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REWIRING CORPORATE DNA

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This paper establishes a case for the importance of understanding the critical role that corporate statutes play in fundamentally driving corporate behavior today. If society wants to permanently modify the behavior of all corporations - to make them more socially, environmentally and economically responsible - then we must work within the framework of corporate statutes. All other efforts, no matter how significant from either a) a governmental regulation standpoint, b) a societal pressure and public relations standpoint, or c) a market pressure/consumers standpoint, will only address the symptoms of corporate behavior and not the underlying forces that are ultimately the cause of undesirable corporate behavior. I call those corporate statutes the DNA code of corporations. By "rewiring"[1] this DNA code, we can bring about the core changes in corporate behavior that further enhance and augment all other efforts to make corporations a better servant to society and the environment. Thus, we need an ultimate legal redefinition of the purpose of corporations. I propose a mid-term solution that could help to migrate society to a long-term solution. Lastly, I will show how the existing statutes of one state, Nevada, can be used today to encourage those desired changes. The Nevada statutes legally lock in that kind of desired corporate behavior, so that social, environmental and economic responsibility is internalized, rather than imposed externally.

[1] The author has deliberately chosen to use a mixed metaphor in the title in order to achieve a strong visual impact. Society has come to view the term DNA to mean the very core instructional code upon which a living organism is built. More correct terms for the modification of the DNA code of an organism would be "genetic engineering, recombinant DNA technology, rearranging genes, genetic modification/manipulation (GM) and gene splicing". These are all terms that are applied to the manipulation of genes, generally implying that the process is outside the organism's natural reproductive process. Rewiring is a term that generally applies to the restructuring of a human-made physical (electrical) device rather than an organic unit. Nonetheless, the term "rewire" is so ingrained in our lexicon, conveying the idea of creating fundamental change in an object, that the author has chosen it over "rearranging", a more technically correct term for manipulation of DNA. The author has further taken liberty by having corporate statutes or 'corporate codes" represented by the concept of the DNA code.

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Reshaping Corporate Behavior

As Bright, Fry and Cooperrider detailed in their paper, "*Transformative innovations for the mutual benefit of business society, and environment*" [2] (Bright, Fry & Cooperrider, 2006) and Peter Gerhart likewise did in his paper, "*Varieties of socially responsible business*" [3] (Gerhart, 2006) there is a great deal of evidence that corporations and their leadership, as well as society as a whole, are not only becoming cognizant of the desirability and benefits of pursuing a more socially and environmentally responsible corporate behavior pattern, but that such behavior frequently translates into a better financial bottom line. However, Gerhart also points out in his paper that the baseline model for how corporations are organized is one that primarily serves the interests of the stockholders, what he calls the Basic Model. That Basic Model is often detrimental to all other stakeholders. The Basic Model causes continuous pressures to be present, especially in public corporations, that constantly push directors and managers in directions frequently antithetical to the rest of society and the environment. Milton Friedman (1962, 1970) is often referred to as the quintessential spokesperson for the idea that the primary purpose of a corporation is to serve the shareholders and anything else done, especially along social and/or environmental directions, should only be done for PR purposes, and not because those goals are right and good in and of themselves.

It is my contention, as an experienced entrepreneur, that Friedman's attitude is pervasive throughout the investment community and, as a result, produces pressures on managers and boards that are far more insidious and impactful than the progressive business community would like to see. This is particularly true for public corporations. In fact, I would posit that until the mandate of "shareholders above all else" is altered, business will have a perpetual ball and chain around its metaphoric ankle that will forever work against all efforts to alter corporate behavior. However, as will be discussed herein, there is a means already present that would allow for circumvention of that mandate, should corporations elect to take advantage of it.

Case in Point

Under most statutes defining the creation and operation of corporations, managers and board members have a legal obligation and fiduciary responsibility directed exclusively to the shareholders, to the exclusion of all other stakeholders (often described as "shareholder primacy").

I have directly encountered the negative ramifications of shareholder primacy and the laws that reinforce it, having lost a company (a holding company with three companies under it) on the verge of going public, to a small group of shareholders who abused their shareholder rights, to the detriment of all others. It is that painful experience that led me to investigate the underlying legal causes that allowed such a thing to happen, and to figure out how such a problem could be avoided in the future.

I am not at liberty to disclose the details of the specific parties involved nor the companies concerned, but here are the key salient points of what occurred. This story is provided in order to help the reader understand the kinds of things that can happen to all parties involved with a corporation, as a result of one or more minority shareholders exercising, or in this case, abusing shareholder rights.

[2] http://worldbenefit.case.edu/research/paperseries/?p=21
[3] http://worldbenefit.case.edu/research/paperseries/?p=18

Several years back, a shareholder with deep pockets attempted to improperly take control of one of my companies, while I was its CEO and a director. That shareholder claimed rights as a shareholder that were supposedly violated by some unspecified acts on my part and on the part of other managers within the company. We subsequently learned that this shareholder was apparently quite versed in shareholder rights and how to manipulate them to their advantage. Anyway, through an attorney, that shareholder demanded in writing that we turn over the company to a minority group of shareholders or face unspecified legal actions against us.

I resisted that shareholder's demands and, in retaliation, that shareholder initiated a campaign to destroy me in a "rule or ruin" type scenario. What resulted was a multi-year legal fight that consumed more than a quarter of a million dollars on our part, to resist the demands made by that shareholder and a small band of colleagues, who used their status as shareholders to give them a legal basis to support their attack.

Their shareholder's rights were used as the legal tool to support their actions, even though they were morally wrong and would harm all the other shareholders. That is because the law doesn't consider whether there is merit to such actions nor whether others – including even other shareholders – are hurt in the process. The process is very Darwinian, with money is often the final arbiter of who wins, not the morally correct party.

After that multi-year battle, we thought we had finally solved the conflict by bringing in a third party who agreed to buy out the interests of those parties and allow the rest of us to move forward. Unfortunately that new third party did not have the experience with them that we did. That party made the critical mistake, as part of the buy-out provisions of the settlement, of providing those shareholders with a small residual equity (at no cost to them) in a new company. That company was created to acquire not only the company where those dissident shareholders had been investors, but another one that I had founded as well, and a newly created 3rd one.

The plan was to take this new company public. This third party assumed that those investors would have an economic motivation to support the company and drop their former claims, and did not believe our warnings that these shareholders might take steps that would in fact be against their own interests.

