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LESSONS FROM INSTITUTIONAL SHAREHOLDER SERVICES: GOVERNING BENEFIT CORPORATIONS' THIRD- PARTY STANDARD

*Tammi S. Etheridge**

Almost one hundred years ago, Henry Ford, as CEO of the Ford Motor Company, announced a plan to cease payment of special dividends to shareholders.¹ Instead, the company would reinvest its profits to employ more workers and build more factories. Investing in new workers and factories would cut the cost of cars and make them affordable to more people.² Ford publicly declared that his “ambition [was] to employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes. To do this we are putting the greatest share of our profits back in the business.”³ Minority shareholders were outraged. Two minority shareholders in particular, the Dodge brothers,⁴ brought suit seeking to stop Ford’s plans.⁵ The Dodge brothers argued that the primary purpose of a company is to maximize shareholder profits, not to help the community.⁶ The trial court agreed with Dodge and ordered Ford to pay the special dividends to its shareholders.⁷ Ford appealed. The Michigan Supreme Court affirmed, holding that a “corporation is organized primarily for the profit of the stockholders,” not for the benefit of the community or its employees.⁸

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1. Dodge v. Ford Motor Co., 170 N.W. 668, 669 (Mich. 1919).

2. *Id.*

3. *Id.*

4. An alternative backstory provides that Ford did not want to pay dividends to his competitors, the Dodge brothers. See, e.g., M. Todd Henderson, *Everything Old Is New Again: Lessons from Dodge v. Ford Motor Company* 1–2 (Univ. of Chi. John M. Olin Law & Econ. 2d Series, Working Paper No. 373, 2007), available at <http://www.law.uchicago.edu/files/files/373.pdf>.

5. Dodge, 170 N.W. at 669.

6. *Id.* at 683.

7. *Id.*

8. *Id.* at 684 (“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. The discretion of directors is to be exercised in the choice of means to attain that end, and does

Dodge v. Ford is the seminal case for the property model of corporate law. The property model propounds the view that the sole purpose of any solvent corporation is to maximize the wealth of its owners.⁹ In contrast, the entity model of corporate law maintains that a corporation can simultaneously serve multiple constituencies and is thus “tinged with a public purpose.”¹⁰ The past few decades have seen the proliferation of new business models purporting to advance such a public purpose, including hybrid nonprofits, low-profit limited liability companies, and “flexible purpose corporations.”¹¹ Consumer and investor demand have driven the creation of a sizeable marketplace for companies that put public purpose, not profit, at the center of business.¹² Yet, while some business models have progressed to the point of taking the community into account, the law has not. For-profit companies that benefit the public are not considered in the existing legal framework.¹³ As such, some states have adopted “benefit corporation” statutes to create a more accommodating framework.¹⁴ The statutes permit a benefit corporation to consider mixed goals in its operation while working in tandem with preexisting corporate law.¹⁵

To date Arizona, Arkansas, California, Colorado, Delaware, Hawaii, Illinois, Louisiana, Maryland, Massachusetts, Nebraska, Nevada, New Jersey, New York, Oregon, Pennsylvania, Rhode Island, South Carolina, Utah, Vermont, Virginia, the District of Columbia, and West Virginia have

not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.”).

9. William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 265 (1992).

10. *Id.*

11. Julie Battilana et al., *In Search of the Hybrid Ideal*, STAN. SOC. INNOVATION REV., 51, 53 (2012), available at http://www.ssireview.org/pdf/Summer_2012_In_Search_of_the_Hybrid_Ideal.pdf.

12. The last three decades have seen the growth of so-called socially responsible investing. A 2010 report on socially responsible investing trends in the United States found that companies identified as socially responsible controlled roughly ten percent of all domestic assets under management, approximately \$3.07 trillion (mostly in mutual funds). SOC. INV. FORUM FOUND., REPORT ON SOCIALLY RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES 8, 10 (2010), available at http://www.ussif.org/files/Publications/10_Trends_Exec_Summary.pdf.

13. Under the letter of many current state laws, a company that chooses to prioritize a public benefit over profits would violate its fiduciary duties to the company’s owners. See *Dodge*, 170 N.W. at 648. In practice, however, state courts have not enforced shareholder wealth maximization, with no case other than *Dodge* operationalizing this rule. Jonathan R. Macey, *A Close Read of an Excellent Commentary on Dodge v. Ford*, 3 Va. L. & Bus. Rev. 177, 180-81 (2008); see also Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford*, 3 Va. L. Bus. Rev. 163 (2008).

14. Hawaii has decided to call its version of a benefit corporation a “sustainable business corporation.” HAW. REV. STAT. § 420D-2 (2011).

15. These statutes allow directors of benefit corporations to consider both people and the planet along with profits. See Michael R. Deskins, *Benefit Corporation Legislation, Version 1.0—A Breakthrough in Stakeholder Rights?*, 15 LEWIS & CLARK L. REV. 1047, 1063 (2011) (discussing the “triple bottom line” concept).

adopted benefit corporation statutes into state corporate law.¹⁶ Alaska, Alabama, Connecticut, Florida, Georgia, Idaho, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Montana, New Hampshire, Ohio, Puerto Rico, and Wisconsin have introduced benefit corporation legislation.¹⁷ Most of these states have adopted the model legislation proposed by B Lab,¹⁸ or its basic structure and content, as their corporate benefit statutes.¹⁹ These benefit corporations are thus statutorily committed to “1) a corporate purpose to create a material positive impact on society and the environment; 2) expanded fiduciary duties of directors which require consideration of non-financial interests; and 3) an obligation to report on its overall social and environmental performance as assessed against a comprehensive, credible, independent, and transparent third-party standard.”²⁰

Generally, the benefit corporation statutes require a corporation’s charter to state that it is obligated to pursue a general public benefit that will create a positive impact on society and the environment as a whole, to be assessed against a third-party standard.²¹ The benefit corporation is then obligated to publish an annual benefit report wherein the corporation’s performance is measured against the third-party standard.²² Although the statutory definition of “third-party standard” is verbose, benefit corporation statutes do not go far enough in providing for the creation or regulation of meaningful standards. Without careful monitoring, the proliferation of public benefit corporations could easily promote the growth of a monopolistic, standard-providing organization of the Institu-

16. *State by State Legislative Status, Enacted Legislation*, BENEFIT CORP. INFO. CTR., <http://benefitcorp.net/state-by-state-legislative-status> (last visited Apr. 14, 2014).

17. *Id.*

18. B Lab is a non-profit organization whose mission, according to its website, is “using the power of business to solve social and environmental problems.” *The Non-Profit Behind B Corps*, B LAB, <http://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps> (last visited Aug. 2, 2015).

19. Differences in a state’s business entity statutory scheme, legislators, bar associations, practitioners, business community, and so on lead to small variations in benefit corporation legislation. Yet the essential provisions are largely identical. The Model Benefit Corporation Legislation (MBCL) is a collection of the strongest provisions from enacted statutes. B Lab has presented the MBCL to states as the ideal legislation to provide for the existence of benefit corporations. *Model Legislation*, BENEFIT CORP. INFO. CENTER, <http://benefitcorp.net/attorneys/model-legislation> (last visited June 3, 2015).

