CONTRACTUAL STAKEHOLDERISM

Kishanthi Parella[*]

ABSTRACT

In 2019, the Business Roundtable announced its commitment to all *corporate stakeholders—consumers, employees, suppliers, and communities—and not just shareholders. This announcement has reawakened an old debate over corporate social responsibility. Stakeholderism advocates argue that corporate leaders must consider the interests of the various stakeholders impacted by corporate decision-making. Stakeholderism critics challenge this view, expressing concerns that stakeholderism will magnify managerial agency costs, chill regulation, risk inauthenticity, and lead to impractical solutions.*

This Article proposes "contractual stakeholderism" to operationalize stakeholderism in accordance with the views of its advocates but in a way that is attentive to the concerns of its critics. Normatively, it advocates for a shift from a benefits-based approach to stakeholderism to one focused on harms prevention. The former often justifies stakeholderism by highlighting benefits that stakeholder protection can offer the corporation, including advancing shareholder value. But this basis for stakeholderism will fall short because what is good for the stakeholder is not always good for the shareholder; instead, sometimes their interests conflict. In these situations, the benefits-based approach will inevitably lead to the prioritization of the shareholder over the stakeholder. To address this shortcoming, this Article advocates for a harms-based approach that focuses on the risks that a corporation's activities create for stakeholders. This approach applies to a wider range of corporate activity and protects a broader range of stakeholders than does the benefits-based approach. This Article justifies the normative shift to a harms-based approach by identifying five dimensions of inequality that place stakeholders at unique risk of harm from corporate conduct: notice, choice, risk management, legal remedies, and the fruits of exchange. Practically, this Article explains that many stakeholder harms arise from the contracting choices that corporate actors negotiate, draft, and bind their companies to perform. A harms-based approach

[*] Professor of Law, Washington and Lee University School of Law; J.D., LL.M. in International & Comparative Law, Duke Law School; M.Phil. in International Relations, University of Cambridge. For feedback on earlier drafts and broader research agenda, many thanks to Afra Afsharipour, Lisa Bernstein, Carliss Chatman, Josh Fairfield, Sarah Haan, Jonathan Lipson, Ann Lipton, Trang (Mae) Nguyen, Elizabeth Pollman, John Sherman, Felicity Slater, and Alan Trammell and faculty participants at workshops at American University Washington College of Law, University of Connecticut Law School, Villanova Law School, and Washington University School of Law.

would require corporate actors to design these contracts differently to mitigate or eliminate risks to stakeholders. To incentivize such contract design, this Article concludes by proposing the following tort duty: Corporations, as contracting parties, must take into account stakeholders' interests when performance of the contract creates a risk of harm to them.

CONTENTS

INTRODUCTION 868
I. THE LIMITS OF THE BENEFITS-BASED APPROACH TO STAKEHOLDERISM 879
A. *What Does It Mean to Protect Corporate Stakeholders?* 880
B. *The Benefits-Based Approach for Stakeholder Protection* 882
C. *The Limits of a Benefits Approach to Stakeholderism: Lack of Interest Convergence Between Shareholders and Stakeholders* 886
D. *The Problem with the Benefits Approach in Practice: Illustrative Examples* 889
II. SHIFTING STAKEHOLDERISM FROM BENEFITS TO HARMS 891
A. *Vulnerabilities in Contracts: Contract Parties vs. Third Parties* 892
B. *Disparities in Risk Acceptance, Management, and Compensation* 893
III. OPERATIONALIZING CONTRACTUAL STAKEHOLDERISM: INTRODUCING A DUTY TO CONTRACT 897
A. *Implementing a Harms-Based Approach to Contracting: Proposing a Duty to Contract* 897
B. *Application of the Duty to Contract to Illustrative Examples* 901
1. Data Privacy 902
2. Labor Abuses in Supply Chains 906
IV. RECONCILING THE STAKEHOLDERISM DEBATE THROUGH THE DUTY TO CONTRACT 909
V. OBJECTIONS 911
A. *Limits of Contract Design* 912
B. *Why Not Regulate?* 918
CONCLUSION 923

INTRODUCTION

When corporations act in the world, the consequences of their actions do not fall only on the corporate leaders who made the decision or the shareholders whose investments may consequently rise or fall. Instead, corporate activity has a long reach, casting a shadow over a corporation's many stakeholders, such as employees, consumers, communities, suppliers, and more. The question is: *Whose interests should a corporation serve?*

We are witnessing a potential shift from "shareholder capitalism"—which prioritizes the interests of a corporation's shareholders—to "stakeholder capitalism," which addresses the interests of a broader segment of society, including consumers, employees, and local communities.[1]

Many have advocated for such a shift, both historically and recently. To begin 2019, Larry Fink, CEO of BlackRock, warned that pursuit of profits is not a substitute for corporate purpose and that "society is increasingly looking to companies, both public and private, to address pressing social and economic issues."[2] The same year, the Business Roundtable—an association of CEOs of major U.S. businesses[3]—created waves when it announced a new statement on corporate purpose, which recognized that "[e]ach of our stakeholders is essential" and which committed to "[d]elivering value to our customers," "[i]nvesting in our employees," "[d]ealing fairly and ethically with our suppliers," "[s]upporting the communities in which we work," and "[g]enerating long-term value for shareholders."[4] The CEOs of nearly 200 of America's largest companies signed the statement;[5] its current signatories include 3M, Salesforce, Raytheon, Pfizer, Lockheed Martin, Morgan Stanley, IBM, Home

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1 *See* Klaus Schwab & Peter Vanham, *What Is the Difference Between Stakeholder Capitalism, Shareholder Capitalism and State Capitalism?*, WORLD ECON. F. (Jan. 26, 2021), https://www.weforum.org/agenda/2021/01/what-is-the-difference-between-stakeholder-capitalism-shareholder-capitalism-and-state-capitalism-davos-agenda-2021/ [https://perma.cc/3SHL-ZZ7T].

2 Letter from Larry Fink, Chairman & CEO, BlackRock, to CEOs (2019), https://www.blackrock.com/americas-offshore/en/2019-larry-fink-ceo-letter [https://perma.cc/F26M-A7SA] ("Purpose unifies management, employees, and communities. It drives ethical behavior and creates an essential check on actions that go against the best interests of stakeholders.").

3 *About Us*, BUS. ROUNDTABLE, https://www.businessroundtable.org/about-us [https://perma.cc/T5XP-TGMP] (last visited Mar. 16, 2022).

4 BUS. ROUNDTABLE, STATEMENT ON THE PURPOSE OF A CORPORATION 1 (2021), https://s3.amazonaws.com/brt.org/BRT-StatementonthePurposeofaCorporationJuly2021.pdf [https://perma.cc/7C9N-WLJP].

5 Press Release, Bus. Roundtable, Business Roundtable Redefines the Purpose of a Corporation to Promote 'an Economy That Serves All Americans' (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans [https://perma.cc/6AUG-RSGZ].

Depot, Coca-Cola, and Ford.[6] Following the statement's release, the World Economic Forum issued its Davos Manifesto 2020, which began by recognizing the following: "The purpose of a company is to engage all its stakeholders in shared and sustained value creation. In creating such value, a company serves not only its shareholders, but all its stakeholders – employees, customers, suppliers, local communities and society at large."[7]

Despite this support, the Business Roundtable's statement has restarted an old debate regarding the purpose of the corporation and the worth of its stakeholders. While this is an old and familiar battleground,[8] this Article focuses on the recent debate that has coincided with or followed the Business Roundtable's statement.

Those advocating for stakeholderism argue that "[t]he purpose of business is to profitably solve the problems of people and planet, and not profit from causing problems."[9] But defining corporate purpose is not enough: "[A] purposeful business will also ensure that measures are in place to ensure accountability within the business for remaining faithful to its purpose and for ongoing monitoring and reporting of delivery of the purpose."[10]

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[6] BUS. ROUNDTABLE, *supra* note 4, at 2-15 (listing signatories); *see also* Letter from Andrew Ninian, Dir. of Stewardship & Corp. Governance, The Inv. Ass'n, to Chair, FTSE 350, at 1 (Apr. 7, 2020), https://www.theia.org/sites/default/files/2020-04/Letter%20to%20FTSE%20Chairs%20-%20April%202020_0.pdf [https://perma.cc/42W6-LJAY] ("[W]e favour companies that can demonstrate they are well run and take a long-term view of how they treat their employees, communities, suppliers, pension savers and customers.").

[7] Klaus Schwab, *Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution*, WORLD ECON. F. (Dec. 2, 2019), https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/ [https://perma.cc/XCC4-7MVU].

[8] *See, e.g.*, E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1148 (1932); Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 32, 33; Capitalisn't, *Shareholders vs. Stakeholders*, CHI. BOOTH REV., at 00:59 (Aug. 29, 2019), https://www.chicagobooth.edu/review/capitalisnt-shareholders-vs-stakeholders [https://perma.cc/9UNR-QJZE] ("[W]e're going to dispel the notion that this stakeholder/shareholder primacy debate is something that's just bubbling up now or something that bubbled up in the 1970s. In fact, it has a much longer history than that.").

[9] BRIT. ACAD., PRINCIPLES FOR PURPOSEFUL BUSINESS 16 (2019).

[10] *Id.* at 17; *see also, e.g.*, MARTIN LIPTON, STEVEN A. ROSENBLUM, SABASTIAN V. NILES, SARA J. LEWIS & KISHO WATANABE, WACHTELL, LIPTON, ROSEN & KATZ; MICHAEL DREXLER, WORLD ECON. F., THE NEW PARADIGM: A ROADMAP FOR AN IMPLICIT CORPORATE GOVERNANCE PARTNERSHIP BETWEEN CORPORATIONS AND INVESTORS TO ACHIEVE SUSTAINABLE LONG-TERM INVESTMENT AND GROWTH 1 (2016) ("[T]he New Paradigm recalibrates the relationship between public corporations and their major institutional investors and conceives of corporate governance as a collaboration among corporations, shareholders and other stakeholders working together to achieve long-term value and resist short-termism."); Martin Lipton, *Directors Have a Duty to Look Beyond Their Shareholders*, FIN. TIMES (London), Sept. 18, 2019, at 11 [hereinafter Lipton, *Directors' Duty*] (arguing that to mitigate societal costs of corporate activity, "directors have the ability, and in many instances the obligation, to use their reasoned business judgment to balance the interests of

Others are more critical of stakeholderism and challenge it on at least four separate grounds: *managerial agency costs*, *regulatory consequences*, *inauthentic commitments*, and *impractical solutions*, among others. Some fear that stakeholderism may magnify the problem at the core of corporate governance: *managing agency costs*.[11] Shareholders already struggle with ensuring that corporate leaders act in the shareholders' interest.[12] Stakeholderism may grant corporate leaders even greater discretion so that "directors' and officers' accountability would become rather problematic."[13] Another fear is that stakeholderism may *chill meaningful regulation* of corporations.[14] This second fear is based on the particular moment in which we find ourselves: skepticism of corporations is great and demand for regulation is

all stakeholders"); Martin Lipton, *Purpose, Stakeholders, ESG and Sustainable Long-Term Investment*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 24, 2019), https://corpgov.law.harvard.edu/2019/12/24/purpose-stakeholders-esg-and-sustainable-long-term-investment/ [https://perma.cc/JYZ2-Z7LL] (outlining key stakeholder governance advice for corporate officers and boards).

[11] *See, e.g.*, Matteo Gatti & Chrystin Ondersma, *Can a Broader Corporate Purpose Redress Inequality? The Stakeholder Approach Chimera*, 46 J. CORP. L. 1, 9 (2020) ("Without specific mandates to corporations and without enforcement mechanisms, these measures do little more than increase managerial discretion."); Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 165 (2020) ("[S]upport for stakeholderism may well be strategic: an attempt to advance a managerialist agenda dressed in stakeholder clothing to make it more appealing to the general public . . . ."); Dorothy S. Lund, *Corporate Finance for Social Good*, 121 COLUM. L. REV. 1617, 1636 (2021) ("[I]t is possible that some management teams would use their enhanced discretion to waste money or maximize their private benefits, leading to economic harm—if not now, then at some time in the future.").

[12] *See, e.g.*, Renee M. Jones, *Law, Norms, and the Breakdown of the Board: Promoting Accountability in Corporate Governance*, 92 IOWA L. REV. 105, 118-19 (2006) ("Because of the flaws in shareholder voting and market discipline as accountability mechanisms, the shareholder lawsuit represents the only forum corporate law provides through which directors could be held to account for poor decisions or oversight failures. Unfortunately, the 'no liability' rule has stripped the shareholder suit of this potential power. The business judgment rule, the special litigation committee, and the demand requirement all work to spare directors of the need to justify their actions." (footnotes omitted)); Jessica Erickson, *The Gatekeepers of Shareholder Litigation*, 70 OKLA. L. REV. 237, 237-38 (2017) (explaining that "[s]hareholder litigation is a key tool in controlling . . . agency costs" but that it is also vulnerable to its own agency cost challenges because "[m]ost shareholder plaintiffs lack sufficient incentives to closely monitor the[] lawsuits" so that "plaintiffs' attorneys can make litigation decisions that benefit themselves at the expense of their shareholder clients").

[13] Gatti & Ondersma, *supra* note 11, at 20.

[14] *See, e.g.*, Bebchuk & Tallarita, *supra* note 11, at 171-73 ("Given that the adoption of law, regulations, and policies is the main avenue through which corporate externalities on stakeholders can be effectively addressed, it is important to consider the potential effect of embracing stakeholderism on the prospects of such reforms. . . . [E]mbracing stakeholderism should be expected to impede such reforms."); Capitalisn't, *supra* note 8, at 31:21 ("I think that [the Business Roundtable statement] was meant to distort regulation or prevent regulation that would better align the objectives of corporations with the community at large.").

high.[15] A poor corporate track record on climate change, data security, executive compensation, workers' rights, and consumers' rights has fueled public support for greater regulation of corporate activity.[16] Stakeholderism critics fear that corporate leaders may use stakeholderism to reestablish their legitimacy and prevent regulation.[17]

[15] *See* Elizabeth Warren, Opinion, *Companies Shouldn't Be Accountable Only to Shareholders*, WALL ST. J., Aug. 15, 2018, at A17 (discussing proposed "Accountable Capitalism Act," which would have required "corporate directors to consider the interests of all major corporate stakeholders—not only shareholders—in company decisions"). Senator Warren has not reintroduced the Accountable Capitalism Act in the 117th Congress. *See Legislation Sponsored or Cosponsored by Elizabeth Warren*, CONGRESS.GOV, https://www.congress.gov/member/elizabeth-warren/W000817? (last visited Mar. 16, 2022).

[16] For example, the Indian government adopted stakeholder-oriented legislation to encourage corporations to deliver public goods. Section 135 of the 2013 Indian Companies Act requires that "the board of directors . . . form a [corporate social responsibility ("CSR")] committee of the board, with at least one independent director to formulate and monitor the company's CSR agenda, policy and practices." Afra Afsharipour, *Lessons from India's Struggles with Corporate Purpose*, *in* RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD 363, 372 (Elizabeth Pollman & Robert B. Thompson eds., 2021). The Act also contains a "2 percent spending provision, which requires that large firms meeting specific size or profit thresholds spend at least 2 percent of their net profit on CSR." *Id.* One scholar notes that "much of the CSR spending has been focused on issues of high need for India's nation-building development such as education, health, and sanitation." *Id.* at 375. Additionally, "the Indian government has . . . enacted a stakeholder-oriented approach to board fiduciary duties and mandated sustainability disclosure for India's largest companies." *Id.* at 379.

