INSTITUTIONAL INVESTING WHEN SHAREHOLDERS ARE NOT SUPREME

CHRISTOPHER GECZY
JESSICA S. JEFFERS
DAVID K. MUSTO
ANNE M. TUCKER*

ABSTRACT

Institutional investors, with trillions of dollars in assets under management, hold increasingly important stakes in public companies and fund individual retirement for many Americans, making institutional investors' behaviors and preferences paramount determinants of capital allocation. In this paper, we examine high fiduciary duty institutions' (HFDIs') response to decreased profit maximization pressure as measured by the effect of constituency statutes on HFDI investment. We ask this question, in part, to anticipate HFDIs' response to alternative purpose firms, like benefit corporations. Only with access to institutional investors' capital can alternative purpose firms gain economic significance to rival the purely for-profit corporation. In our empirical study, we ask whether decreased profit maximization pressure, as evidenced by expanded director discretion to pursue nonshareholder interests, affected HFDIs' decision to invest (or remain invested) in firms incorporated in constituency statute states because of a conflict, or perceived conflict, between fiduciary duties owed to beneficiaries and shareholders and the "other" serving interests. HFDIs, as agency investors for their shareholders and beneficiaries, are subject to strict fiduciary duties, which, among other things, explicitly disallow sacrificing monetary returns for other goals. We focus on HFDIs under the theory that any impact of fiduciary duties on investment behavior would be strongest among those subject to the strictest duties. In other words, if we were to see an effect at all between expanded duties and investment behavior, it would be most easily observable in HFDIs. Our findings also answer questions raised in earlier scholarship regarding the scope and impact of constituency statutes. In addition, our findings connect constituency statutes to the current academic debate on alternative purpose firms by identifying potential litigants and theories of recovery under the new statutes. Finally, we observe that HFDIs did not meaningfully change investment behavior in response to constituency statutes' expansion of director duties. Our empirical observations are evidence against fiduciary concerns that impede alternative purpose firms' access to public capital.

* Christopher Geczy, Academic Director, Wharton Wealth Management Initiative, Director of Jacobs Levy Equity Management Center for Quantitative Research; Jessica S. Jeffers, Ph.D. candidate, Wharton School, University of Pennsylvania; David K. Musto, Ronald O. Perelman Professor in Finance & Department Chair, Wharton School, University of Pennsylvania; Anne M. Tucker, Associate Professor of Law, Georgia State University College of Law.

I. Introduction

According to the shareholder primacy view of U.S. corporations, a corporate board's duty is to maximize shareholder value. Although debated,[1] it is a popular and influential view supported de jure through case law and de facto through the assignment of votes exclusively to shareholders. Recently, however, entrepreneurs, legislators, and investors have contemplated variations of this duty. Pressure on the shareholder wealth maximization rationale is evidenced by trends such as social and impact investing, the emergence of benefit corporations, and even the actions of some of the most notable corporations. A recent episode involving the largest U.S. corporation by market capitalization, Apple, Inc. (Apple), illustrates the resulting tension. In a March 2014 debate over Apple's environmental policies, including a plan to power its new facilities using "100% green energy," CEO Tim Cook advised, "If you want me to do things only for ROI [Return on Investment] reasons, you should get out of this stock."[2]

Whether an investor who wants Apple to focus on return on investment can, in fact, get out of the stock depends on whether the investor has delegated investment discretion to someone else. An investor who has retained discretion can heed the advice and exit the individual stock.[3] But if investment discretion has been delegated to an institution, like a mutual fund or a pension plan, then the investor cannot simply exit the stock. Thus, many investors rely on investment agents to decide whether nonmonetary goals, such as Apple's, are appropriate.

Reliance on investment agents is widespread. Institutional investors own a majority of Apple stock,[4] which is consistent with stock ownership trends for public companies generally, according to the Federal Board Flow of Funds. Absent certain external restrictions, such as those imposed by in-

---

[1] *See*, *e.g.*, Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 Harv. L. Rev. 1735, 1752 (2006) (generally asserting that director incentives to efficiently monitor the company and maximize profits provide sufficient incentives for directors to act appropriately absent frequent shareholder interference in the form of votes, disclosures, and other mechanisms); Stephen M. Bainbridge, Unocal *at 20: Director Primacy in Corporate Takeovers*, 31 Del. J. Corp. L. 769, 775–84 (2006) (describing the corporation as a "legal fiction representing the nexus of a set of contracts . . . [among] the organization's various constituencies"); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 Va. L. Rev. 247, 250–53 (1999) (describing a firm as an entity that creates unique outputs because of the inputs of various constituencies such as employees and managers and rejecting the notion of a shareholder as the owner of a corporation).

[2] Leif Johnson, *Angry Tim Cook Tells Climate Change Skeptic to Get Out of Apple Stock*, Mac Life (Mar. 3, 2014), http://www.maclife.com/article/news/angry_tim_cook_tells_climate_change_skeptic_get_out_apple_stock.

[3] We set aside for now the question of whether it would make sense to trade the stock after such an announcement, since the Efficient Market Hypothesis would suggest that any potential costs of Apple's approach would be priced into the value of the stock.

[4] *See, e.g.*, Thomson Reuters. As of December 31, 2013, 449 million of Apple's 893 million shares outstanding were held by institutions filing Form 13F with the Securities & Exchange Commission.

dex funds, institutions wield investment discretion, deciding which stocks to hold and which to sell. With this discretion comes responsibility in the form of fiduciary duties owed to the institutions' principals (for example, shareholders and other beneficiaries). These duties, if breached, expose institutions to liability. How then do institutions reconcile fiduciary duties to their investors with the discretion to invest in companies, some of which may pursue nonmonetary corporate goals?

Recent trends contribute to the significance of this question. Alternative purpose firms, including the benefit corporation, are one such trend toward social enterprise.[5] Many states have passed legislation allowing firms to register as benefit corporations, which commit to goals, putatively beneficial to society, which may conflict in the short or long run with shareholder value maximization. The legislation protects boards from liability that could otherwise follow from this conflict, such as liability from refusing to sell the firm to an acquirer who would sacrifice the socially beneficial goals. The legislation also creates new liability if the board sacrifices the stated "benefit" goals. The other trend is the growing fraction of shares held by institutions, rather than directly by households. The Federal Reserve's Flow of Funds data reports that at the end of 2013, the household sector accounted for 37% of holdings of corporate equities ($12.45 trillion of $33.67 trillion). This represents a decrease from 55% twenty years prior ($3.44 trillion of $6.30 trillion) and 84% fifty years prior ($470 billion of $560 billion).[6] Household ownership has decreased as institutional ownership has increased, reflecting the prevalence of agency investing.

Institutions' attitudes toward alternative purpose firms would be evidenced by their investment in such firms. However, this investment is difficult to observe because the firms in question are all still privately owned. Instead, we examine laws that changed the duties of public firms' directors in a similar direction. The changes we consider are those wrought by state laws known as "constituency statutes." Constituency statutes, passed as a part of widespread antitakeover legislation, authorize directors to consider other interests (that is, nonshareholder interests) in corporate actions. Other interests typically include those of employees, suppliers, creditors, and the community. A salient example of when the statutes would apply is an acquisition attempt that pays shareholders a market premium but threatens employees. Constituency statutes extend directors' discretion to fight such an

[5] A similar trend, though without the legal protections, is "B Corp certification," by which a firm verifies and advertises the strength of its commitment to a set of goals enumerated by B Lab, a private non-profit consultancy. *See The Nonprofit Behind B Corps*, B CORPORATIONS, http://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps (last visited Aug. 4, 2014). There is also the low-profit, limited liability corporation, known as an "L3C," enabled by a minority of states, which can make a profit but whose primary purpose is a social benefit. *See*, *e.g.*, Cassady V. Brewer, *Seven Ways to Strengthen and Improve the L3C*, 25 REGENT U. L. REV. 329 (2013).

[6] *Federal Reserve Statistical Release: Financial Accounts of the United States*, FED. RES. (Sept. 18, 2014), http://www.federalreserve.gov/releases/z1/current/data.htm.

acquisition, and thus create potential tension with value maximizing mandates.

The tension between constituency statutes and value maximization was the common focus and theme of the first wave of constituency statute scholarship in the late 1980s and early 1990s. Since then, interest in constituency statutes has reorganized into a second wave of scholarship linking the easing of profit-maximization pressure by these statutes to the emergence of alternative purpose firms. We introduce a third element to the debate by examining how institutional investors, particularly those subject to elevated fiduciary standards, respond to reduced pressure to maximize shareholder value.

Before testing changes in institutional investment, we verify that constituency statutes, once enacted, were enforced and therefore changed directors' duties in practice. We do this by assembling the history of case law citing constituency statutes, and then analyzing each citation to determine whether the statute expanded boards' rights to serve nonshareholder interests (as opposed to, for example, the citation merely mentioning the statute or asserting that it just restates existing rights). The enforcement review answers several first wave questions and provides some insight on how alternative purpose firm legislation may be litigated in the future by identifying potential litigants and theories of recovery. Important for our empirical question, the enforcement review also confirms the potency of constituency statutes, so we proceed to test the effect of constituency statutes on institutional investment.

Our test focuses on the investment behavior of institutional investors subject to especially strict fiduciary duties; we term this category the "high fiduciary duty institutions" (HFDIs). HFDIs include public and private pension funds, as well as endowments. What makes these institutions well-suited for our test is that for institutions within this category, sacrificing monetary returns for other goals is explicitly forbidden. Thus, we can execute our test by determining the effect of constituency statutes on HFDI investment. We do this with a "differences-in-differences" methodology where we measure the change in HFDI investment in public firms after the state of incorporation passed a constituency statute, and then contrast this change to the change in HFDI investment in firms incorporated in states that did not pass such a statute. This contrast addresses our third wave question at least in part. While constituency statutes are not a perfect substitute because they represent a smaller change to directors' duties compared to alternative purpose firms, they represent an expansion of directors' rights to consider goals other than profit maximization. Moreover, they are particularly well suited to an empirical study because (1) institutional holdings of public firms, as opposed to private firms, are easily observable due to the disclosure requirements specific to public firms; (2) the sample is large, as it comprises all public firms in all states; and (3) the timespan over which states passed these statutes—three decades—makes it unlikely that any effect observed across the statutes' passages dates would be confounded empirically by some other concurrent event.

The main empirical result of this Article is that HFDIs did not decrease their investment participation in response to the passage of constituency statutes. Thus, we have a partial answer to our question: expanding a corporation's latitude to pursue nonmonetary goals does not constitute a roadblock to institutional investment from HFDIs.

This Article contains six parts. Part II reviews the federal and state law governing HFDI investors in our focus, including the Employee Retirement Income Security Act (ERISA). In Part III, we review and catalog constituency statutes. Part IV contains the literature review of constituency statutes scholarship following the first wave's focus on takeovers and corporate social responsibility. Part IV also details the second wave of scholarship identifying constituency statutes as precursors to alternative purpose firms and providing a comparison between constituency and benefit corporation statutes. Our third wave question—does decreased profit maximization pressure deter HFDI investment—is introduced in Part IV. In Parts V and VI, we turn to the empirical portions of our study, analyzing case law citing constituency statutes in Part V, and executing and interpreting empirical tests in Part VI. We summarize and conclude in Part VII.

II. The Missing Link: Institutional Investors & Fiduciary Duties

Whether institutional investors accept or avoid legal regime changes that exert pressure on shareholder profit maximization is a missing, and necessary, component to thinking about institutional investors' response to alternative purpose firms. In this Part, we prepare to address this question by considering the main categories of institutional investors, and the duties associated with those categories.

"Institutional investor" is a broadly used term that refers generally to pooled investment entities that are professionally managed on behalf of individuals, and that invest through a variety of financial instruments.[7] We focus our discussion in this Article on institutional investors filing Form 13F with the Securities & Exchange Commission (SEC)—required for all institutional investment managers with $100 million or more in U.S.-listed equities under management and control.[8] We further narrow our scope of inquiry to pen-

---

[7] *Form 13F—Reports Filed by Institutional Investment Managers,* U.S. Sec. & Exch. Comm'n, https://www.sec.gov/answers/form13f.htm (last visited June 20, 2014) ("In general, an institutional investment manager is: (1) an entity that invests in, or buys and sells, securities for its own account; or (2) a natural person or an entity that exercises investment discretion over the account of any other natural person or entity. Institutional investment managers can include investment advisers, banks, insurance companies, broker-dealers, pension funds, and corporations."). *See also* Serdar Çelik & Mats Isaksson, *Institutional Investors as Owners: Who Are They and What Do They Do?* (OECD Corporate Governance Working Papers, No. 11, 2013), at 7–8, *available at* http://dx.doi.org/10.1787/5k3v1dvmfk42-en.

[8] U.S. Sec. & Exch. Comm'n, *supra* note 7.

sions (both public and private) and endowments, which we categorize together as HFDIs. There are additional institutional investment accounts with elevated fiduciary duties that we exclude from this study because 13F filings are grouped by the filer who may also manage lower-duty accounts, and comingled filings would obscure the role of elevated duties in our empirical study.[9]

Institutional capital is the dominant source of finance for public companies. The Organisation of Economic Co-operation and Development (OECD) reports that U.S. institutional investors control over $84 trillion in assets, of which pension funds control over $20 trillion.[10] The Federal Board Flow of Funds data indicate that institutional investors own, on average, more than 50% of all public firms in the U.S.[11] Moreover, institutional investors do not just provide capital to corporations. They also play a primary role in individual retirement savings—$23 trillion are held in various retirement plans mostly managed by institutional investors.[12] If the investment behavior of those who manage these large pools of capital is or is perceived to be limited by fiduciary duties to invest only in companies that maximize shareholder value, there are significant consequences for both firms looking to raise capital and individual investors saving for retirement.

The following discussion highlights the potential conflict between altered fiduciary duties to stakeholders of either constituency or alternative purpose firms and the unaltered fiduciary duties imposed upon institutional investors. This Part poses presently unanswered questions about institutional investors' response to changes in the profit maximization legal regime. We first review the fiduciary duties governing institutional investors and then review existing guidance regarding alternative purpose investments.

A. *Institutional Investors' Fiduciary Duties*

The law of trusts, a backbone of fiduciary duties imposed upon institutional investors,[13] calls upon a trustee to act "as a prudent investor would."[14]

---

[9] *See infra* Part II.A.1 for a description of the high fiduciary duty classification used in this Article. For example, an investment adviser may manage accounts held by a pension, which would be subject to high fiduciary duties, as well as accounts held by a wealthy individual, which would not be subject to the elevated duties. Thus, when the investment adviser files Form 13F it is reporting the holding of assets subject to mixed fiduciary duties.

[10] Çelik & Isaksson, *supra* note 7, at 8–9.

[11] John Van Reenen et al., *Innovation and Institutional Ownership*, VOX (Mar. 20, 2009) http://www.voxeu.org/article/innovation-and-institutional-ownership (citing to the Federal Board Flow of Funds). The OECD reports that institutional investors hold over $32 trillion in publicly traded equities. Çelik & Isaksson, *supra* note 7, at 8–9.

[12] Inv. Co. Inst., 2014 Investment Company Factbook 126 (54th ed. 2014), *available at* http://www.icifactbook.org/pdf/2014_factbook.pdf (reporting year end data for 2013).

[13] *See* Restatement (Third) of Trusts § 90 cmt. (a) (2007) ("Several bodies of state and federal legislation dealing with various types of charitable, pension, or public funds have for several decades incorporated rules more or less similar to the prudent investor rule. *See* § 91. The principles of this Section are generally appropriate to those statutory rules, both by analogy and when those rules incorporate general principles of trust law. Specific provisions

This standard requires, among other things, "the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust."[15] In addition, trustees' fiduciary duties require loyalty to beneficiaries, diversification of investment, and prudence in delegation of responsibilities and attention to reasonable expenses.[16] The Restatement (Third) of Trusts (the Restatement) discusses social investing but does not offer clear guidance regarding compliance with trustees' fiduciary duties.[17]

The Restatement, along with myriad federal and state statutes that govern the investment behavior of institutional investors, adopted the modern prudent investor rule that is based upon the tenets of Modern Portfolio Theory.[18] These general principles—assessing investments in the context of the portfolio rather than individually, diversifying the portfolio, and evaluating throughout the stages of the investment—infuse the standards applicable to many institutional investors.[19]

1. HFDIs

In this Article, we focus on HFDIs, which we define as pension funds, both public and private, as well as endowment funds.[20] Institutions in these categories share similar, although not identical, strict fiduciary duties.[21] Moreover, pension plans and endowment funds have distinct and observable

---

and special circumstances or relationships involved in the application of those statutory rules, however, may present different considerations. See, e.g., discussion of the ERISA statute in the Reporter's General Note."). For a concise description of the history and current status of fiduciary duties for institutional investors, *see* Jay Youngdahl, *The Basis of Fiduciary Duty in Investment in the United States*, *in* CAMBRIDGE HANDBOOK OF INSTITUTIONAL INVESTMENT AND FIDUCIARY DUTY 20–30 (James P. Hawley et al. eds., 2014).

[14] RESTATEMENT (THIRD) OF TRUSTS: GENERAL STANDARD OF PRUDENT INVESTMENT § 90 (2007).

[15] *Id.* at § 90(a).

[16] *Id.* at § 90(b)–(c).

[17] *See* David Hess, *Public Pensions and the Promise of Shareholder Activism for the Next Frontier of Corporate Governance: Sustainable Economic Development*, 2 VA. L. & BUS. REV. 221, 248 (2007).

[18] *See* UNEP FINANCE INITIATIVE, ASSET MANAGEMENT WORKING GROUP, A LEGAL FRAMEWORK FOR THE INTEGRATION OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES INTO INSTITUTIONAL INVESTMENT 102 (2005), *available at* http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf [hereinafter UNEP FINANCE INITIATIVE].

[19] *Id.*

[20] *See* Jeffery S. Abarbanell et al., *Institutional Investor Preferences and Price Pressure: The Case of Corporate Spin-Offs*, 76 J. BUS. 233, 234–35 (2003) (classifying institutional investors according to their fiduciary duty and stating that "bank trusts and pensions and endowments face the most stringent fiduciary standards"). *See generally* BENJAMIN J. RICHARDSON, FIDUCIARY LAW AND RESPONSIBLE INVESTING IN NATURE'S TRUST, 112–13 (2013) (treating banks as a distinct category because the fiduciary duty is not owed to depositors, but to the institution). Additionally, banks are subject to a strict, but distinct set of fiduciary obligations as compared to pensions and endowments. *See also* discussion *infra* Part II.B.

[21] Fiduciary duty standards under ERISA have been described as "the highest known to the law." Dudenhoefer v. Fifth Third Bancorp, 692 F.3d 410, 417 (6th Cir. 2012) (internal

classes of beneficiaries on whose behalf investments are made.[22] HFDIs also allow for cleaner testing of the effect of high fiduciary duties than do the investors categorized in the data as investment advisers, investment companies, and banks.[23] These latter categories mix accounts with different levels of fiduciary duty, and thus cloud the role of elevated fiduciary duties. Finally, if fiduciary duties present a legal obstacle for institutional investment in firms subject to increased director discretion and modified profit maximization requirements, we should see the results most significantly among this group of HFDIs. Similarly, if we find no effect for HFDIs, then our findings should logically extend to other institutions managing assets subject to similar or lower fiduciary duties.

a) Private Pensions (ERISA)

ERISA governs private defined benefit pension plans,[24] and, among other things, imposes fiduciary duties on the investment of their assets.[25] As of the end of 2013, these assets totaled $3.08 trillion.[26] Public pension plans are discussed separately below.[27] ERISA mandates five principles for fiduciaries that build upon the common law of trusts. Fiduciaries must (1) act for the exclusive benefit of beneficiaries, (2) defray reasonable expenses, (3) act in accordance with the prudent fiduciary standard, (4) diversify investments, and (5) follow plan documents and the law.[28] Additionally, fiduciaries must act in the best interest of beneficiaries, without undisclosed and unmitigated conflicts of interest or self-dealing.[29]

ERISA regulations alter the common law prudent investor standard by imposing a higher standard for the duty of loyalty by disallowing conflict of

quotation marks omitted) (citing Pfeil v. State St. Bank & Trust, 671 F.3d 585, 591 (6th Cir. 2012)).

[22] *See* RICHARDSON, *supra* note 20, at 112 ("Trusts law is particularly applicable to pension plans, which have distinct beneficiaries. Likewise, investment foundations are typically governed by trust principles.").

[23] *See, e.g.*, 12 C.F.R. § 9 (2014) (authorizing banks to operate trust departments to function as fiduciaries).

[24] *See* Anne M. Tucker, *Retirement Revolution: Unmitigated Risks in the Defined Contribution Society*, 51 HOUSTON L. REV. 153, 164–65 (2013); *see also id.* at 157 (noting that a defined benefit pension plan promises to pay a retired employee a monthly payment dependent upon the number of years of service and salary). *See generally id.* at 167–70 (discussing defined contribution plans generally).

[25] *See id.* at 163–76 (discussing the distinctions between defined benefit and defined contribution plans). Defined contribution plans are beyond the scope of this Article.