20. WILLIAM H. CLARK & LARRY VRANKA, *THE NEED AND RATIONALE FOR THE BENEFIT CORPORATION 1* (2013), available at http://benefitcorp.net/storage/documents/Benevit_Corporation_White_Paper_1_18_2013.pdf.

21. Critics have called this mission into question. Delaware Supreme Court Chief Justice Strine has said, “[Benefit corporations exist in] a fictional land where you can take other people’s money, use it as you wish, and ignore the best interests of those with the only right to vote.” Leo E. Strine, Jr., *Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 150 (2012).

22. *Reporting Requirements by State*, BENEFIT CORP. INFO. CTR., <http://benefitcorp.net/reporting-requirements> (last visited Aug. 2, 2015).

tional Shareholder Services (ISS) type. The creation of such an organization would endanger the primary purpose of implementing an open third-party standard policy—transparency.

This Comment proceeds as follows: Part I discusses the structure of benefit corporation statutes, outlining the provisions associated with the statutorily mandated goals of corporate purpose, accountability, and transparency. Part II compares the third-party standard to ISS’s third-party corporate governance rating system for general corporations. Part III explains how some of the concerns associated with ISS’s corporate governance rating system are applicable to the third-party standard despite proponents’ arguments to the contrary.

I. BENEFIT CORPORATION STATUTES

A. *Public Benefit as Corporate Purpose*

According to the Benefit Corp Information Center, a benefit corporation “is a new class of corporation that voluntarily meets higher standards of corporate purpose, accountability, and transparency.”²³ Statutorily, a benefit corporation must have a purpose of creating “general public benefit” and is permitted to identify one or more specific public benefit purposes.²⁴ By definition, a general public benefit is a “material, positive impact on society and the environment, taken as a whole, as assessed against a third-party standard, from the business and operations of a benefit corporation.”²⁵ The Model Legislation offers a nonexhaustive list of potential specific public benefits. The list includes

- (1) providing low-income or underserved individuals or communities with beneficial products or services;
- (2) promoting economic opportunity for individuals or communities beyond the creation of jobs in the ordinary course of business;
- (3) preserving the environment;
- (4) improving human health;
- (5) promoting the arts, sciences, or advancement of knowledge;
- (6) increasing the flow of capital to entities with a public benefit purpose; and
- (7) conferring any other particular benefit on society or the environment.²⁶

According to the Model Legislation, “[t]he creation of general public benefit and specific public benefit . . . is in the best interests of the benefit corporation.”²⁷

23. *Business FAQ’s*, BENEFIT CORP. INFO. CTR., <http://benefitcorp.net/business> (last visited Apr. 14, 2014).

24. See MODEL BENEFIT CORP. LEGISLATION § 201(a) (B Lab, 2013), available at http://benefitcorp.net/storage/documents/Model_Benefit_Corporation_Legislation.pdf. See, e.g., MD. CODE ANN., CORPS. & ASS’NS § 5-6C-06(a)(1), (b)(1) (LexisNexis 2014).

25. MODEL BENEFIT CORP. LEGISLATION § 102. There are some variants. Under the New Jersey statute, a general public benefit is “a material positive impact on society and the environment by the operations of a benefit corporation through activities that promote some combination of specific public benefits.” N.J. STAT. ANN. § 14A:18-1 (2011).

26. MODEL BENEFIT CORP. LEGISLATION § 102(a).

27. *Id.* § 201(c).

B. *Accountability*

Benefit corporation directors, in managing the business, must consider a wide variety of stakeholders. Directors must

consider the effects of any action or inaction upon: (i) the shareholders of the benefit corporation; (ii) the employees and workforce of the benefit corporation, its subsidiaries and its suppliers; (iii) the interests of customers as beneficiaries of the general public benefit or specific public benefit purposes of the benefit corporation; (iv) community and societal factors, including those of each community in which offices or facilities of the benefit corporation, its subsidiaries, or its suppliers are located; (v) the local and global environment; (vi) the short-term and long-term interests of the benefit corporation, including benefits that may accrue to the benefit corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the benefit corporation; and (vii) the ability of the benefit corporation to accomplish its general benefit purpose and any specific public benefit purpose . . .²⁸

Directors are also bound to “any other pertinent factors or the interests of any other group” as they deem appropriate.²⁹

C. *Transparency and the Third-Party Standard*

To assure its commitment to a particular public benefit and to provide increased transparency for its stakeholders, the benefit corporation must file an annual benefit report with the Secretary of State,³⁰ make it available to all of the company’s shareholders, and post the report on its website so that the broader public has access to it.³¹ The report should include a description of the manner in which the corporation sought to impute a public benefit, the success of that effort, the manner in which the corporation sought to impute a specific benefit (if any are stated in the company’s articles), the success of that effort, any circumstances that may have hindered the effort, and the rationale for the selection of the third-party standard used to prepare the benefit report.³² To dispel any concerns about selection of the third-party standard, the Model Legislation requires the annual report to include a list of material shareholders and a statement concerning any connection between the benefit corporation and the third-party standard.³³ In this way, stakeholders are kept apprised of relationships that could be perceived as controversial. Lastly, and perhaps most significantly, the annual report must include

an assessment of the overall social and environmental performance of the benefit corporation against a third-party standard: (i) applied consistently with any application of that standard in prior benefit reports; or (ii) accompa-

28. *Id.* § 301(a)(1).

29. *Id.* § 301(a)(2).

30. *Id.* § 402(d).

31. *Id.* § 402(b)–(c).

32. *Id.* § 401(a)(1).

33. *Id.* § 401(a)(6).

nied by an explanation of the reasons for: (A) any inconsistent application; or (B) the change to that standard from the one used in the immediately prior report.³⁴

The third-party standard is arguably the heart of benefit corporation legislation. The Model Legislation defines “third-party standard” as

a recognized standard for defining, reporting and assessing overall corporate social and environmental performance that is:

- (1) Comprehensive because it assesses the effect of the business and its operations upon the interests listed in section 301(a)(1)(ii), (iii), (iv) and (v).
- (2) Developed by an entity that is not controlled by the benefit corporation.
- (3) Credible because it is developed by an entity that both:
 - (i) has access to necessary expertise to assess overall corporate social and environmental performance; and
 - (ii) uses a balanced multistakeholder approach to develop the standard, including a reasonable public comment period.
- (4) Transparent because the following information is publicly available:
 - (i) About the standard:
 - (A) The criteria considered when measuring the overall social and environmental performance of a business.
 - (B) The relative weightings, if any, of those criteria.
 - (ii) About the development and revision of the standard:
 - (A) The identity of the directors, officers, material owners, and the governing body of the entity that developed and controls revisions to the standard.
 - (B) The process by which revisions to the standard and changes to the membership of the governing body are made.
 - (C) An accounting of the revenue and sources of financial support for the entity, with sufficient detail to disclose any relationships that could reasonably be considered to present a potential conflict of interest.³⁵

Proponents of the statute claim that the assessment and disclosure of the benefit corporation’s overall social and environmental performance against a third-party standard allows the company’s shareholders and the public to easily evaluate the company.³⁶ The third-party standard is thus meant to promote due diligence by these two groups. Proponents also argue that consumers will use the third-party standard to differentiate good deeds from good marketing, and thus the standard will improve customer loyalty and facilitate greater investment in benefit corporations.³⁷ Finally, advocates opine that the third-party standard process may result in a market-driven positive feedback loop that rewards companies with

34. *Id.* § 401(a)(2).

