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A STATUTORY MODEL FOR CORPORATE CONSTITUENCY CONCERNS

*Edward S. Adams**
*John H. Matheson***

> *The modern corporation by its nature creates interdependencies with a variety of groups with whom the corporation has a legitimate concern, such as employees, customers, suppliers, and members of the communities in which the corporation operates.*[1]

Corporate governance involves a system of contractual and fiduciary duties that influence directors and officers to make decisions consistent with defined obligations. This system requires that directors consider shareholders' interests first and foremost in making corporate decisions because the shareholders are the "owners" of the corporation.[2] Over the past several decades, a number of states have implemented this policy by enacting constituency statutes.[3] These statutes transform the obligations of corporate directors by expanding the groups to which boards of directors are accountable in decisionmaking, greatly impacting the management decisions of business firms.[4] Both legal and economic changes result from redefining the duties of corporate directors, ultimately transforming American business.

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[1] 1 AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE ANALYSIS AND RECOMMENDATIONS § 2.01 cmt. f, at 57 (1994).

[2] *See* R. Cammon Turner, *Shareholders vs. the World: 'Revlon Duties' and State Constituency Statutes*, BUS. L. TODAY, Jan./Feb. 1999, at 32, 33 (stating that corporate directors owe fiduciary duties exclusively to the corporation, raising an obligation to act in the best interests of the shareholders).

[3] *See infra* note 9.

[4] *See* Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 134 (1992) (stating that "[c]onstituency statutes plainly were meant to expand the corporate fiduciary duty of care and the business judgment rule, and they should be applied accordingly"); *see also* Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 589 (1992) (illustrating how constituency statutes threaten to revolutionize generations of corporation law by changing the established principle that directors owe fiduciary duties primarily to shareholders); Turner, *supra* note 2, at 33 (noting that corporate governance has evolved to include consideration of parties other than shareholders); Katherine Van Wezel Stone, *Employees As Stakeholders Under State Non-*

This development has engendered a hot debate about the desirability of such a policy.[5] This Article posits that the best solution is to simply offer a choice to corporations, corporate management, shareholders, and stakeholders by enacting an opt-out statute.[6] An opt-out statute would create a default rule that makes consideration of nonshareholder interests mandatory upon incorporation, but allows shareholders to amend the articles to favor themselves if they so choose.[7]

The Article will give a description of both the shareholder primacy model and constituency statutes. However, because constituency statutes are relatively new and corporate law has historically been based on the shareholder primacy model,[8] the Article will focus primarily on the policies behind and justification for constituency statutes. While we will provide a form of model corporate constituency statute, we do not advocate one position over another. Instead, we advocate the idea that corporations should begin as stakeholder-centered, but then have a choice to focus on the shareholder if they decide to do so.

I. UNDERSTANDING CONSTITUENCY STATUTES

Thirty-two states have adopted some form of constituency statute, exemplifying the prominence of constituency statutes' underlying principles.[9] In gen-

shareholder Constituency Statutes, 21 STETSON L. REV. 45, 47 (1991) (stating that constituency statutes create fiduciary duties on the part of directors to stakeholders other than shareholders); Gary von Stange, *Corporate Social Responsibility Through Constituency Statutes: Legend or Lie?,* 11 HOFSTRA LAB. L.J. 461, 462 (1994) (explaining that the new corporate social responsibility created by constituency statutes threatens to change traditional fiduciary duties of the board of directors).

[5] *See infra* Part I.B.

[6] *See infra* Part VII.

[7] *See infra* notes 26-31 and accompanying text (comparing mandatory, permissive, and opt-in constituency statutes).

[8] *See infra* Part II and note 30 and accompanying text.

[9] *See* John H. Matheson & Brent A. Olson, *Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation,* 59 GEO. WASH. L. REV. 1425, 1520 (1991) (showing that, as of 1991, the following states each had adopted some form of constituency statute: Arizona, Arkansas, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Virginia, Washington, Wisconsin, and Wyoming). Since then, four states, Maryland, Nevada, North Dakota, and Vermont, have added statutes while one state, Connecticut, repealed its statute. *See, e.g.,* ARIZ. REV. STAT. ANN. § 10-2702 (West 1996); FLA. STAT. ANN. § 607.0830 (West 1993 & Supp. 2001); GA. CODE ANN. § 14-2-202 (1994 & Supp. 2000); HAW. REV. STAT. § 415-35 (1993 & Supp. 1999); IDAHO CODE § 30-1-1602 (1999); 805 ILL. COMP. STAT. 5/8.85 (West 1999); IND. CODE ANN. § 23-1-35-1 (Michie 1999); IOWA CODE ANN. § 491.101B (West 1999); KY. REV. STAT. ANN.

eral, "[c]onstituency statutes purport to allow directors of public corporations to consider an expanded group of 'interests' when making decisions on behalf of the corporation or, more precisely, decisions concerning the course of the corporation's business."[10] "The interests defined vary from state to state, but always include interests beyond shareholders, the primary group to whom directors must traditionally answer."[11]

In fact, some "constituency statutes" allow directors to virtually consider the world in arriving at control transaction decisions.[12] The Minnesota statute is illustrative, stating that:

> [A] director may, in considering the best interests of the corporation, consider the interests of the corporation's employees, customers, suppliers, and creditors, the economy of the state and nation, community and societal considerations, and the long-term as well as short-term interests of the corporation and its shareholders including the possibility that these interests might be best served by the continued independence of the corporation.[13]

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§ 271B.12-210 (Michie 1989 & Supp. 2000); LA. REV. STAT. ANN. § 12:92 (West 1994); ME. REV. STAT. ANN. tit. 13-A, § 716 (West 1981 & Supp. 2000); MD. CODE. ANN., CORPS. & ASS'NS § 2-104(9) (1999 & Supp. 2000); MASS. GEN. LAWS ANN. ch. 156B, § 65 (West 1996); MINN. STAT. ANN. § 302A.251 (West 1985 & Supp. 2001); MISS. CODE. ANN. § 79-4-8.30 (1999 & Supp. 2000); MO. REV. STAT. 351.347 (1986); NEB. REV. STAT. § 21-2432 (1997); NEV. REV. STAT. ANN. § 78.138 (Michie 1999); N.J. STAT. ANN. § 14A:6-1 (West 1969 & Supp. 2000); N.M. STAT. ANN. § 53-11-35 (Michie 1983); N.Y. BUS. CORP. LAW § 717 (McKinney 1986 & Supp. 2001); N.D. CENT. CODE § 10-19.1-50 (1995 & Supp. 1999); OHIO REV. CODE ANN. § 1701.59 (Anderson 1997 & Supp. 2001); OR. REV. STAT. § 60.357 (1988); 15 PA. CONS. STAT. ANN. § 1715 (West 1995); R.I. GEN. LAWS § 7-5.2-8 (1999); S.D. CODIFIED LAWS § 47-33-4 (Michie 2000); TENN. CODE ANN. § 48-103-204 (1995); VT. STAT. ANN. tit. 11A, § 8.30 (1997 & Supp. 1999); VA. CODE ANN. § 13.1-727.1 (Michie 1999); WIS. STAT. ANN. § 180.0827 (West 1992); WYO. STAT. ANN. § 17-16-830 (Michie 1999); *see also infra* Appendix.

[10] Jonathan R. Macey, *Fiduciary Duties As Residual Claims: Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective*, 84 CORNELL L. REV. 1266 (1999) (arguing that nexus-of-contract theory allows shareholders and stakeholders to revise their fiduciary duties via contracts).

[11] Orts, *supra* note 4, at 26-27 (stating that the interests directors must consider under constituency statutes include those of suppliers, customers, employees, creditors, and the community in which the corporation conducts its primary business); *see also* Wai Shun Wilson Leung, Comment, *The Inadequacy of Shareholder Primacy: A Proposed Corporate Regime that Recognizes Nonshareholder Interests*, 30 COLUM. J.L. & SOC. PROBS. 587 (1997) (arguing that the existing corporate regime in which maximizing shareholder profits is the overriding duty of management should be replaced with mandate that boards must consider equally the interests of stakeholders and shareholders when decisions can affect both groups).

[12] These statutes were originally designed to provide target company boards of directors more leeway in fending off hostile takeovers. *See* Matheson and Olson, *supra* note 9, at 1450 ("One scholar asserts that these statutes 'vesting of such extraordinarily broad discretion in a board' likely affirms the 'just say no' defense."); *see also* Thomas J. André, *Preliminary Inquiry into the Utility of Vote Buying in the Market for Corporate Control*, 63 S. CAL. L. REV. 533, 573 (1990). Directors' duties statutes potentially provide directors with much greater leeway in rejecting tender offers than current case law.

[13] MINN. STAT. ANN. § 302A.251, subd. 5 (West Supp. 1985).

The effect of this legislation is to help shield directors from liability by expanding the criteria that directors may consider in reaching corporate decisions. Notions of corporate governance and director duties are expanding to consider the desires of a wider group of individuals. This change is exemplified by the adoption of constituency statutes.

A. *Scope of Constituency Statutes*

Despite the traditional view of shareholders as "owners" of corporations whose interests are superior to all others, no state corporation code in existence specifies that the directors of a corporation owe a fiduciary duty solely to the shareholders.[14] Accordingly, each state implicitly recognizes that a broader group of interests may be considered even absent any constituency statute in its code.[15] Constituency statutes transform this implicit principle into an explicit proviso of the law, minimizing ambiguity as to the breadth of directors' responsibilities by explicitly delineating the groups of individuals to whom directors are accountable.

The breadth of interests that a board of directors or a corporation's officers may consider in making corporate decisions is the defining characteristic of constituency statutes.[16] While all directors' duties statutes use similar language, they exhibit several strands of variation: (1) the breadth of factors directors may consider;[17] (2) the applicable contexts in which nonshareholder interests may be considered (e.g., some states limit application to takeover contexts);[18] (3) the corporate fiduciaries protected by the statute (e.g., Illinois's statute protects officers of a corporation);[19] (4) the nonshareholders specifically protected (e.g., Wyoming's statute provides for specific protection to bondholders in a takeover context);[20] (5) the level of protection: Indiana and Pennsylvania have enacted statutes that enhance protection of a board's decision.[21] With respect to applicability, these statutes have taken three primary forms: *permissive*, which is the form adopted by the majority of the

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[14] Steven M.H. Wallman, *The Proper Interpretation of Corporate Constituency Statutes and Formulation of Director Duties*, 21 STETSON L. REV. 163, 166 (1991) (noting that a few corporation codes specify that directors have a duty to the corporation *and* its shareholders).

[15] *See* Bob Jones Univ. v. United States, 461 U.S. 574 (1983) (holding that legislative inaction can be construed as legislative opinion).

[16] *See* von Stange, *supra* note 4, at 479-80.

[17] *See infra* Appendix.

[18] *See id.*

[19] *See id.*

[20] *See id.*

[21] *See id.*

jurisdictions promulgating constituency laws;[22] *mandatory*, which has thus far been adopted only in Connecticut;[23] and *opt-in*, found only in Georgia.[24]

Permissive statutes authorize directors to consider a wider group of interests when making corporate decisions if they so choose. Accordingly, permissive statutes *allow* consideration of stakeholder interests without *demanding* it.[25] They do not require any further corporate action before contemplation of stakeholder interests can be included.[26] Mandating statutes strictly *require* directors to take into account a wider group of interests when making corporate decisions.[27] Instead of granting authority, these statutes impose a strict obligation on directors to consider stakeholder interests in decisionmaking.[28] Opt-in statutes merely give an individual corporation the option either to invoke the coverage of the state's constituency statute in its articles of incorporation, or to forgo governance by the statute through neglecting that election.[29] Such a statute does not grant authority to the board to consider stakeholder interests unless the corporation specifically elects to be governed by the statute in its articles of incorporation.[30] Though they differ in their practical application to corporate governance, each of these types of constituency statutes is plainly meant to expand the corporate fiduciary duty of care to encompass interests beyond those of the shareholders of the corporation.

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22 *See, e.g.*, ARIZ. REV. STAT § 10-2702 (West 1996); FLA. STAT. ANN. § 607.0830 (West 1993 & Supp. 2001); HAW. REV. STAT. § 415-35 (1993 & Supp. 1999); IDAHO CODE § 30-1-1602 (1999); 805 ILL. COMP. STAT. § 5/8.85 (West 1999); IND. CODE ANN. § 23-1-35-1 (Michie 1999); IOWA CODE ANN. § 491.101B (West 1999); KY. REV. STAT. ANN. § 271B.12-210 (Michie 1989 & Supp. 2000); LA. REV. STAT. ANN. § 12:92 (West 1994); ME. REV. STAT. ANN. tit. 13-A, § 716 (West 1981 & Supp. 2000); MASS. GEN. LAWS ANN. ch. 156B, § 65 (West 1996 & Supp. 2000); MINN. STAT. ANN. § 302A.251 (West 1985 & Supp. 2001); MISS. CODE. ANN. § 79-4-8.30 (1999 & Supp. 2000); MO. REV. STAT. 351.347 (1986); NEB. REV. STAT. § 21-2432 (1997); N.J. STAT. ANN. § 14A:6-1 (West 1969 & Supp. 2000); N.M. STAT. ANN. § 53-11-35 (Michie 1983); N.Y. BUS. CORP. LAW § 717 (McKinney 1986 & Supp. 2001); OHIO REV. CODE ANN. § 1701.59 (Anderson 1997 & Supp. 2001); OR. REV. STAT. § 60.357 (1988); 15 PA. CONS. STAT. ANN. § 1715 (West 1995); R.I. GEN. LAWS § 7-5.2-8 (1999); S.D. CODIFIED LAWS § 47-33-4 (Michie 2000); TENN. CODE ANN. § 48-103-204 (1995); VA. CODE ANN. § 13.1-727.1 (Michie 1999); WIS. STAT. ANN. § 180.0827 (West 1992); WYO. STAT. ANN. § 17-16-830 (Michie 1999).

