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Brand New Deal: The Branding Effect of Corporate Deal Structures

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BRAND NEW DEAL: THE BRANDING EFFECT OF CORPORATE DEAL STRUCTURES

*Victor Fleischer**

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INTRODUCTION

Consider the unusual legal structures of the following four deals:

- When Google went public in 2004, it used an Internet auction to sell its stock to shareholders.
- When Ben & Jerry's went public in 1984, it sold its stock only to Vermont residents.
- Steve Jobs's contract with Apple entitles him to an annual cash salary of exactly one dollar.
- Stanley Works, a Connecticut toolmaker, considered reincorporating in Bermuda to reduce its tax liability. Under public pressure, it changed its mind and remains legally incorporated in Connecticut.

What do these deals have in common? In each case, the legal infrastructure of the deal had a *branding effect*: the design of the deal altered the brand image of the company.

The structure of each of the first three deals is difficult to understand using the traditional tools of corporate finance alone. The deals appear to be inefficient, at least if one thinks about efficiency in the usual way.¹ But if one also considers the impact of the deal on brand image, the Google, Ben & Jerry's, and Apple deals are success stories. The Stanley Works deal was a failure. But it did not fail because of some flaw in its financial design, such as a miscalculation of the tax savings or difficulty in communicating the tax benefits to its shareholders. The deal failed because its managers failed to predict the negative impact that its legal infrastructure would have on its brand image.

The concept of branding rarely appears in academic debates about corporate finance and corporate governance. Finance scholars focus their attention on the relationship between the firm; its investors and creditors,

1. Deal structures with positive branding effects may appear to be inefficient in the short term (for example, by increasing the cost of capital). But these structures can be efficient in the long run by increasing revenue from product markets. In theory, if the capital markets recognize the positive revenue implications, there may not in fact be an increase in the cost of capital. This would make the deals efficient in both the short term and the long term. Evidence from the case studies below, however, suggests that the capital markets are slow to recognize the branding implications of deal structures. The stock price of Google and Ben & Jerry's rose steadily following their unusual IPOs, suggesting at least the possibility that the capital markets undervalued the branding effects of the deals. The stock price of Stanley Works jumped at the announcement of its proposed inversion, notwithstanding the negative branding implications that ultimately helped sink the deal.

who supply financial capital; and its managers, who supply human capital.² Contracts are efficient when they properly align incentives; a good contract design is one that allows managers to raise capital cheaply and deploy it effectively. At best, consumers enter the discussion as the emotionless buyers who make up the product markets and serve as a potential indirect check against agency costs.³

The functionality-oriented consumer. The implicit assumption in these debates is that consumers have no rational reason to care about the internal corporate governance of a firm whose products they buy. Most consumers, after all, have only the haziest notion of how firms interact with the capital markets and labor markets. Finance scholars, then, act like the editors of Consumer Reports. They assume that consumers only value basic product attributes like price, durability, resale value, and quality. Contract design, after all, would seem to have little effect on the absorbency of a paper towel, the sound quality of an mp3 player, or the creaminess of a pint of frozen yogurt. From this perspective, the best managerial structure is whatever structure produces the best products while keeping production costs and transaction costs low. Corporate governance is a matter for shareholders and managers and creditors to work out amongst themselves. By focusing on the functionality of products, however, we mask any link between products and contract design.

The brand-oriented consumer. Focusing only on functionality is, of course, problematic. Consumers choose brands, not just product attributes. Buying a pint of Ben & Jerry's is not the same experience as buying a pint of Häagen-Dazs, even if the product is similar. Brand image reflects the values of the people who create the product. In certain circumstances, I argue here, contract design contributes to the atmospherics of the brand. An innovative deal structure may cost the company something in short-term efficiency, but it may pay dividends in the form of increased demand from consumers in the long run. Deal structure, then, is not just a method of managing transaction costs. It is also an advertising medium. Unlike direct marketing tactics, however, the process is more subtle. Whatever its content, the "message" of the deal structure reaches consumers indirectly through early adopters or other opinion leaders—knowledgeable, sophisticated consumers who experiment with new products and are particularly sensitive to the trustworthiness of the manufacturer. Just the sort of consumer, in other words, who might pay attention to deal structure.

This Article explores the branding effect of deal structures by looking at four case studies. First, I examine two initial public offerings (IPOs), the

2. See generally RICHARD A. BREALEY & STEWART C. MYERS, *PRINCIPLES OF CORPORATE FINANCE* (7th ed. 2003); RONALD J. GILSON & BERNARD S. BLACK, *THE LAW AND FINANCE OF CORPORATE ACQUISITIONS* (2d ed. 1995).

3. If management shirks or lacks the talent to lead the company effectively, the firm will produce lower quality products, and customers will turn to competitors. In turn, this may turn the company into a takeover target or may lead shareholders to press the board to make a change in personnel. See D. Gordon Smith, *Corporate Governance and Managerial Incompetence: Lessons from Kmart*, 74 N.C. L. REV. 1037 (1996).

first by Google; the second by Ben & Jerry's. From a traditional corporate finance perspective, the goal of a properly structured IPO is to manage the information asymmetry between the issuer and potential buyers in order to raise the largest amount of money possible per share of stock sold. From this perspective, the success of the Google deal is questionable. Few would call this deal elegant or efficient.⁴ But this is not really what the Google IPO structure was about, or at least it is not the full story. When Google structured its IPO as an auction, it reinforced Google's identity as an innovative, egalitarian, playful, trustworthy company. Talking about Google's IPO makes you want to use Google's products.

Similarly, the Ben & Jerry's deal structure may not have been terribly efficient. By selling its stock only to Vermont residents, the company saved a few thousand dollars in legal and accounting fees. On the other hand, the geographic restriction artificially limited demand for the stock, which may have pushed the price down. Was the tradeoff worth it? Without considering consumers, the cost-benefit analysis fails to capture the essence of the deal. The offering was not just about selling stock and raising capital. It was also about selling ice cream. Selling stock to Vermonters helped build the brand image of the company.

The next case study looks at Apple and its contract with its CEO, Steve Jobs. Jobs takes a salary of one dollar a year. He also owns a substantial amount of Apple stock. Executive-compensation contracts typically provide a mix of cash and equity designed to align the executive's incentives with those of the company's investors.⁵ But I argue here that Jobs's salary isn't designed to provide an efficient mix of cash and equity. His contract is a symbolic statement indicating that he's not in it for the money. "One Dollar" feeds the cult of the Mac.

The last case study looks at Stanley Works, a Connecticut toolmaker. In 2002 Stanley Works considered reincorporating in the tax haven of Bermuda. Conventional wisdom holds that there is no patriotic duty to pay more in taxes than one is legally required to pay.⁶ Stanley Works was within its rights, legally speaking, to reincorporate in Bermuda. One would expect a well-advised corporation managed by rational profit-maximizing agents to do so. But Stanley Works' reincorporation, or rather its failure to close the deal, was not ultimately about taxes. It was about selling hammers and screwdrivers in the heartland. Corporate expatriation won't play in Peoria.⁷

What can we learn from these case studies? Innovative deal structures allow us to peer through the gossamer corporate veil and spy the values of

4. See *infra* text accompanying notes 59–66.

5. See Michael C. Jensen, Kevin J. Murphy & Eric G. Wruck, *Remuneration: Where We've Been, How We Got to Here, What Are the Problems, and How to Fix Them* (Eur. Corp. Governance Inst., Working Paper No. 44/2004, 2004), available at <http://ssrn.com/abstract=561305>.

6. See *Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934).

7. "Will it play in Peoria?", a phrase that originated during Peoria's successful vaudeville days, has become a commonly used metaphor for measuring whether something will appeal to the mainstream American public. See Jennifer S. Everett, *Will it Play in Peoria*, <http://www.historicpeoria.com/select.cfm?chose=231> (last visited Feb. 10, 2006).

the company's founders and managers. Like the Emperor penguins stoically waddling in single file to their breeding ground,⁸ unusual deal structures anthropomorphize the firm in the eyes of consumers. Innovative deal structures are striking, and they can marginally affect the set of mental associations that make up brand image. Google is not just a network of connected contracts;⁹ it is playful and innovative. Ben & Jerry's isn't just a manufacturer of a dessert product; it's a loyal companion.

Deal structure, then, is a specialized kind of advertising medium, and it fits some firms better than others. Reputation and brand image are especially important for firms that produce expensive credence goods like medical treatment, financial advice, or an Ivy League education.¹⁰ Consumers, skeptical of self-serving claims, turn to sources of information in addition to traditional advertising, such as newspaper articles, U.S. News Rankings,¹¹ word-of-mouth, product reviews on Amazon.com, or blogs. Deal structure provides these opinion leaders with another source of information. Deal structure, then, is more likely to prove effective as an advertising medium for companies that rely heavily on opinion leaders to drive demand, such as consumer-technology companies or manufacturers of trendy consumer goods and cult brands. These companies seek consumers who highly value attributes like innovation, creativity, coolness, or altruism, and not just functionality. For these companies, the legal infrastructure of deals provides early adopters with a window through which they can view, or imagine, the soul of the company.

* * *

Roadmap and clarification of terms. Following this introduction, I have organized this Article into three main sections. In Section II below, I briefly review the literature on the lawyer's role in structuring deals. Many would consider branding a "business issue" of little concern to lawyers; Section II explains why responsible lawyers should consider the institutional and social context in which deals are done. The case studies in Section III explore in some detail how the legal infrastructure of deals can have a branding effect. In Section IV, I conceptualize the role of branding as it relates to deal structure. Certain legal events in the lifecycle of the company—what I call *branding moments*—provide opportunities for firms to signal company values. I also consider the mechanisms by which knowledge of innovative structures spreads to consumers, which in turn provides some insight into

8. See LA MARCHE DE L'EMPEREUR [MARCH OF THE PENGUINS] (Bonne Pioche 2005).

9. See G. Mitu Gulati, William A. Klein & Eric M. Zolt, *Connected Contracts*, 47 UCLA L. REV. 887 (2000).

10. Credence goods are items for which the quality cannot be easily assessed even after the purchase has been made, such as financial advice or auto repair. See Michael R. Darby & Edi Karni, *Free Competition and the Optimal Amount of Fraud*, 16 J.L. & ECON. 67 (1973).

11. See Bernard S. Black & Paul L. Caron, *Ranking Law Schools: Using SSRN to Measure Scholarly Performance*, 81 IND. L.J. 1 (2006); Posting of Victor Fleischer to Conglomerate, http://www.theconglomerate.org/2005/08/branding_legal_.html (Aug. 12, 2005).

what companies might be best suited to take advantage of the branding effects of corporate deal structuring.

Before proceeding further, it may be useful to clarify what I mean by “deals” or the “legal infrastructure of deals.” It may seem obvious that deal-makers think about brand image. When Canon hires Maria Sharapova or Andre Agassi as a spokesperson, the deal has a branding effect. But my focus here is not on the branding implications of run-of-the-mill advertising transactions. This Article focuses instead on the sorts of deals for which a firm might engage outside legal counsel. These deals include IPOs, mergers and acquisitions, securities offerings, executive-compensation arrangements, and other matters of internal corporate governance. This Article, in other words, focuses on contracts in which the branding implications are non-obvious, and in which lawyers may have an institutional role in advising the client.¹²

Lastly, I do not wish to overstate the importance of branding. The deals I highlight here involve some unusual companies. This Article does not purport to prove that branding concerns caused the founders or managers to adopt these structures, nor does it suggest that every deal has important branding implications.¹³ I certainly do not mean to suggest that these deals originated in the marketing departments of these companies. Rather, this Article claims that deal structures sometimes have branding implications (whether by design or accident) and that lawyers ignore the implications at their peril. The ethereal link between product markets and capital markets is what makes the branding effects of deal structures both challenging and promising as a new avenue of research.

I. UNDERSTANDING THE LEGAL INFRASTRUCTURE OF DEALS

What determines the legal infrastructure of deals? In *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, Ronald Gilson argues that the defining activity of the corporate lawyer is minimizing transaction costs.¹⁴ Transaction costs do not refer simply to the costs associated with

12. It may also be worth noting that this Article is not about the marketing of financial products to investors. While financial innovation and the marketing of financial products are important topics, those topics are beyond the scope of this Article. I am not focusing on how investment banks change the legal structure of securities in order to sell securities. Rather, I am interested in how firms and their lawyers tweak the legal structure of contracts in order to sell more *widgets*.

13. These case studies do not prove that concerns about branding caused the companies to adopt the structures I discuss. That is not the goal of this Article. Rather, I want to suggest that the structures had branding effects. The case studies do generate some testable hypotheses that additional empirical research could help prove or disprove. See Gregory Mitchell, *Case Studies, Counterfactuals, and Causal Explanations*, 152 U. PA. L. REV. 1517 (2004). In addition, the Article contributes to the legal-profession literature by suggesting that deal lawyers should be aware of branding implications notwithstanding the occasional admonition from clients to stick to the “legal issues” and leave the business concerns to other professionals.

14. Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239 (1984). Another important strand of the literature emphasizes the decision-making process and long-term contracts. See Charles J. Goetz & Robert E. Scott, *Principles of Relational*

“papering” the deal. Transaction costs include the costs of searching for an appropriate exchange partner, negotiating the terms of the deal, producing information, policing strategic behavior, and enforcing the contract. Gilson focuses on deal hurdles that lawyers commonly address, like asymmetric information and moral hazard. These problems can require costly monitoring by deal participants, cause buyers to discount the projected value of assets, or even suffocate deals altogether under a blanket of suspicion. Drawing on the work of economists and finance theorists like Ronald Coase, Oliver Williamson, and Michael Jensen,¹⁵ Gilson argues that when lawyers structure deals, they increase efficiency. Lawyers add value to the deal by designing contracts that facilitate the flow of information and properly align incentives. When the buyer and seller disagree about the value of an asset, for example, lawyers might draft an earn-out agreement that links the price of the asset to the actual earnings it generates.¹⁶

Asymmetric information and strategic behavior are not the only costs that transactional lawyers consider. Regulatory costs also affect deal structure.¹⁷ Accounting treatment, tax incentives, antitrust concerns, and financial intermediation rules may all come into play.

Ron Gilson, Victor Goldberg, David Schizer, and others at Columbia Law School have developed an empirical case-study approach to examine how deal lawyers create value when they engineer the legal infrastructure of transactions.¹⁸ This Article adds a Gen-X flavor to the “Deals” approach, extending and updating the work of the Columbia School with a brand-conscious examination of deal structuring.¹⁹ I agree with the basic premise of the Columbia School that the primary purpose of the legal infrastructure

Contracts, 67 VA. L. REV. 1089 (1981); Oliver Hart, *Financial Contracting*, 39 J. ECON. LITERATURE 1079, 1083–98 (2001).

15. See, e.g., Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 323 (1986); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305, 309–10 (1976) (discussing how agency problems can affect firm structure); Stewart C. Myers & Nicholas S. Majluf, *Corporate Financing and Investment Decisions When Firms Have Information That Investors Do Not Have*, 13 J. FIN. ECON. 187, 195–98 (1984) (examining the effect of information asymmetry on firm structure).

16. See Gilson, *supra* note 14, at 262–65 (explaining how an earn-out agreement manages information asymmetry).

17. See *id.* at 246. But see Merton H. Miller, *Debt and Taxes*, 32 J. FIN. 261, 262 (1977) (“I will argue that even in a world in which interest payments are fully deductible in computing corporate income taxes, the value of the firm, in equilibrium will still be independent of its capital structure.”).

18. For a discussion of the Columbia approach, see Victor Fleischer, *Deals: Bringing Corporate Transactions into the Law School Classroom*, 2002 COLUM. BUS. L. REV. 475.

19. Generation X refers to Americans born roughly between 1965 and 1975. Our relationship to brands and branding tends to be more complex and nuanced than the Baby Boomers’. We are postmodernist, not modernist. Rather than earnestly fighting marketing and consumerism, we resign ourselves to it or embrace it with a sense of irony. We acknowledge that brands help form our identity, and we ultimately accept consumerism even as we recognize its drawbacks. For our generation, the purchasing decision is rarely based only on functionality. Image matters more than it did before.

of deals is to minimize transaction costs and regulatory costs.²⁰ But I argue here that deal structure may also affect a company's brand image. Contract design helps form the identity of the firm and consumers' perception of the firm.

While the literatures on both corporate finance and branding are extensive, linking the two together is a new idea.²¹ The corporate finance literature rarely discusses branding. Black & Gilson's textbook on the *Law and Finance of Corporate Acquisitions*, for example, never mentions branding. Neither does the leading corporate finance textbook.²² Of course, I can hardly claim to be the first scholar to emphasize the importance of understanding the social context in which contracts are made. Beginning with the "law in action" scholarship of Stewart Macaulay,²³ scholars such as Ian MacNeil,²⁴ Robert Ellickson,²⁵ and Lisa Bernstein²⁶ have considered the im-

20. See also Manuel A. Utset, *Producing Information: Initial Public Offerings, Production Costs, and the Producing Lawyer*, 74 OR. L. REV. 275 (1995) (drawing a distinction between the lawyer's role in managing transaction costs and the lawyer's role in producing information).

21. Corporate finance scholars have considered whether brand image affects investors' preferences. See Joshua D. Coval & Tobias J. Moskowitz, *Home Bias at Home: Local Equity Preference in Domestic Portfolios*, 54 J. FIN. 2045 (1999); Laura Frieder & Avaniidhar Subrahmanyam, *Brand Perceptions and the Market for Common Stock*, 40 J. FIN. & QUANT. ANALYSIS 57 (2005); Gur Huberman, *Familiarity Breeds Investment*, 14 REV. FIN. STUD. 659 (2001). Only a few, however, have touched on whether a firm's capital markets decisions affect consumer preferences. See James C. Brau & Stanley E. Fawcett, *Initial Public Offerings: An Analysis of Theory and Practice*, 61 J. FIN. 399 (2006) (finding that many high-tech firms go public for strategic reasons related to reputation rather than out of a need for capital); Elizabeth Demers & Katharina Lewellen, *The Marketing Role of IPOs: Evidence from Internet Stocks*, 68 J. FIN. ECON. 413 (2003). A recent paper by law professor Kim Krawiec considers whether law firm structuring decisions lead to changes in status, which could be considered a branding effect. See Kimberly D. Krawiec, *Organizational Form as Status and Signal*, 40 WAKE FOREST L. REV. 977 (2005).

22. See BREALEY & MYERS, *supra* note 2. The leading marketing textbooks, for that matter, contain no references to financial structure. Marketing scholars have only begun recently to test the effect of run-of-the-mill branding on shareholder value, let alone to consider whether financial contract design could itself affect brand equity, which in turn could affect firm value. See, e.g., Thomas J. Madden, Frank Fehle & Susan M. Fournier, *Brands Matter: An Empirical Demonstration of the Creation of Shareholder Value Through Brands* (May 2, 2002) (working paper on file with the author), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=346953 (noting the "deeply embedded cultural condition that distances marketing from the broader executive functions of the firm" and, as an attempt to provide "a bridge across the marketing-finance divide," offering what the authors contend is a "clear and compelling empirical demonstration of the relationship between branding and the creation of shareholder value.").

23. See Stewart Macaulay, *An Empirical View of Contract*, 1985 WIS. L. REV. 465; Stewart Macaulay, *Elegant Models, Empirical Pictures, and the Complexities of Contract*, 11 LAW & SOC'Y REV. 507 (1977); Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963).

24. See IAN R. MACNEIL, *THE NEW SOCIAL CONTRACT: AN INQUIRY INTO MODERN CONTRACTUAL RELATIONS* 71-117 (1980) (describing modern contract law in relational terms); Ian R. Macneil, *The Many Futures of Contracts*, 47 S. CAL. L. REV. 691 (1974).