[17] LIPTON ET AL., *supra* note 10, at 2 ("In a broader context, we hope that the New Paradigm will . . . through voluntary cooperation by corporations and institutional investors, obviate the need for regulation and legislation to enforce a longer-term approach."); *id.* at 7 ("The New Paradigm does not require new legislation or regulation and relies instead on the initiatives, commitments and follow-through of corporations and investors."); Lipton, *Directors' Duty*, *supra* note 10, at 11 ("This solution would be far less intrusive than proposals by presidential candidate Elizabeth Warren to put worker representatives on boards."); *id.* ("We do not need new laws or court decisions allowing well-informed directors to take all stakeholders into account."); Gatti & Ondersma, *supra* note 11, at 10 ("[E]xecutives can deploy stakeholderism defensively—by accepting a nominal change they preempt direct regulation that could truly shift power and resources to weaker constituents."); *see also* Afsharipour, *supra* note 16, at 367 ("The Indian approach to CSR provides an environment where corporations can use their CSR efforts and corporate purpose rhetoric to curry political favor with the state, while the state can use CSR and sustainability rhetoric to politically signal that it values society, even in the face of rising inequality and persistent poverty."); Capitalisn't, *supra* note 8, at 17:16 ("[Billionaire investor Seth] Klarman is saying managers, in excessively being concerned about only shareholders, were actually hurting shareholders because they opened themselves up to too much regulation. And so, in order to better benefit shareholders, they have to pretend, or at least appear, that they are not going to be acting in the interest of shareholders.").

A third fear is that corporate statements favoring stakeholderism are *inauthentic*[18] because, for instance, these statements are vague,[19] many CEOs signed on to the Business Roundtable statement without board approval,[20] director and CEO incentives continue to privilege shareholder welfare,[21] and the stakeholder debate can perpetuate marginalization instead of addressing it.[22] Concerns over inauthenticity are supported by an empirical study that found that "[original] signatories of the [Business Roundtable] statement have higher rates of environmental and labor-related compliance violations . . . despite the . . . statement's specific reference to employees and the environment"[23] and that they "are more likely to pay out labor lawsuit settlements."[24] Another study found that corporate leaders frequently failed to negotiate and include protections for stakeholder groups in acquisition deals with private equity buyers, even in states with stakeholder-friendly constituency statutes.[25] Finally, if stakeholderism *is* authentic, then critics argue that it is *impractical*,[26] forcing

[18] *See* Bebchuk & Tallarita, *supra* note 11, at 108-10 (terming this "instrumental stakeholderism" and arguing that "enlightened shareholder value" version of stakeholderism is conceptual equivalent of traditional shareholder value principles).

[19] *See, e.g.*, *id.* at 127 (criticizing vagueness of Business Roundtable statement); Jill E. Fisch & Steven Davidoff Solomon, *Should Corporations Have a Purpose?* 99 TEX. L. REV. 1309, 1337-39 (2021) (arguing that corporate purpose statements have limited value because "[n]ot only is it unclear what these commitments mean, but it is almost impossible to determine whether they are being met").

[20] Bebchuk & Tallarita, *supra* note 11, at 130-33.

[21] *See id.* at 141 ("The most conspicuous aspect to notice is that, while director compensation practices are designed to align the interests of directors with shareholder interests, they produce no alignment of director interests with the interests of stakeholders.").

[22] *See* Veronica Root Martinez, *A More Equitable Corporate Purpose*, *in* RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD, *supra* note 16, at 47, 59 ("[T]he original arguments about the importance of stakeholders were not arguments rooted in achieving greater racial and gender equality—it appears that they might still have been arguments about how white men should sort out the balance of power amongst them.").

[23] Aneesh Raghunandan & Shiva Rajgopal, Do Socially Responsible Firms Walk the Talk? 2 (Apr. 1, 2021) (unpublished manuscript) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3609056).

[24] *Id.* at 16.

[25] Lucian A. Bebchuk, Kobi Kastiel & Roberto Tallarita, *For Whom Corporate Leaders Bargain*, 94 S. CAL. L. REV. 1467, 1476 (2021) (finding that corporate leaders rarely negotiated for post-deal protections for variety of stakeholders, including employees, creditors, consumers, suppliers, local communities, and environment).

[26] Bebchuk and Tallarita raise this concern through what they term "pluralistic stakeholderism." *See* Bebchuk & Tallarita, *supra* note 11, at 114-15 ("[P]luralistic stakeholderism relies on directors to make the hard choices necessary to define the groups of stakeholders whose interests should be taken into account and then to weigh and balance these interests, which are often difficult to measure, in the vast number of situations in which trade-offs arise."); *see also* Gatti & Ondersma, *supra* note 11, at 19-20 (noting director confusion regarding stakeholder interest prioritization as "recurring critique" of stakeholderism).

corporate directors to engage in impossible trade-offs to balance competing stakeholder interests.[27]

As a result of this debate over stakeholderism, some scholars have attempted to reconcile the differences by arguing that corporate leaders should consider

[27] *See* Bebchuk & Tallarita, *supra* note 11, at 119-23; *The Perils of Stakeholderism*, ECONOMIST, Sept. 19, 2020, at 65, 65 ("[A]mid increasingly polarised politics, what is good for one set of stakeholders may be anathema to another."). *But see* Colin Mayer, *Shareholderism Versus Stakeholderism – A Misconceived Contradiction. A Comment on "The Illusory Promise of Stakeholder Governance" by Lucian Bebchuk and Roberto Tallarita* 5 (Eur. Corp. Governance Inst., Law Working Paper No. 522/2020, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3617847 ("The weight that is attached to different impacts is determined by the values that are ascribed to them, not simply their financial value. By seeking to translate everything into monetary terms, a shareholder perspective does not, as is often claimed, simplify management by promoting just one objective instead of many, but complicates it by requiring the incommensurable to be made commensurable.").

stakeholder interests as part of their fiduciary duties.[28] Others have proposed reforms that could help incentivize corporate leaders to protect stakeholders.[29]

[28] *See, e.g.*, Lund, *supra* note 11, at 1626 ("There is a growing consensus that corporations could make public-interested decisions if they wanted to: Legal scholars defend a view of fiduciary obligation that would allow directors and officers to make public-interested choices, even those that sacrifice corporate profits."); Leo E. Strine, Jr., Kirby M. Smith & Reilly S. Steel, Caremark *and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective* Caremark *and EESG Strategy*, 106 IOWA L. REV. 1885, 1889 (2021) ("By engaging in a thoughtful updating and integration of existing regulatory reporting and compliance and [environment, employee, social, and governance ("EESG")] processes, corporate leaders can efficiently generate robust information about their EESG performance and legal compliance to share with stakeholders and simultaneously fulfill their duty to monitor the corporate enterprise."); Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401, 1459 (2020) ("[C]ourts should recognize [environment, social, and governance ("ESG") considerations] as an essential part of boards' monitoring mission."); Matthew T. Bodie, *Employment as Fiduciary Relationship*, 105 GEO. L.J. 819 *passim* (2017) (arguing that employers owe fiduciary and quasi-fiduciary duties to employees); Kent Greenfield, *The Third Way*, 37 SEATTLE U. L. REV. 749, 751 (2014) (arguing that it would violate fiduciary duties "to prioritize one stakeholder over others consistently and persistently or to fail to consider the interests of all stakeholders in significant corporate decisions"); Andrew Johnston, *Facing Up to Social Cost: The Real Meaning of Corporate Social Responsibility*, 20 GRIFFITH L. REV. 221, 236 (2011) ("[D]irectors' duty to act in good faith . . . should be reformed to require the directors to take action that is capable of producing returns for the shareholders while internalising the externalities of which they become aware in the course of management."); Marleen A. O'Connor, *Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69 N.C. L. REV. 1189, 1194 (1991) (proposing "stakeholder model of corporate social responsibility" that "expands directorial fiduciary duties to encompass actions that shield workers from disruptions brought about by plant closings and other corporate changes"). *But see* Gatti & Ondersma, *supra* note 11, at 9 ("[A]ll existing proposals to broaden the scope of fiduciary duties to cover weaker constituencies are absolutely vague on the actual measures or initiatives the board should undertake to benefit such constituencies."). Some scholars also point out that shareholders are often the parties who advance stakeholder-oriented objectives. *See, e.g.*, Cathy Hwang & Yaron Nili, *Shareholder-Driven Stakeholderism*, U. CHI. L. REV. ONLINE (Apr. 15, 2020), https://lawreviewblog.uchicago.edu/2020/04/15/shareholder-driven-stakeholderism-hwang-nili/ [https://perma.cc/4HFM-NXH5] ("[I]t seems that shareholders play an enormous role in influencing companies to adopt the ESG-related policies that are often aligned with stakeholder theory."). *See generally* HEIDI WELSH & MICHAEL PASSOFF, AS YOU SOW, PROXY PREVIEW 2020 (2020) (identifying hundreds of shareholder resolutions addressing topics as varied as human rights, climate change, gun control, board diversity, and corporate governance).

[29] *See* Veronica Root Martinez & Gina-Gail S. Fletcher, *Equality Metrics*, YALE L.J.F. 869, 875-76 (2021) (proposing that institutional investors should pressure corporations to adopt "equality metrics," which are "systematized corporate disclosure[s] of the current demographic diversity of the workforce and supply chain, as well as measurable, specific plans to improve racial equity" and that "firms should (i) measure the state of (in)equality in their organizations and supply chains; (ii) identify a list of specific, assessable equality goals; (iii) implement policies and procedures aimed at achieving those goals that can be tested and measured; (iv) disclose their progress toward meeting these goals at regular intervals; and (v) use their own and others' measured performances on these metrics to direct their future

This Article offers its own proposal for operationalizing stakeholderism in a way that is attentive to many well-founded concerns of its critics. *Normatively*, this Article proposes shifting the normative foundation of stakeholderism from *receipt of benefits* to *prevention of harms*. Many arguments in favor of stakeholderism rest upon a benefits-based approach encompassing a diversity of views on the benefits—to a corporation, specifically, or society, generally—that result from stakeholder protection. The appeal of a benefits-based approach is obvious. For example, some proponents of the "business case" for stakeholderism explain how protecting the interests of nonshareholders can increase company value.[30] Others favor transparency laws that improve access to information on environmental, social, and governance ("ESG") practices for both stakeholder and shareholder audiences because informed stakeholders can help sanction corporate actors for undesirable conduct, thereby helping to align corporate practices with societal expectations.[31] While these views are certainly not substitutes for each other, they share a common expectation that stakeholder-centric reforms will ultimately bring about certain important benefits—to shareholders, society, or both. The value of these approaches is that they illuminate how stakeholder protection advances objectives for other

efforts at creating a more equitable organization"). *But see* Gatti & Ondersma, *supra* note 11, at 70 ("[T]he reasons that employees, consumers, and other weaker constituents have lost power and resources do not likely stem from any corporate governance changes, but rather from problems such as increased market concentration, weakening of labor market institutions, and regressive taxation."). *See generally* Lund, *supra* note 11 (discussing creation of "CSR bonds" that can financially incentivize corporate leaders to take on prosocial but profit-sacrificing projects); Ofer Eldar, *Designing Business Forms to Pursue Social Goals*, 106 VA. L. REV. 937 (2020) (proposing new "social enterprise" legal form as commitment device to attract capital and income from investors and consumers).

30 *See* Fisch & Solomon, *supra* note 19, at 1330 ("If corporate officials are charged with maximizing shareholder value, and the consideration of stakeholder interests enhances shareholder value, then properly informed corporate officials will do so regardless of whether the corporate purpose statement identifies the consideration of such interests as a distinct obligation, and their broad discretion to do so will be protected by the business judgment rule. Indeed, if consideration of stakeholder interests is necessary to maximize shareholder value, corporate officials would be remiss for failing to afford sufficient consideration to those interests." (footnotes omitted)); Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563, 2566 (2021) ("Today many companies pursue ESG goals, and many investors favor ESG funds, not for moral reasons or a prosocial willingness to sacrifice profits, but because ESG is thought to provide sustainable long-term value or higher risk-adjusted returns for shareholders. This reframing has in turn shaped managerial decisionmaking about the kinds of ESG activity in which corporations should engage." (footnote omitted)).

31 Ann M. Lipton, *Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure*, 37 YALE J. ON REGUL. 499, 561-62 (2020); *see also* Elizabeth Pollman, *Corporate Social Responsibility, ESG, and Compliance*, *in* THE CAMBRIDGE HANDBOOK OF COMPLIANCE 662, 668-69 (Benjamin van Rooij & D. Daniel Sokol eds., 2021) (describing various forms of external meta-regulation); Hillary A. Sale, *Public Governance*, 81 GEO. WASH. L. REV. 1012, 1013-14 (2013) (describing shift in corporate governance from "private ordering" to "public governance").

constituencies, including shareholders. The challenge is that these groups' interests do not always converge.[32] Instead, sometimes what is good for a stakeholder may be bad for shareholders—or even other stakeholders. It is important to recognize when a benefits-based approach may fall short. In contrast, a harms-based approach does not depend on the benefits that stakeholder protection brings to a corporation or society but on the risks that unconsenting stakeholders face in the absence of protection.[33] This distinction is important because the harms-based approach may protect stakeholders that a benefits-based approach would not.

Practically, this Article emphasizes the hard fact that many stakeholder harms arise from contracts—namely, the contracting choices that corporate actors negotiate, draft, and bind their companies to perform.[34] We already recognize the ways stakeholders may be harmed directly by the contracts they enter into

[32] Derrick A. Bell, Jr., Brown v. Board of Education *and the Interest Convergence Dilemma*, 93 HARV. L. REV. 518, 523-24 (1980) (developing theory of "interest convergence" and applying it to racial equality: "The interest of blacks in achieving racial equality will be accommodated only when it converges with the interests of whites. . . . Racial remedies may instead be the outward manifestations of unspoken and perhaps subconscious judicial conclusions that the remedies, if granted, will secure, advance, or at least not harm societal interests deemed important by middle and upper class whites. Racial justice — or its appearance — may, from time to time, be counted among the interests deemed important by the courts and by society's policymakers"); *id.* at 524 ("I contend that the decision in *Brown* to break with the Court's long-held position on these issues cannot be understood without some consideration of the decision's value to whites, not simply those concerned about the immorality of racial inequality, but also those whites in policymaking positions able to see the economic and political advances at home and abroad that would follow abandonment of segregation."). This analysis is applicable to the ESG debate regarding the priorities of shareholders and stakeholders. *See, e.g.*, Lund & Pollman, *supra* note 30, at 2614 ("[A]lthough the move to value-enhancing ESG arguably narrowed the range of public-minded activities that companies might pursue, CSR advocates may have been willing to accept the ESG movement, as previous efforts to change corporate behavior had made limited inroads. In other words, in a world anchored to shareholder primacy, advocates of CSR may have realized that many lawmakers and legal advisors would only support reform that was framed as value-maximizing ESG.").

[33] *See, e.g.*, BRIT. ACAD., *supra* note 9, at 16 (explaining that corporate purpose statement "identifies how companies assist people, organisations, societies and nations to address the challenges they face, while at the same time helping companies to avoid or minimise the problems they might cause").

[34] For a discussion of the effects of contract performance on third parties, see generally Aditi Bagchi, *Other People's Contracts*, 32 YALE J. ON REGUL. 211 (2015); David A. Hoffman & Erik Lampmann, *Hushing Contracts*, 97 WASH. U. L. REV. 165, 198-203 (2019); David A. Hoffman & Cathy Hwang, *The Social Cost of Contract*, 121 COLUM. L. REV. 979 (2021); and Andrew Johnston, *Governing Externalities: The Potential of Reflexive Corporate Social Responsibility* (Univ. of Cambridge Ctr. for Bus. Rsch., Working Paper No. 436, 2012). For a discussion of the negative externalities that private social impact investing imposes on targeted communities due to limited community participation, see generally Cary Martin Shelby, *Profiting from Our Pain: Privileged Access to Social Impact Investing*, 109 CALIF. L. REV. 1261, 1265-66, 1285-86 (2021).

with corporations. This awareness has raised concerns over contracting practices and bargaining power, information asymmetries, and informed consent. In contrast, this Article focuses on contracts to which stakeholders are *not* parties but third parties. Even if they are not signatories, contracts can still injure these stakeholders *as third parties* in myriad ways. For example, a supply contract between an American retailer and an overseas garment manufacturer can impose costs on two types of stakeholders: (a) employees of the American retailer who may face the risk of layoffs and (b) employees of the overseas supplier who may face enhanced labor risks as a result of the contract's terms. These stakeholders are placed at risk because of the terms of the contract between the retailer and the supplier. Third parties' vulnerability also raises a distinct set of concerns regarding contracting from those raised when they are contract signatories. Specifically, it alerts us to five dimensions of inequality that place stakeholders at unique risk of harm from corporate conduct: *notice*, *choice*, *risk management*, *legal remedies*, and the *fruits of exchange*. Only by changing contracting practices do corporations protect stakeholders in a meaningful way.