He did not count on the fact that apparently the rich investor in particular apparently didn't care about the success or failure of the company, but rather to continue the attack on me in particular. Waiting till just before that company was to go public, that person trumped up a new reason to threaten legal action and had an attorney communicate that threat in writing. That attorney's letter explicitly claimed rights as a shareholder as the basis for the demands and the threat.

What was all the more insane about that situation was that claim was based strictly on the small amount of stock that shareholder had been given and had not even purchased. Once again, the law doesn't distinguish between the fairness of such a circumstance, nor the amount the shareholder paid for the stock, if anything. The fact that the shareholder even owns just one share grants them a certain set of automatic rights that can allow for this kind of mischief.

Regardless, in this case the dissident shareholder finally achieved their goal. Given the previous history with this party demonstrating a willingness to use their position as a shareholder to harm the corporation, every single investor that we had lined up to support the company going public, once they learned of this new threat, elected to walk on the opportunity and the company was forced into bankruptcy, with a total loss to all parties.

As the reader might well imagine, this kind of scenario doesn't happen every day, but it does happen often enough that many lives can be and in fact have been ruined by investors who are

able to manipulate the laws to their advantage, especially if they can afford the legal expenses to do so. Having spent decades in Silicon Valley, I can tell you that there is no shortage of stories of venture capitalists and other wealthy investors who have used such money and shareholder's laws to manipulate situations to their advantage, and to the detriment of the other shareholders.

Corporate Laws

The majority of the business laws in place today were written decades, if not centuries, ago. Those laws reflect the values, beliefs and objectives of society at the time of their crafting. Fortunately or unfortunately, society has evolved and changed and, in many cases, those laws do not adequately reflect society's current values, beliefs and objectives. One of the greatest disconnects between a set of laws and the current needs of society, as reflected in its modern day values and awareness, are the laws governing the creation and operation of corporations and other legal entities like LLCs, partnerships, etc.[4] Below I will delineate how those statutes drive corporate behavior and why I believe that only by changing those statutes can we permanently alter that behavior. [5]

Stuart Hart, in his book "*Capitalism at the Crossroads*" (Hart, 2005, 2007), explores the evolution of corporations as they and society have interacted, and how corporations have morphed and evolved, bringing them to a major transition point. Hart gives us a vision of where he thinks capitalism will have to go. Building on Hart's work, I argue that corporations will ultimately have to change their legal pact with society, in nothing less than a wholesale redefinition of their very purpose and their right to exist.

Today, most people in society don't question the assumption that a corporation has the legal right to serve only its shareholders. However, it is helpful to remember that there was also a time when feudal lords were thought to have a divine right to own property, and that others existed and served for their exclusive benefit. We must remember that corporations are a creation of society.

When viewed from a "long haul" perspective, given the power and influence that corporations have on society and the planet, society will ultimately be forced to have to redefine this creation, to insure that it exists for the benefit of society as a whole, and not just for a limited number of participants and to the detriment of all others. Any other conclusion will ultimately be recognized as self destructive to society in one form or another and therefore, sooner or later, will no longer be tolerated. When that happens, the following guidelines will, in all likelihood, prevail.

Corporations should exist for a larger purpose and greater good than just making money. Profit should be recognized as a critical factor in the corporation's sustainability and be part of a

[4] For simplicity, the term corporation shall be used throughout this document to represent all such entities.

[5] While this paper will argue that it is the above referred to laws that are the ultimate defining source of corporate behavior, and I will refer to a number of others who share that opinion, I want to point out that there is not universal consensus that those laws are to blame. Ian B. Lee in his paper '*Corporate Law, Profit Maximization and the "Responsible" Shareholder*' (2004) argues that numerous states have statutes that permit corporate behavior that would not be strictly construed as maximizing the profit for shareholders, and that it is not the laws, but rather pressure from shareholders that drives corporate behavior. I would argue that even though he is legally correct with that claim, as a practical matter, shareholders are able to use corporate statutes to drive their profit maximizing agenda, along with the nature and structure of the stock markets, which nurture and support that one sided objective. There is no "stock market" dedicated to socially and environmentally oriented investors and the kinds of companies they might want to support, and therefore they are forced to "play on another man's playing field". That is why I am not only advocating the need to have laws that allow an alternate form of corporation to be voluntarily adopted by those wishing to go that route, but likewise the need for establishing an entire "eco system" for such companies and their investors, including an alternate form of stock exchange and other such mechanisms. Lee's article is here: http://www.law.utoronto.ca/documents/lee/Responsibleshareholder_SJLBF.pdf,

necessary mix that includes social and environmental mandates. Yet, it cannot be the dominant attribute of the corporation. When society fully grasps the appropriateness of this concept, the laws that govern the creation and operation of corporations will change.

A corporation should exist only because it provides some beneficial good and/or service that humanity and the environment needs, and which will be operated on the mandatory basis of social and environmental, as well as economic, imperatives (the triple bottom line). Naturally, in the near term business will resist such a fundamental change in its very purpose and, as a result, I present an intermediate and near term means by which we can move towards that ultimate goal. I will show how the current statutes of one state, Nevada, may be creatively used today to accomplish some of the herein envisioned goals.

What is a Corporation?

A corporation is an artificial entity legally established under a set of laws commonly referred to as corporate statutes. Such statutes are created and adopted by a governmental jurisdiction empowered to create such laws. All sovereign countries represent such governmental jurisdictions, and have the right to create such laws. Some countries, such as the United States, have allowed subdivisions within the sovereign government the right to create such statutes. In the case of the U.S., each of the 50 states are empowered to write their own corporate statutes, and parties desiring to create a corporation may choose any of those 50 states to be the legal sponsor for their corporation. The state selected becomes the state of "domicile" for the corporation. Such state statutes vary somewhat state by state but, with the apparent exception of Nevada[6], every one of them defines, in one form or another, serving its shareholders as the "raison d'être" of the corporation.

Once established, a corporation has virtually all the rights and privileges of a real person, a legal condition often equated to personhood. In theory, the creation of a corporation is a privilege, not a right. However, rarely is it revoked because of corporate misdeeds.

