Achieving the Double Bottom Line: A Framework for Corporations Seeking To Deliver Profits and Public Services

Lisa M. Fairfax*

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* Assistant Professor, University of Maryland School of Law, A.B. Harvard College, 1992, J.D. Harvard Law School, 1995. I would like to thank my husband Roger A. Fairfax, Jr., for his support and probing comments. I would also like to thank my colleagues Michael Van Alstine and Jana Singer for their comments on earlier versions of this Article. Special thanks to my research assistants Ted Castell, Brien Penn, and Ryan Nowlin for their timely and effective help. In addition, I would like to thank the Sloan Foundation and the participants in the Sloan Program for the Study of Business in Society for their comments and insights on earlier versions of this Article. Finally, I would like to thank Donna Nage and the members of the University of Cincinnati Law School faculty for their comments on earlier versions of this Article. All errors and omissions, of course, are mine.

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In recent years, there has been a significant growth in "double bottom line" corporations—for-profit corporations that deliver some public service such as health care or primary education while also promising financial returns to their shareholders.[1] Such corporations have generated a firestorm of opposition and debate.[2] Opponents argue that these corporations should be rejected altogether because their for-profit status inevitably will cause them to compromise on the quality of the services they deliver in favor of generating profits.[3] Proponents disagree, insisting that through increased competition and efficiency, these double bottom line corporations will enhance the quality of services being offered.[4] Moreover, proponents' unqualified support of these entities suggests a belief that the for-profit regime adequately ensures that these double bottom line companies will not ignore their public mission in order to satisfy their financial objectives.

Although both of these positions appear to be based on a particular understanding of the corporate law regime, few scholars have analyzed double

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[1] *See infra* Part I.B (describing growth of for-profits within various areas).

[2] *See, e.g.*, Lawrence E. Singer, *The Conversion Conundrum: The State and Federal Response to Hospitals; Changes in Charitable States*, 23 AM. J.L. & MED. 221, 236-37 (1997) (noting legislative challenges to public hospital conversions from nonprofit to for-profit form); Jordana Hart & Jill Zuckman, *For-Profit Firms Get 4 of 8 Charters for Schools*, BOSTON GLOBE, Feb. 26, 1998, at B1 (noting that Boston legislators introduced bills seeking to prevent for-profit companies from operating charter schools); Karen Hayes, *Charter School Gets Settled in Plymouth, Rising Tide Gets Past Early Resistance, Growing Pains, Now Has Long Waiting List*, BOSTON GLOBE, Mar. 12, 2000, at 1 (noting "storm of opposition" from local school officials in Boston and legislation aimed at prohibiting the use of for-profit firms); *Agreement on Taking Philly Schools Private; Deal for Troubled City System Draws Opposition*, NEWSDAY, Dec. 22, 2001, at A12 [hereinafter *Philly Schools*] (noting opposition from teachers, school workers, student activists, and community groups, and that two-dozen protesters occupied a school building to protest Edison's operation of their school).

[3] *See, e.g.*, Nicole B. Casarez, *Furthering the Accountability Principle in Privatized Federal Corrections: The Need for Access to Private Prison Records*, 28 U. MICH. J.L. REFORM 249, 250 (1995) (describing fear that for-profit corporations may put profit-making concerns above care of prisoners); Bradford H. Gray & Walter J. McNerney, *For-Profit Enterprise in Healthcare: The Institute of Medicine Study*, 314 NEW. ENG. J. MED. 1523, 1524 (1986) (noting that some object to for-profit health care based on the belief that profit-making is fundamentally inconsistent with the values and purpose of health care organizations); Susan Vivian Mangold, *Welfare Reform & the Juvenile Courts: Protection, Privatization & Profit in the Foster Care System*, 60 OHIO ST. L.J. 1295, 1311 (1999) (describing opposition to potential "orphans for profit" industry arising within the foster care system); Peter Schrag, *Edison's Red Ink Schoolhouse—The Biggest Brand Name in For-Profit Education is Floundering*, NATION, June 25, 2001, at 20 (stating "what the critics most dislike—is simply the idea that somebody is trying to turn public education into a profit-making enterprise").

[4] *See* Martha Minow, *Public & Private Partnerships: Accounting for the New Religion*, 116 HARV. L. REV. 1229, 1243-44 (2003) (noting that for-profit competition may enhance the provisions of services); Lewis D. Solomon, *The Role of For-Profit Corporations in Revitalizing Public Education: A Legal and Policy Analysis*, 24 U. TOL. L. REV. 883, 925-26 (1993) (noting that for-profit corporations foster competition that may stimulate more creative and efficient school systems).

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bottom line corporations in the context of corporate law.[5] In an effort to fill this gap, this Article examines both positions, concluding that neither appropriately addresses the impact of the corporate law regime on double bottom line corporations, and hence neither provides an adequate response to them. On the one hand, this Article explores the impact of the internal and external mechanisms that shape corporate behavior, concluding that critics of the double bottom line corporation have exaggerated the ability of such mechanisms to compel corporate officers and directors to focus only on shareholder profit. This exaggeration suggests that intense opposition to double bottom line corporations may be unwarranted. On the other hand, however, this Article finds flaws in the apparent assumption of proponents that the for-profit regime sufficiently ensures that double bottom line corporations will not compromise on the delivery of critical services in order to maintain financial viability. This means that while complete rejection of double bottom line corporations is not appropriate, neither is complete acceptance. Instead, this Article concludes that the corporate law regime should be altered to more adequately ensure that double bottom line corporations will not ignore their public mission in order to satisfy their financial objectives.

After examining possible alterations, this Article ultimately proposes that states require double bottom line entities to establish a monitoring committee composed of disinterested and independent directors responsible for facilitating the achievement of the entities' public mission. This committee should be modeled after the auditing committee required by regulating authorities such as the Securities and Exchange Commission (the "SEC"), the New York Stock Exchange ("NYSE"), and Nasdaq National Market, Inc. ("Nasdaq").[6] These regulatory authorities believe that

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[5] In fact, much of the scholarship regarding these double bottom line entities has focused on the need to legislate the conversion from not-for-profit to for-profit status. *See, e.g.*, James J. Fishman, *Checkpoints on the Conversion Highway: Some Trouble Spots in the Conversion of Nonprofit Health Care Organizations to For-Profit Status*, 23 J. CORP. L. 701, 737 (1998) (proposing enhanced scrutiny of hospital conversion process); Mark Krause, *"First Do No Harm": An Analysis of the Nonprofit Hospital Sale Acts*, 45 UCLA L. REV. 503, 508 (1997) (discussing conversion legislation); Singer, *supra* note 2, at 222-23 (discussing federal and state regulation of nonprofit conversions to for-profit status).

[6] *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (requiring that SEC direct the national securities exchanges and national securities associations to prohibit companies from listing securities unless the auditing committee of all such companies are independent, and are made responsible for overseeing the auditing work of accounting firms). Similarly, the NYSE requires that companies have a qualified audit committee, consisting of independent directors, as a condition to listing on the exchange. *See* NEW YORK STOCK EXCHANGE, LISTED COMPANY MANUAL § 303.01, *available at* http://lcm.nyse.com (last modified Dec. 20, 1999) [hereinafter NYSE MANUAL] (providing that each company listed on the New York Stock Exchange have a qualified auditing committee with a formal charter consisting of at least three directors all of whom must be independent). Finally, the National Association of Securities Dealers, Inc. ("NASD") imposes an audit committee requirement as a condition to quotation on Nasdaq. *See* NASDAQ STOCK MARKET, NASD MANUAL §§ 4200(a)(14), 4350(d), *available at* http://cchwallstreet.com/NASD/keyword_index/toc_mg.asp.

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independent committees responsible for monitoring the financial interests of a corporation are necessary to ensure the financial health of the corporation, and to prevent directors and officers from compromising their duty to shareholders.[7] Consequently, a similar committee should be required for those entities seeking to ensure the attainment of a nonfinancial goal. Like auditing committees, these committees would monitor the behavior of corporate officials to ensure that they remain committed to their nonfinancial obligations, thereby making it possible for double bottom line entities to achieve those obligations within the for-profit regime.

This Article will examine the factors shaping for-profit behavior primarily in the context of one of the most challenging double bottom line corporations—for-profit companies that deliver kindergarten through 12th grade ("K-12") education. Delivering such education is the quintessential public service because of its fundamental importance to the welfare of the nation and the fact that it must be provided to all of the nations' children without regard to their ability to pay.[8] Opponents of such corporations insist that delivering such education is inconsistent with any attempts at profit making.[9] Thus, the entrance of for-profits into the K-12 sector has been met with significant opposition.[10] As a consequence of this opposition and other related factors, these entities have experienced significant setbacks that call into question the viability of mixing profit-making and educational objectives.[11] Hence, these companies represent an ideal case study for evaluating the efficacy of the current corporate regime's ability to accommodate double bottom line corporations.

Part I of this Article explores the dual aims of the double bottom line corporation and the manner in which such corporations differ both from other for-profit entities and the not-for-profit entities that traditionally provided public services. Part I also discusses the growth of such corporations generally and the growth of for-profit education companies more specifically. Part I concludes by examining the manner in which the largest for-profit provider of K-12 education

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[7] *See* NEW YORK STOCK EXCHANGE, 1999 REPORT AND RECOMMENDATIONS OF THE BLUE RIBBON COMMITTEE ON IMPROVING THE EFFECTIVENESS OF CORPORATE AUDIT COMMITTEES, *available at* http://www.nyse.com [hereinafter BLUE RIBBON REPORT] (noting that audit committees serve as a catalyst for effective financial reporting, and are critical to ensuring that boards fulfill their role to shareholders).

[8] *See infra* note 20 and accompanying text (describing importance of education to American children); *see also* Plyler v. Doe, 457 U.S. 202, 221 (1982) (noting that public schools constitute "the most vital institution for the preservation of a democratic system of government"); Brown v. Bd. of Educ., 347 U.S. 483, 493 (1954) ("Education is perhaps the most important function of state and local government.").

[9] *See infra* note 72 and accompanying text (describing objections to for-profit education).

[10] *See infra* notes 64-67 and accompanying text (describing various opposition to for-profit education).

[11] *See infra* notes 68-70 and accompanying text.

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seeks to accomplish the objectives of delivering quality services and financial returns.

Part II examines the merits of the objections to double bottom line corporations by analyzing the theoretical basis for the current corporate law regime as well as the internal and external forces that shape corporate behavior in order to determine whether such forces permit corporate agents the freedom to pursue dual objectives. This Part concludes that critics of double bottom line corporations have overstated the impact of such forces on corporate behavior. This conclusion counsels against total rejection of these corporations.

Part III addresses the strength of proponents' claims that the double bottom line corporations can provide quality services without compromise. Part III concludes that while the for-profit regime may have a positive impact on the delivery of certain services by providing greater efficiency and additional resources, the notion that competition will compel for-profit corporations to generate quality services may not be applicable in the context of double bottom line entities. Part III further points out that the corporate regime offers few incentives for ensuring that nonshareholders, such as students or patients, will have an affirmative voice within that regime.

In light of these facts, Part IV reviews some proposals for modifying the corporate regime to create this affirmative voice. This Part more fully develops the monitoring committee proposal, and explains the manner in which it will allow these entities to serve adequately their dual objectives. Part V then offers some conclusions about the ultimate viability of double bottom line corporations in light of this proposal.

The emergence of double bottom line corporations has generated significant opposition. This Article demonstrates that the fierceness of that opposition may not have been warranted because many base their opposition on a misunderstanding of the impact of the forces that shape corporate behavior. A better understanding of these forces reveals that while there may still be cause for concern, rejection of double bottom line corporations may neither be necessary nor appropriate. Instead, this Article concludes it is possible to alter the corporate governance system to facilitate the accomplishment of the unique obligations that the double bottom line corporation undertakes. Requiring independent committees to monitor the behavior of these corporations may represent a key component of that facilitation.

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I. Overview of the Double Bottom Line Corporation

A. Characteristics of the Double Bottom Line Corporation

This Article uses the term double bottom line corporation to refer to those entities organized as for-profit corporations that are also responsible for delivering some public service. Because such entities focus on profits as well as their public or social mission,[12] they have two bottom lines.

1. The Public Bottom Line

Double bottom line entities seek to provide public services, defined herein as services fundamental to the health and welfare of the nation and intended to be provided for the benefit of everyone within the nation without regard to ability to pay. For example, health care may be defined as fundamental because it represents a life and death service. Although many people pay for health care, many nonprofit and public hospitals historically provided health care to those who lacked the ability to pay for it.[13] Thus, for-profits that assume management of such hospitals also assume the public function of providing health care services to indigent patients. Similarly, because incarceration represents an important component of our criminal justice system, private entities that operate prison facilities also deliver an important public service.[14] Indeed, such entities take responsibility for the traditional state function of "confining, punishing, and hopefully rehabilitating" the prison population.[15] In this same vein, the foster care system seeks to provide safe housing and attendant care to abused or neglected children.[16] For-profits that participate in delivering this service, therefore, assume the responsibility of caring for some of the

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[12] This Article will use the terms "social mission" and "public mission" interchangeably to refer to the obligation that double bottom line companies undertake to provide particular kinds of critical services as set forth in Part II.A.1.

[13] *See, e.g.*, Shelley A. Sackett, *Conversion of Not-For-Profit Health Care Providers: A Proposal For Federal Guidelines on Mandated Charitable Foundations*, 10 STAN. L. & POL'Y REV. 247, 248 (1999); Fishman, *supra* note 5, at 703 (noting that "from the time of Elizabethan Statute of Uses" nonprofit hospitals have served as a symbol of the charitable healthcare provider); Jack Needleman, *Non-Profit to For-Profit Conversions in Health Care: A Review*, PIONEER INST. FOR PUB. POL'Y RES., Feb. 1998, at 12, *available at http://www.pioneerinstitute.org/research/whitepapers/research_white.cfm* [hereinafter Needleman, *Conversion Review*] (noting that historically, while the well-off were treated at home or by family members, early hospitals treated only the poor, transient, or those without family support).

[14] *See* E.S. Savas, *Privatization & Prisons*, 40 VAND. L. REV. 889, 897 (1987).

[15] Casarez, *supra* note 3, at 250.

[16] *See* Mangold, *supra* note 3, at 1298 (defining foster care systems as placement services with placements ranging from care by families to care within group home settings).

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most needy children in society—a responsibility traditional delegated to nonprofits.[17]

As the introduction points out, organizations that provide K-12 education take responsibility for one of the most quintessential public services. While the Supreme Court has refused to characterize education as a fundamental right,[18] all states require children under a certain age to attend school without regard to their ability to pay for such schooling.[19] In this way, for-profit companies that provide primary education take responsibility for a state-required service. Then too, primary education serves a critical function, not only instilling certain values in school children, but also preparing children to become full members of society—economically, politically, and socially.[20] Thus, for-profit entities that operate such schools, like those that deliver health care or foster care, serve a critical public function.

2. The Financial Bottom Line

In addition to providing these services, double bottom line corporations also promise to generate profit for their shareholders. In doing so, such entities represent a hybrid—differing both from not-for-profit and traditional for-profit firms.

Obviously, the fact that double bottom line entities organize as for-profits distinguishes them from not-for-profits. Certainly, nonprofit corporations owe a duty to the beneficiaries they serve, similar to the responsibility double bottom line corporations undertake.[21] However, the quintessential characteristic of the nonprofit

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[17] *Id.* at 1302-07 (describing private, nonprofit involvement in foster care).

[18] *See* San Antonio Indep. Sch. Dist. v. Rodriguez, 411 U.S. 1, 35, 37 (1973) (stating that education is not a fundamental right and not a right that is constitutionally protected).

[19] *See* LAWRENCE KOTRIN & WILLIAM F. AIKMAN, LEGAL FOUNDATIONS OF COMPULSORY SCHOOL ATTENDANCE 25 (1980); W. VALENTINE, 1 EDUCATION LAW, PUBLIC & PRIVATE § 5.2 (1985) (describing compulsory attendance requirements). In fact, several state supreme courts have held that education is a fundamental right under their state constitution. *See, e.g.*, Pauley v. Kelly, 255 S.E.2d 859 (W. Va. 1979); Horton v. Meskill, 376 A.2d 359 (Conn. 1977); Campbell County Sch. Dist. v. Wyoming, 907 P.2d 1238 (Wyo. 1995).

[20] *See* Brown v. Bd. of Educ., 347 U.S. 483, 493 (1954) (confirming eloquently that "[t]oday, education is perhaps the most important function of state and local governments . . . . It is required in the performance of our most basic public responsibilities, even service in the armed forces. It is the very foundation of good citizenship. Today it is a principal instrument in awakening the child to cultural values, in preparing him for later professional training, and in helping him to adjust normally to his environment. In these days it is doubtful that any child may reasonably be expected to succeed in life if he is denied the opportunity of education").

[21] *See* Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 507 (1981) (noting that nonprofits serve the interests of their patrons). Then too, in order to qualify for a tax exemption, nonprofit organizations must be organized for a "charitable purpose." *See* Treas. Reg. § 1.501(c)(3)-1(b)(1) (as amended in 1993). As Professor Hansmann points out, there are many different forms of nonprofits. *See* Hansmann, *supra*, at 505. This

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is the nondistribution constraint.[22] This constraint means that while nonprofits can generate a profit, they may not distribute those profits, or any portion of their net earnings, to their members or to those who exercise control over the enterprise.[23] Instead, any income must be retained and devoted to furthering the purposes for which the nonprofit was organized.[24] Similarly, when the government operates or manages some entity, such as a hospital or school, it does not distribute any profits or earnings, but channels all resources toward advancing the social or public mission of that entity. While the double bottom line corporation offers an essential service similar to those traditionally provided by these not-for-profits, it is not constrained in its ability to distribute money to its owners or members. This lack of constraint distinguishes the double bottom line corporation from similar not-for-profits.

Because double bottom line corporations promise to provide essential services while generating a profit for their shareholders, they also are distinct from traditional for-profit enterprises. Obviously every corporation provides some good or service, and thus must devote attention to producing those goods and services. However, most agree that the for-profits ultimate obligation runs to the shareholder, and the maximization of her profit.[25] In contrast, the double bottom line corporation has an obligation to the shareholder and to beneficiaries who depend on its public service. In fact, some contend that in certain circumstances, this latter obligation should take precedence over profit making considerations.[26] Even when it does not, no one disputes that double bottom line companies have a duty to deliver a high quality service. This dual obligation sets the double bottom line entity apart from traditional for-profit corporations.

Article uses as a point of comparison those nonprofits that provide complex and vital services. *See id.* at 506. Others include third party payment nonprofits, such as the American Red Cross, which are donative nonprofits that collect contributions from third parties and provide relief to poor individuals. Also, there are public good nonprofits, which offer some public benefit such as providing for a public monument or scientific research. *See id.* at 505-06.

[22] Hansmann, *supra* note 21, at 501.

[23] *See id.* This is referred to as the private inurement limitation, which prohibits tax exempt entities from diverting any portion of their net earnings to the benefit of any private shareholders or individuals. *See* Treas. Reg. § 1.501(c)(3) (as amended in 1993).

[24] Hansmann, *supra* note 21, at 501.

[25] *See* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 441 (2001) (noting "there is convergence on a consensus that the best means to this end (that is, the pursuit of aggregate social welfare) is to make corporate managers strongly accountable to shareholder interests and, at least in direct terms, only to those interests").

