MILTON FRIEDMAN HAS A LOT TO ANSWER FOR: A RESPONSE TO JOSHUA FERSHEE'S "LONG LIVE DIRECTOR PRIMACY: SOCIAL BENEFIT ENTITIES AND THE DOWNFALL OF SOCIAL RESPONSIBILITY"

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In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to their basic rules of the society, both those embodied in law and those embodied in ethical custom.

Milton Friedman[1]

In his seminal article, economist Milton Friedman restated his position that "there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits . . . ."[2] Evangelical Friedman preached to an appreciative choir, and his shareholder wealth maximization[3] ("SWM") *theory*, emphasis

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* Waller Lansden Distinguished Professor of Law, University of Tennessee College of Law. Email: jacobs@utk.edu. A sincere thank you to my amazing colleagues, Joan Heminway and George Kuney, who always organize wonderfully stimulating symposia and who allow me to participate, and to Rebekah Pritchard and Elizabeth Holland, the Transactions editors who went far above and beyond to make the event possible and enjoyable. Thanks also to all of the Business Law Prof Bloggers who attended and stimulated the intellect, particularly Joshua Fershee, whose insightful work provided the basis for my response. Finally, a heartfelt thanks to Brad Finney, UT Law 2018, for his erudite participation and snappy comebacks.

1 Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at SM17.

2 *Id.* (quoting MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962)).

3 For this essay, I will use the terms "shareholder primacy" and "shareholder wealth maximization" interchangeably.

intended, has survived Gordon Gekko's "greed is good" era[4] to become a foundational corporate doctrine. While, as my colleague Joan Heminway so succinctly notes, "none of [the relevant] statutory frameworks regarding officer and director management or conduct mention—no less require—management action in a manner that maximizes shareholder wealth or value or compels shareholder primacy[,]"[5] shareholder primacy and the maximization of shareholder wealth are axiomatic corporate governance objectives. Even if it has not been codified, SWM is the mantra by which most corporate lawyers and MBAs are indoctrinated and how they frame their advice to directors: "maximize shareholder wealth." This makes sense given that, until the relatively recent introduction of benefit corporate structures, our system was structured binarily as for profit or non-profit, with our securities and tax laws regulating and perpetuating the distinctions.

It is a particularly rational belief in Delaware, where the judiciary appears to have quite a thirst for Friedman's economic "Kool-Aid."[6]

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[4] This quote was made famous in a speech made by Michael Douglas in his role as Gordon Gekko. WALL STREET (Twentieth Century-Fox Film Corp. 1987).

[5] Joan MacLeod Heminway, *Shareholder Wealth Maximization as a Function of Statutes, Decisional Law, and Organic Documents*, 74 WASH. & LEE L. REV. 939, 948 (2017) (citing Stephen M. Bainbridge, *Interpreting Non-Shareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 990 (1992)).

[6] A humorous representation of Friedman's "Free-Market Kool Aid" appears in DAILY KOS. Azazello, *Milton Friedman: The Man Who Made the Kool-Aid*, DAILY KOS (June 2, 2010, 6:32 PM), https://www.dailykos.com/stories/2010/6/2/869765/-. Beginning with *Dodge v. Ford*, 170 N.W. 668 (Mich. 1919), the Delaware courts have consistently concluded that for-profit corporations must seek profit for their stockholders. *See, e.g.*, eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1985). In a published speech eerily reminiscent of both the tone and the substance of Milton Friedman's writings, Chancellor Leo Strine of the Delaware Court of Chancery states unequivocally that "for-profit corporations will seek profit for their stockholders using all legal means available[.]" Leo E. Strine, Jr., *Our Continuing Struggle with the Idea that For-Profit Firms Seek Profit*, 47 WAKE FOREST L. REV. 135, 136 (2012). The fact that courts have rarely had to opine on director obligations regarding shareholder wealth maximization is likely attributable to the

Despite the fact that the Delaware Code does not require that corporations be formed for a specific purpose,[7] nor does it directly specify the constituency on whose behalf the directors manage a corporation's affairs,[8] it is difficult to ignore the words of Delaware Chief Justice Strine in his 2015 Wake Forest Law Review article in which he opines that it is a pretense "that directors do not have to make stockholder welfare the sole end of corporate governance within the limits of their legal discretion, under the law of the most important American jurisdiction – Delaware."[9]

Delaware judiciary's strong adherence to the business judgement rule. As one commentator has so eloquently and concisely put it:

> Because of the business judgment rule, directors have near total discretion to run firms the way they see fit. It is true, therefore, that it is nearly impossible to enforce the shareholder primacy norm through litigation, absent, essentially, an explicit statement by directors that they are managing the firm towards some other goal. Absent, that is, a confession that negates the presumption of good faith that the business judgment rule supplies.