The problem is incentives. As third parties, stakeholders are not at the bargaining table when contract terms are negotiated and drafted. Those at the negotiating table—in this case, corporate leaders—encounter little incentive to consider interests beyond shareholders' or their own.[35] As a result, contracts often neglect the interests of a range of stakeholders who are at risk of harm once the contract is performed.[36] To supply the missing incentive, this Article proposes the following tort duty: *Corporations, as contracting parties, must take into account stakeholders' interests when performance of the contract creates a risk of harm to them*.[37]

This duty derives from the reality that parties sometimes design contracts negligently. While we frequently keep tort law and contract law distinct, we should recognize how the former imposes limits on the latter. We should expect contract parties to exercise reasonable care in contract design when the anticipated performance creates a risk of harm to those absent from the bargaining table: third parties. This obligation does not arise from the contract itself but from tort law, which commands us all to consider the harmful effects of our conduct on others. *Contracting is conduct*, independent of the acts that it binds the parties to perform. Negligence law thus circumscribes the "freedom of contract" that the contract parties enjoy.

A contractual duty to account for stakeholder interests would apply to *all* contracting parties—not just corporate actors. However, given the severity of

[35] *See* Bebchuk et al., *supra* note 25, at 1525-27 (noting incentives created by shareholder legal rights, executive compensation, and markets for labor and control).

[36] *Id.* at 1524-25.

[37] In previous work, I advocate for a similar duty to address human rights abuses in supply chains. Kishanthi Parella, *Protecting Third Parties in Contracts*, 58 AM. BUS. L.J. 327, 336-37 (2021). In this Article, I pursue two different objectives: (a) a general framework for how this duty can protect stakeholders in a variety of contracts, not just supply contracts, and (b) a harms-based normative foundation for this duty.

impact, diversity of stakeholders, and scale of operations, this Article focuses on contracting choices of corporations as an illustration of the broader contractual duty to third parties. This examination is particularly significant in the context of the debate over corporate purpose because it demonstrates a way to address some of corporations' negative stakeholder impacts. By applying a tort duty to contract design, corporate actors must be mindful of the risks that their contracts create for nonsignatories to the contract. Specifically, they must account for their contract's negative externalities, which "occur[] where a decision is taken that results in an event which has adverse, uncompensated effects on another party who does not consent to it."[38] This analysis is especially significant where applicable regulations do not sufficiently address the negative externalities that the contracts create for corporate stakeholders. It may be less relevant when parties conform their transactions to regulations that address many of the pressing externalities that stakeholders confront.[39] For that reason, this Article applies its analysis to two contexts—data privacy and global supply chains—that illustrate the severe externalities created by corporate conduct that remain inadequately addressed by current regulation.

Collectively, these proposed normative and practical changes offer a "contractual stakeholderism" approach that addresses many concerns of both camps of the stakeholder debate. It addresses the concerns of stakeholderism advocates by proposing a contractual solution for those stakeholder harms that originate within contract design. Through a *duty to contract*, this proposal creates an incentive to protect stakeholders that is otherwise absent. It also addresses two fears of the critics discussed above: *inauthenticity* and *impracticality*. It addresses inauthenticity by making a corporation's commitment to stakeholderism observable and verifiable; if corporate leaders mean what they say, then we should see that commitment demonstrated in the contracts that they write. It addresses impracticality by identifying whose interests count and which interests to privilege, as well as what action is needed—contract design. While not eliminating the burden of balancing interests, the proposed duty relieves much of this burden by providing greater clarity as to what stakeholderism requires of corporate leaders.

[38] Johnston, *supra* note 34, at 1; *see also id.* ("Prima facie, this is a market failure because it results in an inefficient allocation of resources: those who gain the benefits of the activity do not bear all the costs. A portion of the costs are transferred onto other economic agents.").

[39] *See, e.g.*, Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227, 238 (2010) ("On the surface, a typical business deal has only two parties: the buyer and the seller. But conceptually there are three parties, not two, at the negotiating table: the buyer, the seller, and the government—typically acting through statutes and regulations written in advance of the deal. The government imposes regulatory costs on transactions in the form of taxes, securities-law disclosure requirements, antitrust constraints, environmental-compliance obligations, and so on."). However, despite these regulations, parties can still engage in "regulatory arbitrage" as "a perfectly legal planning technique used to avoid taxes, accounting rules, securities disclosure, and other regulatory costs." *Id.* at 229.

This Article proceeds as follows. Part I explains how many stakeholder-oriented views justify stakeholder protection based on the benefits that such protection brings to the corporation. Part I also demonstrates the limitations of a benefits-based approach by introducing a taxonomy that classifies "corporate-stakeholder" interactions based on whether their interests converge, diverge, or conflict. Part II argues in favor of abandoning a benefits basis for stakeholder protection in favor of a normative foundation of harm prevention: corporate actors should protect stakeholders not because it benefits them to do so but because stakeholders will be harmed absent that protection. Part III proposes a duty to contract that can help operationalize the harms-based approach by requiring that corporate actors design contracts to minimize or eliminate risks to stakeholders that would otherwise result from contract performance. This Part provides concrete suggestions for contract design by applying the duty to contract to two illustrative examples involving data security and labor violations in supply chains. Part IV explains how this Article's proposal for "contractual stakeholderism" fulfills the aims of stakeholderism's advocates while simultaneously addressing the concerns of its critics. Finally, Part V addresses two potential objections to the normative and practical suggestions offered in this Article: (a) the limits of contract design to protect stakeholders and (b) the alternative option of public regulation to protect stakeholders.

I. THE LIMITS OF THE BENEFITS-BASED APPROACH TO STAKEHOLDERISM

The justifications for stakeholder protection are important because they can determine the scope, strength, and beneficiaries of that protection. As discussed in this Part, many justifications rest upon a "business case" for stakeholder protection that emphasizes the business benefits that corporations gain from providing such protection. Unfortunately, this type of justification will insufficiently protect stakeholders from corporate harm. Section I.A provides a brief introduction to the stakeholder concept, while Section I.B examines several different strands of benefits-based approaches to stakeholder protection, beginning with the business case. Section I.C explains the limitations of the benefits approach by providing a taxonomy of interests between stakeholders and shareholders: *convergence*, *stalemate*, and *conflict*. The benefits approach may protect stakeholders when their interests converge with those of shareholders; it is less effective when their interests do not. Finally, Section I.D applies the benefits approach to two illustrative examples to demonstrate its limitations.

A. *What Does It Mean to Protect Corporate Stakeholders?*

A corporation's stakeholder is "[a]ny group or individual who can affect or is affected by the achievement of the firm's objectives."[40] Examples of such stakeholder groups include: owners, consumer advocates, customers, competitors, media, employees, suppliers, environmentalists, governments, and local community organizations.[41] According to business scholar R. Edward Freeman, these are all stakeholders of a corporation because "[e]ach of these groups plays a vital role in the success of the business enterprise in today's environment"[42] and "[e]ach . . . has a stake in the modern corporation."[43] Shareholders provide financial capital; employees provide human capital; consumers provide revenue; suppliers provide raw materials, intermediate goods, and finished products (and human capital); governments provide a regulatory framework; and local communities provide the "social license to operate," to name a few.

Given their ability to affect the success of a corporation, one may expect that corporate managers would protect the interests of these stakeholders. Michael Porter and Mark Kramer advocate for "shared value," which refers to the "policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates."[44] Shared value is based on a belief in the interdependence of the well-being of the business organization and the broader environment in which it operates.[45]

If stakeholders matter, then what steps would we expect corporations to take to protect their interests? Let's consider two examples involving corporate stakeholders. In Hypothetical 1, a social media company allows its users to post pictures, videos, and other types of media through an app, which collects additional information such as users' locations, facial recognition data, and online browsing and purchasing practices. The social media company can, and does, sell that information to a number of other companies at considerable profit.[46] The app's users are stakeholders of the social media company because

[40] R. EDWARD FREEMAN, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH 25 exhibit 1.5 (Edwin M. Epstein ed., 1984).

[41] *Id.*

[42] *Id.* at 25.

[43] *Id.*

[44] Michael E. Porter & Mark R. Kramer, *Creating Shared Value: How to Reinvent Capitalism—and Unleash a Wave of Innovation and Growth*, HARV. BUS. REV., Jan.-Feb. 2011, at 62, 66.

[45] *Id.*; *see also* JEFFREY PFEFFER & GERALD R. SALANCIK, THE EXTERNAL CONTROL OF ORGANIZATIONS: A RESOURCE DEPENDENCE PERSPECTIVE 2 (Stanford Univ. Press 2003) (1978) (arguing that "organizations survive to the extent that they are effective" and "effectiveness derives from the management of demands, particularly the demands of interest groups upon which the organizations depend for resources and support").

[46] For example, in *Goldenshores Technologies*, the FTC had brought a complaint against the developer of a free flashlight app alleging that "the company's privacy policy deceptively

they are the ones posting photos and uploading other information about themselves. If they desisted from these activities, the app would fail and, consequently, so would the social media company. Company policies and conduct also impact them, such as the company's decision to sell their personal information to another business.[47] To protect stakeholders, we would expect the social media company to protect the data security of app users by disclosing to users, at registration and routinely after that, all the types of information that the app may collect and the company's planned uses of it, including the possible sale of the information to others (who may then sell it to additional third parties). We might also anticipate that the company would refrain from activities, including sale, that they could expect to be adverse to app users' interests, or

failed to disclose that the app transmitted users' precise location and unique device identifier to third parties, including advertising networks." Press Release, FTC, Android Flashlight App Developer Settles FTC Charges It Deceived Consumers (Dec. 5, 2013), https://www.ftc.gov/news-events/press-releases/2013/12/android-flashlight-app-developer-settles-ftc-charges-it-deceived [https://perma.cc/Q25A-KG5U]. According to the FTC complaint, Goldenshores "represented . . . that [it] may periodically collect, maintain, process, and use information from users' mobile devices to provide . . . services to users related to the Brightest Flashlight App," but "failed to disclose or failed to adequately disclose that, when users run the Brightest Flashlight App, the application transmits, or allows the transmission of, their devices' precise geolocation along with persistent device identifiers to various third parties, including third party advertising networks." Goldenshores Techs., LLC, 157 F.T.C. 700, 705 (2014) (complaint). The FTC also alleged that although the users were given a choice to accept or reject the user license agreement, which contained terms on data collection, "the application transmits or causes the transmission of their device data, including the device's precise geolocation and persistent identifier, even before they accept or refuse the terms of the [agreement]." *Id.* at 704. In May 2020, the New York Attorney General entered into an agreement with Zoom Video Communications after the former investigated significant privacy concerns reported in the media regarding Zoom's videoconferencing technologies, including: (a) "Zoombombing," which involved uninvited participants interrupting conferences; (b) failures to use adequate encryption; (c) collection of Zoom users' data by Facebook, even from users without Facebook accounts; (d) data accessing and unnecessary disclosures by LinkedIn; and (e) leaks of personal information. Letter from Kim A. Berger, Chief, Bureau of Internet & Tech., New York State Off. of the Att'y Gen., to Travis LeBlanc, Cooley LLP (May 7, 2020), https://ag.ny.gov/sites/default/files/nyag_zoom_letter_agreement_final_counter-signed.pdf [https://perma.cc/K5FA-G82D].

[47] *See* Kurt Wagner, *Facebook Shared User Data with Developers Longer than Promised*, BLOOMBERG L. (July 1, 2020, 5:10 PM), https://news.bloomberglaw.com/privacy-and-data-security/facebook-shared-user-data-with-developers-longer-than-promised ("If a user of a third party app was also connected to a Facebook friend through that app, developers are allowed to pull data from both users at once."); Shoshana Zuboff, *You, Me and a Dark New Economic Logic*, FIN. TIMES (London), Jan. 26, 2019, at 26 ("Some cellphone apps record your location as often as every two seconds for sale to third parties. In July 2017, iRobot's autonomous vacuum cleaner, Roomba, made headlines when the company's CEO, Colin Angle, told Reuters about its data-based business strategy for the 'smart home', stating that its stock price increased after its proposal to share free floor plans of customers' homes, scraped from the machine's new mapping capabilities.").

that the company would only engage in those activities subject to app users' express permission.[48]

In Hypothetical 2, a brand company contracts with an overseas supplier to produce brand clothing at a particular price. This price is so low that the overseas supplier engages in hazardous labor practices to turn a profit, including subcontracting to informal production sites, enforcing a longer work day of up to twelve hours, and compromising health and safety precautions at the factory.[49] Suppliers are recognized stakeholders of the company they supply; their employees may also qualify as stakeholders because their welfare can affect the level of reputational risk that a company faces for "sweatshop conditions" overseas. We would expect that corporate actors would desist from using contracting terms once they realize those terms create "sweatshop conditions."

But despite the desirability of these actions, we witness a disappointing lack of them—*even* when corporations recognize that stakeholders are important. This is because it is not enough to identify the importance of stakeholders or even the desirable types of stakeholder protection. Instead, the extent, quality, and nature of that protection depend on its justifications.

B. *The Benefits-Based Approach for Stakeholder Protection*

There are many good justifications for stakeholder protection. The trouble is that these justifications tend to rely on some form of a benefits-based approach in which stakeholders (*Group A*) should be protected because doing so brings some type of benefit—usually to someone else (*Group B*). The clearest example of this approach is the "business case" for stakeholder protection, but it is not

[48] In numerous ways, the opposite is true. *See, e.g.*, Zuboff, *supra* note 47, at 29 ("It has long been understood that capitalism evolves by claiming things that exist outside of the market dynamic and turning them into market commodities for sale and purchase. Surveillance capitalism extends this pattern by declaring private human experience as free raw material that can be computed and fashioned into behavioural predictions for production and exchange.").

[49] In a number of lawsuits, plaintiffs brought claims against retailers for failure to monitor and inspect facilities in their supply chains. *See, e.g.*, Doe I v. Wal-Mart Stores, Inc., 572 F.3d 677, 679-80 (9th Cir. 2009) (affirming dismissal of claims by employees of Wal-Mart's foreign suppliers against Wal-Mart for failure to adequately monitor factory conditions); Rahaman v. J.C. Penney Corp., No. N15C-07-174, 2016 WL 2616375, at *1 (Del. Super. Ct. May 4, 2016) (recounting plaintiffs' allegations that J.C. Penney and others "fail[ed] to ensure safe and healthy working conditions for [certain] garment factory employees"). In *Doe I v. Wal-Mart*, "[p]laintiffs allege[d] that the short deadlines and low prices in Wal-Mart's supply contracts force suppliers to violate [Wal-Mart's] Standards [for Suppliers] in order to satisfy the terms of the contracts." 572 F.3d at 680. Additionally, consumers have brought lawsuits under state consumer protection statutes against companies for failure to disclose the risk of child labor or forced labor in their supply chains. *See, e.g.*, Complaint for Violation of California Consumer Protection Laws at 4, Hodsdon v. Mars, Inc., 162 F. Supp. 3d 1016 (N.D. Cal. 2016) (No. 15-cv-04450) (alleging Mars did not disclose products made with child and slave labor).

the exclusive one. Instead, as discussed below, the category of benefits-based approaches is much broader and includes a greater diversity of arguments.