[26] *See* Cheryl L. Wade, *Lessons From a Prophet on Vocational Identity: Profit or Philanthropy?*, 50 ALA. L. REV. 115, 131-32 (1998) (arguing that when duties to shareholders and other beneficiaries collide, the duty to the beneficiaries should take precedence).

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B. Growth of the Double Bottom Line Corporation

Over the past several decades, the number of double bottom line corporations has risen sharply.[27] For example, the number of for-profit corporations that manage prison facilities has grown significantly within the past two decades.[28] Thus, while privately operated prisons were nonexistent at the beginning of 1980, by 1990 there were some 25-30 adult prisons, and the annual growth rate for such private prisons was four times that of the growth rate for not-for-profit prisons.[29] Similarly, as a result of changes in federal law,[30] the number of for-profit companies that deliver social services such as welfare and foster care has grown significantly within recent years.[31] Moreover, in the 1990s, the number of for-profit providers of health care services increased dramatically, with some referring to such increase as a "revolution."[32] This revolution encompassed almost every area of health care, from health maintenance organizations ("HMOs")[33] and health care insurers such as Blue Cross and Blue Shield[34] to hospitals.[35] Thus, about 70% of HMOs are currently for-

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[27] *See* Savas, *supra* note 14, at 892 (describing the trend towards for-profit provision of services within a variety of different industries). The increase in the for-profit management of public services can be viewed as part of the larger increase in "privatization," or increased governmental reliance on the private sector. This reliance may take the form of contracts between government agencies and private corporations pursuant to which such corporations provide tangential services such as meals or construction of various facilities. Or it may include allowing private entities to provide directly some service. This Article focuses solely on the growth in for-profit companies directly responsible for providing an essential service.

[28] *See generally* GARY W. BOWMAN ET AL., PRIVATIZING CORRECTIONAL INSTITUTIONS (1993); ADRIAN L. JAMES ET AL., PRIVATIZING PRISONS: RHETORIC AND REALITY (1997); W.J. Michael Cody & Andy D. Bennett, *The Privatization of Correctional Institutions: The Tennessee Experience*, 40 VAND. L. REV. 829 (1987); Peter J. Duitsman, *The Private Prison Experiment: A Private Sector Solution to Prison Overcrowding*, 76 N.C. L. REV. 2209 (1998); Savas, *supra* note 14, at 896;.

[29] *See* John G. Dipiano, *Private Prisons: Can they Work? Panoptican in the 21st Century*, 21 NEW ENG. J. ON CRIM. & CIV. CONFINEMENT 171, 178 (1995).

[30] *See* Mangold, *supra* note 3, at 1311; *see also* 1996 Personal Responsibility and Work Opportunity Reconciliation Act, 42 U.S.C. § 672(c) (Supp. III 1997) (allowing for-profit providers to receive federal reimbursement for foster care, opening the door for such entities broadened participation in the foster care system).

[31] *See, e.g.*, Michele Estrin Gilman, *Legal Accountability in an Era of Privatized Welfare*, 89 CAL. L. REV. 569 (2001) (discussing social welfare programs); Mangold, *supra* note 3, at 1311 (discussing increase in the for-profit provision of foster care after change in federal law).

[32] *See* Philip P. Bisesi, *Conversion of Nonprofit Health Care Entities to For-Profit Status*, 26 CAP. U. L. REV. 805, 805 (1997) ("A revolution has descended upon the health care industry."); Fishman, *supra* note 5, at 702 ("[T]he United States has witnessed the largest redeployment of charitable assets in the Anglo-American world since Henry VII closed the monasteries in 1536-1540.").

[33] *See generally* Theresa McMahon, *Fair Value? The Conversion of Nonprofit HMOs*, 30 U.S.F. L. REV. 355 (1996).

[34] *See* Needleman, *Conversion Review*, *supra* note 13, at 23-24; Leonard D. Schaeffer, *Health Plan Conversions: The View from Blue Cross of California*, HEALTH AFF., Winter 1996, at 183-87. Five Blue Cross and Blue Shield plans have converted to for-profit status while 47 operate for-profit subsidiaries. *See* Bisesi, *supra* note 32, at 822.

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profit, as compared to 20% in 1981.[36] Also, for-profit hospitals account for approximately 15% of the total number of hospitals, reflecting the fact that the number of hospitals converting to for-profit status almost quadrupled in the 1990s.[37]

A similar explosion has struck the education market.[38] Thus, while for-profit education, particularly in the K-12 sector, was virtually nonexistent a decade ago,[39] revenues from for-profit education companies presently account for approximately 14% of the total amount spent on education.[40] For-profit companies account for roughly 19% of the educational training market,[41] 30% of early childcare

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[35] *See* Gary Claxton et al., *Public Policy Issues in Nonprofit Conversions: An Overview*, HEALTH AFF., Mar./Apr. 1997, at 9, 12.

[36] *Id.* at 13-15 (discussing number of HMOs currently operating as for-profits); *see also* Bisesi, *supra* note 32, at 823 (discussing number of for-profit HMOs prior to recent growth).

[37] *See* David A. Hyman, *Hospital Conversions: Fact, Fantasy, Regulation Follies*, 23 J. CORP. L. 741, 749 (1998). As compared to previous years, the number of hospitals converting to for-profit status in 1994 went from approximately nine per year to thirty-four in 1994 and then to fifty-nine in 1995. *See* Claxton, *supra* note 35, at 12.

[38] In 2000, the for-profit portion of the United States education industry was approximately 13%, reflecting $105 billion of the $815 billion education market. This was up from 10% in 1999. *See* Jeffrey A. Fromm & Todd V. Kern, *Education Industry Offers World of Investment Opportunity*, VENTURE CAP. J., Mar. 1, 2001. For-profit companies operate in at least four sectors of the education market, including educational training, early child care, K-12 and post secondary education. *See* Carrie Lips, *"Edupreneurs": A Survey of For-Profit Education*, POL'Y ANALYSIS, Nov. 20, 2000, at 3, *available at* http://www.cato.org. The education market also includes consumer products and services. That market is relatively small and totally controlled by the for-profit industry. *See id.*

[39] *See* John Greenwald, *School for Profit: Private Companies Can Run Public Schools, but Can They Make Them Pay?*, TIME, Mar. 20, 2000, at 56.

[40] Revenues from for-profit companies accounted for $113 billion of the total $800 Billion education market. *See* William C. Symonds, *A New Push to Privatize*, BUS. WK., Jan. 14, 2002, at 123 [hereinafter Symonds, *A New Push*]. This is up from 10% for the year ending 1999; William C. Symonds, *Industry Outlook 2000: Services*, BUS. WK., Jan. 10, 2000, at 138 [hereinafter Symonds, *Outlook*]. One researcher estimates that as of the end of 2000, there were some 75 publicly traded education companies. *See* Fromm & Kern, *supra* note 38 (quoting Eduventures, Inc., an independent research firm dedicated exclusively to education). Moreover, while the rates of spending in the general education industry began to slow in 2001, many companies in the for-profit arena flourished. *See* Symonds, *A New Push, supra*, at 123 (noting the general slow-down of funds to education resulting from the recession and the terrorist attacks of September 11); *The ABCs of Education Stock*, BUS. WK., Sept. 24, 2001, at 128E1 ("While the rest of the market languishes, the education sector until recently has been on a tear."). Some researchers expect revenues in the for-profit sector to grow 5% in 2002, outpacing the general education market and the economy as a whole. *See* Symonds, *A New Push, supra*, at 123 (quoting Eduventures); Fromm & Kern, *supra* note 38, (noting that industry trends support increased growth in education stock even though the economy is softening).

[41] *See* Lips, *supra note* 38, at 3. Companies spent more than $1 billion on e-learning systems in 2000 and experts believe that the market will grow to $11 billion by 2003. *See* Danielle Sessa, *Business Plan: A Look at All the Different Ways Companies Hope to Make Money From On-Line Education*, WALL ST. J., Mar. 12, 2001, at R8. This growth is spurred by changes in technology. *See generally* Fromm & Kern, *supra* note 38. Such changes not only increase the demand for training among corporate employees, but also spark the growth of companies that provide technology in the K-12 arena. *See id.* The educational training market includes companies such as Sylvan Learning Systems, Inc., which runs nationwide tutoring and testing

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companies,[42] and a small, but growing number of post-secondary institutions.[43] In the K-12 market, there are currently some 250 for-profit public schools serving more than 120,000 students.[44] These companies either operate traditional public schools or public charter schools.[45] With 75,000 students, Edison Schools, Inc. ("Edison") is the

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centers for school children, as well as educational training for corporate employees, and Advantage Learning Systems, Inc., which provides learning information systems for K-12 schools. *See* Lips, *supra* note 38, at 10. Information systems provided by Advantage consist of computer-based tests on various subjects including math, grammar, and literature. The programs not only offer feedback to students, but also enable teachers to assess student progress. On the corporate training side, for-profit companies dominate the market. *See* Symonds, *Outlook*, *supra* note 40, at 138. One of the biggest companies in this area is SmartForce, which specializes in educational training for corporate employees. *See* Sessa, *supra*. SmartForce, which previously sold information technology courses to corporations, had more than $168 million in revenue for the 2000 year. *See id.*

[42] Lips, *supra* note 38, at 3. The nation's largest for-profit child-care provider is Bright Horizons Family Solutions, Inc. ("Bright Horizons"), which is employee-sponsored and serves more than 31,000 children. *See id.*, at 6. Bright Horizons has 345 family centers for over 250 clients in 34 states, DC, Guam, the UK and Ireland. *See* BRIGHT HORIZONS FAMILY SOLUTIONS, INC., 2002 ANNUAL REPORT 1 (2003). It also serves 80 Fortune 500 companies. *See id.* Another company in this field is Nobel Learning Communities, Inc. ("Nobel"). Nobel runs 171 schools in 15 states, though some of them serve K-12 students. *See* NOBEL LEARNING COMMUNITIES, INC., 2001 ANNUAL REPORT 1 (2001) [hereinafter NOBEL ANNUAL REPORT].

[43] Although for-profit companies specializing in post-secondary education comprise only 3% of the market, such companies expect increased enrollment and earnings for the upcoming years. *See* Symonds, *A New Push*, *supra* note 40, at 123 (noting that education analysts expect earnings to grow 20% to 25%). Indeed, any economic slowdown improves the outlook of such companies as unemployed workers seek to upgrade their skills. *See id.* Moreover, when students enroll in these institutions, companies have a predictable revenue stream that spans several years. *See* Sessa, *supra* note 41 (noting that companies lock students into a series of course, producing a reliable income from student tuition fees). Many for-profit companies engaged in post-secondary education have beaten Wall Street estimates. *See The ABCs of Education Stocks*, *supra* note 40. Apollo Group, Inc.'s University of Phoenix is the largest for-profit university in America and the first one to be accredited by the American Bar Association. *See* Mary Beth Marklein, *The New Face of Higher Education: Upstart College Makes the Grade and a Profit*, USA TODAY, April 27, 1999, at 01D. The University of Phoenix serves nearly 62,000 adults with classrooms in 13 states, the Netherlands and Puerto Rico. *See id.* Like other such schools, the University of Phoenix offers a variety of post-secondary educational programs, including "distance learning" programs over the Internet. *See* Lips, *supra* note 38, at 13. For-profit companies offering post secondary educational opportunities have also expanded into foreign markets. For example, Thompson Corp. recently started an on-line university with a consortium of 16 universities including the University of Virginia and New York University, targeting Latin America and Asia. *See* Elena Cherney, *E-Business: Thomson Joins Consortium of 16 Schools to Start an On-Line University*, WALL ST. J., Aug. 20, 2001, at B6. While the University of Phoenix does not compete with the nation's elite schools, it attracts older and alternative students that may have otherwise attended community colleges. *See* Lips, *supra* note 38, at 13. In the fall of 1998, Kaplan Inc., created Concord University School of Law, the nation's only online law school. *See id.*, at 14. Although it currently enrolls more than 500 students, Concord is not accredited by the American Bar Association (the "ABA"), which does not accredit online legal programs. Thus, Concord graduates can only take the bar in California and can only be admitted to practice in California courts. *See id.*

[44] Greenwald, *supra* note 39, at 56.

[45] For-profit companies that manage traditional public schools either operate the school directly, or contract with local school officials to manage particular schools within their

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largest for-profit operator of public schools, and has a total enrollment larger than that of the public school system in Boston or San Francisco.[46] Such enrollment makes Edison the forty-fifth largest school district in the nation.[47] As of the 2002-2003 school year, Edison managed 150 public schools in twenty-three states and the District of Columbia.[48] Then too, at the end of 2001, Edison became part of "the nation's biggest experiment in school privatization"[49] when Philadelphia hired Edison to manage dozens of the city's worst schools.[50] Moreover, the No Child Left

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district. *See* Solomon, *supra* note 4, at 891-92. Similarly, in the context of charter schools, for-profit companies can either operate a charter school directly by obtaining a charter from the appropriate legislative authority, or indirectly by contracting with a nonprofit entity that has secured a charter. *See* Frank Kemerer & Catherine Maloney, *The Legal Framework for Educational Privatization and Accountability*, 150 EDUC. L. REP. 589, 605 (2001). The number of charter schools with for-profit operators accounts for about 15% of total charter schools. *See* BERYL NELSON, ET AL., U.S. DEPT OF EDUC., NATIONAL STUDY OF CHARTER SCHOOLS: THE STATE OF CHARTER SCHOOLS 2000: FOURTH YEAR REPORT 11 (2000), *available at* http://www.ed.gov/pubs/charther4thyear/.

[46] *See* William C. Symonds, et al., *How to Fix America's Schools*, BUS. WK., Mar. 19, 2001, at 66. Edison was one the first of these companies to host a public offering in November of 1999, raising more than $100 million, though the listing price of $18 per share was below the expected $25 per share. *See, e.g.*, Symonds, *Outlook*, *supra* note 40, at 138. On November 14, 2003, however, Edison completed a transaction that took it private. *See* Press Release, Edison Schools, Merger To Take Edison Private Completed (Nov. 14, 2003), *available at* http://www.edisonproject.com. Other for-profit entities involved with charter schools include Chancellor Beacon Academies, The Tesseract Group, SABIS Educational Systems, Advantage Schools, The Leona Group, Beacon School Management, Mosaic Education, and National Heritage Academy. *See* F. Howard Nelson & Nancy Van Meter, *What Does Private Management Offer Public Education?*, 11 STAN. L. & POL'Y REV. 271, 272 (2000). After its success with preschools, Nobel expanded into the K-12 market. *See* Lips, *supra* note 38, at 6 (noting that both Nobel and Bright Horizons expanded into K-12 education due to parental satisfaction and enthusiasm for their early child care programs). Indeed, Nobel notes that it typically opens a pre-elementary school first before opening an elementary or high school. *See* NOBEL ANNUAL REPORT, *supra* note 42, at 6. As of September 28, 2001, Nobel operates 171 schools serving 28,000 students in 15 states. *See id.* at 1. Nobel also focuses on providing schools for children with learning challenges or developmental delays. These schools are called Paladin Academy. *See id.* at 7. Since 1994, Nobel acquired 50 pre-elementary schools, 22 elementary schools and six high schools. *See id.* at 6. From June 2000 to June 2001, Nobel opened five elementary schools, 11 pre-elementary schools and two high schools. *See id.*

[47] *See* EDISON SCHOOLS, 2001 FOURTH ANNUAL REPORT ON SCHOOL PERFORMANCE 1 [hereinafter FOURTH ANNUAL SCHOOL PERFORMANCE REPORT].

[48] *See* EDISON SCHOOLS, 2002 FIFTH ANNUAL REPORT ON SCHOOL PERFORMANCE 4 [hereinafter FIFTH ANNUAL SCHOOL PERFORMANCE REPORT]. This is an increase from 136 public school operated by Edison at the end of the 2001-2002 school year. *See* FOURTH ANNUAL SCHOOL PERFORMANCE REPORT, *supra* note 47, at 1. This in turn is an increase from 113 public schools operated by Edison at the end of the 2000-2001 school year. *See, e.g.*, EDISON SCHOOLS, INC., PROSPECTUS 43 (Mar. 20, 2001) [hereinafter EDISON PROSPECTUS]; William C. Symonds, *Edison: Pass, Not Fail*, BUS. WK., July 9, 2001 at 70; *Edison Schools to Buy Rival School Manager for $36 Million in Stock*, WALL ST. J., June 5, 2001, at B6.

[49] *See Philly Schools*, *supra* note 2; *Judge Clears Way for Edison to Run Philadelphia Schools*, WALL ST. J., Dec. 28, 2001, at A10 [hereinafter *Judge Clears Way*]; *Phila. Turns Schools Over to State: Negotiations Continue on Nation's Biggest Privatization Project*, WASH. POST, Dec. 22, 2001, at A09.

[50] *See Philly Schools*, *supra* note 2.

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Behind Act, enacted into law in 2002, requires that under-performing schools consider alternative strategies such as hiring for-profit firms.[51] The Act therefore increases the likelihood that for-profit education companies will continue to grow. Edison's growth parallels the general rise in for-profit corporations that provide educational and other critical public services.

C. The Edison Model for Achieving a Double Bottom Line

Like all double bottom line entities within its field, Edison seeks to deliver a quality education while promising profits to its shareholders. Its model for delivering a quality education involves a variety of different features, including longer school days and school years,[52] increased offerings in special subjects such as language and arts,[53] and enhanced use of technology in the classroom.[54] While Edison seeks to tailor its schools to the needs of the various communities it serves, Edison also uses centralized training of its teachers and administrators to ensure that its educational model is implemented.[55] As will be explained later in this Article, there is disagreement regarding whether Edison's educational model has been successful.[56]

In contrast to the relative complexity of its educational plan, Edison's model for achieving profitability is straightforward and depends on economies of scale. In order to make a profit, Edison's revenues must be higher than its operating expenses. With respect to revenues, Edison receives a set amount of money per student.[57] With regard to expenses, Edison has typical operating expenses associated with schools, such as teacher salaries and general administrative expenses.[58] Yet Edison differs from other public schools in that it is a national organization, and

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[51] *See* No Child Left Behind Act of 2001, Pub. L. No. 107-110, 115 Stat. 1425 (2002); Dale Mezzacappa, *After 10 Years, Edison Schools Still Struggling to Prove Itself*, PHILA. INQUIRER, Nov. 10, 2002, at C02 (noting impact of new federal law on growth of for-profit companies that operate public schools). The No Child Left Behind Act was signed into law on January 8, 2002. In addition to providing for private operators of public schools, the Act increased the amount of federal funds available for public education to more than $22.1 billion for elementary and secondary schools. *See* Press Release, White House, President Bush Signs Landmark Education Reform into Law (2002), *available at* http://www.whitehouse.gov/news/releases/2002. This represents a 27% increase over 2001 and a 49% increase over 2000 levels. *See id.*

[52] *See* Kathleen Conn, *For-Profit School Management Corporations: Serving the Wrong Master*, 31 J.L. & EDUC. 129, 139 (2002) (noting that Edison children attend school 210 days versus the typical 185-190 days, while their school days are 2-3 hours longer than the typical school day); *see also* EDISON SCHOOLS, *available at* http://www.edisonproject.com (explaining longer school year and school days) [hereinafter EDISON SCHOOLS].

[53] *See* EDISON SCHOOLS, *supra* note 52.

[54] *See infra* note 170 (explaining Edison's use of technology).