[26] *Federal Reserve Statistical Release: Financial Accounts of the United States*, FED. RES. (Sept. 18, 2014), http://www.federalreserve.gov/releases/z1/current/data.htm, Table L 117, Row 23.

[27] This Article does not discuss multiemployer collectively bargained pension plans, which are pension plans maintained by more than one employer, usually within the same or related industries, and a labor union.

[28] 29 U.S.C. § 1104 (2013).

[29] ERISA § 404(a), 29 U.S.C. § 1104(a) (2013).

interest transactions,[30] even if otherwise profitable.[31] Additionally, the duty of care under ERISA requires specialized skill, drawing the scope of reasonableness from those "acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[32] The comments to the Restatement discussing and distinguishing ERISA acknowledge "an interpretation [of ERISA] that imposes a standard of skill in investment management different from that imposed by general trust law."[33]

ERISA's broad fiduciary principles have been interpreted to govern investments by requiring that fiduciaries give appropriate consideration of "facts and circumstances" that are relevant to an investment strategy.[34] This requirement means that a fiduciary must make a determination that a given investment under consideration is "reasonably designed . . . to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment or investment course of action . . . ."[35] In other words, the fiduciary must be maximizing expected returns conditioned on the desired risk profile. Additionally, this information is weighed in conjunction with the diversification, liquidity, and projected return of a portfolio.[36]

b) Public Pensions (non-ERISA)

Similar to the pooled retirement savings discussed above, public pension funds are a form of defined benefit pension plan that are exempt from ERISA, but largely governed in reference to the Restatement[37] and the mod-

---

[30] Prohibitions on conflict of interest transactions prevent parties in interest from doing business with the defined benefit plan. Parties of interest include "the employer, the union, plan fiduciaries, service providers, and statutorily defined owners, officers, and relatives of parties-in-interest." EMPLOYMENT LAWS ASSISTANCE FOR WORKERS AND SMALL BUSINESSES ERISA FIDUCIARY ADVISOR, DEP'T OF LABOR, ARE SOME TRANSACTIONS PROHIBITED? IS THERE A WAY TO MAKE THEM PERMISSIBLE?, *available at* http://www.dol.gov/elaws/ebsa/fiduciary/q4d.htm (last visited July 24, 2014); *see also Private Pensions: Conflicts of Interests Can Affect Defined Benefit and Defined Contribution Plans*: *Testimony Before the S. Comm. on Health, Employment, Labor and Pensions, Education and Labor*, 111th Cong. (2009) (statement of Charles A. Jeszeck, Acting Director Education, Workforce, and Income Security), *available at* http://www.gao.gov/assets/130/122042.pdf.

[31] *See* RESTATEMENT (THIRD) OF TRUSTS § 90 (2007) ("Heavy emphasis in the regulations on the duty of loyalty and prohibited transactions (even for otherwise prudent, profitable investments) is understandable in this context . . . .").

[32] 29 U.S.C. § 1104 (2013). Compare this language with the following language: "reasonable care, skill, and caution, and is to be applied to investments." RESTATEMENT (THIRD) OF TRUSTS § 90 (2007).

[33] RESTATEMENT (THIRD) OF TRUSTS § 90 (2007) (Reporter's Notes).

[34] 29 C.F.R. § 2550.404a-1 (2014).

[35] *Id.*

[36] *See id.*

[37] Hess, *supra* note 17, at 247.

ern prudent investor rule, both discussed above.[38] Federal, state, and local public pension plans controlled $5.2 trillion in assets as of the end of the first quarter of 2013.[39] Fiduciary duties governing public pension funds, absent the nuances of enabling statutes,[40] are largely consistent with ERISA standards,[41] but may have fewer restrictions in some circumstances due to variations in state regulations.[42] Under state law, public pension plan fiduciaries are subject to a "prudent person" standard, including reasonable diligence in selection and monitoring investments,[43] and most jurisdictions have adopted the Uniform Prudent Investor Act (UPIA).[44] Additionally, some states enumerate permissible investments and allocation percentages.[45]

2. *Endowments & Foundation Funds*

Endowments and foundation funds maintain portfolios on behalf of charities, colleges, and universities.[46] Endowments and foundations invest with an eye toward maintaining and building an asset base to be used in pursuit of the mission of the entity. This focus distinguishes endowment and foundation funds from pension plans and other institutional investors, such as insurance companies, who primarily focus on meeting current liabilities or the present value of future liabilities.[47] Additionally, private contracting plays a role in defining the responsibility and rights of fiduciaries managing

---

[38] UNEP FINANCE INITIATIVE, *supra* note 18, at 103 (noting that forty-three states and the District of Columbia have incorporated the Uniform Prudent Investor Act into public pension fund statutes).

[39] Robert Steyer, *ICI: U.S. Retirement Assets Hit Record $20.8 Trillion*, PENSIONS & INVESTMENTS, (June 26, 2013), http://www.pionline.com/article/20130626/ONLINE/130629908/ici-us-retirement-assets-hit-record-208-trillion.

[40] *See, e.g.*, CALPERS, CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT LAW 49–51 (2014), *available at* http://www.lexisnexis.com/clients/caperlaw/CalPERS_2014.pdf.

[41] U.S. GOV'T ACCT. OFFICE, GAO-12-324, DEFINED BENEFIT PENSION PLANS: RECENT DEVELOPMENTS HIGHLIGHT CHALLENGES OF HEDGE FUND AND PRIVATE EQUITY INVESTING 6 (2012), *available at* http://www.gao.gov/assets/590/588623.pdf ("Public sector plans, such as those at the state, county, and municipal levels, are not subject to funding, vesting, and most other requirements applicable to private sector defined benefit pension plans under ERISA, but must follow requirements established for them under applicable state law. Many states have enacted standards comparable to those of ERISA.").

[42] Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 800 (1993) [hereinafter Romano, *Public Pension Fund*].

[43] Hess, *supra* note 17, at 247.

[44] *Id.*

[45] Romano, *Public Pension Fund*, *supra* note 42, at 800.

[46] *See* Hany A. Shawky & David M. Smith, *Endowment and Foundation Funds*, *in* INSTITUTIONAL MONEY MANAGEMENT: AN INSIDE LOOK AT STRATEGIES, PLAYERS, AND PRACTICES, 295, 295–96 (Hany A. Shawky & David M. Smith, eds., 2012) (discussing the distinctions between public and private foundations). *See generally* Keith L. Johnson & Stephen Viederman, *The Philanthropic Fiduciary: Challenges for Nonprofits, Foundations and Endowments*, *in* CAMBRIDGE HANDBOOK OF INSTITUTIONAL INVESTMENT AND FIDUCIARY DUTY 89–98 (James P. Hawley et al. eds., 2014) (discussing the fiduciary duties of nonprofits, foundations and endowments).

[47] *See* Shawky & Smith, *supra* note 46, at 295 (discussing the distinctions between public and private foundations).

endowments and foundation funds. The limiting hand of a governing trust document may impose additional restrictions requiring that "investments should be consistent with the charitable purpose of the institution, subject to the intent of the donor."[48]

The Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) governs the management of endowments and foundation funds.[49] Under UPMIFA, investments for foundations and endowments are subject to the general prudence standards requiring those responsible for investment allocations to act as a prudent investor would, using a modern portfolio approach in making investments and considering the risk and return objectives of the fund.[50] In other words, fiduciaries must "invest for the risk-adjusted return best suited to the organization's goals."[51] Specifically, UPMIFA Section 3(e)(1), Standard of Conduct in Managing and Investing Institutional Fund, designates the following factors as relevant fund management considerations: (1) economic conditions, (2) inflation or deflation, (3) expected tax consequences, (4) the role of decisions with regard to the fund's overall investment strategy, (5) total expected return and appreciation, (6) other resources, (7) the need to make distributions or preserve principal, and (8) potential special relationship of assets to charitable purpose.[52] There is no obligation of impartiality under UPMIFA, however, because these institutions rarely confront the conflicting interests between multiple beneficiaries.[53] Additional fiduciary duties include care, loyalty, minimized costs, investigation of investment decisions, and diversification.[54]

Nonetheless, endowments and foundations are not immune to questions of how to marry profit (return on investment) to purpose. Like other institutional investors, endowments and foundations face a host of options to serve other purposes with investment allocations. In fact, endowments and foundations may have more latitude than other institutional investors because of an ability to allocate resources to program-related investments (PRI), which is

---

[48] Daniel M. Erwin, *Academic Questions: A Practical Response to the University Endowment Crisis*, 24 Quinnipiac Prob. L.J. 43, 57 (2010).

[49] *See* Susan N. Gary, *Charities, Endowments, and Donor Intent: The Uniform Prudent Management of Institutional Funds Act*, 41 Ga. L. Rev. 1277, 1290–91 (2007) ("Some of the provisions UPMIFA adopts derive from trust law, so charitable trusts are already subject to a number of the rules set forth in UPMIFA. In a few respects, however, UPMIFA provides new rules and powers for those who manage charitable funds, and the benefits and restrictions of UPMIFA make sense for all charities, regardless of organizational form."); *see also Prudent Management of Institutional Funds Act*, Unif. L. Comm., *available at* http://uniformlaws.org/Act.aspx?title=Prudent+Management+of+Institutional+Funds+Act (last visited July 24, 2014) (showing that, as of 2014, UPMIFA has been adopted in all U.S. states and territories, with the exception of Pennsylvania).

[50] Unif. Prudent Management Inst. Funds Act §3, 7A-III U.L.A. 2 (Supp. 2007).

[51] Joel C. Dobris, *A Letter About Investing to a New Foundation Trustee, with Some Focus on Socially Responsible Investing*, 34 ACTEC J. 234, 234 (2009).

[52] Unif. Prudent Management Inst. Funds Act §3.

[53] *Id.*

[54] *Id.*

an acceptable practice recognized under the tax code.[55] Alternatively, foundations may want to make mission-related investments (MRI) or avoid mission-conflicted investments, aligning investment strategy with entity mission. Salient examples are cancer prevention charities avoiding tobacco investments and environmental charities investing in green technology. The conventional wisdom is that both PRI and MRI are potentially acceptable for foundations and charitable organizations. Investment decisions linked to risk-adjusted returns, organizational goals, investment policies and the prudent investor standards that also serve a nonmonetary purpose may be safe.[56]

3. Interpretive Guidance from the U.S. Department of Labor

The U.S. Department of Labor (DOL) has provided direct guidance to ERISA-governed institutional investors regarding the propriety of alternative investments selected for noneconomic reasons.

Amid the rise of constituency statutes and the emergence of social investing, the DOL grappled with the boundaries of fiduciary duties and standards of investment conduct for ERISA-governed retirement plans beginning in the early 1980s.[57] The lessons of these early cases, the "all things being equal rule," were that defined benefit assets could be invested in such a way as to generate collateral benefits, but only if such an investment was "equal to or superior" in risk, return, and soundness to other alternatives.[58] The first issues arose in the context of union-negotiated pension plans that contained private agreements with the employer to invest in mortgages in communities that served the union worker beneficiaries.[59] In 1981, the DOL first articulated its stance on agreements with "collateral benefits" to participants, cautioning "a fiduciary could not take a course of action

[55] *See* Dobris, *supra* note 51, at 238–40; *see also* 26 U.S.C. § 4944(c) (2013); Treas. Reg. § 53.4944-3 (1972).

[56] *See* Dobris, *supra* note 51, at 240–41.

[57] *See* Ian D. Lanoff, *The Social Investment of Private Pension Plan Assets: May It Be Done Lawfully under ERISA*, 31 LAB. L.J. 387, 389 (1980) ("It is not consistent with the prudence standard for the fiduciary to make his or her investment decision based on other objectives, such as to promote the job security of a class of current or future participants."). *But see generally* Ronald B. Ravikoff & Myron P. Curzan, *Social Responsibility in Investment Policy and the Prudent Man Rule*, 68 CALIF. L. REV. 518 (1980) (positing that social investments may be consistent with defined benefit fiduciary duties if fiduciaries may consider current retirees and employees and if future beneficiaries may authorize nontraditional investments).

[58] Jayne Elizabeth Zanglein, *Protecting Retirees While Encouraging Economically Targeted Investments*, 5 KAN. J.L. & PUB. POL'Y, 47, 49 (1996) ("The Department of Labor's position under the direction of Lanoff became known as the 'all things being equal' test."); *see also id.* at 48–50 ("Each of Lanoff's successors has taken a similar position."). *See generally id.* (reviewing subsequent Pension and Welfare Benefits Program appointees' views on noneconomic factor investments and fiduciary standards).

[59] *See, e.g.*, Lapinski, 1981 WL 314491 (Dep't of Labor, Pension and Welfare Benefits Administration Aug. 3, 1981); Katz, 1985 WL 32830 (Dep't of Labor, Pension and Welfare Benefits Administration Oct. 23, 1985).

which would not be the most advantageous economically to the plan."[60] However, the DOL concluded that noneconomic factors may be a decisive factor between two "equally advantageous" investments.[61]

In confronting a similar issue of specified investments with collateral benefits to beneficiaries, the DOL warned that where fiduciaries "forego other alternative investment opportunities," the prudence standard cannot be met if the investment provides investors with "less return, in comparison to risk, than comparable investments available to the plan, or if it involved a greater risk to the security of plan assets than other investments offering a similar return."[62] In other words, noneconomic factors cannot dictate investment decisions, "unless the investment, when judged solely on the basis of its economic value to the plan, would be equal or superior to alternative investments available to the plan."[63] When revisiting this issue for a third time, the DOL reiterated its reasoning, but softened its conclusion stating:

> [ERISA allows for] plan fiduciaries to follow an investment course of action that reflects non-economic factors, so long as application of such factors follows primary consideration of a broad range of investment opportunities, and the investment course of action ultimately taken is as at least as economically advantageous as any alternative course of action.[64]

Later, the DOL elaborated on its position on collateral benefit agreements stating that "arrangements designed to bring areas of investment opportunity which provide collateral benefits to the attention of plan fiduciaries will not in and of themselves violate sections 403 or 404, where the arrangements do not restrict the exercise of the fiduciary's investment discretion."[65]

In 1994, the DOL issued an interpretive bulletin about ERISA fund investment in economically targeted investments (ETI).[66] The DOL wanted

---

[60] Lapinski, 1981 WL 314491 (Dep't of Labor, Pension and Welfare Benefits Administration Aug. 3, 1981) 3.

[61] *Id.*

[62] Katz, 1985 WL 32830 (Dep't of Labor, Pension and Welfare Benefits Administration Oct. 23, 1985) 1.

[63] *Id.* at 2.

[64] Cohen, 1993 WL 1370527 (Dep't of Labor, Pension and Welfare Benefits Administration May 14, 1993) 3 (noting that at issue in the UAW plan was a private agreement for GMC to invest up to five percent in mortgage investments and for UAW to submit a list of up to seven restricted investment companies whose policies, including involvement in South Africa, were objectionable on noneconomic grounds); *see also* Ridella, Opinion No. 88-16A, 1988 WL 222716 (Dep't of Labor, Office of Pension and Welfare Benefit Programs Dec. 19, 1988) 3 ("A decision to make an investment may not be influenced by noneconomic factors unless the investment, when judged solely on the basis of its economic value to the plan, would be equal or superior to alternative investments available to the plan.").

[65] Interpretive Bulletin Relating to the Employee Retirement Income Security Act of 1974, 59 Fed. Reg. 32,606, 32,606 (Dep't of Labor June 23, 1994) (to be codified at 19 C.F.R. pt. 2509) 2.

[66] *Id.* at 1 (stating that "nothing in ERISA precludes trustees and investment managers from considering ETIs in constructing plan portfolios.").

to counter the perception that ETIs are incompatible with ERISA fiduciary obligations.[67] In doing so, it restated the standards of equal economic advantage and commensurate risk and returns.[68] The DOL highlighted its permissive view of noneconomic goals, but ultimately concluded that "fiduciaries who are willing to accept expected reduced returns or greater risks to secure collateral benefits are in violation of ERISA."[69]

At the beginning of the social investing debate, there was no empirical data to support or debunk the assertion that social investments were comparable to traditional investments. In the intervening thirty years since the social investing debate began, academics and industry professionals have striven to quantify the value of social investing, often with mixed results. In June 2012, Deutsche Bank Climate Change Advisors published a meta-analysis of 100 existing academic studies, examining the correlation between firm value and the many branches of noneconomic investment strategies including sustainable investing, socially responsible investing (SRI), and screening for ESG —environmental, sustainability, and governance factors.[70] They found that 89% of high ESG companies "exhibit[ed] market-based outperformance" and 85% "exhibit[ed] accounting-based outperformance" of the market.[71] Additionally, however, the survey found that 88% of SRI funds reported neutral or mixed results, concluding that "SRI fund managers have struggled to capture outperformance in the broad SRI category but they have, at least, not lost money in the attempt."[72] By contrast, a 1994 study reported a one percent drop in investment returns for public-sector pension plans with ETI requirements as compared to plans without such a requirement.[73] Also in a 2005 paper, Christopher Geczy, Robert F. Stambaugh & David Levin characterized the cost of socially responsible screening for portfolios of mutual funds.[74] They found that in the case of investors focusing on market indexing, the cost of forming a portfolio of socially screened funds was likely to be low.[75] However, the cost of social screening rose substantially when investors sought diversification by incor-

---

[67] *See id.* at 2.

[68] *See id.* at 3–4.

[69] *Id.* at 6.

[70] *See Sustainable Investing: Establishing Long-term Value and Performance*, Deutsche Bank Climate Change Advisors 1–72 (June 2012), *available at* https://institutional.deutscheawm.com/content/_media/Sustainable_Investing_2012.pdf. Note that the cited meta-analysis does not generate its own data set, but rather uses the data reported in existing academic studies.

[71] *Id.* at 5.

[72] *Id.* at 5–6.

[73] Thomas A. Smith, *Institutions and Entrepreneurs in American Corporate Finance*, 85 Cal. L. Rev. 1, 32 (1997) (citing Olivia Mitchell & Ping Lung Hsin, *Public Pension Governance and Performance* 5, 15–16 (Pension Research Council Working Paper Series, No. 94-1, 1994)).

[74] *See generally* Christopher Geczy, Robert F. Stambaugh & David Levin, Investing in Socially Responsible Mutual Funds (Oct. 2005) (unpublished manuscript), *available at* http://ssrn.com/abstract=416380.

[75] *Id.* at 2.

porating different investment styles or when investors believed strongly in manager skill.[76] The lesson of these studies is that although there may conceivably be support for a fiduciary to consider a socially-driven investment as a comparable investment satisfying fiduciary obligations, the evidence is mixed.[77] There is no safe harbor for these types of investments, only an argument that allocations in social investments may satisfy ERISA's duty of care requirements.[78] In the intervening thirty years since the debate began, institutional investors, including ERISA fiduciaries, have accelerated through the DOL's guarded green light on social and impact investing. Sustainable and responsible investing now account for an estimated 11% of assets under management in the U.S., or over $3.3 trillion, an increase of 486% since 1995.[79] CalPERS is an example of an active public pension fund with established social investing programs devoting $600 million to environmental technology initiatives[80] and a robust program on sustainable investments targeting physical, financial, and human capital.[81]

4. *Other Studies and Considerations for HFDIs*

While an institution's latitude to engage in social investing is relevant to our inquiry, it is not dispositive to our question of whether fiduciaries can allocate investment assets to firms with latitude to serve goals other than shareholder value. Social investing is a question of voluntary business preferences and models, whereas constituency statutes and alternative purpose firms alter the legal landscape by changing directors' duties. Nonetheless, DOL regulatory interpretations and subsequent empirical work suggest a permissive environment for institutional investors, including HFDIs, to allocate to such firms, provided that their prospects are comparable in terms of risk and expected return.

---

[76] *Id.*

[77] Although a wide range of literature examines how sustainability factors might impact risk and return for long-term investors like CalPERS, there is a lack of consensus about definitions and evidence. CalPERS, Towards Sustainable Management & Operations, Making Progress (2014), *available at* http://www.calpers.ca.gov/eip-docs/about/pubs/esg-report-2014.pdf; s*ee also* Zanglein, *supra* note 58, at 52 ("The question is: are things ever really equal? Economists tell us that risk and return can be quantified and compared, but are any two economically targeted investments ever really equal?").

[78] *See* 29 U.S.C.A. § 1104 (2013); *see also* Restatement (Third) of Trusts § 90 (2007) ("[The general standard of prudent investment] requires the exercise of reasonable care, skill, and caution, and is to be applied to investments.").

[79] Rob Zozlowski, *$3.7 Trillion Now Following SRI, Survey Finds*, Pensions & Investments (Nov. 14, 2012), http://www.pionline.com/article/20121114/ONLINE/121119957/37-trillion-now-following-sri-survey-finds (citing USSIF, *Report on Sustainable and Responsible Investing Trends in the United States*, USSIF 11 (2012), http://www.ussif.org/files/Publications/12_Trends_Exec_Summary.pdf).