David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L.J. 181, 223 (2013).

[7] DEL. CODE ANN. tit. 8, § 101(b).

[8] *Id.* § 141(a). Commentators contend that Delaware code indirectly imposes fiduciary duties on directors to the corporation and its stockholders by authorizing corporations to excuse directors from liability for breaches of that obligation: "the certificate of incorporation may also contain . . . [a] provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty . . . ." *Id.* § 102(b)(7).

[9] 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*, 50 WAKE FOREST L. REV. 761, 763–64 (2015).

In this symposium and elsewhere,[10] Joshua Fershee expresses his concern that the rise of social benefit entities only reinforces this normative trend, undermining director primacy and providing even stronger grounds for judicial scrutiny of director decisions with public or social benefit aspects. In his article for this symposium, Professor Fershee states:

> [T]here is an increased risk that traditional entities will be viewed (by both courts and directors) as pure profit vehicles, eliminating directors' ability to make choices with the public benefit in mind, even where the public benefit is also good for business (at least in the long term). Narrowing directors' decision making in this way limits the options for innovation, building goodwill, and maintaining an engaged workforce, to the detriment of employees, society, and, yes, shareholders.[11]

I both agree and disagree with Professor Fershee's gloomy assessment of the state of play in this area of the law. I agree that he may be at least theoretically correct in Delaware and that he will find support among the judiciary in that state.[12] However, I disagree more generally

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[10] *See, e.g.*, Joshua Fershee, *Long Live Director Primacy: Social Benefit Entities and the Downfall of Social Responsibility*, L. PROFESSOR BLOGS NETWORK: BUS. L. PROF BLOG (July 18, 2017), http://lawprofessors.typepad.com/business_law/2017/07/long-live-director-primacy-social-benefit-entities-and-the-downfall-of-social-responsibility.html.

[11] Joshua P. Fershee, *The End of Responsible Growth and Governance?: The Risks Posed by Social Enterprise Enabling Statutes and the Demise of Director Primacy*, 19 TENN. J. BUS. L. 361 (2017).

[12] One might infer this from public writings of the Chief Justice, Delaware Supreme Court Leo E. Strine, Jr.:

> That is what is refreshing about the benefit corporation movement. Rather than ignore the importance of the accountability structure within

for several reasons, the first of which is that Delaware is just one State among fifty, even if it is incredibly influential in the corporate law context.[13] Further, while SWM may be a strong, persistent, judicially-created norm in Delaware, constantly reinforced by some of the very judges who helped to establish and are determined to maintain its dominance,[14] even its most ardent advocates acknowledge that, as

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> which corporate managers operate, the benefit corporation movement set out to change it. In the liberal tradition of incremental, achievable reform rather than radical renovation, the benefit corporation is a modest evolution that builds on the American tradition of corporate law. But that evolution is potentially important because, if it gains broader market acceptance, the benefit corporation model puts some actual power behind the idea that corporations should be governed not simply for the best interests of stockholders, but also for the best interests of the corporation's employees, consumers, and communities, and society generally.

Leo E. Strine, Jr., *Making It Easier for Directors to "Do the Right Thing"?,* 4 HARV. BUS. L. REV. 235, 242 (2014).

[13] *See infra.* Discussions on the topic of corporate purpose are incredibly confusing for the uninitiated; commentators are all over the map. There is a dizzying array of special purpose legal mechanisms designed for profit distribution and CSR impact: (1) a low-profit limited liability company; (2) a flexible purpose corporation; (3) a social purpose corporation; (4) a benefit corporation; and (5) a benefit LLC. *See, e.g.*, Orrick, Herrington & Sutcliffe LLP, Report, *Balancing Purpose and Profit: Legal Mechanisms to Lock in Social Mission for "Profit with Purpose" Businesses across the G8*, 8 (Dec. 2014), https://www.trust.org/contentAsset/raw-data/1d3b4f99-2a65-49f9-9bc0-39585bc52cac/file.