[55] *See infra* note 173.

[56] *See infra* notes 177-81 and accompanying text.

[57] *See infra* note 179.

[58] *See* EDISON PROSPECTUS, *supra* note 48, at 30.

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Edison hopes to use its national presence to cut back on operating expenses by centralizing its administrative costs.[59] According to Edison, in order to make profits, it must expand the number of schools it operates while keeping these central costs low.[60]

While Edison appears to recognize the unique nature of its enterprise, it uses traditional techniques to ensure that its public objectives are not ignored by its financial ones. In its literature, Edison appears to make an effort to state that its mission is to generate a financial return while maintaining a high-quality education for its students.[61] In support of this claim, Edison undertakes periodic performance assessments of its students and issues annual school performance reports in order to evaluate achievement within its various schools.[62] However, other than the fact that a few members of its board have backgrounds in education, its corporate structure is relatively similar to most other for-profit enterprises. In this regard, Edison's corporate model is no different than other for-profit enterprises. This Article will attempt to assess whether double bottom line companies like Edison can truly achieve their objectives without making some alterations in the traditional corporate governance model.

II. Deconstructing the Costs Associated with For-Profit Status

A. Understanding the Opposition

The growth of double bottom line corporations has generated fierce opposition in all of the impacted industries.[63] However, opponents of for-profit education have mounted one of the strongest attacks against such companies. Thus, as early as 1992, half the teachers at nine Baltimore public schools taken over by a for-profit management company boycotted the first day of the company's training.[64] In 1998, Boston lawmakers and teachers "lashed out" at the state's decision to award

[59] *See id.*

[60] *See id.*

[61] *See id.* (explaining that Edison's profitability must be consistent with maintaining quality educational objectives).

[62] *See id.*

[63] *See, e.g.*, Bisesi, *supra* note 32, at 845 (describing one legislator's outcry against for-profit health care); Singer, *supra* note 2, at 236-37 (describing several "high profile" challenges to hospital conversions).

[64] *See* Paul Hemp, *Desperate City Tries Schools-for- Profit*, BOSTON GLOBE, Aug. 30, 1992, at 1. Education Management Alternatives was awarded a five-year contract to operate nine Baltimore public schools. Baltimore teachers boycotted, in part, because of the company's plan to replace experienced teachers with young student interns. After a dismal performance, Education Alternatives' contract has not been renewed. *See* Nelson & Van Meter, *supra* note 46, at 271-72.

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charters to for-profit companies, and legislators introduced bills that would prevent such companies from managing public charter or traditional schools.[65] Nearly three years later, teachers and parent activists in New York waged a campaign against Edison and ultimately resisted Edison's attempts to manage several public schools in the area.[66] At the end of 2001, two dozen protestors in Philadelphia occupied the school administration building, while other opponents filed a lawsuit against the state seeking to prevent Edison's management of their schools.[67]

These efforts have prevented, or at the very least hampered significantly, the growth of double bottom line entities seeking to provide K-12 education. For example, the opposition in New York prevented Edison from operating five public schools.[68] Similarly, controversy surrounding the Philadelphia schools led to a reduction in the number of schools the city allowed Edison to operate.[69] These measures not only undermined Edison's expansion efforts within a particular city, but also undermined the more general support for the for-profit management of public schools.[70]

While objections to for-profit public schools vary,[71] commentators agree that most critics of for-profit education simply object to the notion "that somebody is

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[65] *See* Hart & Zuckman, *supra* note 2.

[66] *See* Lynette Holloway, *Parents Explain Resounding Rejection of Privatization at 5 Schools*, N.Y. TIMES, Apr. 13, 2001, at B1; Emily Lambert, *School's Out at Edison and It's Grade Time*, N.Y. POST, Aug. 19, 2001, at 62 (explaining decision by New York parents to vote down Edison takeover of their schools).

[67] *See Philly Schools*, *supra* note 2, at A12 (indicating that the Philadelphia plan has generated fierce opposition from teachers, school workers, student activists and community groups); *Judge Clears Way*, *supra* note 49 (noting lawsuit to prevent the hiring of Edison); *Schools Seized in Philadelphia Education: The First Stage of State Takeover Will Begin with Swapping the School Board with a Reform Commission*, L.A. TIMES, Dec. 23, 2001, at A37 [hereinafter *Schools Seized*] (noting the filing of two lawsuits seeking to prevent Edison's Philadelphia takeover and probable court challenge by the Philadelphia Federation of Teachers).

[68] *See* Lambert, *supra* note 66, at 62.

[69] *See* Peg Tyre, et. al, *Philly's Tough Lessons; As Stock Plunges, A Radical Experiment in Educating the Poorest Kids Becomes a Soap Opera*, NEWSWEEK, Oct. 21, 2002, at 60 (noting intense pressure from teachers' unions and community groups led the state to cut the number of schools Edison would operate from 45 to 20).

[70] *See* Rebecca Winters, *The Philadelphia Experiment: All Eyes Are on this City's Public Schools, Which Have Become a National Laboratory for Reforms by For-Profit Managers*, TIME, Oct. 21, 2002, at 64 ("How well Philadelphia's children fare in these real-life laboratories will ultimately touch public schools in every corner of the U.S. . . . ."); *see also* Mezzacappa, *supra* note 51 (noting that when Edison loses a contract, it is felt at the national level).

[71] Some fear that schools operated by for-profit companies will erode the common educational experience of all American school children. *See* Solomon, *supra* note 4, at 920-22 (noting critics' assertions that privatization will retard civic equality and the common educational experience of America's school children). Opponents also maintain that a quality public education should be available to all children regardless of race or economic or social status. *See, e.g.*, Harry Schwartzbart, *Costly Lesson For-Profit Education Lacks a Conscience*, L.A. DAILY NEWS, May 6, 2001, at V3 ("The public school is charged with the awesome and difficult responsibility of trying to educate all American children, regardless of race, color, religion, etc., even of physical or mental handicap"). Such opponents view for-profit education as a

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trying to turn public education into a profit-making enterprise."[72] Indeed, the dual nature of the double bottom line corporation means that such entities must be allowed to focus on their public mission in addition to profit considerations. However, opponents believe that while the for-profit regime more than adequately ensures that these corporations will focus on profit, it does not provide mechanisms for ensuring that the corporations; nonfinancial goals will be met.[73] Quite the opposite, opponents of such firms contend that the for-profit regime will affirmatively prevent the attainment of such goals. This contention is two-fold. First, opponents suggest that corporate law prevents directors from adopting policies that favor nonshareholders, particularly when such policies have a negative impact on shareholder profit.[74] In this way, fiduciary law may prevent directors and officers from devoting resources to programs and policies that enhance the position of students, teachers, and administrators because such actions drain resources away from shareholders.[75] Second, even when the law does not prohibit such actions, opponents contend that corporate forces will compel directors to align their decisions with the monetary interests of shareholders.[76] For example, for-profit managers may be more inclined to cut corners in spending by using poor quality textbooks, supplies, and other equipment.[77] Such managers also may seek to save money by hiring more inexperienced teachers who cost less to employ, but may be

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movement away from this ideal. Others not only disagree, but also maintain that the reality of public education has never been consistent with such an ideal. *See* Solomon, *supra* note 4, at 922 (asserting that the notion of the common school and the concept of civic equality in schools "appears to be a dream from another era").

[72] Peter Schrag, *Edison's Red Ink Schoolhouse—The Biggest Brand Name in For-Profit Education is Floundering*, NATION, June 25, 2001, at 20; *see also* John Greenwald, *School for Profit: Private Companies Can Run Public Schools, But Can They Make Them Pay?*, TIME, Mar. 20, 2000, at 56 (noting that "the very notion [of for profit public schools] seems heretical"); Edward Wyatt, *Higher Scores Aren't Cure-All, School Run for Profit Learns*, N.Y. TIMES, March 13, 2001, at A1 [hereinafter Wyatt, *Higher Scores*] (noting that "mostly [opponents of privatized education] have promoted a single principle: profit-seeking companies should stay out of public education."); *Philly Schools*, *supra* note 2 (noting that public school advocates fear Edison "will put profit ahead of education").

[73] *See* Gray & McNerney, *supra* note 3, at 1524.

[74] *See* Sackett, *supra* note 13, at 250 (noting that for-profit boards have a fiduciary duty requiring them to generate returns on shareholder investment, while nonprofit boards have a duty to the organization's charitable purpose).

[75] *See* Solomon, *supra* note 4, at 924.

[76] *See id.* (explaining concern that for-profit entities will maximize profits by exploiting children); *see also* Gray & McNerney, *supra* note 3, at 1524 (noting the conflict between profit-making and caring for indigent hospital patients); Rene Sanchez, *Edison School Project Growing Slowly; Public Education Venture, Entering Third Year, Has Yet to Make Profit*, WASH. POST, Aug. 22, 1997, at A3 (noting school districts' concern that for-profit companies will not be able to make a profit unless they take budget shortcuts that will have a negative impact on students).

[77] *See* Solomon, *supra* note 4, at 924.

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less equipped to instruct students.[78] Then too, these managers may attempt to maximize profits by increasing the number of students within the classroom. While many educational experts agree that smaller classroom sizes improve the quality of education, increasing classroom sizes generates more revenue because corporations receive funds for every student within the school.[79] By forcing directors and officers to choose financial considerations over student welfare in the above mentioned ways, the for-profit regime undermines the ability of double bottom line entities to meet their social objective.

As the foregoing suggests, opponents of double bottom line corporations presume that the for-profit status of such entities makes it difficult, if not impossible, for them to focus on concerns unrelated to wealth maximization. The next sections evaluate that presumption. Specifically, the next sections examine three internal forces (corporate fiduciary duty, shareholder derivative suits, and shareholder voting authority) and the largest external factor (the capital markets) shaping the behavior of corporate directors and officers in order to assess the extent to which those directors have the freedom to attend to interests beyond shareholder profit. If such freedom does not exist then double bottom line corporations cannot meet their dual objectives, and hence it may be appropriate to prevent their emergence. By contrast, if such freedom exists, then the costs of operating within the for-profit regime may not be prohibitive.

B. Fiduciary Duty Constraints, the Profit Maximization Norm, and the Team Production Theory

As an initial matter, critics of double bottom line corporations suggest that for-profit directors and officers have a fiduciary duty to maximize shareholder wealth, and that this duty prevents such officials from pursuing the interests of other groups.[80] By statute, corporate directors and officers owe a fiduciary duty to the corporation, and must operate the corporation consistent with that duty.[81] Conventional interpretations of this fiduciary duty have been shaped by a particular understanding of the governance issues confronting the corporation. Indeed, over seventy years ago, Adolf Berle and Gardiner Means identified the key corporate

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[78] *See* F. HOWARD NELSON, AM. FED'N OF TEACHERS, STUDENT ACHIEVEMENT IN EDISON SCHOOLS: MIXED RESULTS IN AN ONGOING ENTERPRISE 17-18 (1998), *available at* http://www.aft.org/research/edisonproject/why.htm [hereinafter STUDENT ACHIEVEMENT].

[79] *See id.* at 17-19 (noting instances where Edison has increased its class size and commenting that such a practice, while a money saver, undercuts educational improvement).

[80] *See, e.g.*, Schwartzbart, *supra* note 71 (noting that these education management companies must focus on profit and hence should not be give the responsibility of educating school children).

[81] *See* REV. MODEL BUS. CORP. Act §§ 8.30(a), 8.42(a) (2002) (describing directors and officers' duties to act in the best interests of the corporation).

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governance problem as the separation of ownership and control.[82] In their view, because shareholders who own the corporation cede control to managers, corporate governance structures must be designed to ensure that such managers act in the best interests of shareholders without pursuing their own agenda.[83] Recent scholars offer a different explanation for managers' focus on shareholders.[84] Such scholars maintain that a corporation is essentially a web of contractual relations or a "nexus of contracts," and that the relationship between corporate managers and shareholders is a contract pursuant to which the mangers serve as the shareholders' agent.[85] Implicit in the contract between managers and shareholders is an understanding that directors have a legal duty to prefer the shareholders' interest over those of other groups because such groups have alternative methods of protecting their interests.[86] Thus, similar to Berle and Means' understanding of the corporate governance problem, proponents of the contractual view believe that legal rules must be aimed at ensuring that directors and officers do not shirk their responsibilities to shareholders.[87] Guided by this conception of the "problem," courts and commentators traditionally construed the corporate fiduciary duty as one owed to the shareholders, and required directors and officers to act in the best

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[82] *See, e.g.*, ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 2-5 (1935). For a recent discussion of Berle and Means, see William W. Bratton, *Berle & Means Reconsidered at the Century's Turn*, 26 J. CORP. L. 737 (2001).

[83] Modern scholars interpret this problem as an agency costs problem. *See* MICHAEL C. JENSEN & WILLIAM H. MECKLING, THEORY OF THE FIRM: MANAGERIAL BEHAVIOR. AGENCY COSTS, AND OWNERSHIP STRUCTURE, IN FOUNDATIONS OF CORPORATE LAW 7 (Roberta Romano ed., 1993); Stephen M. Bainbridge, *The Politics of Corporate Governance*, 18 HARV. J.L. & PUB. POL'Y, 671, 672 (1995) (noting that modern scholars refer to the Berle and Means problem as an agency problem).

[84] *See, e.g.*, Barry D. Baysinger & Henry N. Butler, *Anti-Takeover Amendments, Managerial Entrenchment, and the Contractual Theory of the Corporation*, 71 VA. L. REV. 1257 (1985); Lucian Arye Bebchuk, *The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395 (1989); Henry N. Butler, *The Contractual Theory of the Corporation*, 11 GEO. MASON L. REV. 99 (1989); Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259 (1982). For a critique of this theory, see William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407 (1989).

[85] *See supra* note 84.

[86] *See, e.g.*, David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223, 232-33 (1991). Indeed, contracts govern the rights of groups such as employees and creditors and these contracts can be altered to the extent they fail to protect the groups' interests. *See, e.g.*, Katz v. Oak Indus., 508 A.2d 873, 879 (Del. Ch. 1986) (noting that groups such as creditors must look to contracts for protection of their rights); 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 (1991).

[87] *See* Millon, *supra* note 86, at 232. Proponents of the contractual view of the corporation refer to the problem that managers may shirk their duty to shareholders or engage in other forms of misbehavior as agency costs. *See id.*; *see also* Bratton, *supra* note 84, at 418.

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interests of the shareholders by maximizing their profit.[88] This construction has two implications. First, courts require corporate officers and directors to focus on the maximization of shareholder wealth.[89] Second, courts disfavor consideration of interests beyond profit maximization.[90]

This one-dimensional understanding of the corporate fiduciary duty appears to prevent contemplation of interests other than those related to financial concerns. Thus, instead of ensuring that students receive a high quality education, such a fiduciary duty would require that profit-making considerations guide directors and officers of double bottom line corporations, counseling them to cut corners when such cuts would increase shareholder profit. For example, this fiduciary duty would require directors to increase class sizes because such an increase would also increase profits, even though it would have a negative impact on educational attainment.[91] It also would prevent corporate officials from spending additional resources on programs that have significant educational value, but no monetary value to shareholders.[92] Thus, costly arts programs or special education programs may be severely cut or never started because, while they may improve the educational environment, they divert resources away from shareholders. In this respect, corporate fiduciary duties prevent directors and officers from considering issues unrelated to shareholder value. This suggests that corporate fiduciary law will prevent double bottom line entities from carrying out their social obligations.

However, recent scholars appear to have redefined the governance problem identified by Berle and Means, as well as those espousing the contractual view of the corporation. Instead of a shareholder wealth maximization norm, Professors Margaret Blair and Lynn Stout assert that corporate law reflects a "team production" norm, where directors act as mediators for the various constituents that comprise the

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[88] *See* Adolf A. Berle, *For Whom Corporate Managers are Trustees: A Note*, 45 HARV. L. REV. 1365 (1931) (arguing that corporations exists exclusively to make profits for the shareholders); Million, *supra* note 86, at 228-29 (noting that the "modern view of the corporation as an engine for shareholder wealth maximization" arose around the turn of the twentieth century). Guided by this conception of the "problem," corporate governance structures are designed to pressure corporate officers and directors to focus on shareholder profit. This conception of the corporation not only means that corporate governance structures will be aimed at shareholder interests, but also makes it difficult to consider other interests within the context of the for-profit regime.

[89] *See, e.g.*, Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) ("A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end.").

[90] *Id.*

[91] *See* STUDENT ACHIEVEMENT, *supra* note 78, at 17-19 (noting instances where Edison has increased its class size and commenting that such a practice, while a money saver, undercuts educational improvement).

[92] *See* Lisa M. Fairfax, *Doing Well While Doing Good: Reassessing the Scope of Directors' Fiduciary Obligations in For-Profit Corporations with Non-Shareholder Beneficiaries*, 59 WASH. & LEE L. REV. 409, 440-42 (2002) (explaining choices dictated by profit-maximization conception of the corporate fiduciary duty).

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corporate team.[93] Although directors control the firm's resources, corporate fiduciary law allocates those resources in a manner beneficial to all parties.[94] Under this theory, shareholder profit is one among a competing set of interests that directors must take into account when carrying out their fiduciary responsibilities.[95]

In support of their theory, Professors Blair and Stout maintain that while most people believe that directors owe a duty exclusively to the shareholders, such a belief may be neither normatively nor positively accurate.[96] Instead, case law reveals that corporate fiduciary law grants directors tremendous freedom to pursue corporate strategies that protect or benefit non-shareholder groups, even when such strategies have a negative impact on profit.[97] For example, courts have protected directors who refuse to take actions benefiting shareholders because such actions could harm creditors.[98] Courts also have enabled directors to pursue policies beneficial to the surrounding community even when such policies may decrease short-term shareholder profit.[99] Then too, courts have enabled corporations to devote resources to charitable organizations even though it results inevitably in a loss of income to shareholders.[100] Moreover, even in the takeover context where shareholders can potentially receive huge profits, directors can adopt policies that

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[93] *See* Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U.L.Q. 403, 408 (2001) [hereinafter *Director Accountability*].

[94] This analysis is based on a team production theory of the firm. Corporate constituents are similar to team members who contribute resources to the corporation but cannot protect their interests sufficiently. Thus, team members relinquish control to the third-party board that in turn maximizes the welfare of the entire team. *See* Margaret Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 275-76 (1999) [hereinafter *Team Production Theory*].

[95] *See Director Accountability*, *supra* note 93, at 408.

[96] *See id.* at 406. Professors Blair and Stout note that a review of the popular literature appears to confirm the shareholder primacy norm of corporate law. However, based on their admittedly limited review of the relevant case law, the professors conclude that such a norm is both positively and normatively incorrect "at least in the extreme rhetorical form in which it is most commonly expressed." *Id.*

[97] *See* Fairfax, *supra* note 92.

[98] Credit Lyonnais v. Pathe Communications Corp., No. CIV.A.12150, 1991 WL 277613, at 34 n.55 (Del. Ch. Dec. 30, 1991). Delaware affirmed directors' rights to consider constituents from creditors to employees while upholding their duty to the corporation. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) (allowing directors to consider interests of creditors, customers, employees, and the general community).

[99] *See* Shlensky v. Wrigley, 237 N.E. 2d 776 (Ill. App. Ct. 1968) (enabling directors to forgo night games that might have generated more revenue in order to prevent the deterioration of the neighborhood surrounding the baseball stadium).