[80] *PE Environmental Technology Program*, CalPERS.ca.gov (Nov. 13, 2012), http://www.calpers.ca.gov/index.jsp?bc=/investments/environ-invest/pe-environ-tech-prog/home.xml.

[81] *See* CalPERS, Towards Sustainable Management, *supra* note 77, at 4–5.

Since the adoption of antitakeover legislation, including constituency statutes, several studies have examined the relationship between constituency statutes and performance, as well as the correlation between institutional fiduciary duties and investment strategies. Two studies found a correlation between stock performance and constituency statutes, antitakeover legislation, or both. A 1997 study analyzed the effect of constituency statutes on the returns of firms incorporated in three states—New York, Indiana, and Ohio—that passed constituency statutes in isolation of other takeover defenses and found negative abnormal returns.[82] In a 1990 study examining stock price, Jonathan M. Karpoff and Paul H. Malatesta found that share prices of Pennsylvania companies underperformed the S&P 500 by an average of 6.9% after antitakeover legislation was publicized and introduced in the House.[83] Other studies document a negative correlation between antitakeover statutes and other performance metrics beyond the stock price. For example, a 2013 study found a correlation between the passage of antitakeover statutes and an increase in innovation, as measured by patent applications and citations, and firm value, based on the market-to-book ratio.[84] In addition, a 2001 study found a correlation between institutional investor fiduciary duty and investment strategy, establishing a relationship between strict fiduciary duties, such as those of pensions, and a preference for near-term earnings over long-term earnings.[85]

An institutional portfolio manager's concern about an investment's future performance can be distinct from her concern about the investment's "fiduciary appropriateness." For example, if firm A is free to pursue non-shareholder interests but B is not, then even if the manager considers their return prospects to be identical, she may choose B over A out of concern that an investment in A carries extra litigation risk. On the other hand, she might believe that directorial freedom affects the firm's prospects, either positively or negatively. Some empirical studies find higher innovation and firm value

---

[82] John C. Alexander, Michael F. Spivey & M. Wayne Marr, *Nonshareholder Constituency Statutes and Shareholder Wealth: A Note*, 21 J. BANKING & FIN. 417 (1997).

[83] Nell Minow, *Shareholders, Stakeholders, and Boards of Directors*, 21 STETSON L. REV. 197, 221 (1991) (citing Jonathan M. Karpoff & Paul H. Malatesta, *Evidence of State Antitakeover Laws*, U. WASH. SCH. BUS., July/Aug. 1990, at 1).

[84] *See* Julian Atanassov, Corporate Governance, Non-Financial Stakeholders, and Innovation: Evidence from a Natural Experiment 8, 24 (June 30, 2013) (unpublished manuscript), *available at* http://ssrn.com/abstract=2181766; Caroline Flammer & Aleksandra Kazperszyk, The Impact of Stakeholder Orientation on Innovation: Evidence from a Natural Experiment, (Aug. 2014) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2353076 (finding that innovation increases as corporations incorporate non-shareholder interests as evidenced by the passage of constituency statutes); *see also* Jonathan Karpoff & Michael D. Wittry, Test Identification With Legal Changes: The Case of State Antitakeover Laws, (Sept. 2014) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2493913 (arguing that constituency statutes are part of a bundle of antitakeover legislation that impair natural event studies focusing on these laws in a vacuum from the other laws passed in conjunction with or as precursors to constituency statutes).

[85] Brian J. Bushee, *Do Institutional Investors Prefer Near-Term Earnings over Long-Run Value?* 18 CONTEMP. ACCT. RES. 207, 240 (2001).

after constituency laws are passed,[86] while other studies argue that antitakeover measures, such as business combination laws[87] or charter amendments,[88] impede firm performance.

The relationship between a firm's investment prospects and its fiduciary obligations depends to some extent on the validity of the Efficient Market Hypothesis (EMH).[89] Under the EMH, expectations about a firm, including expectations arising from any latitude not to serve shareholders, are captured in its share price. To the extent this is true, a buyer is compensated through a discounted share price at the point of purchase for any expected shortfall in shareholder value maximization. This would be nearly economically equivalent to investing in a firm discounted by the market because its management is regarded as inferior to competitors at serving shareholders, as opposed to a firm whose managers are authorized or mandated to serve other constituencies or goals. But despite the economic similarity, the legal ramifications could be quite different, since a drop in firm A's stock price could arguably reflect A's latitude to not maximize shareholder value. Thus, even if the HFDI believes that, all else equal, the return prospects of firm A match or maybe even exceed those of firm B, given the current market price, the HFDI might choose to avoid firm A because of the litigation threat if the investment does not perform well.

Thus, strict fiduciary duties impart litigation risk that may discourage investment in firms with the right or duty to pursue alternative goals, even if the stock price discounts for this right or duty. The strict duties of HFDIs thus present a prime opportunity to test whether this discouragement is a significant force on investment.

B. Other Institutional Investors

The other institutional investor categories in the 13F data are banks,[90] insurance companies, investment companies,[91] and investment advisers.[92] We

---

[86] *See* Atanassov, *supra* note 84; Flammer & Kazperszyk, *supra* note 84.

[87] *See*, *e.g.*, Marianne Bertrand & Sendhil Mullainathan, *Enjoying the Quiet Life? Corporate Governance and Managerial Preferences*, 111 J. Pol. Econ. 1043–75 (2003).

[88] *See*, *e.g.*, Anup Agrawal & Gershon N. Mandelker, *Large Shareholders and the Monitoring of Managers: The Case of Antitakeover Charter Amendments*, 25 J. Fin. & Quantitative Analysis 143 (1990).

[89] *See generally* Eugene F. Fama, *Efficient Capital Markets: II*, 46 J. Fin. 1575, 1575–76 (1991) (explaining the efficient market hypothesis).

[90] S*ee generally* Richard Scott Carnell, Jonathan R. Macey & Jeffrey P. Miller, The Law of Banking and Financial Institutions 34–39 (4th ed. 2009) (discussing the legal and functional definition of banks); Gail Rolland, Market Players: A Guide to the Institutions in Today's Financial Markets 4–6 (2011) (also discussing the legal and functional definition of banks).

[91] S*ee* Lee Gremillion, Mutual Fund Industry Handbook: A Comprehensive Guide for Investment Professionals 3–5 (2005) (discussing the different types of mutual funds including open- and closed-end funds and unit investment trusts).

[92] 15 U.S.C. §80b-2(11) (2013) (defining investment adviser as "any person [or firm, per §80b-2(16)] who, for compensation, engages in the business of advising others, either directly

exclude these categories because the institutions within them are not all held to strict fiduciary duties. We will refer to these excluded institutional investors as "other fiduciary institutional investors" (OFII). In this Part we outline the duties that attach to this category of institutions.

OFII are governed by a variety of state and federal laws and regulations.[93] Banks,[94] investment companies,[95] and investment advisers[96] are subject to various versions of the duty of loyalty, including the ERISA standard if the OFII manages ERISA-governed assets. For example, insurance companies may not be subject to an undivided duty of loyalty,[97] but rather a duty of good faith and fair dealing.[98] OFII are also subject to duty of care standards,[99] but the establishment of those standards varies within the industry. The duty of care requirements of insurance companies and investment companies are often determined by private contract, such as insurance policies,[100]

---

or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities" and listing entities, including certain brokers and banks, excluded from the definition of investment adviser).

[93] *See* Office of the Comptroller of the Currency, The Director's Book: The Role of a National Bank Director 77–92 (2013), *available at* http://www.occ.gov/publications/publications-by-type/other-publications-reports/The-Directors-Book.pdf (providing examples of the regulations that apply to banks); *see also* Richard A. Witt, *Insurance Companies: A Practitioner's Perspective*, *in* Institutional Money Management: An Inside Look at Strategies, Players, and Practices 327, 341–42 (David M. Smith & Hany A. Shawky eds., 2012) (discussing the state regulatory system for insurance companies). *See generally* U.S. Sec. & Exch. Comm'n, Study on Investment Advisers and Broker-Dealers: As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act 32 (2011) [hereinafter SEC 913 Study] (describing the regulation of investment advisers and broker-dealers).

[94] *See* Federal Reserve Board, Commercial Bank Examination Manual § 5000.1 (2014) (describing bank fiduciary duties); Office of the Comptroller of the Currency, *supra* note 93, at 78 (describing the duty of loyalty).

[95] *Frequently Asked Questions About Mutual Fund Directors*, Investment Company Institute, http://www.ici.org/faqs/faq/ci.faq_fund_gov_idc.idc (last visited June 18, 2014) (describing the duty of loyalty as requiring directors to avoid self-dealing and conflicted transactions); *see also* Investment Company Act of 1940, 15 U.S.C. §§ 80a-1–80a-64 (2013).

[96] SEC 913 Study, *supra* note 93, at 32.

[97] *See Frequently Asked Questions About Mutual Fund Directors*, *supra* note 95; *see also* 15 U.S.C. §§ 80a-1–80a-64 (2013).

[98] William T. Barker, Paul E.B. Glad & Steven M. Levy, *Is an Insurer a Fiduciary to Its Insureds?*, 25 Tort & Ins. L.J. 1, 2–3 (1989) ("An insurer's obligations to its insured are those imposed by the express terms of its policy, plus an implied obligation of good faith and fair dealing that includes certain elements of fiduciary duty.") Insurance company fiduciary duties do not require the undivided loyalty mandated in other trust relationships, but allow an insurer to consider its own interests in performing the terms of the contract "so long as it gives 'at least as much consideration to the welfare of its insured as it gives its own interests' and refrains 'from doing anything to injure the right of the [insured] to receive the benefits of the agreement.'" *Id.* (citing Egan v. Mut. of Omaha Ins. Co., 24 Cal. 3d 809, 818 (Cal.1979)).

[99] For banks, the duty of care requires good faith, prudence, and sufficient knowledge. Office of the Comptroller of the Currency, *supra* note 93, at 78; *see also Frequently Asked Questions About Mutual Fund Directors*, *supra* note 95 (discussing the duty of good faith for investment companies and director requirements); 15 U.S.C. §§ 80a-1–80a-64 (2013).

[100] Barker, Glad & Levy, *supra* note 98, at 2 (establishing that the robust role of private agreements alters the fiduciary relationship between the insurance company and policy holders).

prospectuses,[101] and laws, such as the Investment Company Act of 1940 (ICA). Banks and investment companies are organized around a corporate governance model[102] and also incorporate elements similar to a business judgment rule standard of review.[103]

Additionally, each OFII has unique attributes shaping its agency investment relationship with its principals or shareholders. For example, bank directors swear an oath to act diligently and honestly, and to uphold the law.[104] Insurance company director actions and allocations are shaped by liquidity[105] and credit rating concerns.[106] Investment companies, subject to board independence requirements,[107] may also be sensitive to credit ratings[108] and performance, as well as have certain asset allocation prohibitions against speculative investments under the ICA.[109] Finally, institutional investors classified in our data as investment advisers and subject to the Investment Advisers Act are subject to additional requirements obliging them to know their clients' risk and portfolio preferences and offer suitable advice.[110]

---

[101] Gremillion, *supra* note 91, at 61–66.

[102] *See, e.g.*, Anita Krug, *Investment Company as Instrument*, 86 S. Cal. L. Rev. 263, 266 (2013).

[103] The business judgment rule—a presumption that directors acted in accordance with fiduciary duties—may protect the actions of bank directors from judicial review, similar to the protections offered to other corporate directors. *See, e.g.*, Stephen M. Bainbridge, Corporate Law 96–102 (2nd ed. 2009); *see also* UNEP Finance Initiative, *supra* note 18, at 104.

[104] 12 U.S.C. § 73 (2013). "When directors are appointed or elected, they are required to take an oath under 12 U.S.C. § 73. The oath states that they will, so far as the duty devolves on them, diligently and honestly administer the affairs of such association and will not knowingly violate or willingly permit to be violated any provisions of banking law." Office of the Comptroller of the Currency, *supra* note 93, at 77. Furthermore, "[t]he duty of loyalty requires that directors exercise their powers in the interests of the organization and its stockholders . . . [and that they] must be independent, meaning they can consider the transaction on its merits, free from any extraneous influences." *Id.* at 78; *see also* 12 U.S.C. §§ 371, 375 (2013); 12 C.F.R. §§ 215, 223 (2014).

[105] UNEP Finance Initiative, *supra* note 18, at 103. Insurance companies are authorized to invest in the full range of asset classes, but in practice the mandate to preserve liquidity favors a conservative approach (to invest, for example, in government bonds). *See* Witt, *supra* note 93, at 337.

[106] Additionally, while not bound by traditional fiduciary duties comparable to other institutional investors, insurers' investments are constructed with an eye toward maintaining a favorable credit rating from one of the three major rating agencies. *See* Witt, *supra* note 93, at 337.

[107] For example, seventy-five percent of investment company directors must be independent. 17 C.F.R. § 270.0-1(a)(7)(i) (2014).

[108] Gremillion, *supra* note 91, at 74–75.

[109] UNEP Finance Initiative, *supra* note 18, at 103.

[110] On the investment side, advisers must provide suitable investment advice recommending products based upon the "client's financial situation and investment objectives." SEC 913 Study, *supra* note 93, at 27–28.

III. Constituency Statutes—The Last 30 Years

As discussed in legal scholarship in the early 1990s,[111] the merger boom of the 1980s and resulting litigation set the stage for state antitakeover legislation, including constituency statutes.[112] Antitakeover legislation included first generation antitakeover statutes, which the Supreme Court rejected, and second generation antitakeover statutes, which the Supreme Court upheld.[113] This resulted in the modern versions of control share[114] and business combination statutes,[115] among other mechanisms. Constituency statutes were also included in the antitakeover arsenal. Only constituency statutes specifically

---

[111] *See, e.g.*, Comm. on Corp. Laws, *Other Constituencies Statutes: Potential for Confusion*, 45 Bus. Law. 2253 (1990) (documenting constituency statute passage between 1983 and 1990). *See generally* Alfred F. Conrad, *Corporate Constituencies in Western Europe*, 21 Stetson L. Rev. 73 (1991) (discussing the European experience with constituency statutes, particularly focusing on German and the United Kingdom).

[112] The "merger mania of the 1980s" sparked a debate about corporate social responsibility and efforts to curb the externalities experienced by employees and communities following a hostile takeover. *See, e.g.*, Ronn S. Davids, *Constituency Statutes: An Appropriate Vehicle for Addressing Transition Costs*?, 28 Colum. J.L. & Soc. Probs. 145, 150 (1995); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 175–76, 182 (Del. 1986) (establishing directors auctioneering duties in the context of a sale of a company). For a discussion of the interplay between the Revlon standards and constituency statutes, see *infra* note 211 and accompanying text.

[113] *See* Edgar v. MITE Corp., 457 U.S. 624, 646 (1982) (finding that these first generation antitakeover statutes presented an unconstitutional burden on interstate commerce); CTS Corp. v Dynamics Corp. of America, 481 U.S. 69, 94 (1987) (upholding an Indiana control share antitakeover statute against Commerce Clause and preemption challenges). Following the *Mite* decision, thirty-six states enacted antitakeover statutes as a part of state securities laws, supplementing disclosure requirements under the Williams Act and requiring fairness determinations by the state securities commissioners. *See* Manning Gilbert Warren, III, *Developments in State Takeover Regulation:* MITE *and Its Aftermath*, 40 Bus. Law. 671, 671 n.3 (1985) (listing the thirty-six jurisdictions that passed first generation takeover statutes); *see also* Roberta Romano, *The Political Economy of Takeover Statutes*, 73 Va. L. Rev. 111, 112 (1987) (describing first generation statutes) [hereinafter Romano, *Political Economy*]. In the wake of the ruling, states adopted second generation antitakeover statutes that focused on amendments to corporate charters rather than changes to state securities laws and corrected other structural flaws such as approval vested in shareholders not state securities commissioners. Since the constitutional green light in *CTS*, thirty-nine jurisdictions have passed control share or business combination statutes as specific antitakeover mechanisms. *See infra* Appendix B. For a discussion of second and third generation (control share and business combination statutes, respectively) takeover defenses, *see* Davids, *supra* note 112, at 164–65; *see also* Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 Tex. L. Rev. 579, 587–89 (1992).

[114] Control share statutes restrict the voting rights of an entity acquiring a controlling block of shares absent approval by shareholders of the issuing (target) corporation. *See CTS*, 481 U.S. at 73–74; *see also* Romano, *Political Economy*, *supra* note 113, at 116 ("A sympathetic view of the statute's approval requirement is that by partially conforming stock purchases to the existing requirements for asset purchases or mergers, it moves the corporation code in the direction of treating different modes of acquisitions uniformly.").

[115] Business combination statutes, on the other hand, broadly prohibit most mergers and acquisitions absent approval by the target corporation's board or until after a period of time, usually two to three years, elapses. These statutes also limit an acquirer's ability to complete the second part of the two-step merger requiring additional shareholder approval or a fair price. *See, e.g.,* Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 Geo. Wash. L. Rev. 14, 38 n.131 (1992); Del. Code Ann. tit. 8, § 203.

addressed directors' fiduciary duties to shareholders and therefore are the exclusive focus of this paper.[116]

The language of constituency statutes was found first in company charter amendments authorizing boards of directors to consider a range of factors including the later common statutory factors of employees, suppliers, customers and "others" when defending against takeovers.[117] Constituency statutes were quickly and widely adopted after Pennsylvania's initial legislation in 1983,[118] with thirty-three total jurisdictions including similar language today.[119] Early and aggressive adopters were located in the rust belt because "[v]oters in these states believed that the takeover 'market for corporate control' caused a geographic redistribution of wealth out of the state and an attendant loss of in-state employment."[120] Texas is the latest state to adopt constituency language, amending its director duties provision in 2003, which became effective in 2006.[121]

Constituency statutes garnered academic attention as a continuation of the original corporate social responsibility debate first sparked by Adolf Berle and E. Merrick Dodd in the 1930s.[122] Others viewed constituency stat-

---

[116] *See generally* Michal Barzuza, *The State of State Antitakeover Law*, 95 VA. L. REV. 1973 (2009) (describing how antitakeover statutes alter directors' duties in takeover situations and documenting departures from Delaware case law established in *Revlon*, *Unocal* and *Blasius*). We distinguish our work from the projects described by Karpoff & Wittry, *supra* note 84, because the institutional features that "complicate" the use of antitakeover statutes for event studies do not apply when constituency statutes are studied solely for their change in director's fiduciary duties, which is what we do in this Article.

[117] Orts, *supra* note 115, at 20.

[118] Comm. on Corp. Laws, *supra* note 111, at 2261.

[119] *See infra* Appendix A.

[120] Davids, *supra* note 112, at 154.

[121] *See* TEX. BUS. ORGS. CODE ANN.§ 21.401(b) (West 2006). Specifically, in 2006, Section 21.401 was amended to state: "In discharging the duties of director under this code or otherwise and in considering the best interests of the corporation, a director may consider the long-term and short-term interests of the corporation and the shareholders of the corporation, including the possibility that those interests may be best served by the continued independence of the corporation." *Id.* In 2013, the statute was revised, changing the phrase "a director may" to "a director is entitled to." TEX. BUS. ORGS. CODE ANN.§ 21.401 (West 2013). Additionally, in 2013 subsection (e) was added, stating that "[n]othing in this section prohibits or limits a director or officer of a corporation that does not have a social purpose specified as a purpose in the corporation's certificate of formation from considering, approving, or taking an action that promotes or has the effect of promoting a social, charitable, or environmental purpose." *Id.*

[122] The original corporate social responsibility debate occurred between Professors Adolf A. Berle Jr. and E. Merrick Dodd, Jr. over the evolving composition of corporations, their resulting role in society, and the appropriate limitations on director authority. *See* Adolf A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931) (arguing that in light of the separation of ownership from control, directors must exercise their powers for the benefit of shareholders); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. Rev. 1145, 1148 (1932) (responding that shareholders are absentee owners whose interests could be subjugated to other corporate constituencies like employees, customers and the general public); *see also* Adolf A. Berle, *The 20th Century Capitalist Revolution*, 41 VA. L. REV. 169 (1954) (conceding that the argument was settled in favor of Professor Dodd).

utes as a potentially powerful defensive tool for management.[123] Still others considered these statutes as "potentially revolutionary" and threatening to the shareholder wealth maximization principle because they "explicitly permit directors to consider the effects of their decisions on a variety of nonshareholder interests."[124]

The following discussion catalogs the history and components of constituency statutes. Part IV describes the subsequent litigation invoking such statutes and affirming the expansion of director discretion enacted by such statutes.

A. Constituency Statute Components

Constituency statutes expand the protection of the business judgment rule[125] by permitting, not mandating, directors to consider nonshareholder constituents. In other words, directors would not face liability for actions justified, in part, by serving nonshareholder interests. Appendix A contains a complete list of the thirty-three jurisdictions with constituency statutes and code citations.[126] Constituency statutes often contain language similar to New Jersey's statute:

> In discharging his duties to the corporation and in determining what he reasonably believes to be in the best interest of the corporation, a director may, in addition to considering the effects of any action on shareholders, consider any of the following: (a) the effects of the action on the corporation's employees, suppliers, creditors and customers; (b) the effects of the action on the community in which the corporation operates; and (c) the long term as well as the short-term interests of the corporation and its shareholders, including the possibility that these interests may best be served by the continued independence of the corporation.[127]

[123] Orts, *supra* note 115, at 24 (explaining that it was not universally accepted that constituency statutes were a part of an identified corporate social responsibility effort, but were viewed as being "born legislatively as part-and-parcel of the spate of state antitakeover statutes passed in the 1970s and 1980s").