25. See ROBERT C. ELICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* 57-58 (1991).

26. See Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765 (1996); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992).

portance of noncontractual mechanisms on deal structure. Broadly speaking, these scholars argue that to understand deals, we must look outside the four corners of the contract and consider the institutional and social context in which the parties strike a deal. Contract law, narrowly defined, exerts less influence on transactions than we might expect.²⁷ In relational agreements, it is common for contract terms to be incomplete. Transactions are often enforced outside of the courtroom by community norms and social sanctions. What is particularly new about this Article, then, is not its focus outside the four corners of the agreement, but rather its consideration of the reputational impact that the contract design itself has in the eyes of those who are *not* parties to the contract (consumers and employees).²⁸

The link between corporate finance and branding may change the professional responsibilities of transactional lawyers. Branding has received scant attention from the legal academy, outside of trademark scholars.²⁹ Corporate lawyers traditionally draw a line, albeit a fuzzy one, between legal issues and business issues.³⁰ If Gilson is right that lawyers are transaction-cost engineers, then the distinction between legal issues and

27. Mark C. Suchman, *The Contract as Social Artifact*, 37 *LAW & SOC'Y REV.* 91, 96 (2003) ("The key finding here is that 'Contract Law,' as the doctrinalists study it, exerts remarkably little influence on a remarkably wide range of transactions.").

28. This Article also draws conceptually on a research agenda proposed by sociologist Mark Suchman in a recent article analyzing contracts as "social artifacts." *Id.* Starting with the intuitive point that the meaning of a contract depends on its social context, Suchman explores the idea that contracts are tools. Like a screwdriver used as a door stop, contracts may be used in ways its designers may not have originally intended. *See id.* at 109. Suchman notes:

Employed with a little ingenuity, detailed contingency provisions can serve to discourage close reading, as much as to ensure mutual agreement; standard-form contracts can serve to disempower front-line sales staff, as much as to constrain transaction partners; and dispute resolution procedures can serve to extract proprietary business information as much as to determine fair remedies. Far from undermining the engineering metaphor, such instances of user creativity simply demonstrate the need for ethnographies of contract practice, parallel to the existing ethnographies of other technology practices.

Id. (internal citations omitted).

These "off-label" uses of contracts may change the way that we measure efficiency and may force the use of multiple design criteria. *Id.* at 109–10 ("Researchers have already begun to explore various extra-contractual influences on contract blueprints, and future investigations will almost certainly explore the extra-contractual consequences of such blueprints, as well. As these explorations proceed, even the meaning of technical efficacy itself may expand to incorporate *multiple* design criteria, rather than transaction-cost minimization alone. The engineering metaphor provides little reason to believe that efficient, positive-sum collaboration will always be the sole, or even the primary, technical objective in contract design.").

Suchman's approach does not undermine the notion of transaction-cost minimization as a measure of contract efficiency, but it stresses that the efficiency of contract design may vary depending on the user. Deals are not one-size-fits-all; your mileage may vary. Branding, then, is just one way of measuring the success or failure of a particular contract design, by a particular firm, in a particular product market.

29. For an overview of the legal framework that protects investments in reputation, see William M. Landes & Richard A. Posner, *Trademark Law: An Economic Perspective*, 30 *J.L. & ECON.* 265 (1987).

30. *But see* Jill Schachner Chanen, *The Strategic Lawyer*, A.B.A. J., July 2005, at 43, 45–47 (discussing increasing pressure for lawyers to think strategically about the business implications of legal decisions).

business issues begins to break down. Designing the structure of a deal is an endeavor that must be pursued jointly between lawyers and other professionals. Lawyers add value to transactions by allocating risks properly through contract, and their negotiations and decisions affect incentives and change how businesses run operations moving forward.³¹ And if I am right that deal structures have branding effects, then the distinction between legal and business decisions breaks down even further. Lawyers can and should include the deal's effect on brand equity in their back-of-the-envelope cost-benefit analysis of different deal structures, in addition to the effect on managers, shareholders, employees, and creditors.

What is not clear from these case studies is whether, as a general matter, lawyers are particularly talented when it comes to understanding the branding implications of deal structures. But whether they are naturally suited to the task or not, they are inevitably involved in the decision-making process that leads to the final structure of the deal. The clearest example of a situation in which counsel ought to speak up is when a structure is efficient from the point of view of managing transaction costs and regulatory costs but would produce negative branding effects, as in the Stanley Works case. Lawyers should not only listen to the branding concerns of management, but also ask the right questions and draw on their prior experience in structuring deals. For some deals, like IPOs or major acquisitions, the lawyers may have vastly more experience than management. Investment bankers, of course, may be in an even stronger position to advise the client.

Even if one hesitates to embrace this expansive notion of the role of the deal lawyer, it's not clear that lawyers can responsibly avoid any and all consideration of branding. As explained more below, unusual deal structures not otherwise explained by transaction-cost concerns or regulatory-cost concerns might then be explained by either managerial consumption on the one hand or branding and consumer signaling on the other. Consumer signaling may be an appropriate action for the firm, but managerial consumption is not. Only by considering the branding implications can counsel determine whether the firm is acting in the best interests of the shareholders.

Consider the predicament of Google's outside counsel. Should Wilson Sonsini have permitted the founders to include a "letter" to shareholders in the prospectus, even though it was likely to complicate and delay the SEC approval process? Should the founders have been permitted to indulge in math humor when they chose the number of shares to be issued? Some law-

31. The view of the lawyer-as-hired-gun is more of a straw man than an accurate depiction of how many transactional lawyers spend their time advising clients. See Ian Ayres, *Never Confuse Efficiency with a Liver Complaint*, 1997 Wis. L. Rev. 503, 513. Most scholars and practitioners recognize that the line between business and legal issues is not so clear. See Robert A. Kagan & Robert Eli Rosen, *On the Social Significance of Large Law Firm Practice*, 37 STAN. L. REV. 399, 407 (1985) (discussing the dominant image of lawyer as independent counselor in connection with JAMES STEWART, *THE PARTNERS* (1983)). They can "fill a managerial void with the uncommitted resources of intellect, energy, and experience that only large law firms have on tap, thus bolstering the corporation's adaptive capacities." *Id.*; see also *id.* at 410 (describing aspects of the dominant image of lawyers as counselors).

yers would articulate a professional responsibility to fight with the founders and managers on these points. After all, if the actions merely reflect the idiosyncratic preferences of quirky founders, then company counsel has a duty to step in and protect the shareholders. But if I am right that deal structures have branding implications, it follows that lawyers have a responsibility to help the founders consider the risks (and rewards) of the unusual contract design. That the deal may tarnish or enhance a firm's brand image becomes yet another factor for the lawyers to consider, not unlike accounting risk, tax risk, or counterparty credit risk. Indeed, lawyers may be especially well suited to advise their clients about the nonlegal effects of legal decisions, including branding effects.³²

II. CASE STUDIES

This Section considers the branding effects of four deals. They are not representative of all deals, nor do they provide a comprehensive view of the ways in which the legal infrastructure of deals can have branding effects. But they are tangible stories that help illustrate how and why branding matters. In Section IV, I offer a more systematic approach to thinking about branding and deal structure. Before getting to the theory, however, it may be useful to consider some real-world examples.

A. Google

Last summer, Google went public in a highly public manner. Rather than use the traditional underwriter-led book-building process, Google instead sold its stock to the public using an Internet auction. Wall Street watched the deal closely and criticized it extensively. After several delays, the auction closed successfully with an offering price of \$85. The stock closed its first day of trading at \$100 for a first-day pop of 18%. The stock then began its steady climb towards \$400. The numerous problems Google faced in executing the deal suggest it was hardly a model of efficiency. Nor was it a model of egalitarianism.³³ But, I argue here, the deal was a success on its own terms. There was more than short-term efficiency at stake. Google used the IPO as a branding event, and the auction structure created branding effects in a way the traditional IPO structure would not have.

32. Kagan and Rosen explain:

More detached and independent than a corporate chief executive's subordinates, the lawyer can feel free to warn business executives that even if proposed actions do not violate the law per se, they might nevertheless be ethically questionable or might lead to popular or political attacks, adverse reactions by customers or competitors, or intensified governmental scrutiny.

Id. at 410. We are used to giving this lawyerly role the more dignified name of counseling. But when we talk about "popular or political attacks" or "adverse reactions by customers," we are already talking about branding. Kagan and Rosen believe, however, that the dominant image was in decline even as they wrote the article twenty years ago. *Id.* at 422-31.

33. See Christine Hurt, *What Google Can't Tell Us about Internet Auctions (And What It Can)*, 37 U. Tol. L. Rev. (forthcoming 2006), available at <http://ssrn.com/abstract=753625>.

1. *The Timing of the Deal*

Sergey Brin and Larry Page met as computer science graduate students in 1995. The two founded Google and developed a search technology based on the “back links” to websites. By 1999, the company began to grow, and it received \$25 million in financing from Sequoia Capital and Kleiner Perkins, two leading venture capital firms. The company could have gone public earlier, when the equity markets were hungry for any technology company, let alone one with Google’s strong track record and promising future. Eric Schmidt (the CEO), Brin, and Page held off.³⁴ They enjoyed the freedom of remaining a private company, and they had no pressing need for cash.³⁵

Google went public in the summer of 2004. The timing was a bit puzzling. Companies normally go public because they need additional equity capital. Google had no pressing need for cash, and so in theory it could have remained a private company.³⁶ For several reasons, it made sense for Google to go public when it did. None of these reasons, however, required Google to maximize its short-term share price.

Backdoor public company. The precipitating event was somewhat unusual. One advantage Google enjoyed as a private company is that it could hold its business strategy close to the vest. Its growth, however, eventually made this strategy impossible. Like most start-ups, Google had given stock to employees. As it recruited programmers and engineers, more and more employees became stockholders. Under the securities laws, any company with 300 stockholders has to make certain public filings. These public filings would have required some disclosure of Google’s business plan and prospects, making Google a “backdoor” public company.³⁷ And because Google would have had to make aspects of its business strategy public under the required filings, the founders lost a key reason for remaining privately owned.

Liquidity. Going public made sense for other reasons as well. Employees who receive stock and options expect to sell at some point.³⁸ Without a liq-

34. See JOHN BATTELLE, *THE SEARCH: HOW GOOGLE AND ITS RIVALS REWROTE THE RULES OF BUSINESS AND TRANSFORMED OUR CULTURE* 213 (2005) (“In an interview with the *San Francisco Chronicle* in the fall of 2001, Eric Schmidt laid down what would become the triumvirate’s standard answer to the IPO question. ‘The IPO question we’ve debated internally, but frankly, we’re profitable,’ Schmidt said. ‘We’re generating cash. We don’t ever need to go public.’”).

35. The company was already profitable by 2001. See Google Inc., Registration Statement (Form S-1) (Apr. 29, 2004), available at http://www.sec.gov/Archives/edgar/data/1288776/000119312504073639/ds1.htm#toc16167_11.

36. Other scholars have noted, of course, that the reasons for going public may be more complicated. See Lynn A. Stout, *The Unimportance of Being Efficient: An Economic Analysis of Stock Market Pricing and Securities Regulation*, 87 MICH. L. REV. 613, 645 (1988) (arguing that firms rarely use equity issues to raise capital).

37. Becoming a backdoor public company also refers to a process in which a larger privately held company merges with a shell company that is publicly traded. I use the term here to refer to the accidental method of becoming a company required to make public filings simply by accumulating at least 300 stockholders.

38. Another liquidity option is to borrow against the stock. Without a public market, however, lenders would have difficulty valuing the stock.

uid market for shares, employees could not capture the full value of their options. Going public allowed the founders, employees, and investors to sell and thereby diversify their portfolios.³⁹

Because excessive insider selling would have depressed the stock price (which would have been self-defeating), selling was limited by contract. The founders, venture capitalists, and employees sold some shares in the IPO and in secondary offerings in the months following the IPO, but most of their equity would remain locked up in Google for a relatively long time.

Acquisition currency. A third reason for going public was to facilitate acquisitions. Companies often use their own stock as acquisition currency. Google was eyeing some potentially large acquisitions, and having a liquid market for its stock would facilitate tax-free acquisitions. After announcing the IPO, Google acquired Picasa, a digital photo management company;⁴⁰ Keyhole, a digital mapping company;⁴¹ Urchin, a web analytics company;⁴² and Dodgeball, a social networking site.⁴³

But there was no pressing need for cash. A higher share price would make any stock-for-stock acquisitions cheaper. At the same time, Google's advertising products were generating sufficient cash flow to meet the company's operating needs. Google had some desire to build a war chest for future acquisitions, but had no immediate big targets. Moreover, the IPO would not be Google's last chance to raise money in the equity markets, as evidenced by their recent follow-on offering.⁴⁴

In sum, Google had to go public, but it was less concerned about short-term share price than many other companies. Maximizing the offering price (so as to maximize the amount of capital raised) was not as important as building long-term value. The IPO presented itself as a perfect branding moment.

Despite Google's enviable position, it faced a few challenges. The timing of the IPO was not ideal. The dot-com bubble was over. Few companies went public in 2004, and it was hard to imagine an Internet technology company, even Google, receiving a warm reception from gun-shy investors. But with the threat of becoming a "backdoor" public company looming, and increasing pressure to provide liquidity for employees and the venture capitalists, the IPO had to be executed one way or another. It was a treacherous

39. Schmidt has acknowledged that the presence of venture investors (and their demands for liquidity) made an IPO inevitable. BATTELLE, *supra* note 34, at 214.

40. Google Press Release, Google Acquires Picasa, <http://www.google.com/press/pressrel/picasa.html> (last visited Mar. 20, 2006).

41. Google Press Release, Google Acquires Keyhole Corp, <http://www.google.com/press/pressrel/keyhole.html> (last visited Mar. 20, 2006).

42. Google Press Release, Google Agrees to Acquire Urchin, <http://www.google.com/intl/en/press/pressrel/urchin.html> (last visited Mar. 20, 2006).

43. John Markoff, *14,159,265 New Slices of Rich Technology*, N.Y. TIMES, Aug. 19, 2005, at C1.

44. A follow-on offering occurs when a company offers new shares to the market at some point in time after an IPO. A secondary offering, by contrast, occurs when an existing shareholder sells a block of shares to the market.

situation. The way out was to think creatively, or, as Apple-lovers might say, to “think different” about the IPO process.⁴⁵

2. *The Appeal of the Auction Structure*

IPOs have an image problem. Before the dot-com bubble burst, tech IPOs were associated with severe underpricing and huge first-day pops. Insiders got rich; companies left money on the table; retail investors got hurt when the bubble eventually burst.⁴⁶ The challenge for Google was to turn a process associated with greed into something positive. Structuring its IPO as an auction did the trick.

It may be useful here to review briefly the traditional IPO process. In a traditional IPO, a company that needs capital approaches the underwriters who will help take the company public. The underwriters set up a road show where managers talk with potential investors. The underwriters also meet with institutional investors and discuss the company behind closed doors, setting the price through a process known as “book-building.” Underwriters then follow up with investors, who express indications of interest and the price at which they would be willing to buy the stock. Based on these indications of interest, the underwriters and the company agree on a price.

Critics of the traditional IPO process focus on two controversial aspects: pricing and allocation. Pricing an IPO is more art than science. For reasons that remain controversial, the company and its underwriters typically set the price somewhat lower than the anticipated market price. During the dot-com bubble, Internet stocks debuted with first-day pops of 100% or more, creating opportunities for abusive practices that benefited Wall Street insiders and corporate executives.⁴⁷

Underpricing has received a great deal of academic attention.⁴⁸ Historically, IPOs are underpriced by an average of eighteen percent. Most

45. Apple’s “Think Different” ad campaign featured pictures of creative thinkers like Albert Einstein, Jim Henson, John Lennon, Mahatma Gandhi, and Ted Turner. Apple received some flak for the apparent grammatical error, although some have pointed out that “Different” may not be an adverb modifying “Think”, but rather an object of the verb “Think,” a use which could be acceptable vernacular, like “think big” or “think playful.” See Multimedia Language Lab, Apple’s Think Different Campaign, http://www.bu.edu/celop/ml/call/TechNote-think_different.html (last visited Feb. 7, 2006); Invention Convention, <http://www.inventionconvention.com/grammar.html> (last visited Feb. 7, 2006).

46. Christine Hurt, *Moral Hazard and the Initial Public Offering*, 26 CARDOZO L. REV. 711 (2005).

47. *Id.* at 715.

48. E.g., Janet Cooper Alexander, *The Lawsuit Avoidance Theory of Why Initial Public Offerings are Underpriced*, 41 UCLA L. REV. 17 (1993); Richard A. Booth, *The Efficient Market, Portfolio Theory, and the Downward Sloping Demand Hypotheses*, 68 N.Y.U. L. REV. 1187, 1203–11 (1993) (arguing that a downward-sloping demand curve explains the phenomenon of underpricing); Richard A. Booth, *Discounts and Other Mysteries of Corporate Finance*, 79 CAL. L. REV. 1055, 1095 (1991) (noting the growth in popularity of Dutch auctions); Sean J. Griffith, *Spinning and Underpricing: A Legal and Economic Analysis of the Preferential Allocation of Shares in Initial Public Offerings*, 69 BROOK. L. REV. 583, 658–61 (2004) (arguing that IPO allocation practices harm issuers, and proposing that individuals should be barred from participating in IPOs).

financial economists believe that the traditional book-building process is efficient, despite (or because of) underpricing. Underpricing may be necessary to compensate institutional investors for investing in price-discovery activities, or to compensate them for the risk of investing in bad deals. Bruce Johnsen and others argue that syndicates, along with underpricing, improve the efficiency of the system by discouraging overinvestment in information-seeking behavior by potential investors.⁴⁹ In their model, underpricing allows the investors to “buy blind” rather than engage in a competition to unearth information about the company to price the issue more accurately.⁵⁰

Whatever its efficiency, the book-building process still smells fishy to legal scholars, who tend to focus more on egalitarian considerations than economists do.⁵¹ The SEC’s mission is to protect the small investor.⁵² In recent years legal scholars have become more interested in the “Dutch auction” model of selling stock in IPOs. The investment bank Hambrecht has developed and refined an “Auction IPO” model in the United States.⁵³

An auction uses a different price-revealing mechanism than the traditional book-building process. In an auction, investors bid on the Internet for the issuer’s stock. The clearing price—that is, the price at which the company sells the stock to the underwriters—is set at the highest price at which the company can sell the number of shares it wants to sell. Anyone who has placed a bid higher than the clearing price receives an allocation of shares at the clearing price, even if they bid higher. Bidders thus may go ahead and disclose their reservation price. If they guess too high, they will not be punished, but instead will receive stock at the clearing price, like everyone else.⁵⁴ Because the bids of investors correlate closely with the bids that arise in the secondary market after trading begins, underpricing the stock may be unnecessary.⁵⁵

49. Yoram Barzel, Michel A. Habib & D. Bruce Johnsen, *Prevention is Better than Cure: Precluding Information Acquisition in IPOs* (Apr. 2004) (unpublished manuscript, on file with the author).

50. *Id.* at 1.

51. A few legal scholars believe that egalitarian concerns have no place in the IPO regulatory landscape. *E.g.*, Ely R. Levy, *The Law and Economics of IPO Favoritism and Regulatory Spin*, 33 Sw. U. L. REV. 185, 216 (2004) (arguing that pro rata allocations are harmful because they interfere with the price-revealing mechanism that institutional investors provide as part of the book-building process). Most legal scholars, however, believe that transparency and democratic access are important values to be protected by regulation. *See, e.g.*, Sean J. Griffith, *The Puzzling Persistence of the Fixed Price Offering: Implicit Price Discrimination in IPOs*, 18 (Oct. 31, 2005) (unpublished manuscript, on file with author), available at <http://ssrn.com/abstract=797865> (“The loser in this bargain is the issuer and, of course, the transparency and efficiency of the primary market.”).

52. *See* *The Investor’s Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, <http://www.sec.gov/about/whatwedo.shtml> (last visited Feb. 18, 2006).