Corporations are, in essence, allowed to be created by virtue of a "contract" between society and a group of owners and managers, wherein society defines (through its corporate laws) how to setup one of those artificial legal entities called a corporation, which then inherits all the rights and privileges granted corporations under those laws. Various courts have expanded on those base laws and rights through their apparent [7] granting of "personhood" to corporations, and such personhood has been viewed by many as one of the critical flaws that has resulted in corporate rights that often trump those of society and individuals.

History of Corporations

One of the most complete reviews of the history of the birth and development of the modern corporation I have found is in the book "*The Corporation: The Pathological Pursuit of Profit and*

[6] Disclaimer - I have not taken the time to examine the statutes of each and every one of the 50 states and therefore cannot claim that Nevada is absolutely unique in this respect. However, even if I had examined every state, what may be true today may not be true tomorrow, as any state is free to modify their statutes at any time they choose. I am nonetheless reasonably confident Nevada's statutes push the boundaries of such statutes. I first learned about Nevada's laws from my son, who recently graduated from law school. There, he studied corporate law and was exposed to the fact that Nevada had somewhat unusual corporate statutes, and alerted me to the same.

[7] There are some who dispute whether the courts in the mid 1800's actually ruled that corporations have personhood but, as a practical matter, subsequent court decisions, including all the way up to the Supreme Court, have acted as though the earlier courts had ruled as such, conveying personhood to corporations.

Power" by Joel Bakan (Bakan, 2004), a Canadian attorney and law professor. His book chronicles the rise of the modern corporation and explains how the legal foundations defined for them go back several centuries, and how those foundations have sown the seeds for the makeup and behavior of corporations today.

Another book, "*Unequal Protection: The Rise of Corporate Dominance and the Theft of Human Rights*" by author and radio personality Thom Hartmann, likewise gives a chronicle of the history of corporations, wherein he emphasizes the development of corporate personhood and how it serves as the chief impediment to desirable corporate behavior. (Hartmann, 2002, 2004).

Originally, corporations had limited life and limited purpose. Frequently, they were used in the U.S. to carry out a specific mission that would be of benefit to the community at large. For example, a corporation might have been created as a means of raising funds to pay for a needed bridge, and once those costs had been recovered (through means like tolls), the corporation would have completed its purpose and would have been dissolved. Even in those early days of corporations, there were various interests who advocated an expansion of those initial rights, and many others who expressed grave concerns (including a number of our founding fathers like Jefferson) about granting corporations expanded powers. Unfortunately for society in many ways, those who expressed concerns did not carry the day.

Over time, the laws governing the creation and characteristics of corporations were changed to remove many of their original limitations, which ultimately resulted in defining corporations as having *unlimited life* and *unlimited purpose*. Various court decisions have given corporations just about every right of living human beings (the aforesaid corporate personhood), with the exception of things like the right to vote. However, given the enormous economic power of corporations today, even that right is indirectly achieved through their ability to influence legislation and virtually dominate the political agenda, often to the exclusion and detriment of the rest of society. In so doing, many would argue that they have largely nullified our individual voting rights, and therefore have even greater power than our right to vote.

And the collective economic power wielded by corporations is awesome. In a report prepared by Sarah Anderson and John Cavanagh of the Institute for Policy Studies, entitled "The Rise of Corporate Global Power" [8] (1996, 2000), Anderson and Cavanagh point out that, of the top 100 globally economies, 51 are corporations and 49 are countries. And the sales of the top 200 corporations are the equivalent to 27.5 percent of all the world economic activity, yet they employ only 0.78 percent of the world's workforce. Yet because these corporations are transnational, they are effectively without a master and have virtually no real accountability to society.

The Dark Side of Corporations

The corporate laws in each jurisdiction define what is required to set up (incorporate) and run a corporation, the responsibilities of the managers and board members, and the rights of the shareholders (and other stakeholders). It is those laws that dictate how corporations must behave. As described above, under those laws, managers and board members have a legal obligation and fiduciary responsibility to honor shareholder primacy. As will be demonstrated later, it is the shareholder primacy attribute that has been fundamentally altered in Nevada's statutes, thereby laying the foundation for a very different legal premise to corporations.

With respect to the other jurisdictions that advocate shareholder primacy, such legal requirements often force managers to take actions that they would never do outside the context

[8] http://www.ips-dc.org/downloads/Top_200.pdf

of their corporation, but which are not only condoned but demanded inside the context of the corporation. Note, for instance, the following observations by Kelly (2003):

> "Wealth inequality, corporate welfare, and industrial pollution are symptoms-the fevers and chills of the economy. The underlying illness, says Business Ethics magazine founder Marjorie Kelly, is shareholder primacy: the corporate drive to make profits for shareholders, no matter who pays the cost. In her book, "*The Divine Right of Capital: Dethroning the Corporate Aristocracy"*, Kelly argues that focusing on the interests of stockholders to the exclusion of everyone else's interests is a form of discrimination based on property or wealth." [9]

Kelly points out that the majority of corporate statutes that define corporations' rights, responsibilities and privileges, were formed in our pre-democratic past and have enabled shareholders to become a kind of economic aristocracy. She also argues that those laws can and should be changed to more correctly align with the rest of society's requirements.

Similarly, Joel Bakan in his book, "*The Corporation: The Pathological Pursuit of Profit and Power*" (Bakan, 2004), paints a compelling picture of the sociopathic nature of corporations and how, if they were a person instead of an artificial entity, we would lock them up . His book was made into a chilling movie entitled "*The Corporation*" (Bakan, Achbar, and Abbott, 2004).

Bakan contends that today's corporation, in pursuit of its profit only mandate, is a pathological institution. In the movie, Bakan, Achbar and Abbot support this contention by pointing out that corporations exhibit every one of the symptoms of a "psychopath", as defined by the World Heath Organization in their manual of mental disorders (DSM-IV), including:

1. Callous unconcern for the feelings of others
2. Incapacity to maintain enduring relationships
3. Reckless disrespect for the safety of others
4. Deceitfulness: repeated lying and conning others for profit
5. Incapacity to experience guilt
6. Failure to conform to social norms with respect to lawful behaviors.

Most recently, Michael Moore [10] in his documentary "Sicko" [11] (Moore, 2007), dramatically and poignantly demonstrates how the healthcare system in the United States yields a massive disservice to society, and is fundamentally flawed as a result of the profit only motive of the healthcare corporations.