The first strand is the business case for stakeholder protection, which emphasizes the instrumental value of stakeholders for maximizing shareholder wealth.[50] As scholars have explained:

> [M]aximizing long-term value for shareholders requires paying close attention to the effects of the company's operations on stakeholders. For example, how the company treats employees could well affect its ability to attract, retain, and motivate the members of its labor force; how the company deals with customers could affect its ability to attract and retain them; and how the company deals with local communities or the environment could well affect its reputation and standing in ways that could be important for its success.[51]

Therefore, "to effectively serve the goal of enhancing long-term shareholder value, corporate leaders should take into account stakeholder effects—as they should consider any other relevant factors."[52]

But because stakeholderism is instrumental to achieving other goals, the latter will inevitably limit the strength of the former:

> Whenever treating stakeholders well in a given way would be useful for long-term shareholder value, such treatment would be called for under either enlightened shareholder value or "old-fashioned" shareholder value. And whenever treating stakeholders well would not be useful for long-term shareholder value, such treatment would not be called for under either enlightened shareholder value or old-fashioned shareholder value.[53]

Critics point to the fact that director and CEO incentives continue to privilege shareholder welfare as support for their prediction.[54]

Other scholars emphasize the risk management function of ESG: consultation with stakeholder groups can inform management of potential social risks that

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[50] *See* Bebchuk & Tallarita, *supra* note 11, at 97.

[51] *Id.* at 109.

[52] *Id.*

[53] *Id.* at 110; Lucian Bebchuk & Roberto Tallarita, *'Stakeholder' Capitalism Seems Mostly for Show*, WALL ST. J., Aug. 7, 2020, at A15 ("[Corporate leaders] can be expected to protect other stakeholders only to the extent that doing so would not hurt share value.").

[54] *See* Bebchuk & Tallarita, *supra* note 11, at 146 ("[T]he labor and control markets do not provide directors with any incentives to protect or benefit stakeholders. Unlike shareholders and management, though, stakeholders play no role in and have no power with respect to the selection or removal of directors. They have no voting rights and no other tool to influence the election of directors."); Fisch & Solomon, *supra* note 19, at 1320 (noting that "corporate law vests shareholders with some decision-making authority, through their power to elect directors and vote on certain structural issues such as mergers and bylaw and charter amendments"); Lund, *supra* note 11, at 7-10 (discussing disincentives for prosocial goals created by takeover markets, hedge fund activism, and executive compensation).

may jeopardize the corporation and, by extension, shareholder interests.[55] They argue that it enables superior risk oversight compared to other monitoring mechanisms because sustainability (a) examines issues broader than legal risk, thereby identifying problems that may mature into misconduct;[56] (b) involves consultation with a broader set of individuals who may possess unique information;[57] (c) encourages information sharing because of its emphasis on prevention through nonconfrontational approaches as opposed to sanctions for past conduct;[58] and (d) builds trust between the company and its stakeholders.[59]

But the business case is *not* the only form of a benefits-based approach. Instead, the category of benefits-based arguments includes the business case and other types of arguments that justify stakeholder protection based on the benefits that such protection will bring—to the corporation, society, or both. Some of these arguments have done substantial work in challenging the primacy of shareholder-centric considerations. However, because the touchstone of these approaches is some *benefit*, they risk establishing a circle of care that leaves some injured by corporate conduct on the outside.

One strand of scholarship views stakeholders as valuable in themselves but still justifies their protection based on the benefits they bring to the corporation.[60] The "team production" school of corporate law argues that "[i]n reality, the public corporation is not so much a 'nexus of contracts' (explicit or implicit) as a 'nexus of firm-specific investments,' in which several different groups contribute unique and essential resources to the corporate enterprise, and who each find it difficult to protect their contribution through explicit contracts."[61] The lack of visibility of these different groups' contributions often

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[55] *See, e.g.*, Gadinis & Miazad, *supra* note 28, at 1426 ("[B]y operationalizing their commitment to [ESG] values, companies are also seeking to avert the reputational uproar, stock price drop, and legal troubles following misconduct.").

[56] *See id.* at 1426-30.

[57] *See id.* at 1430-35.

[58] *See id.* at 1435-40.

[59] *See id.* at 1440-48; *id.* at 1466 ("[A] board that completely fails to operationalize sustainability is simply exposing its shareholders to much greater risk than they would otherwise have faced. . . . Thus, developing an ESG function and providing the company with a mechanism for early risk discovery and prevention is an imperative for directors and officers, who should find themselves in bad faith if they fail to act.").

[60] *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 250 (1999) ("Our analysis rests on the observation—generally accepted even by corporate scholars who adhere to the principal-agent model—that shareholders are not the only group that may provide specialized inputs into corporate production. Executives, rank-and-file employees, and even creditors or the local community may also make essential contributions and have an interest in an enterprise's success." (footnote omitted)).

[61] *See id.* at 275; *see also* Tamara Belinfanti & Lynn Stout, *Contested Visions: The Value of Systems Theory for Corporate Law*, 166 U. PA. L. REV. 579, 600 (2018) ("Business corporations consist of separate yet interconnected elements, including human capital (employees, executives, directors), financial capital (funds raised from operations and from

leads to the elevation of shareholders over other stakeholders: "Fixating on the contributions of only one of these groups—shareholders—blinds us to the essential investments of the others and encourages management to prioritize shareholder interest alone."[62] Therefore, it is important to recognize how each member of the "team" contributes to the corporation's success, and boards of directors should serve as a "mediating hierarch" that balances the interests of all those who make firm-specific contributions to the corporation.[63] However, this leads to the inclusion of some stakeholders but not others. For example, some scholars prioritize employee interests:

> The non-separable inputs within team production really belong to employees and shareholders. Shareholders provide capital that is taken within the firm and turned into discretionary funds. Employees work together under the aegis of the firm to produce goods or services in a manner that generally cannot be separated out to assign specific values. . . . Employees and shareholders are part of that team production process in a way that stakeholders outside the firm are not.[64]

By no means are these views substitutes for one another. However, they share a belief that stakeholder protection will ultimately generate certain important benefits—to shareholders, society, or both. As such, they all represent different

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equity and debt investors), and physical capital (plant and equipment, inventory). Each element is distinct and serves a distinct purpose. For example, directors and officers supply managerial expertise; employees supply labor; the physical plant produces goods for sale; and financial capital purchases the labor and raw materials needed to produce more goods. These elements do not exist in isolation vis-à-vis each other. They are interconnected, influencing each other in ways that allow them to operate as a unified whole, separate and apart from their individual selves.").

[62] Greenfield, *supra* note 28, at 761.

[63] *See* Blair & Stout, *supra* note 60, at 271 ("When the potential for shirking and rent-seeking is especially pronounced, team members as a group might prefer to relinquish control over both the team's assets and output to a third party—a 'mediating hierarch'—whose primary function is to exercise that control in a fashion that maximizes the *joint welfare of the team as a whole*."); *cf. id.* at 266 ("Team production . . . poses a difficult problem when it comes to designing efficient incentives. If the team members agree in advance to allocate any profits according to some fixed sharing rule, obvious free-rider problems arise: Each team member will have an incentive to shirk, since he will get the same share of the total whether or not he works hard. On the other hand, if the team members have no fixed sharing rule but simply agree to allocate rewards after the fact, when the time comes to divvy up the surplus all have incentives to indulge in wasteful rent-seeking, squandering time and effort haggling and trying to grab a larger share of the total output. The result in either case is suboptimal." (footnote omitted)).

[64] Grant M. Hayden & Matthew T. Bodie, *The Corporation Reborn: From Shareholder Primacy to Shared Governance*, 61 B.C. L. REV. 2419, 2456-57 (2020) (footnotes omitted); *see id.* at 2473-76.

variants of a "benefits-based approach" to stakeholderism that, as discussed below, may ultimately fail to protect stakeholders in important ways.[65]

C. *The Limits of a Benefits Approach to Stakeholderism: Lack of Interest Convergence Between Shareholders and Stakeholders*

The main limitation of a *benefits approach* to stakeholderism is that, in many situations, stakeholder protection does *not* benefit the corporation. If it were in a corporation's interest to protect its stakeholders, then the social media company would *not* sell app users' data for profit,[66] and the clothing company would *not* dictate price terms so low so as to create risks of physical harms to the workers at its overseas factories.[67] Corporations fail to protect even significant stakeholders because, sometimes, the corporation may benefit from their exploitation. Otherwise, we would likely observe corporations acting differently than they currently do.

The root of this limitation is the lack of interest convergence between corporate actors and stakeholders.[68] What is good for the stakeholder is not always good for the company.[69] Instead, stakeholder dynamics can fall within at least three plausible scenarios. The effectiveness of the benefits approach depends on which of these scenarios accurately describes a particular interaction between a corporation and its stakeholders. As illustrated below in Figure 1, the benefits approach may be sufficient to justify stakeholder protection in Scenario 1, but becomes increasingly inadequate as we move along the spectrum to Scenarios 2 and 3.

[65] *See* Lund & Pollman, *supra* note 30, at 2631 ("[T]ying the consideration of stakeholder welfare to long-term shareholder value limits acceptable rationales and favors activity that can be reduced to measurable metrics tied to risk or financial value. It also renders the promotion of stakeholder welfare that cannot be justified as benefitting shareholders as outside the bounds of acceptable corporate activity, no matter the overall welfare benefits.").

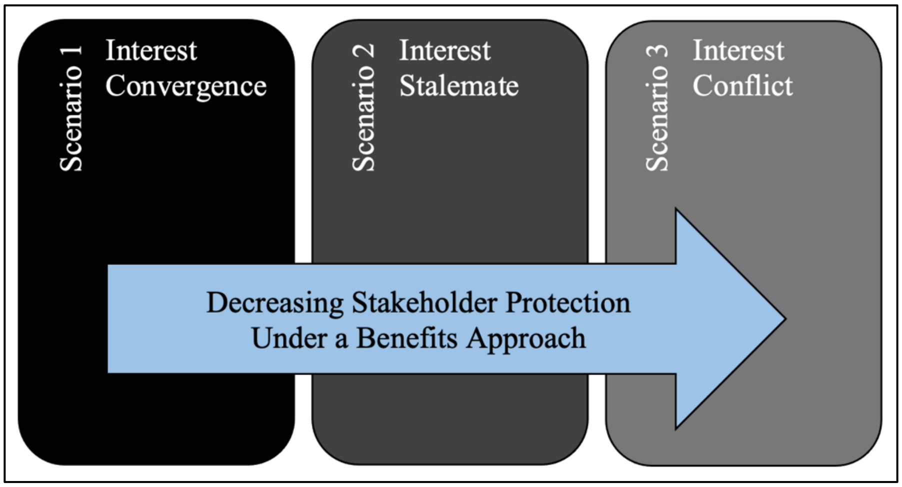
[66] For an illustration of this hypothetical scenario, see *infra* Section III.B.1.

[67] For an illustration of this hypothetical scenario, see *infra* Section III.B.2.

[68] *See* Bell, *supra* note 32, at 523; Lund & Pollman, *supra* note 30, at 2609-12.

[69] *See* Lund, *supra* note 11, at 7-10.

Figure 1. Stakeholder Protection Based on Interest Convergence.



In Scenario 1 ("interest convergence"), stakeholder and corporate interests converge: addressing the needs of various stakeholders will also benefit the company (and its shareholders). Interest convergence occurs when *direct* costs to stakeholders who are directly harmed by the misconduct lead to *derivative* costs to corporations in terms of reputational, litigation, and regulatory (compliance) threats. For example, poor labor practices overseas can harm a variety of stakeholders, including employees of overseas suppliers and consumers (*direct costs*).[70] These practices also threaten corporate well-being by leading to reputational losses, litigation threats, and even regulatory investigations and legislative action (*derivative costs*).

Stakeholder protection can offer a means for corporate actors to minimize the prospect of derivative costs by preventing direct costs to stakeholders. For example, corporations can manage both types of costs by consulting with stakeholders as part of risk management.[71] Stakeholders benefit by raising pressing issues with corporate representatives; these representatives benefit by gaining information of which they may have been unaware and that can be used to protect the company from a variety of risks.[72] By addressing these risks, the corporate representatives protect both the interests of stakeholders and the interests of shareholders.

But not all direct costs impose derivative costs on corporations. In Scenario 2 ("interest stalemate"), management may be ambivalent about risks to

[70] *See, e.g.*, Doe I v. Wal-Mart Stores, Inc., 572 F.3d 677, 679-80 (9th Cir. 2009) (recounting claims by foreign suppliers' employees against Wal-Mart for working conditions in suppliers' factories).

[71] *See* Gadinis & Miazad, *supra* note 28, at 1466.

[72] *Id.* at 1432.

stakeholders because, if realized, those risks do not trigger the types of derivative costs that endanger corporations. For example, some misconduct that imposes direct costs on stakeholders will lead to minimal reputational risks to the corporation because of limited media coverage, perceived insignificance of issues, and lack of interest among constituents who exercise leverage on the corporation.[73] Similarly, some misconduct will not lead to a viable litigation threat because there may be no cause of action with which to hold the corporation accountable.[74] Finally, legislators and regulators may lack the information, capacity, or will to respond to misconduct with legislative reform or heightened regulatory standards.[75] These limitations introduce a break in the chain between direct costs and derivative costs: what is bad for stakeholders is *not* necessarily bad for a corporation's management and its shareholders. Here, stakeholder protection has limited instrumental value; thus, under a benefits approach, corporate management is unlikely to consider the needs of stakeholders.

Finally, there are situations in which what is best for the company is worst for other stakeholders. In Scenario 3 ("interest conflict"), the corporation may benefit financially from neglecting or even harming one or more stakeholder groups. Here, direct costs to stakeholders lead to derivative benefits to shareholders. Therefore, it does not benefit the corporation to address stakeholder concerns: it benefits them to impose the harm.

Which of these scenarios best captures reality? That is an open empirical question. If Scenario 1 describes the majority of stakeholder-corporation interactions, then a benefits approach is adequate to protect stakeholders: corporate actors protect stakeholder interests because doing so also protects the interests of the corporation. If Scenario 2 is the reality, then derivative costs will not follow from direct costs to stakeholders and, as a result, corporate actors may have little motivation to protect stakeholders because they have not incurred sufficient derivative costs. If Scenario 3 is the reality, then we can't expect corporate actors to protect stakeholder interests because doing so wouldn't

[73] *See* Nicole Deitelhoff & Klaus Dieter Wolf, *Business and Human Rights: How Corporate Norm Violators Become Norm Entrepreneurs*, *in* THE PERSISTENT POWER OF HUMAN RIGHTS 222, 229 (Thomas Risse, Stephen C. Ropp & Kathryn Sikkink eds., 2013) (noting that not all companies and sectors are vulnerable to consumer boycotts); *cf.* Kathryn Sikkink, *Codes of Conduct for Transnational Corporations: The Case of the WHO/UNICEF Code*, 40 INT'L ORG. 815, 823-33 (1986) (describing "special convergence of favorable characteristics" that led Nestlé to adopt infant formula marketing code in an effort to appease critics).

[74] *See, e.g.*, *Doe I*, 572 F.3d at 685 ("[W]e conclude that Plaintiffs have not stated a claim against Wal-Mart. Wal-Mart had no legal duty under [its Supplier] Standards or common law negligence principles to monitor its suppliers or to protect Plaintiffs from the suppliers' alleged substandard labor practices." (footnote omitted)); Rahaman v. J.C. Penney Corp., No. N15C-07-174, 2016 WL 2616375, at *10 (Del. Super. Ct. May 4, 2016) ("Just as in *Doe I v. Wal-Mart,* Plaintiffs in this case have failed to allege facts to establish that Defendants owed Plaintiffs a duty of care.").

[75] *See* Gadinis & Miazad, *supra* note 28, at 1436-37.

benefit them; in fact, it would hurt them. The benefits approach only works if Scenario 1 describes reality; if not, the benefits approach fails to protect stakeholders most of the time. Reality most likely falls among all three scenarios. Stakeholders in Scenario 1 will receive protection; stakeholders in Scenarios 2 or 3 will not. The result is a skewed patchwork of protection for some stakeholders but not others.

Finally, it is important to acknowledge that a comparable thought exercise can apply to other variants of the benefits-based approach. For example, there may be situations in which the envisioned stakeholder protection does not bring about the expected societal benefits. The question is whether stakeholder protection is jeopardized if these benefits fail to materialize.