[100] *See* Theodora Holding Corp. v. Henderson, 257 A.2d 398, 405 (Del. Ch. 1969) ("It is accordingly obvious, in my opinion, that the relatively small loss of immediate income otherwise payable to plaintiff and the corporate defendant's other stockholders, had it not been for the gift in question, is far out-weighed by the overall benefits flowing from the placing of such gift in channels where it serves to benefit those in need of philanthropic or educational support . . . ."); DEL. CODE. ANN. tit. 8, § 122(9) (2003) (providing that every corporation has the power to make donations for the public welfare or for charitable or educational purposes).

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delay or prevent the attainment of such funds in order to protect other corporate constituents, including employees and corporate creditors,[101] or to preserve the culture of their corporate enterprise.[102] Only in limited situations where directors contemplate the break-up of the corporation or institute a sale of the corporate enterprise do courts require directors to focus solely on profit maximization.[103] Moreover, some state statutes allow directors to favor other groups even when contemplating the sale or break-up of a company.[104] Thus, even in the takeover context, when shareholder and other constituents' interests are most at odds, directors' fiduciary duty gives them the flexibility to prefer nonshareholder interests over those related to profit-maximization.

By allowing such flexibility, the team production model appears to accommodate the double bottom line entity, enabling its directors and officers to pursue, and even favor, the interests of students, teachers, administrators, and even the community as whole without violating their fiduciary duty. Certainly if traditional corporations can devote resources to charitable goals with no connection to the corporation's core mission, then corporations like double bottom line entities that have an identifiable social mission should be allowed to channel resources

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[101] For example, directors can adopt shareholder rights plans in order to protect the interest of corporate constituents from employees to the public. *See* Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985). These plans, known as "poison pills" have the effect of making it more difficult for corporations to gain a controlling interest in a targeted corporation. *See* Michael J. Powell, *Professional Innovation: Corporate Lawyers and Private Lawmaking*, 18 LAW & SOC. INQUIRY 423 (1993). For a review of the various kinds of poison pills, see generally Suzanne S. Dawson, et al., *Poison Pill Defensive Measures*, 42 BUS. LAW. 423 (1987). The ability of directors to simply reject takeovers in order to protect employees and other corporate constituents has been termed the "just say no" defense. For an examination of the defense, see Robert A. Prentice & John H. Langmore, *Hostile Tender Offers and the "Nancy Reagan Defense": May Target Boards "Just Say No"? Should They Be Allowed To?*, 15 DEL. J. CORP. L. 377 (1990).

[102] *See* Paramount Communications, Inc. v. Time, 571 A.2d 1140, 1144 (Del. 1990) (allowing directors to prevent a takeover attempt in order to preserve the company's journalistic integrity, referred to as the "Time culture").

[103] The duty to maximize shareholder profit is referred to as the "Revlon duty" after the case establishing such an obligation. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); *see also* Paramount Communications v. QVC Networks, 637 A.2d 34 (Del. 1994) (extending the *Revlon* duty to change of control transactions); Paramount Communications, 571 A.2d at 1150 (finding that the duty to maximize shareholder profit is triggered when corporate directors initiate an active process to sell itself, affect a reorganization involving a break-up, or respond to a bidders offer by seeking to engage in a break-up transaction). However, Delaware courts emphasize that this duty to favor shareholder profits is very narrow and only arises when management abandons their commitment to the corporate enterprise. *Id.* The court explained that in most cases, directors are under no per se duty to maximize shareholder value, even in the takeover context. Further, directors who do not abandon their long-term position have no duty to maximize shareholder profit. *See id.* at 1150-51.

[104] *See* Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14 (1992). Currently, 32 states have enacted such statutes. These statutes vary by state, but states passed them in order to allow directors wider flexibility in the context of hostile takeovers. *See id.* at 24-25.

towards that mission. Indeed, shareholders of these double bottom line corporations are on notice that such diversion will occur, and this notice may be viewed as tacit consent for some instances of subordination. Even without that consent, the foregoing case law suggests that fiduciary law does not prevent directors from choosing to make decisions that do not focus on profit making. Instead, corporate fiduciary law provides an ideal framework for double bottom line corporations, enabling them not only to consider the interests of other groups when carrying out their fiduciary duty,[105] but also to advance nonshareholder interests even if they have negative repercussions for shareholders' profits.[106] The fact that such entities can do so even in the takeover context, when shareholder and nonshareholder interests are most at odds, reveals the significant flexibility corporate fiduciary law affords to for-profit directors and officers. Thus, those who view corporate fiduciary law as an insurmountable obstacle to the viability of double bottom line corporations fail to appreciate the more modern understanding of that law. Instead, the flexibility afforded to these entities at least sets the stage for the successful operation of the double bottom line entity.

Of course concluding that directors and officers have the discretion to pursue the interests of other constituents fails to resolve the question of how such actors will exercise that discretion.[107] In order to respond to this question, we must examine whether other internal or external corporate governance forces will compel directors of for-profit companies to favor shareholder interests.

C. The Relative Ineffectiveness of Derivative Liability Rules

Arguably, the shareholder's exclusive ability to bring a derivative action[108] against directors and officers for a breach of their fiduciary duty makes it more likely

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[105] *See* Paramount Communications, 571 A.2d at 1150 (noting that the director's duty to manage the corporation includes the authority to chart a course "without regard to a fixed investment horizon").

[106] *See Director Accountability, supra* note 93, at 430 (noting that the law of corporate fiduciary duty does not preclude directors "from aiding other corporate constituencies at the shareholders' expense").

[107] *See Id.* at 408 (noting that the law does not preclude directors from using their autonomy to pursue a higher stock price).

[108] The derivative suit enables shareholders to sue members of the board of directors on behalf of the corporation. *See* DEBORAH DEMOTT, SHAREHOLDER DERIVATIVE ACTIONS: LAW & PRACTICE § 2:01 (1992); Tim Oliver Brandi, *The Strike Suit: A Common Problem of the Derivative Suit and the Shareholder Class Action*, 98 DICK. L. REV. 355, 359 (1994); Susanna M. Kim, *Conflicting Ideologies of Group Litigation: Who May Challenge Settlements in Class Actions and Derivative Suits?*, 66 TENN. L. REV. 81, 99 (1998); John W. Welch, *Shareholder Individual and Derivative Actions: Underlying Rationales and the Closely Held Corporation*, 9 J. CORP. L. 147, 153. Because of this, any remedy recovered in a derivative suit flows back to the corporation rather than the individual shareholders who have brought the suit. *See* Kim, *supra*, at 99. This fact also may reduce the incentive of shareholders to bring such actions.

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that these officials will respond to shareholders' profit-making concerns. Indeed, although some have suggested allowing groups other than shareholders to bring a suit against directors for violation of their fiduciary duty,[109] shareholders are currently the only group that has such a privilege.[110] Certainly, directors and officers have tremendous discretion and thus can focus on nonshareholder interests if they choose. However, since other groups cannot enforce their rights or protect their interests through a fiduciary suit, directors may believe that there are no repercussions for neglecting these groups' interests.[111] By contrast, because shareholders represent the only group that can object to the outcome of a decision via a lawsuit, directors and officers will gravitate towards the outcome favoring shareholder interests. Thus, whenever there is a conflict between shareholder interests and the interests of students, the shareholder's ability to threaten litigation may cause directors to choose the option that maximizes shareholder wealth. In this regard, shareholder litigation represents a powerful tool for aligning shareholder interests with those of directors.

However, both procedural and substantive rules blunt the force of this tool. Procedurally, the demand requirement poses the greatest impediment to the ability of liability rules to shape the behavior of corporate actors.[112] Most jurisdictions

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[109] For example, some Delaware courts have begun to tentatively recognize that other groups might deserve to be granted standing to sue directors of for-profit corporations in a derivative action. *See, e.g.*, Geyer v. Ingersoll Publications Co., 621 A.2d 784 (Del. Ch. 1992) (recognizing that at insolvency, directors owe corporate creditors fiduciary duties); Credit Lyonnais v. Pathe Communications Corp., No. CIV.A.12150, 1991 WL 277613 (Del. Ch. Dec. 30, 1991) (noting that directors of a solvent corporation on the verge of insolvency may be justified in following a course of action that diverges from the choice that shareholders would make if given the opportunity and that the fiduciary duties of corporate directors should reflect this reality); Harff v. Kerkorian, 324 A.2d 215, 222 (Del. Ch. 1974) (stating that insolvency triggers a shift in duties to corporate creditors); *see also* Gregory V. Varallo & Jessee A. Finkelstein, *Fiduciary Obligations of Directors of the Financially Troubled Company*, 48 BUS. LAW. 239 (1992) (recognizing that footnote 55 of *Credit Lyonnais* creates duties to creditors that may be deemed inconsistent with their duties to shareholders). However, this normative assessment has not crystallized into the formal granting of such rights. *See* Rima Fawal Hartman, *Situation-Specific Fiduciary Duties for Corporate Directors: Enforceable Obligations or Toothless Ideals?*, 50 WASH. & LEE L. REV. 1761, 1774 (1993) (noting that while some courts appear receptive to the idea, thus far no reported cases exist that grant a creditor standing to bring a derivative action against a board of directors).

[110] *See, e.g.*, *Harff*, 324 A.2d at 218-19 (noting that Delaware law seems clear that one must be a stockholder in order to maintain a derivative action).

[111] *See* Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Constituency Statutes*, 70 TEX. L. REV. 579, 606 (1992) [hereinafter Mitchell, *Constituency Statutes*] (noting that since stockholders pose the sole internal threat to directors' exercise of their discretion, the directors' best means of protecting themselves is to act solely in the interests of shareholders).

[112] Other procedural hurdles also undermine the effectiveness of derivative actions. For example, shareholders who bring a derivative action must have owned their shares at the time of the complained transaction. *See, e.g.*, MODEL BUS. CORP. ACT § 7.41(a) (2003). This is known as the contemporaneous ownership or shareholder rule. The rule is designed to

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require that a shareholder make a demand on the corporation's board of directors before bringing a derivative suit, unless demand is excused.[113] When demand is required, board members can move for dismissal of the shareholder derivative suit.[114] When demand is excused, the entire board cannot seek dismissal.[115] However, boards can appoint a special litigation committee to do so.[116] Predictably, most boards and special litigation committees decide that derivative suits should not go forward, claiming that they are not in the best interests of the corporation.[117] Courts review such decisions in a deferential fashion, thereby honoring the vast

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ensure that individuals do not purchase shares for the purpose of bringing a lawsuit. *See* John C. Coffee, Jr., & Donald E. Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261, 312-13 (1981). A plaintiff must also be a shareholder at the time of the lawsuit and remain a shareholder throughout the life of the lawsuit. *See* MODEL BUS. CORP. ACT § 7.41; Lewis v. Anderson, 477 A.2d 1040, 1049 (Del. 1984) (noting that a plaintiff who ceases to be a shareholder loses standing to sue derivatively). Legislators designed this rule to prevent shareholders from purchasing shares in order to "buy" a lawsuit. *See* Coffee & Schwartz, *supra*, at 312-13. However, the rule reduces the number of shareholders able to bring an action, particularly if some time passes before a claim arises. In addition, some states allow corporations to require that shareholders bringing derivative claims post security for expenses the corporation reasonably expects to incur in connection with the litigation. The purpose of the rule is to reduce the number of strike suits filed against the board. *See id.* at 314; *see also* ALASKA STAT. § 10.06.435 (2003); ARK. CODE ANN. § 4-26-714 (2003); COLO. REV. STAT. § 7-107-402 (2003); N.J. STAT. § 14A:3-6 (2003); N.Y. BUS. CORP. § 627 (N.Y. 2003); 15 PA. CONS. STAT. § 1782 (Pa. 2003). The rule means that if shareholders cannot afford the up-front costs of such expenses, they will not be able to bring their suit regardless of its merit. Both of these rules may impede the ability of shareholders to bring derivative suits thereby limiting the effectiveness of such suits as corporate monitoring devices.

[113] *See* Carol B. Swanson, *Juggling Shareholder Rights and Strike Suits in Derivative Litigation: The ALI Drops the Ball*, 77 MINN. L. REV. 1339, 1349 n.55 (1993) [hereinafter Swanson, *Shareholder Rights*]. The shareholders' demand enables board members to assess the suit, while encouraging shareholders to exhaust internal remedies before resorting to the courts. *See id.* at 1349-50.

[114] For a policy and historical view of the demand requirement, see Coffee & Schwartz, *supra* note 112, at 262.

[115] In some jurisdictions, such as Delaware, if shareholders can prove that demand should not be required, they do not have to make a demand on the corporation. A demand is deemed futile and thus excused if a complaint creates a reasonable doubt that (1) the directors are disinterested and independent and (2) the challenged transaction is a product of a valid exercise of business judgment. *See* Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984). Generally, a shareholder must prove that the directors being sued have some monetary interests in the programs being challenged. *See id.* at 805. However, courts are generally reluctant to excuse demand. *See id.*; *see also* Patricia Daniel, *Recent Developments Concerning the Duty of Care, the Duty of Loyalty, and the Business Judgment Rule*, 40 VAND. L. REV. 631, 638 (1987) (noting that *Aronson* limits the application of *Zapata* by classifying very few cases as demand excused).

[116] *See* Swanson, *Shareholder Rights*, *supra* note 113, at 1358. Although board members of the special litigation committees are not interested in the sense that they did not participate in the underlying transaction being challenged, courts and commentators point out the inherent bias of directors called upon to assess the validity of suits against their fellow directors. *See id.*

[117] *See* James D. Cox, *Searching for the Corporation's Voice in Derivative Suit Litigation: A Critique of* Zapata *& the ALI Project*, 1982 DUKE L.J. 959, 960 (1982).

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majority of them.[118] Thus, whether demand is excused or required, the board—either on its own or through its special litigation committee—is able to prevent shareholder suits from going forward. This means that directors and officers who chose to favor students or other groups have nothing to fear from shareholders because they can most likely terminate any suits such shareholders choose to bring. If board members control the fate of derivative actions, then the shareholder's ability to bring such actions represents nothing more than an empty threat.[119] For this reason, the demand requirement severely limits the impact of liability rules on corporate behavior, diminishing the extent to which such rules will pressure directors and officers to advance only the interests of shareholders.[120]

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[118] *See* Zapata v. Maldonado, 430 A.2d 779, 784 (Del. 1981) (explaining that a board's decision will be respected unless it is wrongful). In fact, court's review of the termination decision does not reach the merits of the underlying transaction. This differs from older case law where courts were willing to review the merits of the underlying claim. *See* Swanson, *Shareholder Rights*, *supra* note 113, at 1357, 1359. In demand-excused cases, courts review more carefully the board's decision regarding dismissal and will apply their own judgment to the dismissal decision. *See Zapata*, 430 A.2d at 788-89. Zapata created a two-part test to determine if a committee's decision will be honored. First, the court requires that the committee is disinterested and independent and conducts a reasonable investigation in good faith. Second, the court applies its own judgment to determine if the dismissal should be granted. Thus, most courts will honor this decision so long as such committees conduct a reasonable investigation. This is true even when such committees offer relatively general rationales for their decisions. *See id.* (pointing out that courts honor board decisions even when they are based on generalized and conclusory justifications). Given that boards and their committees overwhelmingly decide to dismiss derivative suits, courts' deferential review means that many of these suits do not reach the court. *See* Carol B. Swanson, *Corporate Governance: Sliding Seamlessly in the 21st Century*, 21 J. Corp. L. 417, 437 (1996) [hereinafter Swanson, *Corporate Governance*] (explaining that shareholders have tremendous difficulties getting the merits of their claim before the court because of the demand rule).

[119] *See* Harry G. Hutchison, *Presumptive Business Judgment, Substantive Good Faith, Litigation Control: Vindicating the Socioeconomic Meaning of* Harhen v. Brown, 26 J. CORP. L. 285, 292 (2001) (explaining that procedural requirements allow the board to wrestle control from shareholders and inhibit the filing of even meritorious claims); Brandi, *supra* note 108, at 374 (commenting that the demand requirement "has often made it difficult for shareholders to wrest control over the derivative suit from the hands of the corporation's directors"). Professor Brandi further notes that the demand requirement creates a disincentive for shareholders to bring these suits. *See id.* at 374.

[120] *See* Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 CORNELL L. REV. 261, 286 (1986) (noting that the overall effect of the legal rules regarding derivative suits is to deemphasize the role of liability rules in conforming managerial behavior); Donald E. Schwartz, *In Praise of Derivative Suits: A Commentary on the Paper of Professors Fischel and Bradley*, 71 CORNELL L. REV. 322, 339-40 (1986) ("The most significant impediment under corporate law to the effectiveness of liability rules . . . is the ability of boards of directors . . . to cause the termination of a derivative suit."); *see also Team Production Theory*, *supra* note 94, at 294 (noting that the procedural hurdles encompassed in the demand requirement insulate directors from shareholder challenge and control); Coffee & Schwartz, *supra* note 112, at 326 ("[T]he ability of even a truly independent board to terminate an action plainly means that meritorious cases will sometimes be aborted."). Weighing these considerations, several corporate scholars as well as the American Law Institute (the "ALI") have concluded that "liability rules enforced by shareholder litigation play a relatively minor role in aligning the interests of managers with

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Apart from this procedural hurdle, courts' substantive analyses of derivative suits reveal the relative shortcomings of liability rules as a force in shaping director and officer conduct. Courts analyze board decisions with reference to the business judgment rule. That rule reflects courts' belief that board members are in the best position to make decisions regarding the corporation.[121] Consistently, so long as directors' decisions are rational and informed, courts will not second-guess those decisions, even if shareholders object to them.[122] Indicative of this deference, shareholders rarely succeed when they bring an action based on a violation of the directors' fiduciary duty of care.[123] Moreover, since the 1919 case of *Dodge v. Ford*

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those of shareholders." Daniel R. Fischel, *The Business Judgment Rule and the* Trans Union *Case*, 40 BUS. LAW. 1437, 1439 (1985); *see also* Michael Bradley & Cindy Schipani, *The Relevance of the Duty of Care Standard in Corporate Governance*, 75 IOWA L. REV. 1, 70 (1989) (noting that derivative suits may not be effective managing devices); Hutchison, *supra* note 119, at 294 (noting that special litigation committees, judicial deference and demand requirements all have chilling effect on shareholder derivative suits, which may inhibit the impact of such suits on director misconduct); Swanson, *Shareholder Rights*, *supra* note 113, at 1346-47 (citing final draft of the Corporate Governance Project of the ALI, which concludes that derivative suits may only have a limited role in curbing managerial misconduct); Fischel & Bradley, *supra* at 292 ("Many analyses of corporate law assume that liability rules enforced by derivative suits play a fundamental role in aligning the interests of managers and investors. We have that this widespread assumption is not supported by either the theory of liability rules, the available empirical evidence, or the structure of corporate law.").

[121] *See* Aronson v. Lewis, 473 A.2d 805, 811-12 (Del. 1984).

[122] *See* Paramount Communications v. QVC Networks, 637 A.2d 34, 42 (Del. 1994) (noting that under normal circumstances neither the courts nor shareholders interfere with managerial decisions); Stephen A. Radin, *The Director's Duty of Care Three Years After* Smith v. VanGorkom, 39 HASTINGS L.J. 707, 728-44 (1988) (finding that directors have only been found liable for cases involving egregious facts related to hurried decision-making); Swanson, *Corporate Governance*, *supra* note 113, at 434 (noting that the hallmark of the business judgment rule is that courts will not substitute their judgment for the boards so long as the board's is rational). Directors violate their duty of care when they fail to make decisions based on incomplete information. *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 893 (Del. 1985) (finding liability for making a decision quickly with inadequate information); Francis v. United Jersey Bank, 432 A.2d 814 (N.J. 1981) (finding liability for failure to review financial statements).