[124] Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 973 (1992).

[125] *See*, *e.g.,* BAINBRIDGE, *supra* note 103, at 96–102.

[126] *See infra* Appendix A. We note that Professor Barzuza reports that thirty-five jurisdictions adopted constituency statutes, including both Virginia and North Carolina. *See* Barzuza, *supra* note 116, at 1989. We exclude those jurisdictions from our review because North Carolina's statute merely states that directors' duties have not changed and Virginia's statute only recognizes that "continued independence" may be a factor in making merger determinations. *See* N.C. GEN. STAT. § 55-8-30(d) (2014); VA. CODE ANN. § 13.1-727.1 (2014).

[127] N.J. REV. STAT. § 14A:6-1 (2014).

1. *Defining Nonshareholder Interests*

Nearly all constituency statutes—thirty-two out of thirty-three—define nonshareholder interests as including the interests of customers, employees, and communities.[128] With the exception of New York, all jurisdictions also authorize the consideration of suppliers.[129] Additionally, twenty-two jurisdictions authorize directors to consider the interests of creditors.[130] The "long-term interests" of the corporation are also an appropriate consideration in twenty-four jurisdictions.[131] Some statutes include nonshareholder interests relating to society or the economy, or both (in sixteen jurisdictions),[132] the continued independence of the company (in nineteen jurisdictions),[133] and "other" factors (in fifteen jurisdictions).[134]

2. *When Expanded Considerations Are Appropriate*

First, most constituency statutes establish a permissive grant of authority, meaning that directors may, but are not required to, consider nonshareholder interests.[135] Idaho provides a slight deviation from the permissive grant, stating that directors shall consider long-term interests and continued independence of the corporation, but other constituency consider-

---

[128] *See infra* Appendix A. Texas's language does not include the familiar language of customers, employees and communities. The Texas statute instead focuses on the long term interests of the corporation and the shareholders, any social purpose established in the articles of incorporation, and any action "that promotes or has the effect of promoting a social, charitable, or environmental purpose." TEX. BUS. ORGS. CODE ANN. § 21.401(b)–(e).

[129] N.Y. BUS. CORPS. LAW § 717(b) (McKinney 2013).

[130] *See infra* Appendix A. The following states' constituency statutes do not authorize creditor consideration: Florida, Idaho, Illinois, Indiana, Maine, Missouri, Nebraska, Oregon, Tennessee, and Wisconsin.

[131] *See infra* Appendix A. The following states' constituency statutes do not explicitly authorize long-term interests: Georgia, Indiana, Louisiana, Maine, Maryland, Missouri, Nebraska, Tennessee, and Wisconsin.

[132] Twelve jurisdictions authorize the consideration of society and the economy: Florida, Hawaii, Kentucky, Louisiana, Massachusetts, Mississippi, Missouri, Nevada, North Dakota, Ohio, Oregon, and Vermont. The Connecticut constituency statute only names "society" as an interest. New Mexico, South Dakota, and Wyoming only name "the economy" as an appropriate consideration, making a combined total of sixteen jurisdictions. *See infra* Appendix A.

[133] State constituency statutes defining nonshareholder interests as the continued independence of the company include: Connecticut, Hawaii, Idaho, Iowa, Kentucky, Massachusetts, Minnesota, Mississippi, New Jersey, New Mexico, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, South Dakota, Texas, Vermont, and Wyoming. *See infra* Appendix A.

[134] State constituency statutes defining nonshareholder interests to include "other" factors are: Connecticut, Georgia, Illinois, Indiana, Louisiana, Massachusetts, Missouri, New York, Oregon, Pennsylvania, Tennessee, Vermont, Wisconsin, and Wyoming. Texas's constituency statute does not contain the catchall for "other purposes" but instead authorizes directors to pursue action "that promotes or has the effect of promoting a social, charitable, or environmental purpose." TEX. BUS. ORGS. CODE ANN. § 21.401(e) (West 2013). *See infra* Appendix A.

[135] Connecticut was an outlier with its original statute mandating that directors *shall* consider other constituencies, but the statute was amended in May of 2010, effective in October 2010, replacing "shall" with "may" and becoming a permissive language statute consistent with most other jurisdictions. CONN. GEN. STAT. § 33-756(d) (2014).

ations such as employees and communities are permissive.[136] Arizona's constituency statute provides that directors shall consider short- and long-term interests for public companies in a merger transaction.[137] Additionally, Connecticut's constituency statute, which also applies only to public companies, was amended in 2010 to change directors' ability to consider the full range of other constituencies from a mandatory obligation ("shall") to a permissive grant of authority ("may").[138]

Nine jurisdictions restrict the expanded scope of review to takeover or change in control situations.[139] Four jurisdictions restrict constituency statutes to public companies,[140] while two jurisdictions make the constituency language an opt-in choice by allowing corporations to adopt charter language authorizing directors to consider nonshareholder constituencies.[141]

B. Non-constituency Statute Jurisdictions

Neither Delaware nor the ABA Model Business Corporation Act, both leaders in corporate legislation, have adopted nonshareholder constituency language.[142] Even without explicit constituency statute language, there is some amount of common law support for directors to consider other constituents in change of control decisions so long as those considerations bear a rational relationship to the stockholders.[143] This relationship is not required in most constituency statutes, and thus serves as a demarcation point between common law and constituency statutes.[144] The common law support for considering other constituents disappears, however, once directors have decided to sell the company, sell a controlling interest, or consider the

---

[136] IDAHO CODE ANN. §§ 30-1602, 30-1702 (2014).

[137] ARIZ. REV. STAT. ANN. § 10-2702 (2014).

[138] CONN. GEN. STAT. § 33-756(d) (2014).

[139] The following jurisdictions restricted applicability of the constituency statute to takeover situations: Iowa, Kentucky, Louisiana, Maryland, Missouri, Oregon, Rhode Island, South Dakota, and Tennessee. *See infra* Appendix A.

[140] Connecticut, South Dakota, Tennessee, and Vermont restrict constituency statutes to public companies. *See, e.g.*, CONN. GEN. STAT. ANN. § 33-756 (2014).

[141] Georgia and Maryland have opt-in constituency statutes. *See, e.g.*, GA. CODE. ANN. § 14-2-202(b) (2014).

[142] *See* MODEL BUS. CORP. ACT § 8.30–8.31 (2013); DEL. CODE ANN. tit. 8, § 14 (2014) (establishing directors' powers and authority).

[143] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986); *see also* Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1153 (Del. 1990) ("[W]e have said that directors may consider, when evaluating the threat posed by a takeover bid, the 'inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on "constituencies" other than shareholders . . . the risk of nonconsummation, and the quality of securities being offered in the exchange.' " (quoting Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985))).

[144] *Cf.* TEX. BUS. ORGS. CODE ANN. § 21.401(b) (establishing a relationship between the directors' conduct and the interests of shareholders limiting directors' discretion to "consider the long-term and short-term interests of the corporation and the shareholders of the corporation.").

breakup of a corporation.[145] In contrast, directors retain their flexibility, either explicitly or implicitly, to consider nonshareholder interests in takeover situations under constituency statutes.[146]

IV. First, Second, and Third Wave Questions: Constituency Statutes, Alternative Purpose Firms, and Institutional Investors

A considerable volume of academic legal literature has focused on constituency statutes. Constituency statute scholarship can largely be categorized in two ways, and by two time periods. The first wave debated the tension between value maximization and constituency statutes, while the second wave has linked the laws with emerging alternative purpose legislation. Our Article adds to the existing literature by introducing two questions relevant to the passage of constituency statutes. First, to what extent might nonmonetary interests conflict with institutional investors' fiduciary duties? Second, how do institutional investors, particularly HFDIs, respond to negative pressure on the shareholder value maximization principle?

A. First Wave: Takeover Defenses and Corporate Social Responsibility

The first wave of constituency statute scholarship emerged from the takeover defense debate in the 1990s. Lawrence E. Mitchell used constituency statutes as a lens to examine vertical conflicts (self-dealing by board members) and horizontal conflicts (conflicts among constituencies) within the corporate power puzzle and concluded that "[c]onstituency statutes are a means of permitting the board to reallocate . . . costs without exposing itself to additional risks of litigation over vertical conflicts."[147] Others examined the role of constituency statutes in understanding the economics of takeover defenses and successful mergers.[148]

The first wave of scholarship also engaged with emerging questions of corporate social responsibility. Constituency statutes were the first legisla-

---

[145] *See Revlon*, 506 A.2d at 182; Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1264 (Del. 1989).

[146] *See also* Barzuza, *supra* note 116, at 2012–13, 2018 (describing how the adoption of other constituency statutes led to the rejection of the heightened scrutiny standard under *Revlon* in constituency jurisdictions).

[147] Mitchell, *supra* note 113, at 593–94.

[148] Davids, *supra* note 112, at 148–49 (arguing that constituency statutes may be able to harmonize the "potentially divergent goals of societal welfare and corporate wealth maximization" and using transition policy to consider "the impact of such corporate downsizing and exit" and ways to mitigate it); *see also* Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 Stetson L. Rev. 23, 26 (1991) (analyzing major critiques of constituency statutes and concluding that top managers benefit the most from constituency statutes because they can use constituency statutes as "still another weapon in their arsenal of antitakeover protective devices").

tive embodiment of a challenge to the shareholder wealth maximization rationale. Several noted scholars, such as David Millon, viewed constituency statutes as a starting point in the corporate social responsibility debate and urged legislatures and courts to recognize an implied right of action on behalf of the beneficiary constituencies to "enforce whatever rights they gain under" the constituency statutes.[149] Nell Minow foreshadowed the link between constituency statutes and social investing—the future of corporate social responsibility—raising both early fiduciary duty claims and alluding to these statutes' continued relevance to the emergence of alternative purpose firms.[150]

While constituency statutes excited progressive corporate law scholars, they troubled those who saw constituency statutes as a way to shroud self-serving board behavior under the pretense of serving other constituents, thus heightening agency conflicts and the potential for management abuse. For example, in an early work, Stephen Bainbridge cautioned that constituency statutes create the potential for managerial abuse of discretion and for disguising director self-interest as service to nonshareholder constituents.[151] Similarly, Roberta Romano viewed the expansion of director authority to include nonshareholder constituents as protective of management because shareholder monitoring through derivative suits is too "legally attenuated," a result which she predicted would "raise the cost of equity capital and impair the market's allocative function."[152]

B. Second Wave: Alternative Purpose Firms

The second wave of constituency statute scholarship focuses on benefit corporations and other emerging alternative purpose firms that facilitate the joint pursuit of profit and purpose.[153] Beginning in 2010, corporate law

---

[149] David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223, 259 (1991); *see also* Mitchell, *supra* note 113, at 585–86 (proposing a two-part framework to enforce constituency statutes that creates a substantive duty owed by directors to consider the impact of corporate actions on constituents and a private enforcement mechanism by those constituents against corporate boards).

[150] Minow, *supra* note 83, at 232–34.

[151] Bainbridge, *supra* note 124, at 1013.

[152] Roberta Romano, *A Guide to Takeovers: Theory, Evidence, and Regulation*, 9 YALE J. ON REG. 119, 172 (1992).

[153] *See, e.g.*, Dana Brakman Reiser, *Benefit Corporations—A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591 (2011); Steven J. Haymore, *Public(ly Oriented) Companies: B Corporations and the Delaware Stakeholder Provision Dilemma*, 64 VAND. L. REV. 1311 (2011); Lyman Johnson, *Pluralism in Corporate Form: Corporate Law and Benefit Corporations*, 25 REGENT U. L. REV. 269 (2013); Christopher Lacovara, *Strange Creatures: A Hybrid Approach to Fiduciary Duty in Benefit Corporations*, 2011 COLUM. BUS. L. REV. 815 (2011); J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*, 2 AM. U. BUS. L. REV. 1 (2012) [hereinafter Murray, *Choose Your Own Master*]; J. Haskell Murray, *Defending Patagonia: Mergers and Acquisitions with Benefit Corporations*, 9 HASTINGS BUS. L.J. 485 (2013); John Tyler, *Negating the Legal Problem of Having "Two Masters": A Framework for L3C Fiduciary Duties and Accountability*, 35 VT. L. REV. 117 (2010).

scholars have tracked, analyzed, and weighed in on benefit corporations and other alternative firms.[154] These alternative purpose firms are in some ways a manifestation of the concerns of first wave scholars insofar as they saw constituency statutes as the top of a slippery slope that could erode shareholder wealth maximization and lay the foundation for corporate social responsibility.[155]

> [Constituency] statutes and their application can influence whether fiduciary duties must ultimately be in furtherance of maximizing shareholder value, corporations as social entities, or some combination. Second, these statutes can influence how directors of for-profit corporations fulfill, and are held accountable, for their duty of care in the thirty-one states with such statutes. Both of these points are critical for understanding the B Corporation and its hybrid approach . . . .[156]

Constituency statutes were the first legislative signal of counter pressure on the profit maximization rationale, as corporate social responsibility advocates highlighted in the early 1990s.[157] Fast-forward nearly twenty-five years and the original pressure on wealth maximization principles first glimpsed in constituency statutes has expanded, creating new dual mission hybrids which seek profit and advancement of social or environmental

---

[154] *See, e.g.*, Brakman Reiser, *supra* note 153, at 591–92 ("These include the low-profit limited liability company ('L3C') available in nine U.S. states and the community interest company ('CIC') available in the United Kingdom. In addition, 'B Corp' is a private certification available to U.S. for-profits that demonstrate their commitment to a dual mission of making profits and promoting social good. Qualifying entities can license the B Corp mark to market themselves to consumers, investors, and others."); Tyler, *supra* note 153, at 117 ("The low-profit limited liability company (L3C) is a new business form that unites in one enterprise two principles often considered irreconcilably in competition with each other: pursuing charitable, exempt purposes and generating and distributing profits.").

[155] *See, e.g.*, Brakman Reiser, *supra* note 153, at 596–97 (describing the common elements of then-existing benefit corporation statutes and discussing the history of the benefit corporation movement in corporate law); Robert T. Esposito, *The Social Enterprise Revolution in Corporate Law: A Primer on Emerging Corporate Entities in Europe and the United States and the Case for the Benefit Corporation*, 4 Wm. & Mary Bus. L. Rev. 639, 698–702 (2013) (describing the common elements of benefit corporation statutes); Haymore, *supra* note 153, at 1315 (describing the impact on corporations with B Lab certification, an alternative approach to incorporating through charter documents as a legally-distinct benefit corporation); Johnson, *supra* note 153, at 289 (discussing directors' fiduciary duties in benefit corporation legislation); Lacovara, *supra* note 153, at 820–23 (discussing directors' fiduciary duties under benefit corporation legislation); Murray, *Choose Your Own Master*, *supra* note 153, at 5–9 (discussing shareholder wealth maximization and benefit corporation legislation); Tyler, *supra* note 153, at 121–22 (discussing LC3 and other hybrid, alternative purpose firms).

[156] Tyler, *supra* note 153, at 131.

[157] Millon, *supra* note 149, at 225–26 ("If the traditional conception viewed the corporation as an engine for shareholder wealth maximization and shaped legal doctrine accordingly, the new [constituency] statutes suggest a more complex notion of the corporation's role in society . . . . Relentless pursuit of profit maximization for their sake can impose substantial costs on nonshareholders.").

goals.[158] Constituency statutes were an early foundation for the conception and statutory authorization of alternative purpose firms.

The following discussion outlines the structural similarities between constituency statutes and benefit corporation legislation. We provide high level information about benefit corporations necessary to add context to our examination of constituency statutes and institutional investors' fiduciary duties, but leave the bulk of the descriptive and normative discussions of these alternative purpose firms to existing and future scholars in the field.[159]

C. Constituency Statutes and Benefit Corporation Legislation

Constituency statutes share common structural features with benefit corporation statutes.[160] In the absence of data on institutional investment in private firms, the effect of constituency statutes on institutional investment in public firms serves as an imperfect, but best available proxy to analyze institutional investors' appetite for and comfort level with investments that may serve nonmonetary objectives.

After the legislative session of 2014, twenty-seven states had passed benefit corporation legislation.[161] While there are other types of alternative purpose firms like the low-profit, limited liability corporation, the benefit corporation model is the most widely adopted and therefore will be the focus of our discussion. Common features of benefit corporation legislation[162] include the creation of a corporate purpose outside of profit,[163] a mandate that directors shall consider nonshareholder constituents,[164] limited director liability for pursuit of alternative purposes,[165] a named benefit officer or named

---

[158] Johnson, *supra* note 153.

[159] *See supra* notes 153–55 citing to the leading scholarship on benefit corporations and alternative purpose firms.

[160] For example, constituency statutes permit directors to consider nonshareholder interests, but do not mandate that directors do so, as is the case under benefit corporation statutes.

[161] Arizona, Arkansas, California, District of Columbia, Colorado, Connecticut, Delaware, Florida, Hawaii, Illinois, Louisiana, Maryland, Massachusetts, Minnesota, Nebraska, New Hampshire, New Jersey, New York, Nevada, Oregon, Pennsylvania, Rhode Island, South Carolina, Utah, Vermont, Virginia, West Virginia. For an up-to-date list of benefit corporation states, *see* LEGISLATION, https://www.bcorporation.net/what-are-b-corps/legislation (last visited October 19, 2014); STATE BY STATE LEGISLATIVE STATUS, http://www.benefitcorp.net/state-by-state-legislative-status (last visited October 19, 2014).

[162] The twenty-seven state benefit corporation statutes are listed in Appendix D of this Article.

[163] Brakman Reiser, *supra* note 153, at 597 ("The main thrust of benefit corporation statutes is to require these entities to pursue purposes beyond profit-making. A benefit corporation must be formed for a 'general public benefit,' meaning a 'material, positive impact on society and the environment.'").

[164] Murray, *Choose Your Own Master*, *supra* note 153, at 22 ("The benefit corporation statutes expressly require the consideration of various non-shareholder stakeholders, unlike the typical permissive constituency statute.") (emphasis omitted).

[165] Esposito, *supra* note 155, at 700 (describing the requirements of an annual benefit report to be sent to shareholders including being made publically available on a website, measuring performance against a third party standard, and providing a description of efforts to serve general or specific public benefits).

benefit director,[166] an annual benefit report,[167] and a benefit enforcement proceeding.[168]

Constituency statutes, like benefit corporation statutes, focus on expanding directors' ability to consider nonshareholder constituents. The two statutory frameworks use similar language to describe nonshareholder interests. For example, employees, customers, communities, and long and short-term interests are common stakeholders named in both constituency and benefit corporation statutes.[169] Additionally, the two statutory frameworks generally limit director liability for considering nonshareholder interests.[170]

Benefit corporation statutes build upon the constituency framework by augmenting directors' authority from a permissive grant in constituency statutes to a mandate in benefit corporation legislation.[171] Additionally, benefit corporation legislation adds elements such as an alternative corporate purpose, benefit officers or directors, benefit reports, and a unique enforcement proceeding available to shareholders. Nonshareholder constituents do not have enforcement rights under current benefit corporation legislation.[172] In this respect, benefit corporation legislation contains a common limitation with constituency statutes despite the statutory language that directors of benefit corporations shall consider nonshareholder constituents.[173] In addition, constituency statutes apply to all firms incorporated in the jurisdiction whereas benefit corporation legislation applies only to firms that elect to organize as a benefit corporation under the statute. Figure 1 below illustrates the structural similarities between the two statutes.

[166] *See, e.g.*, Ark. Code Ann. § 4-36-302 (2014) (allowing a named benefit director); Ark. Code Ann. § 4-36-304 (2014) (authorizing a named benefit officer).

[167] Esposito, *supra* note 155, at 700–01 ("The third fundamental element of benefit corporation statutes is the annual benefit report (ABR). In all states, benefit corporations are required to submit an ABR to each shareholder and, in most cases, to make the most recent ABR publicly available on its website. The ABR must be measured against some independent, third party standard chosen by the board. In general, ABRs must include a narrative description of: (1) the ways in which the benefit corporation pursued both its general and any specific public benefits during the year, (2) any circumstances that have hindered the creation of general or specific public benefits, and (3) an assessment of the social and environmental performance of the benefit corporation.").

[168] Lacovara, *supra* note 153, at 829 ("[T]he provision suggests that public benefit purposes represent or create a class of enforceable duties separate from other duties of B-corp directors . . . .").

[169] *See infra* Appendices A and D; *see also* Esposito, *supra* note 155, at 699 (describing common statutory components of constituency statutes and benefit corporations respectively).