35. *Id.* § 102(a). Similar third party standards have been included in a number of the benefit corporation statutes that have been introduced, including those introduced in Iowa, Maine, North Carolina, and Oklahoma. *See* S. Study B. 1188, 86th Gen. Assemb., 2015 Sess. (Iowa 2015); H. Paper 792, 127th Leg., Reg. Sess. (Me. 2015); H.B. 534, 2015 Gen. Assemb., Reg. Sess. (N.C. 2015); H.B. 1039, 55th Leg., 1st Sess. (Okla. 2015).

36. CLARK & VRANKA, *supra* note 20, at 19.

37. *Id.* at 20.

higher standards of corporate governance and levels of overall social and environmental performance.³⁸

II. CORPORATE GOVERNANCE RATING SYSTEMS AS AN ANALOGOUS ENDEAVOR

A. *Institutional Shareholder Services and Corporate Governance*

Researchers, investors, and policymakers commonly hold that the quality of corporate governance can affect a corporation's performance.³⁹ This view is naturally accompanied by a heightened interest in corporate governance⁴⁰ and a concomitant interest in measuring the quality of corporate governance arrangements. The increased attention to corporate governance has incentivized some shareholder advisors to develop governance metrics to inform the investment decisions of institutional investors.⁴¹ Yet efforts to measure are complicated. Institutional Shareholder Services (ISS) is a case study of how such metrics can be exceedingly influential and not an unambiguous force for good. ISS and its subsidiary RiskMetrics operated the Corporate Governance Quotient (CGQ) system⁴²—the most influential shareholder-advisor-developed ranking sys-

38. *Id.*

39. See, e.g., Sanjai Bhagat & Brian Bolton, *Corporate Governance and Firm Performance*, 14 J. CORP. FIN. 257, 267 (2008) (reporting a correlation between various measures of corporate governance and firms' operating performance); Bernard S. Black et al., *Does Corporate Governance Predict Firms' Market Values? Evidence from Korea*, 22 J.L. ECON. & ORG. 366, 410–11 (2006) (reporting evidence that corporate governance is an important factor in predicting the market value of Korean firms).

40. See, e.g., Stijn Claessens, *Corporate Governance and Development*, 21 WORLD BANK RES. OBSERVER 91, 91 (2006) ("Corporate governance . . . has now become a mainstream concern—a staple of discussion in corporate boardrooms, academic meetings, and policy circles around the globe." (italics omitted)); Yair Listokin, *Interpreting Empirical Estimates of the Effect of Corporate Governance*, 10 AM. L. & ECON. REV. 90, 94 (2008) ("Over the last decade, a series of important empirical articles have evaluated the impact of many levers of corporate governance on firm value and performance.").

41. See generally Marco Becht et al., *Corporate Governance and Control* 4–13 (European Corp. Governance Inst., Fin. Working Paper No. 02, 2002), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=343461 (noting the impact of institutional investors' growing presence and the demand for governance-related services).

42. The CGQ had several iterations since its inception. Currently, ISS markets ISS Quickscore 3.0: "QuickScore uses a numeric, decile-based score that indicates a company's governance risk relative to their index or region. A score of 1 indicates relatively lower governance risk, and, conversely, a score of 10 indicates relatively higher governance risk. Companies receive an overall QuickScore and are also assessed across four pillars: Board Structure, Compensation/Remuneration, Shareholder Rights, and Audit & Risk Oversight." See *ISS Quickscore 3.0*, ISS, <http://www.issgovernance.com/governance-solutions/investment-tools-data/quickscore/> (last visited May 21, 2015); see also Mike Sheehan, *There They Go Again: ISS Introduces Yet Another Corporate Governance Measure*, VENABLE, LLP (Feb. 8, 2013), <https://www.venable.com/files/Publication/f9583253-d578-4f7d-9a6f-b35b8c4cd7df/Presentation/PublicationAttachment/a4e4d88c-5208-406a-9292-b917b5148560/ISS-Introduces-Yet-Another-Corporate-Governance-Measure.pdf>.

tem in the world.⁴³ The organization's sway was far-reaching. A 2006 New York Times article, for example, reported estimates that ISS advice affected the "governance decisions of professional investors controlling . . . half the value of the world's common stock."⁴⁴ Moreover, RiskMetrics rated the governance arrangements of more than 7400 companies in more than thirty markets.⁴⁵ These numbers exemplify the level of power that one standard-providing organization can obtain.

ISS gained its initial sway over corporate America through its proxy advisory company. Over the past twenty-five years, institutional shareholders such as mutual funds and pension funds grew dramatically.⁴⁶ During the same period, the United States government expanded the types of issues that must be decided by shareholders to include issues such as board appointments, mergers, stock issuances, and the "say on pay" vote.⁴⁷ Institutional shareholders, which own billions of shares in thousands of public companies,⁴⁸ are thus entitled to vote on tens of thousands of matters every year.⁴⁹ The cost and time associated with researching every item would be exponential. To mitigate this cost, most institutional shareholders hire a third party, a proxy advisory company, to advise them on votes. ISS was able to acquire such a large share of the proxy advice-seeking market because it had the first-mover advantage.⁵⁰ ISS then leveraged its advantage to create its own rating system by which it could justify its proxy decisions.

Investors were not the only ones to rely on these ratings as indicators of the quality of a company's corporate governance; professionals also re-

43. See Robert Daines et al., *Rating the Ratings: How Good Are Commercial Governance Ratings?* 1, 4 (Stanford Law Sch. Law & Econ. Research Paper Series, Working Paper No. 360, 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1152093 (noting that RiskMetrics is the largest commercial rater).

44. Robert D. Hershey, Jr., *A Little Industry with a Lot of Sway on Proxy Votes*, N.Y. TIMES, June 18, 2006, at S3.

45. RISKMETRICS GROUP, INC., REGISTRATION STATEMENT (FORM S-1/A) 91 (2007), available at <http://ir.msci.com/secfiling.cfm?filingID=1047469-07-8328&CIK=1295172> ("Our CGQ ratings currently cover more than 7,400 companies across 34 countries, with underlying data for up to 70 individual corporate governance variables.").

46. Gerald F. Davis, *A New Finance Capitalism? Mutual Funds and Ownership Concentration in the United States*, 5 EUROPEAN MGMT. REV. 11, 12 (2008).

47. See generally Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

48. Luis A. Aguilar, *Institutional Investors: Power and Responsibility*, U.S. SEC. & EXCH. COMM'N (Apr. 19, 2013) http://www.sec.gov/News/Speech/Detail/Speech/1365171515808#.VR7V4_nF.pdf.