In *Gaines v. Haughton*, 645 F.2d 761, 778 (9th Cir., 1981), *cert. denied*, 454 U.S. 1145 (1982), the Ninth Circuit explained the deference afforded to board decisions in the following fashion:

> Many corporate actions taken by directors in the interest of the corporation might offend and engender controversy among some stockholders . . . . The tenor of a company's labor relations policies, economic decisions to relocate or close established industrial plants, commercial dealings with foreign countries which are disdained in certain circles, decisions to develop (or not to develop) particular natural resources or forms of energy technology, and the promulgation of corporate personnel policies that reject (or embrace) the principle of affirmative action, are just a few examples of business judgments, soundly entrusted to the broad discretion of the directors which may nonetheless cause shareholder dissent.

[123] Indeed, researchers focusing on this issue have found very few reported cases holding directors liable for a breach of their fiduciary duty outside of self-interested transactions. *See* Joseph W. Bishop, Jr., *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L. J. 1078, 1099 (1968) (finding only

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Motor Co.,[124] no court has prevented directors from advancing non-shareholder interests other than in the limited takeover context.[125] Courts' substantive analysis of derivative suits underscores the relative freedom corporate directors and officers have to pursue, and even favor, the interests of groups other than shareholders without fear of reprisals.[126]

Weighing these procedural and substantive considerations, several corporate scholars as well as the American Law Institute (the "ALI") have concluded that "liability rules enforced by shareholder litigation play a relatively minor role in aligning the interests of managers with those of shareholders."[127] In this regard, opponents' fears that liability rules would pressure double bottom line corporations to ignore their social obligations in favor of maximizing shareholder wealth appear at the very least to have been overstated.

D. The Illusive Power of Shareholder Voting

In addition to the liability rules, some contend that shareholders' exclusive ability to vote on corporate affairs ensures that corporate managers advance shareholder interests.[128] From this perspective, as the sole group entitled to vote for the election and removal of directors as well as to approve certain other fundamental

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four cases); Stuart R. Cohn, *Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule*, 62 TEX. L. REV. 591, 593-94 (1983) (finding only seven cases); Henry R. Horsey, *The Duty of Care Component of the Delaware Business Judgment Rule*, 19 DEL. J. CORP. L. 971, 982 (1994) (affirming Bishop's study).

[124] *See* Dodge v. Ford Motor Co., 170 N.W. 668, 668 (Mich. 1919).

[125] *See* William H. Simon, *What Difference Does it Make Whether Corporate Managers Have Public Responsibilities?*, 50 WASH. & LEE L. REV. 1697, 1698 (1993) (finding that no modern cases have held directors liable for favoring non-shareholder interests over shareholders). My research similarly revealed no reported cases that prevented directors from favoring non-shareholders over shareholders.

[126] *See Director Accountability*, *supra* note 93, at 426-27 (noting that given the substantive nature of directors' fiduciary duties, the shareholders exclusive right to bring a derivative action "should not, however, be interpreted to mean that directors owe fiduciary duties only to shareholders").

[127] *See* Fischel, *supra* note 120, at 1439; *see also* Bradley & Schipani, *supra* note 120, at 70 (derivative suits may not be effective managing devices); Fischel & Bradley, *supra* note 120, at 292 ("Many analyses of corporate law assume that liability rules enforced by derivative suits play a fundamental role in aligning the interests of managers and investors. We have shown that this widespread assumption is not supported by either the theory of liability rules, the available empirical evidence, or the structure of corporate law."); Hutchison, *supra* note 119, at 294 (noting that special litigation committees, judicial deference, and demand requirements all have chilling effect on shareholder derivative suits, which may inhibit the impact of such suits on director misconduct); Swanson, *Shareholder Rights*, *supra* note 113, at 1346-47 (citing final draft of the Corporate Governance Project of the ALI, which concludes that derivative suits may only have a limited role in curbing managerial misconduct).

[128] *See* John H. Matheson & Brent A. Olson, *Corporate Law and the Longterm Shareholder Model of Corporate Governance*, 76 MINN. L. REV. 1313, 1328 (1992) [hereinafter Matheson & Olson, *Corporate Law*].

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transactions,[129] the shareholder can determine the fate of directors and their programs. This ensures that such directors and officers remain responsive to shareholder concerns, while decreasing the likelihood that they will focus on issues unconnected to shareholders.

Yet, there is reason to doubt that shareholders' power to vote aligns their interests with corporate managers. First, evidence reveals that traditional shareholders wield their voting power infrequently at best.[130] Instead of using their vote to shape corporate conduct, most shareholders cast votes that heavily favor incumbent management and their policies.[131] More importantly, when those shareholders become dissatisfied, they simply sell their stock, rather than seek to impact management behavior through voting.[132] Thus, traditional shareholders do not use voting as a mechanism for influencing corporate conduct. Second, a similar pattern has emerged with regard to institutional investors. Scholars explain that because most shareholders are widely dispersed and only hold small percentages of stock, they do not believe that they have the ability to impact corporate policies through voting, and thus behave relatively passively with regard to such conduct.[133] However, many scholars believed that institutional investors, who own larger blocks of shares, could overcome this passivity and play a more active role in shaping the behavior of officers and directors.[134] Yet evidence suggests that such investors

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[129] *See* Rev. MODEL BUS CORP. ACT §§ 7.28 (noting that directors are elected by a plurality of the votes cast by shares entitled to vote), 8.63 (requiring shareholder approval of conflict of interest transactions), 10.03 (allowing shareholders to vote on amendments to the articles of incorporation); 11.04 (requiring shareholder approval of certain mergers), 12.02 (requiring shareholder approval of certain asset dispositions).

[130] *See* Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 821 (1992) [hereinafter Black, *Agents Watching Agents*]; *Team Production Theory*, *supra* note 94, at 310.

[131] *See Team Production Theory*, *supra* note 94, at 311 (noting that shareholders do not in any real sense elect directors); Black, *Agents Watching Agents*, *supra* note 130, at 821.

[132] *See* Black, *Agents Watching Agents*, *supra* note 130, at 821.

[133] Scholars explain that traditional shareholders are apathetic about voting because the costs of becoming active are higher than the anticipated return—the probability that they will be able to effect the ultimate outcome of the decision. *See* FRANK H. EASTERBOOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 83 (1991) (noting that the rational strategy for most shareholders is to sell their stock rather than incur the costs of voting); *Director Accountability*, *supra* note 93, at 433 (noting that shareholders are prone to "rational apathy"); Lynne L. Dallas, *The Control and Conflict of Interest Voting Systems*, 71 N.C. L. REV. 1, 37-38 (1992). This may overstate the case for apathy because when outcomes are uncertain and hence every vote counts, shareholder apathy is less rational. Indeed, Professors Blair and Stout note that the right to vote serves as a "safety net" for truly egregious conduct. *See Team Production Theory*, *supra* note 94, at 312.

[134] *See* D. Gordon Smith, *Corporate Governance and Managerial Incompetence: Lessons from KMART*, 74 N.C. L. REV. 1037, 1105-08 (1996). In the 1980s, shareholders' institutional ownership of stock began to explode. *See* Black, *Agents Watching Agents*, *supra* note 130, at 827-29; Matheson & Olson, *Corporate Law*, *supra* note 128, at 1354-55 (noting the "staggering rise" of institutional ownership); Swanson, *Corporate Governance*, *supra* note 118, at 424 (calling increase of institutional investors in 1980 a "stealth attack" on corporate management).

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generally concern themselves only with truly egregious conduct, rather than attempting to monitor or affect the day-to-day actions of corporate directors and officers.[135] Third, the limited nature of the voting power undermines the impact such voting can have on director and officer conduct. Corporate statutes limit shareholder voting to a few spheres, including the election of directors, self-interested transactions, and fundamental transactions.[136] Such negative power means that, even if they desired to, shareholders cannot actively participate in management decisions,[137] and are "locked out of the decision-making process on many issues."[138] Professors Blair and Stout sum up the impact of shareholder voting in this fashion: "Practical and legal obstacles ensure that the vast majority of

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Because institutional investors tend to own a larger percentage of shares, they have a greater stake in companies than other shareholders. *See* Matheson & Olson, *Corporate Law, supra* note 128, at 1355-56. Such an increased stake may translate into a greater incentive to invest time and resources in monitoring corporate officials and insuring that they act consistently with the shareholder's interests. *See id.; see also* Black, *Agents Watching Agents, supra* note 130, at 821-22 ("A shareholder who owns a large percentage stake is more likely to engage in monitoring than a shareholder who owns a smaller stake."). Indeed, some institutional investors have become involved in proxy contests. *See* Smith, *supra*, at 1104; Swanson, *Corporate Governance, supra* note 118, at 425-426. Others have played a role in introducing shareholder proposals. *See* Matheson & Olson, *supra* note 128, at 1357. In 1989, institutional shareholders introduced 215 proposals and in 1990 that number had increased to 285. However, these actions are relatively minor as compared with predications. *See* Jill E. Fisch, *Relationship Investing: Will it Happen? Will It Work?*, 55 OHIO ST. L. J. 1009, 1029-34 (1994) (pointing out the limited nature of shareholder activism).

[135] *See* Black, *Agents Watching Agents, supra* note 130, at 828 (pointing out that shareholders have been successful in proposals related to poison pills and golden parachutes, but do not focus on less visible signs of managers conduct); Smith, *supra* note 134, at 73 (discussing shareholders role in ousting KMART CEO).

[136] *See supra* note 129 and accompanying text (describing shareholder voting authority).

[137] Thus, shareholders do not have the ability to vote for the election and removal of officers. Instead, shareholders vote for directors who then elect or appoint officers. *See* MODEL BUS. CORP. ACT § 8.40 (providing that officers are elected or designated by board); MODEL BUS. CORP. ACT § 8.03 (providing that shareholders elect directors at annual meeting). Also, in public corporations, shareholders are prevented from entering into agreements that seek to elect officers directly or compel directors to elect specific officers. *See* McQuade v. Stoneham, 189 N.E. 234 (N.Y. 1934) (refusing to enforce stockholders agreement to elect directors and fix their salaries). In closely held corporations, shareholders are allowed to enter into agreements pertaining to the election of officers or some other matter that limits the traditional discretion of directors. *See* Galler v. Galler, 203 N.E.2d 577 (Ill. 1964) (enforcing shareholder agreement based on the conceptual difference between the close corporation and the public one). Thus, if a company's policies stem from officers, rather than directors, at best the shareholders can signal their displeasure by removing directors. Then too, shareholders cannot compel directors to take particular actions. *See Director Accountability, supra* note 93, at 424. Indeed, as Professors Blair and Stout point out, under the federal proxy rules regulating shareholder proposals directors can reject shareholder proposals that require directors to take particular actions. Instead, such proposals must be cast as recommendations or suggestion and are nonbinding on the company. *See* 17 C.F.R. § 240.14a-8(i)(1) and accompanying note (2000).

[138] Matheson & Olson, *supra* note 128, at 1358; *see also* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 559 (2003) (noting that the vast majority of corporate decisions are made by the board of directors alone).

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shareholders in the vast majority of firms exercise little or no authority over the board of directors."[139]

Like liability rules, shareholders' ability to vote may have little or no impact on the decision-making of directors and officers. Certainly, if double bottom line corporations have institutional investors, they may feel pressured when making extraordinary decisions, and hence may ignore the interests of other groups in the context of such decisions. However, the shareholders' ability to vote should have little influence over these officials' conduct with respect to most of the decisions they must make. As a consequence, we should expect that decisions by a for-profit corporation regarding classroom size, instructions, and even teacher salaries, can be made without regard to their impact on shareholders because such decisions relate to day-to-day actions that shareholders rarely have any influence over. In this respect, the notion that shareholder voting would serve to prevent double bottom line corporations from attending to nonshareholder objectives seems inconsistent with the evidence related to the actual impact of such voting.

E. The Continued Strength of the Capital Markets

The capital markets may represent a powerful external force pressuring directors and officers to focus on profits.[140] Such markets force directors and officers to focus on profit rather than other nonfinancial goals because shareholders measure corporate conduct based on stock prices and financial statements.[141] Managers who fail to maximize profits fear retaliation from shareholders who do not want to see their stock values decline.[142] This fear pressures corporate directors and officers into focusing on issues of short-term profit and financial viability.[143] Professor Lawrence Mitchell refers to this phenomenon as "short-termism," and notes that it prevents directors and officers from focusing on long-range goals, which would include the kinds of social goals that a double bottom line entity may have.[144]

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[139] *See Team Production Theory*, *supra* note 94, at 315.

[140] Although this Article discusses markets only in the context of the financial markets, there are other market forces that impact corporate conduct. Indeed, the market for corporate control may also impact director conduct because when directors fail to act in a manner that increases stock prices, directors become vulnerable to change of control transactions that seek to replace them.

[141] *See, e.g.*, Lawrence E. Mitchell, *A Critical Look at Corporate Governance*, 45 VAND. L. REV. 1263, 1287-92 (1992) (explaining that capital markets drive corporate managers to favor short-term profit because stockholders measure board conduct based on stock prices and financial statements).

[142] *See id.* at 1292.

[143] *See id.* at 1286-88.

[144] *See id.* at 1290. While Professor Mitchell views short-termism as an inevitable by-product of publicly held corporations, he also sees it as a problem because it prevents directors from focusing on corporate constituents and long-range programs.

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Fortunately, this short-termism may be tempered within the double bottom line corporation, enabling directors and officers of those entities to pursue more long-term objectives. Indeed, market analysts judge these companies both on their ability to produce profit and their success in the academic arena.[145] Because these companies are not evaluated in terms of traditional short-term profit margins, the market does not prevent corporate officials from ignoring those margins in favor of considering other interests. Indicative of this, analysts claim that these stocks are not suited for investors with a short-term horizon.[146] Thus, even when education stock prices dropped considerably, many analysts expressed approval of such companies because they had faith in their long-term educational objectives.[147] Hence, the dual nature of these companies may attract investors that appreciate the long-term importance of considering the interests of all corporate constituents, thereby tempering the traditional pressure to focus only on short-term financial goals.

Then too, analysts' and shareholders' expectations about the company's non-financial objective may create affirmative market pressure for corporate agents to attend to these objectives. Just as news regarding certain negative social practices, such as a company's alleged operation of a sweatshop, may hurt a corporation's stock, the double bottom line corporation's failure to achieve its identified social mission has had a negative impact on its stock price.[148] For example, in the case of Edison, allegations of cheating scandals and other educational improprieties have had a negative impact on the public's perception of that company, and consequently have had a negative impact on its stock price. Then too, Edison's apparent inability to show meaningful success has had a negative impact on analysts' assessments of that company and its stock.[149] This impact not only reveals the important role these entities' social mission plays in the market place, but also suggests that the market may force those entities to attend to that mission.

Despite this force, it is clear that the market continues to play a significant role in forcing corporate officers and directors' attention towards profit making. Indeed, while market watchers initially appeared willing to wait for Edison to achieve its goals, there were limits to this willingness.[150] Thus, initially market

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[145] *See* Beth Piskora, *Wall Street Gives Edison Schools High Marks, But Stock Falls*, N.Y. POST, Dec. 23, 2001, at 36 ("Students in Edison-run schools also score much higher on standardized tests than they did before the Edison takeover.").

[146] *See id.*; *see also* Lambert, *supra* note 66, at 62; Theodore Spencer, *A Tale of Two Education Stocks*, FORTUNE, Jan. 22, 2001, at 144.

[147] Piskora, *supra* note 145, at 36 (noting that market analysis "are not worried about the stock's short-term moves, and call it an excellent long-term holding.")

[148] *See* Mezzacappa, *supra* note 51 (noting that report of failing test scores led to dramatic decline in stock price).

[149] *See id.* (explaining analysts' disappointment with reports about Edison's low test scores).

[150] As one commentator explained it, Edison's CEO Chris Whittle:

analysts issued glowing reports regarding Edison, even when Edison failed to demonstrate any financial returns.[151] In this respect, market watchers appeared to give Edison the freedom to implement its educational plan, as well as time to show that its plan could generate profitability for shareholders. However, when it appeared evident that Edison would not boast significant financial returns, the market support for the company appeared to wane.[152] This lack of support impacted Edison's behavior, pressuring the company to show its financial viability.[153] In fact, Edison outlined reports detailing plans designed to generate financial returns.[154] Announcement of these plans appeared to have a positive impact on Edison's stock price, causing it to increase thirty-three percent.[155] This increase in turn surely encourages corporate managers to continue to focus on financial goals. More importantly, while Edison claims that its financial plans will not interfere with its

> has long assumed that investors and educators would give him plenty of time to prove that his for-profit company could revolutionize American education. With good reason: Since founding Edison a decade ago, Whittle has raised $509 million—without ever coming close to turning a profit. But time may finally be running out on his bold experiment.

William C. Symonds, *Edison: An "F" in Finance*, BUS. WK., Nov. 4, 2002, at 52 [hereinafter *Edison F*].

[151] *See supra* note 147 and accompanying text.

[152] Edison announced a net loss of $19.7 million for the September 2002 quarter. *See* Charles Forelle, *Edison Schools Sees Net Loss Widen in Period*, WALL ST. J., Nov. 15, 2002, at B2. This caused the stock price to drop to 75 cents a share, when earlier in the year the stock had been as high as $22 a share. *See* Mezzacappa, *supra* note 51.

[153] *See Edison Schools, Inc.: Programs to Expand in Effort to Raise Additional Revenue*, WALL ST. J., Nov. 19, 2002 [hereinafter *Edison Programs*] (noting that reports about Edison's loss of revenues placed pressure on the company to reassure investors that it would be financially sound); *see also* Liz Bowie, *Edison Tries to Reassure State Board of Education; Schools Operator Upbeat Despite Stock Price Dip*, BALT. SUN, Oct. 30, 2002 (noting Edison's assurances that it would remain financially viable and that it would seek to keep schools in operation); Forelle, *supra* note 152 (noting that Edison was under pressure to engineer a turn-around because of its consistent failure to post positive financial returns); *Edison F*, *supra* note 150 (noting that Edison's precarious financial position has caused its officers to pledge the "strongest financial year" in the company's history in order to boost investor confidence); Martha Woodall, *Edison's Loss Widens in its First Quarter*, PHILA. INQUIRER, Nov. 15, 2002 (noting that reports about losses in revenue caused Edison stock to dip and put pressure on that company to make assurances about its financial position). This pressure was increased because Edison's stock price had fallen below $1.00 for more than 30 days, and it therefore risked delisting from Nasdaq. Thus, Edison had to ensure investors of its financial prowess in order to stay afloat. *See Edison Programs*, *supra*.

[154] *See* Chris Brennan, *Edison Says It's Expanding School Biz*, PHILA. DAILY NEWS, Nov. 19, 2002 (noting Edison's plan to buy-back 5.4 million shares and possibly take the company private in order to generate stronger returns); Forelle, *supra* note 152 (noting that Edison planned to sell some of its notes and speed up collection of receivables in order to boost its revenue); *Edison Programs*, *supra* note 153 (identifying plans to expand program offerings and offer supplemental tutorial services in order to generate $100 million in revenue in three years).

