intended to mask harmful business practices, but reduce them. That fact should ameliorate the potential for negative repercussions for the nonprofit that funds a bond.

Other institutional investors, such as mutual funds and pension funds, are unlikely to be a major source of investment for these bonds, but they might contribute occasionally. Indeed, institutional investors that offer pro-social investment vehicles could highlight that they would supplement their voting and engagement efforts with investment in the occasional corporate social responsibility bond. Some prosocial mutual funds could even *substitute* voting and engagement efforts with donations to corporate social responsibility bonds. This approach is especially appealing for ESG index funds, which promise to track the performance of a baseline index composed of companies that are screened for environmental and social criteria. Major index providers have been launching ESG indices at rapid pace, and investors have been gobbling them up: the largest 120 ESG index funds already have at least \$11 billion in assets under management, and BlackRock predicts that investment in ESG funds will rise to more than \$400 billion in the next ten years.¹³⁹

How are ESG index funds created? First, the index creator adopts a set of standards for inclusion—FTSE Russell, for example, maintains the “FTSE4Good” indices, which include

¹³⁶ See note XX *infra*.

¹³⁷ Alan R. Andreasen, *Profits for Nonprofits: Find a Corporate Partner*, HARV. BUS. REV., Nov.–Dec. 1996, at 47.

¹³⁸ *Id.*

¹³⁹ Adam Connaker & Saadia Madsbjerg, *The State of Socially Responsible Investing*, HARV. BUS. REV. (Jan. 17, 2019), <https://hbr.org/2019/01/the-state-of-socially-responsible-investing>.

DRAFT

Please do not circulate

companies that meet certain ESG criteria.¹⁴⁰ The indices automatically exclude tobacco companies and manufactures of nuclear weapons, for example.¹⁴¹ An independent committee of experts, NGOs, academics, and investors collaborate on the criteria for inclusion, and periodically review companies' compliance with the standards.¹⁴²

Mutual fund sponsors can then license the FTSE4Good indices to be used as the baseline index for their index funds. For example, Vanguard offers a FTSE Social Index fund that seeks to track the performance of the FTSE4Good US Select Index.¹⁴³ Investors who purchase shares get the benefit of broad diversification in socially responsible companies without having to pay for the underlying research. But they also entrust their governance rights to these funds, which may not always exercise them in a way that investors would want or even expect.

Consider that in the 2019 proxy season, sustainable funds offered by BlackRock, JPMorgan, and Vanguard frequently voted against so-called “green” shareholder proposals.¹⁴⁴ This may be because the voting obligations overburden the portfolio managers, as well as the governance groups entrusted with the task of casting these votes. Most mutual fund families centralize their voting within a single stewardship group.¹⁴⁵ Sometimes individual funds can depart from the house recommendation, but not always.¹⁴⁶ And most often, the index fund portfolio manager will have no interest in participating in governance. Recall that the index fund portfolio manager has delegated the responsibility of gathering firm-specific information to the index creator, and therefore will find it difficult to discharge voting obligations.¹⁴⁷ Therefore, ESG index fund holders might find that their votes are being used differently than they would expect or desire.¹⁴⁸

Vanguard's FTSE4Good fund could solve this problem in a few different ways. It could commit to spending the resources necessary to cast informed votes on ESG issues—likely raising fees by several basis points. Or, it could continue to vote as the institution determines is best for investors and instead devote a small fraction of the fee to corporate social responsibility bonds that are aligned with the fund's philosophy. The latter course of action is equally likely to maximize

¹⁴⁰ *FTSE4Good Index Series*, FTSE RUSSELL, <https://www.ftserussell.com/products/indices/ftse4good> (last visited Nov. 11, 2019).

¹⁴¹ But sometimes mistakes are made. See <https://www.ft.com/content/fbdb36d0-a293-11e9-974c-ad1c6ab5efd1> (“A \$500m exchange-traded fund run by Vanguard that claims to “specifically exclude” fossil fuel stocks invests in a host of companies in the oil and gas industry, amplifying concerns that investors could be misled by socially and environmentally focused products.”).

¹⁴² *Id.*

¹⁴³ <https://institutional.vanguard.com/web/cf/product-details/fund/0213>

¹⁴⁴ <https://www.ft.com/content/5d342a5d-443d-3327-9502-2361f37f251c> (“For environmental and social proposals that received strong support from investors, six BlackRock sustainability funds voted with a company's management 72 percent of the time.... At Vanguard, two ESG funds, which combined have almost \$7bn of assets, voted with management on environmental and social issues 93 per cent of the time when the proposals won support from at least 40 percent of investors.”).

¹⁴⁵ Griffith and Lund, *Conflicted Mutual Fund Voting*, *supra* note XX.

¹⁴⁶ *Id.*

¹⁴⁷ See Adriana Z. Robertson, *Passive in Name Only: Delegated Management and “Index” Investing*, 795 *YALE J. ON REG.* 795 (2019).

¹⁴⁸ Cf. Hart & Zingales (positing that investing in green index funds should help management determine which types of decisions are welfare-maximizing).

DRAFT

Please do not circulate

investor welfare—rather than supporting duplicative governance research, that money would be spent on a bond that would be very likely to change decision-making for the better.

But in all likelihood, the primary source of corporate social responsibility bonds would not be index funds, but family foundations and other wealthy donors. This feature leads to the possibility that these individuals could take advantage of the opportunity to shape corporate decision-making for their own benefit, as will be discussed in Section XX *infra*.

iv. Enforcement

Investment is only possible if potential donors have faith that the company will not get to keep the money unless the decision is made. This makes a sophisticated third-party enforcer all the more important. And if the company commits in advance to certain covenants, such as meeting certain pre-defined milestones or being overseen by the third party, that might satisfy donors. Of course, if the company breaches these covenants, they will have to remit the money, providing an incentive to comply. Indeed, the possibility of securing covenants could itself be advantageous for the nonprofit issuer. The nonprofit that is able to secure a right to oversee operations, to take one example, will gain something by having insight into company operations, as well as a voice in the room.

However, the fact that the investors only get their money back if the bond fails could lead to distorted incentives and complicate enforcement. In particular, hedge funds might purchase discounted bonds on a secondary market and then undermine the company's implementation. Even if the company claims success, the hedge fund might challenge that decision. The possibility of these transaction costs down the road may limit the usefulness of corporate social responsibility bonds in any situation where compliance with the terms would be difficult to measure.

* * *

In discussing these details, the limitations of corporate social responsibility bonds are evident. For one, the bond issuer faces an information asymmetry—it might not know enough about the company to dictate the decision, price the bond, and understand how to enforce it. This information asymmetry will be reduced if the company works with the issuer in creating the bond, but that collaboration might also reduce the issuer's leverage in negotiations. And if the information asymmetry between the company and the public is sufficiently great, the company is not a good candidate for a bond.

Issuing a bond would also entail high transaction costs, mostly in the form of negotiation and disclosure. It is possible that these transaction costs are too overwhelming for issuers and potential donors to navigate. However, the next section describes recently created financial instruments that aim to link private investors with public and private providers of public goods. Although these instruments entail hefty transaction costs, that has not stopped issuers from creating them and investors from funding them. Ultimately, however, the prospect of transaction costs limits the usefulness of this tool.