When discussing corporate purpose or director responsibility or fiduciary duty, some business law experts speak in terms of SWM; some in terms of Shareholder Primacy; some in terms of Director Primacy; and yet others of the Business Judgment Rule. For non-academics trying to find solid guidance on how to structure their business affairs, it is a minefield of acronyms, disagreements, confusion, and contention.

[14] *See, e.g.*, Strine, *supra* note 6.

previously mentioned, no statute imposes a legal obligation on directors to maximize short-term shareholder wealth in the ordinary course of everyday business decision-making.[15]

Too, let us not forget the Business Judgment Rule ("BJR"), which is alive and well in Delaware and elsewhere. As Delaware's Chancellor Chandler himself acknowledged in the *eBay* case, under the BJR, absent conflicts of interest, there is a presumption that directors acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company.[16] While he ultimately decided in that case that the craigslist directors were not entitled to the BJR presumption, the Chancellor stated that, "[w]hen director decisions are reviewed under the business judgment rule, this Court will not question rational judgments about how promoting non-stockholder interests—be it through making a charitable contribution, paying employees higher salaries and benefits, or more general norms like promoting a particular corporate culture—ultimately promote stockholder value."[17]

It is also significant that a substantial number of states, some thirty plus or so, have adopted "other constituency" statutes that emphasize management's ability to consider the effects of corporate action on a variety of stakeholders when exercising business judgment.[18] Permissible constituency groups vary from state to state, but typically

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[15] Joan MacLeod Heminway, *supra* note 5, at 946.

[16] *See eBay*, 16 A.3d at 36.

[17] *Id.* at 33. The Chancellor concluded that the business judgment rule's protections did not apply to the ROFR/Dilutive Issuance. *Id.* at 41–47.

[18] Christopher Geczy et al., *Institutional Investing When Shareholders Are Not Supreme*, 5 HARV. BUS. L. REV. 73, 105–14 (2015) (presenting the thirty-three constituency state statutes in Appendix A, including Tennessee's statute, TENN. CODE ANN. § 48-103-204 (2016)). Professor Haskell Murray also discussed Tennessee's "other constituency" statute in his presentation, and the accompanying article, for this symposium. *See* J. Haskell Murray, *Examining Tennessee's For-Profit Benefit Corporation Law*, 19 TENN. J. BUS. L. 325, 337 (2017).

include employees, creditors, customers, suppliers, and the community in which a corporation is located.[19]

Noteworthy too are the number of "traditional" publicly-traded C-corporations incorporated in Delaware that top the ranks of the most socially conscious companies, including Alphabet (Google) and Kellogg Company.[20] These entities, and others like them, including Walt Disney Company and Amazon, are quite open about their corporate social responsibility ("CSR") missions.[21] The difference between these entities and the newer benefit corporations is that the boards of benefit corporations not only are explicitly *permitted* to consider non-profit-maximizing goals, non-shareholder constituencies, and the environment, among other things, in governance decision-making, but rather that they are *required* to do so.[22] Further, many of the statutes under which benefit

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[19] *See, e.g.*, TENN. CODE ANN. § 48-103-204, which states, in part, that:

> [N]or [shall] any of its officers and directors . . . be held liable at law or in equity for . . . for opposing any proposed merger, exchange, tender offer or significant disposition of the assets of the resident domestic corporation or any subsidiary of such resident domestic corporation because of a good faith belief that such merger, exchange, tender offer or significant disposition of assets would adversely affect the resident domestic corporation's employees, customers, suppliers, the communities in which such resident domestic corporation or its subsidiaries operate or are located.

Id.

[20] GOOGLE, https://environment.google/; KELLOGG, http://www.kelloggcompany.com/en_US/corporate-responsibility.html; *see also* Jessica Chu, Note, *Filling a Nonexistent Gap: Benefit Corporations and the Myth of Shareholder Wealth Maximization*, 22 S. CAL. INTERDISC. L.J. 155, 191 (2012).

[21] *See, e.g.*, WALT DISNEY COMPANY, http://purpleteamdoesdisney.weebly.com/csr.html; AMAZON, https://www.amazon.com/p/feature/wnsdvqqghme982o.