[155] *See Edison Programs*, *supra* note 153. The stock rose 43 cents to $1.73.

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educational objectives,[156] evidence suggests that such plans can and will weaken the attainment of such objectives, drawing resources away from the company's educational goals. Indeed, it appears that when Edison's stock plummeted because it did not obtain all of its expected contracts in Philadelphia, and hence could not meet its earnings projections, Edison cut back on some of its educational programming, including reducing computers and supplies to various schools.[157] Then too, other sources note that Edison is seeking to expand significantly the number of summer and after-school programs it runs.[158] While such an expansion generates increased revenues, it may undermine the quality of education within the traditional public schools Edison operates because it diverts resources away from those schools, and does so at a time when its strength has not yet been established.[159] Edison's apparent shift in priorities as well as the new emphasis it has placed on financial matters underscores the market's ability to shift the attention of the double bottom line corporation away from its public goals.

F. Conclusions

This section indicates that the costs of operating within a for-profit regime may be exaggerated at least with respect to most of the structures designed to focus directors and officers' attention towards profit and away from other social objectives. Most importantly, fiduciary law does not prevent directors and officers from considering and even favoring the interests of nonshareholders. Also, the derivative liability rules and shareholder voting rights play a less decisive role in aligning

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[156] Indeed, in the midst of discussions regarding methods to bolster Edison's financial position, company executives insisted that they would continue to commit necessary resources to schools, and would not take actions that would fail to improve schools. *See* Event Brief of Q1 2003, Edison Schools Earning Conference Call—Final, FD Wire, Nov. 14, 2002.

[157] *See* Chris Brennan, *Edison Schools Angles to Avoid Bankruptcy; New Feature Monitors Firm's Status*, PHILA. DAILY NEWS, Oct. 23, 2002 (noting that in an effort to conserve resources, Edison did not provide laptops to its teachers or home computers to its students, and took away additional supplies it had allocated to various schools claiming they were not needed); Scott Elliott, *Charter Schools' Fiscal Future Called Sound*, DAYTON DAILY NEWS, Oct. 22, 2002 (noting that in order to address investor concerns, Edison made certain cut backs, including cutting 10% of its administrative staff); Charles Forelle, *Flunked by Investors, Edison Schools Scorns Talk of Failure*, WALL ST. J., Oct. 22, 2002 (noting that Edison did not provide for computers and promised textbooks in order to respond to investor concerns); Mezzacappa, *supra* note 51 (noting that Edison appeared to forfeit some of its key school strategies in order to secure more contracts and generate greater revenues for its investors); Tyre, *supra* note 69 (noting that Edison took away some of the new equipment it had purchased for its schools in Philadelphia); *see also Edison F*, *supra* note 150 (noting that Edison's financial plans appear to weaken its educational model).

[158] While previously only operating such programs in Missouri, Edison plans to expand to Texas, New York and California. *See Edison Programs*, supra note 153. Indeed, Edison is negotiating with some 150 districts for after school and summer programs. *See* Woodall, *supra* note 153.

[159] *See* Woodall, *supra* note 153.

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directors and officers' behavior with shareholders' profit-making interests. Because of this, directors and officers have greater freedom to attend to other interests without fear of reprisal from shareholders either through voting or successful lawsuits. This minimizes the role these internal governance structures have in undermining the viability of double bottom line corporations. However, while the impact of the capital markets may not be as powerful on double bottom line corporations as it is on traditional for-profits, evidence suggests that there is considerable risk that the markets will cause corporate directors and officers to forego their social objectives in the pursuit of financial success. Thus, while opponents have overstated their case against the for-profit regime, there are clearly some forces that compel corporate actors to focus on profit.

III. Assessing the Advantages of the For-Profit's Role in Delivering Public Services

Proponents of double bottom line corporations tout the advantages of such entities. They claim that these entities' for-profit status generates additional revenue for public schools and, more importantly, fosters competition that will facilitate improvement in the overall quality of educational services being offered. Implicit in theses claims is the notion that the current corporate law regime adequately protects against any tendency such companies may have to favor profits over delivery of these services. This Part evaluates these claims and the presumption that underscores them.

A. Financial Resources: Diversion or Remedy?

Arguably double bottom line corporations intend to divert resources away from public services by promising to generate shareholder profit. Many may assert that this diversion may never be justified. In the context of public schools, we have recognized for years that the current system is significantly under funded.[160] As a result, many school districts suffer from million-dollar deficits, chronic teacher

[160] This lack of funding has triggered several lawsuits against state funding system. *See, e.g.*, William E. Thro, *Issues in Education Law and Policy: Judicial Analysis During the Third Wave of School Finance Litigation: The Massachusetts Decision as a Model*, 35 B.C. L. REV. 597, 598 n.3 (1994) (identifying decisions involving constitutional challenges to state funding systems in twenty nine states). Some claim that we have historically under funded schools attended by black children; *see also* Kevin Brown, *Has the Supreme Court Allowed the Cure for* De Jure *Segregation to Replicate the Disease?*, 78 CORNELL L. REV. 1, 14-17 (1993); Wendy R. Brown, *The Convergence of Neutrality and Choice: The Limits of the State's Affirmative Duty to Provide Equal Educational Opportunity*, 60 TENN. L. REV. 63, 125-26 (1992) (pinpointing history of under funding of black colleges).

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shortages, and crumbling infrastructures.[161] All of these problems undermine the ability of the public school system to provide quality education. To the extent that double bottom line corporations divert *any* resources away from the already depleted public school system, it would appear that the existence of such corporations cannot be justified.

Instead of such a diversion, however, proponents argue that these corporations can remedy the problems associated with inadequate funding by providing additional financial resources to public schools. Nonprofits and governmental agencies are constrained in the manner in which they can raise money to fund their services.[162] Historically, such entities raised capital via tax-exempt financing, which meant that they could raise money at significantly lower costs than for-profit firms.[163] However, new federal laws have altered and limited the use of such financing, making it both more costly and more difficult to obtain.[164] By contrast, for-profit firms have broader options. Indeed, they can raise debt financing without the restrictions imposed on nonprofit and governmental entities. Then too, for-profits have access to the capital markets.[165] Thus, when shareholders purchase stock in these companies, they provide resources that may enable such companies to fulfill their social mission.[166] Apart from the shareholders' capital, for-profits can take advantage of a variety of different funding sources unavailable to their nonprofit and governmental counterparts.[167] For example, many venture capital firms have invested in these companies, providing millions of dollars in available resources.[168]

This increase in funds translates into additional resources for the beneficiaries being serviced by these entities. Indeed, many school districts hire for-profit companies like Edison as a last ditch effort to save poorly performing

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[161] *See supra* note 49 and accompanying text (explaining deficiencies within Philadelphia school district); *see also* Suzanne Ernst Drummond, *Déjà Vu: The Status of School Funding in Ohio After* DeRolph II, 68 U. CIN. L. REV. 435, 435-36 (2000) (explaining status of Ohio public schools where students were taught in classrooms that had asbestos and lacked text books and adequate funding for other supplies).

[162] *See* Fishman, *supra* note 5, at 713; Singer, *supra* note 2, at 226-27.

[163] *See* Fishman, *supra* note 5, at 713; Singer, *supra* note 2, at 226.

[164] *See* Singer, *supra* note 2, at 227 (explaining that in the hospital context, the restriction limits the amount of funds that can be used for non-hospital purpose, such as administrative costs, while imposing a cap on the total amount of funds that can be used for such activities); *see also* I.R.C. § 145 (2003).

[165] *See* Hansmann, *supra* note 25, at 550 (noting that the nonprofits inability to access the capital markets cripples its growth).

[166] *See id.* at 507 (noting that because the nonprofit cannot raise equity capital through stock issuance, it cannot meet all of its capital needs).

[167] *See* Fairfax, *supra* note 92, at 418.

[168] *See id.* at 422-23 (describing private equity support for education management companies).

schools.[169] Edison, in turn, claims to inject significant resources into such schools. Thus, Edison boasts that it will provide a new computer to every family in an Edison school beginning in grades 1-3,[170] as well as laptop computers for every teacher and administrator within its schools.[171] Edison also apparently spends millions of dollars of its own funds improving school buildings and purchasing new supplies for students and faculty,[172] while investing in professional development training for teachers.[173] One parent at an Edison school noted that, even without increased test scores, she was pleased with Edison's performance because, where her daughter had previously attended a school that was "dirty and rough," now she attended art and music classes in a "safe learning environment."[174] Even these cosmetic changes reflect the added resources for-profit companies may provide to their beneficiaries. Hence, instead of diverting resources, double bottom line corporations may generate additional sources of funding that can be used to improve that public service.[175]

B. Achieving Quality Education

There is an ongoing debate regarding the extent to which for-profit companies can improve the quality of services being offered to students within the

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[169] *See, e.g.*, Richard Lee Colvin, *A Renewed Fight Over Firm's Role in School Education: Low Test Scores at Edison Charter Academy in San Francisco Raise Questions About its For-Profit Operator*, L.A. TIMES, Oct. 28, 2001, at B1 ("Typically, the company [Edison] is brought in as a last resort to take a shot at reviving schools that have failed to educate poor and minority students."); Symonds, *supra* note 48, at 70 (noting that school districts often give Edison their worst schools, with students whose performance scores are at or near the bottom of the city and where schools often have a history of violence).

[170] *See* FIFTH ANNUAL SCHOOL PERFORMANCE REPORT, *supra* note 48, at 11.

[171] *See id.*

[172] Edison spends nearly $500 per student on instructional materials before a school opens and has spent $28 million in such expenditures since 1995. *See* FOURTH ANNUAL SCHOOL PERFORMANCE REPORT, *supra* note 47, at 11; *see also* Maria L. La Granga, *Charter School's Scores Up, So Why is Board Unhappy?*, L.A. TIMES, Mar. 18, 2001, at A1 (noting that Edison spent $1.8 million to fix up the school in San Francisco and purchase new computers for student families); Paul Hemp, *Desperate City Tries Schools-for-Profit*, BOSTON GLOBE, Aug. 30, 1992, at 1 (noting that prior to privatization student restrooms at one school "resembled vandalized tombs," but private companies revitalized with renovations).

[173] *See* FIFTH ANNUAL SCHOOL PERFORMANCE REPORT, *supra* note 48, at 11; FOURTH ANNUAL SCHOOL PERFORMANCE REPORT, *supra* note 47 at 9, 11 (noting that Edison teachers receive four to six weeks of training prior to school opening).

[174] *See* Colvin, *supra* note 169.

[175] In the context of health care, experts similarly agree that one of the primary reasons for the growth in for-profit provision of such services was the need for capital infusion such corporations could meet. *See* Singer, *supra* note 2, at 221-22 ("Increasingly, nonprofit tax-exempt hospitals have come to believe that they are at a significant disadvantage vis-à-vis their for-profit brethren in their ability to attract the capital needed to compete in the market."); *see also* Fishman, *supra* note 2, at 713; Sackett, *supra* note 13, at 250 ("A principal factor motivating many not-for-profits to convert is an increased need for access to capital in order to compete with for-profit entities.").

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schools they operate, at least when measured in terms of increasing student test scores.[176] On the one hand, opponents point to reports revealing that Edison's overall performance on test scores is at best mixed.[177] On the other hand, Edison claims that its success is marred by the fierce opposition it receives[178] and by inappropriate analysis of its test scores.[179] In fact, other commentators agree that some Edison schools have demonstrated improvement, and in some cases the improvement has been significant.[180] These commentators maintain that this improvement is particularly impressive given the fact that when Edison takes over a school, the test scores are at or near the bottom of the region.[181] Measured in terms

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[176] Many experts disagree that testing is the best or most accurate indicator of a school systems overall success. *See* Fairfax, *supra* note 92, at 467. Despite this fact, testing has become the dominant method by which we judge the quality of the nation's public schools. *See id.*

[177] In 1998, the American Federation of Teachers ("AFT") conducted a study of Edison schools (later updated in 2000) and found that the rates of student achievement in such schools were mixed. *See* F. HOWARD NELSON, AM. FED'N OF TEACHERS, STUDENT ACHIEVEMENT IN EDISON SCHOOLS: MIXED RESULTS IN AN ONGOING ENTERPRISE (1998), *available at* http://www.aft.org/research/edisonschools.html [hereinafter STUDENT ACHIEVEMENT]; F. HOWARD NELSON, AM. FED'N OF TEACHERS, TRENDS IN STUDENT ACHIEVEMENT FOR EDISON SCHOOLS, NC.: THE EMERGING TRACK RECORD (2000), *available at* http://www.aft.org/research/edisonschools.html [hereinafter TRENDS IN STUDENT ACHIEVEMENT]. The study, which claims to be the only "comprehensive, independent evaluation" of Edison schools, reviews state and local student achievement scores from 40 Edison schools in eight states, representing the majority of Edison schools in operation for at least two years. *See id.* The AFT report concludes, "[s]tudents in Edison schools mostly perform as well as or worse than students in comparable schools; occasionally they perform better." *Id.* at 8.

[178] *See* Winters, *supra* note 70, at 64 (noting that the resistance Edison faces from teachers' unions and community groups often prevents it from fully implementing its educational plans).

[179] Edison argues that its student achievement must be evaluated by analyzing single groups of students as they progress from grade to grade. *See, e.g.*, EDISON SCHOOLS, INC., RESPONSE TO THE AFT REPORT ON STUDENT ACHIVEMENT IN EDISON SCHOOLS 5 (1998), *available at* http://www.aft.org/research/edisonproject/edrespnd/edresp2.htm [hereinafter EDISON RESPONSE]. Based on this methodology, and in contrast to the AFT report, Edison's 2000 annual report states that 85% of its schools have posted positive achievement trends. *See* EDISON PROSPECTUS, *supra* note 48, at 2. In the 1999-2000 school year its average gain in reading, language arts, spelling, writing, and math was 5-7%. *See id.* at 15; Wyatt, *supra* note 72(noting that students raised their test scores an average of 5% per year). In Boston, where the AFT reported students performing worse than the students in surrounding schools, Edison found that student scores increased by 18%. *See* EDISON RESPONSE, *supra*, at 20. In Michigan, the student's fourth grade scores in math, reading, and writing improved respectively by 19%, 10%, and 27%. *See id.* at 18-19. Similarly, in San Francisco, the percentage of students scoring in the upper half on math and reading tests more than doubled. *See* Wyatt, *supra* note 72. These gains are compared to the essentially stagnant performance of students nationwide. *See* EDISON RESPONSE, *supra*, at 18.

[180] *See, e.g.*, Karen Breslau & Nadine Joseph, *Society: Edison's Report Card*, NEWSWEEK, July 2, 2001, at 48; Piskora, *supra* note 145 ("Students in Edison-run schools also score much higher on standardized tests than they did before the Edison takeover.").

[181] *See, e.g.*, Symonds, *supra* note 48 (noting that school districts often give Edison their worst schools, with students whose performance scores are at or near the bottom of the

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of test scores, then, it appears undeniable that at least some of Edison's schools have experienced modest if not remarkable success, improving not only the quality of education within the school, but also the quality of the educational environment as a whole.[182] Ultimately, it may be too soon to tell the impact of Edison and for-profit schools on the overall quality of education within those schools. Indeed, a study by the General Accounting Office (the "GAO") concluded that the available research on private schools was insufficient to determine their overall effectiveness.[183] However, the success Edison has had within at least some schools suggests that for-profit corporations may have a positive impact on these schools.

From a normative perspective, for-profit entities may add value to the industries they seek to serve both in terms of increasing the available financial resources and with regard to enhancing the quality of the social services being delivered. Thus, those interested in improving the overall quality of public services should be prepared to accept the entrance of these for-profit firms.

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city and where schools often have a history of violence); Breslau & Joseph, *supra* note 180, at 48 (noting that determining which reports are right is complicated by the lack of reliable comparison data because Edison often manages the worst schools within the district). For example, in Philadelphia, a governor's report found that 80% of students had failed standardized tests and that four out of five students could not read or write at grade level. *See* Tom Gorman, *Philadelphia Wary of School Takeover: The Governor has Plans to Turn the Stumbling Eighth Largest School District Over to Private Management*, L.A. TIMES, Nov. 19, 2001, at A19 (noting that the Philadelphia schools rank at the bottom 1% of all Pennsylvania school districts); *Report Blasts Philadelphia Schools*, L.A. TIMES, Nov. 3, 2001, at A24. Similarly, at the time Edison took over a particular school in San Francisco, its student test scores put the school at the bottom of other schools in the city. *See* Colvin, *supra* note 169; La Granga, *supra* note 172 (reading scores of San Francisco students were the lowest in the district and math scores were 5th from the bottom); Symonds, *supra* note 48, at 70 (noting that the school in San Francisco ranked near the bottom and had a history of being undisciplined). Also, private companies generally manage schools that, in addition to having low-test scores, have students who are from poor and minority communities. *See Schools Seized*, *supra* note 67 (noting that 80% of students in Philadelphia schools were poor and that the students in Philadelphia schools spoke 70 different languages); *Id.* at 70 ("Edison's challenge is compounded by its target audience: poor, mostly minority children who are the most likely to fail.").

[182] Edison's report reveals improvements in various schools. However, even AFT's report indicates improvements within some Edison schools. For example, the AFT study found that in one Colorado school third grade reading proficiency improved from 21% to 40%. *See* STUDENT ACHIEVEMENT, *supra* note 177, at 21-25. Similarly, in Kansas, where Edison has operated three schools since the fall of 1995, AFT reported that one Edison school had improved its scores and performed better than comparable schools. *See id.* at 30-34. In this same vein, the study found that the scores of Massachusetts' students at one Edison school had improved substantially. *See id.* at 35-37.

[183] *See* GENERAL ACCOUNTING OFFICE, PUBLIC SCHOOLS: INSUFFICIENT RESEARCH TO DETERMINE EFFECTIVENESS OF SELECTED PRIVATE EDUCATION COMPANIES (GAO-03-11) (2002), *available at* http://www.gao.gov. The report focused on three private schools operating in Washington, D.C.—Edison, Mosaica Education and Chancellor Beacon Academies—and found that the studies provided regarding those companies were insufficient because they offered no comparisons with students in other schools. *See id.* at 2-3. Hence, the GAO could draw no conclusions about the effectiveness of for-profit education companies. *See id.*

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C. Evaluating the Strength of Markets as Monitors

Proponents of double bottom line corporations also suggest that the increased competition generated by such firms may have a positive impact on the overall quality of services provided.[184] Indeed, proponents maintain that not only do for-profit firms have a strong incentive to maintain high quality services, but the entrance of these firms into the government-dominated educational market should serve to improve the quality of public education.[185] In their view, the government has no incentive to improve public education because the public monopoly it exercises over education enables it to prosper even when it delivers poor services.[186] For-profit firms do not have this luxury. Instead, such entities must satisfy their customers to remain profitable and stay in business.[187] Corporations providing poor services will gradually be eliminated.[188] In this way, the market provides an incentive for for-profit corporations to maintain a high quality service. Moreover, by entering the education market, for-profit firms put pressure on government-run schools to meet more effectively the needs of its students.[189] As a consequence, the market ensures that for-profit firms pay heed to their public beneficiaries, while instigating reform within the entire educational arena.