53. Selling stock through auctions has historically been more common overseas.

54. In a pure Dutch auction, bidders pay the price they bid, not the clearing price.

55. Even in a Dutch auction, some underpricing may be necessary to compensate investors for risk.

The differences between auctions and book-building go beyond the technological leap from the telephone to the Internet. Using an auction affects not only the price mechanism, but also the allocation mechanism. Unlike a traditional IPO, anyone with a computer can participate.⁵⁶ Auctions are more democratic and egalitarian. Because the allocation process eliminates favoritism, it also eliminates the possibility of using underpriced IPO shares to benefit insiders or curry favor with clients. Christine Hurt has advocated a move towards auction IPOs to reduce moral hazard. Other legal scholars remain skeptical. Anita Indira Anand argues that auction structures may not reduce underpricing and that fairness in allocation may not lead to an improvement in market efficiency.⁵⁷ Peter Oh argues that Dutch auctions are risky and susceptible to fraud, and he shows that the benefits are unproven.⁵⁸

When Google announced its intentions to conduct an IPO by auction, the financial press took notice. Google would become by far the largest and most prominent company to sell IPO stock by auction. The financial press pitched the story as Silicon Valley populism versus Wall Street capitalism, making it the deal to watch during an otherwise sleepy summer for the capital markets. Google scored some early PR victories. It strong-armed the white-shoe underwriters into cutting their usual hefty fees, and it forced them to accept a more democratic IPO process. No more Friends of Frank;⁵⁹ Google would conduct its auction according to its company mantra, Don't Be Evil.

3. Execution of the Deal

Conducting an Internet auction forced Google into the role of regulatory entrepreneur.⁶⁰ Securities laws prohibit offers to sell securities until a registration statement is effective; the registration statement cannot become

56. Ironically, this may lead institutional investors to react like Groucho Marx: because anyone can participate, it's not clear why anyone would want to participate. Without underpricing, investors have no incentive to bid on the IPO stock because they can wait and acquire the stock in the secondary market at the same price.

57. Anita Indira Anand, *Is the Dutch Auction IPO a Good Idea?* (Yale Law Sch. Ctr. for Law, Econ. & Pub. Pol'y, Working Paper No. 320, 2005), available at <http://ssm.com/abstract=794464>. Anand points to institutional considerations that make price discovery more efficient in book-built offerings. *Id.* at 11–18. Analyzing the IPO process as a public good, she argues that the results of allowing unimpeded access to retail investors may be undesirable from a market-efficiency standpoint. *Id.* at 22–30. Anand notes that larger, more widely known issuers may benefit from an auction mechanism, particularly for follow-on and secondary offerings. *See id.* at 40. Somewhat generously, she describes Google's IPO as successful from an efficiency standpoint. *Id.* at 33.

58. Peter B. Oh, *The Dutch Auction Myth* (William Mitchell Legal Studies Research Paper No. 33, 2006), available at <http://ssm.com/abstract=890127>.

59. "Friends of Frank" refers to friends and clients of CSFB's Frank Quattrone, who led many of the high-profile tech IPOs. Friends of Frank received allocations of underpriced IPO shares in return for the promise of future investment banking business.

60. *See* A Taxing Blog, http://vic.typepad.com/taxingblog/2005/04/google_as_regul.html (Apr. 26, 2005).

effective until the final price is determined. In an auction, however, the final price cannot be determined until offers to buy the stock have been received, creating a catch-22. The SEC had previously issued no-action letters concerning online auctions to Wit Capital, Hambrecht, and Bear Stearns.⁶¹ Google moved forward with the auction, working closely with the SEC to establish systems for (1) setting the price through indications of interest rather than binding bids, and (2) confirming bids after the registration statement was declared effective.

The size of Google's offering forced a difficult decision early on. Most companies that conduct auctions do so through Hambrecht, the auction pioneer. Hambrecht has an infrastructure in place to handle auction IPOs. Google was concerned, however, that their offering needed more assistance from traditional underwriters, who can reach out to institutional investors. Google retained Hambrecht to advise on the offering but chose the more traditional investment banks Morgan Stanley and CSFB to lead the syndicate. Some viewed the choice of investment banks as a missed opportunity to further egalitarian reform of the IPO process.⁶²

PR for the deal took a hit when the investment banks made access to the deal somewhat difficult for individual investors. To ensure that bids were serious, the banks required that investors have high minimum account balances to make a bid. Rumors circulated that some banks required minimum account balances of half a million dollars. The auction would not be as egalitarian as initially promised. Google responded by expanding the syndicate to include smaller firms, including E*TRADE, some of which required minimum balances as low as \$2,000.⁶³

The next hurdle concerned the issue of insider selling. Traditionally, underwriters ask insiders to agree not to sell any stock within 180 days of the initial offering. Google had no such agreement in place, and analysts began to question whether insider selling would put excessive pressure on the stock price immediately following the offering. Eventually, the founders and venture capitalists cut back on the number of shares they would sell in the initial offering, and management agreed to a waterfall-style lockup agreement, with increasing numbers of shares sold after 15, 90, 120, 150, and 180 days.

Google's road show brought acrimony from analysts as well. Investors complained that Google disclosed little information about the company's plans. Mary Meeker, a high profile analyst, complained that she had never dealt with a company as unhelpful as Google. Institutional investors accustomed to receiving favored treatment had little advantage over any small investor with a computer.

61. Hurt, *supra* note 33, at 8; Bear, Stearns & Co., SEC No-Action Letter, 2000 WL 1013584 (July 20, 2000); W.R. Hambrecht & Co., SEC No-Action Letter, 2000 WL 987735 (July 12, 2000); Wit Capital Corp., SEC No-Action Letter, 2000 WL 1013585 (July 20, 2000); Wit Capital Corp., SEC No-Action Letter, 1999 WL 49854 (July 14, 1999).

62. See Hurt, *supra* note 33.

63. *Id.* at 14.

The deal was delayed into August, bringing yet more trouble. The buzz started to fade; August is a slow month on Wall Street, as bankers and traders depart for Nantucket, Martha's Vineyard, or the Hamptons. Things got even worse on August 12, when an issue of Playboy magazine reached the newsstands; the timing could not have been worse. The magazine had printed an interview with Brin and Page talking about the company. Publication of the article arguably violated the gun-jumping rules, which companies often address by halting the IPO process and "cooling off." Google managed to keep the process moving by filing yet another amendment to the registration statement, reprinting the article in full, and disclosing the risk in the prospectus.⁶⁴ Google then disclosed that it had failed to register certain shares received by service providers, potentially violating SEC rules. The bidding process finally began on August 13. Demand appeared soft, and Google lowered its price target from \$108–135 to \$85–95 a share. To Wall Street insiders, Google was beginning to look amateurish, not innovative.

The auction finally closed, and Google sold the stock to the underwriters at \$85 per share, who then distributed it to the bidders. Successful bidders (i.e., anyone who bid over \$85) were allocated 75% of their requested shares, suggesting that Google intentionally left some money on the table to ensure a positive first-day close and compensate those bidders who had stuck it out. The stock closed its first day of trading at \$100, in line with the historical underpricing average of 18%.

In sum, the deal did not go altogether swimmingly. Wall Street resented having to accept an innovative deal structure that weakened the control and importance of the underwriters. Institutional investors may have invested less effort in investigating the company, resulting in lower bids. Stock-market pundit Jim Cramer explained:

The "go it alone" method that Google used was a total fiasco, just ridiculous. The arrogance, the incompetence was beyond belief. Their own missteps and misbehavior have brought *much lower* prices than they ever would have gotten for the deal. Institutions, mutual funds and hedge funds all are boycotting the deal. So the price will be artificially *low*. These guys will have totally messed it up for themselves.⁶⁵

It is hard to disagree with Cramer's conclusion that Google left money on the table. But in hindsight, with Google now trading near \$400, and having successfully completed a \$4 billion follow-on offering, I'm not sure it's fair to say that the Google guys "totally messed it up for themselves."

64. If the magazine article violated the gun-jumping rules, investors would constructively acquire a put option (an option to sell the stock back to Google at the offering price) along with the Google shares. This may help explain the underpricing of the deal, as the underpricing moves the strike price of this constructive put option out of the money. As long as the price of Google remains above the offering price, in other words, the Playboy article isn't a problem, as no shareholder would want to exercise its remedy by selling the stock back to the company at the low offering price. By lowering the offering price, underpricing thus serves as an (expensive) method of insurance against gun-jumping liability.

65. James J. Cramer, *How to Buy Google: After the Deal*, REALMONEY.COM, Aug. 18, 2004, quoted in Hurt, *supra* note 33, at 23.

Whether the deal was successful depends on the metric one uses to measure success.

4. *Evaluating the Deal: Efficiency*

Few would characterize the Google IPO as efficient. It is difficult to know what would have happened if Google had instead used the traditional book-building method. The unusual deal structure certainly drove up legal fees. Google paid its underwriters a 3% commission, well below the industry standard 7–8%, but its ability to drive down investment-banking fees came primarily from its market power, not its selection of an auction process. It seems likely the company could have raised more money had it used the traditional IPO process. Following the IPO, institutional investors rushed to buy the stock, pushing the price higher and higher.

Jim Cramer is not alone in thinking that the offering price would have been higher if Google had done a traditional IPO. The central problem faced by IPO issuers is the information asymmetry between the issuer and potential buyers. Issuers overcome this problem by disclosing information and by renting the reputation of financial intermediaries.⁶⁶ Google did a poor job on both counts. They were tight-lipped about the company, disclosing little information other than the basic financial information and risk factors required by the SEC. The founders' letter, while entertaining, was short on useful insight about the company's plans. As far as renting reputation, Google hired Morgan Stanley and CSFB to lead the syndicate. But even here, Google showed little interest in gathering up the support of intermediaries. After Google slashed fees, Merrill Lynch walked away from the deal. While Google did receive the implicit endorsement of the many banks that remained in the syndicate, the ill will it generated by slashing fees may have reduced selling efforts. Moreover, auctions are associated with less underpricing, removing an incentive for institutional investors who might otherwise have gotten involved. And without the firm promise of underpriced shares, the underwriters had little financial incentive to push the stock on their favored clients.

In sum, the post-IPO run-up in Google's stock price suggests that the deal structure may indeed have left money on the table. Without a clear promise of underpricing and no possibility of a favorable allocation even if they did participate, institutional investors had little reason to investigate the company. It cost them very little to wait until the stock began trading on the secondary market. The run-up in the stock price thus may have been caused by the inability of the auction process to reduce the information asymmetry between Google and its potential investors. Post-IPO events and

66. See Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984).

announcements may have contributed to the run-up in the stock price, but it is hard to imagine such events accounting for the full increase.⁶⁷

5. *Evaluating the Deal: Branding Effects*

Despite these apparent flaws in both design and execution, the Google IPO should be considered a success. The IPO was not just a financing transaction; it was a branding moment. It generated benefits for Google outside the four corners of the prospectus.⁶⁸ Each story in the business press was a love letter to customers who value corporate integrity. From a corporate-finance perspective, the deal was at best mediocre. From a marketing perspective, it was simply brilliant.

Google, more than most, needs a good brand image to ensure long-term success. Marketing theory helps explain why this is so. Products may be categorized as search goods, experience goods, and credence goods.⁶⁹ Search goods are goods for which consumers may easily assess quality before purchase, like clothing or furniture. Experience goods are goods for which consumers may easily assess quality after purchase, like a haircut or a lawnmower. Credence goods are goods for which quality is difficult to assess even after purchase, like financial advice, auto repair, or education.

Branding is especially important for experience goods and credence goods. Google's search engine is an experience good.⁷⁰ For such goods, branding is a way for a seller to commit to product attributes that are difficult for third parties (such as courts) to verify.⁷¹ The search engine and other Google products might even be considered credence goods. Consumers would find it difficult to verify the quality of search results, even after examining the results, unless they also sampled other search engines. In theory, consumers could spend a few hours running experiments, trying out different searches on each site and comparing results. Few consumers, however, are so diligent. Comparing results, moreover, is not so easy. Only with careful inspection can one figure out which sites, deep in the results, one search engine discovered and another did not. Often the relevance of results is not

67. The auction structure may also have encouraged a post-IPO increase in revenue by spreading ownership of the stock out more broadly. Search engines have network effects, and broad-based stock ownership may nudge investors to use Google. I am indebted to Bruce Johnsen for identifying this point.

68. A more formal way of stating this idea is to consider the positive externalities of the IPO. Some economists have noted the effect. See, e.g., Alexander Ljungqvist, *IPO Underpricing: A Survey*, in HANDBOOK OF CORPORATE FINANCE: EMPIRICAL CORPORATE FINANCE (B. Espen Eckbo ed., forthcoming 2007) (manuscript at 1, on file with author), available at <http://ssrn.com/abstract=609422> ("The act of going public itself shines a spotlight on the company, and the attendant publicity may bring indirect benefits, such as attracting a different caliber of manager.").

69. Fleischer, *supra* note 11.

70. See I.P.L. Png & David Reitman, *Why Are Some Products Branded and Others Not?*, 38 J.L. & ECON. 207, 209 (1995) ("[S]ellers are more likely to brand when consumers find personal search and experimentation relatively unattractive.").

71. See Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981).

apparent without clicking through. Rather than experiment with different products, consumers rely on word-of-mouth and brand image.

Other search engines and Internet portals, like Ask.com, Yahoo! and America Online spend lavishly on advertising to convey a sense of relevance or usefulness to consumers. Google's branding strategy, on the other hand, is subtle. It relies on the diffusion of buzz through informal networks. It has a blog targeted at early adopters⁷² that introduces and discusses new products. Because Google derives most of its profits from advertising revenue, it can give away most of its products and services for free, relying on users to pass along knowledge to friends, family, and colleagues.

Google is well aware of both the importance of its brand and the challenges it faces in enhancing and protecting the brand. The risk-factor section of the S-3 to their recent follow-on offering explains that the business "depends on a strong brand." Google notes that its management of information raises privacy concerns, making the integrity of the brand that much more important.⁷³ Litigation involving Google is high profile, and as the legal issues get resolved, Google must also win in the court of public opinion.⁷⁴

The IPO structure enhanced Google's brand image in several ways.

Playfulness and Geek Humor. The name Google derives from a mathematical term, Googol, which means the numeral one followed by 100 zeros.⁷⁵ From a branding perspective, "Google" appears at first glance to be an arbitrary word, like Apple or BlackBerry, with no obvious tie-in to the company. It also conveys playfulness, however, and tells an inside joke known to mathematicians. The mathematics tie-in is not deeply hidden, however. Instead, it's just hidden enough to trigger questions from business reporters, who then convey the clue to the public, letting them in on the joke. The name also conveys a functional meaning: Google can search large

72. On early adopters, see generally MALCOLM GLADWELL, *THE TIPPING POINT: HOW LITTLE THINGS CAN MAKE A BIG DIFFERENCE* (1st paperback ed. 2002), and EVERETT M. ROGERS, *DIFFUSION OF INNOVATIONS* (5th ed. 2003).

73. Google explains that "people have raised privacy concerns relating to the ability of our Gmail email service to match relevant ads to the content of email messages. In addition, some individuals and organizations have raised objections to our scanning of copyrighted materials from library collections for use in our Google Print product." Google, Inc. Registration Statement (Form S-3), at 9 (Aug. 18, 2005).

74. See A Taxing Blog, http://vic.typepad.com/taxingblog/2005/06/googles_copyrig.html (June 30, 2005); Posting of Brad Hill to the Unofficial Google Weblog, <http://google.weblogsinc.com/entry/1234000483056521> (Aug. 29, 2005).

75. The company website explains:

Google is a play on the word googol, which was coined by Milton Sirota, nephew of American mathematician Edward Kasner, and was popularized in the book, *Mathematics and the Imagination* by Kasner and James Newman. It refers to the number represented by the numeral 1 followed by 100 zeros. Google's use of the term reflects the company's mission to organize the immense, seemingly infinite amount of information available on the web.

numbers of sites—a googol sites, perhaps—and offer the user the most relevant hits.⁷⁶

The playfulness extended to the IPO. A story in *Wired* entitled “More Reasons to Love Google” explained that the amount of money that Google sought to raise, \$2,718,281,828, was a bit of “geek humor.”⁷⁷ 2.718281828 is the mathematical constant e , or Euler’s number, which is the base of the natural-logarithm function.⁷⁸

Google continued winking at the nerds in its follow-on offering in August 2005, selling 14,159,265 shares. The number represents the first eight digits after the decimal in the mathematical constant pi.⁷⁹ Other examples of Google’s math humor include the numbering of its buildings in Mountain View, which include Buildings phi (also known as the golden mean or golden ratio), e , and pi.⁸⁰ The numbering systems of the buildings and the stock offerings also pay homage to Donald Knuth, a professor in the Stanford Computer Science Department (where Sergey and Larry met). Knuth’s TEX program has versions 3.1, 3.14, 3.141 and so on, and his METAFONT has versions 2.7, 2.71, 2.718, and so on.⁸¹

And the auction process itself, of course, is interesting, fun, and intriguing. It is a technologically savvy way to gather and manage information. Instead of websites or web-maps, the information gathered and managed in the IPO was the price and allocation preferences of thousands of investors. Google IPO, like Google Search, Google Maps, and Google Talk, became not just a transaction but a technologically-appealing method of managing information.

It would be quite a struggle to explain these choices—particularly the number of shares—with an unbranded, pure efficiency rationale. Like a monkey typing the collected works of Shakespeare, an investment-banking analyst given an infinite number of hours could eventually come up with a model that generates the eight digits of pi after the decimal point as the optimal number of shares. But the real story, of course, is about branding. The founders, it seems, recognize that the amount of money raised in an offering is somewhat arbitrary (at least within a range—notice that Google did not offer 31.4 million or 3.1 million shares). Instead of picking a round number, Google seized the moment to show the world how nerds conduct an IPO.

76. See Google Corporate Information: Company Overview, <http://www.google.com/corporate/index.html> (last visited Mar. 6, 2006).

77. Cf. Top $\ln(e^{10})$ Reasons Why e Is Better Than Pi, <http://www.mu.org/~doug/exp/etop10.html> (last visited Mar. 6, 2006).

78. See BATTLE, *supra* note 34, at 217 (“By manipulating the actual offering to provide this knowing wink to nerd humor, Google was in effect declaring: *the geeks are in control.*”).

79. Word of mouth spread the math joke quickly around Wall Street. Interview with Scott Pintoff, General Counsel, GFI Group, Inc. (Aug. 18, 2005).

80. Michael Kanellos, *Gwyneth, the Grateful Dead and Google*, ZDNET AUSTRALIA, July 28, 2003, http://www.zdnet.com.au/news/business/soa/Gwyneth_the_Grateful_Dead_and_Google/0,39023166,20276597,00.htm. I am indebted to Bernard Eskandari for this observation.

81. Donald E. Knuth, *The Future of TEX and METAFONT*, http://www.ntg.nl/maps/pdf/5_34.pdf (last visited Mar. 6, 2006). I am indebted to Paul Ohm for this observation.

Integrity. Most search engines and Internet portals are cluttered with links, ads, and promotions. The main Google search page, on the other hand, is mostly white space. Other than a few barebones links and the playful “I’m Feeling Lucky” button, the site concentrates on helping the user. The search results page is similarly clean. There are no pop-up ads or advertising banners.

Google does not distort its search results, instead setting aside its Sponsored Links in a separate sidebar and in a box across the top. It does not engage in “search engine payola.”⁸² Google’s website explains,

Advertising on Google is always clearly identified as a “Sponsored Link.” It is a core value for Google that there be no compromising of the integrity of our results. We never manipulate rankings to put our partners higher in our search results. No one can buy better PageRank. Our users trust Google’s objectivity and no short-term gain could ever justify breaching that trust.⁸³

Not all consumers care about payola as a matter of principle, but to the extent payola distorts the search results that the algorithm would otherwise generate, payola matters. And Google’s approach is refreshing. Its consistency with respect to integrity issues makes PageRank credible despite its relative lack of transparency.⁸⁴

The Auction IPO enhanced Google’s brand image by solidifying its reputation as being more concerned with integrity than insider profits. Dot-com founders became millionaires by cashing in on IPOs.⁸⁵ Google’s founders are billionaires, but their choice of deal structure reflects little desire to cash in quickly at the expense of long-term shareholders.