49. Charles M. Nathan, *Future of Institutional Share Voting Revisited: A Fourth Paradigm*, HARVARD L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (Sept. 27, 2011) <http://blogs.law.harvard.edu/corpgov/2011/09/27/future-of-institutional-share-voting-revisited-a-fourth-paradigm/>.

50. See generally Birger Wernerfelt, *Brand Loyalty and User Skills*, 6 J. ECON. BEHAV. & ORG. 381 (1985) (stating that as consumer experience with a brand increases, so too does the consumer's reliance upon that particular brand, reinforcing consumer brand loyalty).

lied on corporate governance ratings. Lawyers, for example, advised public company clients on how to manage their CGQ scores for the benefit of their companies.⁵¹ Public companies boasted about their high CGQ scores.⁵² RiskMetrics offered public companies fee-based consulting services for improving their CGQ scores,⁵³ and the popular “Yahoo! Finance” web site included CGQ scores in companies’ online profiles.⁵⁴ Additionally, academics used the CGQ system to measure the quality of firms’ governance arrangements.⁵⁵ Researchers analyzed the link between RiskMetrics’s governance scores and firm performance, tried to assess which the CGQ factors that affected firm valuation, and used companies’ CGQ scores to study governance differences between banking and non-banking firms.⁵⁶ Most relevant, however, is the power that RiskMetrics universally yielded over corporate governance despite a complete lack of corresponding checks or balances.

B. ISS’s Corporate Governance Ratings (The “CGQ”)

The Corporate Governance Quotient (CGQ) was derived from ISS’s Governance Analytics platform.⁵⁷ According to ISS, Governance Analyt-

51. See, e.g., *What’s Your “CGQ” IQ? What Every Corporate Executive Should Know About the Corporate Governance Quotient*, OPPENHEIMER WOLFF & DONNELLY LLP (Jan. 4, 2007), <http://www.oppenheimer.com/News/Default.aspx?id=1410>.

52. See, e.g., Monica Langley, *Want to Lift Your Company’s Ranking on Corporate Governance? Buy the Test*, WALL ST. J., (June 6, 2003, 12:38 AM) <http://www.wsj.com/articles/SB105485006531971100> (revealing that after paying for “premium” corporate-governance services, Aetna released a press release saying “‘Aetna earns high ranking on corporate governance’ with a near-perfect score of 99.7 by ISS, an ‘independent provider of proxy voting and corporate governing services.’”).

53. See U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-07-765, CORPORATE SHAREHOLDER MEETINGS: ISSUES RELATING TO FIRMS THAT ADVISE INSTITUTIONAL INVESTORS ON PROXY VOTING 10 (2007), available at <http://www.gao.gov/new.items/d07765.pdf> (noting that ISS “offers corporate governance consulting services to help clients understand and improve their corporate governance ratings”).

54. Yabing Jiang et al., *Web-Based Corporate Governance Information Disclosure: An Empirical Investigation*, in 4 WEB TECHNOLOGIES: CONCEPTS, METHODOLOGIES, TOOLS, & APPLICATIONS 2479, 2486 (Arthur Tatnall ed., 2010) (“[ISS] provides [corporate governance grades] free on the ‘company profile’ pages on Yahoo Finance (<http://yahoo.finance.com>).”).

55. See, e.g., Craig Doidge, G. Andrew Karolyi, & René M. Stulz, *Why Do Countries Matter So Much for Corporate Governance?*, 86 J. FIN. ECON. 1, 11–12 (2007) (using firms’ CGQ scores as a proxy for the quality of their corporate-governance arrangement); Vidhi Chhaochharia & Luc Laeven, *Corporate Governance Norms and Practices* (European Corp. Governance Inst., Finance Working Paper No. 165, 2007) (studying the relationship between CGQ scores and their components and firm value); Reena Aggarwal & Rohan Williamson, *Did New Regulations Target the Relevant Corporate Governance Attributes?* 21–24 (Feb. 12, 2006) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=859264 (reconstructing the CGQ Index to find correlation between governance and firm value).

56. Aggarwal & Williamson, *supra* note 55, at 21–24.

57. Tamara C. Belinfanti, *The Proxy Advisory and Corporate Governance Industry: The Case for Increased Oversight and Control*, 14 STAN. J. L. BUS. & FIN. 384, 401 (2009).

ics was “a dynamic corporate governance rating tool that helps investors manage investment risk and drive value while also helping corporations perform peer analysis and benchmark their corporate governance practices.”⁵⁸ The system considered sixty-five factors in formulating each U.S. company’s CGQ. The sixty-five rating factors fell into eight different categories: (i) Board, (ii) Audit, (iii) State of Incorporation, (iv) Executive and Director Compensation, (v) Qualitative Factors, (vi) Ownership, (vii) Director Education, and (viii) Charter/Bylaws.⁵⁹ The system then assigned two distinct ratings. One rating compared the company to its industry peer group (for example, travel and leisure, or healthcare equipment and services), while the other compared the company to its relative market index (for example, S&P 500, Mid-Cap 400, or Small Cap 600).⁶⁰ Given the proprietary nature of the system, the weight assigned to each variable and sub variable was always unknown.⁶¹ The organization weighted the variables according to its determination of their relative importance.⁶²

C. *The Trouble with ISS and CGQ*

As ISS grew, criticism of the proxy advisory industry increased. A 2011 white paper from the Center on Executive Compensation, outlines the critiques in three succinct arguments.⁶³ First, the report argues that there are inherent conflicts of interest in the ISS structure.⁶⁴ ISS provided consulting services to the same corporations that are subject to the ISS proxy recommendations. The report states that “[t]his approach creates a vicious cycle in which companies may feel an obligation to patronize ISS for its consulting services in order to obtain favorable proxy voting recommendations on their proposals.”⁶⁵ Next, the report argues that “the lack of transparency of the advisory firms’ analytical models makes it extremely difficult for investors or companies to determine why a proxy advisor has made certain determinations or to correct factual inaccuracies before a vote is held.”⁶⁶ Lastly, the report notes concerns that “inaccurate information is being transmitted to investors.”⁶⁷

58. *Id.*

59. *Id.*

60. *Id.*

61. *Id.*

62. *Id.* (explaining that the relative importance of each variable changes over time and that ISS reserves the right to add or subtract factors from the CGQ, or change a factors weight, based on current corporate governance trends).

63. CTR. ON EXEC. COMPENSATION, A CALL FOR CHANGE IN THE PROXY ADVISORY INDUSTRY STATUS QUO: THE CASE FOR GREATER ACCOUNTABILITY AND OVERSIGHT (2011), available at <http://online.wsj.com/public/resources/documents/ProxyAdvisoryWhitePaper02072011.pdf>.

64. *Id.*

65. *Id.* at 85.

66. *Id.* at 1.