At this point one might rightfully pose the question, are there no corporations out there who behave in a different manner than described above? And the answer is yes. However they are few and far between, especially in the community of "public" corporations. The pressure by the investment community on CEOs and Board of Directors of public corporations makes it nearly impossible for management of a public company to pursue anything other than a pure profit (and short term profit at that) course of action. To do otherwise, in a manner that is anything more than just image building, is to virtually guarantee that the corporation will face shareholder lawsuits. And historically the courts have ruled nearly universally in favor of investors.

Thus, far more often than not, examples of corporations who genuinely behave in a more environmentally and socially benign fashion (i.e. "do no harm") at a minimum, or in some rarer cases where they are viewed as outright beneficial to society and the planet, are almost always found among private corporations, and not public ones. The consequences of that reality are

[9] http://www.bkpub.com/ProdDetails.asp?ID=1576752372&PG=1&Type=AUTH&PCS=BKP
[10] http://www.michaelmoore.com/
[11] http://www.michaelmoore.com/sicko/about/synopsis/

poignantly described in a book by Bo Burlingham entitled "*Small Giants: Companies that Choose to Be Great Instead of Big*". [12] (Burlingham, 2005)

Burlingham determined that there were literally thousands of small and medium sized companies who voluntarily elected to remain private in order to pursue business in a manner that was more consistent with their values and objectives, than that which they would be required to do were they to go public. The 14 companies he highlights in the book serve as a good model for what corporations could be like if they were freed from the profit only mandate.

In another example of what might be possible for the kind of behavior we would like to see in corporations, Kim Cameron and Marc Lavine, in their book "*Making the Impossible Possible: Leading Extraordinary Performance: The Rocky Flats Story*" (2006), tell a very inspiring story of how CH2MHill, an environmental engineering firm, achieve results that everyone thought were impossible. They took a site that many considered the worst environmentally damaged facility in U.S. history and cleaned it up in $1/7^{th}$ of the time projected and at $1/6^{th}$ the projected cost. It is noteworthy that CH2Mhill, being an "employee owned" corporation, was not constrained by the pressures of the stock market to "milk" the project for maximum profit, but rather to achieve extraordinary results for all concerned.

Thus, we see the contrast between the current "public" corporate world, which operates on principles that nearly universally violate a beneficial relationship with society (with the sole exception of generating goods and services consumed by society and generating profit for its owners - to some, all the justification needed – to many others, the personification of sociopathic behavior), and private corporations who are able to "march to a different drummer". What is needed is a framework to allow the public corporations to likewise march to that same drummer.

Society's Tug-of-War with Corporations

In the late 1800's and early 1900's, abuses by corporations led to federal anti-trust legislation and other federal efforts to curb excessive and antisocial behavior on the part of corporations. The stock market crash of 1929 further brought about regulation and control of stock markets and securities. In addition, corporations became more savvy about public relations and actively worked to build a more benign and beneficial image in the public's eye. As a result, we saw a shift in the public's perspective towards corporations that, for a time, appeared to be more favorable. It was the time when phrases such as "What's good for General Motors is good for the country" [13] became part of the myth of the benevolence of corporations.

However, beginning with the birth of the environmental movement in the 1970's, the dark side of corporations began to unavoidably reveal itself once again. That dark side was always there, just not as obvious to the general public.

As time progressed, anti-social and anti-environmental corporate behavior patterns, driven by the shareholder primacy mantra, became more and more obvious to society, especially as seen from the perspective of stakeholders other than shareholders (employees, society at large and the environment, just to name a few) . Shareholders, in contrast, often applauded behavior such

[12] See the following interview with Bo Burlingham, Editor at Large for Inc. magazine and author of "Small Giants: Companies that Choose to Be Great Instead of Big" (http://www.smallgiantsbook.com) at www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2006/02/21/BUGFTHARMB1.DTL&hw=Ilana+DeBare&sn=002&sc=592.

[13] Original statement made by Charles Wilson, CEO of General Motors, in testimony before Senate Armed Forces Committee, 1952

as plant closings and layoffs as beneficial to the financial bottom line, and therefore beneficial to them.

In contrast, a high percentage of the rest of society now has a very negative opinion about such corporate behavior. In September, 2000, Business Week published an article entitled "*Too Much Corporate Power?*", [14] in which they referred to a poll they did which showed that nearly three-quarters of Americans think business has gained too much power over too many aspects of their lives. They stated that "Consumers are seething about insensitive corporate behavior." They had a companion story entitled "*Three Views on Anticorporate Attitudes*". [15]

In a subsequent article in the New York Times, entitled "*US: Poll Shows Americans Distrust Corporations*" [16] (December 2005), writer Claudia H. Deutsch quotes several polls which show this phenomenon rising. She said, "More than ever, Americans do not trust business or the people who run it", and quotes statistics like:

- Only 2 percent checked off "very trustworthy" to describe the chief executives of very large companies, and
- 72 percent of respondents felt that wrongdoing was widespread in industry
- 90 percent of respondents …. said big companies had too much influence on government

On a personal anecdotal note, recently I was invited to speak to a number of high school classes on the topic of corporations and their contribution to society. When I did an informal poll of the students in each class, I was astounded to see that not one single student was willing to state that they viewed corporations favorably.

When an institution established by society's consent is viewed so negatively by the majority of its citizens, something clearly needs to change. It is time for society to re-evaluate its contractual relationship with corporations, and to require corporations to have a more constructive relationship with society at large, not just to their shareholders.

However, on the flip side, one cannot argue with the fact that the profit mandate has, to date, created an incredibly effective machine that has been enormously successful in concentrating wealth and financial power, and achieving many remarkable results. It is my contention that such wealth and financial power needs to be redirected for the benefit of society as a whole, and not just for the wealthy few.

In the interim, the negative impact on society and the environment wrought by that corporate success is becoming more and more apparent. In addition, and unfortunately, America's current brand of capitalism, as practiced by its corporate creations, has served as an example to the rest of the world, which has rushed to emulate the United States. They too will have to change.