Egalitarianism. Google presents an image of being democratic and non-elitist. Google Search is freely available without a fee or even registration. Basic versions of fancier applications like Google Maps, Google Print, and

82. Compare Posting of Victor Fleischer to Conglomerate, http://www.theconglomerate.org/2005/08/search_engine_p.html (Aug. 9, 2005), with Posting of Joshua Wright to Conglomerate, http://www.theconglomerate.org/2005/08/google_and_sear.html (Aug. 8, 2005). See generally Ronald Coase, *Payola in Radio and Television Broadcasting*, 22 J.L. & ECON. 269 (1979).

83. Google Corporate Information: Our Philosophy, <http://www.google.com/corporate/tenthings.html> (last visited Mar. 6, 2006).

84. Integrity is especially important for Google as it grows. Market research shows that a corporate image strategy can affect corporate credibility and increase the acceptance of brand extensions. See KEVIN L. KELLER, *STRATEGIC BRAND MANAGEMENT: BUILDING, MEASURING, AND MANAGING BRAND EQUITY* 546 (2d ed. 2003); Kevin L. Keller & David A. Aaker, *The Effects of Sequential Introduction of Brand Extensions*, 29 J. MARKETING RES. 35–50 (1992). A company with an innovative corporate image is viewed as an expert in the area. Research also shows that innovative companies are also seen as trustworthy and likable. A brand image of credibility may be especially important for high-tech companies, because the products themselves change quickly over time. A leading marketing professor explains that in “a high-tech setting, trustworthiness also relates to consumers’ perceptions of the firm’s longevity and staying power. With technology companies, the president or CEO often is a key component of the brand and performs an important brand-building and communication function, in some cases as an advocate of the technology involved.” Keller, *supra*, at 741.

85. The self-satisfied greed of the era was captured in the documentary *Startup.com*, in which one manager refers to himself as a “lowly millionaire,” as contrasted with the company’s founders, who would become billionaires. See *STARTUP.COM* (Live/Artisan 2001).

Google Earth are free. Even on the revenue-producing side, Google maintains an egalitarian bent. The cost of creating an account for Google's AdWords service is only five dollars, and there is no minimum ad expenditure required.⁸⁶

The prospectus materials suggest that this egalitarian image was important to Google. Consider two examples. First, the founders' letter, originally planned to appear at the front of the prospectus, raised a predictable objection from the SEC over the concern that, by departing from the standard form, the prospectus might confuse investors. The founders felt it was worth the battle. Second, Google fought the SEC over whether it could refer to the founders and the CEO on a first-name basis, even as it conceded other issues.⁸⁷ The SEC found the informality objectionable. Google ultimately won the battle and was permitted both to include the founders' letter and to refer to Eric, Sergey, and Larry on a first-name basis in the prospectus.

The auction pricing mechanism also played into this idealistic image. Rather than having underwriters set the price using the traditional book-building method, investors set the price for shares over the Internet. The voice of the people, not Wall Street insiders, set the price. The deal structure eliminated the favoritism problems that accompany the traditional process and gathered information in an evenhanded manner.

The press ate it up. A Wall Street Journal article, *Google's Dutch Treat*, noted the fit between the IPO and Google's business model: "In a sense, this auction is the perfect IPO expression of Google's own business model. The company's success has derived from its ability to democratize access to information via the Internet, and its auction will likewise open its shares to a wide spectrum of investors."⁸⁸

That sort of PR can't be bought.

Internal Branding. Internal branding is the process of ensuring that employees embrace the brand and what it represents.⁸⁹ Branding can have an effect not just on customers, but on employees. Branding, in other words, is more than marketing.⁹⁰

For a company that relies on intellectual capital, internal branding is especially important.⁹¹ The auction structure fed into Google's nonconformist style.⁹² The company calls its headquarters the Googleplex, and it is de-

86. Google Corporate Information: Quick Profile, <http://www.google.com/corporate/facts.html> (last visited Mar. 6, 2006).

87. Verne Kopytoff, *How SEC Held Search Engine's Feet to the Fire in Its IPO Filing: Lengthy Give-and-Take Unfolds in Letters with Regulators*, S.F. CHRONICLE, Aug. 14, 2005, at B1.

88. Editorial, *Google's Dutch Treat*, WALL ST. J., May 3, 2004, at A20.

89. See KELLER, *supra* note 84, at 156.

90. See LYNN B. UPshaw & EARL L. TAYLOR, *THE MASTERBRAND MANDATE: THE MANAGEMENT STRATEGY THAT UNIFIES COMPANIES AND MULTIPLIES VALUE*, at ix (2000) (noting that branding tends to be compartmentalized as solely a marketing tool).

91. NICHOLAS IND, *LIVING THE BRAND: HOW TO TRANSFORM EVERY MEMBER OF YOUR ORGANIZATION INTO A BRAND CHAMPION* 50-80 (2d ed. 2004) (discussing the importance of values to organizations).

92. See BATTELLE, *supra* note 34, at 215.

scribed as an open, informal space. Employees can bring their dogs to work. Google touts its corporate culture as collegial, flexible, and collaborative. Google's website highlights the use of rubber exercise balls as office chairs and the hiring of Charlie Ayers, former chef to the Grateful Dead, as company chef.

6. The Branding Power of Auctions

Google is not alone in using the auction structure as a branding opportunity.⁹³ Other companies that have completed auctions include redEnvelope, Peet's, Salon.com, Overstock.com, Morningstar, and Ravenswood. The pattern suggests that companies that brand themselves as contrarian, egalitarian, and user-oriented are more likely to conduct auction IPOs.⁹⁴ The auction structure appears to be useful for cult brands (those seeking a devoted customer base and quirky or counterculture brand association) and integrity brands (companies whose business model depends on transparency or trust).⁹⁵

Ravenswood Winery and Peet's Coffee and Tea are examples of cult brands.⁹⁶ Cult companies often position themselves in opposition to the market leaders. Google is anti-Microsoft. Apple is anti-Microsoft. Whole Foods⁹⁷ and Trader Joe's are cult brands positioning themselves opposite legacy supermarkets like Albertson's, Kroger, Safeway, and Ralph's. Peet's Coffee and Tea is the anti-Starbucks.⁹⁸ Ravenswood Winery, with its motto "No Wimpy Wines," pushed red zinfandel and cultivates a contrarian brand image.⁹⁹ Other examples of specialty companies using an auction process to

93. Finance scholars have noted the possibility that underpricing may enhance branding. Evidence is mixed. Larry L. DuCharme, Shivaram Rajgopal & Stephan E. Sefcik, *Lowballing for "Pop": The Case of Internet IPO Underpricing* 5 (Jan. 2001) (working paper on file with author), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=257725 (finding a strong association between media hype and underpricing, but also finding "mixed" evidence of a branding effect, specifically finding that although underpricing is higher for business-to-consumer (B2C) firms, sales increases post-IPO are not significantly related to the extent of underpricing).

94. A complete list is available at WR Hambrecht + Co: Auctions and Offerings, <http://www.openipo.com/ind/auctions/index.html> (last visited Mar. 8, 2006).

95. See MICHAEL LEVINE, *A BRANDED WORLD: ADVENTURES IN PUBLIC RELATIONS AND THE CREATION OF SUPERBRANDS* 107 (2003) (discussing "soul branding," or the notion that companies that appeal to the soul will eventually dominate the market, as a growing contingency of consumers are willing to pay a bit more for a product if it helps a worthy cause).

96. Peet's used the auction process for a follow-on offering, not its IPO. The company went public in 2001, before Hambrecht had tried out the OpenIPO system.

97. Whole Foods did a traditional IPO. Other Whole Foods deals, however, reflect sensitivity to branding concerns. For example, it refuses to accept slotting fees (the fees that retailers charge manufacturers for product placement and shelf space).

98. Cf. AUSTIN POWERS: *THE SPY WHO SHAGGED ME* (New Line Cinema 1999). Peet's, ironically enough, was the original owner of the Starbucks brand. It started as the "Starbuck's Coffee Company" in 1971 before acquiring Peet's Coffee and Tea in 1984. It sold its Seattle-based assets, including the Starbucks brand, to Il Giomale coffee company in 1987. PEET'S COFFEE & TEA, PROSPECTUS 30-31 (2002), available at <http://www.openipo.com/tradfo/peet/20020419.pdf>.

99. Ravenswood does not go so far as to push white zin. No one is that daring.

distribute stock include Salon.com (a nontraditional media outlet) and redEnvelope (an online gift retailer).

Overstock.com is an example of a company that seeks a savvy, knowledgeable consumer base. The company is an online outlet-shopping site that specializes in liquidating excess inventory through direct Internet sales. It also has an online auction branch. Its founder, Patrick Byrne, reported that he received little interest from venture capitalists and viewed the traditional IPO process with skepticism.¹⁰⁰ The Overstock.com website includes an unusual letter to stockholders that stresses transparency and integrity and explains Overstock's conservative accounting.¹⁰¹

Morningstar is an example of an "integrity" company providing a credence good to savvy consumers. Morningstar is a financial-services company that provides services to individuals, advisors, and institutions. The brand is one of the most recognized and respected in the investment industry. A traditional IPO—with its associations with underpricing, favored allocations, and insider profiteering—could have undermined the Morningstar brand image. Morningstar emphasized its commitment to integrity in its IPO prospectus: it noted that it would not provide guidance to analysts (because of the inherent conflict it presents to management's personal financial interest) and that it voluntarily expensed its stock options on the income statement.¹⁰²

Conclusion. It is difficult to measure the effect the deal structure had on Google's brand equity. But the evidence suggests that from a branding perspective, the deal was successful. Google's CEO has publicly speculated that publicity surrounding the IPO—no doubt attributable in part to the unusual deal structure—may have boosted revenues in that quarter.¹⁰³ By boosting revenues and increasing brand equity, the apparent dichotomy between branding and efficiency disappears. While the auction IPO may not have produced the maximum share price possible, it may have helped boost revenue, which in turn supports Google's current share price.

B. Ben & Jerry's Homemade, Inc.

The Google IPO, while innovative, was not the first deal to blend Wall Street finance with Main Street values. When Ben & Jerry's went public in 1984, it sold its stock directly to customers, employees, and friends, limiting the offering to Vermont residents. Smaller companies occasionally use direct public offerings, or DPOs, to go public. In a direct public offering, a com-

100. *The Charlie Rose Show* (PBS Television broadcast Mar. 11, 2005).

101. Overstock.com, CEO Letter to Owners, <http://www.shareholder.com/overstock/owners.cfm> (last visited Feb. 23, 2006).

102. MORNINGSTAR, PROSPECTUS FOR INITIAL PUBLIC OFFERING OF COMMON STOCK 27 (2005), available at <http://www.openipo.com/ind/auctions/openipo/mom/mom20050502.pdf>.

103. Paul Kedrosky's Infectious Greed, <http://paul.kedrosky.com/archives/001570.html> (July 21, 2005) (quoting Google CEO Eric Schmidt as noting that the third quarter of 2004 was particularly strong for Google "because of improvements in our ability to monetize traffic and perhaps because of the publicity surrounding our IPO approximately a year ago.").

pany raises capital by marketing its stock directly to customers, employees, friends, and family, without the help of an underwriter. Following the offering, the stock trades over-the-counter, if at all. DPOs do double duty for the small companies that employ them. Besides raising capital, they bond the consumer to the company.¹⁰⁴ Ben & Jerry's coupled this direct-marketing strategy with a rarely used exception to the securities laws for intrastate offerings. By selling stock directly to customers, and by limiting the geographic distribution to Vermont, Ben & Jerry's cleverly and carefully designed a way of raising money that, although not necessarily achieving the lowest cost of capital, furthered other goals.

The story of how "two real guys" from Vermont opened their first scoop shop on the site of an old gas station in Burlington, Vermont is quite familiar.¹⁰⁵ Ben & Jerry's is often held out as a paragon of social responsibility.¹⁰⁶ Cynics might dismiss the Ben & Jerry's brand image as little more than a marketing ploy; today, Ben & Jerry's is owned by Unilever, a multinational conglomerate. But whatever the current state of the brand, it is indisputable that for many years Ben & Jerry's made the most of their unusual, powerful brand image. This Section explores how the deal structure the company used back in 1984 contributed to the ubiquitous image in our minds of aging, contented hippies eating ice cream.

1. *Vermonters-Only*

Ben & Jerry's went public in 1984. The founders, Ben Cohen and Jerry Greenfield, needed investment capital to build a new factory in Waterbury, Vermont. The founders already saw the factory as more than a factor of production: it would be built close to the ski resort in Stowe and its attendant tourist traffic. The company could not borrow enough money to build the factory. They needed equity. Bankers advised the two to seek venture capital.¹⁰⁷ The founders chose to do a public offering instead. In and of itself, the decision to raise money from the public rather than venture capitalists is

104. Mark Kollar, *Do-It-Yourself Public Offerings*, INVESTMENT DEALERS' DIG., Mar. 24, 1997, at 15 (discussing Ben & Jerry's and other DPOs and noting that a company must have a "built-in fan club" that wants to be a part of the business). "'People become better customers when they are part owners . . . This also enhances the marketing of the product and services.'" *Id.* (quoting Drew Field, a securities lawyer in San Francisco).

105. BEN COHEN & JERRY GREENFIELD, *BEN & JERRY'S DOUBLE-DIP: HOW TO RUN A VALUES-LED BUSINESS AND MAKE MONEY, TOO* (1997). The Ben & Jerry's brand image has arguably been overplayed. Two Ben & Jerry-like characters are parodied in an episode of *The Simpsons*, in which Homer encounters two hippies running a juice business. Homer concludes, "I guess the juice business is more important than the ideals our hippie forefathers refused to go to war and die for." *The Simpsons*: TV.com, *D'oh-in in the Wind Summary*, <http://www.tv.com/simpsons/doh-in-in-the-wind/episode/1494/summary.html> (last visited Mar. 20, 2006). The episode also pokes fun at the founders of Nantucket Nectars, the "Juice Guys." *Id.*; see also Nantucket Nectars, *The Company*, <http://www.juiceguys.com/thecompany.php> (last visited Mar. 20, 2006).

106. E.g., Ralph Nader, *Legislating Corporate Ethics*, 30 J. LEGIS. 193, 197 (2004).

107. FRED LAGER, *BEN & JERRY'S: THE INSIDE SCOOP* 91 (1994) ("The bankers said Ben's proposal to sell stock only to Vermonters was 'naive and impractical' Everyone politely suggested that venture capital was the way to go.").

not so surprising; venture financing would have resulted in a substantial loss of control, including control over the commitment to social responsibility the founders valued so highly. What made the offering unusual was that stock was offered directly to investors without the help of an underwriter, and it was offered only to Vermont residents.

Local interest in the offering was initially scant.¹⁰⁸ The founders were frustrated by the need to complete a prospectus, which was required under state law notwithstanding the federal securities-law exemption. The founders and managers patiently plugged the company in a Burlington-only “road show” at a local hotel, night after night. The company priced the offering cheap, at \$10.50 a share, with a minimum purchase of just twelve shares. Demand eventually picked up, and the offering successfully closed. The company raised enough equity capital to secure additional government loans and grants, and they built the new factory in Waterbury. As explained below, the company may have left money on the table by limiting the potential purchasers of their stock to Vermont residents. But the offering allowed the company to accomplish other goals: it protected the integrity and identity of the company.

Ben & Jerry’s Homemade did not stay a Vermont-only operation for long. The company followed up the Vermont-only offering with a NASDAQ offering just one year later, providing liquidity to shareholders and additional capital to the growing company.¹⁰⁹ The company continued to grow throughout the late ’80s and ’90s. Its return to stockholders was mediocre, however, and the company attracted takeover bids. Unilever, a European food-and-consumer-goods conglomerate, acquired the company in 2000 at \$43.60 per share, nearly a 100% premium to the trading price. Unilever created a separate board of directors to run the company, to maintain the company’s social mission and, presumably, to hold on to the brand image that sells so many pints of ice cream.¹¹⁰

2. Costs and Benefits of the Geographic Restriction

From a corporate-finance perspective, limiting the initial offering to Vermont residents seems inefficient. Institutional investors—mutual funds, foundations, pension funds, insurance companies—dominate the market for IPOs. Few of these institutions are incorporated in Vermont. Individuals, then, made up the vast majority of the buyers. Vermont has its share of

108. Local coverage was matter-of-fact. *E.g.*, *Ben & Jerry’s Offers Stock*, RUTLAND DAILY HERALD, May 2, 1984, at 6. A former employee recalls some radio and news coverage. Email from Ben & Jerry’s Consumer Services to Jennifer Locke (Sept. 1, 2005, 08:40 EST) (on file with author).

109. Prior to the secondary offering, the company created a class of preferred stock, held by the charitable Ben & Jerry’s Foundation, that would make a takeover more difficult. Susan Youngwood, *Ben and Jerry’s Stockholders Approve Common Stock Issue*, BURLINGTON FREE PRESS, Oct. 26, 1985, at 7A.

110. This decision to create a separate board of directors can itself be viewed as an example of branding affecting deal structure.

wealthy individuals, but the geographic restriction had the foreseeable effect of limiting demand for the stock, which very likely pushed down the price at which the company was able to sell the stock.¹¹¹ Were there non-branding-related factors that may have justified this seemingly irrational deal structure?

Regulatory-cost engineering. From a transaction-cost engineering perspective, the geographic restriction makes little sense. From a regulatory perspective, however, the structure had a few advantages. Federal securities laws normally require a company offering securities to the public to file documents with the SEC and distribute materials to prospective investors. The Securities Act of 1933, however, has a narrow exemption for intrastate offerings.¹¹² The exemption does not render the securities law irrelevant; it only relieves issuers of the obligation to register the offering and deliver a prospectus.¹¹³ Antifraud provisions still apply to intrastate offerings.¹¹⁴ And Vermont laws protecting investors still applied to the transaction. As a result, Ben & Jerry's had to prepare an offering circular and prospectus. But it did not have to prepare audited financial statements going back in time, which would have been difficult for the disorganized company.¹¹⁵

Avoiding federal registration produced some cost savings to Ben & Jerry's. "By not having to deal with the SEC," wrote Fred Lager, the company's General Manager, "we'd be able to save the tens of thousands of dollars in legal and accounting fees that would have been necessary in order to comply with the stricter securities laws that applied to any offering that crossed state lines."¹¹⁶

The savings from reduced paperwork, however, may not have been worth the tradeoff, at least if one disregards the branding implications of the structure. By Fred Lager's possibly generous estimate, the company saved tens of thousands of dollars in legal and accounting fees. But this amount was likely offset by the additional money the company could have raised had they looked to non-Vermont residents. If, for example, by offering the stock nationally, the company had sold the stock at \$11.50 instead of \$10.50 per share, it would have raised an additional \$73,500, presumably more than

111. This is actually a tricky point if resale out of state is permitted.

112. Securities Act of 1933 § 3(a)(11), 15 U.S.C. § 77(c)(a)(11) (2000); LOUIS LOSS & JOEL SELIGMAN, *FUNDAMENTALS OF SECURITIES REGULATION* 377–87 (5th ed. 2004) (discussing intrastate offering exemption). See generally Daniel J. McCauley, Jr., *Intrastate Securities Transactions under the Federal Securities Act*, 107 U. PA. L. REV. 937 (1959).

113. McCauley, *supra* note 112, at 939.

114. *Id.* at 955–59.

115. LAGER, *supra* note 107, at 93 ("A fully registered offering would also have required audited financial statements going back three years, which was something we didn't have.")