67. *Id.*

The list of grievances against ISS, and its CGQ specifically, is significantly longer. Accusations of conflicts of interest,⁶⁸ faulty analysis, errors or omissions impacting CGQ ratings,⁶⁹ hiring relatively unskilled employees to conduct governance analysis,⁷⁰ being “blatantly opportunistic” in peddling its services,⁷¹ and following the fads of the time instead of developing sound corporate governance policies⁷² abound. Legal scholar Lynn Stout has noted the following:

[T]here is reason to doubt whether ISS analysts have particularly good insight into what makes for ‘good corporate governance.’ Instead, ISS seems to simply follow governance fads and fancies. [For example, ISS’ position on staggered boards and other anti-takeover protections is] extreme . . . and relies on some flawed academic studies that looked only at how anti-takeover protections affected share price around the time a takeover bid was made, and ignores evidence that anti-takeover defenses can enhance share performance measured over longer periods.⁷³

Despite these criticisms, ISS services are still used because, as Delaware Supreme Court Chief Justice Strine explained, “[f]ollowing ISS constitutes a form of insurance against regulatory criticism, and results in ISS having a large sway in the affairs of American corporations.”⁷⁴

68. *E.g.*, Gretchen Morgenson, *How to Succeed on Wall Street, Conflict-Free*, N.Y. TIMES, Dec. 19, 2004, at S3.

69. *See* Langley, *supra* note 52 (quoting Patrick McGurn, ISS Senior Vice-President, as stating that, “occasionally we miss one” and acknowledging that in at least one instance ISS “had not made the [appropriate] disclosures nor check[ed] the reports to see if it had.” McGurn then stated, “We screwed up . . . [and ISS] was embarrassed by the [revealed] operational misstep.”).

70. *See* Paul Rose, *The Corporate Governance Industry*, 32 J. CORP. L. 887, 897 (2007) (“ISS . . . has been known to use relatively unskilled temporary employees to conduct governance reviews”) (citing Eleanor Laise, *Is This the Most Influential Man on Wall Street?*, SmartMoney Mag., Oct. 16, 2002, available at <http://www.smartmoney.com/mag/index.cfm?story+oct02-influential>).

71. Langley, *supra* note 52 (statement of Agilent Technologies Inc.’s General Counsel, Craig Nordlund) (“[I]t would be rating [Agilent] on its corporate governance and that, for a fee of \$16,000, [ISS] could provide guidance [to Agilent] on improving its scores . . . [t]his is blatantly opportunistic. I feel less like we’re getting rated and more like we’re getting pressured to buy another product.”).

72. *See* Joann S. Lublin, *Turning the Tables: RiskMetric’s Head Faces His Day of Shareholder Judgment*, WALL ST. J., June 2, 2008, at C1.

73. Lynn A. Stout, *Why Should ISS Be the New Master of the Corporate Governance Universe?* DOWJONES CORP. GOVERNANCE, Jan. 4, 2006, at 14–15 (guest column).

74. Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (And Europe) Face*, 30 DEL. J. CORP. L. 673, 688 (2005).

III. LESSONS LEARNED FROM ISS AND THEIR APPLICABILITY TO CONCERNS ABOUT THE THIRD-PARTY STANDARD

A. *The Option to Choose a Third-Party Standard*

1. Third-Party Standard Selection Based on Minimal Auditing

One of the primary concerns regarding implementation of a third-party standard is the benefit corporation's ability to choose any third-party standard. Selection of the third-party standard is critical because it allows the benefit corporation to shop around for a third-party standard according to how well a given standard will highlight the corporation's accomplishments and minimize its failures. Presently, the Global Reporting Initiative (GRI), GreenSeal, Underwriters Laboratories (UL), ISO2600, Green America, and B Lab all provide commonly used standards for the use of benefit corporations.⁷⁵ Both GRI and B Lab offer their reporting and assessment tools for free. And while these few companies are the most popular, there are at least 100 more organizations that provide rating services for corporate sustainability practices.⁷⁶

Interestingly, B Lab, the proponent of the Model Legislation, has developed its own standard⁷⁷—much like ISS monopolized the proxy advisory field and subsequently developed the CGQ. According to its website, B Lab's mission is “to use the power of business to solve social and environmental problems.”⁷⁸ To achieve its mission, B Lab promotes the adoption of its Model Legislation, which allows for the formation of benefit corporations, certifies a qualifying corporation as a “Certified B Corporation,” and hosts a database of verified social and environmental performance data for private companies.⁷⁹ “Certified B Corporation” status

75. LYNNE A. WEIKART ET AL., BUDGETING AND FINANCIAL MANAGEMENT FOR NONPROFIT CORPORATIONS 318 (Charisse Kiino et al. eds., CQ Press 2013).

76. The research and consulting firm SustainAbility has conducted a study called “Rate the Raters” that aims “to better understand the universe of external sustainability ratings and to influence and improve the quality and transparency of such ratings.” *Rate the Raters*, SUSTAINABILITY (2010), <http://www.sustainability.com/projects/rate-the-raters>. Thus far the study has been implemented in five phases. Phase one considered the evolution of the corporate sustainability ratings agenda and identified the trends and challenges associated with the ratings process. Phase two was created to illuminate the breadth and depth of the ratings system by inventorying over 100 ratings and their attributes and by surveying global sustainability experts. Phase three uncovered best practices by parsing through the feedback of certain ratings organizations and offers recommendations. Phase four shares SustainAbility's vision for the future of ratings. Lastly, phase five offers four deliverables: Polling the Experts 2012, The Company Perspective, The Investor View, and The Raters Response. For more information about SustainAbility's work, visit <http://www.sustainability.com/projects/rate-the-raters>.

77. *The Non-Profit Behind B Corps*, B LAB, <http://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps> (last visited Dec. 12, 2013). (“B Corps are certified by the nonprofit B Lab to meet rigorous standards of social and environmental performance, accountability, and transparency.”).

78. *Id.*

79. *Id.*

means that the corporation has met B Lab's standards as a socially responsible corporation.⁸⁰ Certification itself, according to the B Lab website, begins with a self-assessment wherein the applicant considers its "overall impact . . . on its stakeholders."⁸¹ B Lab staff accepts the submission with payment, then reviews the self-assessment and any additional supporting documentation.⁸²

More than 794 corporations and limited liability companies have been certified as B Corporations.⁸³ B Lab's website lists these certified B Corporations, maximizing the companies' potential to be profiled and allowing them to promote themselves as such.⁸⁴ The privileges associated with certification thus enhance a corporation's ability to market its goods and services and to attract capital. Yet B Lab's certification process involves auditing only in the loosest sense of the word. In fact, despite relaxed certification standards, B Lab anticipates conducting site visits only once every ten years.⁸⁵ In the interim, the organization relies on self-assessments from the benefit corporations.⁸⁶ The slack certification process also calls into question the likelihood that a benefit corporation could be decertified. The B Lab website does not disclose any procedure by which a failing benefit corporation would lose its certification or whether such a procedure exists.⁸⁷ It is unlikely that a decertification procedure would exist because the act of decertifying a benefit corporation would result in diminished fees for B Lab.