DRAFT

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If transaction costs are not insurmountable, why then have these instruments not been used? One possibility is that innovation in public interested financial products is relatively recent—as the next section reveals, green bonds, carbon offsets, and impact bonds were all created in the past decade. Another likely reason is that corporations are wary to call attention to their bad behavior. For example, when I check out at Whole Foods, I am given the option to donate to a foundation that fights cancer. Why am I not prompted to support a higher wage for the company’s own cashiers? Companies are in the business of virtue signaling—not the other way around.¹⁴⁹ And this hurdle is likely to most difficult one for issuers of corporate social responsibility bonds to overcome. In fact, there will likely be a first-mover problem: the first corporation to utilize the bond could suffer reputational consequences. Likewise, the first nonprofit to participate might suffer as well, if the public is unhappy about the decision to give a corporation money to offset harm. However, as discussed, a savvy marketing operation could decrease the risk of any reputational blowback—for both the corporation, as well as any nonprofits involved.

But the point remains that the corporate social responsibility bond will not make sense for every company, and for every instance of corporate irresponsibility. For that reason, it should be viewed as a complement to action in other directions—from investors, consumers, employees, politicians, and regulators—rather than a substitute.

C. Analogues

The concept of a corporate social responsibility bond has many analogues in law and finance. I discuss three financial analogues in the sections that follow: impact bonds, green bonds, and carbon offsets. I conclude with a discussion of legal analogues.

i. Impact Bonds

“Impact bonds” pool investment from private investors to improve public services.¹⁵⁰ Any repayment is contingent upon the achievement of desired outcomes—if the objectives are not met, investors get nothing; if the project succeeds, usually far down the road, the investors make their money back.¹⁵¹ In other words, the public entity only needs to repay investors if the project provides its intended benefit.

These instruments are relatively new—Goldman Sachs’ Urban Investment Group launched the first social impact bond in the United States in 2012—a \$9.6 million loan for therapy services for juveniles incarcerated at Rikers Island.¹⁵² The transaction was structured as follows: Goldman made funds available to the nonprofit MRDC, and the nonprofit used the funds to hire the Osborne

¹⁴⁹ Jillian Jordan & David Rand, *Are You ‘Virtue Signaling’?*, N.Y. TIMES: OPINION (Mar. 30, 2019), <https://www.nytimes.com/2019/03/30/opinion/sunday/virtue-signaling.html>.

¹⁵⁰ See Rebecca Leventhal, *Effecting Progress: Using Social Impact Bonds to Finance Social Services*, 9 N.Y.U. J.L. & Bus. 511 (2013).

¹⁵¹ See *id.* Note that this is the opposite of how I propose the corporate social impact bond would operate. Although making repayment contingent on achievement of the outcome provides an incentive for it to be achieved, it also creates the prospect of a lose-lose situation: one in which investors get nothing, and neither does the public.

¹⁵² John Olson & Andrea Phillips, Goldman Sachs, *Rikers Island: The First Social Impact Bond in the United States*, 9 COMMUNITY DEV. INV. REV. 97 (2013). Other social impact bonds solicit investment from multiple investors. See Leventhal, *supra* note 150, at 458.

Association, which provides therapy services to incarcerated youth.¹⁵³ MRDC was charged with overseeing the day-to-day implementation of the project. In addition, the Vera Institute of Justice, another nonprofit center for justice policy, was tasked with evaluating whether the program reduced the recidivism among Rikers' inmates.¹⁵⁴ The City of New York agreed to provide success payments to MDRC based on the projected savings from the reduced recidivism rate after five years, informed by the Vera Institute's evaluation. For example, a 20% reduction in recidivism would result in an estimated savings of \$20.5 million for the city.¹⁵⁵ If Vera and MRDC determined that the program had led to a 20% reduction in recidivism, the city would pay MDRC about half of that sum. Bloomberg Philanthropies also made a guarantee of \$7.2 million, reducing Goldman's risk that it would not be repaid.

As this example shows, impact bonds encourage ventures that improve the efficiency of public services and are expected to generate financial benefits at some future date. Public sector organizations often lack funding and political fortitude to take on such risks, even if they will pay off down the line; impact bonds therefore unite the public sector with private suppliers of capital, and if the venture is successful, allow those suppliers of capital to share in the proceeds. Of course, a for-profit company is not limited in the same way: Management is free to pursue any strategy designed to maximize profits, and will likely be able to secure funding to support them. The key difference, therefore, between an impact bond and the instrument I envision is that the latter will be used to push companies (and not public entities) to make money-losing choices, rather than profitable ones. Although the company will receive money to offset the costs, the main point of the bond is not to raise money, but to encourage the company to make the public interested choice.

The fact that the choice is money losing, however, means that the social responsibility bond donor will not be paid if the bond is successful. Although this structure results in a win-win of sorts—the donor either gets the money back or has the satisfaction of knowing that the donation made a real impact—there is also the prospect of distorted incentives discussed in Section XX.

ii. Green Bonds

Another analogue is a so-called “green bond.” Green bonds earmark funds for corporate projects that benefit the environment.¹⁵⁶ These bonds were invented by the World Bank in 2007; investment in green bonds has escalated since then, breaking a record with \$107 billion issued in the first half of 2019.¹⁵⁷

¹⁵³ Id.

¹⁵⁴ Id.

¹⁵⁵ Id.

¹⁵⁶ *Financing the Transition to a Green Economy: Their Word Is Their (Green) Bond?*, CLIMATEBRIEF (CDC Climat Research, Caisse des Dépôts, Paris, Fr.) May 2012, <https://www.i4ce.org/wp-core/wp-content/uploads/2016/03/12-05-Climate-Brief-14-Financing-the-transition-to-a-green-economy-their-word-is-their-green-bond.pdf>.

¹⁵⁷ Nina Chestney, *Green Bond Issuance Surpasses \$100 Billion So Far This Year; Data*, REUTERS: Sustainable Bus. (June 25, 2019, 8:03 PM), <https://www.reuters.com/article/us-bonds-environment/green-bond-issuance-surpasses-100-billion-so-far-this-year-data-idUSKCN1TQ11V>. See also Olivier David Zerbib, *The Effect of Pro-environmental Preferences on Bond Prices: Evidence from Green Bonds*, J. BANKING & FIN., Jan. 2019, at 39 (showing a steady increase in green bond issuance on page 4).

Here's how green bonds work: An issuer solicits funds for a "green" project, defined as a project with a positive environmental benefit.¹⁵⁸ Importantly, the bond price is generally the same as an ordinary bond from that issuer, and recourse is also the same.¹⁵⁹ The main difference is that the funds are earmarked for qualifying green projects. This could include starting a new green project, as well as refinancing existing projects to make them green. Thus far, development banks have been the largest issuers,¹⁶⁰ but major companies, including Apple and SolarCity have issued green bonds;¹⁶¹ government bodies—including the state of Massachusetts—have also issued green municipal bonds.¹⁶²

The main difference between a green bond and corporate social responsibility bond is that the latter is designed to push companies to make undesirable choices, at least, from the perspective of wealth maximization. By contrast, a green bond simply allows companies to secure funding for profit-maximizing green projects—projects that would be worth the cost of the debt.¹⁶³ The fact that lenders charge the same rate for green bonds and "brown" bonds indicates that the lenders are not placing much of a constraint on decisionmaking, as borrowers are not in the habit of taking on onerous constraints for free.