116. *Id.*

offsetting the regulatory savings.¹¹⁷ Reducing the company's cost of capital, however, did not seem to be the goal of the offering.¹¹⁸

Bonding with customers by making them investors. The founders wanted to strengthen the bond between the company and its local clientele and community.¹¹⁹ Although the company had started to sell ice cream outside the state, most of its sales still came from Vermonters. Offering stock to Vermonters first was a way to underscore the company's early supporters. According to Lager, "[Ben's] conviction was that we were holding the business in trust, and that we should give the people who had supported the company from its earliest days the first opportunity to profit from our success."¹²⁰ The small minimum investment of just twelve shares, or \$126, reflects this goal.¹²¹ "We wanted to make it available to all economic classes," Cohen told *Inc.* magazine in a 1989 interview.¹²² "We were seeking somewhat to redistribute wealth."¹²³

Ben's statement about redistributing wealth reflects a naïve view of investing. Access to an IPO does not necessarily redistribute wealth. An IPO is not a money machine. If the company had failed, access to the IPO would have cost Vermonters, not helped them. Offering stock to Vermonters reflects Ben's optimism, however. Vermonters who bought the stock did well for themselves. A share of stock purchased in 1984 for \$10.50 would have been sold in 2000 to Unilever for \$391, adjusting for stock splits.¹²⁴

Ben's lack of sophistication regarding investment risk should not be confused with poor business judgment. Although going public created fiduciary duties to his new shareholders, Ben believed it could be a two-way street. Shareholders could work for him. The idea "was for the company to be owned by the same people who had lined up for scoops of ice cream at the

117. BEN & JERRY'S HOMEMADE, INC., PROSPECTUS 1 (May 1, 1984) (on file with author) (showing number of shares offered at 73,500, with price to public at \$10.50).

118. LAGER, *supra* note 107, at 100 ("Our offering was directed at people who had never invested in stocks before. Most tombstones appear in the financial section. We were placing ours with the movie and TV listings.").

119. Terry Minsky, *The Entrepreneur: Scooping Up Cold Cash*, *ESQUIRE*, March 1985, at 58 ("The company went public last year, but Ben and Jerry have sold their stock only to residents of Vermont, as a way of thanking them for their help."); Gail Perrin, *A Solid Success in Ice Cream*, *BOSTON GLOBE*, May 30, 1984, at 46 ("The company began offering shares to Vermont residents May 1. Ben emphasizes he made this decision 'because I really believe business has a responsibility to give back to the community.'").

120. LAGER, *supra* note 107, at 90.

121. Ben & Jerry's Prospectus, *supra* note 117, at 25.

122. Erik Larson, *Forever Young: Ben and Jerry's Quest to Keep Their Company's Spirit Alive as the Business Grows*, INC., July 1988, at 50 (quoting Ben Cohen).

123. *Id.* at 52 (quoting Ben Cohen). It is not self-evident, of course, that allowing Vermonters to purchase the stock necessarily redistributes wealth. Offering the stock only redistributes wealth if the insiders know that the company is worth more than the offering price per share; it seems likely that Cohen believed this, but could not know it for sure.

124. Basis in the original shares was reduced to \$1.17 by splits. Ben & Jerry's, Public Capitalization and Stock Split History, http://www.benjerry.com/our_company/research_library/financial_info/index.cfm#sec3 (last visited Mar. 5, 2006).

gas station.”¹²⁵ Customer-stockholders could add value in a way that faceless stockholders would not.¹²⁶ Potential stockholders were given ice cream at the road show.¹²⁷ The company also targeted the 1985 secondary offering to customers rather than institutional investors, although the offering was not limited to Vermont residents. The underwriter explained to a Vermont newspaper, “ ‘We told Ben (Cohen, president and founder of Ben & Jerry’s) that customers of Ben & Jerry’s will have equal preference as customers of [the underwriter].’ ”¹²⁸ Observers estimated that by the mid-1980s, one percent of Vermont residents owned stock in the company.¹²⁹

Still, the value added by having stockholders harangue their local Kwik-E-Mart owners seems rather slim. Because each individual shareholder owned such a small percentage of the company, each one would have had little economic incentive to engage in the sort of watchdog behavior Ben touted. Perhaps some of this behavior occurred, especially in Burlington. But the real value of the intrastate offering wasn’t local. It was global.

Branding. The unusual deal structure gave Cohen a chance to talk about the company with the business press, not just when the offering occurred in 1984, but for years afterwards. In interviews, Cohen highlighted the community-oriented nature of the company, and, much like Google, he stressed the founders’ willingness to act independently from Wall Street.¹³⁰ The company ran advertisements in Vermont newspapers that read “Get a Scoop

125. LAGER, *supra* note 107, at 91.

126. Lager explains:

Ben wanted the minimum investment to be \$125. The investment bankers we’d talked to thought that lots of small stockholders would be an unnecessary financial burden, owing to the administrative costs. Ben saw advantages in having lots of shareholders. Like us, they could straighten out the pints in the supermarket freezers and bug the frozen-food clerk when the store didn’t have Heath Bar Crunch in stock.

Id.

127. *Id.* at 101 (“The meetings would run about two hours, beginning with presentations from Ben and me and ending with a question-and-answer period during which we scooped ice cream. The ice cream freezer that we hauled around with us for the meetings was always prominently placed in the front of the room, to entice those who came to stay to the end.”).

128. Susan Youngwood, *Ben & Jerry’s Offers More Stock*, BURLINGTON FREE PRESS, Sept. 18, 1985, at 4B (quoting Ned Morris, vice president at Tucker Anthony & R.L. Day Inc., the brokerage firm underwriting the offering). Friends of Phish Food, not Friends of Frank, had dibs.

129. *E.g.*, Lewis D. Solomon, *On the Frontier of Capitalism: Implementation of Humanomics by Modern Publicly Held Corporations: A Critical Assessment*, 50 WASH. & LEE L. REV. 1625, 1638 (1993).

130. Bruce Posner writes:

By “Vermonters,” moreover, Cohen did not mean a few well-heeled vacationers from New York and Boston. Quite the contrary. “We’re very community-oriented,” he says, “and I wanted to give typical Vermonters a chance to participate.” So Cohen and his attorney approached the local offices of several regional and national underwriters to discuss the prospect of a \$600,000 public equity offering for Vermont residents only. While some of the underwriters seemed intrigued, “nobody wanted to do an intrastate offering,” reports Cohen. “Nor were they willing to do anything that small.”

of the Action,” inviting readers to request a copy of the prospectus.¹³¹ Indeed, some investors appeared to buy the stock as more of a memento than an investment.¹³² For some holders, Ben & Jerry’s stock was somewhat analogous to owning stock in the Green Bay Packers.¹³³ The cult of Ben & Jerry’s was being built, stock certificate by stock certificate.

The cult of Ben & Jerry’s spread. The new factory lured the tourist trade.¹³⁴ “What better way to reinforce the image of ‘Vermont’s Finest,’” Lager explained, “than to offer people a taste of fresh ice cream right off the production line, in the shadow of the Green Mountains?”¹³⁵ The factory was not an accidental tourist attraction; it was designed with precisely that goal in mind. The prospectus explained, “The Company intends to organize plant tours ending in the Company’s retail facility.”¹³⁶ The deal, as Calvin Trillin later noted, financed the plant “through a scheme that was well attuned to Ben & Jerry’s style.”¹³⁷

The IPO was not the only time Ben & Jerry exploited the branding implications of legal events. The first time involved its chief super-premium ice cream competitor, Häagen-Dazs. Häagen-Dazs, despite the Scandinavian name, was an American company. Häagen-Dazs was founded by hardworking entrepreneur Reuben Mattus, and Pillsbury acquired the company in 1983.¹³⁸ In the early 1980s, Ben & Jerry’s sued Häagen-Dazs concerning distribution to retailers. Seizing on the opportunity to enhance its brand image as a counterculture company, Ben & Jerry’s played up its underdog status. They gave away T-shirts and bumper stickers that poked fun at the Pillsbury trademark. The shirts asked, “WHAT’S THE DOUGHBOY AFRAID OF?”¹³⁹ They took out classified ads in *Rolling Stone* magazine.¹⁴⁰ The company ran ten-second late-night television commercials in the New York area. Cohen told the *New York Times*, “We say, ‘We might not be able

131. *Id.*

132. About a third of the investors purchased the minimum amount of shares, and a large number of shares were purchased by people in trust for their children or grandchildren. LAGER, *supra* note 107, at 103.

133. Purchasers of Green Bay Packers common stock own a security that resembles common stock only in the most formal sense of the word. They cannot sell the stock or redeem the stock, nor are they entitled to dividends or proceeds on liquidation, nor do they have any meaningful voting rights. The stock is intended, in other words, to sit on the mantle and be passed down from one generation of Packers fans to the next. See generally Philip D. Drake & Mark D. Griffiths, Green Bay Packers, Inc., http://www.thunderbird.edu/pdf/about_us/case_series/a06980004.pdf (last visited Mar. 20, 2006).

134. Will Lindner, *Ben & Jerry’s Stock Offering is Complete*, RUTLAND DAILY HERALD, July 4, 1984, at 7 (“The company hopes to build the 25,000-square-foot facility to increase production and lure the tourist trade.”).

135. LAGER, *supra* note 107, at 94.

136. Ben & Jerry’s Prospectus, *supra* note 117, at 6.

137. Calvin Trillin, *American Chronicles: Competitors*, NEW YORKER, July 8, 1985, at 43.

138. Häagen-Dazs, Company History, <http://www.haagen-dazs.com/coibrh.do> (last visited Mar. 20, 2006).

139. Charles P. Alexander, *A Stock Scoop for Ice Cream*, TIME, Nov. 4, 1985, at 59.

140. Trillin, *supra* note 137, at 31.

to afford a 30-second commercial but we sure make good ice cream.' And their battle with Häagen-Dazs, he added, shows that 'we can stand up to the big guys.'"¹⁴¹ The *Times*, of course, helped out by printing a story about the dispute.

The antitrust claim was settled out of court.¹⁴² A marketing professor described Ben & Jerry's image as appealing to the "Reformed Hippy" market.¹⁴³ Calvin Trillin, writing in the *New Yorker*, explained that the geographical connection Ben & Jerry's tried to project "was not with the capitals of Europe but with rural Vermont." Trillin explains, "Times had changed. For the generation Ben and Jerry belonged to, the Continent had lost its cachet. Cachet had lost its cachet. Cohen and Greenfield were interested not simply in using natural ingredients but in being natural themselves."¹⁴⁴

By casting Häagen-Dazs as a villain, the campaign drew thousands of supporters and garnished substantial attention in the press.¹⁴⁵ The campaign had a serious side; the founders enlisted the white-shoe Boston firm of Ropes & Gray to pursue what they believed was a genuine antitrust violation.¹⁴⁶ Ben Cohen acknowledged, however, that he saw the campaign both as an attempt to expose corporate bullying and as publicity that might result in some ice-cream sales.¹⁴⁷ Häagen-Dazs's founder, meanwhile, viewed the campaign as an irritating but effective publicity stunt to avoid the hard work of elbowing one's way into a national market, as he had done himself as an entrepreneur. Trillin reported: "'They got P.R. and exposure they couldn't buy for millions,' [Mattus] has said. 'What they did in a couple of years took me eighteen years to do. I did it the hard way.'"¹⁴⁸

3. A Scoop of the Action: Epilogue

Ben & Jerry's deal gimmicks would pay dividends for years to come. Ben & Jerry's first placed stock in the same hands as consumers who ate the ice cream.¹⁴⁹ And when they succeeded, they both bonded with their current

141. *Vermont's Ice Cream Upstart*, N.Y. TIMES, Mar. 29, 1985, at D1.

142. *Id.*

143. *Id.* (quoting Dr. Meryl Gardner, assistant professor of Marketing at NYU). Not all of the media was eating the ice cream; one article in *Forbes* referred to the "sugar-laden, cholesterolly toxic products" as "yuppie pom," noting that the product is far more popular with "men in red suspenders" than inner-city residents, who would "need a bridge loan to take home a pint." Joe Queenan, *Purveying Yuppie Pom*, FORBES, Nov. 13, 1989, at 60.

144. Trillin, *supra* note 137, at 41.

145. *Id.* at 44 (citing a typical letter to Pillsbury as beginning, "CORPORATIONS LIKE YOURS REALLY MAKE ME SICK!").

146. *Id.* at 45.

147. *Id.*

148. *Id.* (quoting Reuben Mattus).

149. Wendy Cooper writes:

customers and established a pattern for dealing with the company's financial issues.¹⁵⁰ A year later, when the company raised more funds through a more traditional secondary offering, they placed a "Scoop up our Stock" message on ice cream cartons, directing customers to a toll-free number to request a prospectus.¹⁵¹ The unusual marketing drew attention from the press; in those interviews, the founders stressed the company's charitable work.¹⁵² The fun would continue well into the 1990s, whether it was picking ice cream flavors or recruiting a CEO.

Unilever, the current owner of the Ben & Jerry's brand, is a far cry from "two real guys" from Vermont. It is a multinational food-and-consumer-products conglomerate, the world's second-largest food company and, according to Professor Douglas Branson, illustrative of the challenge facing corporate social responsibility in an international context.¹⁵³ But through careful brand management, the Ben & Jerry's brand has largely survived. The mythology is powerful. The Vermont-only offering, while it left some money on the table, contributed to the cult. It was a wise investment.

* * *

Lawyers played a role in this production of the Ben & Jerry's cult, but not always a particularly constructive one. Lawyers fought the founders' urge to take the company public, and they fought the founders over the production of information in the offering circular. Lager reports an interaction between the lawyers and the founders that will sound familiar to both:

Ben [Cohen] and Allen [Martin, issuer's counsel] were approaching the circular from different perspectives. To the lawyers it was a disclosure document, intended to protect us from any suggestion of misleading investors in the event things didn't work out as well as we had projected. To Ben

"The people we wanted to own our stock were the people eating our ice cream," explains Fred Lager, Ben & Jerry's general manager. Hence the direct pitch, which company co-founders Ben Cohen and Jerry Greenfield reinforced during the week before the offering by standing on Wall Street in blue jeans and T-shirts handing out free ice cream cones.

Wendy Cooper, *Investor Relations: Gimmicks*, 1986, INSTITUTIONAL INVESTOR, Apr. 1986, at 83.

150. See Jim Schembari, *Investors Bet Ben & Jerry's Is Cream of Crop*, CHI. SUN-TIMES, Nov. 10, 1985, at 4 (reporting on 1985 NASDAQ IPO, and quoting an underwriter as saying, "Half the issue eat the ice cream . . . Virtually no institutions bought the stock.").

151. Alexander, *supra* note 139, at 59.

152. *Ice Cream Stock All Gone*, BURLINGTON FREE PRESS, Nov. 7, 1985, at 5C. Like Google, Ben & Jerry's marketing antics drew attention from the SEC. For the 1985 secondary offering, in addition to the "Scoop Up Our Stock" advertisements on ice cream cartons, Cohen's interview with *Time* was published just two days before the offering became effective. The SEC investigated the offering but declined to comment on its findings. Junius Ellis, *Why Initial Public Offerings Are Bad Bets*, MONEY, April 1986, at 175.

153. Douglas M. Branson, *The Social Responsibility of Large Multinational Corporations*, 16 TRANSNAT'L LAW. 121, 129-30 (2002).

it was a selling tool that he was going to have to rely on to persuade people to buy the stock.¹⁵⁴

By the time Google tangled with the SEC twenty years later, its lawyers seemed much better attuned to the branding implications of the deal. Not only did its lawyers recognize the Google prospectus as a selling tool to investors, they recognized its value as a selling tool to consumers.

But perhaps what was most remarkable about the Ben & Jerry's 1984 stock offering had nothing to do with corporate finance. What makes it remarkable is what it did for dessert. By inviting the consumer to participate in corporate-governance issues, Ben & Jerry's changed the nature of buying ice cream.¹⁵⁵

C. Apple

IPOs are not the only branding opportunities for companies. I turn now to executive compensation, and the contract between an unusual company, Apple, and its CEO, Steve Jobs.

1. One Dollar

Steve Jobs and Steven Wozniak founded Apple Computer in the late 1970s. The Apple II computer became widely popular in the late 1970s; by 1980 the company had several thousand employees. Jobs focused his attention on the user-friendly Macintosh computer, which was released in 1984. During the third quarter of the Super Bowl that year, Apple aired a sixty-second commercial introducing the Macintosh.¹⁵⁶ The commercial, directed by Ridley Scott (who had recently finished *Blade Runner*), depicted the Orwellian IBM world shattered by the new, friendly Mac. Apple's brand image was established. Jobs left the company in 1985 over strategic disagreements with the company's CEO. Apple then struggled for years.

154. LAGER, *supra* note 107, at 97–98; *see also id.* at 98 (noting that in a prior case dealing with a dispute over distribution of the ice cream, “Ben had deferred to his lawyer’s advice. This time around, he wasn’t willing to assume that the ‘experts’ knew everything and that his input wasn’t of equal value.”).

155. One scholar has gone so far as to call Ben & Jerry’s the first postmodern ice cream cone. Referring specifically to the marketing of Ben & Jerry’s Rainforest Crunch ice cream as an attempt to save the Amazon Rainforest, she explains:

This uncanny meshing of an urgent politics, accompanied in Brazil by assassinations, class struggle, and the political discourse of those very meta-narratives Lyotard claims are now lost, is translated at our end into, on the one hand, a truly helpful gesture of creating a market for indigenous rainforest products instead of burning the jungle down for short-term cattle raising ventures, but on the other a product which relies on all the marketing networks, advertising and image construction, paper products and packaging, mass market supermarket distribution, agribusiness-supplied milk and corporate, international sugar resources, etc., to construct this genuinely postmodern ice cream cone.

Jennifer Wicke, *Postmodern Identity and the Legal Subject*, 62 U. COLO. L. REV. 455, 472 (1991).

156. Apple Company History: 1983–1985, <http://www.apple-history.com> (follow “Company History” hyperlink; then follow “1983–1985” hyperlink) (last visited Mar. 20, 2006).

Jobs returned to Apple in 1997. Since then, he has led the company to enormous successes both in the product markets and in the eyes of the capital markets. Apple shareholders received a mediocre 4.2% return from 1984–1997; in contrast, they earned a 38.8% return from 1997–2004.¹⁵⁷ In return for this spectacular performance, Jobs has asked for a cash salary of exactly one dollar a year.

No one pretends that this is the only remuneration Jobs receives. He received options when he formally accepted the CEO job in 2000. And not just a few options: his options to acquire 10,000,000 shares were valued in 2000 at more than \$240 million.¹⁵⁸ He voluntarily canceled these options, after they were in-the-money, in exchange for restricted stock. He also allowed the company to buy him a private jet.¹⁵⁹ Still, Jobs's refusal to accept more than a token cash salary, at the very least, is unusual.

2. *The Executive-Compensation Image Problem*

Public-company CEOs are overpaid. American CEOs make vastly more money than their European and Japanese counterparts. The sheer size of many executive compensation contracts is impressive. After Michael Ovitz was fired from Disney, he received a severance package of \$140 million, which struck both shareholders and the general public as wasteful. Richard Grasso, the former head of the New York Stock Exchange, received a pay package totaling \$187 million. Public outrage has swelled at the contrast between the well-paid CEOs and their struggling companies, some of which have been mired in accounting scandals.

For most scholars, however, the more significant problem is not the size of compensation but its form. The link between pay and performance is weak. In a widely-discussed book, Lucian Bebchuk and Jesse Fried argue that executive-compensation contracts are not the product of arms-length efficient bargaining.¹⁶⁰ Rather, the contracts become vehicles for managerial rent-seeking. Bebchuk, Fried, and tax scholar David Walker have pointed out the various ways in which executive pay camouflages managerial rent-seeking.¹⁶¹ Steve Bainbridge and others disagree, arguing that the contracts properly align incentives.¹⁶² Jeffrey Gordon argues that the problem might be

157. From January 1, 1985 to January 1, 1997, the stock price rose (adjusted for splits and dividends) from \$3.18 to \$5.22. From January 1, 1997 to January 29, 2006, the stock price rose (adjusted for splits and dividends) from \$5.22 to \$72.03. Yahoo! Finance, <http://finance.yahoo.com> (last visited Jan. 29, 2006).