D. *The Problem with the Benefits Approach in Practice: Illustrative Examples*

In order to demonstrate the limitations of the benefits approach, this Section revisits the hypotheticals discussed above.[76] In Hypothetical 1, users of the social media app certainly bring a range of benefits to the social media company. However, what is in the best interest of these users may not be in the best interest of the company. Instead, it is often in the financial interest of the latter to collect information about its users—volunteered and otherwise—that it then sells to third parties.[77] This is a classic example of interest conflict (Scenario 3) because the types of privacy controls desirable to users may be contrary to the social media company's financial objectives—especially when some, such as Apple CEO Tim Cook, claim that the business of such social media companies is the users' information.[78] For example, one sociologist has argued the following:

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[76] *See supra* Section I.A.

[77] *See generally, e.g.*, APPLE INC., A DAY IN THE LIFE OF YOUR DATA (2021) (describing how user data is collected, tracked, shared, and utilized by Apple, app developers, third-party data brokers, advertisers, and other entities); Zeynep Tufekci, Opinion, *Facebook's Surveillance Machine*, N.Y. TIMES (Mar. 19, 2018), https://www.nytimes.com/2018/03/19/opinion/facebook-cambridge-analytica.html (explaining how Cambridge Analytica offered to pay Facebook users to download and use personality quiz app on Facebook that "'scraped' information from their Facebook profiles as well as detailed information from their friends' profiles" which "Facebook then provided . . . to the makers of the app, who in turn turned it over to Cambridge Analytica").

[78] *Apple CEO Tim Cook Takes Shots at Facebook over Online Privacy*, MKT. WATCH (Jan. 28, 2021, 7:25 PM), https://www.marketwatch.com/story/apple-ceo-tim-cook-takes-shots-at-facebook-over-online-privacy-01611879927 (reporting Cook's statement that "[t]oo many [social media companies] are still asking the question 'how much can we get away with?' when we should be asking 'what are the consequences?'"); Matthew Panzarino, *Apple's Tim Cook Delivers Blistering Speech on Encryption, Privacy*, TECHCRUNCH (June 2, 2015, 5:34 PM), https://techcrunch.com/2015/06/02/apples-tim-cook-delivers-blistering-speech-on-encryption-privacy/ [https://perma.cc/6XHZ-KLTV] (reporting Cook's statement: "I'm speaking to you from Silicon Valley, where some of the most prominent and successful companies have built their businesses by lulling their customers into complacency about their personal information. . . . They're gobbling up everything they can learn about you and trying

"Facebook makes money . . . by profiling us and then selling our attention to advertisers, political actors and others. These are Facebook's true customers, whom it works hard to please."[79] It may also not be in the interests of these companies to safeguard the security of their users' information from third parties because the companies are not the ones who suffer directly from the harms that may result: "Because companies do not have to internalize the[] negative externalities borne by individuals, the number of data breaches continues to grow."[80]

In Hypothetical 2, a number of companies benefit from decreasing payments to their suppliers while simultaneously increasing production volume and shortening delivery times.[81] These choices benefit companies' marketing efforts, sales, and production of goods, helping to maximize profits.[82] In certain circumstances, the reputational backlash from "sweatshop conditions" may persuade companies to change these contract parameters because the direct costs to suppliers lead to negative derivative costs for corporations (Scenario 1); in other situations, not so much (Scenario 3).

For example, following the onset of the COVID-19 pandemic, many brand-name companies, such as Kohl's and Primark, suspended or canceled their orders with their foreign suppliers.[83] Other companies, such as Marks and Spencer or PVH Corporation (the parent company of Calvin Klein and Tommy Hilfiger, among others) used the pandemic to unilaterally modify contracts to extend payment terms, such as from 90 days to 120 days; still others requested deep discounts that applied retroactively.[84] Many took these actions *even* when they could afford not to do so *and* when the suppliers had already produced the goods *and* when these companies knew (or could reasonably predict) the

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to monetize it. We think that's wrong. And it's not the kind of company that Apple wants to be."); *see also* Tufekci, *supra* note 77 (arguing that Cambridge Analytica scandal was "an all-too-natural consequence of Facebook's business model, which involves having people go to the site for social interaction, only to be quietly subjected to an enormous level of surveillance").

79 Tufekci, *supra* note 77.

80 Daniel J. Solove & Danielle Keats Citron, *Risk and Anxiety: A Theory of Data-Breach Harms*, 96 TEX. L. REV. 737, 745 (2018).

81 *See, e.g.*, Mark Anner, *Squeezing Workers' Rights in Global Supply Chains: Purchasing Practices in the Bangladesh Garment Export Sector in Comparative Perspective*, 27 REV. INT'L POL. ECON. 320, 321 (2020) (recognizing that fashion brands compete with low retail prices and high speed to market through "source squeezing" on suppliers).

82 *Id.* Other contributing factors include increased competition among suppliers, technological innovation that augments the power of lead firms, and "growing pressure from investors on lead firms to reduce costs and increase margins." *Id.* at 323.

83 JEFF VOGT, INT'L LAWS. ASSISTING WORKERS NETWORK; MIRIAM SAAGE-MAAß & BEN VANPEPERSTRAETE, EUR. CTR. FOR CONST. & HUM. RTS.; BEN HENSLER, WORKER RTS. CONSORTIUM, FARCE MAJEURE: HOW GLOBAL APPAREL BRANDS ARE USING THE COVID-19 PANDEMIC TO STIFF SUPPLIERS AND ABANDON WORKERS 5-7 (Corey Barber & Arite Keller eds., 2020).

84 *Id.* at 7.

consequences of terminated contracts for the suppliers (and their workers).[85] Following consumer backlash, some companies reversed course and agreed to honor the terms of the original purchase orders.[86] Many still refused to do so, even when the business case would have recommended another course of action; suppliers are important stakeholders and it would serve the interests of brand companies to maintain the operational viability and loyalty of these companies for post-pandemic operations.[87] Additionally, the consequences of terminated contracts, including the harms suffered by overseas workers, can and did expose the brand companies to reputational harm.[88] But despite these benefits from protecting stakeholders, many companies still chose not to do so. This is but one example of corporations imposing direct costs on stakeholders because it benefits the corporation to do so.

In both of these examples, the benefits approach to stakeholderism falls short: Corporations do not protect their stakeholders when it does not benefit them to do so or when they benefit by imposing the harm. To protect stakeholders effectively, we need to shift our foundations for stakeholder protection from receipt of benefits to prevention of harms.

II. SHIFTING STAKEHOLDERISM FROM BENEFITS TO HARMS

A better normative basis for stakeholder protection focuses on the *threatened harms* from corporate conduct rather than the perceived benefits of stakeholder protection. The prevention of harms requires closer examination of a corporation's contracting practices. Contracts are the primary means through which corporations interact in society. Many harms befalling stakeholders originate in various contracts that corporations maintain: *arbitration agreements* that foreclose the possibility of litigation, thereby impeding consumer rights;[89] *employment agreements* that force workers to give up privacy rights at the workplace;[90] and more. These contracts can reduce the well-being of signatories, but the promised performance can increase or decrease the well-being of one or more individuals who were never part of the deal.[91]

A harms-based stakeholderism approach requires corporations to consider the effects on stakeholders when they negotiate, draft, and sign contracts with others—even if doing so doesn't bring any tangible benefits to corporations.

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[85] *Id.* at 4-7, 11.

[86] *Id.* at 1-2.

[87] *Id.* at 2, 7-8.

[88] *See id.* at 1-2.

[89] *See* Lauren Guth Barnes, *How Mandatory Arbitration Agreements and Class Action Waivers Undermine Consumer Rights and Why We Need Congress to Act*, 9 HARV. L. & POL'Y REV. 329, 336-40 (2015).

[90] *See* Daniel P. O'Gorman, *Looking Out for Your Employees: Employers' Surreptitious Physical Surveillance of Employees and the Tort of Invasion of Privacy*, 85 NEB. L. REV. 212, 253-54 (2006).

[91] Bagchi, *supra* note 34, at 212.

This is because the act of contracting sets into motion processes that may not have otherwise occurred. While both the contracting parties and the broader public may reap considerable benefits from those processes, each may also be at risk for various types of harms; however, only parties are afforded an opportunity to consent to and address those risks that the contract creates. Section II.A describes the unique vulnerabilities that a contract creates for both contracting parties and third parties. While both are vulnerable, five dimensions of inequality distinguish the powers of contracting parties and third parties: *notice*, *choice*, *risk management*, *legal remedies*, and *fruits of exchange*.

A. *Vulnerabilities in Contracts: Contract Parties vs. Third Parties*

Each contracting party's risk originates in its vulnerability to the other party or parties. Contractual vulnerability is particularly acute in "idiosyncratic exchanges" which refer to goods and services "where investments of transaction-specific human and physical capital are made and, contingent upon successful execution, benefits are realized."[92] These types of exchanges leave contracting parties particularly vulnerable because the transaction-specific investments lead to a "bilateral monopoly."[93] As a result:

> [B]oth buyer and seller are strategically situated to bargain over the disposition of any incremental gain whenever a proposal to adapt is made by the other party. Although both have a long-term interest in effecting adaptations of a joint profit-maximizing kind, each also has an interest in appropriating as much of the gain as he can on each occasion to adapt.[94]

A famous example involves General Motors and its supplier, Fisher Body Corporation.[95] The parties' contract contemplated that Fisher Body make highly specific investments to produce automobile bodies for General Motors; the level of specificity created the risk that General Motors could leverage the investments by threatening to purchase a lower output, or none at all, unless Fisher Body reduced the price.[96]

Notably, these vulnerabilities result from contract design.[97] The same contract that creates the potential for profit also creates the possibility of harm. For example, franchises create the possibility of immense wealth for both

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[92] Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233, 240-41 (1979).

[93] *Id.* at 241; *see also* Oliver D. Hart, *Incomplete Contracts and the Theory of the Firm*, 4 J.L. ECON. & ORG. 119, 121 (1988) ("Once . . . relationship-specific investments have been made the parties are (at least partially) 'locked in,' and hence they are at each other's mercy and opportunistic behavior may rule.").

[94] Williamson, *supra* note 92, at 242.

[95] *See* Benjamin Klein, *Why Hold-Ups Occur: The Self-Enforcing Range of Contractual Relationships*, 34 ECON. INQUIRY 444, 445-46 (1996).

[96] *Id.* at 445. In practice, the contract design solution that was adopted to prevent this type of hold-up resulted in General Motors being held up by Fisher Body. *Id.* at 446-47.

[97] *See id.* at 446.

franchisors (through sales, fees, and royalties)[98] and franchisees (through profits).[99] However, the arrangement places the two parties in a position of vulnerability vis-à-vis the other. Franchisors are vulnerable to free riding by franchisees who may sacrifice quality control to maximize profits, thereby placing the franchisor at risk if poor quality control jeopardizes the franchisor's trademark and broader franchise.[100] Conversely, franchisees are vulnerable to franchisors leveraging franchisee capital investments by raising prices or increasing volume requirements, among other efforts.[101]

But contracting parties are not the only ones who may confront risks of harm. *Stakeholders* may also be affected as contractual *third parties*. For example, all of the stakeholders discussed in the previous hypotheticals are injured as a result of the contracts that a corporation enters into with another party. In Hypothetical 1, the contracts at issue are between the social media company and, for example, a marketing company, but the exchanged performance—money for data sharing—affects the interests, if not rights, of all the users who use that platform.[102] In Hypothetical 2, supply contracts between a corporation and its suppliers create the risks of labor, safety, and health risks—even human trafficking—for those individuals who are employed by the supplier or subcontractor.[103] While they did not sign the supply contract, their rights will be affected by the price, volume, and other terms set in that agreement.[104] These examples highlight how stakeholders—as contractual third parties—can still suffer from the terms of corporate agreements.

B. *Disparities in Risk Acceptance, Management, and Compensation*

There's something particularly disturbing about subjecting individuals to risks of harms to which they have not consented; this is the *problem of unconsented risk*. But this problem is compounded when we allow a different class of individuals to consent before it is subject to similar risks from the same source; this is the *problem of disparity in risk acceptance*. This disparity is evident in five distinct contexts: *notice*, *choice*, *risk management*, *legal remedies*, and *fruits of exchange*.

First, unlike third parties, contracting parties have notice of the risks the contract creates because they are the agents of its creation; as such, they have information about how the contract is designed to unfold and the foreseeable consequences of performance.[105] Admittedly, even contracting parties cannot

98 *See* Gillian K. Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, 42 STAN. L. REV. 927, 935-36 (1990).

99 *See id.* at 950, 958.

100 *Id.* at 949-50.

101 *Id.* at 951-52.

102 *See supra* notes 77-79 and accompanying text.

103 *See supra* notes 81-82 and accompanying text.

104 *See* Anner, *supra* note 81, at 321.

105 *See, e.g.*, Klein, *supra* note 95, at 447 ("General Motors and Fisher Body were aware

envision all possible outcomes of performance.[106] The literature on "incomplete contracts" highlights the challenge of attempting to anticipate all contingencies in an efficient manner.[107] But contracting parties more likely struggle to predict the *unforeseen causes of breach* than the *expected consequences of performance*.

A contract may be breached for a number of reasons—some predictable, others not. For example, with respect to the COVID-19 pandemic, parties may not have foreseen the possibilities of a pandemic, governmental responses, and the effects on the parties' abilities to fulfill their contractual obligations.[108] Therefore, they may not have included language in their force majeure clause that addresses the pandemic[109]—or may even have neglected to include a force majeure clause at all.[110] The parties were therefore stuck with a risk allocation they may not have agreed to had they anticipated the possibility and consequences of the COVID-19 pandemic.[111]

of the hold-up problems inherent in their relationship, and both Fisher and General Motors had to have been aware that the contract they adopted to solve their hold-up problem was 'defective' in the sense that it contained obvious malincentives.").

[106] *See, e.g.*, Nabil I. Al-Najjar, *Incomplete Contracts and the Governance of Complex Contractual Relationships*, 85 AM. ECON. REV. 432, 435 (1995) (describing two ways contracting parties introduce flexibility in incomplete contracts to efficiently address contingencies: intentional ambiguity and alternative governance instruments, such as reputation, property rights, or legal system).

[107] *See, e.g.*, Hadfield, *supra* note 98, at 947 ("[T]he key characteristic of the franchise contract is its incompleteness."); *id.* at 947-48 ("To write a complete contract for this purpose would be to attempt to reduce to written form a complete listing of all the different business decisions that the franchisor could undertake under all possible future circumstances, and also to specify the range of compliance responses available to the franchisee in each case. . . . [T]his is an essentially impossible task . . . .").

[108] *See* Colin C. Holley, *A Closer Look at the Coronavirus Pandemic as a Force Majeure Event*, AM. BAR ASS'N (Mar. 31, 2020), https://www.americanbar.org/groups/tort_trial_insurance_practice/publications/committee-newsletters/closer_look_coronavirus_pandemic/.

[109] *See, e.g.*, Jacqueline M. Carolan, *Not 'If' but 'When' — Navigating a Force Majeure Clause During the COVID-19 Pandemic*, FOX ROTHSCHILD LLP (Mar. 14, 2020), https://www.foxrothschild.com/publications/not-if-but-when-navigating-a-force-majeure-clause-during-the-covid-19-pandemic [https://perma.cc/F743-BNRK] ("Whether COVID-19 may be considered a *force majeure* for purposes of excusing a party from a contractual obligation depends almost entirely on the express language of the provision and the circumstances it seemingly anticipates."); Holley, *supra* note 108 (noting key issues in interpretation of force majeure clauses amidst pandemic, including ambiguity as to whether COVID-19 pandemic triggers force majeure clauses that do not specifically reference disease).

[110] *See, e.g.*, Memorandum of Law in Support of Defendant's Motion for Summary Judgment Dismissing Plaintiff's Complaint at 1, Victoria's Secret Stores, LLC v. Herald Square Owner LLC, No. 651833/2020, 2021 WL 69146 (N.Y. Sup. Ct. Jan. 7, 2021) (noting plaintiff tenant's argument that lease should be annulled due to COVID-19 pandemic, despite lack of force majeure clause in agreement, under doctrines of impossibility and frustration of purpose).

[111] *Victoria's Secret*, 2021 WL 69146, at *1 (granting defendant landlord's motion for summary judgment and rejecting plaintiff's tenant's "mistaken theory" that rent should be

Putting aside arguably unpredictable events, contracting parties can more easily predict the consequences of contract performance than third parties can because performance occurs principally one way—as the parties designed. And even if the parties cannot predict every consequence of performance, they are empowered in the course of performance to decide if the risk of unknowns is too great to proceed.