Take Apple's second green bond offering as further support for this point. Shortly after the Trump administration announced that it would withdraw from the Paris Climate Agreement, Apple issued a green bond of \$1 billion, following a larger green bond issuance a few years before.¹⁶⁴ It announced that these funds would support projects to reduce emissions in Apple's corporate facilities, stores, and supply chain.¹⁶⁵ The company explained that if implemented, these projects would save the company money over time.¹⁶⁶ Not only that, Apple had already announced that all

¹⁵⁸ For more information about the requirements for issuing a green bond, see The Green Bond Principles, which set forth "voluntary process guidelines that ... promote integrity in the development of the Green Bond market." INT'L CAPITAL MKT. ASS'N, THE GREEN BOND PRINCIPLES, 2016 (2016),

<http://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/GBP-2016-Final-16-June-2016.pdf>.

¹⁵⁹ OECD, MOBILISING BOND MARKETS FOR A LOW-CARBON TRANSITION (2017) (stating that the financial characteristics of green bonds and conventional bonds produced by the same issuer are identical at the issue date); see also IGOR SHISHLOV ET AL., INST. FOR CLIMATE ECON., BEYOND TRANSPARENCY (2016)

(arguing that there is "no clear evidence" that green bonds reduce the cost of capital for their issuers).

¹⁶⁰ Zerbib, *supra* note XX.

¹⁶¹ APPLE, ANNUAL GREEN BOND IMPACT REPORT (2018); Beate Sonerud, Climate Bonds Initiative, *SolarCity Issues US\$200m of Retail Bonds, Maturity Ranging from 1-7 Years, Coupon 2-4%. What a Pioneering Company! First Public Solar Bond Offering in the US, After Also Doing the First Solar Securitisation in 2013*, CLIMATE BONDS INITIATIVE (Oct. 16, 2014), <https://www.climatebonds.net/2014/10/solarcity-issues-us200m-retail-bonds-maturity-ranging-1-7-years-coupon-2-4-what-pioneering>.

¹⁶² MASS. CLEAN WATER TR., ANNUAL GREEN BONDS REPORT (2019).

¹⁶³ Indeed, some green bonds might not even support green projects. See <https://www.bloomberg.com/news/articles/2019-11-07/green-bonds-get-rubber-stamped-as-investors-question-the-label>

¹⁶⁴ It is somewhat puzzling that Apple, a company with \$257 billion in cash on hand, would borrow money. Lauren Feiner, *Apple Now Has \$345 Billion Cash On Hand, up 3% from Previous Quarter*, CNBC: TECH (Jan. 29, 2019, 4:38 PM), <https://www.cnbc.com/2019/01/29/apple-now-has-tk-cash-on-hand.html> (last updated Jan. 29, 2019, 6:38 PM); <https://www.ft.com/content/db5b911e-508a-11e7-bfb8-997009366969>. The answer is likely that Apple wished to avoid tapping into offshore cash reserves. <https://www.ft.com/content/af9a76a4-d4ca-11e5-8887-98e7feb46f27>. Before 2017, green bond issuers could have also received tax advantages. See <https://www.irs.gov/pub/irs-drop/n-18-15.pdf>.

¹⁶⁵ *Id.*

¹⁶⁶ *Id.*

of the company's facilities were powered by renewable energy; these funds were being used to "maintain that achievement."¹⁶⁷ In sum, the green bond funding went toward supporting projects that had already promised to take on, or that it had plenty of incentives to do already. There is no evidence that the presence of green bond funding actually caused Apple to make profit sacrificing decisions.¹⁶⁸

Therefore, the main difference between a green bond and a corporate social responsibility bond is that the latter encourages companies to make profit sacrificing choices. A corporate social responsibility bond, for example, might be used to push Apple to better accommodate consumers who want to upgrade their electronics, rather than replace them, which would reduce carbon emissions created during the manufacturing process, as well as landfill waste.¹⁶⁹ This would likely have a larger environmental impact than building a LEED certified Apple store in Japan, but of course, would sacrifice profits, and therefore, no amount of green bond funding for the same interest rate would encourage the company to do it.

iii. Carbon Offsets

Finally, carbon offset markets also provide an analogy to the instrument I envision here. Individuals who are concerned about the impact of activities that generate greenhouse gas emissions can purchase carbon offsets, which fund emission reduction projects elsewhere.¹⁷⁰ For example, if I am forced to take a cross-country flight for business travel, I cannot easily avoid the expansion of my carbon footprint. A non-profit like TerraPass offers me the opportunity to purchase an offset for every one metric ton of carbon dioxide emissions that my flight created.¹⁷¹ Indeed, some companies give consumers the option to purchase offsets in order to (supposedly) directly offset the emissions created by the consumption of their products. For example, most airlines provide an opportunity for passengers to offset the emissions produced by their trip.¹⁷² Oil and gas companies often do, too. Shell, for example, gives customers in the Netherlands the option to pay .01 euro per liter of fuel which the company uses to buy carbon credits that would offset the carbon emissions of that gasoline purchase.¹⁷³ These offset funds go toward funding projects that reduce carbon dioxide emissions, including planting trees, initiating gas capture projects at landfills, and funding wind power.¹⁷⁴ And these campaigns have been quite successful in attracting participation: Nearly \$4.5 billion had been spent on offsets from 2005 to 2015.¹⁷⁵

¹⁶⁷ APPLE, *supra* note 161.

¹⁶⁸ See also Caroline Flammer, https://www.bu.edu/gdp/files/2018/11/GEGI-GDP.WP_Corporate-Green-Bonds.pdf (showing that green bond issuance is correlated with improved financial performance, as measured by stock price reaction).

¹⁶⁹ David L. Veksler, *Apple Is Not as Green As It Seems*, FEE (Oct. 15, 2017), <https://fee.org/articles/apples-environmental-claims-are-misleading/>.

¹⁷⁰ NADAA TAIYAB, *EXPLORING THE MARKET FOR VOLUNTARY CARBON OFFSETS* (2006).

¹⁷¹ *Carbon Offsets Explained*, TERRAPASS, <https://www.terrapass.com/climate-change/climate-changecarbon-offsets-explained> (last visited Nov. 12, 2019).

¹⁷² Katie Genter, *Everything You Need To Know About Carbon Offsetting for Your Flights*, POINTS GUY (Oct. 7, 2019), <https://thepointsguy.com/guide/a-guide-to-airline-carbon-offset-programs/>.

¹⁷³ Akshat Rathi, *Shell Will Spend \$300 Million To Offset Carbon Emissions. Here's the Catch*, QUARTZ (Apr. 10, 2019), <https://qz.com/1590325/whats-wrong-with-shells-plan-to-offset-your-carbon-emissions/>.