158. STEVEN BALSAM, AN INTRODUCTION TO EXECUTIVE COMPENSATION 62 (2002).

159. Balsam characterizes this as the second-largest short-term bonus paid to an executive, ever. *Id.* at 103–05.

160. LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004).

161. See Lucian Ayre Bebchuk, Jesse N. Fried & David I. Walker, *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751 (2002).

162. Stephen M. Bainbridge, *Executive Compensation: Who Decides?*, 83 TEX. L. REV. 1615 (2005); John E. Core, Wayne R. Guay & Randall S. Thomas, *Is U.S. CEO Compensation Inefficient*

best addressed through improved disclosure.¹⁶³ Whatever the extent of the pay-performance gap, one thing is clear. Executive compensation contracts, like IPOs, have an image problem.

Jobs's salary is an effective way of addressing this image problem. Before rushing to the conclusion that Jobs's salary is just about image, however, it is worth considering other possibilities. The structure of the deal—all equity, no cash—is arguably efficient. It makes some sense from the point of view of aligning incentives. Giving stock to executives roughly aligns their interests with those of long-term shareholders. Cash, on the other hand, feeds managerial risk aversion. Offering cash, moreover, is often tax-inefficient. It requires some explanation to understand why executives routinely demand cash in addition to equity.

Some amount of cash is normally considered efficient from the point of view of both the company and the executive.¹⁶⁴ Executives have recurring expenses like mortgage payments and tuition payments for their kids. Although it is often possible to borrow against the equity portion of their salary, borrowing costs are not trivial. Cash eases executives' liquidity concerns, and executives are willing to accept smaller pay packages in return.

Offering executives some amount of cash also reduces the risk premium and thus may reduce the total amount of compensation paid to the executive. Most academics believe that executives are generally risk averse.¹⁶⁵ If a company offered compensation only in the form of equity rather than cash, its executives would demand a higher risk premium. The risk premium might exceed any expected gain from aligning incentives.¹⁶⁶ The optimal form of compensation, then, is presumed to be a mix of cash and equity.

It is possible that Jobs has enough wealth and adequate liquidity that he prefers to take compensation in the form of equity alone. Indeed, because Jobs became wealthy in the 1980s, much of his wealth may now be held in the form of income-generating assets, easing any possible liquidity concerns. But from any traditional academic perspective, Jobs's cash salary of one dollar is difficult to explain. Why one dollar, and not zero? Why not \$100,000? Why not a negative number—requiring Jobs to spend his own Pixar-generated cash to buy more stock in the company? The choice of one dollar is best explained by its branding effects. (If the company had better foresight, it might have set his salary at ninety-nine cents—the cost of a download from iTunes.)

Pay Without Performance? (Vanderbilt Univ. Law Sch. Law & Econ. Working Paper Series, No. 05-05, 2004), available at <http://ssrn.com/abstract=648648>.

163. Jeffrey N. Gordon, *Executive Compensation: If There's a Problem, What's the Remedy? The Case for 'Compensation Disclosure and Analysis'*, (Columbia Law Sch. Pub. Law & Legal Theory Working Paper Group, No. 0590, 2005), available at <http://lsr.nelco.org/columbia/pill/papers/0590>.

164. Victor Fleischer, *The Missing Preferred Return*, J. CORP L. (forthcoming 2006).

165. On the risks of using risk aversion as an explanation, see Victor P. Goldberg, *Aversion to Risk Aversion in the New Institutional Economics*, 146 J. INSTITUTIONAL & THEORETICAL ECON. 216 (1990).

166. Iman Anabtawi, *Tournament Theory* (unpublished manuscript, on file with author).

It is also possible that Jobs is simply an altruistic man. As discussed in more detail below, he does not appear to be driven primarily by economic self-interest. But declining cash salary would be an odd way of expressing altruism. It is difficult to know if the benefits of his denying himself cash salary ultimately benefit shareholders, creditors, or customers. If Jobs's goal were simply altruistic, he would be better advised to accept the cash and make a tax-deductible donation to the charity of his choice.¹⁶⁷

3. "One Dollar"

Whatever Jobs's motivation, the branding effects of the structure of Jobs's salary are powerful. The gesture is especially powerful because it fits so nicely with the existing Apple brand. Apple has developed and cultivated a following among its consumers in a way that Microsoft, Dell, Intel, and other computer-related companies have not. People love their Macs. Despite the market dominance of PCs, Mac users stubbornly hold on to their Macs, sometimes forming user groups to help each other out. People try to convert others to Apple products. And iPods have become a cultural icon of their own. Apple has some of the hallmarks of not just a well-run company, but a religion.

Steve Jobs, as the founder, savior, and leader of Apple, anchors this belief system. His salary reflects his commitment to integrity. It confirms his desire to do the job for reasons other than money alone. Blogger Hadley Stern explained in his blog post, "One Dollar is Why We Love Apple":

A buck.

This is why we love Apple. Because inherent in this salary is an ethos of doing things differently and better. Take any old Fortune 500 executive and they would insist on a huge salary with a bevy of options thrown in. Not

167. In an interview, Jobs explained the decision as follows:

INTERVIEWER: You've finally done away with the word "interim" in your title. But you still only let Apple pay you \$1 a year. Why don't you take any salary or stock yet?

JOBS: The board has made several incredibly generous offers. I have turned them all down for a few reasons. For the first year I did not want the shareholders and employees of Pixar to think their CEO was going on a camping trip over to Apple never to return. After two and a half years, I think that the management teams at Pixar and at Apple have demonstrated that we can handle this situation. That's why I dropped the "interim" from my title. I'm still called iCEO, though, because I think it's cool.

Bottom line is, I didn't return to Apple to make a fortune. I've been very lucky in my life and already have one. When I was 25, my net worth was \$100 million or so. I decided then that I wasn't going to let it ruin my life. There's no way you could ever spend it all, and I don't view wealth as something that validates my intelligence. I just wanted to see if we could work together to turn this thing around when the company was literally on the verge of bankruptcy. The decision to go without pay has served me well.

Steve. In the age of Enron and Worldcom this is a refreshing thing indeed.¹⁶⁸

Stern's language is telling. He addresses an audience presumed to share his values: "We," not "I." And we "love" Apple, we do not just admire or respect it. He recognizes the Apple ethos of doing things "differently"—echoing Apple's ad campaign admonishing the public to "Think Different." He assumes a sense of familiarity and shared space with Jobs, whom he refers to as Steve, not Jobs.¹⁶⁹ The blogger continues:

Of course, Steve Jobs is not a poor man. His wealth is counted in the billions. But it is rare for someone to run a company and not get paid a huge salary. And he isn't doing it for the power. He is doing it for the love of creating beautiful pieces of technology. The cult of the Mac can be traced directly to this spirit. Whether it is Steve Jobs obsessing over the details of the original Mac calculator, or over the interface of the iPod, the love is there. He wants to do the right thing and is passionate about it.

We see this passion in the products and as Apple users become imbued with it . . . This is why there is the Mac web. Ever heard of the Dell web? Or the Windows web? I haven't. And it all goes back to that salary.¹⁷⁰

This relationship with consumers—the cult of the Mac—is exactly in tune with Apple's brand. Through the iPod, Apple is extending the cult of the Mac into new products and revenue streams.¹⁷¹

I do not mean to suggest that Jobs is motivated solely or even principally by marketing concerns. By all accounts, Jobs is a generous, socially conscious person. When a New York City teenager was killed on his way to the subway by thieves demanding his iPod, Jobs called the family to offer his condolences and offer help. (This was not a calculated PR move; the family, not Apple, spoke to the press about the phone call.)¹⁷² Jobs's touching graduation speech at Stanford this year reflects his inspiring, contrarian approach. The speech, which admonished graduates to "Stay hungry, stay foolish," was widely distributed by email.¹⁷³ But however pure Jobs's motivation, his salary structure has marketing effects. His acceptance of a dollar is symbolic, but symbolism is not the same thing as an empty gesture. It is part of the company's formation of an identity.

168. Apple Matters, One Dollar Is Why We Love Apple, http://applematters.com/index.php/section/comments/one_dollar_is_why_we_love_apple/ (last visited Mar. 20, 2006).

169. Bill Gates, in contrast, is rarely referred to as Bill, even on blogs.

170. *Id.*

171. See also STEVEN LEVY, *INSANELY GREAT: THE LIFE AND TIMES OF MACINTOSH, THE COMPUTER THAT CHANGED EVERYTHING* (2000).

172. Jobs Calls Family of Stabbing Victim, CNNMONEY.COM, July 6, 2005, http://money.cnn.com/2005/07/06/news/newsmakers/stevejobs_ipod.

173. Steven Jobs, Commencement Address at Stanford University (June 12, 2005), available at <http://news-service.stanford.edu/news/2005/june15/jobs-061505.html>.

* * *

By now the reader may not be surprised to learn that Google and Ben & Jerry's, like Apple, also have unusual executive-compensation contracts. In 2005 the Google founders and the CEO all agreed to take a cash salary of one dollar.¹⁷⁴ The founders are worth more than \$7 billion each on paper and have sold substantial stakes in the IPO and secondary market. The gesture is symbolic. But the symbolism matters.¹⁷⁵

Ben & Jerry's restrictions on compensation were more than symbolic and arguably hampered the company's ability to find talented executives. At the time of the IPO, no officer or director received aggregate remuneration in excess of \$30,000, and all directors and officers received a combined compensation of \$56,440.¹⁷⁶ For some years following, Ben & Jerry's had a "five-to-one salary ratio," limiting the top salary at the company to five times that of the lowest-paid employee.¹⁷⁷ The company managed to turn this challenge into a branding opportunity.

Consider the company's search for a CFO in 1989. The five-to-one salary structure limited the salary to \$75,000 at a time when comparable CFOs earned \$125,000 to \$300,000. A New York Times story entitled "Wntd: C.F.O. With 'Flair for Funk'" explained, "The company got the idea that the search might take a while when it heard that some of the applicants, while they were being interviewed, found it hard to keep from giggling."¹⁷⁸ Again, the search generated some brand-positive publicity.¹⁷⁹ Indeed, some of the "difficulties" in finding a CFO seem a little contrived. Search methods included ads in *Mother Jones*, *the Nation*, *the Utne Reader*, and *New Age*.¹⁸⁰ While such ads might find left-leaning CFOs who would value the psychic income from working at Ben & Jerry's, the ads may have been more about selling ice cream to left-leaning readers than about efficiently locating a suitable executive.

174. Paul R. La Monica, *Google Chiefs Agree to Work for \$1*, CNNMONEY.COM, Apr. 8, 2005, http://money.cnn.com/2005/04/08/technology/google_salary.

175. See BALSAM, *supra* note 158, at 62, 63. Balsam reports other examples of executives forgoing salary, including the CEOs or Chairmen of Capital One Financial, El Paso Energy, Viacom, PepsiCo, and Borders. The Pepsi proxy statement explained:

At [Chairman and CEO Roger] Enrico's request, the Committee again approved a reduction in Mr. Enrico's annual salary from \$900,000 to \$1, and recommended to the Board of Directors that it consider using the savings to support front line employees. In January 1999, the Board approved annual charitable contributions of approximately \$1,000,000 to fund additional scholarships for children of PepsiCo's front line employees.

Id. at 63.

176. Ben & Jerry's Prospectus, *supra* note 117, at 20.

177. Erik Larson, *Forever Young: Ben and Jerry's Quest to Keep Their Company's Spirit Alive as the Business Grows*, INC., July 1988, at 50; see also *id.* at 57–58 (discussing internal company debate over whether to keep the policy, which "makes recruiting difficult").

178. N.R. Kleinfeld, *Wntd: C.F.O. With "Flair for Funk"*, N.Y. TIMES, Mar. 26, 1989, § 3, at 4.

179. Solomon, *supra* note 129, at 1660; Kleinfeld, *supra* note 178, at 4.

180. Kleinfeld, *supra* note 178, at 4.

Ben & Jerry's turned the salary restriction into an even more explicit branding opportunity with its gimmicky "Yo! I'm Your CEO!" search in 1994.¹⁸¹ The contest attracted thousands of mostly ridiculous applications; the company ultimately turned to a search firm and hired a former McKinsey partner to run the company.

Google, Ben & Jerry's, and Apple have different customer bases and company values. One thing they have in common is a commitment to executive integrity and a contrarian brand image, and their executive-compensation policies reinforce that image.

D. Stanley Works

The first three case studies illustrate how companies can use deal structure to build brand equity. The Stanley Works story illustrates how executives can squander it.

In February 2002, Stanley Works announced plans to undergo a "corporate inversion"—that is, it planned to expatriate from the United States and reincorporate in the tax haven of Bermuda. Inversion deals are little more than a shuffling of corporate papers with the aim of lowering a corporation's long-term U.S. tax liability. An inversion is different from outsourcing, both conceptually and substantively. It does not require any substantive change in the company's operations, such as a relocation of factories, employees, or even corporate headquarters. It is a strategy driven by regulatory-cost engineering. From a corporate-finance perspective—both as a matter of transaction-cost engineering and regulatory-cost engineering—it is perfectly rational and sensible for a company like Stanley Works to reincorporate in Bermuda.¹⁸² The puzzle is not why inversion deals take place, but rather why we see so few.¹⁸³ Branding may be part of the answer.

1. An All-American Company

Stanley Works is a Connecticut-based tool manufacturer. Stanley tools are among the most recognized tools in the United States; its carpentry, garden, and masonry tools can be found in most American garages or toolsheds. Stanley's door products, which span everything from simple door

181. Ben & Jerry's Timeline, http://www.benjerry.com/our_company/about_us/our_history/timeline/index.cfm (last visited Mar. 20, 2006).

182. One potential drawback is the loss of the Delaware laws and courts; under the internal affairs doctrine, corporate governance matters will be governed by the laws of the state (or country) of incorporation.

183. The leading economic analysis of inversion deals is Mihir A. Desai & James R. Hines, Jr., *Expectations and Expatriations: Tracing the Causes and Consequences of Corporate Inversions* 55 NAT'L TAX J. 409 (2002). The authors conclude that market response to inversion announcements reflects not just an anticipation of a reduction of U.S. tax liability on foreign source income, but also an expectation of a reduction in U.S. tax liability on U.S. source income through techniques such as earnings stripping, in which the inverted corporation receives tax-deductible interest payments from its U.S. subsidiary. Their paper identifies the capital gains liability of shareholders as an important friction. Their analysis does not, however, address branding effects as a potential friction.

hinges to automatic and revolving doors, are widely known. The company sells industrial, pneumatic, and hydraulic tools to commercial buyers. Its two leading distribution channels are Wal-Mart and Home Depot. Home Depot alone accounted for eighteen percent of Stanley Works' 2001 revenue.¹⁸⁴

Stanley Works maintains an all-American brand image. The company has been based in New Britain, Connecticut, since its founding in the nineteenth century.¹⁸⁵ Stanley has sold millions of hand saws, planes, chisels, rulers, tape measures, screwdrivers, and levels to professionals and serious Do-It-Yourselfers. The company's brand image taps into the American cultural vision of independence, self-reliance, and industrious self-sufficiency. Its reputation for producing quality tools is a valuable asset. The company extended its brand by licensing its mark to makers of work boots and gloves, lawnmowers, ladders, and other products that the company did not manufacture itself.¹⁸⁶

2. *The Inversion Deal*

Corporate inversion describes the legal process of reincorporating an American company in a tax haven such as Bermuda. The basic deal works as follows. A domestic parent corporation first secures approval from its shareholders to do the deal. Then, with appropriate consent, it creates a new corporation in the tax haven. The foreign corporation exchanges its stock for the stock or assets of the inverting corporation, which becomes a subsidiary of the foreign parent. The shareholders of the domestic corporation are left holding shares of the foreign parent. It is nothing more than a paper-shuffling transaction: no factories, offices, or headquarters must be moved. There are some nontax regulatory implications. The company may be subject to fewer environmental regulations or consumer regulations. Shareholders may not be able to bring lawsuits in state court in the United States. By all accounts, though, tax savings are the deal's reason for being.

The tax savings arise from the residence-based system for taxing the income from international operations. The United States taxes its citizens, including corporate citizens, on their worldwide income. Foreign citizens, however, are taxed only on their U.S. source-based income. Reincorporation accomplishes nothing for a company that has operations exclusively in the United States. For companies like Stanley Works with operations both at home and abroad, the potential gains are impressive, through manners both clearly licit and less so.

184. *Id.* at 12.

185. *See Developments in the Law—Jobs and Borders*, 118 HARV. L. REV. 2171, 2274 (2003).

186. The Beanstalk Group, Client Showcase Case Studies: The Stanley Works, <http://www.beanstalk.com/casestudies/stanley.html> (last visited Mar. 20, 2006).

The United States looks to the place of incorporation to determine whether a corporation is domestic or foreign.¹⁸⁷ Domestic corporations generally face U.S. taxation on foreign source income when that income is repatriated to the United States. Incorporating a foreign subsidiary to conduct foreign operations can defer taxation until the foreign earnings are distributed to the domestic parent as a dividend. Under the “subpart F” anti-deferral regimes, however, certain types of mobile passive income earned overseas, such as interest, dividends, and royalties, are taxed currently as if earnings had already been distributed to the domestic parent.¹⁸⁸ The domestic parent is only able to use the benefits of deferral with respect to income earned by the foreign subsidiary if it is not “subpart F” income. U.S.-based multinational corporations, then, are at a significant disadvantage from otherwise similarly situated foreign multinationals. Corporate inversions may be rationalized as “self-help territoriality”¹⁸⁹—a regulatory-engineering maneuver designed to level what many believe is an unfair playing field.¹⁹⁰

As a practical matter, inversion offers two main sources of tax savings: reduction of U.S. tax on foreign income and reduction of U.S. tax on U.S. income. Reduction of U.S. tax on foreign income results from the elimination of U.S. tax on foreign subpart-F income. A Bermuda company can make its portfolio investments from Bermuda, earning income from interest, dividends, and royalties, and not face U.S. tax on that income. The highly mobile nature of passive income makes this tax reduction somewhat problematic, but there are sound arguments in favor of the United States not taxing this income.

More problematic is the reduction of U.S. tax on U.S. income. These savings take place primarily through techniques of earnings-stripping and transfer pricing. Earnings-stripping refers to techniques in which the U.S. subsidiary is saddled with large amounts of intercompany debt; interest payments to the foreign parent are normally deductible in the United States. Other techniques for reducing U.S. income include aggressive manipulation of royalty payments to the parent company, administrative fees, and transfer prices.¹⁹¹ Code provisions preclude the ability of a multinational corporation to eliminate U.S. tax on U.S. income entirely, but opportunities for substantial tax savings remain.¹⁹²

187. I.R.C. § 7701(a)(4) (2000) (“The term ‘domestic’ when applied to a corporation . . . means created or organized in the United States or under the law of the United States or of any State . . .”).

188. See generally I.R.C. §§ 952–64 (2000 & Supp. 2003).

189. See Michael S. Kirsch, *The Congressional Response to Corporate Expatriations: The Tension Between Symbols and Substance in the Taxation of Multinational Corporations*, 24 VA. TAX REV. 475, 491 (2005).

190. Cf. OFFICE OF TAX POL’Y, DEP’T OF TREASURY, CORPORATE INVERSION TRANSACTIONS: TAX POLICY IMPLICATIONS (2002), <http://www.treas.gov/press/releases/docs/inversion.pdf>.