23 *See* CONN. GEN. STAT. ANN. § 33-756 (West 1997).

24 *See* GA. CODE ANN. § 14-2-202 (1994).

25 *See supra* note 23.

26 *See id.*

27 *See* CONN. GEN. STAT. ANN. § 33-756 (West 1997).

28 *See id.*

29 *See* GA. CODE ANN. § 14-2-202 (1994).

30 *See id.*

B. Historical Debate over the Consideration of Multiple Constituencies

Consideration of multiple constituencies grew out of an ongoing debate between fundamental viewpoints—those of traditionalists and constructionists. This debate was best noted in the popular arguments between Professors Adolf Berle and Merrick Dodd in the 1930s.[31] Berle and other traditionalists urged primacy of shareholder interests because shareholders are traditionally the parties to which directors and officers owe a fiduciary duty to return their initial investment.[32] Because a conflict of interest arises when directors and officers consider interests other than those of shareholders, the traditionalist viewpoint demands that only one group's interests—the shareholders'—constitute the focus of director decisionmaking.[33]

Dodd and other constructionists, on the other hand, urged consideration of the interests of various corporate constituents, including both shareholders and stakeholders.[34] They recognized that the corporation consists of many individuals with a stake in the firm's welfare, such as employees, suppliers, and creditors, and the general public.[35] Accordingly, the constructionists sought to include the interests of these individuals in decisionmaking in addition to the interests of shareholders.[36]

The following diagram demonstrates the increased complexity of the decisionmaking process of a corporation under the constituency statute regime of the constructionists:

[31] *See* Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 971-72 (1992) (illustrating the clashing of traditionalist and constructionist viewpoints exemplified by Professors Berle and Dodd).

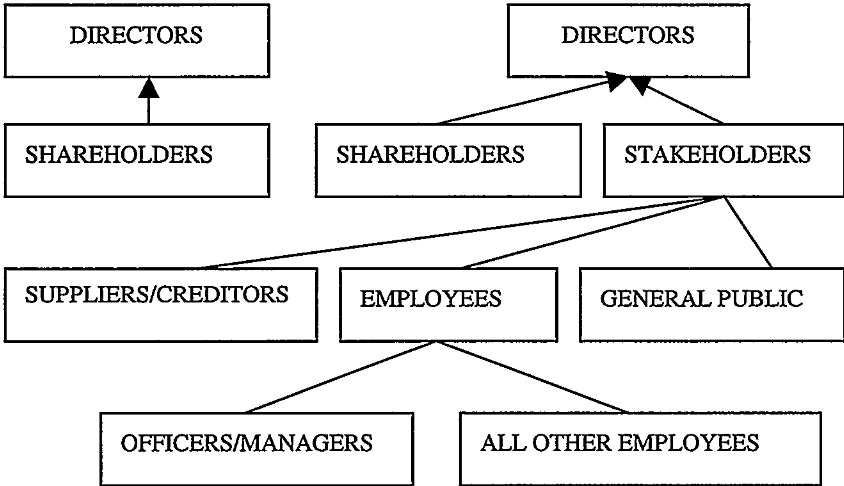
[32] *See id.* at 972 (illustrating that Professor Berle espoused the traditionalist viewpoint that "the board of directors should operate the corporation for the sole benefit of the shareholders .... [C]orporate concern for nonshareholder interests is appropriate only if shareholder interests are thereby advanced.").

[33] *See id.*

[34] *See id.* at 972-73 (noting that Professor Dodd espoused the constructionist viewpoint that shareholders are really absentee owners whose interests can be subjugated to those of other stakeholders, including the community in which the corporation operates).

[35] *See id.* at 973.

[36] *See id.*



While the constructionist viewpoint broadens the interests informing directors' decisions, it also complicates decisionmaking by increasing the factors directors must consider before arriving at corporate decisions.[37] Pecuniary interests of shareholders often conflict with and oppose the interests of employees and the general public, increasing the complexity of director decisions.[38] The principles underlying constituency statutes have permeated corporate ideals in the United States for decades. Corporate society in the 1930s debated the validity of the "corporate social responsibility" principle.[39] This ideal urged corporations to recognize a duty of "trusteeship" or "responsibility" toward social interests beyond those of shareholders.[40]

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37 *See* William J. Carney, *Does Defining Constituencies Matter?*, 59 U. CIN. L. REV. 385, 419 (1990).

38 *See* Edward D. Rogers, *Striking the Wrong Balance: Constituency Statutes and Corporate Governance*, 21 PEPP. L. REV. 777, 779 (1994).

39 *See* Orts, *supra* note 4, at 21 (stating that constituency statutes revitalize an older debate concerning "corporate social responsibility" by reviving the classic dispute concerning the parties for whom corporate managers are trustees); Mitchell, *supra* note 4, at 598 n.94 (noting a number of early cases articulating management's fiduciary duties as being owed to creditors as well as to shareholders and the corporation generally). *See, e.g.*, Koehler v. The Black River Falls Iron Co., 67 U.S. (2 Black) 715, 720-21 (1862); Union Nat'l Bank v. Douglass, 24 F. Cas. 621, 624 (C.C. Iowa 1877); Haywood v. Lincoln Lumber Co., 26 N.W. 184, 186-87 (Wis. 1885).

40 Orts, *supra* note 4, at 21-22.

In the 1970s, corporate managers recognized that executives "should consciously make decisions that balance the often competing ... claims of shareholders, employees, customers, and the general public."[41] Throughout the 1970s and 1980s, corporations adopted this standard through "corporate charter amendments" altering the considerations of directors in making corporate decisions.[42] These amendments authorized directors to consider the social and economic effects of acquisitions on a company's employees, suppliers, and customers, in much the same manner as constituency statutes.[43]

Delaware common law recognizes that a board has no duty to maximize short-term value for its shareholders. As long as there is a rationally related benefit for the shareholders in the long run, however, a board may consider the interests of nonshareholder constituencies.[44] Even Ralph Nader once proposed that corporations should have specific directors devoted solely to voicing the interests of constituents, as opposed to the interests of shareholders.[45] Though this approach never became widely adopted, it reflects a historical trend toward modern constituency statutes and the principles reflected in Delaware corporate law. Constituency statutes do not represent a new invention attempting to penetrate corporate legal regimes, but instead constitute an innovative means to express the ideals embraced by corporate America throughout the twentieth century.

C. Antitakeover Genesis of Modern Constituency Statutes

Despite some interesting historical antecedents, the modern adoption of constituency statutes has its impetus in the desire to give a target company's

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[41] *Id.* at 22 (quoting from LEONARD SILK & DAVID VOGEL, ETHICS AND PROFITS: THE CRISIS OF CONFIDENCE IN AMERICAN BUSINESS 134 (1976) (illustrating how companies in the mid-1970s often followed a version of corporate social responsibility specifically defined in terms of "stakeholders" or the "corporate constituency")).

[42] Ronn S. Davids, Comment, *Constituency Statutes: An Appropriate Vehicle for Addressing Transition Costs?*, 28 Colum. J.L. & SOC. PROBS. 145, 152 (1995) (quoting Control Data Corporation's charter amendment and illustrating how it broadened the factors directors could consider in change of control circumstances).

[43] Control Data Corporation was the first entity to adopt such an amendment in 1978. *See id.*

[44] *See* Turner, *supra* note 2, at 33 (noting, however, that, in a change of control situation, directors are prohibited from considering the interests of nonshareholders, and doing so may constitute a breach of fiduciary duty). *See also* Davids, *supra* note 42, at 172 (discussing the ABA's rejection of a rule allowing directors to consider nonshareholder interests without relating such consideration in some manner to shareholder welfare).

[45] *See* Al Myers, *Whom May the Corporation Serve?—An Argument for the Constitutionality of Non-Stockholder Constituency Statutes*, 39 N.Y.L. SCH. L. REV. 449, 451 (1994) (illustrating that ideas supporting the appointment of directors devoted solely to the interests of nonstakeholders received significant support from the advent of constituency statutes in the 1970s).

board of directors, fighting a hostile takeover, a broader base of interests to consider than just the corporation and its shareholders.[46] "The scope of constituency statutes appears so far to be limited to cases that involve corporate takeover decisions. This finding is not surprising, given that the statutes were specifically designed and intended as a type of antitakeover statute."[47] The frenzy of takeovers in the 1980s resulted in corporations developing and adopting many defensive tactics to repel takeover attempts. Constituency statutes are the culmination of various antitakeover statutes adopted by states over the past several decades to bolster corporate defensive arsenals. The predecessors of constituency statutes include control share statutes,[48] fair price statutes,[49] poison pill-shareholder rights statutes,[50] cash out statutes,[51] disgorgement statutes,[52] and antigreenmail statutes.[53] Constituency statutes improve upon these measures by giving the stakeholders actual rights, rather than relying on directors' compassion. Enacting constituency statutes through a statutory frame-

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46 *See* Matheson & Olson, *supra* note 9, at 1448-50; *see also* Roberta S. Karmel, *Implications of the Stakeholder Model,* 61 GEO. WASH. L. REV. 1156, 1165 (arguing that the danger of directorial self-interests necessitates the consideration of nonshareholder constituencies); Mitchell, *supra* note 4, at 606 (explaining that a major benefit of constituency statutes is their chilling effect on directorial self-interests which usurp corporate assets and opportunities).

47 Orts, *supra* note 4, at 35 (noting further that the relative absence of hostile takeovers in the late 1980s and early 1990s prevents an accurate determination of the effectiveness of constituency statutes designed only as antitakeover measures). *See, e.g.,* IOWA CODE ANN. § 491.101B (West 1999); LA. REV. STAT. ANN. § 12:92 (West 1994); MO. REV. STAT. 351.347 (1986); OR. REV. STAT. § 60.357 (1988); TENN. CODE ANN. § 48-103-204 (1995).

48 *See* Orts, *supra* note 4, at 38 n.127 (stating that "[c]ontrol share statutes provide that a majority of a corporation's shareholders must approve the acquisition of a statutorily defined 'control share,' which is usually defined to begin at twenty percent of outstanding shares. If the shareholders do not approve, the 'control block' of shares is stripped of voting rights, thus preventing a takeover.").

49 *See id.* at 38 n.137 (providing that "'[F]air price' statutes . . . require, at the 'back-end' stage of a two-step acquisition, either (1) supermajority shareholder vote approving the step, or (2) payment of a statutorily defined 'fair price' to shareholders who did not initially tender into the offer.").

50 *See id.* at 38 n.149 (explaining that poison pill provisions distribute to shareholders a right to purchase shares of the target corporation at a substantial discount in the event of an unsolicited merger or acquisition. These provisions effectively increase the number of shares of the target company, which increases the price the acquiring company must pay to purchase the targeted entity.).

51 *See id.* at 39 n.142 ("'[C]ash out' statutes provide that an acquiror of a controlling interest of a corporation's shares must, upon demand by the other shareholders, purchase the remaining shares at a price reflecting the premium paid for the initially acquired shares.").

52 *See id.* at 39 n.143 (illustrating that disgorgement statutes adapt the "short swing" policies of the Securities and Exchange Act of 1934 by seeking to "recover profits made within short-term prohibited periods by 'speculators' or 'greenmailers' who put a company 'in play' and then sell out their stakes at a vastly increased price.") (citations omitted).

53 *See id.* at 39 n.141 (noting that "'Antigreenmail' statutes provide that corporations may not purchase shares from a person who owns more than a specified percentage (usually three to five percent) of outstanding shares unless the purchase is either (1) preapproved by a majority vote of disinterested shareholders, or (2) offered at the same terms to all outstanding shareholders").

work such as the one proposed by this Article provides even more protection by conferring a legal cause of action upon stakeholders.

Constituency statutes purport to change the duty of care of officers and directors while creating judicial standards for reviewing nonstatutory antitakeover devices such as poison pills.[54] Whereas many of the early antitakeover devices imposed limitations on entities attempting an unsolicited purchase of another firm without addressing the duties of directors for the target firm,[55] constituency statutes may be expanded to apply outside the context of hostile takeovers to influence everyday board decisions. These improvements suggest that constituency statutes enhance and codify widely accepted legal principles.[56]

II. SHAREHOLDER PRIMACY MODEL

The traditional view of corporate law commands directors to make decisions that will maximize shareholder wealth.[57]

> A business corporation is organized and carried on primarily for the profit of the shareholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.[58]

This unabashed appeal to greed is defensible only because corporations have value themselves.[59] The question then becomes what the most efficient way is

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54 *See* Mark E. Van Der Weide, *Against Fiduciary Duties to Corporate Stakeholders*, 21 DEL. J. CORP. L. 27, 32 (1996) (discussing case law and statutes that give legal standing to stakeholders).

55 *See* Roberta Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111 (1987) (discussing some of the features of second generation antitakeover statutes and the political maneuvering that enacted them).

56 *See* Charles Hansen, *Other Constituency Statutes: A Search for Perspective*, 46 BUS. LAW. 1355, 1375 (1991).