How to Change Corporate Behavior

At present, society frequently responds to undesirable behavior patterns of corporations by enacting new laws (such as anti-pollution laws, employment laws, anti-bribery laws, truth in labeling laws, etc.) to counteract various actions taken by corporations in fulfilling their mandated corporate objectives. The problem is that those laws only address the *symptoms* and not the *underlying cause* of such corporate behavior. As long as corporations are formed under laws that define shareholder primacy and the profit motive as their "prime directive," that anti-social behavior will continue, and more and more laws will have to be enacted to try and curb the

[14] http://www.businessweek.com/2000/00_37/b3698001.htm
[15] http://www.businessweek.com/2000/00_37/b3698009.htm
[16] http://www.corpwatch.org/article.php?id=12863

behavior at the symptomatic level. The image of the children's game "Wack-A-Mole" is an apt visual metaphor for the perpetual need for new laws directed at ever changing bad corporate behavior. [17]

So how do we break this symptom treating cycle? We do it by addressing the underlying cause, not just the symptoms. In HP folklore, Bill Hewlett, co-founder of Hewlett Packard Company, was well-known for saying something to the effect, "Tell me how a person is measured and I will tell you how they will behave." That same thing applies to corporations. Upon examination, it is perfectly clear that corporations behave exactly as they are measured. Corporate statutes legally define the requirements for behavior on the part of boards and managers, and those statutes therefore constitute the legal yardsticks we use to measure their behavior.

The boards of directors and officers of all corporations follow a legal mandate that they have to do everything they can to maximize profit for the owners (shareholders) of the company. The statutes that govern the creation and operation of corporations in nearly every jurisdiction say that the managers have a "fiduciary" (translate that – legal) obligation to their shareholders and *only* to their shareholders. That means that the rest of society, their employees and the environment, are not given consideration in their actions. As much as the managers might like to give these other stakeholders equal weight, they legally cannot.

Thus, it is the laws under which a corporation is established that set the tone for all subsequent corporate behavior. To expect a different behavior pattern in the light of those laws would be naïve.

In order to truly modify corporate behavior constructively and pervasively, one needs to address the underlying laws which govern the formation and operation of corporations. As stated above, the current laws were written by society in accordance with society's values and beliefs at the time of their original writing, and society is at liberty to choose to change those rules whenever it wishes to do so. If society determines that it wants corporations to have a different mandate than the pure profit motive and shareholder primacy over all other stakeholders, then society need only rewrite its laws to set down those new objectives. Should that be attempted however, there would likely be a substantial and powerful pushback on those who might try to change said laws, by those who have a vested interest in the status quo, if the near term approach were framed as a mandatory change on the part of all corporations. To circumvent that anticipated resistance, an alternate approach is proposed below.

Changing Corporate Statutes

As stated above, I propose that the long term solution to countering anti-social corporate behavior is realized through a change in corporate codes in every jurisdiction where corporations may be formed. However, I recognize that the existing business community will probably resist and block any proposed changes that would mandate their conversion over to a new set of underlying laws. I have personally experienced that resistance in the California legislature.

As chronicled in the book "*Megatrends 2010: The Rise of Conscious Capitalism*," (Aburdene, 2005) by Patricia Aburdene, I testified before the California Senate Judiciary Committee (in support of someone else's effort [18]) to change the corporate laws of California, to broaden the mandate for corporations beyond just a profit motive. The effort was shot down as a result of

[17] A game in which mechanical moles endlessly pop up out of holes and the player is required to hit them with a mallet to drive them back "underground". See http://en.wikipedia.org/wiki/Whack_a_mole

resistance from the business community, with the most vocal opponent being the Chamber of Commerce.

Seeing that the business community would strongly resist any mandatory requirements to change, I subsequently proposed that California, and other states, create an additional class of corporation in their statutes that allowed parties to voluntarily adopt such a classification. I assumed that this would diffuse the objections of the business community, while simultaneously embedding these concepts into laws. Once enacted, social pressure to adopt those laws might push many corporations to go that direction, even though the law did not compel them. Nevada is the first state that I know of that has taken any such steps.

New kinds of corporations

What most people don't realize is that the corporate laws can be *re-written* to produce a different kind of corporation, one whose behavior would be viewed as beneficial to society at large and not detrimental, as is the current case. This can be approached in two ways: (1) re-write the laws to require *existing* corporations to be run under a different set of rules than they have done to date, or (2) write laws to define *a new kind of corporation,* one that would offer another *option* to both those forming new corporations and to those wishing to convert existing corporations, while simultaneously allowing existing corporations to continue as they are, if they so choose.

I believe that ultimately the mandatory rules contemplated under option number one will become the norm, when society and even corporations learn that businesses are actually more successful and sustainable when following a socially and environmentally responsible mode. However, old belief systems and habits die hard so, in the meantime, to begin moving jurisdictions in a positive direction, I believe that option number two represents the only practical way to get movement in the near term without engendering the "anti-body" reaction of the traditional business and investment community.

Others have attempted to work within the confines of existing statutes to achieve a similar new kind of corporation, most notably one that was recently reported on by INC magazine, in an article entitled "*A New Kind of Company*" [19] (Clark, 2007). In it, they presented the idea of a "B" corporation (The B stands for "beneficial") as put forth by B Lab, [20] a new non-profit organization. The article states, "It's less a legal designation than a certification system that will allow businesses to define themselves as socially responsible to consumers and investors. To become a certified B Corporation, a company must amend its articles of incorporation to say that managers must consider the interests of employees, the community, and the environment instead of worrying solely about shareholders."

As to the rationale for creating the B Corporation standard, the article talks about the legal mandate to maximize profits to shareholders, and refers to an often sited example of how a socially oriented public corporation, Ben & Jerry's, was forced to sell out to another corporation

[18] I was there to support Mr. Robert Hinkley (a former senior New York lawyer, social responsibility activist and current partner in an international law firm) who has been advocating that states convert their existing corporation statutes to include the following: "The duty of directors henceforth shall be to make money for shareholders but not at the expense of the environment, human rights, public health and safety, dignity of employees and the welfare of the communities in which the company operates." I am grateful to Mr. Hinkley for his pioneering work in identifying this problem and serving as an inspiration to the effort that he is currently pursuing.

[19] http://www.inc.com/magazine/20070701/priority-a-new-kind-of-company.html

[20] http://www.bcorporation.net/

because of that very mandate: *"They want to avoid the fate of ice cream maker Ben & Jerry's, which received a buyout offer from the Dutch conglomerate Unilever (NYSE:UL) in 2000. Founders Ben Cohen and Jerry Greenfield didn't want to sell, so Cohen assembled a group of investors to make a counteroffer. When they couldn't offer as much as Unilever, shareholders sued, and the company, then publicly traded, was forced to relent. In April 2000, Ben & Jerry's was acquired by Unilever for $326 million."*

However, the article states "….whether the amendments are legally binding will be up for debate until they are tested in court". It then sites the differences between a number of different state statutes, and how they do and don't provide the legal framework for addressing such issues. Conspicuously absent from the article was a discussion of the unique attributes of Nevada's statutes, or any others that may be similar. Had Ben & Jerry's been a Nevada corporation, they would have been able to block that purchase by Unilever. That will become clear in the below described Nevada scenario.