2. First-Mover Advantage

Although the corporate governance industry includes multiple players,⁸⁸ ISS operates to this day with little competitive pressure. An anemic

80. *How to Become a B Corp*, B LAB, <http://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp> (last visited Dec. 12, 2013).

81. *Id.*

82. *Id.*

83. *Find a B Corp*, B LAB, <http://www.bcorporation.net/community/find-a-b-corp> (last visited Dec. 12, 2013).

84. See, e.g., *What makes Greyston Bakery and New Belgium Brewing Best for the World?*, B LAB, <http://www.bcorporation.net/blog/what-makes-greyston-bakery-and-new-belgium-brewing-best-the-world> (last visited June 5, 2015).

85. See *B Lab Visits B Corps in Mexico*, B LAB, <http://www.bcorporation.net/blog/b-lab-visits-b-corps-in-mexico> (last visited June 5, 2015) ("B Lab annually visits 10% of certified companies for an onsite review to maintain the authenticity of the Certified B Corp Seal and verify the accuracy of all the answers in the company's B Impact Assessment.").

86. *Id.*

87. See *How to Become a B Corp*, B LAB, <http://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp> (last visited Dec. 12, 2013).

88. See Rose, *supra* note 70, at 899 ("There are about a half-dozen well-established firms in the U.S. corporate governance industry, and a few others who operate in Asia and Europe." In the U.S., the most significant market players were the Corporate Library and its subsidiary, Board Analyst; Glass Lewis; GovernanceMetrics International; ISS; Proxy Governance, Inc.; and the credit rating agencies, Egan-Jones, Moody's Inc. and Standard & Poor's.).

level of competition means that the organization with a monopoly share is subject to few checks. One of the key reasons that RiskMetrics was subject to such little competition is that it reaped the benefits of being the first mover. The first-mover advantage theory posits that the first group entering a new industry will gain the advantage and then create barriers, which are sometimes insurmountable, for new entrants.⁸⁹

Professors Lieberman and Montgomery published the seminal paper on first-mover advantage.⁹⁰ According to Lieberman and Montgomery, one of the advantages to being the first mover is the network effect.⁹¹ In a separate paper, Lieberman expounds on the network effect, explaining that it occurs when “[t]he positive feedback that is generated causes the market to tip in favor of the firm that emerges as the standard, potentially leading to a winner-take-all market structure In markets with network effects, the leading firm is likely to capture disproportionate returns.”⁹²

Presently, B Lab has garnered some name recognition. If B Lab becomes the leading standard provider, the entire industry will exhibit network effects that will inure to the benefit of B Lab. Benefit corporations by and large would try to fall in line with B Lab’s standards. In other words, if B Lab is able to dominate benefit corporation governance early, the resulting network effects will serve to reinforce its prominence in the industry. In this way, the unspoken rule will be to adhere to the standards promulgated by the most popular entity—likely the first mover—despite the best intentions of forming a competitive market. As with ISS, such a result could foreseeably result in incompetence, self-interested dealing, or both. B Lab is already well on its way to acquiring first-mover status. It has established its place by propping itself up as the go-to company for benefit statutes. B Lab will thus be in a position to chill the market. This is concerning because a disregard for high standards could result in a universally diminished benefit corporation ideal.

89. See generally Gurumurthy Kalyanaram et al., *Order of Market Entry: Established Empirical Generalizations, Emerging Empirical Generalizations, and Future Research*, 14 *MARKETING SCI.* G212, G212 (1995); Roger A. Kerin, et al., *First-Mover Advantage: A Synthesis, Conceptual Framework, and Research Propositions*, 56 *J. MARKETING* 33, 33–34 (1992); Marvin B. Lieberman & David B. Montgomery, *First-Mover Advantages*, 9 *STRATEGIC MGMT. J. (SPECIAL ISSUE: STRATEGY CONTENT RES.)* 41, 41 (1988); David Szymanski et al., *Order of Entry and Business Performance: An Empirical Synthesis and Reexamination*, 59 *J. MARKETING* 17, 17 (1995); Pieter VanderWerf & John F. Mahon, *Meta-Analysis of the Impact of Research Methods on Findings of First-Mover Advantage*, 43 *MGMT. SCI.* 1510, 1510 (1997).

90. See Lieberman & Montgomery, *supra* note 89.

91. *Id.* at 45.

92. Marvin B. Lieberman, *Did First-Mover Advantage Survive the Dot-Com Crash?* 7 (Dec. 2, 2007) (unpublished manuscript), available at http://www.anderson.ucla.edu/faculty/marvin.lieberman/working_papers/InternetFMA.pdf.

3. Confusion from Too Many Standards

Benefit corporation supporters believe that allowing benefit corporations to select their own standards will promote the development of new standards, creating competition among the standard-providing organizations so that the market will find its own equilibrium.⁹³ But this is precisely the problem. The proliferation of standards could easily result in either watered-down standards or standards that are meaningless to the general public. BBWoof, Inc., a Maryland benefit corporation, provides a good example. BBWoof is a typical Certified B Corporation. It sells “eco-friendly pet supplies, Fair Trade items, and merchandise sourced from local and North American companies, with preference given to small manufacturers and minority owned companies.”⁹⁴ BBWoof must utilize a standard that is capable of quantifying the company’s activities.⁹⁵ The “B Consumer Report” on the company website has a composite score of 94.2, an environmental score of 10.7 points earned, with a value of 55 percent.⁹⁶ But the report does not include any information on what these scores mean. Moreover, it is unclear from the report whether the assessment was based on a third-party standard and, if so, what third-party standard was used. The report also fails to disclose exactly how BBWoof’s business affects the environment.

As the BBWoof example illustrates, an increase in the number of standards will precipitate a parallel increase in public confusion. The Model Legislation would have better served states and benefit corporations by providing a small, set number of standards and associating each standard with a specific type of public benefit. Simple regulation, in this case, would facilitate clarity and comprehension.

B. *No Mandatory Benefit Report Verification Process*

1. Need for External Benefit Report Auditing

Benefit corporation statutes and the Model Legislation do not require benefit corporations to have their reports certified or audited.⁹⁷ In contrast, federal laws and regulations require publicly traded companies to facilitate independent financial audits and disclose specified financial and

93. See CLARK & VRANKA, *supra* note 20.

94. *About the Woof*, THE BIG BAD WOOF, <http://www.thebigbadwoof.com/page/aboutwoof?n=aboutbbw&s=aboutwoof> (last visited Dec. 15, 2013).

95. See MD. CODE ANN., Corps. & Ass’ns § 5-6C-08 (West 2015) (“(a) A benefit corporation shall deliver to each stockholder an annual benefit report including: (1) A description of: (i) [t]he ways in which the benefit corporation pursued a general public benefit during the year and the extent to which the general public benefit was created.”).

96. *Benefit Corp Reports*, THE BIG BAD WOOF, <http://www.thebigbadwoof.com/files/My%20B%20Report2011.pdf> (last visited Dec. 15, 2013).