57 *See* Orts, *supra* note 4, at 26 (explaining the classic argument for shareholder primacy, as expounded in *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919)); *see also* Turner, *supra* note 2, at 34 (arguing that the absence of a shareholder primacy requirement in constituency statutes is a "controversial leap away from traditional corporate governance law").

58 Orts, *supra* note 4, at 27.

59 *See* William W. Bratton, *Confronting the Ethical Case Against the Ethical Case for Constituency Rights*, 50 WASH. & LEE L. REV. 1449 (1993) ("Shareholder wealth maximization by managers who play the role of agent is a norm because it is assumed to be the means to the end of maximum wealth for the society as

to manage the corporation. Many commentators believe the shareholder wealth maximization model is the best way of achieving this goal.[60]

Not only do opponents believe constituency statutes are contradictory to notions of shareholder supremacy, some argue that existing law already adequately protects the interests of stakeholders.[61] Creditors are protected by their contracts and Uniform Commercial Code provisions dealing with fraudulent conveyances and bulk transfers. Employees are protected by collective bargaining agreements, employment contracts, and wage, safety, and health laws.[62] Furthermore, the market gives stakeholders a certain level of protection.[63] These protections do not fully insulate stakeholders from the decisions of corporate management, but they put stakeholders in a better position to defend themselves than shareholders.[64] Shareholders need this protection because of the disconnect between ownership and control.[65] Because the shareholders own the company through owning stock, but do not have direct control of the corporation, managers need incentives to favor the shareholders.[66] The proposed statutory framework deals with these concerns by conferring standing upon stakeholders through a mandatory system and providing them with a legislative or statutory avenue for enforcement of their interests.[67] Consideration of many groups' needs and desires may be a challenging task, but mandating this process forces boards to consider the long-term interests of the corporation over those of any single group.

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a whole. It is not itself the end in view. Its ethical power derives from the fact that, in a world of scarcity, more is better than less.").

[60] *See* Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 403 (1983) ("[As the] [r]esidual claimants, the shareholders are the group with the appropriate incentives . . . to make discretionary decisions. The firm should invest in new products plants, etc., until the gains and costs are identical at the margin. Yet all of the actors, except the shareholders, lack the appropriate incentives.").

[61] *See* James J. Hanks, Jr., *Playing with Fire: Nonshareholder Constituency Statutes in the 1990s*, 21 STETSON L. REV. 97, 115 (1991) (asserting that stakeholder groups have protections other than constituency statutes already available).

[62] *See id.* at 116 (demonstrating other protections available for stakeholders).

[63] *See* Carney, *supra* note 37, at 423 (stating that "[p]lant closings are costly for employers, too. They represent abandonment of an investment in a specific asset which may have very little salvage value.").

[64] *See* Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23, 36-39 (1991) (arguing that of all groups, shareholders face the most severe contracting problems).

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

[66] *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 258-59 (1999).

[67] *See infra* Part VII.

III. ARGUMENTS AGAINST CONSTITUENCY STATUTES

Criticisms of constituency statutes come from several angles. Throughout history, regimes favoring consideration of stakeholder interests have confronted constitutional as well as economic and legal challenges.[68] Milton Friedman even went so far as to call the doctrine of stakeholder social responsibility a "fundamentally subversive doctrine."[69] These animadversions against constituency statutes, however, are not themselves impervious to criticism.

Opponents argue that constituency statutes violate the Contracts Clause of the United States Constitution.[70] The modern trend in state law is to view the corporation as a "nexus of contracts" involving various constituents, including shareholders, directors, managers, and employees.[71] The foremost aspect of these contracts, they argue, is the predominance of shareholder interests.[72] They argue that any state law impairing these previously existing contracts among shareholders, directors, and their corporations violates the legitimate expectations of those groups and, therefore, must be declared unconstitutional under the Contracts Clause.[73] However, "[o]ver the last two centuries, the [Supreme] Court has been unwilling to read the contracts clause as a strict

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[68] *See infra* notes 71-113 and accompanying text.

[69] *See* Alexander C. Gavis, *A Framework for Satisfying Corporate Directors' Responsibilities Under State Nonshareholder Constituency Statutes: The Use of Explicit Contracts*, 138 U. PA. L. REV. 1451, 1451 (1990), (quoting MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1982) ("[F]ew trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible.")).

[70] *See* U.S. CONST. art. I, § 10, cl.1; Orts, *supra* note 4, at 67 (stating that, despite the fact that courts might consider contract clause arguments against constituency statutes frivolous, opponents nonetheless assert the legislation violates a strict interpretation of the contract clause).

[71] *See* Henry N. Butler & Larry E. Ribstein, *The Contract Clause and the Corporation*, 55 BROOK. L. REV. 767, 770 (1989) (recognizing that corporate governance arrangements are contracts); Myers, *supra* note 45, at 459 (noting that the central question is whether corporations represent contractual relationships in and of themselves); Lynda J. Oswald, *Shareholders v. Stakeholders: Evaluating Corporate Constituency Statutes Under the Takings Clause*, 24 J. CORP. L. 1, 15 (1998) (asserting that corporations constitute a nexus of contracts); *cf.* Bratton, *supra* note 59, at 1460-66 (positing that legal recognition of constituency rights causes ethical problems due to the fact that constituents have only implicit contracts which do not give rise to legal rights).

[72] *See* Butler & Ribstein, *supra* note 71, at 770.

[73] *See id.* at 800 (arguing that constituency statutes cannot be sustained as "reasonable and necessary" to protect a public interest); Myers, *supra* note 45, at 462 (demonstrating that few, but some, commentators have attempted to assert that shareholders' contracts with the corporation are violated because equity owners would not normally willingly give up their rights under traditional regimes).

limitation on government regulation that affects pre-existing contracts."[74] In addition, the relationship between shareholders and corporations is not a contractual one in the ordinary sense, because contracts attempt to reduce risk.[75] However, there is inherent risk in equity that defies the risk reduction aspect of contracts.

For example, all states can amend their corporate statutes at any time, and shareholders knowingly accept this as a risk implicit in their investments.[76] Constituency statutes can only be defeated by the Contracts Clause if such statutes cause the shareholders to suffer some loss in their investment or some other real effect as a result of the alteration of contractual rights. In reality, we cannot assume that corporations governed by constituency statutes will make any less money and therefore confer any less benefit on shareholders than will corporations operating free of constituency statutes.[77] Therefore, the Contracts Clause argument against constituency statutes is also without legal justification.

Opponents also argue that requiring that corporations consider the interests of parties other than shareholders constitutes a taking in violation of the Fifth Amendment of the Constitution.[78] They say this constitutes a taking because shareholders' legal claim to the residual interest of the firm is reduced by consideration of constituent interests, which reassigns property rights from shareholders to stakeholders.[79] Corporations do not have the right to alter their form at will because such uncontemplated alterations will inevitably upset shareholder reliance, leading to a derogation in their property rights as equity holders. A taking does not exist, however, unless the expectations of shareholders are altered as a result of the government's activities.[80] No real

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[74] Orts, *supra* note 4, at 69 n.357, (illustrating how "the very lack of a stopping point constitutes a principal reason why courts are unlikely to strike down state corporate statutes on Contract Clause grounds.") (quoting Ronald D. Rotunda, *The Impairment of the Contracts Clause and the Corporation*, 55 BROOK. L. REV. 809, 811 (1989)).

[75] *See* Larry Garvin, *Adequate Assurance of Performance: Of Risk, Duress, and Cognition*, 69 U. COLO. L. REV. 71, 131 (1998).

[76] *See* Myers, *supra* note 45, at 460 (stating that an implied term of state incorporation laws is that the provisions of those laws may be amended at any time).

[77] *See id.* at 461 (noting that because companies do not make any less money when considering non-shareholder interests, it is questionable whether shareholders suffer any real harm due to constituency statutes).

[78] *See* U.S. CONST. amend. V; Oswald, *supra* note 71, at 21-22 (demonstrating that shareholders invest their capital in the firm with the expectation that their "interests will be protected by the state" and "constituency statutes upset those expectations").

[79] *See id.* at 21-23 (arguing that such an act must be "accompanied by just compensation or be struck down as a taking").

[80] *See id.*

evidence exists to suggest that constituency statutes negatively alter shareholder expectations.[81] Moreover, constituency statutes do not strip shareholders of the entire value of their stock; they merely limit the preferential treatment of shareholder interests.[82] "[L]egislation which reallocates benefits and burdens among private parties, but which is nonetheless intended to achieve a public purpose, will not amount to a taking."[83] Accordingly, a challenge against constituency statutes based on the Takings Clause cannot be sustained.

One might also contend that the Williams Act, as a result of federal preemptive law, forbids states from passing constituency statutes. The Williams Act regulates tender offers by requiring firms to disclose information about potential takeovers and by establishing procedural rules to govern tender offers.[84] By also regulating decisions by directors in the takeover context, constituency statutes potentially run afoul of the Williams Act provisions and policies, violating federal law.[85] This is exemplified where directors considering the interests of employees and the community deny tender offers, thereby depriving shareholders of takeover premiums protected by the Williams Act. However, the Supreme Court, in *CTS Corp. v. Dynamics Corp. of America*, defends state implementation of antitakeover statutes as follows:

> It thus is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares. A State has an interest in promoting stable relationships among parties involved in the corporations it charters, as well as in ensuring that investors in such corporations have an effective voice in corporate affairs.[86]

Justice Scalia rejects this argument in his concurring opinion.[87] Scalia opines that "[a]s long as a State's corporation law governs only its own corporations and does not discriminate against out-of-state interests, it should survive [the Court's] scrutiny under the Commerce Clause, whether it promotes share-

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[81] *See* Myers, *supra* note 45, at 474 (stating that constituencies are consistent with the existing understanding of the nature of corporations as a nexus of contracts).

[82] *See id.* at 468 (concluding that constituency statutes do not amount to takings).

[83] *Id.* at 475-76 (recognizing that constituency "statutes are part of a broad trend toward promoting the wellbeing of various groups in society").

[84] 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1994).

[85] *See id.*

[86] 481 U.S. 69, 91 (1987).

[87] *See id.* at 94-97.

holder welfare or industrial stagnation."[88] Scalia's statement reflects courts' general disenchantment with preemption arguments except where Congress explicitly indicates intent to preempt state action. In reality, "[c]onstituency statutes address a fundamental issue of corporate governance in an area traditionally left to the states to define: the nature and extent of directors' fiduciary duties."[89] A majority of the Supreme Court believes that "[t]o the limited extent that [a state antitakeover mechanism] affects interstate commerce, this is justified by the State's interests in defining the attributes of shares in its corporations and in protecting shareholders."[90] Thus, preemption arguments against constituency statutes also lack legal foundation.

Opponents of constituency statutes further argue that such legislation violates the dormant Commerce Clause because the federal government has purposely chosen not to adopt federal legislation including constituency statutes.[91] The primary purpose of constituency statutes, however, is to promote the interests of corporations under state legal regimes. Each state has its own corporate code illustrating the duties and rights of firms incorporating within the jurisdiction.[92] No hard evidence exists that constituency statutes discriminate against interstate commerce. Such legislation is not discriminatory on its face. The potential of such laws to hinder tender offers has the same effect on offerors from the corporation's state of incorporation as it does offerors from other states. Additionally, the Court itself has determined that statutes harmful to an offeror's ability to take over a corporation do not discriminate against interstate commerce.[93] Like the others, this constitutional challenge to constituency statutes fails as well.

Certain scholars oppose constituency statutes claiming that states adopt such legislation only at the urging of executives constantly threatened by takeovers.[94] Many assert that these statutes increase management discretion,

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[88] See Orts, *supra* note 4, at 64 (explaining that Scalia, in his opinion in *CTS*, expressed how courts disfavor preemption arguments); *see also CTS*, 481 U.S. at 95-96.

[89] Orts, *supra* note 4, at 65 (demonstrating how a majority of the Justices in *CTS* plainly rejected arguments that constituency statutes violate basic principles of corporate federalism).

[90] *CTS*, 481 U.S. at 94.

[91] *See* Orts, *supra* note 4, at 51 (demonstrating how opponents of constituency statutes attempt to raise issue with constituency statutes by arguing that such legislation violates the *CTS* dormant Commerce Clause tests).

[92] *See* Wilson v. United States, 221 U.S. 361, 383-84 (1911).

[93] *See CTS*, 481 U.S. at 94 (holding that control share statutes restricting the ability of offerors to take over a corporation do not discriminate against interstate commerce).

[94] *See* Orts, *supra* note 4, at 49 (illustrating that many critics claim the undue influence of corporate executives on legislators has fed the evolution of constituency statutes in the same manner as other historical

allowing directors to use such statutes not to do what is best for the stakeholders, but to increase executives' welfare.[95] By giving management more discretion in decisionmaking, such legislation allows managers to hide behind the law when those decisions are questioned, making the process one which benefits managers instead of the constituents they are meant to serve.[96]

These scholars also mention that managers who support constituency statutes opposed other legislation that would have benefited stakeholders.[97] For instance, plant closing notification legislation was vehemently opposed by corporate managers.[98] Thus, critics argue that constituency statutes are not necessarily backed by the will of the people and lack careful deliberation by the legislature.[99]

As a final assault against constituency statutes, opponents argue that they are too broad, and that if constituency statutes are going to achieve their goals, stakeholders need to be able to enforce their rights under the statutes.[100] As many of the statutes are written currently, stakeholders do not have an adequate remedy to force consideration of their interests.[101] By attempting to reach too many varying interests, constituency statutes fail to provide a benchmark for shareholders and stakeholders to hold directors accountable for

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developments of corporate law, essentially leading to a "race to laxity" of state corporate statutes); von Stange, *supra* note 4, at 483 (asserting that constituency statutes "promote unaccountability by widening the separation between ownership and control" and enabling management to "hide behind the statutes to justify business decisions" which benefit themselves over shareholders).