¹⁷⁴ *Id.*

¹⁷⁵ KELLY HAMRICK, *FOREST TRENDS, AHEAD OF THE CURVE* (Molly Peters-Stanley & Gloria Conzalez eds., 2015).

DRAFT

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Like a carbon offset, the corporate social responsibility bond is a voluntary market transaction by individuals who are concerned about externalities created by the companies with which they interact. I might enjoy shopping for cheap products at Wal-Mart, but remain concerned that my consumer surplus is taken from employees who do not earn living wages. As with a carbon offset, I can compensate for some of this harm by investing in a corporate social responsibility bond directed at improving working conditions and wages for Wal-Mart employees.

But corporate social responsibility bonds offer additional benefits. A carbon offset offers a consumer a chance to pay for the harm they generate, instead of making changes in their lifestyle that would reduce emissions. The purchaser of the corporate social responsibility bond, however, has no other option to generate the prosocial good—they are trying to encourage a choice that wouldn't otherwise be made.

However, criticism of offset markets has analogues here too. For example, some environmentalists believe that the ability to offset carbon emissions will discourage people from taking steps to reduce their carbon footprint.¹⁷⁶ (As support for their point of view, consider why airlines and oil and gas companies offer offset opportunities to their customers—they provide a reason for customers to continue to travel in cars and airplanes without guilt, rather than make changes to their lifestyle that would reduce their consumption). Likewise, as discussed, it is possible that the prospect of receiving money as compensation for harmful activities will weaken any impetus for companies to stop them; indeed, it could even encourage companies to increase harmful activity in order to solicit payments from bond issuers.¹⁷⁷ Perhaps, for example, the polluting coal company would decide to emit even more pollution in an effort to try to attract bond proceeds.

The possibility for moral hazard should weigh on the mind of anyone considering whether to use corporate social responsibility bonds. But in many circumstances, corporate reputational

¹⁷⁶ See, e.g., Ascelin Gordon et al., Forum, *Perverse Incentives Risk Undermining Biodiversity Offset Policies*, 52 J. APPLIED ECOLOGY 532 (2015).

¹⁷⁷ A related critique is that monetary incentives can “crowd out” altruistic incentives. See Richard Titmuss, *The Gift Relationship* (1970) (positing that monetary compensation for donated blood would reduce the supply of donors); Carl Mellström & Magnus Johannesson, *Crowding Out in Blood Donations: Was Titmuss Right?*, 6 J. Eur. Econ. Ass'n 845 (2008) (confirming these results). As an example, a study of Israeli daycare attendees found that lateness increased when parents were not prohibited from coming late, but instead were asked to pay a fine. See Uri Gneezy & Aldo Rustichini, *A Fine Is a Price*, 29 J. LEGAL STUD. 1 (2000),

Other studies have demonstrated that economic incentives can backfire or be counterproductive. See, e.g., Bruno S. Frey & Felix Oberholzer-Gee, *The Cost of Price Incentives: An Empirical Analysis of Motivation Crowding-Out*, 87 AM. ECON. REV. 746 (1997) (providing survey data showing that individuals were less likely to accept locating a nuclear waste facility in their neighborhood if they were offered monetary compensation); see also Yochai Benkler, *The Unselfish Gene*, HARV. BUS. REV., <https://hbr.org/2011/07/the-unselfish-gene> (last visited Nov. 12, 2019).

(“Whenever you design a policy that relies on monetary rewards, you have to assume that it will have side effects on the psychological, social, and moral dimensions of human motivation. A change that would lead to more behavior of the kind you are rewarding, or less of the kind you are punishing, may cause the exact opposite behavior because the effects on the material self-interest vector will be more than canceled out by the effects on the intrinsic motivation vectors.”).

However, crowding-out is less likely to occur when the target of the incentive payment is a corporation, rather than an individual. Corporations do not have altruistic feelings, nor do they have intrinsic motivation. And while corporations are populated by employees, but those employees do not directly benefit from the reward in question—the entity does.

considerations should limit moral hazard. Unlike individual polluters, corporations who do harm are subject to constant scrutiny—from the news media, consumers, employees, regulators, and shareholders.¹⁷⁸ This scrutiny should serve as a constraint on corporations who might otherwise feel encouraged to engage in worse behavior in order to secure funding from corporate social responsibility donors. Relatedly, if the receipt of funds is not guaranteed, risking bad behavior is especially unlikely to pay off. Unless this tool becomes ubiquitous—which is unlikely—corporations are unlikely to hold back social responsibility efforts in order to attract bond proceeds.

Nonetheless, the prospect of moral hazard should influence corporate social responsibility bond issuers and their processes, especially if the bonds become common. For example, an issuer of bonds might refuse to work with a company that seeks out a bond. Or, an issuer could adopt a policy of only working with companies that have made genuine efforts at improving its ESG activities over time.

iv. Legal Analogues

The idea of paying corporations to engage in beneficial activity is unpalatable in many ways. Indeed, some may view paying people to stop causing harm as morally problematic.¹⁷⁹ But in many instances, our government does just this: it provides incentives for private parties to take action that benefits the public good. For example, the United States government provides billions of dollars in “climate aid” each year; these funds are used by development banks and foreign countries to help those developing countries achieve environmental goals.¹⁸⁰ The idea is that this money will encourage developing countries to make green choices—reducing ozone emissions, carbon emissions, cleaning chemical waste, etc.—that would not otherwise be made without financial support. Of course, there is also a justice-based argument supporting this aid: developing countries might reasonably ask why they are the ones that should make developmental sacrifices to mitigate problems that developed countries created and benefitted from.

But in other contexts, the government offers subsidies in the form of tax deductions for prosocial behavior simply to encourage it. The deduction for charitable donations is an obvious example. Individuals who donate to eligible non-profits are able to offset some of that cost by paying lower taxes.¹⁸¹ Indeed, charitable deductions are also available for other prosocial

¹⁷⁸ John L. Campbell, *Why Would Corporations Behave in Socially Responsible Ways? An Institutional Theory of Corporate Social Responsibility*, 32 Acad. Mgmt. Rev. 946 (2007).

¹⁷⁹ See also Daniel Hemel & Dorothy S. Lund, *Sexual Harassment and Corporate Law*, 118 COLUM. L. REV. 1583 (2018) (discussion on discursive harm).

¹⁸⁰ Joe Thwaites, *US Climate Finance Improves with 2019 Budget, but There’s Still a Long Way To Go*, WORLD RESOURCES INST. (Feb. 20, 2019), <https://www.wri.org/blog/2019/02/us-climate-finance-improves-2019-budget-theres-still-long-way-go>. The United States supports two global environmental funds: the Montreal Protocol Multilateral Fund, which helps developing countries eliminate ozone-depleting substance, as well as the Global Environment Facility, which collects funds to help support environmental initiatives in the developing world. It also supports climate finance through the State Department and USAID. Id.