Second, contracting parties can control whether they are at risk at all because they are the ones who decide whether the contract, with its attendant risks, comes into being.[112] The contract only binds them with their consent, and they are not subject to its risks absent this consent. They are thus protected from unconsented risks, whereas third parties are by definition subjected to contractual risks without their consent.[113]

Third, contracting parties can manage risks to themselves through contract design. Admittedly, contract design is not always perfect at risk management; contracting parties may continue to suffer from risks they did not anticipate or adequately guard against.[114] But their seats at the bargaining table provide them with some measure of control over the risks that the contract may create for them. They may not exercise this control well or it may be limited by other factors, such as the bargaining power of the counterparty.[115] But that is beside the point. Contracting parties are both afforded a say in whether they will be subject to contractual risks at all and have the opportunity to exercise some measure of risk management through contract design. In contrast, third parties are not able to control these risks through ex ante contract design because they are not present at the bargaining table.[116]

Fourth, our laws recognize and remedy risks to contracting parties but not third parties. Contract law recognizes risks to *contracting parties* and has developed doctrines addressing modification,[117] duress,[118] and restitution,[119] for example, which help mitigate these risks and provide the contracting parties with a remedy for injuries sustained. Third parties are not so fortunate. Their best bet

excused because "the parties did not allocate the risk of tenant not being able to operate its business").

[112] *See* Parella, *supra* note 37, at 384.

[113] *See id.* at 329.

[114] *See* Klein, *supra* note 95, at 447.

[115] *See, e.g.*, Gatti & Ondersma, *supra* note 11, at 24 (noting that workers and consumers contracting directly with corporations lack meaningful bargaining power and are therefore largely incapable of protecting themselves through contract design).

[116] Parella, *supra* note 37, at 343.

[117] RESTATEMENT (SECOND) OF CONTS. § 89 (AM. L. INST. 1981).

[118] *Id.* § 175.

[119] RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 1 (AM. L. INST. 2011).

is to claim that they are third-party beneficiaries of promises exchanged by the contracting parties.[120] Unfortunately, this does not often succeed.[121]

In *Doe I v. Wal-Mart Stores, Inc.*,[122] employees of Wal-Mart's numerous overseas suppliers alleged that Wal-Mart's failure to exercise its contractually guaranteed inspection rights facilitated serious labor violations.[123] Plaintiffs also argued that the supply contracts' design created numerous risks to them: "[T]he short deadlines and low prices in Wal-Mart's supply contracts force[d] suppliers to violate [Walmart's] Standards [for Suppliers] in order to satisfy the terms of the contracts."[124] The Ninth Circuit rejected their third-party beneficiary claims, explaining that the contracts provided Wal-Mart with inspection rights but not duties to exercise those rights: "Because, as we view the supply contracts, Wal-Mart made no promise to monitor the suppliers, no such promise flows to Plaintiffs as third-party beneficiaries."[125]

Finally, contracting parties expect to receive benefits that outweigh the risks of harms to them. They are the most direct beneficiaries of the fruits of exchange. While they assume risks, they also incur benefits. Third parties are subject to the former, but do not necessarily enjoy the latter.

What normative foundation permits contracting parties to protect themselves from risks but does not allow third parties to do so? This disparity grows starker when we realize that contracting parties and third parties face distinct risks. In certain situations, the risks confronting third parties are particularly grave and pose physical threats to life and limb.[126] Despite the gravity of these risks, third parties are not afforded a say in whether they should be subject to them.

[120] *See* Alan Schwartz & Robert E. Scott, *Third-Party Beneficiaries and Contractual Networks*, 7 J. LEGAL ANALYSIS 325, 330 (2015).

[121] *See id.* at 350 (finding that courts recognized third-party beneficiary in only 35% of third-party beneficiary claims); *see also* Bebchuk et al., *supra* note 25, at 1517 ("We found that the designers of these [acquisition] agreements generally elected to explicitly deny third-party beneficiaries, including employees, any power to enforce provisions that purportedly would protect them.").

[122] 572 F.3d 677 (9th Cir. 2009).

[123] *Id.* at 680.

[124] *Id.*

[125] *Id.* at 681-82 ("The language and structure of the agreement show that Wal-Mart reserved the right to inspect the suppliers, but did not adopt a duty to inspect them.").

[126] *See, e.g.*, Doe I v. Wal-Mart Stores, Inc., No. 05-cv-07307, 2007 WL 5975664, at *2 (C.D. Cal. Mar. 30, 2007) ("The non-California Plaintiffs are workers in Defendant's suppliers' garment factories in China, Bangladesh, Indonesia, Swaziland, and Nicaragua. The non-California Plaintiffs have suffered from various poor working conditions, including excessive hours or days of work, withheld pay, confiscation of withheld pay, overtime without pay, less than minimum-wage pay, denial of overtime pay, less than required rest periods, lack of safety equipment, denial of maternity benefits, discrimination because of union activities, and physical abuse." (citation omitted)), *aff'd*, 572 F.3d 677 (9th Cir. 2009).

III. Operationalizing Contractual Stakeholderism: Introducing a Duty to Contract

It is not enough to shift the normative foundation for stakeholder protection from receipt of benefits to prevention of harms. The next critical step is to operationalize this harms-based approach. This Article argues that if contracts are the mechanism by which stakeholders are injured, then the solution is to target the contracts that corporations execute. Section III.A proposes a duty intended to incentivize corporate leaders to consider the potential harms that their contracting choices impose on third parties. Such an incentive could change their contracting behavior and reduce or eliminate the risks that these contracts pose to stakeholders, even when protecting those stakeholders does not benefit the corporation. Section III.B applies this proposed duty to the two hypotheticals discussed earlier in the Article.

A. *Implementing a Harms-Based Approach to Contracting: Proposing a Duty to Contract*

To operationalize a harms-based approach, this Section proposes a duty to contract: *Corporations, as contracting parties, must take into account stakeholders' interests when performance of the contract creates a risk of harm to them*. This duty is grounded in the prevention of harm rather than the provision of benefits. Thus, it is triggered by the potential for harm.

This does not involve a new duty per se but the application of a classic tort duty to the activity of contracting. We are required to exercise reasonable care in our conduct when that conduct creates a risk of harm to others.[127] Contracting should be no different. Contracts legally bind the parties to set into motion a particular chain of events that may not have occurred in the absence of the parties' agreement. The consequences of these events do not fall on the contracting parties exclusively; instead, they can also fall on various third parties and range from positive effects to grave harms.

Subjecting contracting to the duty of reasonable care is to remove it from some exemption that it has acquired over the years through contracting practice and judicial blessing. It is time to subject contracting to the same rules by which we live the other dimensions of our lives. This does not present a revolution in contract law but a restoration of tort law. It is true that they abut each other in this instance. But that does not mean that the latter should cede ground to the former just because the conduct at issue takes a contracting form. Contracting is not special; as conduct, it creates risks of harm that must be addressed under tort law. Contracting parties are not special either; as actors, they are liable when

127 Restatement (Third) of Torts: Liab. for Physical & Emotional Harm § 7(a) (Am. L. Inst. 2010) ("An actor ordinarily has a duty to exercise reasonable care when the actor's conduct creates a risk of physical harm."); *see also id.* cmt. o ("An actor's conduct creates a risk when the actor's conduct or course of conduct results in greater risk to another than the other would have faced absent the conduct.").

they fail to exercise reasonable care while engaging in contracting activity that creates harm to others.

Section 3 of the Restatement (Third) of Torts identifies three primary factors to consider in evaluating whether a person's conduct lacks reasonable care: (a) "foreseeable likelihood that the person's conduct will result in harm,"[128] (b) "the foreseeable severity of any harm that may ensue,"[129] and (c) "the burden of precautions to eliminate or reduce the risk of harm."[130] Comment d to section 3 clarifies that these factors "are most relevant in cases in which the actor is generally aware of some risk entailed by conduct yet because of the burden of risk prevention is willing to tolerate that risk."[131] To address risks, the Restatement advocates in favor of a "risk-benefit" analysis "where the 'risk' is the overall level of the foreseeable risk created by the actor's conduct and the 'benefit' is the advantages that the actor or others gain if the actor refrains from taking precautions."[132]

Reasonable contract design depends on the risk-benefit analysis advocated in section 3. Comment f further clarifies:

> [E]ven if the likelihood of harm stemming from the actor's conduct is small, the actor can be negligent if the severity of the possible harm is great and the burden of precautions is limited. Similarly, even if the severity of expected harm is low, the person can be negligent if the likelihood of harm is high and the burden of risk prevention limited.[133]

In a contractual setting, risk refers to the severity and likelihood of harms to third parties, whereas burden of precautions refers to the costs contracting parties would incur to mitigate or eliminate that risk.

One way that contracting parties can fulfill this contractual duty is to perform "stakeholder impact assessments" that subsequently inform the formal contract negotiations and design between the parties.[134] The value of these assessments is that they can identify the contractual obligations that raise particular risks and guide parties on the appropriate contractual responses.[135] As Table 1 shows,

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[128] *Id.* § 3.

[129] *Id.*

[130] *Id.*

[131] *Id.* § 3 cmt. d.

[132] *Id.* § 3 cmt. e.

[133] *Id.* § 3 cmt. f.

[134] The Restatement (Third) explains: "Foreseeability often relates to practical considerations concerning the actor's ability to anticipate future events or to understand dangerous conditions that already exist. In such cases, what is foreseeable concerns what the actor 'should have known.'" *Id.* § 3 cmt. g. In situations when an actor could only learn of danger by gathering information, courts "take into account the likely benefit in risk reduction the actor could have achieved by endeavoring to gather more information before engaging in conduct, and also the burden the actor would have borne in making such an effort." *Id.*

[135] *See* U.N. OFF. OF THE HIGH COMM'R FOR HUM. RTS., PRINCIPLES FOR RESPONSIBLE CONTRACTS: INTEGRATING THE MANAGEMENT OF HUMAN RIGHTS RISKS INTO STATE-INVESTOR CONTRACT NEGOTIATIONS, at 6-10, U.N. Doc. HR/PUB/15/1, U.N. Sales No.

contracting parties would cross-reference two data points: (a) the nature and magnitude of the risk[136] and (b) potential for contract reform to mitigate the risk.[137]

Table 1. Contract Planning in Response to Stakeholder Impacts and Contract Design Options.

	Stakeholder Impact High	**Stakeholder Impact Low**
Contract Reform High	Reform the contractual obligation	Reform the contractual obligation
Contract Reform Low	Eliminate the contractual obligation	Contract design excused

When the nature and extent of the stakeholder impact is high (*stakeholder impact high*), contracting parties foresee the possibility that their contracting choices create the risk of physical harm; they are therefore bound to exercise reasonable care in contracting.[138] They are then left with two options depending on the possibilities for contract reform. *If* contracting parties can mitigate or eliminate the risks through contract design (*contract reform high*), we can imagine that they would include the contractual obligation but with the reformed provisions. If contractual reform does not adequately mitigate or eliminate the risk (*contract reform low*), then we would expect the contracting parties to eliminate the underlying contractual obligation.[139]

When the stakeholder impact is low (*stakeholder impact low*), contracting parties cannot reasonably foresee that stakeholders may be injured as a result of their contracting choices.[140] Stakeholders may be injured, but the types of

E.15.XIV.5 (2015); *id.* at 11 ("For the business investor, it is important to complete a first [human rights risk] assessment as early as possible, even before contract negotiation, to better understand from the outset the project's potential risks and benefits to people.").

136 RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL & EMOTIONAL HARM § 3 cmt. e (AM. L. INST. 2010) ("'[M]agnitude of the risk' includes both the foreseeable likelihood of harm and the foreseeable severity of harm that might ensue.").

137 *See* Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act of 2019, 116th Cong. § 3 (discussion draft July 2, 2019), https://financialservices.house.gov/uploadedfiles/bills-116pih-corphuman.pdf [https://perma.cc/H9JB-JAAG] (proposing that public companies file annual report listing "any human rights risks" in their operations ranked based on gravity of harm and "any anticipated challenges in remedying any potential harm").

138 *See* RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL & EMOTIONAL HARM § 7 (AM. L. INST. 2010).

139 *See id.* § 3 cmt. i ("In identifying a precaution that should have been adopted, the party alleging negligence need not prove that the precaution would have entirely eliminated the risk of harm. The party can instead prove that the precaution, if implemented, would have reduced that risk.").

140 *See id.* § 3.

injuries they suffer do not generally result from the kinds of risks that flow naturally from the contract as designed.[141] Here, the stakeholder risk is outside the scope of the contracting parties' liability. Because we want to incentivize greater caution in contracting, it may be advisable for contracting parties to reform the contract if feasible (*contract reform high*) but not eliminate the contractual obligation. If contract design has limited effectiveness for managing risks *and* the stakeholder impact is low, then corporate leaders may be excused from including provisions that specifically address stakeholder risks.

But these data points—and the recommended contractual response—are only as good as the information supporting them. Whether stakeholder impact is low or high depends on the quality of information, and we can expect that contracting parties would engage with stakeholders to ensure that this information is as accurate as possible. The contracts could also contain provisions for postformation stakeholder consultation, such as consultations triggered by certain events.[142] These consultations could allow contracting parties to gather additional information from impacted stakeholders if certain events materialize.[143]

The duty proposed here is broad, with far-reaching implications for how parties engage in contracting. This may invite anxiety over unlimited liability for anyone who enters into a contract. Such anxiety is misplaced. Section 29 of the Restatement (Third) provides the limiting principle to liability: "An actor's liability is limited to those harms that result from the risks that made the actor's conduct tortious."[144] As such, a contracting party is not liable for every harm that befalls any third party as a result of the contract's performance. Instead, liability would depend on the types of risks that the contract creates and whether the harm suffered is a product of one of those risks coming to fruition.[145] A contract, like any conduct, creates a penumbra of risks around it. It sets in motion a chain of events, and those events create risks. If the harm suffered is a product of one or more of those risks, it is within the penumbra of risks created by the contract and should trigger liability for the contracting party.

Therefore, the inquiry begins by asking what foreseeable risks a contract creates for third parties. Without a duty that requires them to engage in this

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[141] *See id.* § 29 cmt. d ("[A]n actor should be held liable only for harm that was among the potential harms—the risks—that made the actor's conduct tortious.").

[142] *See, e.g.*, Andrew Johnston, Kenneth Amaeshi, Emmanuel Adegbite & Onyeka Osuji, *Corporate Social Responsibility as Obligated Internalisation of Social Costs*, 170 J. BUS. ETHICS 39, 41 (2021) ("[C]orporations should be mandated to establish 'hybrid fora', which would bring together creators of, and those affected by, externalities in order to trace those social costs and identify mutually acceptable solutions to them.").

[143] *See* Shelby, *supra* note 34, at 1296 ("Providing a mechanism to require input from community members that are the targeted beneficiaries of [opportunity zone] investments could reduce at least some of the negative externalities generated by these schemes.").

[144] RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL & EMOTIONAL HARM § 29 (AM. L. INST. 2010).

[145] *See id.*

foreseeability analysis, contracting parties may only consider those foreseeable risks a contract creates for *them*. However, third parties may still be at risk as a result of contract design choices; they just lack a voice at the bargaining table communicating these risks. The proposed duty supplies the incentive for contracting parties to consider risks to those absent from the bargaining table.