191. Kirsch, *supra* note 189, at 493.

192. See *id.* Section 163(j) limits interest stripping by limiting the deductibility of interest payments to related corporations by taxpayers with excessive leverage. Section 482 addresses transfer pricing and other non-arms-length transactions that attempt to shift income improperly. *Id.*

Inversions can trigger some immediate adverse tax consequences, particularly for shareholders. If the inversion is structured as a stock transaction in which shareholders exchange their old shares for new shares in the corporate parent, then the shareholders may have to recognize gain equal to the excess of the fair-market value of the stock over the shareholder's adjusted basis.¹⁹³ The inversion, in other words, is treated as a realization event. The corporation itself may have to pay tax if the inversion is structured as an asset acquisition by the new foreign parent.¹⁹⁴

Stanley Works proposed an inversion transaction to its shareholders; reincorporation requires shareholder approval. The company explained to shareholders that the transaction was necessary to compete globally: "In today's global economy, numerous foreign competitors pay lower taxes on their worldwide operations. The U.S. tax rules place us at a competitive disadvantage in the global marketplace."¹⁹⁵ The company noted that two of its U.S. competitors, Ingersoll-Rand and Cooper Industries, reincorporated in Bermuda. "In our view our reincorporation in Bermuda is necessary in order to create a level playing field enabling us to become a stronger, more competitive company."¹⁹⁶ The company noted, however, that it would retain its character as an American company. "It is our goal to keep our management in the U.S. and our headquarters in New Britain, Connecticut."¹⁹⁷ Market reaction to the inversion announcement was positive, and the company narrowly received shareholder approval. The shareholder vote was declared void, however, after the Connecticut Attorney General sued to block the transaction, alleging that 401(k) shareholders may have been confused by contradictory statements in their materials regarding the consequences of a failure to vote by proxy.¹⁹⁸ In the months following the voided shareholder vote, public protests and media criticism increased, and the board of Directors ultimately voted to cancel the transaction in August 2002.¹⁹⁹

3. What Stopped the Deal?

The Stanley Works inversion would have generated tax savings for the company. Market reaction was positive. Why, then, did the Stanley Works board reverse course?

193. I.R.C. § 367 (2000); Kirsch, *supra* note 189, at 494–95.

194. I.R.C. § 367(a)(1) (2000); Kirsch, *supra* note 189, at 495; Samuel C. Thompson, Jr. & Robert Allen Clary II, *Economic Substance, Inversions, and the Bush-Kerry International Tax Reform Debate*, 103 TAX NOTES 1385, 1546–48 (June 14, 2004).

195. Stanley Works Ltd., Registration Statement (Form S-4), at 2 (May 28, 2002).

196. *Id.*

197. *Id.*

198. *See Developments in the Law—Jobs and Borders*, *supra* note 185, at 2274.

199. Kirsch, *supra* note 189, at 529.

Political pressure was an obvious concern. Politicians were not shy about branding Stanley Works a traitor.²⁰⁰ Senator Charles Grassley charged the company with taking advantage of the economic effect of the September 11 terrorist attacks: "Here's a company pulling up stakes when the cleanup at Ground Zero is barely done."²⁰¹

The political rhetoric led to legislation that prevents expatriated corporations from entering into government contracts with the Department of Homeland Security.²⁰² The restriction may be waived, however, if the Secretary of Homeland Security determines that a waiver is required "in the interests of homeland security."²⁰³ Some states enacted similar provisions barring state agencies from contracting with expatriate corporations.²⁰⁴ Congress considered several tax bills aimed at eliminating the benefits of corporate inversions, ultimately enacting a forward-looking provision in 2004, long after the Stanley Works deal failed.²⁰⁵

Stanley Works did not cite bad publicity as a reason for canceling the proposed transaction. Instead, the company rather dubiously pointed to "the growing prospect of comprehensive tax legislation. . . . Congress has started down a path to deliver comprehensive tax reform that would eliminate the inequities of U.S. international taxation"²⁰⁶ But it seems unlikely that the board anticipated meaningful international tax reform. What was really going on?

The Stanley Works inversion received significant attention from tax scholars.²⁰⁷ A combination of factors, including shareholder hostility, legal uncertainty, and patriotism may have contributed to management's decision not to move forward. Even the issue of shareholder hostility is complex. Some shareholders may have been motivated by altruism, patriotism, or social responsibility, while others may have been motivated by economic self-interest. (Recall that a stock inversion like the one proposed by Stanley Works triggers a shareholder-level tax. The amount of the tax depends on the shareholder's basis.) It is also possible that some shareholders resisted the move for non-tax-related reasons. With the parent company in Bermuda,

200. Cf. Nader, *supra* note 106, at 201 (noting a ban on repatriation as one of several important social-responsibility issues).

201. Tim Reason, *Love It and Leave It? The Hue-and-Cry Over Corporate Inversions May Change the Way Overseas Income Is Taxed*, CFO.COM, July 1, 2002, http://www.cfo.com/article.cfm/3005328/1/c_3046525?f=archives.

202. Kirsch, *supra* note 189, at 482.

203. Homeland Security Act of 2002, 6 U.S.C. 395(d) (Supp. 2003).

204. Kirsch, *supra* note 189, at 499.

205. *Id.* at 506.

206. Stanley Works, Current Report (Form 8-K), at 5 (Aug. 1, 2002), available at <http://www.secinfo.com/dsVsj.31k4.htm>.

207. See, e.g., OFFICE OF TAX POL'Y, *supra* note 190; Desai & Hines, *supra* note 183; Kirsch, *supra* note 189; Thompson & Clary, *supra* note 194.

shareholders would have had a more difficult time protecting their rights through a derivative action.²⁰⁸

Michael Kirsch's recent article provides the most detailed examination of the Stanley Works transaction and the political fallout that followed. Kirsch describes the Homeland Security restrictions as symbolic legislation. He cites the rhetoric used by inversion critics—calling the corporations Benedict Arnolds, traitors, tax dodgers, tax cheats, and so on, and the use of September 11, 2001 as the retroactive date of many bills—as evidence of the symbolic importance of the bill.²⁰⁹ But he argues that the legislation had little instrumental effect.

Kirsch views the Homeland Security legislation largely as a victory for expatriate corporations.²¹⁰ In one sense, Kirsch is certainly correct. As he points out, the legislation is drafted in such a way to allow U.S. subsidiaries of expatriate corporations to contract with the Department of Homeland Security, eviscerating the practical impact of the bill. For example, Accenture, a Bermuda company that inverted in 2001, was awarded a \$10 billion contract by the Department in 2004.²¹¹

Kirsch does not directly address the branding implications of the deal. He does, however, discuss the effects in terms of social norms.²¹² Kirsch acknowledges that “there also appear to have been some aspects of nonlegal social norms enforcement in play.”²¹³ He explains,

As one contemporary newspaper article observed, “The question is whether all this ill will [arising from the planned expatriation] is headed out to the Home Depot in Peoria.” Another article on the same topic observed that “[t]he typical Stanley customer is an American male, age 25 to 54. Often, he is a tradesman who belongs to a union. And union members generally know which companies are perceived as friendly to American workers and American causes.”²¹⁴

Kirsch also notes that Stanley sold retail products to consumers under its own name, whereas most of the other expatriating corporations did not.²¹⁵

208. *Developments in the Law—Jobs and Borders*, *supra* note 185, at 2280.

209. Kirsch, *supra* note 189, at 509.

210. *Id.* at 511 (“It enabled its supporters to claim credit for *some* legislation that purported to address a perceived problem, thereby satisfying the general public’s demand for action. At the same time . . . it ensured that the interested, involved group that would actually be affected by the legislation [i.e. expatriate corporations] received their desired result.”).

211. *Id.* at 514.

212. *Id.* at 523 (“[A] corporation could be the target of second order sanctions to the extent social norms disfavored a corporate parent changing its place of incorporation in pursuit of tax savings. For example, the firm might experience a backlash from U.S. customers and a possible reduction in revenue.”).

213. *Id.* at 530.

214. *Id.* at 531 (quoting Dan Haar, *Image Hammered: Stanley Move Draws Sharp Criticism, But Will Customers Stick with Brand?*, HARTFORD COURANT, May 10, 2002, at E1; Matthew Lubanko, *Stanley’s Brand Tarnished? Experts: Over Long Haul, Consumers Aren’t Likely to Hammer Toolmaker*, HARTFORD COURANT, Aug. 3, 2002, at E1).

215. *Id.* at 532.

Kirsch, however, argues that Stanley's decision resulted not from informal social-norm enforcement, but from concern about legal-based instrumental factors.²¹⁶

With respect to Stanley Works, Kirsch's analysis understates the effectiveness of rhetoric. The rhetoric tarnished the brand. Although it is possible that Stanley Works declined to do the inversion because of its uncertain legal treatment, that explanation strikes me as highly unlikely. Retroactive tax legislation is unusual. Here, I think the simpler explanation is the correct one: the political rhetoric worked. It amplified the branding implications of the deal.

Inversion critics offered a powerful narrative, casting Stanley Works' management in the stereotypical role of greedy capitalist. The story is a familiar one. In popular culture, local communities are often presented as under attack by soulless multinational corporations. In the movie *Other People's Money*,²¹⁷ for example, a takeover artist (Larry "the Liquidator" Garfield), played by Danny DeVito, targets the New England Wire and Cable Company. The struggling company is defended by its paternalistic founder, Andrew Jorgensen, played by Gregory Peck.²¹⁸ Stanley Works could easily drop into this familiar narrative as the old wire-and-cable company. By barraging the Stanley Works directors with publicity, opponents forced the directors to choose their self-image—would they be Danny DeVito, or Gregory Peck?

The political rhetoric might not have had the same impact on a reinsurance company or oil and gas company. No one expects Exxon or Tyco to be socially responsible. Stanley Works' inversion attempt ultimately may have been sunk by its own valuable brand image. Consider the many companies that completed inversions before Stanley Works: McDermott, Helen of Troy, Triton Energy, Chicago Bridge & Iron, Tyco, Santa Fe International, Fruit of the Loom, Playstar, Gold Reserve, Xoma, Transocean, PXRE, Everest Reinsurance, White Mountain Insurance, Trenwick, Applied Power, R&B Falcon, Foster Wheeler, Cooper Industries, Global Marine, Ingersoll Rand, Nabors Industries, and Noble Drilling.²¹⁹ Of these, only Fruit of the Loom sells directly to a broad base of consumers. If Stanley Works were just another reinsurance company or oil and gas conglomerate, its directors would now be attending annual meetings in the Caribbean instead of Connecticut.

216. *Id.* at 530. Kirsch explains that members of Congress had offered Stanley assurances that tax reform was on the horizon, and he notes that some of the tax-focused bills in Congress might have eliminated the tax benefits that Stanley sought, and that the Homeland Security legislation was being actively considered. *See id.*

217. *OTHER PEOPLE'S MONEY* (Warner Bros. 1991).

218. *See* Larry Ribstein, *Wall Street and Vine: Hollywood's View of Business* 14 (Univ. Ill. Law & Econ. Research Paper No. LE05-010, 2005), available at <http://ssrn.com/abstract=563181>.

219. Desai & Hines, *supra* note 183, at 18–20.

III. BRANDING THE DEAL: THE MECHANISMS OF MARKETING INEFFICIENCY

The case studies in the previous Section show that deal structure can affect the brand image of a company. Finding the common thread, though, is a challenge. Is the branding effect accidental and unexpected, or can it be predicted? How does a decision about legal structure filter down to the point at which it has an effect on consumers? Does branding a deal make sense for all companies, or only some?

In this Section, I argue that the branding effects of deal structure are most important for companies that target early adopters or other opinion leaders.²²⁰ Companies are more likely to reach consumers effectively through branding moments early in the lifecycle of the company, and the branding message of an unusual deal structure is more likely to reach consumers indirectly. The branding implications of deals are more important, then, for companies that can target early adopters or opinion leaders, such as technology companies, firms that produce trendy or fashionable consumer goods, cult brands, and socially responsible companies.

To explain which companies are more likely to use deal structure as a branding mechanism, it is useful to consider the process and not just the underlying activities of the firm. Consider two alternative explanations for branding through deal structure: managerial consumption and consumer signaling.

Managerial consumption. Unusual deal structures might simply reflect idiosyncratic, economically irrational preferences on the part of the founders. Larry and Sergey might be expressing geek solidarity; Ben and Jerry, localism; Steve Jobs, altruism; and the Stanley Works managers, patriotism. Their chosen deal structures might reflect an effort by founders to engage in "conspicuous consumption," meaning that the founders derive utility not from the intrinsic value of the deal structure but rather because of its wastefulness or opulence. The structure's value exists only because it could be observed by select friends and competitors.²²¹

If managerial consumption is the real goal, then we should approach the deals with a skeptical eye, as we might view other goods with a strong consumption component, like corporate charitable contributions, golf retreats, or private jets. If managerial consumption is driving these unusual cases, then lawyers involved in such deals have an ethical duty to look out for the corporate entity and its shareholders.²²²

220. For a discussion of innovators, early adopters, and the diffusion of innovation, see EVERETT M. ROGERS, *DIFFUSION OF INNOVATION* (4th ed. 1995); GEOFFREY A. MOORE, *CROSSING THE CHASM: MARKETING AND SELLING HIGH-TECH PRODUCTS TO MAINSTREAM CUSTOMERS* 9–25 (rev. ed. 1999).

221. On the origins of the term "conspicuous consumption," see THORSTEIN VEBLEN, *THE THEORY OF THE LEISURE CLASS* 75–77 (B. W. Huebsch ed. 1918). In this context, it is not a leisure class but rather an entrepreneurial class at issue.

222. In practice, of course, the business judgment rule would likely protect the company against any potential lawsuits.

Consumer signaling. Alternatively, unusual deal structures may send valuable messages to consumers. If the structure is costly to the firm in the short term, it may prove valuable in the long run by acting as an investment in reputation and signaling quality assurance.²²³ This familiar model of branding, often referred to as the Klein-Leffler model,²²⁴ would suggest that the unusual deal structure is simply a reputational bonding mechanism. The deals are costly but economically rational, as the resulting brand equity is expected to pay dividends over time. This signaling explanation suggests that companies that produce credence goods are more likely to employ unusual deal structures.

But unlike the usual Klein-Leffler situation, in this case the signal need not be especially costly to be valuable.²²⁵ It may also be valuable if opinion leaders can verify the signal and communicate the message to consumers. Klein-Leffler focuses our attention on the suppliers of goods and services; advertising reflects their commitment to deliver quality products over the long haul. But the key here is the demand side of the equation: consumers. Deal structure may be more effective for some companies than others, depending on the demographics of their consumers and the stage of their brand development. Specifically, deal structure is an effective advertising medium when it reaches early adopters and opinion leaders: sophisticated, knowledgeable consumers who start trends.²²⁶

Casual empiricism supports the signaling explanation. It seems unlikely, for example, that the Stanley Works directors suddenly and spontaneously became more patriotic for reasons unrelated to branding. And while the Google founders are quirky, it seems unlikely that they could have forced the auction structure on the other pre-IPO shareholders without justifying the move in terms of long-term shareholder value. Still, I cannot dismiss the managerial consumption explanation out of hand. Empirical testing would be useful. For example, the managerial-consumption explanation would predict that companies with weak shareholder accountability would be more likely to use unusual deal structures. The signaling story, on the other hand,

223. Marketing scholars already find a direct relationship between a firm's financial performance and the perceived quality of its goods. See Jerry B. Swann et al., *Trademarks and Marketing*, 91 TRADEMARK REPORTER 787, 790 (2001). It is only one step further to take a firm's structuring of internal corporate governance matters and use it to upgrade the perceived quality of the goods.

224. See Klein & Leffler, *supra* note 71.

225. Focusing on deal structure as a method of quality assurance for credence goods is part of the story, although ultimately it does not seem to explain everything. If deal structure is used solely as a quality-assurance tool, the value of the signal depends on its cost. While it seems likely that the contract designs in the case of Google, Ben & Jerry's, or Apple were inefficient (setting aside any branding implications), it is not so clear that the Ben & Jerry's and Apple structures were exceedingly costly. Nor is it clear that the Google founders anticipated leaving quite so much money on the table. Furthermore, the brand equity generated by the deal structure may not bear a close relationship to its cost. Finally, if quality assurance were the whole story, then one would expect deal structure to be used most often to brand credence goods. But consider the list of firms that have conducted auction IPOs. While some companies are "integrity companies"—Morningstar and arguably Google—others offer experience goods for which the quality is immediately apparent, such as Peet's Coffee.

226. See generally Gladwell, *supra* note 72.

suggests that the use of unusual deal structures is more related to the process of branding than to the process of financing. It is not the manager-shareholder relationship that drives these deals; it is the company-consumer relationship—the topic to which I now turn.

A. Branding through Desirable Atmospheric

The legal system often treats consumers as if they care only about the functionality of the products they buy.²²⁷ This approach is grounded in the thinking of the pre–World War II “Harvard School” of economics, which viewed brand marketing as little more than a method for insulating market share from price competition and creating high barriers to entry.²²⁸ Advertising deserved scorn, not praise. Harvard’s Edward Chamberlain would have permitted unlimited confusion through imitation, rendering advertising almost pointless.²²⁹ Advertising was little more than consumer deception, tricking consumers into buying products based on illusory wants or desires.²³⁰

Legal scholarship reflected the Harvard School’s teachings. In his seminal article, *Advertising and the Public Interest*, Yale’s Ralph Brown characterized modern advertising as a “black art” whose practitioners “are part of the larger army which employs threats, cajolery, emotions, personality, persistence and facts in what is termed aggressive selling.”²³¹ Brown drew a sharp line between providing information and persuasive advertising. Only the former benefited the public interest. “To the extent that the blandishments of sellers inform buyers what is to be bought, and at what price, advertising undoubtedly quickens the stream of commerce.”²³² Persuasive advertising, on the other hand, was economic waste. “If we consider first the total stream of production and consumption, persuasive advertising seems only to consume resources that might be put to better use producing more goods and services. It does not increase total demand; it only increases wants.”²³³ Brown dismissed advertising’s shaping of consumer preferences as mere illusions.²³⁴ Competition among brands was a choice “between one

227. See Douglas A. Kysar, *Preference for Processes: The Process/Product Distinction and the Regulation of Consumer Choice*, 118 HARV. L. REV. 525 (2005).

228. See Swann et al., *supra* note 223, at 788.

229. *Id.*

230. See Mark A. Lemley, *The Modern Lanham Act and the Death of Common Sense*, 108 YALE L.J. 1687, 1692 (1999).

231. Ralph S. Brown, Jr., *Advertising and the Public Interest: Legal Protection of Trade Symbols*, 57 YALE L.J. 1165, 1165–66 (1948).

232. *Id.* at 1168.

233. *Id.* at 1169.

234. *Id.* at 1181. Brown notes:

Other values derive from the proposition that cheapness is not enough. The buyer of an advertised good buys more than a parcel of food or fabric; he buys the pause that refreshes, the hand that has never lost its skill, the priceless ingredient that is the reputation of its maker. All these may be illusions, but they cost money to create, and if the creators recoup their outlay, who is

illusion and another.”²³⁵ The task for courts addressing trademark claims, therefore, was to pick out the threads of informative advertising, and ignore the persuasive fabric.²³⁶ Trademark protection, Brown concluded, should be limited to cases in which there was a likelihood of consumer confusion.

Times have changed.²³⁷ Most scholars today, applying the lessons of the Chicago School, view brands as a mechanism for enhancing consumer efficiency, diversifying goods, improving quality control, and facilitating entry for new manufacturers.²³⁸ Trademark law increasingly protects trade symbols not just in cases of consumer confusion, but also in cases in which another’s use of the trademark may affect the cultural meaning of the brand.²³⁹

Marketing scholarship reflects this shift in how we understand consumers. A consumer buying a car looks at more than price, power, safety, color, and gas mileage. Consumers also buy the brand—the set of mental associations that accompanies the name. But the fact that branding is triggered by memory does not mean that it is smoke and mirrors. Consumers strive to satisfy their psychological needs, not just their physical needs. Opening a Tiffany’s box feels different than opening a box from Kmart, and will appeal to different customers.²⁴⁰ Brands help the consumer create an identity, not just identify the source of the product.²⁴¹ Through brands, products produce not just functional benefits but emotional and self-expressive benefits.