For now, I consider the following to be the more practical midterm solution to the overall problem. After that, you will see an immediate solution using the existing statutes found in the State of Nevada, statutes that are sufficiently malleable and adaptable to allow us an immediate set of options that will go a long way towards an ideal solution.

For the midterm solution, I propose to get all states (and other countries) to adopt a "parallel" set of statutes alongside their existing statutes, such that new corporations may voluntarily elect to form under those statutes instead of the conventional ones. Buckminster Fuller was well known to have said, "You never change things by fighting the existing reality. To change something, build a NEW model that makes the existing model obsolete."

I advocate the optional approach for two reasons: (1) trying to force ALL existing corporations to follow a new set of rules would be a near impossible task, and (2) it is possible to use the very essence of how modern business works to not only get new corporations to be established under these new rules, but to get existing corporations to voluntarily convert over to the new corporate format as well. Just how and why that is possible is covered in the next section.

Introducing the "CR" corporation

Taking these arguments and applying them to the corporate model, I recently began to advocate a new kind of corporation, which I call a "CR" corporation[21]. It is similar to the B Corporation in intent, only it would be sanctioned by, and be a part of, the legal structure established by the government, and not just the founders of an individual corporation. Thereby, the CR corporation would have the weight of government behind it, making legal challenges much more difficult to mount.

What would this entail? Everyone is familiar with the two main forms of corporations: for-profit corporations and non-profit corporations. Non-profit organizations exist purely for public benefit purposes and they have no "owners", per se. For-profit corporations are the kind that are owned by individuals, pension funds, other corporations, and a host of other entities. For-profit corporations normally exist for the exclusive purpose of making a profit for their owners.

Both types of corporations are separately defined in each state's corporate statutes. In fact, most states have further divisions within both their for-profit and non-profit corporate codes that create different variants of each. For example, California has multiple categories of "professional"

[21] Santa Barbara Institute of Law and Society (www.sbils.org).

corporations that have various characteristics that distinguish them from the generic, run of the mill, for-profit corporation. Likewise, there are several variants of non-profit corporation, each with their own set of rules.

What I am proposing is a new kind of for-profit corporation that has characteristics of both for-profit and non-profits corporations. It would resemble for-profit corporations in that they would be owned by various parties, would be entitled to make and distribute profit to those owners, and would not be considered a tax exempt organization. As a result, they would be a variant of corporation under the for-profit category.

However, making profit would not be their sole purpose. Rather, the CR corporation would have an expanded purpose, which includes serving its employees, the community it resides in and society at large, in addition to making a profit. In the new statutes, I would encourage including a number of the characteristics of the existing Nevada statutes, as described below, with the exception that the corporation would have a mandatory requirement to incorporate triple bottom line parameters in their corporate decision making and actions.

The label "CR corporation" was chosen to embody the core concepts that would be imbedded in such a new corporation. In essence, all such corporations would be required to be simultaneously ***S****ocially,* ***E****nvironmentally and* ***E****conomically* ***R****esponsible* corporations, or 'SEE" - "R" or "CR" for short.

Once formed, the managers and boards of directors of CR corporations would be legally required to behave in a balanced manner, demonstrating social, environmental and economic responsibility. They would have a fiduciary (that means legal) obligation to represent not only the shareholders but other stakeholders as well, including their employees, the community and the planet.

Will Voluntary Adoption of This New Corporate Code by Corporations Be Effective?

What factors would cause that voluntary approach to have a meaningful impact on the problem and help to bring about the kind of fundamental change in the corporate world that much of society would like to see? It is likely that once the new corporate statutes have been enacted in any given jurisdiction, there will be internal and external dynamics that operate to bring both subtle and overt pressure to bear on corporations in that jurisdiction, to adopt the CR form of corporate governance.

There is evidence that such external pressures can be more effective than might be first thought. Recent history bears witness to another set of laws that tapped into the same dynamic anticipated here. Those laws also had a benign appearance on the surface, but in fact produced a much greater impact than was anticipated by the authors of the legislation and the public.

The laws in question are commonly referred to as the "Toxics Reporting Act"[22] in which the federal government mandated that companies publicly report the toxic chemicals they generated and what they did with them. There were no further requirements beyond the reporting – just tell the world what toxic substances you are generating and what you are doing about them – period. In retrospect, this set of laws is considered by many to be the most successful environmental legislation ever.

[22] It is more correctly called Title III of SARA (the Superfund Amendments and Reauthorization Act). Title III is called the Emergency Planning and Community Right-To-Know Act (EPCRA). Companies report their emissions in a Toxics Release Inventory (TRI). See http://www.epa.gov./tri/.

The results of that simple sounding, nearly toothless legislation have been amazing. Surprise, surprise - disclosure works. As they say, sunshine is the greatest disinfectant. Following passage of the Toxics Reporting Act, corporations began to tell the world what they were doing with respect to toxic chemicals, and most of them became embarrassed into radically altering their behavior patterns. By virtue of wanting their prospective investors and customers to think positively of them, they began to change their practices, to "clean up their act," as it were.

Many got into a competitive stance with respect to others in their industry. Company after company raced to paint themselves as a more responsible corporation than their competitors, with respect to how well they were handling toxics. Probably more toxic clean up has resulted from the anticipated public pressure (often not forthcoming but, nonetheless, feared by the corporations) than by all the other environmental legislation in history.

Applying that same logic to these new corporate codes, I anticipate that companies that adopt the new code and become CR corporations will want to tell the world that they are CR corporations, with the expectation that it will enhance their image in the public's mind, thereby benefiting them with increased sales and improvement in their stock value.

Many will probably use the same techniques of the companies that report their toxics profile; they will compare themselves to the companies that don't adopt the new laws. If so, it is possible that the forces of the marketplace (i.e., capitalism in its truest form) may very well drive the adoption of this alternative code better than any kind of mandatory action could ever accomplish.