[22] *See, e.g.*, DEL. CODE ANN. tit. 8, § 362(a) (2016) ("A 'public benefit corporation' is a for-profit corporation organized under and subject to the requirements of this chapter

corporations are formed conspicuously state that these new forms are not intended to, and will not, have an impact on the law pertaining to other existing business entity forms.[23]

Thinking more philosophically, the SWM theory more generally assumes that there is a single definition of "shareholder" and one agreed-upon notion of what that theoretical shareholder values, assumptions I strongly dispute. The various shareholders of one particular company have different needs and interests depending upon their investing time horizons, degree of diversification and interests in other assets, and perspectives on corporate ethics and social responsibility. The SWM ideology appears to focus primarily on the interests of only a narrow subgroup of shareholders whose focus is on short-term, opportunistic financial plays. Short-term management decisions often are made at the expense of long-term performance—think Enron, Tyco, WorldCom, and

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that is intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner. To that end, a public benefit corporation shall be managed in a manner that balances the stockholders' pecuniary interests, the best interests of those materially affected by the corporation's conduct, and the public benefit or public benefits identified in its certificate of incorporation. In the certificate of incorporation, a public benefit corporation shall: (1) Identify within its statement of business or purpose pursuant to § 102(a)(3) of this title 1 or more specific public benefits to be promoted by the corporation; and (2) State within its heading that it is a public benefit corporation."). While directors of benefit corporations are shielded from personal liability, shareholders, sometimes based upon a size threshold, are authorized to bring derivative suits, or benefit enforcement proceedings, if boards ignore their benefit responsibilities. *See id.* § 367 ("Stockholders of a public benefit corporation owning individually or collectively, as of the date of instituting such derivative suit, at least 2% of the corporation's outstanding shares or, in the case of a corporation with shares listed on a national securities exchange, the lesser of such percentage or shares of at least $2,000,000 in market value, may maintain a derivative lawsuit to enforce the requirements set forth in § 365(a) of this title.").

[23] *See, e.g.*, *id.* § 368 (2013) ("This subchapter shall not affect a statute or rule of law that is applicable to a corporation that is not a public benefit corporation . . . .").

other corporate scandals.[24] These opportunities often externalize costs, may be ethically questionable or even criminal, and may be at the expense of the welfare of others.

There is a growing body of academic literature that supports the link between higher social and environmental performance and long-term financial performance.[25] The triple-bottom-line approach to sustainable business, which measures corporate performance and success in three separate dimensions: "economic prosperity, environmental quality, and social justice,"[26] is attracting more and more corporate adherents. Indeed, the "business case" showing how firms benefit from engaging in acts of CSR is so well-established that it would be challenging for even the Freidman Kool-Aid-imbibing Justice Strine and Chancellor Chandler from Delaware to find socially responsible decisions that are made in the name of SWM to be a breach of director fiduciary duty.

And, there is already a significant market for socially-responsible investors who reject those outcomes, and that market is increasing.[27]

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[24] *See generally* William S. Lerach, *Plundering America: How American Investors Got Taken for Trillions by Corporate Insiders*, 8 STAN. J.L. BUS. & FIN. 69 (2002) (discussing the nature of these and related scandals).

[25] *See, e.g.*, Gunnar Friede et al., *ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies*, 5 J. SUSTAINABLE FIN. & INV. 210, 212 (2015).

[26] Judd F. Sneirson, *Green Is Good: Sustainability, Profitability, and a New Paradigm for Corporate Governance*, 94 IOWA L. REV. 987, 991 (2009) (citing JOHN ELKINGTON, CANNIBALS WITH FORKS: THE TRIPLE BOTTOM LINE OF 21ST CENTURY BUSINESS 55 (1998)).