[95] *See* Carney, *supra* note 37, at 423 (arguing that constituency consideration can only exacerbate problems of management disloyalty); Timothy L. Fort, *The Corporation As Mediating Institution: An Efficacious Synthesis of Stakeholder Theory and Corporate Constituency Statutes*, 73 NOTRE DAME L. REV. 173, 180 (1997) (stating that constituency statutes will enhance managerial discretion by allowing managers to play constituencies against one another); Rogers, *supra* note 40, at 778 (suggesting that to deal with this problem, corporations should use mechanisms to ensure accountability similar to those used in the political arena).

[96] *See* Carney, *supra* note 37 at 424 ("Under the special pleading of interested managers in many jurisdictions, friendly legislators have struck a serious blow at management accountability in the context of bids for corporate control.").

[97] *See* Rogers, *supra* note 38, at 808-10.

[98] *See id.* at 810.

[99] *See id.*

[100] *See* Fort, *supra* note 95, at 180 (arguing that having "too many bosses makes it difficult for management to effectively and fairly" complete its job); Hanks, *supra* note 61, at 113 (noting that none of the constituency statutes in effect today provide guidance as to how much weight should be given various constituencies); Leung, *supra* note 11, at 618 (stating that constituency statutes provide little guidance in defining who is a stakeholder, thus making the guidelines of protected parties vague and ambiguous); Rogers, *supra* note 38, at 780 (citing criticism of constituency statutes as reducing management accountability because they are too broad).

[101] *See* Leung, *supra* note 11, at 617-18 (noting that directors are likely to favor shareholders in decisionmaking because their position on the board depends on the vote of the equity owners).

their decisions.[102] Moreover, constituency statutes as they exist today are permissive and discretionary, permitting directors to ignore the interests of stakeholders in an attempt to keep satisfied those parties that are supplying the capital for operations—the shareholders.[103] In this sense, constituency statutes arguably sacrifice director accountability for diminished consideration of shareholder interests and unenforceable consideration of stakeholder interests.

IV. ARGUMENTS FAVORING CONSTITUENCY STATUTES

Constituency statutes validate the modern trend of stakeholder management, present a legal regime consistent with modern theories of the corporation, and promote a consistent and efficient approach to judicial policing of corporate fiduciary duties. Proponents of constituency statutes say they exemplify an effective means to ensure that the many varying interests affected by a corporation are given a voice in directors' decisions.[104] More broadly, one noted proponent maintains that:

> The corporate constituency concept . . . has several benefits. First, by requiring directors to act in the best interests of the corporation, it assures shareholders that their money will be invested with the goal of enhancing long-term corporate wealth and the corporation's ability to maximize corporate profits. Second, the statutes expressly permit the directors to take into consideration the interests of other corporate stakeholders. This affords directors flexibility to balance the sometimes competing goals and expectations—especially in the takeover context—of those who have invested in the corporation, whether through financial capital or human capital. Finally, and most importantly, these statutes embody the best standard for director decisionmaking.[105]

Others argue that the relationship between stakeholders and shareholders does not have to be antagonistic.[106]

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[102] *See supra* note 101.

[103] *See* Hanks, *supra* note 61, at 111 (illustrating that it is "difficult enough to determine the best interests of the corporation and [its] shareholders without *also*" attempting to consider the best interests of "other groups with varying characteristics"); Leung, *supra* note 11, at 617 (analyzing whether constituency statutes adequately protect the interests of stakeholders).

[104] *See* Wallman, *supra* note 14, at 169 (illustrating the manner by which constituency statutes impact the firm and create an optimal result for all constituencies taken as a whole).

[105] *Id.* at 168-69.

[106] *See* John H. Matheson & Brent A. Olson, *Corporate Cooperation, Relationship Management, and the Trialogical Imperative for Corporate Law*, 78 MINN. L. REV. 1443 (1994).

A. Validation of Stakeholder Consideration by Management

Most importantly, constituency statutes legally validate the practice of stakeholder management, departing from other legal models that solely manage shareholder value.[107]

> Employees . . . are as much members [of the firm] as shareholders who provide the capital. Indeed, the employees may have made a much greater investment in the enterprise by their years of service, may have less ability to withdraw, and may have a greater stake in the future of the enterprise than many of the stockholders.[108]

Constituency statutes support the popular practice of considering a wide spectrum of corporate interests beyond those of shareholders.[109]

Some commentators argue that shareholders bear the primary risk for corporate decisions and that this is appropriate because of their comparative wealth and ability to diversify their holdings.[110] As a consequence, they say shareholder interests should be of primary concern in director decision-making.[111] However, it must be borne in mind that all primary stakeholders of a firm bear a degree of residual risk from corporate decisions that should not be overlooked; "[w]hen directors are negligent or engage in self-dealing, there is no intuitive reason why only shareholders should be entitled to hold directors to account, because these transgressions also harm other corporate stakeholders."[112]

Bondholders may lose their interest payments and possibly their principal, if the corporation cannot pay them. Managers' jobs are threatened by proposed takeovers and disagreements with the company's board of directors. Both managers and employees contribute "human capital," which is often specific to

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[107] *See* Van Wezel Stone, *supra* note 4, at 48-49.

[108] *Id.* (quoting Clyde W. Summers, *Codetermination in the United States: A Projection of Problems and Potentials,* 4 J. COMP. CORP. L. & SEC. REG. 155, 170 (1982)).

[109] *See* Van Wezel Stone, *supra* note 4, at 48-49.

[110] *See* Van Der Weide, *supra* note 54, at 36 (arguing that the shareholder primacy model is the most efficient way to balance risks and interests for corporations because of the ability for shareholders to most effectively bear risk).

[111] *See* Easterbrook, *supra* note 60.

[112] Karmel, *supra* note 46, at 1173 (noting that mechanisms must be developed for holding directors accountable for due care and fair dealing with regard to all constituents); *see also* Richard B. Tyler, *Other Constituency Statutes,* 59 MO. L. REV. 373, 395 (1994) (urging that no single group of constituents has a right to view itself as the "owner" of a firm and noting that constituencies other than shareholders are often affected more by takeovers than shareholders due to the fact that such stakeholders are not as diversified as shareholders).

the particular corporation.[113] Moreover, employees invest in the firm during their training and high productivity years, with the expectation of reaping the benefits of their investment later in life.[114] Layoffs due to restructuring during a corporate takeover subject employees to great obstacles in making lateral moves and adversely affect all businesses in the surrounding community.[115] Even though managers, employees, suppliers, and the surrounding community risk an arguably more significant investment (their primary time and opportunity costs) than the mere financial investment of shareholders—their interests are not typically considered in major corporate decisions potentially having life-altering affects on stakeholders.[116] Together, each of these constituent parts of a corporation affect productivity and deserve consideration and influence in corporate decisionmaking.

One theorist has remarked that by creating fiduciary duties on the part of corporate directors toward stakeholders other than shareholders, constituency statutes hold directors liable for preserving a corporate capital structure that is fair to all constituencies and truly in the best interests of the corporation.[117] Another adds that nonshareholder constituents lack an effective means under existing labor, contract, and corporate laws to protect their human capital investments in corporations.[118] These stakeholders of the firm lack the ability to

[113] *See* Tyler, *supra* note 112, at 395 (discussing the possibility that groups other than shareholders should be viewed as sharing control of the corporation).

[114] *See* Van Wezel Stone, *supra* note 4, at 51-52 (recognizing that if employees' expectation of a return on human capital investment is breached and their investment reaped by shareholders, then the employees should have a means of legal recourse).

[115] *See* Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B.C. L. REV. 283, 300 (1998).

[116] *See* Mitchell, *supra* note 4, at 622 (stating that a board which cannot delegate its power to an independent committee requires consideration of constituent interests to resolve conflicts of interests in which the board itself might be an interested party); *see also* Auerbach v. Bennett, 393 N.E.2d 994, 1001 (N.Y. 1979) (stating that "[i]n the very nature of the corporate organization it was only the existing board of directors which had authority on behalf of the corporation to direct the investigation and to assure the cooperation of corporate employees, and it is only that same board by its own action—or as here pursuant to authority duly delegated by it—which had authority to decide whether to prosecute the claims against defendant directors").

[117] *See* Van Wezel Stone, *supra* note 4, at 47 (noting that because these fiduciary duties represent a change from conventional corporate law, constituency statutes have provoked considerable controversy); *see also* Timothy L. Fort, *Corporate Constituency Statutes: A Dialectical Interpretation*, 15 J.L. & COM. 257, 288 (1995) (illustrating how the "Ruder Rule" maintains that the goal of profit maximization does not itself require a rejection of corporate responsibility to nonshareholder parties).

[118] *See* Mitchell, *supra* note 4, at 605 (stating that stakeholder interests are not sufficiently covered under most corporate laws absent a constituency statute because shareholders—the only parties with standing to sue under traditional corporate laws—lack sufficient incentive to bring derivative actions unless their own interests are at stake); Van Wezel Stone, *supra* note 4, at 48 (concluding that constituency statutes, as they are currently written, probably do not provide adequate protection for employees but nonetheless have a positive social value in that they recognize employees roles and vulnerability); *cf.* Marleen A. O'Connor, *Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69 N.C. L.

protect themselves contractually, and thus need a form of constituency statute to help them assert their rights.[119] Constituency statutes allow consideration of those other than shareholders who have contributed to a corporation's success by allowing all constituencies to influence the decisions of companies they help operate and depend on for financial security.[120] Moreover, mandating that directors consider the interests of stakeholders simultaneously benefits directors by diminishing the likelihood that their decisions on behalf of the corporation will subject them to legal suits or prevent their re-election to the board.[121]

B. Consistency with the Modern Theory of the Corporation

The new corporate regime promoted by constituency statutes reflects the modern theory of the corporation. Shareholders have an equity stake in corporations from which they expect to gain economically when share price increases.[122] However, corporations are increasingly financing operations through issuance of debt instruments such as bonds and debentures.[123] The amount of profit expected and the level of risk incurred, however, represent the primary distinctions between the two groups.[124] Both bondholders and shareholders expect to make a profit by investing in a corporation. Yet, shareholders accept more risk than bondholders.[125] As residual claimants, shareholders

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REV. 1189 (1991) (arguing that corporations are responsible for the effects of restructuring on their employees and constituency statutes do not go far enough to provide an adequate legal remedy).

[119] *See* Tyler, *supra* note 112, at 396 (stating that certain groups are able to bargain for contractual protections whereas many constituency groups do not have that ability and consequently lack an effective voice in the corporation).

[120] *See* Lawrence Ponoroff, *Enlarging the Bargaining Table: Some Implications of the Corporate Stakeholder Model for Federal Bankruptcy Proceedings*, 23 CAP. U. L. REV. 441, 442 (1994) (discussing "how the renewed appreciation in the corporate law field for the interests of nonshareholder groups interrelates with the growing sympathy in the bankruptcy law literature for the rights of non-creditor interests in chapter 11").

[121] *See* Mitchell, *supra* note 4, at 606 (noting the benefits to directors and management of constituency statutes designed to broaden the groups of interests considered by directors when acting on behalf of the corporation); von Stange, *supra* note 4, at 488 (explaining that incumbent management benefits from constituency statutes because they take away the accountability of management to shareholders).

[122] *See* Henry T.C. Hu, *Buffett, Corporate Objectives, and the Nature of Sheep*, 19 CARDOZO L. REV. 379, 381 (1997) (positing that corporate managers "once believed" that making accounting and operating decisions that increase earnings per share "would maximize the prices at which their shares would trade in the stock market and thereby maximize the wealth of their shareholders").

[123] *See* Yakov Amihud et al., *New Governance Structure for Corporate Bonds*, 51 STAN. L. REV. 447, 449 (1999) (reporting that substantially more capital was raised through selling debt, namely bonds, than stock).

[124] *See* Morey W. McDaniel, *Stockholders and Stakeholders*, 21 STETSON L. REV. 121, 150 (1991) (stating that stakeholders may be entitled to payment for their investments despite the performance of the corporation, whereas shareholders receive a return only when the company is profitable and successful).

[125] *See* Robert A. Levy, *The Prudent Investor Rule: Theories & Evidence*, 1 GEO. MASON L. REV. 1, 10-12 (1994).

do not realize profit until all other credit obligations are met.[126] Bondholders, on the other hand, invest in instruments with some guaranteed return[127] and a higher priority than stock in the event of a bankruptcy.[128] Accordingly, shareholders receive higher rates of return on their investments than bondholders. Today, practice demonstrates that there are no "owners" of corporations in the traditional sense.[129] "The corporation is viewed as a nexus or focal point for a web of contracts, explicit and implicit, among a variety of participants: stockholders, lenders, employees, managers, suppliers, distributors, and customers."[130] In essence, all the stakeholders of a firm bear residual risk.[131] Accordingly, proponents argue that modern corporate directors must consider the interests of all corporate stakeholders to ensure the best result for society, not just the best result for shareholders.[132]

In most jurisdictions, constituency statutes are permissive, allowing managers and directors to exercise greater discretion in considering broader interests of the firm, without giving stakeholders any legally enforceable rights.[133] Only one state legislature has adopted a mandatory constituency statute.[134]

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[126] *See* Easterbrook, *supra* note 60.