¹⁸¹ Individual Income Tax Act 1944, 26 U.S.C. § 23(aa) (Supp. III 1946) (repealed 1950); see also Ellen P. Aprill, *Churches, Politics, and the Charitable Contribution Deduction*, 42 B.C. L. REV. 843 (2001). Corporations are also entitled to take a tax deduction for charitable donations.

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activities—such as giving up an easement to develop your property in favor of conservation.¹⁸² In these cases, we do not think that it is morally problematic to compensate individuals who voluntarily act to promote the public interest—indeed, we are grateful that the subsidy exists, or else such activity might not happen.¹⁸³

However, it is certainly more controversial when the government subsidizes *corporate* behavior with the goal of benefitting the broader community. Recall Amazon’s search for a secondary corporate headquarters which led to fierce competition among states that promised tax incentives and other benefits. The eventual winner—New York—ultimately promised approximately \$3.4 billion in tax incentives to attract the company’s corporate headquarters.¹⁸⁴ The reason, of course, is that luring the corporate giant to New York would have many offsetting benefits for the state—thousands of new jobs (supposedly),¹⁸⁵ increased revenue from sales and income tax, redevelopment plans, etc.—that likely exceeded the costs. But that did not stop fierce protests by residents and public officials. “Amazon is a billion-dollar company,” Representative Alexandria Ocasio-Cortez tweeted.¹⁸⁶ “The idea that it will receive hundreds of millions of dollars in tax breaks at a time when our subway is crumbling and our communities need MORE investment, not less, is extremely concerning to residents here.”¹⁸⁷ These protests eventually led to Amazon to abandon its plan to build a second corporate headquarters in New York.¹⁸⁸

The corporate social responsibility bond concept could be plagued by a similar conceptual problem: even if the bond would maximize social welfare, the idea of paying a corporation to move in a positive direction might be unpalatable to many. However, the benefit of the bond concept is that it links *private* donors with private entities. If individuals want to subsidize corporate decisionmaking in order to generate large social benefits, why shouldn’t they? Although taxpayers will support the decision to the extent that the donation is tax deductible, this limited subsidy provides less of an optics problem than the large direct subsidies that citizens ultimately pay when local and state governments attempt to incentivize corporate behavior that benefits the locality.

¹⁸² Peter J. Reilly, *Crackdown on Conservations Easement Syndications*, FORBES, <https://www.forbes.com/sites/peterjreilly/2018/12/20/crackdown-on-conservation-easement-syndications/#3645120016fa> (last visited Nov. 12, 2019).

¹⁸³ Eminent domain for economic development provides another example of paying individuals or entities to take action that is in the public good: it is legally permissible for the government to force individuals to part with their land in service of an economic project that will create new jobs, increase tax and other city revenues, or revitalize a depressed urban area. *See Kelo v. City of New London*, 545 U.S. 469 (2005).

¹⁸⁴ Jacob Passy, *This Is What Amazon’s ‘HQ2’ Was Going To Cost New York Taxpayers*, MarketWatch (Feb. 16, 2019, 4:13 PM), <https://www.marketwatch.com/story/what-amazons-hq2-means-for-taxpayers-in-new-york-and-virginia-2018-11-14>; Jack Stewart & Marielle Segarra, *After Political Resistance and Protests, Amazon HQ2 in New York Is No More*, MARKETPLACE (Feb. 14, 2019), <https://www.marketplace.org/2019/02/14/after-political-resistance-and-protests-amazon-h2q-new-york-no-more/>.

¹⁸⁵ *But see* Austin Carr, *Inside Wisconsin’s Disastrous \$4.5 Billion Deal with Foxconn*, BLOOMBERG BUSINESSWEEK (Feb. 6, 2019, 7:00 PM), <https://www.bloomberg.com/news/features/2019-02-06/inside-wisconsin-s-disastrous-4-5-billion-deal-with-foxconn>.

¹⁸⁶ Alexandria Ocasio-Cortez (@AOC), TWITTER (Nov. 12, 2018), <https://twitter.com/aoc/status/1062204614496403457?lang=en>.

¹⁸⁷ *Id.*

¹⁸⁸ Day One Staff, *Update on Plans for New York City Headquarters*, about amazon (Feb. 14, 2019), <https://blog.aboutamazon.com/company-news/update-on-plans-for-new-york-city-headquarters>.

D. Unintended Consequences

I have already considered whether corporate social responsibility bonds could lead to moral hazard—encouraging corporations to act worse than they would otherwise in order to seek payouts. Could the issuance of a corporate social responsibility bond (or the possibility of the issuance) lead to other unintended consequences?

For example, the issuance of a corporate social responsibility bond could redirect nonprofit attention away from worthy causes. Nonprofits have limited resources available to achieve a social impact. Perhaps the issuance of a corporate social responsibility bond could eat up valuable time and resources that would be better spent elsewhere—such as by lobbying for externality regulation, or by organizing a consumer boycott. This reality may further decrease the likelihood that corporate social responsibility bonds will be issued—given the limited time and resources of nonprofits, these bonds will only be palatable when they offer a greater return on investment than other prosocial projects.

But there is reason to think that on occasion, these bonds will be a useful complement to nonprofit efforts elsewhere. Indeed, corporate social responsibility bonds could aid nonprofits and regulators by forcing disclosure about harmful corporate practices. As discussed, a company that wants to issue a bond or work with a nonprofit issuer will have to disclose information about its business practices. It may even need to allow the third-party to monitor its operations. This disclosure could help nonprofits understand harmful corporate behavior; it could also aid regulators seeking to pass regulation in the future.¹⁸⁹ And as discussed, the corporate social responsibility bond could target an industry leader and convert them into a proponent of regulation that would bind rivals.¹⁹⁰

But the issuance of a corporate social responsibility bond could have a different harmful consequence: it could direct donor and investor attention away from other worthy causes. An individual will likely only donate a certain amount of money to charity each year. Likewise, an investor may be less willing to invest in benefit corporations or SRI mutual funds if they have donated to corporate social responsibility bonds. But this consequence has some advantages. As discussed, SRI mutual funds provide an opportunity for investors to invest in companies that align with their values, without offering any real opportunity to alter corporate decisionmaking.¹⁹¹ These funds rarely advertise that fact, and often obscure it.¹⁹² Therefore, the issuance of a corporate social responsibility bond could draw attention to the fact that sacrificing returns is necessary to alter corporate decisionmaking, and help alleviate investor misunderstanding about what their investment in SRI mutual funds will really accomplish.

¹⁸⁹ Note, however, that a company that fears that greater disclosure will lead to regulation and other harmful consequences, they will be less likely to accept the money. This reality also constrains the risk of moral hazard.

¹⁹⁰ However, government bodies could see the efforts of private sector financing as evidence that the area is a lower priority for legislative action. For that reason, perhaps the use of social responsibility bonds should be limited to domains where it appears unlikely that regulation would be forthcoming because of industry capture or other reasons.

¹⁹¹ Brest et al., *supra* note 31.