97. *Benefit Corp v Certified B Corp*, BENEFIT CORP. INFO. CTR., <http://benefitcorp.net/what-makes-benefit-corp-different/benefit-corp-vs-certified-b-corp> (last visited Apr. 14, 2015).

non-financial information to shareholders and the general public.⁹⁸ Corporations may also undergo procedural audits to evaluate and assess the corporation's practices and procedures. External auditing in this way is designed to serve a regulatory purpose, ensuring that companies act in a fiscally responsible manner and provide honest disclosures about their financial practices and economic situation. In fact, many firms that are not obliged by law to perform external audits nonetheless contract for such services.⁹⁹ Yet the benefit reports associated with benefit corporations do not undergo nearly as rigorous a review process.¹⁰⁰

The absence of external auditing is especially conspicuous given that benefit corporations purport to act in the public's best interest. Proponents of the status quo argue that mandatory verification was intentionally excluded from the benefit corporation requirements. They compare benefit corporation legislation with securities regulation, arguing that the SEC requires financial reports only for publicly traded companies¹⁰¹ while private companies are regulated by state corporate statutes that do not require audited financial reports.¹⁰² Like private corporations, proponents of the status quo argue, benefit corporations should not be forced to provide audited reports of any sort, especially benefit reports regarding their social and environmental performance.¹⁰³ However, it is precisely because benefit reports make assertions regarding social and environmental performance that they should be audited. Benefit corporations, unlike traditional corporations, owe a duty to the public at large, not just to shareholders. As such, they should be held to a more exacting standard, wherein they are accountable to the general public for both their claims and their outcomes.

2. Accountability for Failure to Perform

The Model Legislation insulates benefit corporations,¹⁰⁴ their officers,¹⁰⁵ and their directors,¹⁰⁶ from any monetary liability for nonfeasance. A corporation could claim to pursue a general or specific public benefit, hoping to garner new business without actually doing so. Supporters of the Model Legislation claim that mandatory verification, defined as

98. See, e.g., *CTR. FOR AUDIT QUALITY, GUIDE TO PUBLIC COMPANY AUDITING 3*, available at <http://www.thecaq.org/docs/for-investors/guide-to-public-company-auditing.pdf?sfvrsn=0>.

99. *Audits, External*, INC.COM, <http://www.inc.com/encyclopedia/audits-external.html>.

100. To be fair, some benefit corporation legislation makes the use of a third party to prepare or audit the annual report mandatory. E.g., CAL. CORP. CODE § 14630(a)(2).

101. CLARK & VRANKA, *supra* note 20, at 25.

102. *Id.*

103. *Id.*

104. See MODEL BENEFIT CORP. LEGISLATION § 305(a)(2) (B Lab, 2013), available at http://benefitcorp.net/storage/documents/Model_Benefit_Corporation_Legislation.pdf.

105. *Id.* at § 303(c).

106. *Id.* at § 301(c).

any process by which the public benefit is authenticated, is undesirable because it would subject benefit corporations, their officers, and their directors to fraud liability for reporting false or misleading information.¹⁰⁷ Even if failure to create a public benefit was actionable, a benefit corporation could avoid fraud liability by omitting any substantive claims from its annual report without repercussions. Because no external agency audits benefit reports, such a maneuver would likely go unnoticed by the general public.

Assuming, *arguendo*, that a claimant chose to bring an action against a benefit corporation for failure to perform, the claimant would likely have little recourse because a buffer—the standard promulgator—stands between the benefit director and any accusation of wrongdoing. The benefit director could easily shift blame to the standard provider for any misrepresentations in the benefit report by claiming that she believed the benefit corporation was following the standards as laid out by the standard promulgator. It is unlikely that the standard creator owes any duty to the standard user¹⁰⁸ or to the institutional investors who rely on the standard in their investment decisions.

3. Costs

Proponents of the Model Legislation claim that any mandatory verification process would be cost prohibitive.¹⁰⁹ In this view, organizations will voluntarily create third-party standards from which benefit corporations can generate a benefit report, but will likely be unwilling to perform verification services at no charge. Because a large annual cost for verification services would impose a financial hurdle on small businesses, adopting mandatory verification would also likely reduce the statute's adoption. However, it is just as likely that the external verification of annual reports would help benefit corporations attract more capital by creating a sort of "bonding mechanism."¹¹⁰ Bonding in this sense would mean that the agent (the benefit corporation) has aligned its incentives completely with the incentives of the principal (the investor) and that there is strong evidence of this alignment in the form of the verified report.¹¹¹ The verified report thus guarantees that the benefit corporation is sincere in its com-

107. CLARK & VRANKA, *supra* note 20, at 25.

108. "Unlike corporate managers, neither institutional investors, as stockholders, nor ISS, as a voting advisor, owe fiduciary duties to the corporations whose policies they seek to influence." Leo E. Strine, Jr., *Towards A True Corporate Republic: A Traditionalist Response to Lucian's Solution for Improving Corporate America* 11 (Harvard John M. Olin Ctr. for Law, Econ., & Bus., Discussion Paper No. 541, 2006), available at http://www.law.harvard.edu/programs/olin_center/papers/pdf/Strine_541.pdf.

109. CLARK & VRANKA, *supra* note 20, at 25.

110. See, e.g., Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976) (discussing bonding mechanisms).

111. This conceptualization of a bonding mechanism would work best if the benefit corporation awarded additional compensation to officers after a successful report audit.

mitment to the benefit corporation model and helps the corporation to garner greater confidence in its claims about environmental and social performance.

C. *Lack of Third-Party Standard Accreditation*

1. Inadequate Corporate Governance and ISS

Without an effective accreditation mechanism, benefit corporation standard-setting organizations will likely follow the same path that ISS and RiskMetrics pioneered. RiskMetrics claimed to conduct over 4000 statistical tests to examine the link between governance variables and sixteen measures of risk and performance.¹¹² This exhaustive study resulted in the CGQ and its sixty-four variables that were weighted according to their correlation with firm risk and prior performance. RiskMetrics would also regularly change its ratings model and weights to reflect current market trends in corporate governance.¹¹³ But outside parties could not independently confirm these studies, resulting in an unreliable system. One study, for example, analyzed the association between CGQ and the recommendations that ISS gave its corporate clients.¹¹⁴ Researchers found that the association was extremely weak, meaning that there was little substantive relation between the CGQ rating and an ISS recommendation.¹¹⁵ The result implied that ISS did not use its own measures when developing voting recommendations for shareholders.¹¹⁶ Clearly, a problem exists when an organization will not rely on the standards and ratings it has created.

The same researchers also analyzed the relationship between CGQ and shareholder voting outcomes.¹¹⁷ They defined the voting outcome as a percentage of votes cast in favor of a proposal or a candidate director.¹¹⁸ The researchers found that when the ISS recommendation was included in the analysis, the coefficient on the CGQ became negative.¹¹⁹ In other words, the higher the CGQ rating, the lower the percentage of votes that were actually cast in favor of the proposal. This means that the CGQ has no statistically significant relationship with voting outcomes. While many corporations sought the ISS/RiskMetrics stamp of approval, the fact of the matter was that the rating score had absolutely no success in predicting firm performance. A thorough accreditation process early on would have

112. Daines et al., *supra* note 43, at 12.

113. *Id.*

114. *See id.* at 40.