[127] *See* Vladimir Jelisavcic, *CORPORATE LAW: A Safe Harbor Proposal to Define the Limits of Directors' Fiduciary Duty to Creditors in the "Vicinity of Insolvency:"* Credit Lyonnais v. Pathe, 18 J. CORP. L. 145, 145-48 n.30-32 (1992).

[128] *See* 11 U.S.C. §§ 362(d), 507, 554, 725, 726(a) (1994).

[129] *See* McDaniel, *supra* note 124, at 149 (asserting that ownership of the firm is an irrelevant concept because corporations in modern times are viewed as a nexus of contracts where shareholders are merely risk-bearers who provide the firm with one form of capital); Myers, *supra* note 45, at 474 (noting modern understanding of corporations as a nexus of contracts); Oswald, *supra* note 71, at 15 (asserting that corporations constitute a nexus of contracts).

[130] *See* McDaniel, *supra* note 124, at 149 (asserting that ownership of the firm is an irrelevant concept where corporations are viewed as a nexus of contracts; shareholders are merely risk-bearers who provide the firm with one form of capital).

[131] *See id.* at 150-51 (recognizing that managers and employees bear residual risk, in addition to the financial risk of shareholders, due to their investment of human capital).

[132] *See* John C. Carter, *The Rights of Other Corporate Constituencies,* 22 MEMPHIS ST. U. L. REV. 491 (1992).

[133] *See supra* notes 9, 23-25.

[134] *See* CONN. GEN. STAT. § 33-756(d) (1999) (requiring that:

> A director of a corporation . . . *shall* consider, in determining what he reasonably believes to be in the best interests of the corporation, (1) the long-term as well as the short-term interests of the corporation, (2) the interests of the shareholders, long-term as well as short-term, including the possibility that those interests may be best served by the continued independence of the corporation, (3) the interests of the corporation's employees, customers, creditors and suppliers, and (4) community and societal considerations including those of any community in which any office or other facility of the corporation is located.

(emphasis added)).

Other states have an opt-in statute, and simply authorize directors and managers to consider interests other than those of shareholders if they so choose.[135] If states were to mandate consideration of stakeholder interests, a potential cause of action might exist if directors overtly neglected to make the considerations required by law. Otherwise, permissive and opt-in statutes as currently written do not afford stakeholders a cause of action on their face.[136]

> [Constituency statutes] permit directors to allocate the externalized costs of rules restraining directorial self-interest among the parties who benefit from those rules by internalizing those costs. . . . Seen in this light, constituency statutes provide a basis for reallocating those costs among all constituent classes that directly or indirectly benefit from fiduciary rules.[137]

However, the state statutes and court decisions insulate managers from liability for making decisions that may prove less advantageous to one group but beneficial to the corporation as a whole.[138] Corporations constantly act as mediating institutions, owing a high degree of responsibility to all individuals within the organization.[139] Accordingly, constituency statutes allow directors to act in the best interest of the corporation as a whole without constantly fearing litigation from constituency groups disfavored by particular decisions.

Considering the best interests of the entire corporation through its various constituencies provides more consistency by maximizing the wealth-producing value of the firm.[140] A corporation is an entity whose interests will generally remain the same over an extended period of time. The goals of profit-maximization and asset growth propel corporations regardless of their age and level of development. Shareholders, however, are individuals whose interests change frequently, depending on their age and aversion to risk as well as financial market forces outside the corporation. Accordingly, a more consistent

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[135] *See supra* notes 23-25.

[136] *See supra* notes 23-25.

[137] Mitchell, *supra* note 4, at 584-85, 594 (asserting that constituency statutes are part of a trend suggesting a need for legal recognition of constituent interests within the corporate structure and are a means of permitting the board to reallocate costs of legal articulations of its duty to shareholders without exposing itself to additional risks of litigation over conflicts between constituency interests).

[138] *See* MINN. STAT. ANN. § 302A. 251 (1985 & Supp. 2000) (best interest of the corporation); Lawrence A. Cunningham, *Commonalities and Prescriptions in the Vertical Dimension of Global Corporate Governance*, 84 CORNELL L. REV. 1133, 1162 n.142 (1999).

[139] *See* Fort, *supra* note 117, at 288 (arguing that the "Ruder Rule" illustrates how the goal of profit maximization does not itself require a rejection of corporate responsibility to nonshareholder parties).

[140] *See* Wallman, *supra* note 14, at 183 (noting that the "best interests of the corporation" standard is the only one which consistently produces this result).

result will come from pursuing the goals of a corporate entity rather than seeking to satisfy the constantly changing, volatile goals of shareholders.

C. *Judicial Advantages of Constituency Statutes*

Widespread state adoption of constituency statutes assists judicial interpretation of issues of corporate law, especially if a model form of constituency statute appears feasible. In brief, constituency statutes will assure that judicial decisions regarding stakeholder management will not shift easily over time through common law policymaking. Also, compare the variety of takeover control mechanisms—control share statutes, fair price statutes, poison pill-shareholder rights statutes, cash out statutes, disgorgement statutes, and antigreenmail statutes—which have been adopted by more than twenty-nine states.[141] While these measures are beneficial to corporations facing takeovers, the variety of standards and rules involved prevent consistent practices among the several states, which seriously complicates operation of multistate corporations. Corporations relying on one or more of these mechanisms constantly risk changes in state laws that might require alterations in corporate governance and could invalidate established corporate practices.

Second, constituency statutes can clarify who has the burden of proof in shareholder derivative suits, and help avoid the pitfalls of the common law. The American Law Institute ("ALI") recommends placing the burden of proof on shareholder plaintiffs for corporate control decisions, as well as for ordinary business judgment rule and duty of care cases.[142] The "business judgment rule" provides:

> A director or officer who makes a business judgment in good faith fulfills the duty [of care] if the director or officer:
>
> > (1) is not interested . . . in the subject of the business judgment;
> > (2) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and

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[141] *See* Orts, *supra* note 4, at 37-39 (stating that adoption of various antitakeover regimes have helped lead to the decline of hostile takeovers and a diminished need to resort to constituency statutes in the takeover context).

[142] *See* AMERICAN LAW INSTITUTE, *supra* note 1, §§ 2.01; *see also* Mitchell, *supra* note 4, at 605 (stating that the business judgment rule insulates from liability directors who act in good faith in the best interests of the corporation); Orts, *supra* note 4, at 90 (illustrating the relationship between the ALI's interpretation of constituency statutes and its business judgment and duty of care schemes, specifically with regard to how each of these three principles are connected and the need for a common burden of proof).

> (3) rationally believes that the business judgment is in the best interest of the corporation.
>
> In short, if a good-faith business decision is made rationally and in an informed manner, then it is shielded from any further judicial scrutiny for "reasonableness."[143]

The "duty of care standard" provides:

> A director shall discharge his duties as a director, including his duties as a member of a committee:
>
> (1) in good faith;
> (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
> (3) in a manner he reasonably believes to be in the best interests of the corporation.[144]

By adopting constituency statutes, legislatures can explicitly designate which parties carry the burden of proof in derivative suits, further encouraging consistent and predictable legal results. Replacing judicial rulemaking and current antitakeover mechanisms with constituency statutes helps to ensure uniform corporate legal regimes among the states, provides predictable and consistent principles of law to guide corporate decisions, and avoids common law policymaking through judicial decisions.

D. Ethical Responsibility of the Corporation

In addition to obligations created by implicit contractual relationships between the corporation and its stakeholders, some scholars argue that a corporation also has an ethical responsibility to its constituents.[145] "High idealism holds that the business corporation's residual goal, and not just its specific, externally imposed legal obligations, should be defined to include a much wider set of interests than those of the shareholders."[146] Along these lines, scholars suggest that corporations should be "mediating institutions"—"private organization[s] with public concerns, foremost being the welfare of internal, non-

[143] Orts, *supra* note 4, at 43 (explaining the basic form of the "business judgment rule"); *see also* ROBERT W. HAMILTON, THE LAW OF CORPORATIONS IN A NUTSHELL 454 (5th ed. 2000).

[144] MODEL BUS. CORP. ACT § 8.30(a) (1991); *see also* AMERICAN LAW INSTITUTE, *supra* note 1, § 4.01(c); Orts, *supra* note 4, at 43.

[145] *See* Merrick Dodd, *For Whom Are Corporate Managers Trustees*, 45 HARV. L. REV. 1145, 1145 (1932).

[146] Davids, *supra* note 42, at 201 (asserting that principles transcending the mundane ideals of corporate legal regimes also mandate that directors consider interests other than just those of the shareholders when making corporate decisions that affect a wide group of individuals).

shareholder constituents."[147] These authorities state that the corporation must become an institution with a moral identity recognizing an obligation to the many external constituents who contribute to its existence and success.[148] This corresponds with the Kantian principle that "human beings should be treated as ends, not as means to ends."[149] According to these authors, constituency statutes recognize and respond to the moral call for corporations to consider the external effects of their internal decisions by mandating observance of ethical behavior by directors.[150] They do so without strictly mandating morality, but by urging recognition of the external elements bringing corporations into existence within a society.[151]

In summary, the numerous advantages of constituency statutes demonstrate how such legislation enables managers and directors to do what they are hired or appointed to do—consider the best interests of the corporation as a whole. The statutes force directors to consider strategies which may be more complex and the results more difficult to see because they will occur in the long-term instead of making decisions that only take into consideration shareholder interests and immediately recognizable benefits.[152] Consequently, constituency statutes promote corporate growth and vitality, which benefits shareholders in the long-term.[153] Requiring directors to act in the best interest of the corporation assures shareholders their money will be invested with the goal of enhancing long-term corporate wealth and maintaining the corporation's ability to maximize corporate profits.[154] "[T]he statutes expressly permit the directors to take into consideration the interests of other corporate stakeholders. This affords directors flexibility to balance the sometimes competing goals and expectations—especially in the takeover context—of those who have invested in the corporation, whether through financial capital or human capital."[155]

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[147] Fort, *supra* note 117, at 279 (arguing that the stakeholder theory of corporate social responsibility should be considered from the perspective of a moral, dialectical theory).

[148] *Id.* at 282 (urging corporations to develop an "internal respect leading to an external respect of other constituents").

[149] Fort, *supra* note 95, at 184.

[150] *See* Fort, *supra* note 117, at 282.

[151] *Id.* at 282.

[152] *See* Wallman, *supra* note 14, at 177 (asserting that longer-term, complex strategies have results which are more difficult to perceive but which result in higher discounts being applied to future income streams).

[153] *See id.* at 168 (noting that constituency statutes demand that directors act in the best interests of the corporation which serves the economy and society better than competing standards).

[154] *See id.* at 169 (listing the benefits of corporate constituency statutes).

[155] *See id.* (concluding that these statutes embody the best standard for director decisionmaking).

V. APPLICATION OF CONSTITUENCY STATUTES

It is well accepted that "[g]roups in addition to shareholders have claims on a corporation's assets and earnings because those groups contribute to a corporation's capital."[156] Additionally,

> [T]hose who assert that the obligation of directors should be owed exclusively to the shareholders because they are 'owners' lose sight of two key points. First, the overall promotion of societal wealth is the primary goal of incorporation; providing attractive returns for shareholders is merely the means. . . . Second, these proponents leap to the unsupported conclusion that shareholders will find corporate investment attractive only if their interests are granted absolute primacy in all contexts.[157]

Even before constituency statutes came into existence, the judiciary played an important role in defining the scope of corporate social responsibility.[158] In the 1919 case, *Dodge v. Ford Motor Company*, the Supreme Court of Michigan adopted the prominent view of the era in ruling that "[a] business corporation is organized and carried on primarily for the profit of shareholders. The powers of the directors are to be employed for that end."[159]

A shift in this viewpoint was evidenced by the United States Supreme Court's decision in *Pepper v. Litton*.[160] The case seemed to alter a director's primary obligation to shareholders, emphasizing the "entire community of interests in the corporation."[161]

In 1985, the Delaware Supreme Court held that a corporation's management may employ defensive tactics to prevent a takeover as long as "(1) the takeover is seen as a reasonable threat to shareholders, and (2) the target's defensive tactics are reasonably related to that threat."[162] More importantly,

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156 Karmel, *supra* note 46, at 1171 (demonstrating that bondholders provide monetary capital, employees provide human capital, communities provide governmental services, and customers and suppliers depend on the corporation for profit, which mitigates against an excessive control premium for shareholders).

157 Wallman, *supra* note 14, at 167 (refuting the notion that shareholders will dispose of their stock if constituency statutes are given legal effect).

158 *See* von Stange, *supra* note 4, at 471-79 (outlining a history of cases developing constituency rights).

159 170 N.W. 668, 684 (Mich. 1919); *see also* Bainbridge, *supra* note 31, at 976 (noting that *Dodge v. Ford Motor Company* is the classical statement of directors' duty to maximize shareholder wealth).

160 308 U.S. 295 (1939).

161 *Id.* at 307; *see also* von Stange, *supra* note 4, at 473 (delineating the history of case law dealing with constituency statutes and noting that the holding in *Pepper v. Litton* was limited to the unique facts of the case).