Unfortunately, this theory applies with less force in the context of double bottom line corporations. Professor Henry Hansmann notes that we should prefer for-profit firms *except* in situations where there is significant contract failure.[190] Contract failure refers to situations in which, owing to the nature of the services being rendered, the market does not serve as an adequate means for policing the performance of the corporation.[191] Most commonly, contract failure occurs when there is a problem of asymmetric information—when the corporation has significantly better information regarding the quality of services it renders, which makes it difficult for the beneficiaries of those services to judge the quality of the services and monitor the agents delivering such services.[192] For example, in the context of health care, it often takes a medical professional to assess the quality of care, which means that patients must rely on such professionals' assessments. This

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[184] *See* Minow, *supra* note 4, at 1243-44 (noting that for-profit competition may enhance the provisions of services); Solomon, *supra* note 4, at 925-26 (noting that the for-profit corporations foster competition that may stimulate more creative and efficient school systems).

[185] *See* Solomon, *supra* note 4, at 913-14.

[186] *See id.*

[187] *See id.*

[188] *See id.*

[189] *See id.*

[190] *See* Hansmann, *supra* note 21, at 507.

[191] *See id.*

[192] *See* Henry Hansmann, *Ownership of the Firm*, *in* FOUNDATIONS OF CORPORATE LAW 24, 24 (Roberto Romano ed., 1993).

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reliance gives these professional agents considerable discretion with respect to the delivery of health care services. It also means that recipients of the service cannot judge, and hence cannot effectively monitor, the agent's performance of her duties. Because they need not fear detection, agents in these circumstances have greater freedom to perform poorly, especially if it brings financial gain. In these situations, Professor Hansmann insists that we should prefer nonprofit firms because their nondistribution constraint gives us assurances that they will remain committed to their obligations without regard to profit making.[193]

This analysis appears particularly relevant to for-profit companies that deliver K-12 education. Like health care, the children serviced by public schools are often too young to assess adequately the quality of the services being provided, which not only enhances the agent's discretion, but also increases the potential for abuse of that discretion. Moreover, these agents' discretion is enhanced for at least two reasons. First, there is a lack of agreement on the proper standard for measuring "success" within the educational arena.[194] This makes it difficult to judge the agents' behavior, and hence easier for the agent to deliver low quality services. Second, often the success of an educational program can only be measured in the long term, well after a child has completed that program.[195] The difficulty with measuring success, particularly in the short term, increases the agents' discretion as well as the potential that such agents will be able to compromise on the delivery of certain services without easy detection. In this way, the provision of K-12 education represents a situation of contract failure in which we cannot be assured that ordinary market devices serve as incentives for the corporation's conduct. Indeed, Professor Hansmann notes that public education is precisely the kind of service that involves contract failures and may cause us to disfavor for-profit firms.[196]

The evidence regarding the impact of the market on the behavior of double bottom line corporations lends credence to Hansmann's assessment. As noted earlier in Part II.E, evidence suggests that capital markets do cause double bottom line firms like Edison to subvert their social concerns for profitably ones—at least at the margins. In this respect, the market appears to exacerbate the problem of contract failure by causing double bottom line corporations to use their already considerable discretion to pay heed to financial concerns over the interests of students. Our traditional preference for the nonprofit form in the context of public

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[193] *See* Hansmann, *supra* note 21, at 504.

[194] *See* Fairfax, *supra* note 92, at 465 (noting the difficulty with determining whether public schools have been successful because of disagreement regarding the proper measures of success, as well as disagreements regarding how to evaluate testing results).

[195] *See generally supra* note 179 and accompanying text.

[196] *See* Henry Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 506 (1981) (noting that the delivery of complex services such as education where suppliers of such services have considerable discretion reflects contract failure).

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education reflects an understanding that the for-profit regime does not provide sufficient safeguards for nonshareholder interests. By supporting double bottom line entities without addressing the need to alter this corporate paradigm, proponents of these entities overlook this important aspect of the nonprofit regime.

IV. Developing a Theory that Accommodates Double Bottom Line Entities

Given the conclusions in the previous sections, allowing double bottom line corporations to enter the current for-profit structure without making some adjustments for their entrance appears ill advised. Indeed, even if the current regime did not pressure directors and officers to maximize profit to some extent, it offers few affirmative mechanisms aimed at ensuring that the directors and officers of double bottom line corporations attend to their social mission. Thus, it is important to examine the manner in which we can alter the regime to better suit the objectives of the double bottom line corporation.

A. The Limits of Altering Corporate Fiduciary Law

Recognizing the necessity of altering the current regime, Professor Cheryl Wade has proposed that we expand fiduciary law to provide that corporate officers and directors owe a duty not only to shareholders, but also to the other beneficiaries within these new corporations.[197] She further maintains that when the two duties are in conflict, we should require corporate officials to choose the course of conduct that favors the beneficiaries' interests.[198] Her remedy is obviously aimed at imposing some affirmative pressure on directors and officers to ensure that they respond to nonshareholder concerns, and hence from that perspective is well intentioned.

However, setting aside for the moment whether expanding corporate fiduciary law in this manner will influence corporate conduct, Professor Wade's solution presumes that it will be easy to identify the fiduciary duty conflicts between shareholder and nonshareholder concerns. Importantly, Professor Wade's solution attempts to resolve one of the more difficult problems inherent to the double bottom line entity—the idea that pursuit of dual objectives may lead to conflicts, where current corporate law fails to guide directors and officers with respect to how those conflicts should be resolved.[199] In other words, when we allow directors and officers

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[197] *See* Cheryl Wade, *For-Profit Corporations that Perform Public Functions: Politics, Profit, and Poverty*, 51 RUTGERS L. REV. 323, 353-55 (1999).

[198] *See id.* at 332-33.

[199] Indeed, critics of corporate fiduciary law models that allow for consideration of a variety of different constituents complain that such models fail to identify when the interests of one constituent should take precedence over the interests of others. *See, e.g.*, Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1435-42 (1993) (noting problems that arise when corporate managers are required to serve the interests of shareholders and other groups); Mitchell, *supra*

to pursue more than one goal, or impose upon them such a requirement, we must give them criteria for determining when pursuit of one goal should be subordinated to the other. Currently, corporate law does not provide such criteria.[200] Because of this, Professor Wade's solution appears to give necessary guidance for double bottom line entities. However, it is unclear how effective this solution will be in practice. Certainly in those areas where there is a decision that triggers a direct conflict between students' interests and those of the shareholders, the rule to favor students is easily applicable. For example, should double bottom line corporations pay a lucrative dividend to the shareholders or purchase better quality textbooks for the students? In this case, both the conflict and the response to that conflict may appear obvious. However, the reality of decision-making within most corporate regimes is subtler, making the conflicts more difficult to detect. As a consequence, Professor Wade's solution may be both over-inclusive and under-inclusive. For example, decisions about classroom sizes may be made seemingly without regard to profits. Yet such decisions have a significant impact on profits because having smaller classroom sizes means expending extra money on teachers, and thus potentially diverting that money from shareholders.[201] Indeed, almost all decisions involving educational programming entail some costs to shareholders. If such decisions pose a fiduciary conflict, then Professor Wade's solution has no limits, and appears to be unworkable and over-inclusive. However, if none of those decisions rise to the level of a conflict, then the solution is not applicable in any circumstance, and again appears unworkable because it is under-inclusive. Ultimately, it may be easier to leave the resolution of these decisions (regardless of whether they involve noticeable conflicts or not) to the discretion of the board and its officers, and carve out a solution ensuring that these officials consider all relevant interests when they use that discretion.[202]

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note 111, at 589 ("The specter is raised of a board of directors blindly groping to balance the conflicting interests of a variety of constituent groups without any means of measuring the interests required to be considered or of assessing the relative priorities of such interests."); James J. Hanks, Jr., *Non-Stockholder Constituency Statues: An Idea Whose Time Should Never Have Come*, INSIGHT, Dec. 1989, at 20, 24-25 (explaining that directors have difficult determining which interests they should pursue when they must respond to multiple stakeholders). Professor Stephen Bainbridge refers to this as the "two masters" problem. *See* Bainbridge, *supra*, at 1435-42. These critics note that the shareholder primacy model requires allegiance to shareholder concern and hence does not place on directors the difficult burden of having to sift through the priorities of multiple stakeholders. Moreover, critics fear that "a manager told to serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither." EASTERBROOK & FISCHEL, *supra* note 133, at 38.

[200] *See id.*

[201] *See* STUDENT ACHIEVEMENT, *supra* note 78, at 17-19 (discussing why corporations focused on generating profit may favor larger classroom sizes).

[202] Indeed, those who defend multi-stakeholder models of governance note that while such models do not resolve Professor Bainbridge's two-masters problem, they nevertheless have viability because we routinely expect corporate directors and officers to balance

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Then too, Professor Wade's solution presumes that corporate fiduciary law does not already allow directors considerable flexibility to consider other interests. However, this Article points out that directors are relatively free to consider a variety of different interests, and even to favor other interests over shareholder profit-making goals.[203] In fact, as this Article reveals, there is no modern court decision that prevents directors and officers from pursuing a course of action that puts nonshareholder interests above those of shareholders.[204] From this perspective, Professor Wade's solution may do little to alter the current status of corporate fiduciary duty.

Finally, to the extent that the purpose of altering corporate fiduciary duty is to ensure that groups other than shareholders may bring suit against the corporation for failing to perform its fiduciary duty, it is doubtful that such an alteration will have any significant impact on corporate behavior. As noted in Part II, only shareholders can bring a derivative suit to challenge director and officer conduct that appears to violate their fiduciary responsibilities.[205] Professor Wade would expand the current standing requirements to enable the state attorney general or the governing body that ceded authority to the double bottom line entity to bring an action against corporate officials when those bodies believe that such actors failed to comply with their responsibilities to corporate beneficiaries.[206] However, this Article highlights the shortcomings of such a remedy. Indeed, liability rules have a limited impact on corporate conduct because they are subject to the demand requirement, which enables directors and officers to prevent many suits from going forward.[207] Even when these disputes advance to court, judges grant considerable deference to corporate decision-makers.[208] One can expect that the courts' traditional reluctance to overturn corporate decisions would apply with even greater force in the context of double bottom line companies because such entities are charged with the difficult tasks of determining the proper programs that will achieve success for their schools. In this way, the procedural and substantive impediments that blunt the force of liability rules more generally will have the same, if not greater, impact in the context of double bottom line corporations. Because of this, expanding derivative liability

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competing interests and we should have confidence that our corporate governance system can develop the principles to guide the behavior of these corporate actors. *See* Ronald M. Green, *Shareholders as Stakeholders: Changing Metaphors of Corporate Governance*, 50 WASH. & LEE L. REV. 1409, 1418 (1993). This Article agrees that so long as we develop those guiding principles, we should rely on directors and officers to balance the competing interests that confront them.

[203] *See supra* Part III.A.

[204] *See supra* note 125 and accompanying text.

[205] *See supra* Part III.A and note 110.

[206] *See* Wade, *supra* note 197, at 363-64.

[207] *See supra* notes 119-20 and accompanying text.

[208] *See supra* notes 122-26 and accompanying text.

rules to include other groups may do little to force corporate directors and officers to pay heed to their nonshareholder beneficiaries.

B. The Importance of External Regulations

Some scholars have maintained that reforms for double bottom line corporations should be aimed at increasing the external regulations surrounding such firms.[209] Thus, we should ensure that when entities contract with for-profit companies they include provisions within those contracts that require such companies to focus on delivering high-quality services.[210] In addition, federal and state governments should impose regulations, or strengthen existing regulations, in order to require double bottom line corporations to demonstrate attainment of their public objectives.[211] These forms of external regulations not only counter-balance the profit-making pressure of the capital markets, but also place affirmative pressure on double bottom line corporations to attend to their public responsibilities.[212]

Certainly, such a solution is important because governmental and other agencies have the regulatory or contracting authority to impose specific requirements on double bottom line corporations, and, in fact, these agencies have exercised that authority. Thus, a review of state regulations governing the behavior of for-profit schools reveals that they are subject to considerable oversight and accountability.[213] For-profit companies that operate public schools contract with local school boards or school officials to manage such schools.[214] This exposes such companies to two possible sources of regulation. First, because they operate public schools, these companies are subject to the same state and federal regulations as traditional public schools, such as requirements regarding teacher certification and curriculum.[215] Second, the local school board or other government agency that contracts with for-profit entities has the ability to impose additional requirements on such entities within those contracts. Thus, Edison reports that some of its contracts require it to keep a school open for the entire year, regardless of the economic impact

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[209] *See, e.g.*, Casarez, *supra* note 3, at 300-01 (describing the need for legislation that sets forth accountability standards); Mangold, *supra* note 3, at 1319 (noting that we should strengthen regulations and contract provisions in order to ensure public accountability of for-profit companies that offer public services such as foster care); Ira P. Robbins, *The Legal Dimensions of Private Incarceration*, 38 AM. U. L. REV. 531, 616-17 (1989) (noting that public agencies should insist on certain features within the contracts they sign with for-profit companies to ensure that such companies are run effectively).

[210] *See* Mangold, *supra* note 3, at 1319; Robbins, *supra* note 209, at 795.

[211] *See* Casarez, *supra* note 3, at 300-01.

[212] *See* Mangold, *supra* note 3, at 1319 (noting that if public agencies strengthen their regulation of for-profit companies, there will be better monitoring, reporting, and investigation of such companies).

[213] *See* Kemerer & Maloney, *supra* note 45, at 609.

[214] *See supra* note 45 and accompanying text.

[215] *See* Kemerer & Maloney, *supra* note 45, at 627.

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of remaining open.[216] In this way, government bodies that cede control of public schools to for-profit companies can and do use their authority to influence the behavior of double bottom line corporations and ensure that they meet their public objective. Then too, for-profit companies that run charter schools also contract with government agencies or public entities, and thus are subject to the same regulation as not-for-profits that operate charter schools.[217] Though charter regulations vary from state to state, companies that operate charter schools generally must meet minimum educational standards and testing requirements, provide programming for students with special educational needs,[218] certify teachers in accordance with specific guidelines,[219] and complete annual reports regarding the progress of their educational program.[220] In this way, external regulations and contracts impose restrictions as well as affirmative obligations on for-profit companies that bind them to consider and enhance the interests of their student beneficiaries.

Moreover, because these contracts, either in the public school or charter school setting, grant the contracting entity the authority to take remedial action when for-profit companies fail to honor their obligations, they can have a significant impact on the behavior of the directors and officers in such companies. These contracts grant public officials the right to investigate improper practices, revoke a company's charter or refuse to renew its contract, and even sue school administrators for undesirable behavior directed towards students.[221] The ability of these officials to take such actions may create incentives for managers of double bottom line companies to consider their public obligation. Certainly, these public agencies have not been afraid to exercise their power. Indeed, in several cases governing agencies have either revoked charters or refused to renew a company's contract after what they considered to be poor performances by for-profit companies.[222] In San Francisco, for example, the school board conducted extensive

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[216] *See* EDISON PROSPECTUS, *supra* note 48, at 14.

[217] *See* Kemerer & Maloney, *supra* note 45, at 627 (describing state statutes allowing private organizations to apply for charters directly with a government entity or through a sub-contract with a public entity).

[218] *See id.* at 610.

[219] *See id.* at 619.

[220] *See id.* Sometimes these visits and reports can lead to changes in the regulations that increase the oversight capabilities of government officials. This was the case at one school where Arizona officials found discrepancies in financial reporting. *See Id.* (noting that in Massachusetts, the charter school statute requires annual reports to the charter and parents).

[221] *See id.* at 616-17 (noting power to revoke a charter without appeal).

[222] *See* Tawnell Hobbs, *DISD to Assess Edison Contract; 2 Years Later, Company's List of 'Low Performing' Campuses Back at Three*, DALLAS MORNING NEWS, May 20, 2002, at 15A (discussing Edison's potential loss of contract); Tawnell D. Hobbs, *DISD to Students—It's Time to Return*, DALLAS MORNING NEWS, Aug. 19, 2003, at 1 (noting 2002 decision to terminate Edison Contract); Julian Guthrie, *San Francisco Schools Vote to End Edison Compact: Academy Expected to Remain Open*, S.F. CHON., June 29, 2001 (discussing board vote to end contract with Edison); Julian Guthrie, *Scathing Report Card for Edison School: Board Gives Charter 90 days to*

hearings regarding allegations that Edison counseled out difficult students in order to improve its test scores.[223] These hearings almost caused Edison to lose its contract with the city, and certainly had an impact on its behavior going forward.[224] In this way, external regulations, and the manner in which they are enforced, may generate powerful incentives for directors to consider educational related interests.

Thus, scholars who focus on these external mechanisms correctly point out their potential power over double bottom line companies, and such mechanisms seem to be an important component of ensuring that such companies meet their objectives. Indeed, these mechanisms provide a necessary source of monitoring and public accountability, ensuring that the public not only helps shape the educational standards within for-profit schools, but also that there is monitoring of the implementation of those standards. Cases such as San Francisco underscore the impact that public agencies can have on identifying poor performers and sending signals to corporations that help shape their behavior. The fact that these investigations have a very real impact on a company's ability to operate its schools means that management must account to these regulatory bodies. Consequently, companies that seek to avoid the negative ramifications of such bodies will focus on student and community interests. Thus, requiring that state agencies create laws or otherwise fashion contract provisions that regulate double bottom line corporations represents an important component of any reform effort.

However, this solution has its limits. First, the effectiveness of these external mechanisms is limited by their external nature. Regulators are company outsiders. This means that they establish guidelines, but must rely on company insiders to implement those guidelines. While regulators do monitor that implementation through reports and cite visits, they cannot play an active role in framing that implementation. Hence, although their role is not as limited as the shareholders', they share some similarities with that role because, like shareholders, regulators remain on the outside of the corporation while directors and officers continue to have considerable discretion with regard to the corporate agenda.

Company, S.F. CHRON., Mar. 28, 2001, at A15; Erika Niedoweski, *Woes Growing, Educator's Fate in the Balance; Edison: Amid Funding and Performance Concerns, the For-Profit Firm Faces a Key Test, Managing 20 Philadelphia Schools*, BALT. SUN, Sept. 28, 2002, at 1A (discussing Edison's loss of several contracts; *Big Charter School in Boston Breaks its Ties with Edison*, N.Y. TIMES, May 17, 2002, at A21.

[223]After San Francisco parents and teachers complained that about one of Edison's management practices, the San Francisco school board waged an investigation and Edison nearly lost its ability to continue operation of the school. *See* Ann Grimes, *School Board Seeks to Revoke Edison Charter*, WALL ST. J., Feb. 20, 2001, at B1. The president of the school board, Jill Wynns, reported "multiple instances of the parents of special education and other students complaining that their children were asked to leave the school or advised not to apply in the first place." *Id.* Edison's spokesperson denied such allegations.

[224] *Id.*

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Second, outside regulators may not have sufficient information to judge whether a particular corporation has complied with its contractual or other requirements until it is too late. Indeed, external regulators rely on the corporation to supply information about its compliance with various requirements. This reliance gives a lot of power to the corporation. Once again, because public officials do not have an internal role in the corporation, they may be at a disadvantage. While these officials will be able to launch investigations once they become aware of improper conduct, they have less ability to take preventative measures because they may not have the information until the deed is done.

Third, the impact of external regulations is limited by the fact that it is difficult to make a contract or law that covers all contingencies. Thus, these regulations cannot fully insulate public beneficiaries from bad conduct.[225] Because there will necessarily be gaps in the regulations, such regulations cannot be the only source of reform for the double bottom line entities.