115. *Id.* at 42 (“Again the relation between CGQ and ISS recommendations is statistically significant, but substantively small, with a one-point . . . increase in CGQ translating into 0.17 (4.70) percentage-point increase in the probability that ISS recommends a vote for a director.”).

116. *Id.* at 43.

117. *Id.*

118. *Id.*

119. *Id.*

revealed how little the CGQ score could actually predict and thus stymied the rapid growth of the RiskMetrics monopoly.

2. Need for Standard Governance

Standard governance in the form of an effective accreditation mechanism can allow benefit corporations to avoid the pitfalls that the ISS legacy demonstrates. The Model Legislation provides that the open third-party standard must be comprehensive, credible, independent, and transparent.¹²⁰ Advocates argue that the definition of the open standard is sufficient because it accords with the best practice criteria for standard developers used by various international standards organizations, including the American National Standards Institute, the International Standards Organization, and the International Social and Environmental Accreditation and Labeling, as well as regulatory bodies such as the U.S. Federal Trade Commission.¹²¹ In the author's view, however, the open standard is insufficient because it does not impose constraints on standard-setters. This creates the potential for opportunism and inconsistency. Although less precise than a rule, the third-party standard has the potential to constrain in much the same way that a policy does. In other words, lawmakers should formulate third-party accreditation provisions in a way that amounts to a meaningful check on would-be benefit corporations.

Most other groups in the corporate governance space are unable to make policy without undergoing various checks and balances. An example of this is the Administrative Procedure Act (APA) and its rule-making procedures that establish the standards for SEC decisions and create a system for decision-monitoring by third parties.¹²² Likewise, the New York Stock Exchange must abide by the external controls, resulting from Section 19(b)(1) of the United States Securities Exchange Act of 1934¹²³ and Rule 19b-4,¹²⁴ in its rule-making process. These rule-making procedural requirements promote transparency in the decision-making process. Yet the Model Legislation does not curtail the standards promulgators in any similar respect. Absent any restrictions, the standards-promulgating organizations will default to self-regulation. This opens the door to both incompetence and self-interested dealing.

120. *Criteria for Acceptable Third Party Standards*, B LAB, <http://benefitcorp.net/third-party-standards/criteria-for-acceptable-third-party-standards> (last visited May 22, 2015).

121. CLARK & VRANKA, *supra* note 20, at 25.

122. Administrative Procedure Act, 5 U.S.C. § 551 (2000).

123. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78a-78lll).

124. Rule 19b-4 requires the NYSE to file a notice of any rule changes with the SEC. 17 C.F.R. 240.19b-4 (2008).

IV. CONCLUSION

Transparency is a critical component of sound corporate governance.¹²⁵ It can manifest in a number of ways. The Sarbanes-Oxley Act of 2002, for example, requires accurate and timely disclosure to improve transparency.¹²⁶ The OECD Principles of Corporate Governance mandate the “timely and accurate disclosure . . . [of] all material matters regarding the corporation.”¹²⁷ The SEC seeks to correct information asymmetries by requiring all registered public companies to disseminate information to constituents at the same time.¹²⁸ The Business Roundtable, an association of chief executive officers of leading U.S. companies, instructs companies to consider the need for candor and for timely disclosure in any communication with their investors.¹²⁹ Transparency allows stakeholders the opportunity to monitor and exert control over a corporation’s actions. Without transparency, the individuals who make up the corporation are responsible only to themselves and thus run the risk of exhibiting opportunistic and self-serving behavior.¹³⁰

In one form of transparency, the Model Legislation weeds out financial influence by requiring standard-providing organizations to disclose an accounting of their financial supporters. Financial support includes funds such as fees, grants, investments, and in-kind support.¹³¹ Theoretically, these disclosures are available to the public and report financial contributions in sufficient detail to inform the public of all relationships that could possibly present a conflict of interest. Additionally, the reporting arm of the Model Legislation requires the benefit corporation’s annual benefit report to include a statement confessing any connections to the third-party standard, its officers, directors, or material owners, which includes any financial or governance relationships that might affect the credibility of the third-party standard’s objective assessment.¹³² While these efforts are

125. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, 116 Stat. 745 (codified in various sections of 11, 15, 18, 28 & 29 U.S.C.); ORG. FOR ECON. CO-OPERATION AND DEV., OECD PRINCIPLES OF CORPORATE GOVERNANCE (2004) [hereinafter OECD PRINCIPLES], available at <http://www.oecd.org/daf/ca/corporategovernanceprinciples/31557724.pdf>; BUS. ROUNDTABLE, PRINCIPLES OF CORPORATE GOVERNANCE (2012) available at <http://business-roundtable.org/studies-and-reports/business-roundtable-principles-of-corporate-governance-2012/>.

126. See SEC Proposes Additional Disclosures, Prohibitions to Implement Sarbanes-Oxley Act, U.S. SEC. & EXCH. COMM’N, <http://www.sec.gov/news/press/2002-150.htm> (last modified Oct. 16, 2002).

127. See OECD PRINCIPLES, *supra* note 125, at 22.

128. Regulation FD, 17 C.F.R. §§ 243.100–03 (2000).

129. See BUS. ROUNDTABLE, *supra* note 125.

130. See, e.g., Note, *Mechanisms of Secrecy*, 121 HARV. L. REV. 1556 (2008) (examining the interplay between secrecy, transparency, and agency costs).

131. See MODEL BENEFIT CORP. LEGISLATION § 102 (B Lab, 2013), available at http://benefitcorp.net/storage/documents/Model_Benefit_Corporation_Legislation.pdf.

132. *Id.*

laudable, the lessons of ISS indicate that they may not be enough to establish an effective level of transparency.

ISS was allowed to manage its corporate governance ratings operations free from any market or regulatory checks. The lack of transparency in ISS's operations produced several valuable lessons. First, the lack of transparency meant that no third party could adequately monitor the system. Therefore, ISS's clients were handicapped in their ability to obtain the information they needed to effectively monitor the company and make their own business decisions. Because the company was immune from scrutiny, there was also no incentive for ISS to correct or improve any system deficiencies—system deficiencies that resulted in a great deal of misinformation. Stakeholders, then, are required to trust that ISS is doing its job ethically and effectively.

Third-party standard providers for benefit corporations will likely acquire the same level of success as ISS. Consequently, the public should be leery of encountering the same concerns, specifically, a lack of transparency, including undefined analytic models, inaccurate and incomplete information, and conflicts of interest. Going forward, the public should also be especially mindful of standard-providing organizations that also sell consulting services. As more states pass benefit corporation legislation, it is imperative that these issues be addressed and that solutions be proposed. Lax and uneven implementation of the third-party standard could mean that benefit corporation regulation, despite being a noble cause, quickly becomes defunct or, worse, meaningless. To preserve the power of business to solve social and environmental problems, we must address the appropriateness of the option to choose a third-party standard, the absence of a benefit report verification process, and the lack of third-party standard accreditation.