162 Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

however, the case permitted consideration of nonshareholder constituencies' interests in a takeover situation.[163]

Other states have invoked constituency statutes in recognizing the propriety of consideration of the interests of a broad group of constituents. Constituency statutes have been analyzed in more than one case in Pennsylvania. In *Baron v. Strawbridge & Clother*, the Eastern District of Pennsylvania upheld a corporate board's defensive decision to reclassify its stock in response to the threat of a tender offer against the company.[164] The Pennsylvania court determined that "[i]t was proper for the company to consider the effects the . . . tender offer would have, if successful, on the company's employees, customers and community."[165] Another Pennsylvania district court employed the then-current statute to determine the appropriateness of a white knight defense to a change in control.[166] Thus, the public policies favoring constituency statutes were acknowledged and accepted by Pennsylvania courts as they invoked the nation's first adopted constituency statute.

The Eastern District of Wisconsin also acknowledged its state constituency statute in upholding a board's refusal to redeem poison pill rights in response to an all-cash, any-or-all shares tender offer.[167] The court concluded that "[t]he board has acted in accord with its fiduciary responsibilities in a manner reasonably related to the perceived threat to the corporation, its shareholders, and other constituencies."[168] Accordingly, the Wisconsin court applied fiduciary duties on a corporation's directors based upon responsibilities iterated in the state's constituency statute.[169]

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[163] *See id.*; *see also* von Stange, *supra* note 4, at 476 (citing cases which reveal the degree to which a board may consider nonshareholder constituencies).

[164] 646 F. Supp. 690, 698 (E.D. Pa. 1986).

[165] *Id.* at 697.

[166] *See* Keyser v. Commonwealth Nat'l Fin. Corp., 675 F. Supp. 238, 258 (M.D. Pa. 1987); *see also* Davids, *supra* note 45, at 169 (citing the Pennsylvania court's acknowledgement of "so-called social issues in evaluating merger proposals").

[167] *See* Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984, 1009 (E.D. Wis. 1989); *see also* Bainbridge, *supra* note 31, at 988 (noting that, as of 1992, *Amanda Acquisition Corp.* represented the nearest thing to a court interpretation of the validity of a constituency statute); Orts, *supra* note 4, at 32 (recognizing that the court in *Amanda Acquisition Corp.* cited Wisconsin's constituency statute in upholding a board's refusal to redeem poison pill rights).

[168] *Amanda Acquisition Corp.*, 708 F. Supp. at 1016.

[169] *See id.*

The federal district court in Maine also applied its state constituency statute in upholding a poison pill mechanism.[170] The court stated that "Maine law suggests that the Directors of a corporation, in considering the best interests of the shareholders and corporation [sic] should also consider the interests of the company's employees, its customers and suppliers, and communities in which offices of the corporation are located."[171] The use of a state constituency statute as foundation for the court's argument demonstrates the positive effect such legislation has on ensuring stakeholders' interests are considered in change of control situations.

The New Jersey Supreme Court has recognized that directors have social duties in addition to the obligations owed to shareholders.[172] The court upheld a charitable donation by a corporation on the basis that "modern conditions require that corporations acknowledge and discharge social as well as private responsibilities as members of the communities within which they operate."[173] These cases symbolize judicial acceptance of the principles underlying constituency statutes and state willingness to adopt and invoke constituency statutes directing the conduct of their corporate leaders.

VI. ECONOMIC EFFICIENCY OF CONSTITUENCY STATUTES

Ultimately, many critics of constituency statutes maintain that promoting the interests of stakeholders leads to a diminution of the weight given shareholder concerns.[174] Some scholars urge that directors should be encouraged to consider either shareholder interests or stakeholder interests, and should not be forced to consider the interests of both parties simultaneously.[175] Commonly used economic models such as the Pareto efficiency model and the Kaldor-Hicks efficiency model, however, suggest that constituency statutes represent an efficient regime through which to influence corporate decisions.[176]

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[170] *See* Georgia-Pacific Corp. v. Great N. Nekoosa Corp., 727 F. Supp. 31, 33 (D. Me. 1989); *see also* Orts, *supra* note 4, at 32 (illustrating the court's application of Maine's constituency statute in upholding an antitakeover measure).

[171] *Georgia-Pacific Corp.*, 727 F. Supp. at 33; *see also* Davids, *supra* note 42, at 168 (demonstrating the effect that Maine's constituency statute had on the court's decision in *Georgia-Pacific*).

[172] *See* A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581, 586 (N.J. 1953).

[173] *A.P. Smith Mfg. Co.*, 98 A.2d at 586; *see also* Bainbridge, *supra* note 31, at 979 (discussing cases which state that shareholder wealth maximization is not the sole responsibility of corporate directors).

[174] *See supra* Part III.

[175] *See supra* Part IV.

[176] *See* ROBIN PAUL MALLOY, LAW AND ECONOMICS: A COMPARATIVE APPROACH TO THEORY AND PRACTICE 40-41 (1990) (illustrating Kaldor-Hicks efficiency in terms of comparative utility between competing interests); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 14 (5th ed. 1998) (explaining Kaldor-Hicks

A Kaldor-Hicks efficient result is one in which winners win more than losers lose, meaning the gains of one proposed course of action outweigh the losses of pursuing that action.[177] Traditional statutory regimes requiring directors to consider the interests of shareholders are arguably Kaldor-Hicks efficient.[178]

Constituency statutes, however, also achieve Kaldor-Hicks efficiency by promoting the interests of the company as a whole in an effort to ensure that directors consider the interests of all or at least most of the stakeholders while maximizing profitability and shareholder return in the long run. "The shareholder primacy doctrine overlooks the distributional consequences of management decisions, allowing corporations to impose externalities on nonshareholders."[179] Negative externalities exist when a corporation creates costs or burdens for others but does not itself pay for these detrimental effects of its business.[180]

The traditional regime imposes externalities on stakeholders who are not given a voice in the direction of the corporation. Moreover, considering stakeholder interests is more ideal in the corporate context because it prevents directors from viewing decisions as correct or "efficient" so long as the shareholders' benefit is greater than the stakeholders' loss. As a result, Pareto efficiency may represent a better ideal because it ensures a result in which no group is made worse off.[181]

Perhaps less idealistic than the Kaldor-Hicks model, the Pareto efficient result is one in which some parties become better situated, and none become

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efficiency and its relationship to Pareto superiority); Leung, *supra* note 11, at 605 (defining Kaldor-Hicks efficiency as "any outcome where gains exceed losses"); McDaniel, *supra* note 124, at 127 (concluding that Pareto efficiency is appropriate for interpreting constituency statutes because control changes will become more civilized when they are Pareto efficient).

[177] *See* McDaniel, *supra* note 124, at 127 (explaining that many economists believe a Kaldor-Hicks efficient transaction should be the goal of a free market).

[178] *See* Leung, *supra* note 11, at 606 (asserting that considering solely the interests of shareholders results in maximizing shareholder wealth, even though such a result may benefit or hurt other stakeholders).

[179] *Id.* (stating that constituency statutes better tolerate Kaldor-Hicks results because they still allow some shareholders to benefit while allowing a vast group of stakeholders to simultaneously realize some gain); *see also* McDaniel, *supra* note 124, at 128 (urging that shareholder confiscation of stakeholder wealth is an externality in need of correction).

[180] *See* POSNER, *supra* note 176, at 232 (describing externalities created by a business enterprise); *see also* McDaniel, *supra* note 124, at 127 (quoting Judge Posner and his assertion that the common law must seek to correct externalities).

[181] *See* Leung, *supra* note 11, at 606 (arguing that Pareto efficiency is a better method than Kaldor-Hicks efficiency for evaluating economic outcomes of transactions).

worse off after the dilemma than they were before it.[182] This is a better measure of efficiency because it incorporates distributional effects.[183] Constituency statutes strive for Pareto efficiency. They represent a Pareto efficient alteration of traditional corporate statute regimes, allowing a corporation's constituent stakeholders to achieve a better result, without making shareholders any worse off than before implementation of the statutes.[184] Stakeholders become better situated because their interests, previously unconsidered, influence directors making corporate decisions.

Achieving Pareto efficiency through constituency statutes may arguably require that shareholders accept lesser gains so stakeholders may benefit.[185] Shareholders too, however, are better situated because constituency statutes force directors to make decisions in the best interests of the corporation itself, which ultimately increases productivity and profitability, thus maximizing shareholder return in the long-term.[186]

Advocates believe all constituents gain significantly under constituency statutes: stakeholders because their interests, previously neglected under existing shareholder primacy regimes, come to bear on directors charting the course of the corporation, and shareholders because they sacrifice only part of their voice—they remain a constituency group whose interests are to be considered—in the affairs of the corporation.[187] In the long run, however, all parties gain from increased efficiency and productivity.[188] "[C]onstituency statutes represent a starting point in the search for a means to harmonize the

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[182] *See* MALLOY, *supra* note 176, at 39-40 (illustrating Pareto efficiency in terms of comparative utility between competing interests); POSNER, *supra* note 176, at 14 (defining Pareto efficiency as a transaction "that makes at least one person better off and no one worse off"); McDaniel, *supra* note 124, at 127 (illustrating that if a transaction is not Kaldor-Hicks efficient, it will not be Pareto efficient, and if a transaction is Kaldor-Hicks efficient it may or may not be Pareto efficient).

[183] *See* Leung, *supra* note 11, at 606 (demonstrating that Pareto efficiency requires that boards examine a Kaldor-Hicks outcome to ascertain what costs would result from a decision but further requires that the board refrain from acting unless some means render the transaction Pareto optimal, thus incorporating the principles of Kaldor-Hicks efficiency but exacting a more stringent standard).

[184] *See* McDaniel, *supra* note 124, at 161 (concluding that constituency statutes represent Pareto efficient outcomes because they seek in the long run to maximize shareholder gain while minimizing stakeholder loss).

[185] *See* Leung, *supra* note 11, at 606 (stating that shareholders would only have to sacrifice potential gains in order to ensure that stakeholders were not harmed, which results in no real loss).

[186] *See supra* Part III.B; *see also* Leung, *supra* note 11, at 606 (arguing that Pareto optimality may ultimately be achieved through constituency statutes without shareholder sacrifice).

[187] *See supra* Part IV.

[188] *See* Leung, *supra* note 11, at 607 ("Pareto efficiency offers a standard by which losses resulting from conflicts between shareholder and stakeholder interests can be minimized."); McDaniel, *supra* note 124, at 128 ("Pareto efficiency should be viewed as a worthwhile economic goal to strive for even if it is seldom attainable.").

potentially divergent goals of societal welfare and corporate wealth maximization."[189] Consequently, supporters maintain that constituency statutes not only represent a positive alternative to implied corporate legal responsibility, but also constitute an economically efficient scheme for corporate governance.

VII. A MODEL CORPORATE CONSTITUENCY STATUTE

The "opt-in" form of constituency statute most closely reflects the current corporate landscape in which directors operate.[190] Currently, owners of a business enterprise determine the type of legal entity under which the business functions, and simultaneously decide how they will operate. By deciding whether to conduct business as a corporation, limited liability company ("LLC"), or limited liability partnership ("LLP"), founders determine the statutory regime governing the activities of the firm.[191] Moreover, most LLCs and LLPs constitute organizations wherein managers are also owners. Accordingly, the interests of shareholders and certain stakeholders are alike in decisionmaking in LLCs and LLPs. By electing to operate as a corporation rather than an LLC or LLP, firm owners accept the governance of a different legal regime, and presumably also accept the potential for consideration of interests other than solely those of shareholders.[192] Despite this inherent acceptance, the majority of business enterprises nonetheless elect to operate as corporations.[193]

The predominance of the corporation in modern America substantiates the fact that business owners willingly recognize the interests of stakeholders for

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[189] Davids, *supra* note 42, at 148 (arguing that constituency statutes benefit both society and corporation itself through allowing both parties to benefit from decisions over the long run).

[190] *See* Orts, *supra* note 4, at 30 (defining "opt-in" statutes as allowing corporations to opt in for coverage under the amendment if they wish to do so. If the corporation decides not to opt in for coverage, then the amendment does not apply to them.).

[191] *See* THOMAS R. HURST & WILLIAM A. GREGORY, CASES AND MATERIALS ON CORPORATIONS 1-7 (1999).

[192] *See supra* Parts I.A and II.B; *see also* Tyler, *supra* note 112, at 391 (asserting the supremacy of opt-in statutes because they "permit the shareholders to decide whether they want to have 'their' corporation include such a limitation on liability"); Wallman, *supra* note 14, at 166 (recognizing that each constituency statute is part of a state corporation code governing interactions among the corporation and various constituencies). Consideration of interests other than those of shareholders prevails whether or not a constituency statute exists under the state laws governing the firm. The numerous antitakeover devices discussed in Part I.C effectively constrain corporate decisionmaking in the takeover context such that in virtually every state corporate directors are forced to consider the interests of parties other than shareholders.

[193] *See* ROBERT CHARLES CLARK, CORPORATION LAW § 1.1 (1986).

the sake of the many benefits afforded under state corporation codes. Accordingly, one might assume that adoption of an "opt-in" form of constituency statute would not compromise the effect of legislation designed to provide stakeholders with a voice in the management of corporations. Perhaps the best way to ensure amicable acceptance of constituency statutes is to allow promoters and shareholders to choose whether constituency statutes will apply to the management of their firm.[194]

While the propriety of opt-in constituency statutes seems apparent, mandatory constituency statutes appear to provide the best form of governance to ensure infiltration of the interests of stakeholders into corporate decisionmaking. The critical question is what duty corporations owe to society and their varied constituencies; constituency statutes aim to help determine "the nature and the scope of ... corporate social responsibility."[195] A constituency statute that properly balances the need for consideration of varied interests and the need for shareholders to have the ultimate voice in the governance of the corporations requires combining mandatory language with the potential for shareholders to opt out of the constituency regime.