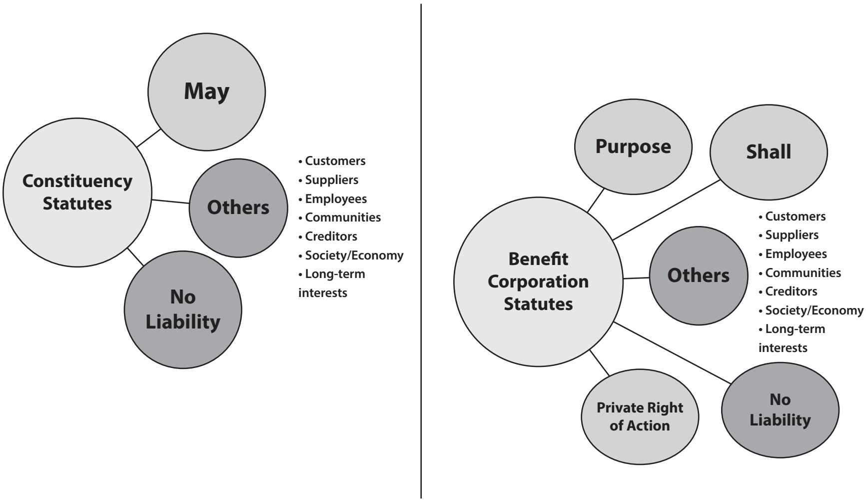
[170] *See infra* Appendix D.

[171] *Id.*

[172] *Id.*

[173] *See, e.g.*, Johnson, *supra* note 153, at 292–93 (discussing the limitations of enforcement mechanisms vested solely in shareholders); Lacovara, *supra* note 153, at 869–70 (describing the limited enforcement mechanisms of nonshareholder constituents).

FIGURE 1: COMPARISON OF CONSTITUENCY AND BENEFIT CORPORATION STATUTES



D. Third Wave Questions

Constituency statutes provide our first glimpse at a complicated problem regarding institutional investors' fiduciary duties, one that was largely omitted from both the first and second waves of scholarship. Changing corporate directors' fiduciary duties and allowing them to pursue non-profit maximizing interests does not alter the separate fiduciary duty under which institutional investors operate.[174] When the legal regime for corporate actions shifts away from profit maximization under either constituency or alternative purpose firm statutes this may not pose a problem for the individual investor, but may create a conflict for agency investors—those who invest the money of others, especially HFDIs.

A review of the first wave constituency statute debate reveals that there is virtually no discussion of institutional investors' response to directors' expanded authority to consider nonshareholder constituents. This is despite the focus of some antitakeover statute legislative histories on pension funds, including the prediction that such funds would avoid investing in companies governed by such regimes.[175] Similarly, a majority of institutional investors

[174] *See, e.g.*, Bushee, *supra* note 85, at 212–13 (discussing the role of fiduciary duties in institutional investor holdings).

[175] *See, e.g.*, 174 PA. LEGIS. J., 551 (Apr. 3, 1990) (Statement of Rep. Godshall), *available at* http://www.legis.state.pa.us/WU01/LI/HJ/1990/0/19900403.pdf ("We have had pension advisers . . . telling us . . . that there was going to be an effect . . . under this legislation as far as purchasing stocks from Pennsylvania corporations that choose to protect themselves under this, and I do not believe all those pension advisers who are the ones that make the decisions . . . are totally wrong."); *see also* 174 PA. LEGIS. J., 549 (Apr. 3, 1990) (Statement of Rep.

responding to a 1989 survey opposed the expanded director considerations provided in constituency statute language.[176]

While first wave scholars may have overlooked the link between constituency statutes and institutional investors, contributions by scholars and policy makers including Roberta Romano,[177] Richard Posner and John Langbein,[178] James Hutchinson and Charles Cole,[179] and Nell Minow[180] focused on the unique conflicts for institutional investors and early social investment initiatives. The social investment debate corresponds in time with the emergence of constituency statutes and reflects a common pressure on the shareholder wealth maximization rationale, although the voluntary aspect of social investment is a critical distinction. In the early social investment debate, the focus was on divestment of certain corporate securities[181] or deployment of pension assets to address community economic problems.[182]

Additionally, the scholarship to date has not closely examined court enforcement actions following the passage of constituency statutes.[183] However, this retrospective is necessary to evaluate the early predictions about how constituency statutes could be used as a tool of shareholders, manage-

---

Davies), *available at* http://www.legis.state.pa.us/WU01/LI/HJ/1990/0/19900403.pdf (noting the concerns of the Pennsylvania state pension fund manager on antitakeover statutes).

[176] Bainbridge, *supra* note 124, at 984–85 ("In 1989, for example, over half of the institutional investors responding to an industry survey reported that they had opposed some nonmonetary factors provisions [social, legal and economic effects of an offer upon employees, suppliers, customers and others], while another one-quarter reported that they did so routinely.") (citing Lauren G. Krasnow, Voting by Institutional Investors on Corporate Governance Issues in the 1989 Proxy Season 37 (1989)).

[177] *See* Romano, *Public Pension Fund*, *supra* note 42.

[178] *See* John H. Langbein & Richard A. Posner, *Social Investing and the Law of Trusts*, 79 Mich. L. Rev. 72 (1980).

[179] James D. Hutchinson & Charles G. Cole, *Legal Standards Governing Investment of Pension Assets for Social and Political Goals*, 128 U. Pa. L. Rev. 1340, 1340–88 (1980).

[180] *See* Minow, *supra* note 83, at 232–37.

[181] Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. Chi. L. Rev. 1105, 1143–44 (1988) ("The campaign to force pension funds to divest shares of firms doing business in South Africa . . . is inconsistent with maximizing the return to the fund because divesting the shares of offending companies imposes additional transaction costs."); *see also* Smith, *supra* note 73, at 30 ("[S]everal pension and other funds . . . would hold no stock in firms that did business in South Africa.").

[182] *See, e.g.*, Withers v. Teachers' Ret. Sys. of New York, 447 F. Supp. 1248 (S.D.N.Y. 1978), *aff'd mem.*, 595 F.2d 1210 (2d Cir. 1979); Minow, *supra* note 83, at 226 ("The New York State Task Force On Pension Fund Investment, established by Governor Mario Cuomo, issued a 1989 report that recommended 'optimizing' instead of 'maximizing' returns in a way that seemed to go beyond long-term returns to encourage trade-offs of pension benefits for other social goals (i.e., local businesses).").

[183] *See* Barzuza, *supra* note 116, at 1995–2018 (cataloging state and federal court opinions addressing directors' duties in a takeover situation in jurisdictions with various antitakeover statutes, including constituency statutes). Additionally, there are few articles that grapple with the early enforcement cases in the late 1980s and contain limited discussion of judicial enforcement. *See also* Bainbridge, *supra* note 124, at 988 (noting the absence of importance guidance from courts on how to enforce constituency statutes); Davids, *supra* note 112, at 162–65 (discussing limited research on enforcement in light of declining hostile takeover market and prevalence of antitakeover statutes, including constituency statutes); Esposito, *supra* note 155, at 661 (noting the "impotence" of constituency statutes and citing to early court opinions that declined to differentiate from the *Revlon* standard).

ment, and nonshareholder constituents. Furthermore, the strength or absence of judicial enforcement affects the doctrinal weight to be given constituency statutes in the emerging debates regarding alternative purpose firms. Our Article attempts to address these gaps that remain thirty years later.

V. Enforcement of Constituency Statutes: Answering First Wave Questions

When constituency statutes were passed, scholars noted the absence of guidelines dictating to directors and courts how to balance the interests of shareholders and nonshareholder constituents.[184] As discussed above, some viewed constituency statutes as an erosion of director fiduciary duty standards that would benefit management abuse; others saw them as a foothold to introduce social responsibility into corporate governance frameworks. In the absence of court opinions interpreting constituency statutes, questions remain about the impact of these statutes. These questions include whether constituency statutes would (1) encourage litigation; (2) facilitate director mismanagement; (3) signal not a change in the law, but a codification of director discretion in common law; or (4) mark the beginning of legal legitimacy of the stakeholder theory by directors owing positive, enforceable rights to nonshareholder constituents. In this Article, we answer those questions in part by cataloguing, analyzing and describing courts' enforcement of constituency statutes over the last thirty years.

A. *Methodology*

To understand how courts enforce constituency statutes, we searched for all federal and state court opinions, at trial and appellate levels, that discuss constituency statutes from 1983[185] through 2013 in the Westlaw database. The search results were cross-referenced by examining constituency statute citing references in each of the thirty-three jurisdictions with constituency statutes. The total pool of cases reviewed exceeds 800. This initial pool of cases was manually searched to identify forty-seven relevant cases in the thirty-year time period.[186] These cases were read, analyzed, and coded for enforcement categories, type of suit, and other identifying information.

We used five enforcement coding categories: Positive, Neutral/Positive, Neutral, Neutral/Negative, and Negative. All categories, excluding Negative where there were no relevant cases, were divided into two subcategories each. The following provides an explanation of the coding categories, a discussion of their application, and examples.

---

[184] Bainbridge, *supra* note 124, at 992.
[185] 1983 Pa. Laws 395.
[186] *See infra* Appendix C.

1. Positive

Cases were coded as Positive if the constituency statute was a determinative element in the court's ruling and the court upheld the boundaries of the statutory language. Constituency statute language was considered to be "upheld" if the court recognized directors' expanded ability to consider nonshareholder constituents, but did not create a private enforcement right in such nonshareholder constituents. If a court positively enforced a constituency statute by recognizing directors' broadened authority to consider other constituents, the case was assigned to subcategory A. Court opinions that positively enforced the constituency statute by refusing to extend standing to nonshareholder constituents, consistent with the language of the statute, were assigned to subcategory B.[187]

For example, in *AMP Inc. v. Allied Signal, Inc.*,[188] a federal district court construed the Pennsylvania constituency statute as authorizing director defendants' amendment of the company poison pill to make it nonredeemable absent approval by a three-person committee.[189] The court found that the directors appropriately considered interests beyond "the consideration that might be offered or paid to shareholders in such an acquisition."[190] Because the court's ruling positively upheld the constituency statute by recognizing expanded director discretion to consider nonshareholder interests, the case was assigned to subcategory A. Similarly, in *Safety-Kleen Corp. v. Laidlaw Envtl. Servs., Inc.*,[191] a federal district court dismissed a breach of fiduciary duty claim for defensive measures in the face of a takeover offer. The court found that the director defendants "considered non-shareholder interests that Wisconsin law explicitly allows them to take into consideration."[192] Interpreting the Wisconsin constituency statute, the court stated:

> [The constituency statute was] adopted in response to the Delaware Supreme Court's decision in *Revlon.* It clearly establishes, as far as this court is concerned, that Wisconsin corporate directors may legitimately and without breaching their fiduciary duties to

[187] This coding category is in opposition to the view of constituency statutes expressed by Professors Millon and Mitchell who advocated for constituency statutes to be construed to grant nonshareholder constituents independent enforcement rights in order to effectuate the intent of the statute, which was a departure from a pure shareholder wealth maximization rationale. *See* Millon, *supra* note 149, at 259–60, 266–68 (arguing for an implied right of action in order for the beneficiaries (nonshareholders) to "to enforce whatever rights they gain under" the constituency statutes); *see also* Mitchell, *supra* note 113, at 634–40. *See generally* Orts, *supra* note 115.

[188] No. CIV. A. 98-4405, 1998 WL 778348 (E.D. Pa. Oct. 8, 1998).

[189] AMP Inc. v. Allied Signal, Inc., No. CIV. A. 98-4405, 1998 WL 778348 at 5 (E.D. Pa. Oct. 8, 1998).

[190] *Id.*

[191] No. 97 C 8003, 1999 WL 601039 (N.D. Ill. Feb. 4, 1998).

[192] *Id.* at 18. "[T]he court is persuaded by Safety-Kleen that Wisconsin law permits the board of directors of a public company to look at factors other than simply enhancing shareholder value in evaluating takeover proposals." *Id.* at 10.

> shareholders take into consideration in exercising their business judgment the impact of their decisions on non-shareholder constituencies. In the face of this statute, the court cannot agree that maximizing short term shareholder value, that is, getting the highest price at the time of the tender, is the only interest the board may legitimately pursue.[193]

In re I.E. Liquidation, Inc.[194] provides an example of subcategory B where standing was not extended to nonshareholder constituents. In that case, a bankruptcy court declined to read Ohio's constituency statute[195] as creating an enforceable duty owed by directors to creditors of a corporation, even if the corporation was insolvent at the time of the alleged action.[196] Rejecting the common law theory of zone of insolvency where corporate directors of insolvent companies may owe a duty to creditors, the court concluded that "the [Ohio] legislature specifically chose language that made the consideration of creditors' interests permissive, without exception."[197] The court further opined on the constituency statute:

> Accepting the permissive definition of the statute provides directors with the option to consider creditor interests. In certain situations, the permissiveness may afford directors an opportunity or leeway to act in a manner which might otherwise be actionable if there was an absolute duty to consider creditor interests. Creating a mandatory obligation on a director to consider the creditors could create a stifling disincentive and impossible conflict for directors of troubled companies.[198]

2. *Neutral/Positive*

The Neutral/Positive coding category captured opinions where the court discussed the scope of constituency statutes both in terms of expanding director rights and declining to extend constituency statutes to create a positive right in nonshareholder constituents consistent with the language of the statute. In the cases coded as Neutral/Positive, the court engaged in a substantive discussion of the statute, but the constituency statute was not a determinative element of the court's ruling. Again, the cases in this category were subdivided into A and B subcategories to reflect the separate issues of expanded director rights (subcategory A) and no enforceable rights in nonshareholder constituents (subcategory B).

---

[193] *Id.* at 12.
[194] In re I.E. Liquidation, Inc., No. 06-62179, 2009 WL 2707223 (Bankr. N.D. Ohio Aug. 25, 2009).
[195] OHIO REV. CODE ANN. § 1701.59(E) (2009).
[196] *In re I.E. Liquidation, Inc.*, 2009 WL 2707223 at 3–5.
[197] *Id.* at 4.
[198] *Id.*

The Neutral/Positive and Neutral/Negative categories were created to reflect coding challenges for the sample of cases analyzed in this Article. The level of the court hearing the matter (that is, trial or appellate), whether the case was a matter in law (for example, breach of fiduciary duty) or in equity (injunctions and declaratory judgments), and the standard of review applied significantly affected the role and weight of a constituency statute in a particular matter. Our sample of cases included federal and state opinions at both the trial and appellate level.[199] Consider, for example, the role of a constituency statute where the court was deciding a motion to dismiss a claim of breach of fiduciary duty brought by defendants at the trial court level where the court must find that there is no question of fact on the matter while construing the evidence in favor of the nonmoving plaintiffs.[200] The standard in this case differs from the one that would apply in a motion brought by plaintiffs or in appellate review.[201] All of these case-driven variables necessitated the creation of the Neutral/Positive and Neutral/Negative categories to capture cases that substantively dealt with a constituency statute, but where the statute was not outcome determinative.

Another factor that dictates the role of a constituency statute in a court opinion is the type of relief sought. The Neutral/Positive and Neutral/Negative categories were created, in part, to facilitate an accurate analysis of the role of constituency statutes in direct claims, like a breach of fiduciary duty, versus equitable claims, such as injunctions and declaratory judgments. Fifteen of the cases reviewed sought declaratory or injunctive relief where the likelihood of succeeding on the merits of the underlying claim was a determinative factor.[202] In many of these cases, the court discussed the likelihood of the plaintiff's ability to prove a breach of fiduciary duty, and in doing so, quoted constituency statutes. These constituency statute references were relevant, but not determinative as to the ultimate question of equitable relief.

---

[199] Sample cases were coded for the following jurisdictions: bankruptcy court, federal district court, federal appellate court, state trial court, and state appellate court. Within our sample, there were seven bankruptcy cases, nineteen federal district court cases, three federal appellate decisions, twelve state trial court cases, and six state appellate decisions.

[200] Shepard v. Humke, IP 01-1103-C H/K, 2002 WL 1800311, at *1 (S.D. Ind. July 9, 2002) ("In deciding a motion to dismiss under Rule 12(b)(6), the court reviews all facts alleged in the complaint and any inferences reasonably drawn from the alleged facts in the light most favorable to the plaintiff. *E.g.*, Gould v. Artisoft, Inc., 1 F.3d 544, 548 (7th Cir.1993) (reversing dismissal). Dismissal is warranted only if the plaintiff can prove no set of facts consistent with the complaint that would entitle her to relief. Hishon v. King & Spalding, 467 U.S. 69, 73 (1984); Conley v. Gibson, 355 U.S. 41, 45–46 (1957).").

[201] For example, compare the above standard with the following: "On appeal from a final decree, the standard of review is not whether there were 'any apparently reasonable grounds for the action of the court below[,'] as is the case when the issuance [or] denial of preliminary injunctive relief is reviewed. . . . the test is whether the trial court . . . abused its discretion or committed an error of law." Warehime v. Warehime, 2001 PA Super 141, 777 A.2d 469, 477 (Pa. Super. Ct. 2001) *rev'd*, 580 Pa. 201, 860 A.2d 41 (2004) (quoting Frankel-Warwick Ltd. P'ship v. Local 274, Hotel, Bartenders & Rest. Employees Union, 334 Pa. Super. 47 (1984)).

[202] *See infra* Appendix C.

TABLE 1: CONSTITUENCY CASES BY CASE POSTURE

Total Motions for Summary Judgment	**11**	
1A (Defendant Motion)		7
1B (Plaintiff Motion)		2
1C (Cross Motions)		2
Motions to Dismiss	**13**	
Motions for Equitable Relief	**10**	
Other	**5**	
Total Appeals	**8**	
Appeal Motion for Summary Judgment		3
Appeal Motion to Dismiss		2
Appeal Equity		1
Appeal Other		2

For example, in *Gut v. MacDonough*,[203] minority shareholders derivatively sought a preliminary injunction on a pending merger agreement alleging breach of fiduciary duty by director defendants because the proposed sale was "grossly inadequate," resulted from a flawed process, contained unreasonable lock up agreements and termination fees, and precluded the participation of other, higher bidders.[204] The court cited to the constituency statute when discussing the protection of the business judgment rule, stating that directors may take into account the "interests of the corporation's employees and customers, the local, regional and national economy, and the long-term and short-term interests of the shareholders."[205] However, the court ultimately denied the preliminary injunction, finding that plaintiffs failed to demonstrate likely success on the merits when reviewing the transaction under a heightened scrutiny freeze-out merger test.[206] The prevalence of cases like *Gut v. MacDonough* in our sample required the creation of a second category that expressed "positive" enforcement by the court even though the outcome of the matter was not dependent upon the constituency statute per se.

3. Neutral

Court opinions that cited, referenced by name, or included dicta regarding constituency statutes were coded as Neutral. Mere citations to constituency statutes were coded as subcategory A. For example, in *In re Mid-State*

[203] CIV.A. 2007-1083-C, 2007 WL 2410131 (Mass. Super. Aug. 14, 2007).
[204] *See id.* at 1.
[205] *Id.* at 11.
[206] *See id.*

Raceway, Inc.,[207] the court discussed director defendants' fiduciary duties, including duties owed to creditors, and cited to New York's constituency statute, including the full text of the provision in a supporting footnote.[208] Other courts, such as the one in *Shepard v. Humke*, cited to director standards of conduct, the business judgment rule, and standards of proof, but not to the constituency provisions when analyzing director behaviors.[209] Later in the *Shepard v. Humke* opinion, the court referenced directors' ability to consider other "constituencies" in takeover situations, but did not provide a citation to the constituency provision.[210] *Shepard v. Humke* and cases like it that reference constituency statutes by name or include other nonsubstantive discussions were coded Neutral, subcategory B.

4. *Neutral/Negative and Negative*

The Neutral/Negative category reflects cases where the court discussed constituency statutes, but declined to recognize expanded director authority or to hold directors to a standard other than Delaware's auction duty as expressed in *Revlon v. MacAndrews & Forbes Holding, Inc.*[211] Additionally, cases coded as Neutral/Negative may have recognized that constituency statutes expanded directors' discretion, but declined to extend augmented discretion to situations affecting shareholder voting rights. As with the Neutral/Positive category, Neutral/Negative cases discussed the scope of the constituency statute, but the reasoning was not determinative of the court's ruling. Cases in this category were similarly subdivided into A and B subcategories reflecting the separate issues of expanded director rights (subcategory A) and no enforceable rights in nonshareholder constituents (subcategory B).

Hilton Hotels Corp. v. ITT Corp.[212] illustrates the Neutral/Negative category. In this case, the court was asked to decide whether a bidding corporation could obtain an injunction against a target company board's adoption of

---

[207] 323 B.R. 40, 57–58 (Bankr. N.D.N.Y. 2005).

[208] *Id.* at 58 n.26.

[209] *See* Shepard v. Humke, No. IP 01-1103-C H/K, 2002 WL 1800311 at *8 (S.D. Ind. July 9, 2002).