¹⁹² *Id.*

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Ultimately, my hope is that corporate social responsibility bonds would be used only where they would have a substantial and tangible impact—therefore supplementing action in other areas, rather than chipping away at it. Public interested investors will need to evaluate where their dollars are best put to use—in a green index fund, with a donation to the Environmental Defense Fund, or by supporting a corporate social responsibility bond.

A larger concern is that the prospect of a corporate social responsibility bond will decrease the incidence of voluntary corporate social responsibility. For example, what B Corp will survive when it has to compete with a company that is being paid to make the same choices? I suspect that many B Corps are not sacrificing profits for the reasons discussed in the first part of this paper: genuine profit-sacrifices are unlikely to exist (and if they do, they are unlikely to do so for long). In other words, it is likely that B Corps signal their alignment with social goals for profit-maximizing reasons.¹⁹³ But the point remains that if all companies are induced to act like B Corps, B Corps may have less of a competitive advantage. But like the concern about moral hazard, this problem would only arise if corporate social responsibility bonds become ubiquitous. It is unlikely that corporate social responsibility bonds will be used often enough to threaten B Corps across all industries; and were that to occur, the social welfare benefits would likely exceed this cost.

However, the issuance of corporate social responsibility bonds might also lead to perverse distributive consequences. For example, a wealthy community could organize a corporate social responsibility bond in the guise of offsetting environmental impact, but with the effect of moving a planned factory into a poorer, less-populated area. But notice that in the absence of a corporate social responsibility bond, the wealthy community could still obtain this result—through lobbying, or behind-the-scenes conversations with legislators and the company. At the very least, the corporate social responsibility bond would increase the transparency of such actions—perhaps making them less likely to happen this way.

But this example reveals a deeper problem: an individual's willingness to pay might not lead us to the social welfare-maximizing choice. For example, a wealthy individual who dislikes millennials could design a bond to induce Wal-Mart to only hire people born before 1979—which is unlikely to further the public interest. But, there are a few reasons to think that bonds will not be used for this purpose. For one, Wal-Mart would likely experience public backlash if it accepted the proceeds in this situation. That backlash could make the bond prohibitively expensive for the ageist donor. And it could also increase the likelihood of regulation, especially if the course of action was widely unpopular—making the tool unappealing for both the donor and the company. Indeed, the prospect of backlash and regulatory scrutiny would likely lead to company to refuse to participate.

¹⁹³ Suntae Kim et al., *Why Companies Are Becoming B Corporations*, Harv. Bus. Rev. (June 17, 2016), <https://hbr.org/2016/06/why-companies-are-becoming-b-corporations> (“Having a clear identity can help firms communicate their values to customers, which is particularly beneficial when they are claiming an identity different from the industry norm.”); James Surowiecki, *Companies with Benefits*, NEW YORKER: FIN. PAGE (July 28, 2014), <https://www.newyorker.com/magazine/2014/08/04/companies-benefits> (“[A]t the operational level, having a social mission can offer distinct advantages. It’s an important way for a company to attract and retain talented employees. Survey data show that workers—especially young ones—want to work for socially conscious companies, and will take less compensation in exchange for a greater sense of purpose. . . . Having a social mission can also be an important selling point with consumers, as the success of the fair-trade movement makes clear.”).

Ultimately, however, there is no guarantee that bonds that are privately welfare maximizing will be aligned with the public interest. (The same is, of course, also true of a stakeholder model, which simply asks corporations to maximize the welfare of a larger group). But for the reasons mentioned above, bonds that do not further the public interest are unlikely to succeed.

Finally, the existence of a corporate social responsibility bond might do damage to the corporate stakeholder movement more broadly by entrenching a shareholder primacy point of view. Advocates of the stakeholder view believe that the goal is to move away from a conception of the corporation that prioritizes investor wealth over all other interests.¹⁹⁴ By working within the wealth-maximization framework, the corporate social responsibility bond could undercut efforts to shift to a different paradigm. But once again, the use of a corporate social responsibility bond is not intended to supplant action in other domains. It is possible for proponents of a stakeholder or team-production model of the corporation to continue to work to implement that perspective, even alongside efforts intended to improve corporate decisionmaking in the near-term. As discussed, a paradigm shift would require major changes; insulation from market forces, or awarding enforceable rights to groups other than shareholders, to name just two options.¹⁹⁵ In the meantime, this article offers a possibility that could begin to work right away. And because the circumstances in which it may work are ultimately narrow, the opportunity to issue a bond is unlikely to convince many people that further action—from legal academics, regulators, consumers, shareholders, and employees—is unnecessary.

E. Alternatives

The advantage of a corporate social responsibility bond is that it would provide incentives for corporations to make public interested choices that they would not otherwise make. But there may be other ways to encourage prosocial corporate decisionmaking. This section explores some of these possibilities.

Instead of issuing a corporate social responsibility bond proactively, major lenders could tailor the cost of the debt to achieving certain E&S milestones. For private equity funds that are concerned about minimizing the amount of free cash flow that goes toward servicing debt, the possibility of a reduction in borrowing costs could be a powerful motivator. Consider CEC Entertainment—better known as the parent company of Chuck E Cheese.¹⁹⁶ If the CEC’s creditor banks were to drop the current interest rate on the total debt by 2.5%, that would result in a pool of cash capable of raising every employee’s wage by 10%. Indeed, a lender could even announce that the interest rate associated with any prospective loan will decrease if the company meets certain pre-defined E&S milestones.

¹⁹⁴ See COLIN MAYER, PROSPERITY (2018); STOUT, *supra* note 8; Stout & Blair, *supra* note 8;

Brett McDonnell, The Corrosion Critique (Sept. 18, 2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3450747.

¹⁹⁵ See Lund and Pollman, The Corporate Governance Machine (unpublished manuscript).

¹⁹⁶ Siddarth Cavale et al., *Apollo Global To Swallow Chuck E Cheese*, REUTERS (Jan. 16, 2014, 5:45 PM), <https://www.reuters.com/article/us-cecentertainment-apollo/apollo-global-to-swallow-chuck-e-cheese-idUSBREA0F0CL20140116>.

But lenders of capital are not likely to give money away. Instead, perhaps social responsibility mutual funds could be tailored to provide pools of capital for profit sacrificing decisions.¹⁹⁷ As discussed, SRI mutual funds essentially hold shares of companies that meet certain social or environmental criteria and have attracted a record-breaking amount of money in the past few years.¹⁹⁸ That is so despite the fact that these funds generally have higher expense ratios; it seems that investors are willing to pay slightly more for funds that meet their standards for good corporate citizenship.¹⁹⁹ The problem is that investing in SRI mutual funds doesn't itself encourage corporate social responsibility: even if a large number of prosocial investors refuse to buy sin stocks, there are other investors that will be happy to buy the now-discounted stock.²⁰⁰ Perhaps these investors hope that these funds will use their shareholder rights to push for social change. But as mentioned, often these prosocial funds fail to use their voting power to support environmental and social proposals.²⁰¹

Is there a better way to harness investor appetite for corporate social responsibility and still assure them some return? One way to do this would be to model SRI mutual funds after green bonds, but with more stringent criteria for corporations seeking to borrow the money. Like a green bond, investors would pool their money and make it available for corporations that meet the funds' exacting guidelines. But instead of charging the same rate of interest, the investors would agree to accept a lower rate; in exchange, the company would commit to ensuring that the funds would only be used for projects that meet the fund's exacting criteria.²⁰² This tool would therefore encourage companies that are looking for cheap cash to alter their business practices.