Keep in mind that a CR corporation could not be accused of "green washing" or similar labels on the social front, as they would have a legal mandate requiring such positive behavior, and they could be legally challenged if they did not follow such a mandate. Thus, any company that voluntarily becomes a CR corporation HAS to walk the talk and, to the extent that the public knows this, public opinion about the company would almost assuredly be tilted towards the positive image.

To reinforce this, I also believe it would be beneficial to establish ways to "kick the rudder" as it were, by helping to publicize those companies that elect to become CR corporations. Perhaps a website dedicated to identifying CR corporations and what they are doing to better the world. It would also be helpful to promote this concept so that other media sources and groups likewise laud the companies that adopt the new corporate format and thereby bring positive public recognition to those companies.

Adoption of This New Corporate Code by Jurisdictions

By proposing this new corporate code as a voluntary option for corporations, a very predictable fight with the business community could in all likelihood be avoided in any jurisdiction where the new code is put on the legislative calendar. Understandably, traditional forces would not like to see the enactment of laws that would force them to convert, but it is quite possible that they would not oppose laws that allow for voluntarily compliance by those companies wishing to adopt them.

In fact, should any segment of the business community object to the adoption of such voluntary laws, especially if they recognize such laws will generate normal market and public pressure on them to convert over to that form of corporation, then they would open themselves up to having to defend why they espouse free market conditions, but object when the market wants them to do something like this. Virtually no cogent argument can be raised against the adoption of such laws without the risk of clear and open hypocrisy on the part of the naysayer.

So, assuming that one jurisdiction after another sees the benefit of adopting such a code, how would that alter things within each individual jurisdiction? After the code has been enacted in a given jurisdiction, new corporations in that jurisdiction will need only to define in their Articles of Incorporation ("Articles") that they are forming under the new section of the corporate statutes and thereafter the officers and board of directors would be required to follow the dictates of that code.

Existing corporations in that jurisdiction who would like to convert over to the new code could likewise do so by simply filing an amendment to their Articles calling for an adoption of the new laws. There are thousands of companies out there who are very good candidates for such a conversion, companies that currently endeavor to practice more social and environmental responsibility. Many such companies currently struggle to counteract the problems created by the current legal mandate for corporations, and long for a different paradigm. Most remain as private companies because of that and the fact that, as public companies, they would almost assuredly have to change.

The companies chronicled by Burlingham in his book "*Small Giants: Companies that Choose to Be Great Instead of Big*", and many thousands more, would be excellent candidates to embrace such laws. Adoption of these new statutes could change their reluctance to become public corporations, and a whole new variety of public company may well evolve from that difference. This could be further encouraged by the creation of a new kind of stock exchange and other publicly related entities. I will address these concepts on my websites and in other papers.

Anyway, the dictates of the new statutes would in all likelihood still prevail even if the company "goes public," because a public company is constrained by the laws of the state in which it is formed. Thus, public CR corporations could have a legal right and mandate to push back on Wall Street and the external forces of the stock market, if such forces tried to push the company to behave in ways that run counter to the laws under which the company was formed.

I certainly would like all jurisdictions that already have corporate statutes to adopt this idea of a parallel set of statutes. Clearly, society would look favorably on such corporations, and having such companies in one's own community should be considered a plus. In the case of the U.S., we all have observed how states launch all kinds of PR campaigns to bring corporations to their state. I believe a friendly rivalry among the 50 states regarding enactment of those statutes could well develop, if new companies start forming in such states and/or existing ones move their legal corporate home to such states because of those new statutes. You can bet that the states who recognize the benefit of having such companies in their states will milk that for all the positive PR that they can. The unique statutes of Nevada may very well serve as the "bell cow" to such a movement.

Nevada and its Unique Statutes

We now come to the exploration of what Nevada has done in the way of modifying its corporate statutes, from the norm found throughout the rest of the country. We will further explore how that difference provides a framework and a legal environment in which much can be accomplished today, without the immediate need for creating the new corporate codes discussed above.

Let me begin by referring you to the specific statutes of concern. The main statutes for Nevada profit corporations are located at http://www.leg.state.nv.us/NRS/NRS-078.html and the specific statues we are focused on are located at:

http://www.leg.state.nv.us/NRS/NRS-078.html#NRS078Sec138. Let me paraphrase the key elements of those statutes and point out how they are different from those found in other jurisdictions.

The key overarching element that sets them apart from the others is found in the very first clause of Section 78.138. It states that the directors and officers serve, and have a fiduciary responsibility to, the "interests of the corporation", whereas the statutes in the other jurisdictions specify that they have a responsibility to the "shareholders". [23] You will note that it says "…*with a view to the interests of the corporation."* It does not say the shareholders, but rather the corporation itself. That means that the corporation is the party to whom the officers and directors owe their primary loyalty and fiduciary responsibility, and not the owners!

That may not seem significant upon first glance, but rest assured, from a legal standpoint that concept contains a sea change in meaning and implications. That single phrase removes the concept of shareholder primacy from Nevada corporations. This is hugely significant in all that it portends. It means that the directors and the officers, subject to the limitations defined in their company's individual articles of incorporations and/or bylaws, are free to determine what is in the best interests of the corporation, as long as they do so in good faith (which is presumed in clause 3). As such, that determination may even go against what shareholders feel is in their best interests.

The Nevada framers have taken the stand that it is the legal entity itself (the corporation) that all parties in interest have an obligation to serve, including the shareholders, and whose interests are considered subordinate to the corporation itself. The Nevada legislators qualified that the officers and directors are allowed to take into consideration all the other stakeholders and other external variables. And to ensure that is the case, clause 4 of those statutes explicitly spells out that officers and directors may consider:

1) the interests of employees, suppliers, creditors, customers
2) the economy of the State and Nation,
3) the interests of the community and of society,
4) and the long-term as well as short-term interests of the corporation and its stockholders

These considerations can be upheld, even if they are not in the best interests of any particular group having an interest in the corporation (like the shareholders). Clause 4 also allows the officers and directors to reject buyout offers that they consider not in the best interests of the corporation.[24]

In addition, so as to remove any doubt as to what is included in that freedom on the part of the officers and directors, clause 5 specifically says that the officers and directors are not required to consider the effect their actions may have on any group ***having an interest in the corporation*** (translate that to mean shareholders, for one) and their dominant rationale for any action they might take. Again, this trumps the shareholder primacy concept.