B. *Application of the Duty to Contract to Illustrative Examples*

As discussed above, the proposed duty may be less relevant where regulation already requires that parties' address negative externalities in their transaction design.[146] However, the following Section applies the proposed duty to the two hypotheticals selected as case illustrations because they involve areas in which current regulations do not sufficiently address the harmful externalities caused by corporate conduct. In the privacy context, "[s]ome people's decision to share their personal information may allow the parties accessing to the information to know more or better about others, those who choose not to share their information."[147] According to research on privacy:

> Information externalities have been more potent due to significant advances in big data analytics which have made it possible to draw more accurate inference [sic] about those consumers who had not shared their data based on the data gleaned from those who had shared. In this environment, even if each user supposedly is aware of the potential harm of personal data release to herself, she may not take into account the entire spillover effects of her data release, either positive or negative, on other users.[148]

In the supply chain context, corporate misconduct is facilitated by supply chain organization technology, regulatory competition, jurisdictional constraints, and challenges with detection, monitoring, and sanctions:

> Brands compete for market share in order to maintain or grow their revenue. This includes pursuing continuous sales growth with low retail prices and ever-changing products and shorter fashion seasons. This 'fast fashion' marketing model requires increasingly shorter production lead times. . . . Lead firms also can use their supply chain power to modify order volume and increase styles, which creates further stress on suppliers. This 'sourcing squeeze' on suppliers – which interacts with the pricing squeeze since lower prices help to increase inventory turnover – impacts workers in

[146] *See, e.g.*, Fleischer, *supra* note 39, at 238 ("The government imposes regulatory costs on transactions in the form of taxes, securities-law disclosure requirements, antitrust constraints, environmental-compliance obligations, and so on.").

[147] Jay Pil Choi, Doh-Shin Jeon & Byung-Cheol Kim, *Privacy and Personal Data Collection with Information Externalities*, 173 J. PUB. ECON. 113, 114 (2019).

[148] *Id.*; *see also id.* (constructing theoretical model of data privacy and finding that, with respect to small websites, "even if each website alone has no incentives to collect personal data due to its small scale of operation, the emergence of data brokerage markets that purchase and aggregate data from multiple websites can restore incentives to collect personal data").

> the form of chronic and forced overtime, and unauthorized outsourcing to unsafe factories.[149]

As in the privacy context, the key contracts in supply chains also create significant negative externalities for third parties. The remainder of this Section will discuss how the duty affects the internalization of these externalities.

1. Data Privacy

In Hypothetical 1, a social media app collects information about users and shares that information with third-party companies, either through direct sales, partnerships, collaborations, or inadequate safeguards that render that information vulnerable to hacking and theft. Users can suffer a variety of privacy, emotional, and financial harms.[150] They may also suffer physical harm as a result of the app's collection and dissemination of data.[151]

The collection and dissemination of data may occur pursuant to myriad contracts. The first set of contracts consists of those the user enters into, such as

[149] Anner, *supra* note 81, at 321 (citations omitted).

[150] *See, e.g.*, Solove & Citron, *supra* note 80, at 756-57 ("Identity-theft victims may face financial ruin. Identity thieves may plunder victims' credit, riddling victims' credit reports with false information including debts and second mortgages obtained in victims' names. Victims struggling with identity theft may be forced to file for bankruptcy, and some may lose their homes. Victims may be turned down for loans or end up paying higher interest rates on credit cards. Their utilities may be cut off and their services denied. Victims' stolen health information may be used to obtain medical care, saddling them with hefty hospital bills and a thief's treatment records. Victims may incur legal fees and have to cover bounced checks." (footnotes omitted)); *see also id.* at 759 ("Another component of the data-breach harm involves a chilling of a person's ability to engage in life's important activities. As a result of a data breach, a person's increased risk of identity theft might prevent her from buying a new house. Identity theft, when it occurs, pollutes a person's credit report, making it difficult if not impossible to obtain a loan. . . . The same concerns are true for employment. In the face of a heightened risk of identity theft, a person might delay looking for a new job because a polluted credit report can interfere with a person's employment opportunities.").

[151] *See, e.g.*, Danielle Keats Citron, *Spying Inc.*, 72 WASH. & LEE L. REV. 1243, 1257 (2015) ("Spyware apps allow stalkers and domestic abusers to terrorize victims. Physical harm is a serious peril when abusers have access to victims' activities and whereabouts."); *see also* Mary Anne Franks, *Sexual Harassment 2.0*, 71 MD. L. REV. 655, 681 (2012) ("The effects on the victims of cyber sexual harassment include suicide, eating disorders, decreased motivation to work or study, and a host of psychological problems."). In December 2021, Rohingya refugees filed a class action lawsuit against Meta Platforms, formerly Facebook, "for $150 billion over allegations that the social media company did not take action against anti-Rohingya hate speech that contributed to violence." Elizabeth Culliford, *Rohingya Refugees Sue Facebook for $150 Billion over Myanmar Violence*, REUTERS (Dec. 8, 2021, 2:14 PM), https://www.reuters.com/world/asia-pacific/rohingya-refugees-sue-facebook-150-billion-over-myanmar-violence-2021-12-07/ ("A [2018] Reuters investigation . . . , cited in the U.S. complaint, found more than 1,000 examples of posts, comments and images attacking the Rohingya and other Muslims on Facebook." (citation omitted)); *see* Complaint at 67-70, Doe v. Meta Platforms, Inc., No. 21-cv-06465 (Cal. Super. Ct. Dec. 6, 2021), *removed*, No. 4:22-cv-00051 (N.D. Cal. Jan. 5, 2022).

terms of service and privacy policies.[152] But the social media company can, in turn, contract with other companies regarding use of the user's data.[153] Certainly, this presents problems that may be better addressed with robust oversight and regulation. As a second-best solution, we may also consider how improved contractual practices may address some of the risks users confront in their daily lives.

Option 1 requires the social media company to inform app users of the types of information the app collects and how the company intends to use it. For example, the FTC brought a complaint against Goldenshores Technologies—developer of a free flashlight app for Android phones—alleging that the company "failed to disclose that the app transmitted users' precise location and unique device identifier to third parties, including advertising networks."[154] In its 2013 settlement, the FTC ordered the company to "clearly and prominently" disclose: "1. That such application collects, transmits, or allows the transmission of, geolocation information; 2. How geolocation information may be used; 3. Why such application is accessing geolocation information; and 4. The identity or specific categories of third parties that receive geolocation information directly or indirectly from such application;"[155] and required that the company "[o]btain[] affirmative express consent from the consumer to the transmission of such information."[156] But some have warned that "consent to ongoing and extensive data collection can be neither fully informed nor truly consensual"[157] given the myriad applications of the data—many of which users may not appreciate given their lack of technological understanding.[158]

Option 2 requires companies to include certain types of precautions in their contracts with companies with whom they share app users' information—for sale or otherwise. For example, article 28(3) of the General Data Protection Regulation ("GDPR") requires that data processing agreements identify "the subject-matter and duration of the processing, the nature and purpose of the processing, the type of personal data and categories of data subjects and the obligations and rights of the controller."[159] Article 28(3) further elaborates on particular stipulations that the contract should include regarding data processing.[160] The European Commission has produced a set of standard

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[152] *See, e.g.*, *Terms and Conditions*, AM. BAR ASS'N, https://www.americanbar.org/groups/business_law/safeselling/terms/ [https://perma.cc/KEC3-PHB9] (last visited Mar. 16, 2022) ("Sometimes a company's privacy policy is set forth, or incorporated by reference, in the terms and conditions. Depending on the factual circumstances, some privacy 'policies' are contracts requiring assent, while other privacy policies are styled as statements of policy.").

[153] *See* Tufekci, *supra* note 77.

[154] Press Release, FTC, *supra* note 46.

[155] Goldenshores Techs., LLC, 157 F.T.C. 700, 743-44 (2014) (decision and order).

[156] *Id.* at 744.

[157] Tufekci, *supra* note 77.

[158] *Id.*

[159] Commission Regulation 2016/679 of Apr. 27, 2016, 2016 O.J. (L 119) 1, 49.

[160] *Id.* at 49-50.

contract clauses for use by controllers and processers, including clauses concerning cooperation between processers and controllers in enabling data subject to exercise their rights under the GDPR,[161] security of processing,[162] use of sub-processers,[163] and notification of personal data breaches.[164]

Option 3 prohibits the social media company from disclosing, selling, or otherwise sharing app users' information with any third-party company. For example, the California Consumer Privacy Act ("CCPA") gives consumers the right to "opt out" of the sale of their personal information.[165] Consumers can opt out of the sale by using the CCPA-mandated "Do Not Sell My Personal Information" link on a business's website[166] and through at least one other acceptable method chosen by the business.[167] But while the CCPA's consumer protections are robust, the statute applies only to California residents.[168] Legislators in other states have attempted to introduce bills that similarly limit the sale of consumer data but the results have been mixed. For example, one bill that the Governor of Hawaii ultimately vetoed[169] would have "prohibit[ed] the

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[161] Commission Implementing Decision (EU) 2021/915 of June 4, 2021, 2021 O.J. (L 199) 18, 24.

[162] *Id.* at 22.

[163] *Id.* at 23-24.

[164] *Id.* at 24-25. According to legal commentary, these types of clauses are ones "that a controller can impose on the processor to satisfy the contractual requirements that the controller is obliged to impose under Article 28 GDPR." Mark A. Prinsley, Oliver Yaros, Björn Vollmuth, Ana Hadnes Bruder & Ondrej Hajda, *European Commission Publishes Draft New Standard Contractual Clauses for International Personal Data Transfers and Article 28 GDPR Clauses Between EU Controllers and Processors*, MAYER BROWN (Nov. 13, 2020), https://www.mayerbrown.com/en/perspectives-events/publications/2020/11/european-commission-publishes-draft-of-new-standard-contractual-clauses-for-transfers-of-personal-data-to-countries-outside-the-european-union [https://perma.cc/9UpW-54KC]. However, "[t]he use of the European Commission-approved Article 28 Clauses will not be compulsory and businesses may continue to use bespoke data processing agreements between controllers and processors to satisfy the requirements of Article 28 GDPR." *Id.* The Commission also published a set of standard clauses that can be used in contracts involving a controller or processor's transfer of personal data to a controller or processor in a third country. Commission Implementing Decision (EU) 2021/914 of June 4, 2021, 2021 O.J. (L 199) 31, 37-56.

[165] CAL. CIV. CODE § 1798.120 (West 2021).

[166] *Id.* § 1798.135.

[167] *See* CAL. CODE REGS. tit. 11, § 999.315(a) (2021) (identifying "a toll-free phone number, a designated email address, a form submitted in person, a form submitted through the mail, and user-enabled global privacy controls, such as a browser plug-in or privacy setting, device setting, or other mechanism, that communicate or signal the consumer's choice to opt-out of the sale of their personal information" as acceptable opt-out methods).

[168] CIV. § 1798.140(g) (defining "consumer" as "natural person who is a California resident [within meaning of state tax regulations] . . . however identified, including by any unique identifier").

[169] EXEC. CHAMBERS, GOV. MSG. NO. 1376, STATEMENT OF OBJECTIONS TO HOUSE BILL NO. 702 (2019) (veto letter from Governor David Y. Ige).

sale or offering for sale of location data collected using satellite navigation technology without the explicit consent of the individual who has primary custody of the satellite navigation technology-equipped device."[170]

The contractual duty proposed here is designed to encourage companies to replicate some of the stakeholder protections discussed above, even in the absence of a settlement agreement or legislative mandate. Option 1's disclosure requirements are consistent with the contractual duty because they would help social media users assess the risks to themselves before and during use of the app.[171] For example, users may be unaware that an app is collecting information about their location, biometrics, demographic data, biographical data, shopping preferences, or political choices when they use the app; they may be even less aware that the app is then transferring that data to one or more third-party companies.[172] Given the available data on privacy invasions, it is not difficult for a social media company to reasonably foresee how its collection of personal data (and subsequent transfer of that data) could lead to the risk of emotional, financial, and physical harm for its users. That foreseeability of harm could lead the social media company to include appropriate disclosures in (a) its agreements with users and (b) its agreements with third-party companies, in which it would mandate that the latter provide similar disclosures to users.

A similar analysis could lead the social media company to adopt Option 2's approach of including particular contractual protections in agreements between companies relating to the transfer of users' personal data. For example, if users are placed at risk because of action or inaction by companies to whom data is transferred, then it would make sense for the company transferring the data—here, the social media company—to include provisions in its contract with the transferee that protect users' data, including potential restrictions on what the transferee may do with that data following transfer.

Finally, if it is too difficult to adopt, monitor, and enforce restrictions on uses of transferred data (pursuant to Option 2), then the proposed contractual duty

[170] H.B. 702, 30th Leg., Reg. Sess. § 1 (Haw. 2019); *see also 2020 Consumer Data Privacy Legislation*, NAT'L CONF. OF STATE LEGISLATURES (Jan. 17, 2021), https://www.ncsl.org/research/telecommunications-and-information-technology/2020-consumer-data-privacy-legislation637290470.aspx [https://perma.cc/72D9-BQQ8] (highlighting additional state data privacy legislation); *2021 Consumer Data Privacy Legislation*, NAT'L CONF. OF STATE LEGISLATURES (Sept. 17, 2021), https://www.ncsl.org/research/telecommunications-and-information-technology/2021-consumer-data-privacy-legislation.aspx [https://perma.cc/SG69-QNVN] (same).

[171] *But see* Choi et al., *supra* note 147, at 114 ("[T]he overall effects of such a consent-based approach may be limited in addressing the negative information externalities problem since well-informed, fully rational consumers may not change their behaviors because opting-out may not be individually rational in the presence of information externalities.").

[172] *See* Danielle Citron, *BEWARE: The Dangers of Location Data*, FORBES (Dec. 24, 2014, 3:04 PM), https://www.forbes.com/sites/daniellecitron/2014/12/24/beware-the-dangers-of-location-data/?sh=45bcf46a43cb ("Companies can sell geolocation data to data brokers, further filling their dossiers with information about consumers' medical conditions, religious affiliations, and more.").

could encourage companies to adopt Option 3 and restrict or prohibit the sale of consumer data to other companies because the sale of such information—like geolocation data—to third parties could place users at considerable risk of physical, emotional, and financial harms.[173] These risks are also compounded when the purchasing company turns around and sells that information to yet another company. The original company may not know the identities of these downstream purchasers and, therefore, cannot guarantee that the information would not be put to particular uses. Thus, given this uncertainty, it would be prudent for a company to adopt prohibitions on disclosure, sale, or unauthorized access of consumer data. As a contractual matter, this would mean that the company would (a) categorically avoid certain types of contracts for the sale or disclosure of information or (b) only enter into such agreements pursuant to written consent from consumers.

2. Labor Abuses in Supply Chains

In Hypothetical 2, a brand company contracts with an overseas supplier to produce clothing at a price so low that the overseas supplier engages in subcontracting, thereby compromising labor conditions in order to turn a profit. The proposed duty would require that the brand company revisit supply contract provisions that create the risk of these harms. Research on supply chains reveals that contract provisions addressing volume, production schedule, and price can exacerbate the risks of labor abuses that would threaten the physical security and well-being of workers in supply chains.[174] For example, when a supply contract requires a high volume in a short delivery window, it increases the likelihood of subcontracting from the supplier to another party.[175] Subcontracting is dangerous for workers in the supply chain because: (a) supply chain codes of conduct may not apply to subcontractors,[176] (b) subcontracting sites may not be monitored or audited because the corporation's representatives may be unaware of them,[177] and (c) suppliers may select subcontractors based solely on their

[173] *See id.* ("Geolocation data is especially revealing about our lives. It is subject to serious abuse, from domestic abuse and stalking to theft and discrimination.").

[174] Anner, *supra* note 81, at 321.

[175] NIKOLAUS HAMMER, RÉKA PLUGOR, PETER NOLAN & IAN CLARK, UNIV. OF LEICESTER CTR. FOR SUSTAINABLE WORK & EMP. FUTURES, NEW INDUSTRY ON A SKEWED PLAYING FIELD: SUPPLY CHAIN RELATIONS AND WORKING CONDITIONS IN UK GARMENT MANUFACTURING 22-25 (2015).

[176] *See* Richard M. Locke, Ben A. Rissing & Timea Pal, *Complements or Substitutes? Private Codes, State Regulation and the Enforcement of Labour Standards in Global Supply Chains*, 51 BRIT. J. INDUS. RELS. 519, 537 (2013); *see also* Michael E. Blowfield & Catherine S. Dolan, *Stewards of Virtue? The Ethical Dilemma of CSR in African Agriculture*, 39 DEV. & CHANGE 1, 6-7 (2008) ("In practice, the coverage of [supply chain] standards is limited, condensing the complex social forms found in transnational production into a single model of the permanent employee, a worker who is increasingly an anomaly in global production.").