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> According to Bloomberg, about 84% of millennials are interested in socially responsible investing, and that figure is not expected to change as the generation ages, suggesting that demand for sustainable products will only increase. . . . [O]ver the long term, it should provide returns greater than funds that are not focused on ESG investing. . . . For this reason, current investors and the largest

Indeed, shareholders are demanding it. In 2017 alone, shareholders submitted some 345 proposals related to environmental and social issues to public companies for presentation at shareholder meetings,[28] constituting 56% of all shareholder proposals.[29] Three climate change-related proposals introduced at ExxonMobil, Occidental Petroleum, and PPL, a utility holding company, received the support of a majority of shareholders; overall, climate change proposals received an average 33.8% support from shareholders.[30]

Most significantly, this support is coming not just from so-called ESG (environmental, social, and governance factors) activist investors such as the disdainfully-termed "gadfly" investors and the active socially-oriented investment funds such as Trillium Asset Management and the Nathan Cummings Foundation. It also is coming from large institutional investors like BlackRock, Vanguard, and Fidelity, and the powerful pension funds in New York, the New York State Common Retirement Fund, and in California, the California Public Employees Retirement System (CalPERS).[31]

Despite all of these points of disagreement with Professor Fershee's prognosis, I cannot ignore the conditioned response that the

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> financial advisors are also moving in this direction, creating another tailwind for ESG companies and investments.

MoneyShow, *Socially-Responsible Investing: Earn Better Returns from Good Companies*, FORBES, (Aug. 16, 2017), https://www.forbes.com/sites/moneyshow/2017/08/16/socially-responsible-investing-earn-better-returns-from-good-companies/#623a3989623d.

[28] Ronald O. Mueller & Elizabeth Ising, *Shareholder Proposal Developments During the 2017 Proxy Season*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (July 12, 2017), https://corpgov.law.harvard.edu/2017/07/12/shareholder-proposal-developments-during-the-2017-proxy-season/.

[29] James R. Copland & Margaret M. O'Keefe, *2017 Finding: Climate-Change Proposals Break Through*, PROXYMONITOR (2017), http://www.proxymonitor.org/Forms/2017 Finding1.aspx.

[30] *See id.*

[31] *Id.*

SWM norm invokes in corporate boards, even in the absence of an enforceable legal requirement. We are fortunate that we have not adopted the concept of customary law as exists in international public law. It may very well be that creating new structures that authorize/mandate corporate social responsibility actions will make legal counsel and directors at traditional entities even more risk reverse in this regard. Why even take the chance? If your board insists, wise counsel would confirm that, in Delaware, the action would, in Chief Justice Strine's terms, "advance the interests of stockholders in the long run"?[32] There may be counsel recommending that their clients incorporate in states with "other constituency" statutes or in jurisdictions with a judiciary less populated with Freidman acolytes. Perhaps Delaware will not always be the most important American jurisdiction[33] if its legal framework is not conducive to the way that businesses seek to operate in today's environment, regardless of the sophistication of that framework.

The real danger that I see in the debate whether SWM is the law or whether benefit corporation forms further entrench an already-firmly-established SWM norm is that the prevalence of the norm provides an excuse for unscrupulous managers and boards of traditional corporations to engage in short-term profit maximizing activities at the expense of CSR efforts, a situation which will prove unfortunate both for society at large and for shareholders over the long-term. As one pair of commenta-

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[32] Strine, *supra* note 9, at 764. (noting that commentators are not convinced that corporations can engage in private ordering in its charter, bylaws, shareholders, or board policies to mandate a corporate purpose that is inconsistent with SWM). *See, e.g.*, Heminway, *supra* note 5, at 939, 966–67.

[33] *See infra*. Specialized courts exist in twenty-eight states to resolve complex business disputes, and similar courts are being formed internationally. *See, e.g.*, Order Establishing the Davidson County Business Court Docket Pilot Project – Phase 2, TENN. SUP. CT. (April 4, 2017), http://tncourts.gov/sites/default/files/docs/order_establishing_davidson_county_business_court_docket_pilot_project-phase_2. pdf; *see also* Michael Cross, *Brussels Latest to Announce English-Language Business Court*, THE LAW SOC'Y GAZETTE (October 30, 2017) (mentioning proposals for English-language courts in Belgium, France, and The Netherlands), https://www.lawgazette.co.uk/practice/brussels-latest-to-announce-english-language-business-court/5063460.article.

tors has opined: "Shareholder primacy and shareholder wealth maximization are merely convenient scapegoats upon which to place the blame for wrongful conduct."[34]

[34] Justin Blount & Kwabena Offei-Danso, *The Benefit Corporation: A Questionable Solution to a Non-Existent Problem*, 44 ST. MARY'S L.J. 617, 669 (2013).