Finally, many public agencies that contract with for-profit companies have an incentive to ensure that such entities locate within their state, and thus we may not be able to rely on such agencies to ensure that beneficiaries' needs are met. Too often, for-profit companies are brought in as a last ditch effort to turn around a failing public school.[226] Thus, agencies may have an incentive to accommodate these companies through lax regulations. In this sense, there may be a race to the bottom among states and public school systems that are desperate to receive private funding for their schools, or otherwise offer alternatives for poorly performing schools. In fact, some have suggested that state officials in Philadelphia offered Edison perks that were not available to the public school board in order to ensure that Edison would take over its failing schools.[227] Others point out that those states most desperate for private funding appear to have relatively weak charter school provisions, allowing for-profit and other companies to run these schools under considerably less stringent guidelines than those imposed for traditional public schools.[228] This suggests a willingness on the part of some public entities to forego stringent regulation in order to entice for-profit companies into their midst. If this

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[225] *See, e.g.*, Edward S. Adams & John H. Matheson, *A Statutory Model for Corporate Constituency Concerns*, 49 EMORY L.J. 1085, 1095 (2000) (noting that contracts are not enough to protect corporate constituents from managers' bad actions); Oliver Hart, *An Economist's View of Fiduciary Duty*, 43 U. Toronto L.J. 299, 303 (1993) (noting that it is hard to make a contract that rules out all bad actions management might take).

[226] *See supra* note 181 and accompanying text.

[227] *See* Niedowski, *supra* note 222 (discussing investigation regarding Philadelphia's contracts and issues related to spending); Susan Snyder, *Vallas Seeks Less Funding for Edison*, PHILA. INQUIRER, May 22, 2003, at B01 (explaining that for-profits receive more per-pupil funding than other schools).

[228] *See* Kemerer & Maloney, *supra* note 45, at 610-19 (comparing more permissive Arizona structure to regulations in Michigan and Massachusetts that are more comprehensive).

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occurs on a more widespread basis, we cannot be confident that public agencies will negotiate contracts and charters that include significant standards of public accountability for double bottom line entities. Therefore, reliance on external regulations seems a necessary, but not sufficient, reform effort.

C. Proposal for Independent Monitoring Committee

In an effort to ensure a more direct monitoring device, this Article proposes that double bottom line corporations be required to have an independent committee of the board designed to monitor and oversee the attainment of the corporation's public objective. Such committees should be a condition of incorporation, just as the SEC and other listing agencies make having a qualified audit committee a condition for appearing before the SEC or listing stock on a national exchange.[229] Also, the committee should mimic the structure and format of the auditing committee. Currently, audit committee members must not only be independent, but must be financially literate.[230] Moreover, the NYSE requires that audit committees have their own charter,[231] meet with corporate officers without other board members, review all financial statements, and independently evaluate those statements.[232] Similar provisions would apply to the double bottom line committee. Thus, it should be composed of directors who are independent from the corporation and have some experience related to the public objective the double bottom line corporation has undertaken. In the case of for-profit education companies, for example, all committee members should have some background and expertise in the operation of K-12 school systems. Moreover, the committee should have the ability to meet regularly with corporate managers, without the presence of other board members. In fact, they should have a direct oversight relationship with all managers involved with the provision of the corporation's public service. Finally, the committee should

[229] *See, e.g.*, NEW YORK STOCK EXCHANGE, LISTED COMPANY MANUAL Rule 303.01(A) (1999) (providing that listed companies must have a qualified audit committee).

[230] *See id.* at Rule 303.01(B)(2)(a) (providing that the audit committee contains at least three members all of whom must be independent—defined as having no relationship to the corporation that may interfere with the exercise of independence from management and the company). The NYSE Manual provides that a committee member is not independent if he or she is or has been an employee of the corporation within the last three years, *see id.* at Rule 303.01(B)(3)(a), has a business relationship with the corporation, *see id.* at Rule 303.01(B)(3)(b), or is an immediate family member. *See id.* at Rule 303.02(A); *see also id.* at Rule 303.01(B)(2)(b) (requiring that audit committee members are, or become within a reasonable time frame, financially literate, as determined by the board of directors). The NYSE Manual also requires that at least one committee member has an accounting background or some comparable experience in financial affairs. *See id.* at Rule 303.01(B)(2)(c).

[231] *See* NEW YORK STOCK EXCHANGE, *supra* note 229, at Rule 303.01(B)(1) (requiring that the board adopt and approve a formal written charter that the audit committee assesses and reassesses annually).

[232] *See id.* at Rule 303.01 (describing responsibilities of audit committee).

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review and make an independent assessment of the corporation's public program, and this assessment should be made available to the public as well as any agencies responsible for contracting with the double bottom line entity. When making this assessment, the committee should meet independent of the entire board. While this reform does not grant constituents the right to bring legal action against the board, it strengthens the contractual remedy held by external regulators. Indeed, by enabling committee members to report directly to the regulators, it provides such regulators with the information necessary to take remedial action if improper conduct is detected. Because this threat can serve to deter corporate misconduct, such committee action serves as an important link in the monitoring of double bottom line corporations.

This reform seems reasonable because the board of a double bottom line corporation should contain committees that respond to both of its objectives. Regulatory authorities believe that the audit committee is necessary to ensure the accomplishment of the corporation's financial goals.[233] Moreover, they believe that the auditing committee is necessary to ensure that the corporation does not cut corners or otherwise shirk its responsibility of providing accurate and complete financial disclosure to the shareholders.[234] If such a committee is integral to the financial success of the corporation, it seems that a similar committee may be integral to the success of the corporation's public mission. In fact, not having such a committee seems to place the attainment of that public mission at a significant disadvantage vis-à-vis its financial mission. The rigor we impose on the pursuit of our financial objectives should be applied equally to the pursuit of our public goals. For that reason, requiring double bottom line corporations to have these committees seems appropriate.

Also, the benefit such a committee has over alternative proposals for reform is that it represents a more direct monitoring device. Indeed, the committee structure allows directors who have the public beneficiaries' interest at heart to participate directly in the on-going management of the company. Unlike external regulators, they will have a seat at the corporate table and thus will be able to more directly guide the implementation of educational programming. In the case of Edison, for example, since the committee's responsibility rests with ensuring the attainment of educational goals, the committee may have prevented the corporation from allowing the dip in its financial success to negatively impact the implementation of its educational curriculum. Then too, because the committee meets with corporate officers on a regular basis, it need not rely on the board for its information about the corporation's compliance with key educational strategies.

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[233] *See* BLUE RIBBON REPORT, *supra* note 7, at 3.
[234] *See id.*

Thus, because committee members would have had the benefit of an internal perspective, Edison may have produced a better, more rigorous analysis of its educational programs that the GAO would have been able to rely on and the public would have had more confidence in. This ability to gain an internal perspective makes such a reform an improvement over those that rely solely on external regulations and contracting devices.

In light of the corporate governance failures, such as those involving Enron Corporation ("Enron"),[235] some may question the impact committees can have on corporate conduct. Indeed, Enron followed many of the best practices for good corporate governance,[236] including maintaining an audit committee composed of independent directors with accounting experience.[237] Yet accounting failures led to that corporation's demise and focused the nation's attention on the monitoring failures of its board committees.[238] The evidence suggests that the board and its committee failed to effectively monitor complex transactions, which allowed that company to make inaccurate earnings reports.[239] If an independent monitoring committee could not prevent the Enron debacle, then one may legitimately question how a similar committee serves to address the concerns related to double bottom line entities.

Fortunately, this committee will be able to learn from the lessons of Enron and borrow many of the reforms enacted and proposed in the wake of Enron to ensure more effective monitoring of corporations. Critics point out several problems with Enron's audit committee that prohibited it from monitoring the corporation effectively. Principally, critics note the close relationship between management and its committee members, which caused such members to rubber stamp management decisions.[240] Indeed, Professor Marleen O'Connor notes that Enron board members fell prone to "groupthink," whereby members strove to achieve unanimity as opposed to making independent decisions.[241] To remedy this and other problem,

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[235] For a discussion of the corporate scandals involving Enron and other entities, see generally Lisa M. Fairfax, *Form Over Substance?: Officer Certification and the Promise of Enhanced Personal Accountability under the Sarbanes-Oxley Act*, 55 RUTGERS L. REV. 1 (2002); Joam MacLeod Heminway, *Enron's Tangled Web: Complex Relationships, Unanswered Questions*, 71 U. CIN. L. REV. 1167, 1177-81 (2003).

[236] *See, e.g.*, Jeffrey N. Gordon, *Governance Failures of the Enron Board and the New Information Order of Sarbanes-Oxley*, 35 CONN. L. REV. 1125, 1127 (2003); Marleen A. O'Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CIN. L. REV. 1233, 1237 (2003).

[237] *See* Gordon, *supra* note 236, at 1127. Indeed, the chair of the auditing committee was a Stanford Business School accounting professor. *See id.*

[238] *See* Fairfax, *supra* note 238, at 6-7; O'Connor, *supra* note 236, at 1233-34.

[239] *See* O'Connor, *supra* note 236 (noting the failure to monitor related party transactions).

[240] *See id.* at 1240.

[241] *See* O'Connor, *supra* note 236, at 1270-98.

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Congress enacted the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley").[242] Much of Sarbanes-Oxley is aimed at ensuring greater board independence, and while it would not apply to the committees enacted by double bottom line corporations, that Act can be used as a guide in best practices. The Act requires direct reporting between audit committee members and outside regulators, which takes management out of the financial reporting loop.[243] As Professor O'Connor notes, providing committee members with direct access to the public undermines groupthink and provides greater assurances that independent decision-making will occur.[244] This Article's proposal that double bottom line committees provide reports to the public and outside agencies responsible for contracting with such entities also provides such an assurance, making these committee members responsive to their nonshareholder constituents. Then too, allowing the committee to meet without other board members and management means that they will be able to discuss corporate objectives without the dominating influence of managers.

Professor O'Connor also points to the need for greater diversity of views on the board to reduce the homogeneity that can lead to groupthink.[245] This reform, though not codified in Sarbanes-Oxley, is important for ensuring that alternative viewpoints are represented on the board, fostering critical—and ultimately better quality—decisions.[246] In this respect, statutes governing double bottom line committees should encourage boards to select members who can reflect the views and positions of its various constituents. Again, this contributes to the independence of committee members, which in turn fosters more effective monitoring.

Critics of Enron also point out the lack of clarity in Enron's disclosure statements, which made it difficult to assess Enron's performance until it was too late.[247] Sarbanes-Oxley calls for additional and specific disclosures regarding accounting practices.[248] Scholars point out that such requirements make disclosure more clear-cut, enabling board members and the market to have a better understanding of a company's performance record.[249] Similarly, committees of double bottom line corporations should have guidelines about the nature of their disclosures so that they are accessible to the public. Like auditing committees, these guidelines will enhance the monitoring capabilities of double bottom line entities.

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[242] *See* Sarbanes-Oxley Act of 2002, Pub.L.No.107-204 § 401, 116 Stat. 785-86 (amending 15 U.S.C. §78m (2000)) [hereinafter "Sarbanes-Oxley"].

[243] *See id.* § 204 (amending 15 U.S.C. §78j-1 (2000)).

[244] *See* O'Connor, *supra* note 236, at 1301.

[245] *See id.* at 1306-10.

[246] *See id.*

[247] *See* Gordon, *supra* note 236, at 1128.

[248] Sarbanes-Oxley, *supra* note 242, § 401.

[249] *See* Gordon, *supra* note 236, at 1138.

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Taken as a whole, these reforms create structural incentives for board and committee members to monitor the corporations more effectively.

Comparative research on corporate boards in other countries suggests that having people that represent nonshareholder interests on the board can be an effective method of protecting those interests. Many other countries have stakeholder representatives on their boards.[250] Most notably, both Germany and Japan have employee representatives on their boards.[251] Germany has a two-tiered board system pursuant to which a supervisory board, which must include significant employee representation, oversees the managing board.[252] Although it does not employ a two-tiered system, there is a similar strong employee presence on Japan's corporate boards.[253] In both cases, scholars agree that the presence of employee representation on these boards serves to protect the interests of employees, leading to better negotiation and resolution of employee objectives.[254] In Japan, the presence of a significant number of employee representatives causes its boards to make employee-oriented decisions.[255] In Germany, the fact that management cannot sit or be represented on the supervisory board appears to lead to more effective monitoring on the part of that board.[256] While many features of the Japanese and German corporate governance systems cannot be replicated in America, the ability of board members to meet and discuss relevant issues independent of more traditional directors appears to be a critical aspect of these systems' success.[257] This supports the intuition expressed by American scholars in the wake of Enron that instituting measures aimed at preventing management domination of committee discussions will ensure the effectiveness of these committees. In relation to double bottom line corporations, then, the ability of committee members to meet and act independently of the entire board will enable that committee to serve an important monitoring function.

Some may assert that preventing management from attending committee meetings and allowing committees to report directly to outsiders may prove disruptive. However, comparative analysis disputes this point. Thus, scholars note

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[250] *See, e.g.*, Benjamin T. Lo, *Improving Lessons from the European Community*, 1 IND. J. GLOBAL LEGAL STUD. 219 (1993).

[251] *See, e.g.*, Mark J. Loewenstein, *Stakeholder Protection in Germany and Japan*, 76 TUL. L. REV. 1673 (2002); David Charny, *The German Corporate Governance System*, 1 COLUM. BUS. L. REV. 145, 151-57 (1998).

[252] *See* Loewenstein, *supra* note 251, at 1676-77. The supervisory board is called the Aufsichtsrat and the managing board is called the Vorstand.

[253] *See id.* at 1684-86 (noting that while there is no mandate, the Japanese tend to draw upon their employees as a primary source of their directors).

[254] *See id.* at 1680; *see also* Susan J. Stabile, *My Executive Makes More than Your Executive: Rationalizing Executive Pay in a Global Economy*, 14 N.Y. INT'L L. REV. 63, 85-86 (2001).

[255] *See* Loewenstein, *supra* note 251, at 1686.

[256] *See id.* at 1678.

[257] *See id.* at 1680; Loewenstein, *supra* note 251, at 241.

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that in Germany and Japan the role of these stakeholder board members is clearly defined as well as limited to oversight of policies and significant decisions.[258] Because of this clear delineation, board members do not become overly entangled in the day to day operations of the company, and hence do not undermine the ability of corporate managers to perform their responsibilities.[259] By modeling their role after these German and Japanese boards, double bottom line committees can fulfill their important monitoring role without hindering the performance of the corporation.

It should be noted that ultimately no reform can ensure the effectiveness of a company that cannot realistically meet both of its objectives in a relatively short time frame. Indeed, the market expects these corporations to meet dual objectives.[260] Consequently, their failure to meet either goal impacts the attainment of the other and the ultimate viability of the double bottom line firm at issue. This appears particularly true in the context of for-profit education. On the one hand, for example, a corporation's failure to meet educational objectives has a negative impact on financial objectives because it decreases the corporation's ability to obtain and retain contracts, which provide necessary resources to the corporation. Unfortunately, K-12 education appears to be one of those industries where the success of the program cannot be measured within a short time frame. Thus, it may be difficult to prevent this failure, and hence the subsequent impact it has on the ability of double bottom line entities to meet their financial goals. On other hand, a firm's failure to produce profit, at least in the long-term, causes investors to lose faith in the enterprise, selling their stock and triggering a decline in the company's stock prices. As this Article revealed with respect to Edison, this decline puts pressure on companies to compromise educational programs and then leads to a vicious cycle, whereby the companies lose money and then once again subordinate educational goals to financial ones. In light of the difficulty Edison appears to face with generating a profit, this cycle may be unavoidable. Indeed, despite almost ten years of operation, Edison has neither achieved profitability nor a positive revenue stream.[261] In fact, some believe that the structure of the K-12 industry will never lend itself to profit making.[262] This in turn will have negative repercussions both for educational programs and for the ultimate viability of the double bottom line corporation that seeks to provide K-12 education.

Nevertheless, if success can be obtained, then the committee model represents an ideal solution for ensuring that success does not come at the expense of the educational objective. By allowing those interested in the double bottom line

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[258] *See id.*
[259] *See id.*
[260] *See supra* note 145 and accompanying text.
[261] *See supra* notes 150-52 and accompanying text.
[262] *See id.*

corporations' public objective to play an active role in managing these enterprises, these committees place affirmative, internal pressure on these companies to achieve that objective. In this way, not only will they provide effective monitoring, but they also will ensure that these companies do not subordinate their public goals to financial considerations.

V. Conclusion

Many believe that the growth in double bottom line corporations means that public agencies have abdicated their responsibility for providing fundamental services. As these entities grow, opponents fear that the internal and external governance structure of corporate law will compel such companies to subordinate their public mission to issues associated with profit. As a result, such companies would produce poor quality services, and given the critical nature of these services, this result is untenable. From this perspective, by allowing double bottom line entities to deliver critical services, not-for-profits have abandoned their duty to the beneficiaries of those services.

However, opponents have exaggerated the extent to which corporate law forces directors and officers to prefer profit over all other interests. Instead, corporate fiduciary law may offer a good framework because it gives directors and officers considerable flexibility not only to consider the interests of groups such as students, teachers, and administrators, but also to favor those interests over short-term profit. When directors and officers make decisions that take account of, or favor, these nonshareholder interests, courts generally honor those decisions, believing that directors and officers, and not judges or even shareholders, are in the best position to determine the fate of the corporation. This belief not only leads to judicial sanction of all but truly egregious conduct, but also translates into a relatively difficult regime for shareholders to challenge director or officer conduct. This means that other corporate governance structures, such as shareholder derivative suits and shareholder voting, that at first glance appear to ensure that directors would use their freedom to prefer shareholders to other groups, are relatively ineffective at such a task. Thus, while shareholders remain the only group entitled to challenge directors and officers' conduct based on a breach of their fiduciary duty, procedural hurdles make such challenges difficult and the substantive rules that protect most all director and officer decisions make such challenges almost meaningless. Hence, shareholder derivative litigation does little to prevent directors from favoring other corporate constituents. Also, in today's climate, even with the increase activism of institutional investors, in most cases the shareholder vote represents little more than a rubber stamp of managerial policies.

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Thus, most governance structures do not force directors and officers to shirk their responsibility to their public beneficiaries.

Despite the exaggeration this conclusion illustrates, the capital markets continue to play a role in ensuring that, at least in the long-term, directors and officers pay heed to financial considerations. While the impact of those markets may be less extreme in the context of double bottom line corporations, they continue to have the ability to pressure these corporations to abandon other interests in order to demonstrate financial viability. Moreover, problems of asymmetric information mean that the market does not incentivize adequately managers of the firms to protect the interests of their nonshareholders.

Thus, some reform to the corporate regime is needed to swing the pendulum in the other direction. This Article proposes that double bottom line entities have independent committees that would monitor the corporation's behavior with respect to its public objective. This committee would prevent the corporation from engaging in actions that undermine that objective by keeping close tabs on officers and directors. While it cannot ensure the viability of companies that cannot realistically achieve dual objectives, such a reform may prevent companies from compromising important public goals in the interim. Thus, regardless of whether they can ultimately achieve success, by providing for a committee that complements the one dedicated to serving the corporation's financial concerns, the proposed committee creates an important framework for ensuring that double bottom line corporations actually serve two masters effectively.

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