But some projects are not undertaken not because they are profit sacrificing, but because they are NPV uncertain. Although a bond could be used to support these choices, another possibility would be to use an instrument that allows for donor repayment if the corporate decision ends up making the company money. The pseudo-earn out mechanism discussed above is a possible tool. Another option would be for ESG investors to use warrants to help the company hedge against uncertainty. That is, an investor would give the company money to pay for the option to purchase stock at the current price at some time in the future, after the decision is made.²⁰³ If the investor is right about the project and its potential, they will profit from the option. And more importantly, the company receives downside protection for the risk in undertaking the project because the investor helps to finance it.

¹⁹⁷ A corporate social responsibility bond could also be used to support the lender's decision to lower interest rates.

¹⁹⁸ See *supra* note XX.

¹⁹⁹ David Kathman, *Are Sustainable Funds More Expensive?*, MORNINGSTAR (Mar. 16, 2017), <https://www.morningstar.com/articles/798280/are-sustainable-funds-more-expensive>.

²⁰⁰ Brest et al., *supra* note 31 (describing the problems with divestment campaigns). Even the divestment campaigns by the influential Norwegian sovereign wealth fund didn't make much of a difference in corporate strategy at the targeted companies. James Mackintosh, *Even \$1 Trillion Can't Make World Better Place*, Wall Street J. (June 30, 2019, 12:17 PM), <https://www.wsj.com/articles/even-1-trillion-cant-make-world-better-place-11561906980>. Other problems with ESG funds, and in particular, ESG index funds, exist, including a lack of transparency about the composition of the baseline indices. Dana Brakman Reiser & Anne Tucker, *Buyer Beware: The Paradox of ESG & Passive ESG Funds* (Aug. 23, 2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3440768.

²⁰¹ See *supra* note XX.

²⁰² Favorable tax treatment could offset the losses to the investors.

²⁰³ Note complication that issuing options to public investors would likely require a public offering.

IV. Broader Implications

The previous sections explored how corporate outsiders could encourage public interested corporate decisionmaking by expanding the set of decisions that qualify as wealth maximizing. A key implication of this analysis is that the individuals and entities with the strongest interest in seeing corporations pursue corporate social responsibility goals are not necessarily the company's shareholders. From that observation comes several additional implications with broad consequences for corporate law and corporate governance. The first and most obvious implication is that our system of corporate law, as it is currently constituted, is unlikely to lead to socially optimal levels of corporate social responsibility.²⁰⁴ Corporate stakeholders and even outsiders may place a high value on corporate social responsibility and nonetheless lack meaningful mechanisms to influence corporate behavior, especially when their preferred course of action conflicts with wealth maximization. Therefore, mechanisms that elevate the voices of corporate outsiders in decisionmaking is likely to improve overall welfare. The bond concept explored in this article is just one mechanism aimed at doing this—other methods, such as increasing worker voice in corporate affairs—could help move the balance of power in a better direction.²⁰⁵

A second and related implication is that we should recognize the limits of shareholder activism to achieve optimal levels of corporate social responsibility.²⁰⁶ Yes, shareholders may have prosocial goals, and some shareholders may even wish to prioritize those prosocial goals over wealth maximization. But the fact remains that most shareholders are only interested in corporate social responsibility that is also wealth maximizing.²⁰⁷ Moreover, the most influential and powerful shareholders that could credibly threaten management with a proxy fight or other intervention—the squeaky wheel, so to speak—are very much focused on wealth maximization.²⁰⁸

What about large, broadly diversified institutional shareholders? Many scholars have focused on these “universal owners” as a possible solution to major social problems ranging from climate change²⁰⁹ to systemic risk.²¹⁰ The claim is that universal owners should have an incentive to reduce

²⁰⁴ See Gordon, *supra* note 64.

²⁰⁵ S. 3348, 115th Congress (2018); Strine, *supra* note 19. Another possible solution would utilize voting markets to transfer votes for CSR issues to the individuals who value them most—who will not necessarily be the shareholders. For a discussion of this possibility, see Alon Brav & Dorothy Lund, *Voting Markets Revisited* (unpublished manuscript) (on file with authors).

²⁰⁶ See Barzuza et al., *supra* note 53; Condon *supra* note 37, Ellen Quigley, Strine, etc.

²⁰⁷ See CII response to BRT letter, *supra* note XX; see also VANGUARD, INVESTMENT AND STEWARDSHIP (2019) (“We believe that good governance practices—thoughtful board composition, effective oversight of company strategy and risks, aligned pay for performance, and strong provisions to empower shareholders—are the foundation on which a company’s board of directors can build enduring shareholder value.”); *Protecting and Enhancing Our Clients’ Assets for the Long Term.*, BLACKROCK, <https://www.blackrock.com/corporate/about-us/investment-stewardship#our-responsibility> (last visited Nov. 13, 2019).

(“Our engagement priorities promote sound corporate governance and business practices that are consistent with sustainable long-term financial return.”); <https://www.ssga.com/about-us/asset-stewardship.html> (“Our stewardship program utilizes a risk-based approach to identify material ESG thematic topics deemed to have the most material impacts on the long-term value of our portfolio companies.”).

²⁰⁸ See Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance & Corporate Control*, 155 U. Pa. L. Rev. 1021 (2007).

²⁰⁹ Barzuza et al., *supra* note 53; Condon *supra* note 37; Ellen Quigley, etc.

²¹⁰ Yesha Yadav, *Too-Big-To-Fail Shareholders*, 103 Minn. L. Rev. 587 (2018); Gordon, *supra* note 64.

the risk of problems that would threaten their portfolio—which consists of the entire market. In theory, therefore, a universal owner might push a polluting company to raise emissions standards, even if doing so would sacrifice profits, if reduced emissions would safeguard the long-term health of the portfolio.²¹¹

But I am skeptical that universal owner engagement is the solution to these problems. Even if universal owners did take a portfolio-level view of their responsibilities—and the largest universal owners generally deny that this is the case²¹²—how would these investors successfully implement such a strategy? The paradigmatic universal owner is an index fund, which offers investors the opportunity to secure market returns for a low cost. But in order to keep costs low, the index fund needs to minimize overall expenditures—including investments in company-specific information and market research.²¹³ For this reason, index funds primarily focus on governance reforms that can be implemented at scale.²¹⁴ They are not well-positioned to solve problems that have generated substantial debate among informed researchers, such as how companies can minimize risks from climate change. They might not even be able to identify the worst offenders.²¹⁵

And even if index funds had sufficient knowledge to identify problematic companies and push them to sacrifice profits in order to minimize portfolio-level risk, how would they implement that strategy? Shareholder voting is a crude tool to bring about specific changes, and these universal owners have tended to follow rather than lead. For example, they never bring shareholder proposals themselves, and they fail to consistently vote in favor of the prosocial shareholder proposals that are brought by others.²¹⁶ Perhaps behind the scenes engagement would be more

²¹¹ Condon, *supra* note 37.