[210] *Id.* at *9 ("For example, Shepard's allegations regarding the directors' misrepresentations and the break-up fee are the sort of allegations that could sustain a breach of fiduciary claim if supported with evidence that the directors deliberately chose not to act in the best interests of the corporation's multiple constituencies or were indifferent to the interests of those constituencies.").

[211] 506 A.2d 173 (Del. 1986). In 1990, the ABA published a report on constituency statutes expressing concern about the legal development, declining to include similar language in the Model Business Corporation Act, and interpreting constituency statutes consistent with existing Delaware case law on directors' duties in takeover situations as expressed in *Revlon* and *Unocal*. Comm. on Corp. Laws, *supra* note 111. The ABA's view was not widely shared among legal academics, particularly with respect to the convergence with or departure from Delaware law. For example, Professor Ronn S. David criticized the ABA's interpretation and justification for viewing constituency statutes as a departure from Delaware law. Davids, *supra* note 112, at 172–73.

[212] 978 F. Supp. 1342, 1346–47 (D. Nev. 1997).

a comprehensive shareholder rights plan. In reviewing the actions taken by the director defendants, the court discussed the interplay between the Nevada constituency statute and Delaware takeover law, concluding that "Delaware case law merely clarifies the basic duties established by the Nevada statutes."[213] The court further discussed the role of constituency statutes acknowledging that the Nevada constituency statute expanded directors' authority to consider nonshareholder constituents, but that "nothing in that statute suggests that the interests of third parties are as important as the right of the shareholder franchise. While the two interests are not exclusive, neither are they equal."[214] Because the matter before the court was a preliminary injunction where constituency statute standards are relevant, but not necessarily determinative, this restrictive interpretation of constituency statutes was coded as a Neutral/Negative case.

Similar to the standard expressed for Positive cases, a case coded Negative would have declined to recognize the expanded director authority under constituency statutes, and the reasoning was determinative to the court's ruling. We did not find cases that fell under the Negative category.

B. Discussion of Constituency Statute Enforcement Findings

The number of enforcement cases reviewed in this study, forty-seven in total, is not large, but not unexpectedly small given the limited enforcement mechanisms in all statutes, and further restrictions in state variations limiting the scope to takeovers, public companies, or both.[215] Additionally, the presence of other antitakeover statutes, such as control share and business combination laws, "curtail[s] the number of hostile takeovers minimizing the need for litigants (and even judges) to resort to . . . constituency statutes."[216] Court enforcement of constituency statutes was overall positive, under the definitional parameters established in this Article. In total, twenty-nine of the forty-seven cases reviewed were in the Positive or Neutral/Positive categories. Twenty cases were marked Positive with eleven opinions recognizing directors' expanded authority to consider other constituents (subcategory A) and nine opinions declining to interpret constituency statutes as creating a positive right in nonshareholder constituents. An additional nine cases fell in the Neutral/Positive category with six addressing directors' expanded duties and three addressing standing for nonshareholder constituents. Fourteen court opinions cited to or superficially discussed constituency statutes in the

---

[213] *Id.* at 1347.

[214] *Id.* at 1351; *see also* Barzuza, *supra* note 116, at 2004–06 (noting the Nevada court's departure).

[215] Barzuza, *supra* note 116, at 1993 (stating that his search of all state and federal cases in both WestLaw and LexisNexis under the parameters "Unocal," "Revlon," "Blasius," poison pill," "hostile takeover," "dead hand pill," and "slow hand pill," produced 108 responsive cases).

[216] Davids, *supra* note 112, at 165.

Neutral category. Of the cases reviewed, only four court opinions were classified as Neutral/Negative because they did not recognize expanded director duties nor depart from *Revlon* duties in takeover settings.[217]

TABLE 2: CONSTITUENCY CASES BY ENFORCEMENT CATEGORY

Total Positive	**20**	
1A		11
1B		9
Total Neutral/Positive	**9**	
2A		6
2B		3
Total Neutral	**14**	
3A		13
3B		1
Total Neutral/Negative	**4**	
4A		4
4B		0
Total Negative	**0**	

Our sample cases discuss constituency statutes from thirteen different jurisdictions,[218] with the Ohio, Pennsylvania, and Nevada statutes analyzed the most frequently.[219] Additionally, most of the cases reviewed occurred in the last fifteen years, with thirty-two cases resolved after 2000.[220] A fifteen year delay makes sense when considering the time necessary for widespread passage of constituency statutes in the late 1980s and early 1990s, directors' subsequent reliance on expanded authority in corporate actions, challenges to those actions, and ultimate resolution by a court.[221]

Of the types of claims brought, seventeen cases raised breach of fiduciary duty claims in a takeover setting, alleging that directors either failed to maximize shareholder value or failed to consider nonshareholder interests. For example in *Cottle v. Storer Communication, Inc.*,[222] the Eleventh Circuit Court of Appeals affirmed a district court's grant of summary judgment to defendants on a breach of fiduciary duty claim arising from a proposed

[217] Barzuza, *supra* note 116 (noting that the findings are consistent with the interpretation of the role of antitakeover statutes on directors' duties in other studies).

[218] *See infra* Appendix A.

[219] Ten cases discuss Ohio's constituency statutes; eight cases discuss Pennsylvania's constituency statutes, and seven cases discuss Nevada's constituency statute.

[220] *See infra* Appendix C.

[221] *See infra* Appendix C (where five cases were decided in the 1980s, ten in the 1990s, twenty-seven in the first decade of 2000, and five additional cases between 2010 and 2013).

[222] 849 F.2d 570 (11th Cir. 1988).

merger.[223] Eleven cases alleged that directors breached other fiduciary duties (those arising outside of takeover contexts).[224] Twelve cases arose in the context of bankruptcy or insolvency proceedings, in which trustees asserted claims against former directors for deepening insolvency or creditors of the now bankrupt corporation alleging that directors owed them enforceable fiduciary duties under the governing constituency statute.[225] Twenty-four cases were brought by shareholders either directly or derivatively.[226] Bankruptcy trustees brought five cases, and corporate creditors brought seven cases after corporate insolvency or bankruptcy.[227]

TABLE 3: CONSTITUENCY CASES BY CASE CONTEXT

Breach of fiduciary duty claim in a takeover setting	17
Breach of fiduciary duty claim in bankruptcy or insolvency	12
Other breach of fiduciary duty claims	11
Other claims	7

TABLE 4: CONSTITUENCY CASES BY TYPE OF SUIT

Direct Breach of Fiduciary Duty Suit	**28**	
By shareholder		16
By Bankruptcy Trustee		5
Creditor	**7**	
Derivative Suit	**8**	
Class Action Suit	**3**	
Other	**8**	

Shareholders and creditors as common plaintiffs comports with our understanding of these groups given their interests in protecting their financial investment in the firm, whether in the form of equity or debt.[228] Additionally, for both groups of plaintiffs, there is precedent for their ability to seek legal redress against corporate directors in the form of derivative suits for share-

---

[223] *Id.* at 575.

[224] *See infra* Appendix C; *see, e.g.*, Kloha v. Duda, 246 F. Supp. 2d 1237, 1242–50 (M.D. Fla. 2003).

[225] *See infra* Appendix C; *see, e.g.*, In re Amcast Indus. Corp., 365 B.R. 91, 97 (Bankr. S.D. Ohio 2007) (deciding breach of fiduciary duty claims brought by a trustee of a corporate debtor against corporate directors).

[226] *See infra* Appendix C.

[227] *See infra* Appendix C; *see, e.g.*, *Amcast*, 365 B.R. at 96 (deciding breach of fiduciary duty claims brought by a trustee of a corporate debtor against corporate directors).

[228] *See, e.g.*, George G. Triantis & Ronald J. Daniels, *The Role of Debt in Interactive Corporate Governance*, 83 CAL. L. REV. 1073, 1077 (1995) (describing the interests and monitoring functions of debt holders).

holders and deepening insolvency claims for creditors.[229] Prior common and statutory law already paved the path to the courthouse for these plaintiffs. In contrast, employees and community members have never had standing to bring a fiduciary duty claim against directors and would have been new plaintiffs under constituency statutes, which may have deterred this group from testing the boundaries of directors' expanded duties. Additionally, the statutory language is clearly permissive, not mandatory, which also would have deterred nonshareholder constituents from filing actions.

C. *Enforcement Conclusions*

We began this Article by cataloging constituency statutes, summarizing the relevant first and second wave academic debates, identifying unanswered questions, and posing our own third wave question: how does decreased profit maximization pressure affect HFDI investment? We now analyze our enforcement case information described above to answer, where possible, these questions.

First, constituency statutes did not open litigation floodgates as some critics cautioned.[230] We identified forty-seven cases, only twenty-six of which were published opinions, in all federal and state courts for a thirty year time period. The number of enforcement cases is low for a thirty year time period, but not entirely unexpected.[231] Constituency statutes enhanced director discretion rather than set firm obligations, and directors' exercise of discretion is protected by the business judgment rule and thus not subject to judicial review in most circumstances. Additionally, because no standing was granted to new third parties, there was a limited pool of potential plaintiffs to bring challenges under these statutes. While constituency statutes represented an important, and potentially a watershed, development in corporate law, they have not dramatically altered the existing landscape.

Second, it is clear that constituency statutes were seen, for the most part, as a true expansion of directors' authority and not merely a codification of earlier common law. The low number of Negative and Neutral/Negative cases supports this assertion. Nevada appears to have the most restrictive interpretation of its constituency statute with courts signaling that the statute is a mere codification of Delaware standards previously expressed in *Revlon* and *Unocal*.[232] Two years following the *Hilton* ruling,[233] the Nevada legisla-

---

[229] *See generally* Henry T. C. Hu & Jay Lawrence Westbrook, *Abolition of the Corporate Duty to Creditors*, 107 COLUM. L. REV, 1321 (2007) (discussing corporate creditor rights).

[230] Comm. on Corp. Laws, *supra* note 111, at 2270 (cautioning against constituency statutes creating a new class of litigants to bring suits against directors and deter qualified participation on boards); *see also* Marleen A. O'Connor, *Corporate Malaise—Stakeholder Statutes: Cause or Cure?*, 21 STETSON L. REV. 3, 16 (1991) (noting that broad interpretation of constituency statutes "may produce a flood of litigation").

[231] *See* Barzuza, *supra* note 116.

[232] *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 949 (Del. 1985); Revlon Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 185 (Del. 1986).

ture clarified that the business judgment rule (not the heightened *Revlon* standard) applied to director actions in takeover defenses unless shareholder voting rights were implicated, as they were in *Hilton*.[234] Despite a negative enforcement action in this jurisdiction, Nevada's legislature refined and narrowed the *Hilton* holding to the limited circumstances of shareholder voting.[235]

Additionally, other jurisdictions expressly reject the idea that constituency statutes do not expand director authority:

> The Wisconsin Legislature enacted § 180.0827 after *Revlon,* and it specifically authorizes corporate directors to consider more than just shareholders in executing their duties. Such a provision is in direct conflict with a rule that would require directors to focus solely on maximizing value for the benefit of shareholders. Thus, *Revlon* cannot be the rule in Wisconsin. Therefore, in total, the court finds that neither *Unocal* nor *Revlon* are applicable in the case at hand and the business judgment rule applies in the first instance.[236]

From this view, constituency statutes do signal a change in the law. Our results are consistent with Michal Barzuza's 2009 study of the impact of antitakeover statutes, including constituency statutes, on directors' duties in takeover situations. Barzuza found that such statutes signaled a clear departure from directors' duties established in Delaware cases such as *Revlon*, *Unocal*, and *Blasius*.[237] Moreover, there is evidence that firms undertook more stakeholder friendly policies after constituency statutes were passed.[238]

On the other hand, constituency statutes were not the transformative event envisioned and hoped for by many early constituency statute scholars, particularly those with ideological ties to corporate social responsibility.[239] Constituency statutes expanded directors' authority to consider nonshareholder constituents, but that expansion only protected directors and did not create an enforceable right in any of the nonshareholder constituents. Courts in twelve of our sample cases declined to recognize a right for nonshareholder constituents to bring an action against directors to enforce constituency statutes. The federal district court in *Stilwell Value Partners I, L.P. v. Prudential Mut. Holding Co.*, a 2007 unpublished opinion, engaged in an extensive discussion regarding the history and purpose of Pennsylvania's

---

[233] Hilton Hotels Corp. v. ITT Corp., 978 F. Supp. 1342, 1346–47 (D. Nev. 1997).

[234] *See* NEV. REV. STAT. ANN. § 78.139 (LexisNexis 2013); Barzuza, *supra* note 116, at 2005–06; *see also* Millon, *supra* note 149, at 227.

[235] Barzuza, *supra* note 116, at 2005–06.

[236] Dixon v. Ladish Co., Inc., 785 F. Supp. 2d 746, 753 (E.D. Wis. 2011), *aff'd sub nom.* Dixon v. ATI Ladish LLC, 667 F.3d 891 (7th Cir. 2012).

[237] *See generally* Barzuza, *supra* note 116, at 2012–13, 2018.

[238] Atannassov, *supra* note 84.

[239] *See* Millon, *supra* note 149, at 227.

constituency statute.[240] The court stated that "although 15 Pa.C.S. §§ 1515(a) and (b) and 1716 permit directors to consider the interests of various groups, it does not provide *any* of these groups standing to sue if their interests, as such, are not considered."[241] Rather, "the intent of the statute was to supplement the corporate constituency provisions and clarify that lawsuits predicated on an independent fiduciary duty to shareholders may not be brought."[242]

A third question raised by constituency statutes was whether they would exacerbate the agency conflict between management and shareholders. Under this theory, constituency statutes would facilitate management misbehavior by shielding more director decisions from liability and judicial review, and thus allow directors to pursue their own interests rather than the interests of shareholders.[243] In our sample, seventeen cases relied upon constituency statutes to recognize expanded director duties in a dispositive (Positive 1A) or substantial (Neutral/Positive 2A) way. Scholars studying the relationship between stakeholder friendly measures, as evidenced by constituency statutes, firm innovation, and governance, have found mixed results.[244]

D. Constituency Statute Enforcement Implications for Alternative Purpose Firms

Having established that constituency statutes effected a change in directors' duties—one that was recognized and acted on by the courts—we confirm that constituency statutes were the first instance of legal pressure on the profit maximization rationale. The enforcement actions cataloged in this Article provide support for scholars' reliance on constituency statutes in second wave scholarship focusing on alternative purpose firms.

Constituency statute enforcement may shed light on the application challenges and enforcement issues for alternative purpose firms. For example, potential plaintiffs under benefit corporation legislation will be those with prior paths to the courthouse, such as shareholders, who are also granted explicit enforcement rights in benefit corporation statutes.

Even though creditors are not named in benefit corporation enforcement proceeding language, they may nonetheless attempt to use benefit corporation statutes to advance debt claims against corporations and enhance

---

[240] No. 06-4432, 2007 WL 2345281, at *10 (E.D. Pa. Aug. 15, 2007).

[241] *Id.* (quoting William H. Clark & W. Edward Sell, *Bisel's Pennsylvania Business Associations Lawsource* 181 (2d ed. 2001)).

[242] *Id.*

[243] *See* Bainbridge, *supra* note 124, at 980.

[244] *See* Atanassov, *supra* note 84 (finding a correlation between stakeholder measures and weaker innovation and governance); Flammer & Kazperszyk, *supra* note 84 (finding a positive correlation between firm innovation and stakeholder measures). *See also* Karpoff & Wittry, *supra* note 84 (critiquing event studies based upon constituency statutes to the extent that they measure antitakeover effects).

protections for debt payments. Creditors have been active litigants under constituency statutes and may use the novel mandatory nonshareholder constituency consideration language as a foothold to seek additional enforcement rights. If under constituency statutes creditors were denied standing because directors had permission, but no obligation, to consider creditors, the mandatory "shall" language in benefit corporation statutes may prove a viable argument. For example, in 2009, a bankruptcy court denied creditors standing to bring a breach of fiduciary duty claim, relying upon the permissive language in the statute:[245] "[T]he legislature specifically chose language that made the consideration of creditors' interests permissive, without exception. This conclusion was reached by . . . considering the meaning of the language utilized in O.R.C. §1701.59(E) and applying well-established canons of statutory construction."[246] This reasoning is easily flipped on its head in the context of mandatory language in benefit corporations.

Additionally, some benefit corporation statutes limit directors' mandatory duties to consider effects of corporate actions on nonshareholder constituents as they relate to the benefit purpose of the corporation.[247] This may not be a barrier to recovery for supplier creditors of benefit corporations or even general creditors so long as the debt was incurred in the ordinary course of the benefit corporation operation. For example, consider a benefit corporation with a give one, get one policy—for each item purchased, another is donated. Money borrowed to fund the operations of the company, and certainly lines of credit with suppliers, facilitates the corporation's pursuit of its benefit purpose. These creditors would not necessarily fall outside of the scope of the statutory mandate to consider nonshareholder constituents as they relate to the benefit purpose of the corporation.

As with constituency statutes, benefit corporation legislation may be seen as strengthening director protections under the business judgment rule and insulating director decisions, good or bad, from judicial review.[248] Open questions remain about whether the emergence of benefit corporations and alternative forms actually marks the change in tide against the shareholder wealth maximization rationale, as was envisioned by some for the constituency statutes, or whether there is little appreciable difference thirty years later.

Finally, the positive constituency statute enforcement actions bring us to our unique third wave question, which is how institutional investors respond to pressure on the profit maximization rationale. In the absence of available data regarding institutional investors and alternative purpose firms,

---

[245] In re I.E. Liquidation, Inc., No. 06-62179, 2009 WL 2707223 (Bankr. N.D. Ohio Aug. 25, 2009).

[246] *Id.* at 4.

[247] *See, e.g.*, L.B. 751, 103rd Leg., 2d Sess. (Neb. 2014).

[248] *See, e.g.*, Bainbridge, *supra* note 124; *see also* Barzuza, *supra* note 116 (describing how antitakeover statutes alter directors' duties in takeover situations and documenting departures from Delaware case law established in *Revlon*, *Unocal*, and *Blasius*).

we look to the passage of constituency statutes to observe how institutional investors, specifically HFDIs, reacted to the change in the law. If pressure on the profit maximization rationale presents a conflict, or a perceived conflict, for HFDIs, then we would expect to observe a decline in HFDI investment in firms incorporated in constituency statute jurisdictions. If not, the passage of such laws will not affect the level of HFDI investment.

The effect of constituency statutes on boards' duties to shareholders is smaller than the structural changes enacted with alternative purpose firms since permissive consideration of nonshareholders' interests is less impactful than mandatory consideration of nonshareholders' interests. Therefore, this should lighten any possible negative effect on HFDI investment, making it harder for us to detect. However, this provides a useful lower bound for the response of HFDI investors to alternative purpose firms. There are also several empirical advantages to considering constituency statutes. Since each statute applies to all firms incorporated in its state, the sample size is large. Furthermore, the various statutes took effect at different times over three decades, so their effect is not confounded empirically by some other concurrent event. We examine data relevant to these questions in the following Part.

VI. Empirical Tests of Third Wave Questions

A. *Sources*

We use Thomson's 13F data for quarterly institutional holdings between 1980 and 2005. During this period, the SEC required institutional investment managers controlling at least $100 million in U.S.-listed equities[249] to report the detail of each holding in form 13F, including number and value of shares held. The data do not include short positions. We match each security to the Center for Research in Security Prices (CRSP) and COMPUSTAT databases to obtain further information on the type of security and the company underlying the security. We restrict our focus to U.S.-based institutions using the country indicator provided in the 13F data.[250] We restrict our universe of securities to common shares (CRSP share codes 10 and 11) present in 13F data[251] and consider only firms incorporated in the fifty states.

---

[249] *See* Division of Investment Management: Frequently Asked Questions About Form 13F, U.S. Sec. & Exch. Comm'n (June 25, 2013), http://www.sec.gov/divisions/investment/13ffaq.htm.

[250] Prior to 1999, this country indicator is missing, but by matching to institutions present in the latter half of our sample, we screen out the non-U.S. based institutions in the pre-1999 data that survived to 1999. We assume that all institutions that do not survive to 1999 are U.S. based.

[251] Ideally, our universe would be CRSP securities available in a given quarter, of which only a few are not held by any institutional investors according to 13F data. This would allow us to include securities whose institutional ownership goes to zero. However, using a list of 13F-eligible securities provided by the SEC, we determine that the vast majority of securities

Very few firms switch their state of incorporation. Using data from Todd A. Gormley and David A. Matsa,[252] we find that a small minority of firms, 6.6%, switch their state of incorporation in our sample period. The vast majority of these switches occurred in the late 1990s and early 2000s, well after the passage of most constituency statutes—twenty-nine of the thirty-three states that passed the law did so by 1991. Moreover, most of the switches did not change the constituency status of the firm: only 1% of firms switched out of a constituency state to a nonconstituency state, and only 0.1% switched out of a nonconstituency state into a constituency state. Out of more than 14,000 firms, only twenty-four firms switched out of constituency states before 1995, and only twenty-seven switched in. For simplicity, we ignore these switches in the following results.