We propose a model statute that exemplifies how states can best ensure that directors consider the interests of a corporation's numerous constituents.[196] Our formulation serves the interests of constituents through many considerations both implicit and explicit in its construction. First, this model statute creates a presumption requiring consideration of all constituents of the corporation in a manner the directors deem appropriate. No action on the part of the promoters or shareholders of the corporation is required to adopt this default constituency provision. Moreover, a supermajority vote of the shareholders is required to alter the presumption away from the interests of constituents. This structure ensures that this statute will apply to the largest possible number of corporations and will not face extinction except at the will of a supermajority of the shareholders. The force of the statute, however, is tempered by the fact that a proposal for its alteration or abolition may be made by either the board of directors or the holders of at least ten percent of the corporation's outstanding capital stock entitled to vote on the matter. Together, these aspects of

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[194] *See* Tyler, *supra* note 112, at 424-25 (noting that it might seem better to permit shareholders to have a say in whether to make the corporation subject to a constituency statute).

[195] von Stange, *supra* note 4, at 461-62 (illustrating how corporations have an obligation to society because they are entities created by law).

[196] The model statute and an official comment are printed in the text following this Part.

the proposed model statute guarantee that states' adoption of this constituency statute will be as effective as possible.

The statute also applies to all determinations of the board of directors; it does not apply solely in the context of a tender offer, merger, or acquisition of the company. This allows the interests of a corporation's constituents to influence all major decisions of the corporation, not only decisions impacting the continuance or discontinuance of the corporate identity. Accordingly, this model constituency statute has a broader extension than many traditional antitakeover mechanisms. Further, the statute applies to all corporations in existence at the time of its passage and all corporations that will be created in the future. This aspect also ensures uniformity and continuity in the treatment of constituents throughout the adopting state.

MODEL CONSTITUENCY STATUTE

§0000. **Responsibilities of directors**

Subdivision 1. Presumptive duty of care; liability. Except as otherwise provided by subdivision 2 of this section, a director shall discharge the duties of the position of director in good faith, in a manner the director reasonably believes to be in the best interests of the corporation, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. In discharging the duties of the position of director, a director shall, in considering the best interests of the corporation, consider the following factors:

(a) The interests of the corporation's shareholders;

(b) The interests of the corporation's employees, customers, suppliers, and creditors;

(c) The economy of the State and the nation;

(d) Community and societal considerations, including, without limitation, the impact of any action upon the communities in or near which the corporation has offices or operations; and

(e) The long-term as well as short-term interests of the corporation and its shareholders, including, without limitation, the possibility that these interests may be best served by the continued independence of the corporation.

The directors can give whatever relative weight to these interests that the directors determine is consistent with the nature and effect of the particular item of the business presented for board action. A person who so performs these duties is not liable by reason of being or having been a director of the corporation.

Subdivision 2. Altering the presumptive duty of care. The standard of care provided for in subdivision 1 of this section may only be amended as provided in this subdivision 2.

(a) Where the conditions required by part (b) of this subdivision 2 are met, a director shall consider only the best interests of the corporation's shareholders in discharging the duties of the position of director.

(b) The corporation's articles of incorporation may be amended to provide that the corporation is subject to Subdivision 2 of this section upon:

(1) Either the petition of a majority of the corporation's board of directors currently holding office or the petition of the holders of at least 10% of the corporation's outstanding capital stock entitled to vote on the matter; and

(2) The affirmative vote of at least two-thirds of the voting power of the corporation's outstanding capital stock entitled to vote on the matter.

Subdivision 3. Scope of this section. This section shall apply to all corporations in existence under the laws of the State of ______ at the time this section became effective and to all corporations created under the laws of the State of ______ following the effectiveness of this section.

OFFICIAL COMMENT

Only a mandatory constituency statute ensures consideration of the interests of all stakeholders by directors. Opt-in statutes bind directors only if the shareholders invoke coverage of the statute. Some commentators argue that it is preferable to allow shareholders to decide for themselves whether to limit their own directors' liability and their own voice in corporate decisions. *See* Richard B. Tyler, *Other Constituency Statutes*, 59 MO. L. REV. 373, 424-25 (1994) (noting that it might seem better to permit shareholders to have a say in whether to make the corporation subject to a constituency statute). Opt-in statutes, however, are counterintuitive because it is difficult to envision shareholders willingly subordinating the priority of their interests in corporate decision-making.

> If legislatures truly wish to accomplish corporate social responsibility through constituency statutes, then legislatures must: (1) expressly mandate consideration for nonshareholder con-stituencies; (2) encourage accountability of incumbent management; (3) alter the composition of the board of directors to include nonshareholders; and (4) enable nonshareholder constituencies access to remedies.

Gary von Stange, *Corporate Social Responsibility Through Constituency Statutes: Legend or Lie?*, 11 HOFSTRA LAB. L.J. 461, 490 (1994) (explaining that constituency statutes may be ineffective unless stakeholders are given standing to enforce them). Requiring a shareholder vote for constituency statutes to apply to a corporation reduces the likelihood that such legislation will have any real effect on directors' decisions. *See* Tyler, *supra*, at 391 (illustrating the problems associated with requiring a shareholder vote and promoting the preference for statutory enactment rather than appropriate provisions in a corporation's charter or articles). With this in mind, it would be frivolous to enact a constituency statute that does not have any real effect, such as opt-in statutes that require a shareholder vote for applicability to a corporation.

Pennsylvania's constituency statute allows directors to consider the impact of their decisions on any affected interest and directors "to the extent they deem appropriate." 15 PA. CONS. STAT. § 1715(a) (1999); *see also* Nell Minow, *Shareholders, Stakeholders and Boards of Directors*, 21 STETSON L. REV. 197, 219-20 (1991) (discussing the effects of giving management the discretion to consider the public interest in the process of making decisions). They are not required "to regard any corporate interest or the interest of any protected group . . . as a dominant or controlling interest or factor" as long as

they act in the best interests of the corporation. 15 PA. CONS. STAT. § 1715(b). A notable feature of this statute is that it requires no shareholder approval for application to a Pennsylvania corporation; it is immediately applicable unless the shareholders opt out of the statute within ninety days. *See id.; see also* Minow, *supra*, at 220 (noting the unique opt-out nature of Pennsylvania's constituency statute). Hence, Pennsylvania's statute most closely approximates the opt-out form of statute that ensures observance of corporate social responsibility ideals by the greatest number of corporations.

Permissive and opt-in statutes do not indicate a true commitment by state legislatures to ensure corporate decisionmaking includes consideration of stakeholders. While critics argue that mandatory constituency statutes require directors to consider interests that are too diverse, mandating consideration of the interests of all constituents in every decision encourages uniformity in decisionmaking and consistency in applying directors' fiduciary duties. *See* Steven M.H. Wallman, *The Proper Interpretation of Corporate Constituency Statutes and Formulation of Director Duties*, 21 STETSON L. REV. 163, 175 (1991) (arguing that the interests of shareholders are themselves as diverse as the interests of other constituents, making decisions of directors inherently complex even under shareholder primacy regimes). Some state constituency statutes (i.e. Delaware) contain shareholder primacy requirements that demand that decisions based on the interests of nonshareholder constituencies must still bear a rational relationship to the interests of shareholders. *See* James J. Hanks, Jr., *Playing with Fire: Nonshareholder Constituency Statutes in the 1990s*, 21 STETSON L. REV. 97, 102 (1991) (noting that Delaware requirement leaves unanswered the question whether the "interests" of shareholders means their interest in the value of their shares or in the welfare of the corporation); *cf.* Charles Hansen, *Other Constituency Statutes: A Search for Perspective*, 46 BUS. LAW. 1355, 1369 (1991) (stating that common law requires some beneficial relationship to the interests of shareholders when other constituencies are considered by a board).

"Interests" means not only the monetary interest of shareholders but also their interests in making decisions based on the welfare of the corporation. The American Law Institute Principles of Corporate Governance also contain a shareholder primacy requirement in describing directors' duty of care. *See* 1 AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE ANALYSIS AND RECOMMENDATIONS § 6.02(b)(2) (1994) (stating that directors may consider the interests of nonshareholders if doing so does not significantly disfavor the long-term interests of shareholders). However, the Comments to

the Principles recognize that "the modern corporation by its nature creates interdependencies with a variety of groups with whom the corporation has a legitimate concern . . . [s]hort-term profits may properly be subordinated to recognition that responsible maintenance of these interdependencies is likely to contribute to long-term profitability and shareholder gain." *Id.* § 2.01 cmt. f, at 57. Therefore, while the Principles do not impose any legal duty on directors, they do recognize that the consideration of other interests is appropriate. *See id.* § 2.01 cmts. a-i, at 55-69.

A mandatory constituency statute obtains the best results for a corporation's varied constituents as well as for the corporation itself. Only a mandatory statute strictly obligates corporations to consider the concerns of individuals and groups other than shareholders. Permissive statutes, the form adopted by most states, do not have any binding effect on directors because they do not strictly require consideration of stakeholder interests. *See* R. Cammon Turner, *Shareholders vs. the World: 'Revlon Duties' and State Constituency Statutes*, BUS. L. TODAY, Jan./Feb. 1999, at 32, 34 (noting that most constituency statutes currently do not specify the weight that should be accorded to a particular factor or constituency, and also noting that shareholders are the only corporate constituency that can legally enforce a breach of fiduciary duty on behalf of the corporation). Stakeholders need to be given standing to sue; otherwise, constituency statutes lack the power necessary to guarantee consideration of nonshareholder interests. *See* Marleen A. O'Connor, *Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69 N.C. L. REV. 1189, 1234 (1991) (criticizing constituency statutes for not providing standing to stakeholder groups to sue directors for failure to consider nonshareholder interests). Management should recognize that it owes affirmative obligations to its constituents and should bear the burden of proving that it has fulfilled those obligations. *See id.* (stating that directors should not be able to hide behind the shield of constituency statutes when it does not properly consider the investment of its nonshareholders). A statutory regime like the one proposed above protects shareholders by informing them of the policies prior to investment decisions and ensures that corporate decisions will be made in the best interests of the corporation as a whole.

Because all states have adopted their own form of corporate code, there is no guarantee for adoption of one form of constituency statute. Thus, this model constituency statute faces obstacles to widespread implementation and consistency among states.

Corporations that opt not to be governed by constituency statutes will arguably retain a reputation advantage over firms that are governed by constituency statutes. Shareholders who insist that their investment be maximized at the expense of the interests of stakeholders will presumably invest only in companies that are not governed by constituency statutes. *See* Mark E. Van Der Weide, *Against Fiduciary Duties to Corporate Stakeholders*, 21 DEL. J. CORP. L. 27, 73 (1996) (arguing that this phenomenon would reduce equity investment and increase the cost of raising capital, resulting in a decline in corporate growth and productivity).

Even if a mandatory form of constituency statute is adopted by most states, constituents will inherently lack the power to enforce their rights under such laws. Because constituency statutes by definition require directors to consider a wide variety of interests; no one interest is automatically more important than another. Consequently, constituency statutes will give directors more leeway by perpetually providing them with the excuse that a derogation of the interests of one constituent group was necessary to pursue the interests of another group.

VIII. CONCLUSION

Constituency statutes represent a logical continuation of historical ideas and the common law trend, as well as the most desirable pronouncement of director fiduciary duties for the future.

The statutory framework proposed by this Article represents a step forward in the process of achieving fair, efficient, and consistent results for all corporate constituents.

The mandatory, opt-out structure of the model statute ensures that it will have the broadest possible application and confer standing for stakeholders. Moreover, requiring encouraging consideration of the best interests of the corporation's multiple constituencies will achieve optimal results for firms in the long-term, an end that will benefit all constituents, including shareholders.

APPENDIX: CONSTITUENCY STATUTES

A. Introduction

Constituency Statutes ("CS") or nonstockholder constituency statutes provide directors with a legal basis for considering nonshareholder interests.

B. Legislative Intent

Most legislatures enacted these statutes to facilitate directors' consideration of long-term corporate interests and societal welfare rather than solely or primarily short-term shareholder welfare. For example, the committee comment accompanying Ohio's 1984 amendments authorizing directors to consider nonshareholders stated that it was believed that existing law permitted directors to consider nonshareholder interests and that the amendment was intended to "specify and clarify the breadth of the interests" which directors could consider. OHIO ST. BAR ASS'N, CORP. LAW COMM. COMMENT REP. 540 (1984).

Indiana's general assembly has stated:

> In enacting this article, the general assembly established corporate governance rules for Indiana corporations . . . . The general assembly intends to reaffirm certain of these corporate governance rules to ensure that the directors of Indiana corporations, in exercising their business judgment, are not required to approve a proposed corporate action if the directors in good faith determine, after considering and weighing as they deem appropriate the effects of such action on the corporation's constituents, that such action is not in the best interests of the corporation . . . . Therefore, the general assembly intends:
>
> > (1) To reaffirm that this section allows directors the full discretion to weigh [nonshareholder constituency] factors . . .
> > (2) To protect both directors and the validity of corporate action taken by them in the good faith exercise of their business judgment after reasonable investigation.

IND. CODE ANN. § 23-1-35-1(f) (Michie 1999).