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[23] In the "Corporate Laws" section above, I referred to a paper by Lee entitled '*Corporate Law, Profit Maximization and the "Responsible" Shareholder*'. In that paper, Lee claims that nearly half of the states in the U.S. have adopted so-called "constituency" statutes, which permit the board of directors to consider the interests of nonshareholder constituencies in forming a judgment as to the "best interests of the corporation." He likewise points out that Canada Supreme Court has recently held that Canada recently held that the phrase 'best interests of the corporation', "should be read not simply as the 'best interests of the shareholders.'"

[24] This clause, coupled with a number of others found in the following section NRS 78.139, is what would have allowed Ben & Jerry's to reject the buyout from Unilever, had the company been a Nevada corporation.

Lastly, clause 6 immunizes the officers, directors and the corporation from shareholder lawsuits if they exercise the rights defined under clauses 4 and 5, further moving Nevada's statutes away from having rights defined in their statutes that place shareholders above all others. Clause 6 states that if the officers and directors took such actions, no parties would have a basis of launching a legal action against the corporations and/or its officers and directors.

Collectively, these statutes have stripped away the entire framework of shareholder primacy, upon which all other jurisdictions are normally based.

Now, let me hasten to point out that the above statutes do not mean that the officers and directors are required to act in a socially and environmentally progressive manner. Quite the contrary. These statutes in fact constitute a two edged sword in that they not only provide the legal coverage for parties who wish to act in such a responsible manner, but also provide coverage for some of the worst behavior imaginable.

In fact, I would posit that these statutes have created the very environment that could well foster the exact kind of behavior that is the source of a major complaint by investors on Wall Street today. That complaint centers around the self serving actions of senior management in most public companies, behavior that is often antithetical to the interests of the shareholders. Nevada's statutes would allow such management to operate in that manner with impunity.

Lee says as much in his paper on page 5, with respect to any state that has similar statutes. "Many commentators, especially (but not exclusively) advocates of shareholder primacy, have criticized the statutes on the ground that, despite their portrayal as "progressive," their permissive formulation serves only to enhance managerial discretion and to facilitate managerial entrenchment without any substantial benefit to non-shareholder constituents."

Nonetheless, in the hands of parties who favor a more responsible behavior on the part of corporations and their officers and directors, Nevada's statutes provide us with one of the best possible legal environments in existence today, short of the more ideal condition espoused above. In fact, such statutes would give a great deal of protection to existing public companies or companies wishing to go public, allowing them to pursue a triple bottom line philosophy without fear of investor interference.

I am unaware of any companies who have deliberately used these Nevada statutes to serve as a framework for them to become a public company. I suspect that those who did would in all likelihood not want to broadcast that fact, as it might attract those who would want to challenge them in the courts, and a low profile on such matters is probably more prudent in today's litigious environment.

The existing Nevada statutes could also serve as a starting template for the new laws in other states, only making the triple bottom line considerations mandatory rather than optional, as in the case of Nevada today. Therefore, in contrast to a corporation formed under Nevada's existing statutes, a corporation formed in a jurisdiction with the proposed new code would voluntarily form under those new statutes, and in so doing, would voluntarily submit themselves to such mandatory behavior after the corporate formation.

Lastly, in addition to the rights conferred directly by the above described statutes, as well as others that I did not point out in this paper, there are other actions that public and private corporations can take to further augment the existing Nevada statutes in order to legally lock in the kind of behavior we would all like to see, without waiting for the new laws to be created. These include corporate governance structures, alternate classes of stock, alternate composition of boards of directors and their committees, and other documents and procedures that creatively

work with those existing statutes to enhance their effectiveness. I will drill deeper into those issues on my websites and in other papers.

Final Thoughts on Corporations and Sustainability Issues

Many of us have come to the conclusion that there is probably no other institution in existence today that can rival the modern day corporation for its ability to impact our lives, both for good and not so good. The modern corporation has become a juggernaut with respect to its ability to define its objectives, marshal resources and execute on its plan, all in pursuit of its goals and purposes. No other institution seems to demonstrate such efficiency and effectiveness.

However, such efficiency and effectiveness has come with a very high social and environmental price tag. Through the tool of the modern corporation and its ability to create the instruments of modern society (cars, roads, dams, factories, etc.), humankind's collective actions have, for the first time, reached the point where it is impacting the global environment as no other species has in the history of the planet. Climate change is the most visible manifestation of that impact, but it filters all the way down to the local level where change, and in most cases negative change, is occurring on many, many dimensions.

The vast majority of those changes can be placed at the feet of the corporate world. Through its rapacious pursuit of profit, supported by a legal infrastructure that encourages and even demands such a focus, much harm has been perpetrated on the rest of the world. However, I want to hasten to say that I don't believe that corporations in and of themselves are bad and undesirable. Quite the contrary. I feel that corporations may well be the hope for humankind and probably represent one of the best, if not the best vehicle for creating the kind of world we all could dream of. We just need to redefine their purpose to a more broadly beneficial one, and thereby change their behavior. Changing corporate behavior would probably have a greater positive impact on the planet, from the standpoint of sustainability, than any other single action we as a society might take. It is not the corporations themselves that I see as the problem, but rather their mandate. Thus, we need to change the laws under which a corporation is established, laws that set the tone for all subsequent corporate behavior.

Summary

In this paper I have put forth the premise that to permanently modify corporate behavior towards a more benevolent stance with respect to society and the environment, the underlying laws that serve as the legal underpinnings to the creation and operation of corporations have to change. I gave the rationale why the existing laws create the legal imperative that forces corporations to behave in a self-serving and irresponsible manner, and why those laws, unless changed, will forever bind corporations to such a behavior pattern.

I then put forth the case for changing those corporate laws, in both the long term and on an intermediate basis. I then showed how the existing laws of Nevada could be used today to achieve objectives similar to those I espoused for the future. I showed that new corporations could elect to form in Nevada at this time, and thereby take advantage of their existing laws to carry out a triple bottom line mandate. I also pointed out that existing corporations could move their state of incorporation to Nevada and thereby take advantage of those laws as well.

By working with these existing and future laws, society can craft a new relationship with corporations that could fundamentally realign what corporations are all about. Such a "new" corporation could better serve humanity and the planet, while still making use of the tools and

resources that business has so carefully nurtured and developed over the last couple of hundred years.

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