Finally, to identify whether the institution is a pension fund, endowment or other type of institution, we make use of data from Brian Bushee's website.[253] Bushee examines institutions classified by Thomson as "Other" and manually identifies private pensions, public pensions, and university or foundation endowments in the 13F data.[254] These data are updated annually. For example, private pensions, by far the largest category, include the YMCA, Firestone Pension Plans, and Evangelical Lutheran BD/Pension. Public pensions include CalPERS, Pennsylvania Public School Employees, and National Rural Electric Cooperative. Endowments include the Bill & Melinda Gates Foundation, Cornell University, and the MacArthur Foundation.

One limitation of this approach is that it does not specifically identify ERISA assets managed by institutions classified as investment advisers in the 13F data, such as Vanguard, that are subject to high fiduciary duties. Since holdings are rolled up to the institution level in the 13F data (for example, Vanguard reports only one entry each quarter), we are not able to differentiate between these institutions' ERISA assets and their other funds.

---

listed in CRSP and not matching to 13F data fail to match because the security is not eligible for 13F reports, not because ownership has gone to zero. The most common reason for this mismatch is that a security has been delisted and not yet cleaned from CRSP. The SEC's list of 13F-eligible securities is only available from 1996, after most constituency statutes were passed, making it impossible to control for eligibility in our analysis. However, very few 13F-eligible securities are not found in the 13F data. Thus for both simplicity and accuracy, we include only securities found in both the CRSP and the 13F data in our subsequent analysis. If anything, this could mean we are underestimating a potential negative effect on institutional investment because we ignore securities whose institutional ownership goes to zero. However, this is exceedingly rare, and tests with the universe of CRSP data do not suggest any cause for concern.

[252] *See generally* Todd A. Gormley & David A. Matsa, *Playing it Safe? Managerial Preferences, Risk, and Agency Conflicts* (June 6, 2014) (Investor Responsibility Research Center Institute) (unpublished report) (providing statistics about when firms switch their state of incorporation).

[253] *See* Brian Bushee, Institutional Investor Classification Data (June 10, 2014), http://acct.wharton.upenn.edu/faculty/bushee/IIclass.html.

[254] Thomson (formerly Spectrum) identifies five categories of institutions: banks, insurance companies, investment companies, independent investment advisers, and others. Abarbanell et al., *supra* note 20, at 239.

Our HFDI category is limited to institutions (pension funds, endowments) whose assets are *all* subject to particularly stringent fiduciary standards. A second, related limitation is the small sample size of HFDIs we obtain. Only 188 institutions of the 5783 unique institutions in Bushee's data are identified as pension funds or endowments, which is about 3.25% of the total number of institutions. This does not affect our total sample size since we include firms not held by HFDIs, but it makes our dependent variables relatively small and potentially noisy. The construction of the HFDI sample is thus restrictive, but it dependably reflects the investment decisions of institutions with strong duties to their beneficiaries.

B. Variables

For most of our analysis, we collapse the data to one observation per security and quarter. As discussed earlier, we define HFDIs as private pensions, public pensions, and university or foundation endowments. HFDI participation refers to the number of HFDIs holding a share in the firm, and HFDI exposure is the percent of the firm's shares held by HFDIs.

The Total Assets variable is taken from the CRSP-COMPUSTAT annual database. Monthly Volume Traded is the volume traded in the last month of the quarter as reported by CRSP.[255] Market Capitalization is calculated as the quarter-end stock price multiplied by the number of shares outstanding, again using the last available data from the monthly CRSP tables.[256]

C. Summary Statistics

Table 5 presents summary statistics for our universe of observations. Importantly, our universe includes multiple observations over time for most firms. In our empirical specification, we address this variation by including firm fixed effects. Since our sample period extends back to 1980, average values are lower than they would be for a snapshot of our firms today. In our empirical specification we also account for time trends by including time fixed effects to absorb aggregate trends.

The difference between means and medians in Table 5 reveals that most of our variables have a long right tail. While 50% of our observations correspond to firms with total assets at or below $156 million, the average asset amount is close to $2.6 billion, reflecting a small number of very large firms. Similarly, the median monthly share volume for the securities in our sample

---

[255] If the observation is not available in the third month of the quarter, we use the observation from the second month. If that is not available, we use the observation from the first month.

[256] We crosscheck this with market capitalization calculated from price and shares outstanding reported in the 13F tables and find the same results.

is 5421 shares, while the average is 46,515 shares, and median market capitalization is $90 million with an average around $1.2 billion.

Table 5 shows that HFDIs, as defined here, are a small category of investors. On average, an observation in our sample has four HFDI investors holding a share of the firm and 1.48% of the firm is held by HFDI investors. The median is one HFDI investor holding 0.26% of the firm.

TABLE 5: SUMMARY STATISTICS FOR UNIVERSE OF OBSERVATIONS

	Mean	Std. Dev.	Median
Annual Total Assets ($ million)	2,595	20,500	156
Monthly Volume Traded (shares)	46,515	309,848	5,421
Market Capitalization ($ million)	1,213	8,290	86
HFDI Participation	4.06	7.12	1.00
Private Pension Participation	1.47	3.26	0.00
Public Pension Participation	2.16	3.48	1.00
Endowment Participation	0.43	1.03	0.00
HFDI Exposure (%)	1.48	3.06	0.26
Private Pension Exposure	0.37	2.00	0.00
Public Pension Exposure	0.97	1.90	0.06
Endowment Exposure	0.14	0.93	0.00

Sample from 1980 to 2005. One observation per security and quarter. Total Assets is AT from COMPUSTAT. Monthly Volume Traded is VOL from monthly CRSP data. Market Capitalization is computed as quarter-end stock price multiplied by shares outstanding. HFDI Participation is defined as the number of pension funds and endowments holding a share in the company. HFDI Exposure is defined as the percent of shares outstanding held by pension funds and endowments.

We split our sample into companies incorporated in states that eventually pass a constituency statute and companies incorporated in states that do not. Taking a snapshot of both groups in 1982, we find that values of all variables are well within one standard deviation of each other, suggesting that the two groups are not discernibly different along important dimensions before the laws are passed. Values are lower overall for this snapshot because it is taken at the very beginning of our sample period. In 1982, firms in states that eventually passed constituency laws had somewhat lower assets, and traded a little less, but had higher market capitalizations. Both groups had an average of roughly two HFDI investors per firm per quarter, holding an average of 1.0–1.5% of the firm.

Table 6: 1982 Snapshot of Summary Statistics for States Eventually Passing Constituency Laws and States Never Passing Constituency Laws

	Pass		Don't Pass	
	Mean	Std. Dev.	Mean	Std. Dev.
Total Assets ($ million)	1,406	6,294	1,532	6,470
Monthly Volume Traded (shares)	7,217	16,771	8,798	16,932
Market Capitalization ($ million)	366	2,386	289	977
HFDI Participation	1.81	4.71	2.10	4.38
HFDI Exposure (%)	1.29	3.57	1.46	4.04

Sample from 1982. One observation per security and quarter. Total Assets is AT from COMPUSTAT. Monthly Volume Traded is VOL from monthly CRSP data. Market Capitalization is computed as quarter-end stock price multiplied by shares outstanding. HF Participation is defined as the number of pension funds and endowments holding a share in the company. HFDI Exposure is defined as the percent of shares outstanding held by pension funds and endowments.

D. *Empirical Approach and Hypotheses*

We use a difference-in-differences methodology to examine the effect of constituency statutes on HFDI investment. The basic regression we estimate is:

$$investment_{it} = \beta\{statute\ passed\}_{jt} + \delta_t + \gamma_i + \varepsilon_{ijt}$$

where i indexes firms, j indexes state of incorporation, and t indexes the quarterly date. On the left hand side, we look at two main measures of investment: participation (the number of HFDIs holding any share in the firm) and exposure (the percent of the firm held by HFDIs). $\{statute\ passed\}_{jt}$ is an indicator variable that takes the value 1 if state j has a constituency statute at time t and 0 otherwise. The δ_t are quarterly fixed effects that control for macroeconomic time trends, and the γ_i are firm fixed effects that control for time-invariant company idiosyncrasies such as industry and location. Thus, the coefficient β is designed to capture only the incremental effect of the law's passage, net of fixed differences between firms and macroeconomic trends. The dispersion of states' passage dates also aids our identification: the thirty-two[257] laws were passed in twenty different quarters over fifteen years, which reduces the likelihood of accidentally capturing the effect of something else that happened at the same time as one of the passages.

An example helps to illustrate our approach.[258] New York passes a constituency law in 1989, while Maryland and Delaware do not. Maryland then passes a constituency law in 1999, whereas Delaware has not passed such a

[257] Texas, the thirty-third jurisdiction to pass a constituency statute, passed, but did not make effective, the statute within the timeframe of our study, 1980 to 2005. Texas is therefore not included as a constituency statute state in our study.

[258] *See* Bertrand & Mullainathan, *supra* note 87, at 1056 (providing an illustration of a differences-in-differences approach).

law to this date. To estimate the effect of the New York law, we could compare HFDI investment after the law to HFDI investment before the law in New York-incorporated firms. This difference would be one estimate of the effect of the New York law. However, something else could have happened in 1989 that affected institutional investment, such as the savings and loans crisis. To control for that, we could look at institutional investment in Delaware and Maryland and see what change they experienced after 1989 compared to before 1989. Comparing the change in New York to the change in Maryland and Delaware, or taking the difference in differences, should yield a better estimate of the New York law's impact. Our empirical specification is an extension of this approach to a panel with different states passing laws at different times, such as New York in 1989 and Maryland in 1999.

Our design allows us to test whether the passage of constituency statutes caused a reduction in HFDI investment in locally incorporated firms, relative to firms incorporated in nonconstituency states. This reduction can take the form of divestment from existing holdings or avoidance of future investment in firms governed by constituency statutes, all else equal. Both actions would lead to fewer HFDI investors in firms in constituency states after the law is passed. In other words, when we run the above regression with HFDI participation as the dependent variable, the average treatment effect of the law (captured by our coefficient β) would, by this logic, be negative. On the other hand, if HFDI investors do not perceive an issue with the new constituency laws, we expect the estimated treatment effect of the law to be statistically indistinguishable from zero.

The percent of shares held ("exposure") captures a somewhat different dynamic for two reasons. First, an investor could choose to reduce but not completely shun investments in constituency firms. This could be indicative of an investor expecting lower performance from constituency firms, which has not yet been priced in by the market. Consider a case where the portfolio of institutional investor A is judged against the performance of a benchmark index that includes constituency firms. If institutional investor A believes constituency firm stock is overvalued, underweighting (reducing holdings relative to the index) constituency firm stock can be an attractive way to outperform the benchmark index without deviating from it too much.[259] In that case, we would see a decline in exposure but not in participation. Second, this variable depends on the number of shares held as well as the number of shares outstanding. The latter could correlate with constituency statutes if management increases buyouts or dilutions in response to the new takeover protection provided. If an investor decreases holdings but shares outstanding decrease simultaneously, the investor could still end up with the same percentage of shares. Conversely, if the investor's holdings remain

[259] For a discussion of this practice, see Simon Wong, *The Problem of "Underweight" Shareholders*, N.Y. Times (Aug. 5, 2014), http://dealbook.nytimes.com/2014/08/05/the-problem-of-underweight-shareholders/.

constant while shares outstanding increase, the percentage of shares held would decrease. In this way the exposure variable also captures investor behavior relative to others.

We summarize the above with the following hypotheses:

Hypothesis H_0 (Null Hypothesis): HFDI investors do not perceive an issue with constituency statutes, and constituency statutes do not have an effect on their propensity to invest, all else equal. Consequently, the estimate of the law's effect is statistically indistinguishable from zero.

Hypothesis H_1: HFDI investors are concerned that constituency statutes, which expand the goals that management can pursue beyond profit maximization, run contrary to their fiduciary duties, and consequently prefer to invest in nonconstituency firms, all else equal. If this is the case, we expect the estimate of the law's effect on HFDI participation to be negative.

Hypothesis H_2: HFDI investors are concerned that constituency statutes run contrary to their fiduciary duties, but they still wish to have some exposure to these investments. Consequently, these HFDI investors underweigh investments in constituency firms relative to other investors. If this is the case, we expect the estimate of the law's effect on HFDI exposure to be negative.

E. Results

We begin with aggregate measures of HFDI participation and exposure. In Table 7, the coefficient on "Statute Passed" represents the difference in HFDI investment attributable to the passage of the constituency statute. Column 1 indicates that on average, firms newly governed by constituency laws had 0.27 fewer HFDIs than their counterparts in states not governed by the laws, all else equal. This represents a 7% decrease relative to an average HFDI participation of 4.06 over our sample period, although the effect is not statistically significant at the usual Type I error levels—we cannot reject above a 90% confidence level that the effect is exactly zero. Nonetheless, the estimate allows us to place bounds on the magnitude of a potential effect: on the lower end, our 95% confidence bound stops at 0.86 fewer HFDIs—a 20% drop relative to the average—while on the upper end we can reject an increase of more than 0.32 additional investors—8% of the average. These results allow for the possibility of a reaction to the constituency statutes but reject a large-scale abandonment.

The results with HFDI exposure are analogous: the null hypothesis of no effect is not rejected, and the test does reject an HFDI exposure drop of more than 0.16%, or 11% of the average HFDI exposure in the sample, as well as an increase in HFDI exposure of 8% relative to the average. From both perspectives, the test results are consistent with no reaction by HFDIs to the statutes, and to the extent calculated here, rule out an economically significant reaction.

TABLE 7: EFFECT OF CONSTITUENCY STATUTE PASSAGE

This table presents results of the regression $investment_{it} = \beta\{statute\ passed\}_{jt} + \delta_t + \gamma_i + \varepsilon_{ijt}$ where i indexes firms, j indexes state of incorporation and t indexes the quarterly date. $\{statute\ passed\}_{jt}$ is an indicator variable that takes the value 1 if state j has a constituency statute at time t and 0 otherwise. δ_t are quarterly fixed effects and γ_i are firm fixed effects. The dependent variable investment is defined as HFDI participation in the first column and HFDI exposure in the second column.

VARIABLES	HFDI Participation	HFDI Exposure
Statute Passed	-0.272	-0.0200
	(0.300)	(0.0705)
Observations	527,231	527,231
R-squared	0.339	0.046
Number of firm ID	20,158	20,158
Firm FE	Y	Y
Quarter FE	Y	Y

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1
Standard errors clustered at state level

To investigate further, we break out HFDIs into their three investor categories: private pensions, public pensions, and endowments. This sheds light on the relationship between the investor categories and reaction to the statutes, at the expense of widening the confidence intervals. We present the results for HFDI participation in Table 8 and for HFDI exposure in Table 9. Consistent with the results above, investor participation has a slightly negative but statistically insignificant coefficient in each case. The absolute magnitude is greatest among pensions (consistent with their duties under ERISA), where constituency firms had an average tenth of an HFDI investor less than their counterparts, representing 6% of the average public pension participation in our sample and 7% of the average private pension participation. The relative magnitude is higher for endowments, where the difference in participation represents 10% of the average participation. This could reflect a weaker fiduciary duty among endowments, or just the lower power of these subsample tests. These results are all consistent with the statutes having a zero or at most modestly negative effect on HFDI investment.

TABLE 8: EFFECT OF CONSTITUENCY STATUTE PASSAGE ON HFDI PARTICIPATION

This table presents results of the regression $investment_{it} = \beta\{statute\ passed\}_{jt} + \delta_t + \gamma_i + \varepsilon_{ijt}$ where i indexes firms, j indexes state of incorporation and t indexes the quarterly date. $\{statute\ passed\}_{jt}$ is an indicator variable that takes the value 1 if state j has a constituency statute at time t and 0 otherwise. δ_t are quarterly fixed effects and γ_i are firm fixed effects. The dependent variable investment is defined as total HFDI participation in the first column, then participation of private pensions, participation of public pensions, and finally participation of university or foundation endowments. The categories are determined by mapping 13F filers to data from Brian Bushee.

VARIABLES	All	Private Pensions	Public Pensions	Endowments
Statute Passage	-0.272	-0.0988	-0.126	-0.0465
	(0.300)	(0.132)	(0.146)	(0.0353)
Observations	527,231	527,231	527,231	527,231
R-squared	0.339	0.155	0.448	0.081
Number of firm ID	20,158	20,158	20,158	20,158
Firm FE	Y	Y	Y	Y
Quarter FE	Y	Y	Y	Y

Robust standard errors in parentheses
*** $p<0.01$, ** $p<0.05$, * $p<0.1$
Standard errors clustered at state level

Results for investor exposure are similar, except that we find a statistically significant and positive result for private pensions following constituency statutes. This suggests that private pensions' exposure to firms *increased* after they became subject to constituency statutes. However, it is critical to note that exposure depends both on the amount held by the investor and the market capitalization of the firm. In fact, when we examine private pensions' holdings more closely, we find that the amount held decreased but that shares outstanding actually decreased by more, leading to a net positive increase in the exposure of private pensions.

Table 9: Effect of Constituency Statute Passage on HFDI Exposure

This table presents results of the regression $investment_{it} = \beta\{statute\ passed\}_{jt} + \delta_t + \gamma_i + \varepsilon_{ijt}$ where i indexes firms, j indexes state of incorporation and t indexes the quarterly date. $\{statute\ passed\}_{jt}$ is an indicator variable that takes the value 1 if state j has a constituency statute at time t and 0 otherwise. δ_t are quarterly fixed effects and γ_i are firm fixed effects. The dependent variable investment is defined as total HFDI exposure in the first column, then exposure of private pensions, exposure of public pensions, and finally exposure of university or foundation endowments. The categories are determined by mapping 13F filers to data from Brian Bushee.

VARIABLES	All	Private Pensions	Public Pensions	Endow-ments
Statute Passage	-0.0200	0.0869**	-0.118	0.0111
	(0.0705)	(0.0391)	(0.0711)	(0.0133)
Observations	527,231	527,231	527,231	527,231
R-squared	0.046	0.019	0.108	0.005
Number of firm ID	20,158	20,158	20,158	20,158
Firm FE	Y	Y	Y	Y
Quarter FE	Y	Y	Y	Y

Robust standard errors in parentheses
*** $p<0.01$, ** $p<0.05$, * $p<0.1$
Standard errors clustered at state level

We perform a variety of robustness checks of these results. Because our dependent variables have long right tails and are always positive valued, we repeat our regressions using natural logs of our dependent variables. This mitigates the effect of potential outliers. We find similar results to those we report in the tables. We also verify robustness to using shorter sample periods and controlling for business combination laws. Finally, including the universe of CRSP securities rather than keeping only those matching to 13F data does not change the qualitative results.

F. Discussion

The empirical findings show that constituency statutes were not a roadblock to institutional investment with especially high fiduciary duties. We cannot rule out that constituency statutes had *some* effect on HFDI investment, but we can rule out that these investors significantly altered investment behavior after the passage of the statutes, as one might expect if these institutions perceived material conflicts with their fiduciary duties. We consider these findings promising for new legislation such as the benefit corporation laws, insofar as constituency laws expanded management prerogatives to consider nonshareholder interests.

That said, constituency laws did not expand management responsibilities, which may prove the more challenging part of benefit corporation and alternative purpose entity legislation. In particular, such legislation may expose corporations to potential lawsuits from disgruntled constituents to whom corporate directors owe duties, such as creditors. Nonshareholder constituency pressure on corporations from such legislation could result in a more significant departure from shareholder interests than previously existed under constituency laws. It is possible, therefore, that the new legislation will tip the balance for institutional investors concerned about their fiduciary duties, reducing the pool of capital available for newly minted alternative purpose firms. If this happens, however, it will be a result of statutorily expanded firm mandatory obligations and resulting liabilities, rather than a result of expanded director discretion.

VII. Conclusion

In this paper we address the question of whether decreased profit maximization pressure poses a detectable barrier to HFDI investment in alternative purpose firms. The growing institutional stake in equities, and the growing likelihood that alternative purpose firms will trade publicly, make this an important and timely question. Access to institutional investors' capital would be crucial for such firms to rival the economic significance of purely for-profit corporations. We address the question by using the passage of constituency laws to examine the effect of expanding directors' rights to consider nonshareholder interests on the investment behavior of HFDIs.

We begin by reviewing both the underlying agency relationship between HFDI managers and the principals (shareholders and beneficiaries) on whose behalf they invest, and also the strict fiduciary duties governing the scope of permissible investment. We conclude from this review that if expanded director discretion to pursue nonshareholder interests is a barrier to institutional investment, it would be most clearly observable in the holdings of HFDIs.

We then revisit constituency laws and the first and second waves of research examining these laws. Our research intersects with existing scholarship on both constituency statutes and alternative purpose firms, and connects the two. While many have examined the two issues from the perspective of corporate directors, none have taken the perspective of the institutional manager charged with independent and unchanged fiduciary duties.