C. Typical Terminology

Nonshareholder Interests:

The statutes vary greatly in the degree of discretion given to directors. Among the factors directors are allowed to consider are:

(1) short term and long term interests of the corporation and its subsidiaries;
(2) interests of, or effects on, current and retired employees, customers, creditors, and suppliers; and
(3) communities in which the corporation and its subsidiaries operate interests of, or effects on, the local, state, and national economies.

Opt-in:

Georgia requires that shareholders elect to be covered by amending articles of incorporation. It is the only state requiring this measure.

D. Summary of State Statutes

STATE AND CITATION	NONSHAREHOLDER INTERESTS TO CONSIDER	LIMITS ON SCOPE OF JUDICIAL REVIEW	EXPRESS DUTIES OR LIMIT ON BOARD DUTIES
<u>Arizona</u> ARIZ. REV. STAT. ANN. § 10-2701 (West 1996).	A director shall consider the long-term as well as short-term interests of the corporation and its shareholders, including the possibility that long-term interests may be best served by the continued independence of the corporation.	none	• mandatory consideration • "this section shall not modify the duties of the position of director in any matter outside the scope of this chapter."
<u>Connecticut</u> CONN. GEN. STAT. ANN. § 33-756 (West 1997).	In takeover context: (1) The long-term as well as short-term interests of corporation; (2) The long-term as well as short-term interests of shareholders; (3) Employees, suppliers, creditors, and customers; (4) Community and society;	none	mandatory consideration in a takeover context (director "shall consider . . .")

	(5) The possibility that long term interests may be best served by the continued independence of the corporation; and (6) Any other factors director reasonably believes to be in the best interests of the corporation.		
<u>Florida</u> FLA. STAT. ANN. § 607.0830(3) (West 1993 & Supp. 2001).	(a) Long-term prospects and interests of the corporation and its shareholders, and the (b) social, economic, legal, or other effects of any action on: (1) Employees, suppliers and customers; (2) Communities and society; and (3) Economy of state and of the nation. {shareholders also mentioned}	none	none
<u>Georgia</u> GA. CODE. ANN. § 14-2-202(b)(5) (1994 & Supp. 2000).	(1) Employees, customers, suppliers, and creditors; (2) Communities; and (3) "All other factors such directors consider pertinent."	none	These provisions "shall be deemed solely to grant discretionary authority to the directors and shall not be deemed to provide to any constituency any right to be considered."
<u>Hawaii</u> HAW. REV. STAT. § 415-35 (1993 & Supp. 1999).	A director may consider: (1) Employees, customers, suppliers, and creditors; (2) Economy of the state and nation; (3) Community and societal consid-	none	none

	erations (without limitation); and (4) The long-term as well as short-term interests of the corporation, including, without limitation, the possibility that long term interests may be best served by the continued independence of the corporation.		
<u>Idaho</u> IDAHO CODE § 30-1-1602 (1999).	(1) Employees, suppliers, customers, and community; and (2) The long-term as well as short-term interests of the corporation, including, without limitation, the possibility that these interests may be best served by the continued independence of the corporation.	none	mandatory consideration of long-term interests
<u>Illinois</u> 805 ILL. COMP. Stat. 5/8.85 (West 1999).	Board of directors, committee of board, individual directors and individual officers may consider: (1) Employees, suppliers, and customers; (2) Communities; and (3) All other pertinent factors.	none	none
<u>Indiana</u> IND. CODE ANN. § 23-1-35-1(d) (Michie 1999).	In any matter, a board may consider both the short term and long term best interests of the corporation; A director may consider: (1) Employees, suppliers and customers; (2) Communities; and (3) "[A]ny other factors directors consider pertinent."	Determination of a majority of the disinterested directors of the board of directors "shall conclusively be presumed to be valid unless it can be demonstrated that the determination was not made in good faith after reasonable investigation."	• Directors are not required to consider the effects of a proposed corporate action on any particular corporate constituency as controlling. • If the board of directors determines to

			reject an offer it deems not in the best interest of the corporation, the board of directors has no obligation to refrain from opposing offer
<u>Iowa</u> IOWA CODE ANN. § 490.1108 (West 1999).	In takeover context, a director may consider: 1) Employees, suppliers, creditors, and customers; (2) Communities; and (3) The long term and short term interests of the corporation, including the possibility that long term interests may be best served by the continued independence of the corporation.	"Consideration of any or all of the community interest factors in not a violation of the business judgment rule or of any duty of the director to the shareholders ..."	"If the board of directors determines to reject [an offer it deems not in the best interest of the corporation], the board of directors has no obligation to [refrain from opposing offer]."
<u>Kentucky</u> KY. REV. STAT. ANN. § 271B.12-210(4) (Michie 1989 & Supp. 2000).	(1) Employees, customers, suppliers, and creditors; (2) Economy of the state and nation; (3) Community and societal considerations; and (4) The possibility that long term interests may be best served by the continued independence of the corporation.	none	none

Louisiana LA. REV. STAT. ANN. § 12:92(G) (West 1994).	In takeover context, directors may consider: (1) Offeror's consideration; estimated future and liquidation prices; premiums paid other corporations in similar transactions; political, economic, and other factors bearing on stock prices and corporation's financial condition and future prospects; (2) Social and economic effects on employees, customers, creditors, and communities; and (3) Offeror's financial condition, competence, experience, and integrity.	none	none
Maine ME. REV. STAT. ANN. tit 13-A, § 716 (West 1981 & Supp. 2000).	The directors and officers may consider: (1) Effects on employees, customers, creditors, and communities; and (2) All other pertinent factors.	none	none
Maryland MD. CODE ANN., CORPS. & ASS'NS § 2-104(9) (1999).	In takeover context, the board of directors may consider: (1) Stockholders, employees, suppliers, customers, and creditors; and (2) Communities.	none	none
Massachusetts MASS. GEN. LAWS ANN., ch. 156B, § 65 (West 1996).	A director may consider: (1) Employees, customers, suppliers, and creditors; (2) Economy of the state, region, and nation, community and societal considerations; and (3) The possibility that long term interests may be best served by the continued independence of the corporation. {shareholders also mentioned}	none	none
Minnesota MINN. STAT. ANN. § 302A.251(5) (West 1985 & Supp. 2001).	A director may consider: (1) Employees, customers, suppliers, and creditors; (2) Economy of the state and nation,	none	none

	community and societal considerations; and (3) The possibility that long term interests may be best served by the continued independence of the corporation. {shareholders also mentioned}		
<u>Missouri</u> MO. ANN. STAT. § 351.347(1) (West 1991).	In takeover context, the board of directors may consider: (1) Social, legal, and economic effects on employees, suppliers, customers and others having similar relationships with corporation; (2) Communities; (3) Offeror's price in relation to board's estimate of current and future value of corporation; (4) Political, economic and other factors bearing on security prices generally or the current market value of the corporation's securities in particular; and (5) Offeror's integrity, financial wherewithal and competence. {shareholders also mentioned}	none	Directors are not required to respond to any particular acquisition proposal.
<u>Nebraska</u> NEB. REV. STAT. § 21-2432(2) (1997).	A director may consider: Employees, suppliers, and customers of corporation, and communities.	none	none
<u>Nevada</u> NEV. REV. STAT. ANN. § 78.138 (4) (Michie 1999).	A director may consider: (1) The interests of the corporation's employees, suppliers, creditors and customers; (2) The economy of the state and nation; (3) The interests of the community and of society; and	none	none

	(4) The long-term as well as short-term interests of the corporation and its stockholders, including the possibility that these interests may be best served by the continued independence of the corporation.		
New Jersey N.J. STAT. ANN. § 14A:6-1 (West 1969 & Supp. 2000).	Where change of control is involved, directors may consider long and short term interests of corporation and shareholders.	none	If the board of directors determines to reject an offer it deems not in the best interest of the corporation, the board of directors has no obligation to refrain from opposing offer
New Mexico N.M. STAT. ANN. § 53-11-35(D) (Michie 1983).	A director may consider: (1) Employees, customers, suppliers, and creditors; (2) Economy of the state and nation; (3) Impact on community; and (4) The possibility that long term interests may be best served by the continued independence of the corporation.	none	none
New York N.Y. BUS. CORP. LAW § 717(b) (McKinney 1986 & Supp. 2001).	A director may consider a corporation's: (1) Growth prospects; (2) Employees, customers and creditors; and (3) Ability to contribute to communities as a going concern. {shareholders also mentioned}	none	Statute does not "create any duties owed by any director to any person . . . or

			abrogate any duty of the directors . . . ."
North Dakota N.D. CENT. CODE § 10-19.1-50(6) (1995 & Supp. 1999).	A director may consider: (1) Employees, customers, suppliers, and creditors; (2) Economy of the state and nation; (3) Community and societal considerations; and (4) Long-term and short-term interests of corporation and the possibility that they may be best served by the continued independence of the corporation.		
Ohio OHIO REV. CODE ANN. §§ 1701.13(F)(7), 1701.59(A)(D)(E) (Anderson 1997 & Supp. 2001).	A director may consider: (1) Employees, suppliers, creditors, customers; (2) Community and societal considerations; economy of Ohio and of the nation; (3) The possibility that long term interests may be best served by the continued independence of the corporation; and (4) Effect of any future indebtedness.	• Directors may resist a change or potential change in control of the corporation if they, by a majority vote of a quorum, determine that the change or potential change is opposed to or not in the best interests of the corporation. • The clear and convincing evidence standard's used for changes in control.	The time frame is at directors' discretion.

		• Directors will be scrutinized solely under the ordinary business judgment rule (i.e., Ohio rejects heightened Unocal standard).	
Oregon OR. REV. STAT. § 60.357 (1988).	In a takeover context, directors may consider: (1) Social, legal, and economic effects on employees, suppliers, customers and on the communities and areas in which corporation operates; (2) Economy of Oregon and of the nation; (3) The possibility that long term interests may be best served by the continued independence of the corporation; and (4) Other relevant factors. {shareholders also mentioned}	none	none
Pennsylvania 15 PA. CONS. STAT. ANN. § 515 (West 1995).	The board, a committee of the board, or individual directors may consider: (1) Employees, suppliers, customers; (2) Community; (3) The effects of changes in control on all constituencies (including creditors); (4) Benefits from long term plans and the possibility that the interests may be best served by remaining independent; and (5) Resources, intent and conduct of suitor.	• Board actions affecting an acquisition to which a majority of disinterested directors assent are presumed to be in the best interests of the corporation (i.e. clear and convincing evidence standard).	• Section 1721 "does not impose upon the board of directors . . . any legal . . . duties . . . ." • "Directors shall not be required . . . to regard any corporate interests [as dominant]." • Directors

		• Nonshareholder constituencies are denied standing. • Absent a breach of fiduciary duty, lack of good faith, or self-dealing, a director will not be subject to Unocal's heightened burden of proof.	not required to redeem poison pills or to take any action solely because of the effect on potential acquisitions.
Rhode Island R.I. GEN LAWS § 7-5.2-8 (1999).	The board or committees therefrom, or individual directors may consider: (1) Employees, suppliers, creditors, customers; (2) Community; and (3) The possibility that long-term interests may be best served by the continued independence of the corporation.	none	"[I]f the board of directors determines that any business combination is not in the best interests of the corporation, it may reject the business combination. . . . [T]he board has no obligation to facilitate, to remove any barriers to, or to refrain from impeding, the business combi-

			nation."
South Dakota S.D. CODIFIED LAWS § 47-33-4 (Michie 2000).	In takeover context, board and individual directors may consider: (1) Employees, suppliers, creditors, customers; (2) Community and societal considerations; (3) The economy of South Dakota and of the nation; and (4) The possibility that long-term interests may be best served by the continued independence of the corporation.	• "The consideration of those factors shall not constitute a violation of the director's fiduciary duty to the corporation or its shareholders. . . ." • If the board rejects a business combination, it "shall have no obligation to facilitate, remove any barriers to, or refrain from impeding the proposal or the offer."	If the board of directors determines to reject an offer it deems not in the best interest of the corporation, the board of directors has no obligation to refrain from opposing offer
Tennessee TENN. CODE ANN. § 48-103-204 (1995).	In takeover context, resident corporations, its officers, and its directors shall not be held liable for considering: (1) Employees, customers, suppliers, communities; and (2) Any other relevant factor.	Corporation, directors, and officers are not liable.	none
Vermont VT. STAT. ANN. tit. 11A § 8.30 (1997 & Supp. 1999).	A director may consider: (1) Employees, suppliers, creditors and customers; (2) Economy of the state, region, and nation; (3) Community and societal considera-		

	tions; and (4) Long and short-term interests and the possibility that those interest may best be served by the continued independence of the corporation.		
<u>Virginia</u> VA. CODE ANN. § 13.1-727.1 (Michie 1999).	A director may consider the possibility that those interests may best be served by the continued independence of the corporation.	none	none
<u>Wisconsin</u> WIS. STAT. ANN. § 180.0827 (West 1992).	A director or officer may consider: (1) Employees, customers, suppliers, (2) Communities; and (3) Any other relevant factor.	none	none
<u>Wyoming</u> WYO. STAT. ANN. § 17-16-830 (Michie 1999).	A director may consider: (1) Employees, suppliers, creditors, customers; (2) Communities; (3) Economies of Wyoming and of the nation; (4) The possibility that long term interests may be best served by the continued independence of the corporation; and (5) "Any other factors relevant to promoting or preserving public or community interests." {bondholders specifically mentioned}	none	none