²¹² Cf. <https://www.blackrock.com/corporate/literature/publication/ftc-hearing-8-competition-consumer-protection-21st-century-011419.pdf>; <https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-index-investing-and-common-ownership-theories-eng-march.pdf> (“Asset managers often offer a variety of investment products, using both index and active strategies, and, as discussed earlier in this paper, each portfolio is managed according to a separate investment mandate. As a result, ascribing a single view on a particular security to an asset manager is not supported by the reality of the business and we do not see why boards would be likely to assume such a uniform view.”).

²¹³ Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. Corp. L. 101 (2018).

²¹⁴ Id.; Marcel Kahan & Edward Rock, *Index Funds and Corporate Governance: Let Shareholders Be Shareholders* (N.Y. Univ. Sch. of Law Law & Economics Research Paper Series, Working Paper No. 18-39, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3295098.

²¹⁵ ESG disclosures could help with this issue, however. See Fisch, Lipton, *supra* note XX.

²¹⁶ Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. (forthcoming Dec. 2019); Tim McLaughlin & Ross Kerber, *Index Funds Invest Trillions But Rarely Challenge Management*, Reuters (Oct. 8, 2019), <https://www.reuters.com/article/us-usa-funds-index-specialreports/index-funds-invest-trillions-but-rarely-challenge-management-idUSKBN1WN107?feedType=RSS&feedName=newsOne>. But see Barzuza et al, *supra* note 53, who describe the State Street campaign to improve board diversity. This campaign is one of the few examples where we see proactive and meaningful ESG activism from the Big Three. As part of this campaign, State Street articulated a goal—increasing board diversity—and supported it with meaningful action—votes against nominating directors at all male boards. And their activity attracted attention from others, including BlackRock and Vanguard, who also targeted the issue and supported it with voting. And these actions resulted in meaningful change. But I view this as the example that demonstrates not the possibilities but the limits of universal owner activism. The universal owner benefits from economies of scope: they can set market wide standards and then enforce them across their large portfolios. See Rock and Kahan, *supra* note XX. But for ESG issues that do not lend themselves to broad portfolio-level application, they are more likely to lack the necessary information and resources to engage in meaningful activism. See Barzuza et al., *supra* note 53 (describing the Big Three’s efforts in environmental activism).

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effective than voting at driving firm-specific changes, but meaningful engagement is time consuming and expensive, and may be ineffective without a credible exit threat.²¹⁷

In sum, shareholders—even the large, universal owners—are unlikely to be the solution to the problem of corporate irresponsibility. Yes, shareholders can push management to focus on long-term wealth creation,²¹⁸ or take a risk on corporate social responsibility that is NPV uncertain, but when it comes to public interested decisions, these are unlikely to be catalyzed by shareholders alone.

The insight that corporate stakeholders may value corporate social responsibility more highly than shareholders reflects on other ongoing conversations within corporate and securities law. For example, Ann Lipton has emphasized the importance of corporate disclosures for the general public, and described how securities law—which mandates disclosure of information that would be material to *investors*—might not achieve the right amount of disclosure from a social welfare perspective.²¹⁹ This insight supports proposals to increase stakeholder disclosures that would shine light on socially harmful corporate behavior—information that would better position corporate stakeholders to act and would facilitate the operation of the bond mechanism identified in this Article.²²⁰

But the fact of the matter is that advocates of social responsibility, for now, are stuck working within the system that we have. And this leads to some perverse consequences. For example, public interested individuals attempt to force corporate disclosure that would benefit the public by “conceal[ing] their true motives.”²²¹ They attempt to bring shareholder proposals that would benefit workers, the environment, and society, by couching those proposals in wealth maximization terms.²²² This is not only misleading,²²³ it strains the entire system.²²⁴ Corporate voting and corporate disclosure were designed for a narrow purpose—accountability to shareholders.²²⁵ When these systems are asked to serve too many masters, we end up in the situation we have today: too many votes, and too much information, for the typical investor to focus on deeply and carefully.²²⁶ If we want companies to pay closer attention to environmental

²¹⁷ See, e.g., Marco Becht et al., *Corporate Governance Through Voice and Exit* (Nov. 8, 2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3456626.

²¹⁸ See Hyun-Dong Kim, *Do Long-Term Institutional Investors Promote Corporate Social Responsibility Activities?*, 101 *Journal of Banking and Finance* (2019) <https://www.sciencedirect.com/science/article/pii/S0378426618302681>.

²¹⁹ Ann M. Lipton, *Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure*, *YALE J. ON REG.* (forthcoming).

²²⁰ *Id.*; see also Fisch.

²²¹ *Id.*

²²² *Id.*

²²³ *Id.*

²²⁴ See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 *J.L. & Econ.* 395 (1983) (“It is well known, however, that when voters hold dissimilar preferences it is not possible to aggregate their preferences into a consistent system of choices. If a firm makes inconsistent choices, it is likely to self destruct. Consistency is possible, however, when voters commonly hold the same ranking of choices (or when the rankings are at least single-peaked.”).

²²⁵ *Id.*

²²⁶ See Strine, *supra* note XX (“If we want institutional investors to wisely focus their voting decisions on sustainable corporate performance, we must reduce the continual mini-referendums occurring each year and the

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and social issues that are priorities for corporate stakeholders, and continue to be constrained to operate within the tools at hand, we need to recognize the collateral consequences that come from using a system that was intended for a different purpose.

This analysis hints at the larger question of whether we should continue to orient our system of corporate law and governance around shareholders, given that it is not always socially optimal to do so. The answer may be no, at least, not always. There are places where giving rights to stakeholders—whether they be informational rights, or legal rights—would likely result in positive changes from a social welfare perspective. As discussed, giving corporate stakeholders voice would enable corporations to make some public interested choices. But the difficulty is designing a system that would empower outsiders without eliminating the accountability that comes from a shareholder-wealth maximization default.²²⁷ In addition, it will be challenging to reorient our system of law, markets, and culture—what Elizabeth Pollman and I have dubbed “The Corporate Governance Machine”—in a new direction.²²⁸ In the meantime, as that project forges on, this paper proposes a course of action that would allow corporate outsiders to influence corporate decision-making now—one decision at a time.

V. Conclusion

[To come]

huge number of votes shareholders must cast each year, which encourages companies to manage to the changing whims of the stock market and institutional investors to outsource voting decisions to proxy advisory firms.”).

²²⁷ See HENRY HANSMANN, *THE OWNERSHIP OF ENTERPRISE* 44 (2000); Berle *supra* note 117; Easterbrook & Fischel, *supra* note 224 (arguing that asking different corporate law stakeholders to vote would result in a lack of consensus and could lead the corporation to “self-destruct”). *But see* Grant Hayden & Matthew Bodie, *Arrow’s Theorem and the Exclusive Shareholder Franchise*, 62 *Vand. L. Rev.* 101 (2009).

²²⁸ See *supra* note XX.