Next, we confirm, through a thirty year case review, that constituency statutes changed the law as applied to director discretion, albeit in a limited way. This enables us to answer outstanding first wave questions from the earliest scholarship in the field regarding the scope of directors' changed duties, permissible plaintiffs, and the incorporation of constituency statutes into common law. Gleaning lessons from the constituency statute enforcement, our Article also offers new insight into alternative purpose firm legislation. First, our finding that shareholders and creditors were common constituency statute plaintiffs forecasts that these same groups will likely be plaintiffs under benefit corporation legislation. Even though creditors are not statutorily vested with standing to bring benefit proceedings as shareholders are, creditors may nonetheless attempt to use benefit corporation statutes to advance their debt claims against corporations and as protection for debt payments. Second, as with constituency statutes, benefit corporation legislation may be seen as strengthening director protections under the business judgment rule that may have the unintended consequence of insulating director decisions, good or bad, from judicial review.

The lessons gain additional significance in light of our subsequent empirical exercise. Using a difference-in-differences approach, we find that HFDIs showed a small and statistically insignificant response to the passage of constituency statutes. Thus we conclude that the negative pressure on profit maximization did not significantly deter HFDI investment. HFDIs may have been concerned about increased director prerogative to serve nonshareholder interests, but the change in the law, observable through the passage of constituency statutes, did not significantly influence their investment behavior. In other words, HFDIs tolerated expanded director duties. If there is no observable legal obstacle to investing in firms with latitude to serve nonshareholder interests for HFDIs, with the strictest of fiduciary duties, then there is likely no fiduciary obstacle for other institutional investors subject to equal or lesser duties. HFDIs' tolerance of constituency statutes signals a potential tolerance by HFDIs to the recent and growing manifestation of expanded director discretion to serve nonshareholder interests: the alternative purpose firm. The findings here are evidence against fiduciary concerns impeding these firms' access to public capital.

Nonetheless, the insignificant reaction to constituency statutes does not guarantee a similar attitude toward alternative purpose firms. The salient difference is the obligatory nature of the firm's duty to nonshareholder constituents in the latter case, in contrast to the permissive duty introduced by constituency laws. Replacing permission with obligation creates new grounds for legal challenges on behalf of nonshareholder constituents, and our case review suggests creditors in particular may try to exploit this amended duty. Therefore, the greatest challenge for alternative purpose firms seeking institutional capital may not be the pursuit of their alternative mission, but rather the increased liability risk. Interpretive guidance and early cases confirming (or denying) the existence and testing the extent, if any, of additional litigation risk will be instrumental in determining the viability of public alternative purpose firms.

Appendix A: Constituency Statutes

State	Statute	Year First Introduced	Litigation
Arizona	Ariz. Rev. Stat. Ann. § 10-2702	1987	
Connecticut	Conn. Gen. Stat. § 33-756(d)	1988	1 case
Florida	Fla. Stat. § 607.0830(3)	1989	1 case
Georgia	Ga. Code Ann. § 14-2-202(b)(5)	1989	
Hawaii	Haw. Rev. Stat. § 414-221(b)	1989	
Idaho	Idaho Code Ann. § 30-1602; § 30-1702	1988	
Illinois	805 Ill. Comp. Stat. 5/8.85	1985	2 cases
Indiana	Ind. Code § 23-1-35-1(d)	1986	3 cases
Iowa	Iowa Code § 491.101B	1989	
Kentucky	Ky. Rev. Stat. Ann. § 271B.12-210(4)	1988	
Louisiana	La. Rev. Stat. Ann. § 12:92(G)	1988	
Maine	Me. Rev. Stat. tit. 13-C M.R.S. § 831(6)	1985	1 case
Maryland	Md. Code. Ann., Corps. & Ass'ns. § 2-104(b)(9)	1999	
Massachusetts	Mass. Gen. Laws ch. 156D, § 8.30(a)(3)	1989	5 cases
Minnesota	Minn. Stat. § 302A.251 subd. 5	1987	
Mississippi	Miss. Code Ann. § 79-4-8.30(f)	1990	
Missouri	Mo. Rev. Stat. § 351.347	1986	1 case
Nebraska	Neb. Rev. St. § 21-2095	1988	
Nevada	Nev. Rev. Stat. § 78.138(4)	1991	7 cases
New Jersey	N.J. Stat. Ann. § 14A:6-1(3) (West)	1989	2 cases
New Mexico	N.M. Stat. Ann. § 53-11-35(d)	1987	
New York	N.Y. Bus. Corp. Law § 717(b) (McKinney)	1989	3 cases
North Dakota	N.D. Cent. Code § 10-19.1-50(6)	1993	
Ohio	Ohio Rev. Code Ann. § 1701.59(F) (West)	1984	10 cases
Oregon	Or. Rev. Stat. § 60.357(5)	1989	
Pennsylvania	15 Pa. Cons. Stat. § 1715(a)(b), 516(a)	1983	8 cases
Rhode Island	R.I. Gen. Laws § 7-5.2-8(a)	1990	
South Dakota	S.D. Codified Laws § 47-33-4(1)	1990	
Tennessee	Tenn. Code. Ann. § 48-103-204	1988	

State	Statute	Year First Introduced	Litigation
Texas	Tex. Bus. Orgs. Code Ann. § 21.401(b)-(e)	2006	
Vermont	Vt. Stat. Ann. tit. 11A, § 8.30(a)(3)	1998	
Wisconsin	Wis. Stat. § 180.0827	1987	3 cases
Wyoming	Wyo. Stat. Ann. § 17-16-830(g)	1990	

Appendix B: Antitakeover Statutes

State	**Business Combination**	**Control Share**
Arizona	Ariz. Rev. Stat. Ann. §§ 10-27421, 10-27422	Ariz. Rev. Stat. Ann. § 10-2725
Connecticut	Conn. Gen. Stat. § 33-844	
Delaware	Del. Code Ann. tit. 8, § 203	
Florida		Fla. Stat. § 607.0902
Georgia	Ga. Code. Ann. § 14-2-1132	
Hawaii		Haw. Rev. Stat. § 414E-2
Idaho	Idaho Code Ann. § 30-1704	Idaho Code Ann. § 30-1607
Illinois	805 Ill. Comp. Stat. 5/11.75	
Indiana	Ind. Code § 23-1-43-19	Ind. Code Ann. § 23-1-42-9
Iowa	Iowa Code § 490.1110	
Kansas	Kan. Stat. Ann. § 17-12,101	Kan. Stat, Ann. § 17-1297
Kentucky	Ky. Rev. Stat. Ann. § 271B.12-210	
Louisiana		LA. Rev. Stat. Ann. § 12:140
Maine	Me. Rev. Stat. Ann. tit. 13-C, §1109	
Maryland	Md. Code. Ann., Corps. & Ass'ns § 3-602	Md. Code. Ann., Corps. & Ass'ns § 3-702
Massachusetts	Mass. Gen. Lawsch.110F § 1	Mass. Gen. Laws ch. 110D § 2
Michigan	Mich. Comp. Laws § 450.1781	Mich. Comp. Laws § 450.1790
Minnesota	Minn. Stat. § 302A.673	Minn. Stat. § 302A.671
Mississippi		Miss. Code Ann. § 79-27-7
Missouri	Mo. Ann. Stat. § 351.459	Mo. Ann. Stat. § 351.407
Montana		
Nebraska	Neb. Rev. Stat. § 21-2452	Neb. Rev. Stat. § 21-2451
Nevada	Nev. Rev. Stat. § 78.438	Nev. Rev. Stat. § 78.379
New Hampshire		
New Jersey	N.J. Stat. Ann. § 14A:10A-4 (West)	
New York	N.Y. Bus. Corp. Law § 912 (McKinney)	
North Carolina		N.C. Gen. Stat. § 55-9A-05
North Dakota		
Ohio	Ohio Rev. Code Ann. § 1704.02 (West)	Ohio Rev. Code Ann. § 1701.831 (West)

State	Business Combination	Control Share
Oklahoma	OKLA. STAT. tit. 18, § 1090.3	OKLA. STAT. tit. 18, § 1149
Oregon	OR. REV. STAT. § 60.835	OR. REV. STAT. § 60.807
Pennsylvania	15 PA. CONS. STAT. § 2555	15 PA. CONS. STAT. § 2564
Rhode Island	R.I. GEN. LAWS § 7-5.2-4	
South Carolina	S.C. CODE ANN. §§ 35-2-218, 35-2-219	S.C. CODE ANN. § 35-2-109
South Dakota	S.D. CODIFIED LAWS § 47-33-17	S.D. CODIFIED LAWS § 47-33-8
Tennessee	TENN. CODE ANN. § 48-103-205	TENN. CODE ANN. § 48-103-303
Texas	TEX. BUS. ORGS. CODE ANN. § 21.606	
Utah		UTAH CODE ANN. § 61-6-10
Virginia	VA. CODE ANN. § 13.1-725.1	VA. CODE. ANN. § 13.1-728.3
Washington	WASH. REV. CODE § 23B.19.040	

Appendix C: Constituency Statute Enforcement Cases

	Case	Law	Enforcement Eval.	Code
1	Baron v. Strawbridge & Clothier, 646 F. Supp. 690 (E.D. Pa. 1986)	PA	Neutral/ Positive	2A
2	Keyser v. Commonwealth Nat. Fin. Corp., 675 F. Supp. 238, 254–59 (M.D. Pa. 1987)	PA	Positive	1A
3	Cottle v. Storer Commc'n, Inc., 849 F.2d 570, 577 (11th Cir. 1988)	PA	Neutral	3A
4	Amanda Acquisition Corp. v. Universal Foods Corp, 708 F. Supp. 984, 1011–12 (E.D. Wis. 1989), *aff'd*, 877 F.2d 496 (7th Cir. 1989)	WI	Positive	1A
5	Georgia-Pac. Corp. v. Great N. Nekoosa Corp., 727 F. Supp. 31 (D. Me. 1989)	ME	Neutral/ Positive	2A
6	Armstrong World Indus., Inc. by Wolfson v. Adams, 961 F.2d 405, 408 (3d Cir. 1992)	PA	Neutral/ Positive	2B
7	Abrahamson v. Waddell, 63 Ohio Misc.2d 270, 272–73, 624 N.E.2d 1118, 1120 (Com. Pl. 1992)	OH	Positive	1A
8	Shoen v. AMERCO, 885 F. Supp. 1332, 1341 (D. Nev. 1994) modified, No. CV-N-94-0475-ECR, 1994 WL 904199 (D. Nev. Oct. 24, 1994)	NV	Neutral/ Negative	4A
9	Hilton Hotels Corp. v. ITT Corp., 978 F. Supp. 1342, 1346–47 (D. Nev. 1997)	NV	Neutral/ Negative	4A
10	Basswood Partners, L.P. v. NSS Bancorp, Inc., CV980163412S, 1998 WL 59476 (Conn. Super. Ct. Feb. 6, 1998)	CT	Positive	IB
11	IBS Fin. Corp. v. Seidman& Associates, L.L.C., 136 F.3d 940, 949 (3d Cir. 1998)	NJ	Neutral	3A
12	AMP Inc. v. Allied Signal, Inc., CIV. A. 98-4405, 1998 WL 778348 (E.D. Pa. Oct. 8, 1998)	PA	Positive	1A
13	Safety-Kleen Corp. v. Laidlaw Envtl. Servs., Inc., 97 C 8003, 1999 WL 601039 (N.D. Ill. Feb. 4, 1998)	WI	Positive	1A
14	In re McCalla Interiors, Inc., 228 B.R. 657, 660 (Bankr. N.D. Ohio 1998)	OH	Neutral	3A
15	Flake v. Hoskins, 55 F. Supp. 2d 1196, 1214 (D. Kan. 1999)	MO	Neutral/ Negative	4A

	Case	Law	Enforcement Eval.	Code
16	First Union Corp. v. SunTrust Banks, Inc., 01-CVS-10075, 2001 WL 1885686 (N.C. Super. Ct. Aug. 10, 2001)	IL	Neutral/ Positive	2A
17	Warehime v. Warehime, 2001 PA Super 141, 777 A.2d 469, 480-81 (Pa. Super. Ct. 2001) *rev'd*, 580 Pa. 201, 860 A.2d 41 (2004)	PA	Neutral/ Negative	4A
18	Shepard v. Humke, No. IP 01-1103-C H/ K, 2002 WL 1800311 (S.D. Ind. July 9, 2002)	IN	Neutral	3B
19	Murray v. Conseco, Inc., 766 N.E.2d 38, 44–45 (Ind. Ct. App. 2002) *vacated*, 795 N.E.2d 454 (Ind. 2003)	IN	Neutral/ Positive	2A
20	Seidman v. Cent. Bancorp, Inc., 030547BLS, 2003 WL 21528509 (Mass. Super. Ct. June 30, 2003)	MA	Positive	1A
21	Kloha v. Duda, 246 F. Supp. 2d 1237, 1245–46 (M.D. Fla. 2003)	FL	Positive	1A
22	Liberty Mut. Ins. Co. v. M.C.K., Inc., 62 Mass. App. Ct. 1103, 815 N.E.2d 655 (2004)	MA	Neutral	3A
23	In re Global Serv. Grp., L.L.C., 316 B.R. 451, 460–61 (Bankr. S.D.N.Y. 2004)	NY	Neutral	3A
24	Official Comm. of Unsecured Creditors of PHD, Inc. v. Bank One, NA, 1:03CV2466, 2004 WL 3721325 (N.D. Ohio Apr. 23, 2004)	OH	Positive	1B
25	In re Mid-State Raceway, Inc., 323 B.R. 40, 57–58 (Bankr. N.D.N.Y. 2005)	NY	Neutral	3A
26	Blond v. Simpson, No. A433821, 2005 WL 4925579 (Nev. Dist. Ct. July 5, 2005)	NV	Neutral	3A
27	Stahl v. Verbus Realty & Auction Co., 2005 WL 6030058 (Ohio Com.Pl.) (Trial Order) (Sept. 26, 2005)	OH	Neutral	3A
28	Goldstein v. Sav. Bank Life Ins. Co. of Massachusetts, CIV.A.98-2330NBLS2, 2006 WL 1720153 (Mass. Super. App. 7, 2006)	MA	Neutral	3A
29	In re Classica Grp., No. 04-19875 (DHS), 2006 WL 2818820, *6–11 (Bankr. D.N.J. Sept. 29, 2006)	NJ	Neutral	3A
30	In re Amcast Indus. Corp., 365 B.R. 91, 110 (Bankr. S.D. Ohio 2007)	OH	Positive	1B

	Case	Law	Enforcement Eval.	Code
31	Stilwell Value Partners I, L.P. v. Prudential Mut. Holding Co., CIV.A. 06-4432, 2007 WL 2345281 (E.D. Pa. Aug. 15, 2007)	PA	Neutral/ Positive	2B
32	Washington Penn Plastic Co., Inc. v. Creative Engineered Polymer Products, LLC, 506CV1224, 2007 WL 2509873 (N.D. Ohio Aug. 30, 2007)	OH	Positive	1B
33	Nelson v. IPALCO Enterprises, Inc., 480 F. Supp. 2d 1061, 1080 (S.D. Ind. 2007) *aff'd sub nom*. Nelson v. Hodowal, 512 F.3d 347 (7th Cir. 2008)	IN	Neutral/ Positive	2A
34	Gut v. MacDonough, CIV.A. 2007-1083-C, 2007 WL 2410131 (Mass. Super. Aug. 14, 2007)	MA	Neutral/ Positive	2A
35	Oldham v. Dendrite International, Inc., No. SOM-C-12017-07, 2007 WL 1453482 (N.J. Super. Ct. App. Div. May 1, 2007)	NJ	Positive	1A
36	Washington Penn Plastic Co. v. Creative Engineered Polymer Products, L.L.C., No. 506CV1224, 2007 WL 2509873, at *2–3 (N.D. Ohio Aug. 30, 2007)	OH	Positive	1B
37	Stilwell Value Partners I, L.P. v. Prudential Mut. Holding Co, CIV.A. 06-4432, 2008 WL 1900945 (E.D. Pa. Apr. 24, 2008)	PA	Positive	1A
38	In re Sec. Asset Capital Corp., 390 B.R. 636, 645–46 (Bankr. D. Minn. 2008)	NV	Neutral	3A
39	Hill v. State Farm Mut. Auto. Ins. Co., 166 Cal. App. 4th 1438, 1485–86 (2008)	IL	Neutral/ Positive	2B
40	In re Las Vegas Sands Corp. Derivative Litigation, No. A576669, 2009 WL 6038660 (Nev. Dist. Ct. Nov. 4, 2009)	NV	Positive	1A
41	In re I.E. Liquidation, Inc., No. 06-62179, 2009 WL 2707223 (Bankr. N.D. Ohio Aug. 25, 2009)	OH	Positive	1B
42	Schmidt v. Lang Motors of Dayton, Inc., No. 2009-CV-0368, 2009 WL 1430673 (Ohio Ct. Com. Pl. May 13, 2009)	OH	Positive	1B
43	Shade v. Athena Equip. & Supply, Inc., 2010 Mass. App. Div. 68 (Dist. Ct. 2010)	MA	Neutral	3A
44	CornerWorld Corp. v. Timmer, 1:09-CV-1124, 2010 WL 3942804 (W.D. Mich. Oct. 6, 2010)	NV	Positive	1B

	Case	Law	Enforcement Eval.	Code
45	Kruss v. Booth, 185 Cal. App. 4th 699, 707–08, 111 Cal. Rptr. 3d 56, 64 (2010)	NV	Neutral	3A
46	Dixon v. Ladish Co., Inc., 785 F. Supp. 2d 746, 751–53 (E.D. Wis. 2011), *aff'd sub nom*. Dixon v. ATI Ladish LLC, 667 F.3d 891 (7th Cir. 2012)	WI	Positive	1A
47	In re Nat'l Century Fin. Enterprises, Inc., 846 F. Supp. 2d 828, 894–95 (S.D. Ohio 2012)	OH	Positive	1B

Appendix D: Benefit Corporation Legislation

1.	Arizona	Ariz. Rev. Stat. Ann. §§10-2401 to -2442 *Effective January 1, 2015*
2.	Arkansas	Arkansas Benefit Corporation Act, Ark. Code Ann. §§ 4-36-101 to -106 *Effective August 16, 2013*
3.	California	Cal. Corp. Code §§ 14600–14630 *Effective January 1, 2012*
4.	Colorado	Colo. Rev. Stat. §§ 7-101-501 to -509 *Approved May 15, 2013*
5.	Connecticut	Conn. Gen. Stat. §§ 140–154 *Effective October 1, 2014*
6.	District of Columbia	D.C. Code §§ 29-1301.01 to -1304.01 *Effective May 1, 2013*
7.	Delaware	Del. Code Ann. tit. 8, §§ 361–368 *Effective August 1, 2013*
8.	Florida	Fla. Stat. §§ 607.601–613 *Effective July 1, 2014*
9.	Hawaii	Haw. Rev. Stat. §§ 420D-1 to-11 *Effective July 8, 2011*
10.	Illinois	The Benefit Corporation Act 805 Ill. Comp. Stat. §§40/1- 5.91 *Effective January 1, 2013*
11.	Louisiana	Benefit Corporation Law La. Rev. Stat. Ann. §§ 12:1801–1832 *Effective August 1, 2012*
12.	Maryland	Md. Code Ann., Corps. & Ass'ns §§ 5-6C-01 to -08 *Effective June 1, 2012*
13.	Massachusetts	Mass. Gen. Laws Ann.ch. 156E, §§ 1–16 (West) *Effective December 1, 2012*
14.	Minnesota	Minnesota Public Benefit Corporation Act Minn. Stat. § 304A.101 (2014) To be enacted at Minn. Stat. §§ 304A.101. *Effective January 1, 2015*
15.	Nebraska	Leg. 751, 103 Leg., 2nd Sess. (Neb. 2014)
16.	Nevada	Nev. Rev. Stat. § 78B.010–190 *Effective January 1, 2014*
17.	New Hampshire	NH. Rev. Stat. Ann.§ 293C:1-13 *Effective January 1, 2015*
18.	New Jersey	New Jersey Business Corporation Act N.J. Stat. Ann. § 14A:18-1 to -11 (West) *Effective March 1, 2011*
19.	New York	N.Y. Bus. Corp. Law § 1701–1709 (McKinney) *Effective February 10, 2012*

20.	Oregon	OR. REV. STAT. § 60.750–770 *Effective January 1, 2014*
21.	Pennsylvania	15 PA. CONS. STAT. § 3301–3331 *Effective January 22, 2013*
22.	Rhode Island	R.I. GEN. LAWS ANN. §§ 7-5.3-1 to -13 *Effective January 1, 2014*
23.	South Carolina	South Carolina Benefit Corporation Act S.C. CODE ANN. §§ 33-38-110 to -600 *Effective June 14, 2012*
24.	Utah	Benefit Corporation Act UTAH CODE ANN. §§ 16-10b-101 to -402 *Effective May 13, 2014*
25.	Vermont	Vermont Benefit Corporations Act VT. STAT. ANN. tit. 11A, § 21.01–14 *Effective July 1, 2011*
26.	Virginia	VA. CODE ANN. §§ 13.1-782 to -791 *Approved March 26, 2011*
27.	West Virginia	West Virginia Benefit Corporation Act W. VA. CODE §§ 31F-1-101 to 5-501 *Effective July 1, 2014*