Brand image is a powerful form of communication with the consumer. Brand image, although intangible, is a valuable piece of property with intrinsic worth and meaning.²⁴² As explained by Jessica Litman, the value of a

the poorer? Among the many illusions which advertising can fashion are those of lavishness, refinement, security, and romance.

Id.

235. *Id.* at 1183.

236. *Id.* at 1184.

237. For a more comprehensive discussion of the development of brands, and the “brand manager system,” see George S. Low & Ronald A. Fullerton, *Brands, Brand Management and the Brand Manager System: A Critical-Historical Evaluation*, 31 J. MARKETING RES. 173 (1994). Low and Fullerton argue that as corporate management evolves away from bureaucratic conglomerate systems to more entrepreneurial ones, more entrepreneurial brand-manager roles will develop. Using deal structure as a marketing device may become more common as brand managers seek more creative ways to market brands.

238. See Swann et al., *supra* note 223, at 790.

239. Laura R. Bradford, *Parody and Perception: Using Cognitive Research to Expand Fair Use in Copyright* (NYU Law & Econ. Working Paper No. 05-09, 2005), available at <http://ssrn.com/abstract=728604>; Jessica Litman, *Breakfast with Batman: The Public Interest in the Advertising Age*, 108 YALE L.J. 1717, 1721–25 (1999). Litman explains, “Courts’ increased willingness to find an actionable likelihood of confusion has meant that, as a practical matter, nearly any unauthorized use of a trade symbol with the potential to undermine the symbol’s trademark distinctiveness may persuade a federal judge to grant an injunction.” *Id.* at 1722.

240. Aaker explains, “Further, the wearing of a Tiffany bracelet may even make the wearer feel more attractive and confident The associations of prestige and quality are hypothesized to actually change the use experience.” DAVID A. AAKER, *MANAGING BRAND EQUITY* 161 (1991).

241. Swann et al., *supra* note 223, at 796.

242. See Alex Kozinski, *Trademarks Unplugged*, 68 N.Y.U. L. REV. 960, 962–63 (1993).

trademark like Batman has nothing to do with identifying Warner Brothers as the manufacturing source. “The worth of such valuable trade symbols lies less in their designation of product source than in their power to imbue a product line with desirable atmospherics.”²⁴³ Indeed, atmospherics may dominate all other product attributes. The product can become simply a delivery vehicle for the brand, which is what is really being consumed. Litman explains:

Ask a child, and he’ll persuade you that the difference between a box of Kellogg’s Corn Flakes with a picture of Batman on it and some other box without one is real. There is nothing imaginary about it. It has nothing to do with the way cereal tastes. What kids want isn’t a nutritious part of a complete breakfast; they want Batman to have breakfast with them.²⁴⁴

In a world where many products serve primarily as brand delivery vehicles—Derek Jeter Bobblehead dolls, NARS Orgasm perfumes,²⁴⁵ Black Dog T-Shirts²⁴⁶—the importance of brand image is hard to deny. If cereal is really about Batman, then the same might be true for other products. Ice cream isn’t just creamy and sweet; it is rain forests and hormone-free cows and leaf-peeping in Vermont. An iPod is not just a convenient method for listening to music; it is a hip world where life is random and rewards go to those who think different.

If I’m right that we live in a world where brand image is both richly textured and powerful in its impact on consumers, it is not surprising that deal structure weaves its way into the purchasing decision. Deal structure changes the atmospherics. From a pure, rational-actor point of view, it is unclear why consumers care about the social responsibility of a manufacturer, let alone its internal corporate governance.²⁴⁷ Yet we know that Ben & Jerry’s sells more ice cream because of its preservation efforts in the Amazon rainforest.²⁴⁸

243. Litman, *supra* note 239, at 1726.

244. *Id.* at 1727. Whether trademark law should protect the powerful impact of brand image is beyond the scope of this Article. Litman makes a powerful case that while the atmospherics are real, they are not worthy of legal protection.

245. See Rob Walker, *Color Coding*, N.Y. TIMES, July 31, 2005, § 6 (Magazine), at 17.

246. See Posting of Victor Fleischer to Conglomerate, http://www.theconglomerate.org/2005/08/gen_x_six_feet.html (Aug. 16, 2005).

247. ROBERT H. FRANK, WHAT PRICE THE MORAL HIGH GROUND?: ETHICAL DILEMMAS IN COMPETITIVE ENVIRONMENTS 65 (2003) (“The standard free-rider model suggests that buyers will not be willing to pay a premium for products produced by socially responsible firms.”).

248. *Id.* Recent scholarship has picked up on the changed relationship between consumers and brands. Cognitive science research suggests that our brains classify things as good or bad as soon as we see them. Laura Bradford, an intellectual-property scholar, has noted that much of “modern advertising is designed to increase positive associations with advertised brands and products through use of symbolic and emotional appeals to the values of the target audience.” Bradford, *supra* note 239, at 31. See generally John O’Shaughnessy & Nicholas Jackson O’Shaughnessy, *PERSUASION IN ADVERTISING* (2003).

Douglas Kysar has identified the importance of process in consumer-preference satisfaction. Regulators and economists draw a process-product distinction. Consumers, however, derive utility from understanding the process by which a product is made. Kysar explains:

B. Reaching Early Adopters

Deal structure is not likely to be an effective advertising medium for reaching large numbers of consumers. A typical ice cream purchaser or computer user doesn't know anything about IPOs. One particular class of consumers, however, is better educated, wealthier, smarter, more open-minded, more adventurous, and has a higher social status than your average consumer: early adopters.²⁴⁹ And that is exactly who marketers try to reach to establish a brand image. Early adopters are sophisticated consumers who experiment with new products and, by word-of-mouth, spread the message to other consumers. Early adopters seek information about innovations more actively than later adopters and have higher degrees of opinion leadership.²⁵⁰

As an advertising medium, deal structure resembles other specialized marketing techniques like buzz marketing. Consider the market for ad space on blogs. Blog ads would seem like an ineffective use of resources, considering the narrow readership of most blogs. The ad space sells, however, because it allows companies who want to reach early adopters an easy access point. Because readers of blogs tend to be highly literate, highly networked, and influential, purchasers of blog ads skew towards the likes of Paramount Pictures, Wall Street Journal, Penguin Books, Oxford University Press, and various political groups.²⁵¹

Using deal structure as a branding device thus seems especially well-suited to companies reaching out to early adopters to build a brand. These include technology brands, integrity brands, cult brands, and socially responsible brands.

Technology brands. Technology products demand trust from consumers. Consumers must invest their time in learning how to use the technology on top of the financial cost. Many consumers, then, wait to adopt a new technology until a critical mass has already done so. This process—documented in detail in Everett Rogers's *Diffusion of Innovations* and more recently in Malcolm Gladwell's *The Tipping Point*—shows the importance of early adopters, who act as a bridge between innovators and the majority of consumers.

[J]ust as people derive utility from feeling as if they participate in certain types of labor or political decisionmaking processes, so too might consumers derive utility from participating in a marketplace that is rich with information about the consequences of consumption. Such a marketplace enables consumers to feel as if their purchasing behavior expresses a viewpoint on critical aspects of the global economy, even apart from consideration of any instrumental impact that such purchasing behavior might have on manufacturing processes.

Kysar, *supra* note 227, at 607. Kysar argues against further use of the process-product distinction by regulators.

249. See EVERETT M. ROGERS, *DIFFUSION OF INNOVATIONS* 288–90 (5th ed. 2003).

250. *Id.* at 292. Particularly for deals with subtle branding implications, like an auction IPO or a policy against slotting allowances, branding is only relevant to the extent PR about the deal reaches financially sophisticated consumers. The socioeconomic status of early adopters makes them a natural fit.

251. Blogads, *Blog Advertising Makes Opinions*, http://www.blogads.com/advertiser_html (last visited Mar. 20, 2006).

Before an innovation can cross the chasm into widespread adoption, the manufacturer must win over the early adopters. When commercializing a product for wider distribution, companies sometimes make changes to the product that produce short-term profits but weaken the technology. Unusual deal structures may allow technology companies to signal to consumers that, notwithstanding the presence of all the bankers and lawyers, the nerds are still in charge.

Integrity brands and socially responsible brands. Credence goods have qualities that the consumer cannot fully evaluate even after purchase and consumption.²⁵² Integrity brands are brands that generate a sense of trust where the integrity or social responsibility of the firm is an important product attribute. Examples include healthcare, financial services, education, environmentally sensitive products, and organic foods.²⁵³ With these products, the quality of the goods is difficult to measure even after purchase. A shareholder in a mutual fund can easily observe cash, but not opportunities for managerial rent-seeking;²⁵⁴ a fine cup of Peet's coffee does not taste organic. The integrity and values of the managers serve as a proxy for the integrity of the process of producing the product. By signaling the integrity of the managers, deal structure can signal the quality of other attributes that are difficult to observe.

With these products, companies are not concerned about early adopters so much as other opinion leaders or information specialists. Consumers purchasing integrity products rely on information specialists such as corporate social responsibility (CSR) groups, experts, or others who have already invested the time to gather the relevant information. Lawyers and law professors, for example, are frequently asked for legal services referrals. Socially responsible mutual funds serve as reputational intermediaries to allow CSR-sensitive investors to allocate their investments in a socially responsible manner. Well-known social-responsibility brands like Ben & Jerry's and the Body Shop cultivate their consumers through their well-informed opinion leaders.²⁵⁵

252. Michael R. Darby & Edi Karny, *Free Competition and the Optimal Amount of Fraud*, 16 J.L. & ECON. 67 (1973); Phillip Nelson, *Information and Consumer Behavior*, 78 J. POL. ECON. 311 (1970); George J. Stigler, *The Economics of Information*, 69 J. POL. ECON. 213 (1961).

253. Jason Scott Johnston, *Signaling Social Responsibility: On the Law and Economics of Market Incentives for Corporate Environmental Performance* 70 (Univ. Of Penn. Law Sch. Inst. for Law & Econ, Research Paper No. 05-16, 2005), available at <http://ssrn.com/abstract=725103> ("The things that [social-responsibility-minded] consumers and investors care about—the environmental, health and safety effects of a company's operations—are what economists call credence goods, goods that the consumer (or investor) never actually learns about fully, even after buying and consuming the good (or investing in the stock)."); see also Timothy J. Feddersen & Thomas W. Gilligan, *Saints and Markets: Activists and the Supply of Credence Goods*, 10 J. ECON. & MGMT. STRATEGY 149 (2001).

254. See William A. Birdthistle, *Compensating Power: An Analysis of Rents and Rewards in the Mutual Fund Industry*, 80 TUL. L. REV. (forthcoming 2006), available at <http://law.marquette.edu/hurt/MutualFunds-Birdthistle8-24-05.pdf>.

255. E.g., Lewis D. Solomon, *On the Frontier of Capitalism: Implementation of Humanomics by Modern Publicly Held Corporations: A Critical Assessment*, 50 WASH. & LEE L. REV. 1625, 1638–63 (1993) (discussing Ben & Jerry's and The Body Shop in depth).

Information specialists who can verify firms' claims about integrity are essential to avoiding the problem of cheap talk.²⁵⁶ Ex post litigation challenging false or misleading claims is unlikely to be effective. And, as illustrated by the recent case involving Nike's statements about sweatshops, cheap talk may even be protected by the First Amendment.²⁵⁷ To make the signal credible, then, the information must be verified or certified by a third party.²⁵⁸ Like the auditors of financial statements, NGOs or other third-party verifiers can investigate the integrity of firms and pass their opinions along to consumers. The presence of these information specialists makes deal structure an appealing advertising medium.

Cult brands. There is no settled meaning to the term "cult brand." As I use the term here, I refer to products that have strong expressive value. Ritual products—products that consumers buy through small, regular purchases—lend themselves to this category. Companies that become part of a social routine, such as Coldstone Ice Cream, Starbucks and Peet's Coffee, and Krispy Kreme, may work well. Similarly, many entertainment products become a regular part of a consumer's day. ESPN, the sports network, brought a sense of journalistic integrity to sports coverage. KCRW, a public radio station in Los Angeles, rejects payola and instead offers "hand-picked" music from knowledgeable deejays.

Other cult brands include technology firms that aim to disrupt product markets by changing the user's relationship with the product. Examples include Apple (including not just the Mac but the iPod and iTunes), TiVo, Netflix, Flickr (an online photo-management site), and Facebook (a social-networking site). Using such products tends not just to improve a consumer's functional relationship with the product but also to express identification as a contrarian. Apple is anti-Microsoft, TiVo is anti-commercial television, Netflix is anti-Blockbuster, and so on. For these products, the early-adopter strategy is an obvious fit.

If this all sounds rather trendy, that's because it is. Cult brands rely on information specialists—fashion leaders or mavens—to convey the information to a broad consumer base. These fashion leaders, in order to maintain their status as leaders, must continually be on the lookout for new insights.²⁵⁹ This also leads them to consume at the upper end of the merchandise

256. See Johnston, *supra* note 253.

257. See *Kasky v. Nike, Inc.*, 45 P.3d 243, 261 (Cal. 2002), *cert granted*, 537 U.S. 1099, *cert. dismissed*, 539 U.S. 654 (2003). The case settled shortly after certiorari was dismissed as improvidently granted. See Johnston, *supra* note 253, at 111. "[I]n the absence of potential civil liability for false SR claims, it may be impossible for the 'good' SR firms to effectively distinguish themselves from the 'bad' SR firms." *Id.* at 119.

258. See *id.* at 70 (noting that nongovernmental organizations play a "crucial role" in making the CSR market).

259. GARY S. BECKER & KEVIN M. MURPHY, *SOCIAL ECONOMICS: MARKET BEHAVIOR IN A SOCIAL ENVIRONMENT* 140 (2000) ("Alert leaders recognize that their distinctive behavior is only temporary, and are on the lookout for new ways to be distinguished from the followers who are closing the gap in behavior.").

spectrum.²⁶⁰ Recall that consumers are seeking not (just) functionality, but (also) satisfaction of other social needs when they buy products.²⁶¹ Quality matters. But when a consumer's assessment of the quality of a product depends not just on intrinsic value but on what someone else thinks, strange things start to happen to demand curves and equilibrium prices. A few good (or bad) words from the right person can cause an avalanche.²⁶² With these fads and fashions, demand is unstable, oscillating wildly following even small shocks.²⁶³

* * *

In sum, companies that sell products rich in credence qualities would seem to benefit most from using deal structure as a branding mechanism, particularly if early adopters or opinion leaders are important to their marketing strategy. I offer one last example: groceries. Consumers used to have a more personal relationship with their grocers and butchers. In today's supermarkets, however, some foods have credence qualities, especially as consumers place a higher value on difficult-to-verify attributes like safety, source of origin (for example, shade-grown coffee) and organic farming methods.²⁶⁴ Whole Foods, Wild Oats, and Trader Joe's, unlike conventional supermarkets, refuse slotting allowances.²⁶⁵ Most economists consider slotting allowances, which are payments made by manufacturers to retailers for shelf space, to be a normal consequence of the competitive market for shelf space.²⁶⁶ Trader Joe's, along with Whole Foods, instead refuses these

260. *Id.* at 97 (“[L]eaders end up consuming excessively high quality merchandise in competitive markets in order to be separated from other consumers.”).

261. *Id.* (“Consumers are largely paying for image, prestige, and distinctiveness, which are social rather than material characteristics of certain products.”).

262. *Id.* at 79 (“The general conclusion is that competition in social markets may magnify small differences in perceived quality among classes of objects into very large differences in equilibrium prices.”).

263. Becker & Murphy write:

The positive slope . . . does not mean that demand in that interval rises as the price of [the] good increases, but rather that each household's willingness to pay for this good increases greatly as other households are consuming more of the good. . . . In other words, demand is unstable in this interval, and explodes up or down in response even to small shocks.

Id. at 136.

264. Johnston, *supra* note 253, at 86 (noting that consumers are willing to pay premium prices for pesticide-free organic produce and seafood that is certified to be safe).

265. Seth Lubove, *Food Porn*, FORBES, Feb. 14, 2005, at 102, available at <http://www.forbes.com/global/2005/0207/050.html>; see also RBC CAPITAL MARKETS RESEARCH REPORT, WILD OATS MARKETS, INC. 5 (2001) (on file with author). It is worth noting that Wild Oats' CEO, Perry Odak, was formerly the CEO of Ben & Jerry's. RBC CAPITAL MARKETS RESEARCH REPORT, *supra* at 8; see also Trader Joe's, How We Do Business, <http://www.traderjoes.com/about/wedobiz.asp> (last visited Mar. 20, 2006) (noting that Trader Joe's does not accept slotting fees).

266. See Benjamin Klein & Joshua Wright, *The Economics of Slotting Arrangements* (Am. Law & Econ. Ass'n Ann. Meetings, Paper No. 53, 2005), available at <http://ssrn.com/abstract=773464>; K. Sudhir & Vithala R. Rao, Slotting Allowances: An Empirical Investigation (Mar. 2004) (unpublished

arrangements, viewing them as an infringement on their commitment to provide quality products.²⁶⁷ Whole Foods also has an unusual executive-compensation policy, limiting cash compensation of executives to fourteen times the average fulltime-employee wage.²⁶⁸

CONCLUSION

It is hard to escape the world of branding. Consumers create identity from the most prosaic items. Take the humble stapler. In the movie *Office Space*, a peculiar character named Milton was unusually fond of his red stapler.²⁶⁹ After the movie achieved cult status, real-world demand for red staplers spiked. Swingline, the leading U.S. manufacturer of staplers, then started production on red staplers. It had never produced a bright red stapler before.²⁷⁰ The experience transformed not just the demand for red staplers, but Swingline's entire marketing strategy:

Now, with all the passion of a convert, Swingline says it has learned how to target younger office-product customers—it calls them “expressive consumers”—with bright-green ergonomic designs and red, white, and blue paper clips. But the company insists its changes were long in the works. “Most people have had a Swingline on their desk, looking at the name every day, year after year,” [Swingline's parent's vice president Bill] Carvell says. “People will do a lot to protect their Swingline.”²⁷¹

Now suppose Swingline proposed a company policy banning the use of efficiency consultants. It would find little support for the policy in the academic literature on labor economics or industrial organization. Economists would scratch their heads. And the lawyer charged with the task of drafting the policy would be unlikely to get the gag.²⁷² From a branding standpoint, however, the policy would make perfect sense.

manuscript, on file with author), available at <http://ssrn.com/abstract=558222>; Mary W. Sullivan, *Slotting Allowances and the Market for New Products*, 40 J.L. & ECON. 461, 463 (1997) (arguing that slotting allowances are consistent with competitive behavior).

267. Trader Joe's, *supra* note 265.

268. Whole Foods Mkt., Inc. Annual Report (Form 10-K/A), at 55 (Mar. 7, 2005), available at http://www.wholefoodsmarket.com/investor/10K-Q/2004_10KA.pdf. What is not clear from these examples, however, is whether the unusual deal structures are especially costly. Whole Foods and Trader Joe's, for example, rely heavily on store brands (“private label brands”); giving up slotting fees may not be costing them much at all.

269. OFFICE SPACE (Twentieth Century Fox 1999).

270. Geoffrey A. Fowler, *Hollywood Ending: Stapler Becomes a Star*, WALL ST. J., July 2, 2002, at B1.

271. *Id.* (quoting Bill Carvel, vice president of ACCO Brands, Inc.).

272. A subplot of *Office Space* involves a corporate downsizing conducted by two consultants, both named Bob, who are “efficiency experts.” OFFICE SPACE, *supra* note 269.