[177] *See* Sarah Dadush, *Contracting for Human Rights: Looking to Version 2.0 of the ABA Model Contract Clauses*, 68 AM. U. L. REV. 1519, 1525, 1540-41 (2019).

ability to meet production demands and not for social compliance quality reasons.[178]

If contracting choices create the risk of subcontracting, then the proposed duty would require that corporations address this risk through contract design. We can imagine three contract approaches varying in quality and effectiveness. Option 1 prohibits subcontracting in supply contracts: "Supplier agrees not to contract with any subcontractors to perform any part of this Agreement." However, simply placing the prohibition in the supply contract is no guarantee that it will be honored. Suppliers have little incentive to abide by this provision if there is no enforcement risk, and the corporation cannot sanction violations it cannot detect. Because subcontracting may occur through informal channels, a corporation may not know that its supplier is using subcontractors or the conditions of those subcontracting sites.[179]

Option 2 goes beyond a blanket prohibition and encourages information flows[180] to the corporation regarding the use of subcontracting, such as:

XX. Subcontracting: Supplier agrees as follows:

- Supplier shall submit a list of proposed subcontractors to Buyer by [insert date] and periodically as appropriate;
- Supplier shall not contract with any subcontractor unless and until it receives written approval from Buyer;
- Upon request, Supplier shall provide Buyer with any additional information Buyer requests in order to evaluate any proposed subcontractor's qualifications, including the ability to comply with the Code of Conduct under this Agreement;
- Supplier and all of its subcontractors agree to permit Buyer, its agents, representatives, and partners, access to Supplier's and any subcontractor's premises and workers in order to conduct monitoring and other auditing activities; and
- Supplier agrees to terminate any and all contracts with any approved subcontractors at Buyer's request.

While these provisions are better than a blanket prohibition against subcontracting, they still fall short because they address the symptoms—the effects of supply contract choices relating to price, delivery, and volume—rather than the roots of the problem. For example, a supplier faced with high volume and low prices who cannot subcontract may find other ways to exploit its workers to meet production demands. A corporation can respond by prohibiting those methods, but only after the incidents have occurred and the corporation

[178] *See id.* at 1540-41.

[179] *See id.*

[180] *See, e.g.*, U.N. OFF. OF THE HIGH COMM'R FOR HUM. RTS., *supra* note 135, at 27-28 (recommending that countries structure contracts with foreign investors to ensure government is able to monitor compliance with operating standards intended to protect human rights).

learns of them. A contracting approach that goes after the symptoms will always be a reactive, not preventive.

To prevent labor violations, Option 3 would require that a corporation examine what it is asking of suppliers that may lead them to engage in subcontracting and other practices that may lead to labor abuses. This better approach requires that corporations reevaluate price, delivery, and volume terms to set parameters that allow suppliers to perform in a way that is consistent with desirable labor practices.[181] In the pandemic context, some have argued that companies have failed to consider the impact that decisions to suspend or cancel orders have on supply chain workers.[182] This is an example of the harms-based approach to stakeholderism that this Article advocates because these scholars argue that corporations must consider the effects of their contracting choices on vulnerable third parties who may be injured by these choices.[183] They advise that companies consult with representatives of these workers beforehand—or at least provide notice—as part of a broader due diligence approach to the supply chain.[184] Similarly, the American Bar Association has developed model supply contract clauses that identify buyers' and suppliers' obligations to prevent and address human rights violations.[185] Critically, the suggested "Buyer Code" identifies best practices for responsible sourcing, including buyer's conduct

[181] *See, e.g.*, 2018 Accord on Fire and Building Safety in Bangladesh 6 (June 21, 2017), https://bangladesh.wpengine.com/wp-content/uploads/2020/11/2018-Accord.pdf [https://perma.cc/3N6N-K2BL] ("In order to induce factories to comply with upgrade and remediation requirements of the program, participating brands and retailers will negotiate commercial terms with their suppliers which ensure that it is financially feasible for the factories to maintain safe workplaces and comply with upgrade and remediation requirements instituted by the [Chief Safety Inspector]."). The Accord on Fire and Building Safety, established after the deadly 2013 Rana Plaza factory collapse, was replaced by the International Accord for Health and Safety in the Textile and Garment Industry in fall 2021. International Accord for Health and Safety in the Textile and Garment Industry (Sept. 1, 2021), https://img1.wsimg.com/blobby/go/7b3bb7ce-48dc-42c3-8e58-e961b9604003/downloads/1%20September%20-%20International%20Accord%20on%20Health%20a.pdf [https://perma.cc/5X4A-4VPN]; *see* Elizabeth Paton, *International Brands Sign a New Accord to Protect Garment Workers in Bangladesh*, N.Y. TIMES (Aug. 25, 2021), https://www.nytimes.com/2021/08/25/business/garment-worker-safety-accord.html.

[182] VOGT ET AL., *supra* note 83, at 13.

[183] *See id.* at 16 ("[C]ontracts between brands and suppliers should explicitly acknowledge supplier factory workers as the intended beneficiaries of the brand's agreement to pay the supplier and give workers the right to sue the brand for any wage arrears that may result from the brand's failure to do so.").

[184] *See id.* at 13.

[185] WORKING GRP. TO DRAFT MODEL CONT. CLAUSES TO PROTECT HUM. RTS. IN INT'L SUPPLY CHAINS, AM. BAR ASS'N, BALANCING BUYER AND SUPPLIER RESPONSIBILITIES: MODEL CONTRACT CLAUSES TO PROTECT WORKERS IN INTERNATIONAL SUPPLY CHAINS, VERSION 2.0, at 19-37; *see Contractual Clauses Project*, AM. BAR ASS'N, https://www.americanbar.org/groups/human_rights/business-human-rights-initiative/contractual-clauses-project/ [https://perma.cc/M7QF-B4UR] (last visited Mar. 16, 2022).

concerning contract negotiations, performance, renewal, remediation, and responsible exit.[186]

Any of these three options would help to reduce the risk of subcontracting, thereby protecting various stakeholders from risks of abuse in the supply chain.

IV. RECONCILING THE STAKEHOLDERISM DEBATE THROUGH THE DUTY TO CONTRACT

The duty to contract addresses the concerns of both camps of the recent debate over stakeholderism by offering an effective means to protect nonshareholder interests, on the one hand, while avoiding the risk of inauthenticity and impracticality, on the other.

A harms-based approach protects stakeholders by changing the justification for protection: protection is warranted not because of the benefits that stakeholders provide to corporations but because of the risks to which corporations may subject stakeholders through contract design, negotiation, and performance. Importantly, this justifies stakeholder protection even when a benefits approach would not.

As a contractual duty, it also addresses critics' concerns of *inauthenticity* and *impracticality*. In their study of acquisition deals, Bebchuk, Kastiel, and Tallarita find that many acquisition agreements lack post-deal stakeholder protections.[187] When parties included such contract terms, they were notably less effective than the terms protecting those at the bargaining table: "Contractual provisions designed to protect shareholders and corporate leaders were typically well specified and effectively enforceable. By contrast, provisions in favor of stakeholders were underspecified and vague."[188] Finally, "stakeholders' ability to enforce them was generally explicitly denied by the acquisition agreement."[189]

Bebchuk, Kastiel, and Tallarita attribute this lack of stakeholder protections in acquisition deals to the fact that "corporate leaders have incentives *not* to protect stakeholders beyond what would serve shareholder value."[190] The trouble is that "interests of corporate leaders, while not perfectly aligned with the interests of shareholders, are robustly linked to them"[191] and that "shareholder legal rights, the structure of director and executive compensation, and the dynamics of the labor and control markets provide directors and top

[186] WORKING GRP. TO DRAFT MODEL CONT. CLAUSES TO PROTECT HUM. RTS. IN INT'L SUPPLY CHAINS, AM. BAR ASS'N, RESPONSIBLE PURCHASING CODE OF CONDUCT 1-5; *see Contractual Clauses Project*, *supra* note 185 ("While most codes of conduct address the supplier, the Buyer Code . . . sets out principles and standards for buyers (including brands) to better protect workers' human rights in their supply chains.").

[187] Bebchuk et al., *supra* note 25, at 1515-24.

[188] *Id.* at 1525.

[189] *Id.*

[190] *Id.* at 1471.

[191] *Id.* at 1526.

executives with incentives to increase shareholder value."[192] Unfortunately, "there is no significant link between the interests of corporate leaders selling their companies and the post-sale interests of stakeholders."[193]

The proposed duty supplies the missing incentive by mandating that those at the negotiating table consider the interests of those who are absent.[194] This duty does not simply *authorize* them to do so—it *requires* them to do so. It makes mandatory what was previously only permissive, such as under state constituency statutes that merely authorize directors to consider stakeholder interests in decision-making.[195] This duty is what aligns the interests of corporate leaders with those of stakeholders. In its absence, we are unlikely to witness a meaningful change in contracting practices by corporate leaders, as demonstrated by the study above.[196] And without those changed practices, corporate leaders will continue to injure stakeholders through their contracting choices. The incentive is key to reversing these practices.[197]

By requiring corporations to translate stakeholderism into contract clauses, this duty facilitates comparison of companies' commitments to stakeholderism. It is these clauses that allow society to observe whether corporate leaders are making good on their proclamations in favor of stakeholders. Not all clauses are equal. The specificity, scope, and enforceability of negotiated contract clauses can help to distinguish those corporations making good on stakeholderism from those that just talk the talk. These comparisons are important if the public actually rewards companies that are more stakeholder friendly, because the duty makes it costlier for companies that do not care about stakeholders to imitate those that do. That is, the duty to contract allows for some level of observability and verifiability of corporate commitments to stakeholderism that can be compared and measured across companies.[198] The resulting market differentiation can offer its own incentive to include increasingly better stakeholder protections in contracts. While initially incentivized by a legal duty,

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[192] *Id.*; *see also* Fisch & Solomon, *supra* note 19, at 1335 ("[S]hareholders ultimately control corporate decisions through their voting power and the capital market discipline.").

[193] Bebchuk et al., *supra* note 25, at 1526.

[194] *See* Fisch & Solomon, *supra* note 19, at 1335 ("[U]nless corporate officials are compelled to consider and even to prioritize nonshareholder interests, we are skeptical that they will do so.").

[195] Bebchuk et al., *supra* note 25, at 1490 ("[A]s of October 1, 2010, all constituency statutes in force are merely permissive.").

[196] *See id.* at 1524-27.

[197] *See* Fisch & Solomon, *supra* note 19, at 1335 (discussing potential reforms to better align interests of corporate officials with stakeholders, such as governance structure and executive compensation changes and contractual constraints).

[198] *See* Eldar, *supra* note 29, at 994-95 (proposing new legal form that can serve as commitment device that distinguishes it in marketplace and, consequently, can help attract capital); Martinez & Fletcher, *supra* note 29, at 903 (explaining that "equality metrics" can help differentiate corporations truly committed to racial diversity from those whose actions are purely performative).

we may hope that the outcome—contract clauses—can trigger a race to the top.[199]

This duty also addresses the trade-offs that can render stakeholderism impractical. Corporate leaders may become overwhelmed by the prospect of identifying who they should protect, how they should do so, and what they should do when protection for one stakeholder detracts from benefits to another. But, under this duty, corporate leaders do not need to fret over what they should be doing because the duty provides that answer: contracting. Certainly, this duty does not eliminate the trade-off problem: contractual protections for some stakeholders can create undesirable impacts for others.[200] But it supplies a limiting principle that makes stakeholderism more effective in practice. Corporate leaders are not charged with accounting for the interests of all potential stakeholders who may be affected by their contract; rather, they are responsible for considering the interests of those who may be harmed by performance of the contract as designed.[201]

V. OBJECTIONS

The normative and practical solutions proposed in this Article raise two potential objections addressed below. Section V.A discusses the risk that the

[199] For example, in October 2021, Merck and the Medicines Patent Pool ("MPP") announced "the signing of a voluntary licencing agreement to facilitate affordable global access for molnupiravir, an investigational oral COVID-19 antiviral medicine" to "help create broad access for molnupiravir use in 105 low- and middle-income countries (LMICs) following appropriate regulatory approvals." Press Release, Meds. Patent Pool, The Medicines Patent Pool (MPP) and MSD Enter into Licence Agreement for Molnupiravir, an Investigational Oral Antiviral COVID-19 Medicine, to Increase Broad Access in Low- and Middle- Income Countries (Oct. 27, 2021), https://medicinespatentpool.org/news-publications-post/mpp-msd-new-licence-announcement-molnupiravir [https://perma.cc/MN27-L52N]. The license agreement is publicly available without redactions. *Molnupiravir (MOL)*, MEDS. PATENT POOL, https://medicinespatentpool.org/licence-post/molnupiravir-mol [https://perma.cc/G7H5-X5JX] (last visited Mar. 16, 2022). Investor groups hoped that the "precedent-setting event" would "pressure other pharmaceutical companies with COVID-19 entries in late-stage trials such as Pfizer and Roche to follow suit and enter into negotiations with the MPP, and for peer companies to consider joining similar license-sharing programs such as the [World Health Organization's] mRNA technology hub." Press Release, Interfaith Ctr. on Corp. Resp., Shareholders Welcome Merck's Decision to Share IP for Covid-19 Anti-viral Drug (Oct. 28, 2021), https://www.iccr.org/shareholders-welcome-mercks-decision-share-ip-covid-19-anti-viral-drug [https://perma.cc/P8FG-XAF2] (quoting Sister Judy Byron of the Northwest Coalition for Responsible Investment: "Merck has become a first-mover with molnupiravir for COVID-19 and we will be letting its peers know of our expectation that they will soon be following in Merck's footsteps").

[200] *Cf.* RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL & EMOTIONAL HARM § 3 cmt. e (AM. L. INST. 2010) ("In certain situations, if the actor takes steps to reduce one set of injury risks, this would involve the burden or disadvantage of creating a different set of injury risks, and these other risks are included within the burden of precautions.").

[201] *See supra* Section III.A (basing duty to contract on harm prevention).

proposed duty overestimates the potential for contract design to address stakeholder harms. Section V.B explores the related concern that regulation may offer a better approach to stakeholder protection.

A. *Limits of Contract Design*

The first potential objection is that the duty to contract overestimates what contract design can accomplish. This concern is partially motivated by the realization that contracts are imperfect at eliminating risks—even for those negotiating and drafting the agreements.[202] Contract design will inevitably fail because of *information costs* and *trade-offs*. Parties encounter information costs when they negotiate, draft, and sign contracts: "[T]he parties might not foresee all possible contingencies or they would have to incur prohibitively high negotiation and drafting costs to partition all contingencies sufficiently to provide for efficient obligations in each case."[203] Information costs impede both ex ante contract design and ex post contract enforcement[204] and contribute to the *incompleteness* of most contracts:

> [T]he parties to a relationship will *not* write a contract that anticipates all the events that may occur and the various actions that are appropriate in these events. Rather they will write a contract that is *incomplete*, in the sense that it contains gaps or missing provisions; that is, the contract will specify some actions the parties must take but not others; it will mention what should happen in some states of the world, but not in others. A result of this incompleteness is that events will occur which make it desirable for the parties to act differently from the way specified in the contract.[205]

For example, some contracting parties do not include a force majeure clause in their contracts. A force majeure clause "defines an area of events that might excuse nonperformance within the contract period."[206] The absence of this clause presented a problem when the COVID-19 pandemic impeded the ability of many contracting parties to perform as expected.[207] This oversight can be partially explained by an informational challenge: prior to the pandemic, contracting parties likely did not anticipate that they would be unable to perform

[202] *See* Robert E. Scott & George G. Triantis, *Incomplete Contracts and the Theory of Contract Design*, 56 CASE W. RSRV. L. REV. 187, 190 (2005).

[203] *Id.* at 191.

[204] *Id.* at 190.

[205] Hart, *supra* note 93, at 123.

[206] Travis S. Hunter & Renée Mosley Delcollo, *Is the Force Majeure with You?*, AM. BAR ASS'N (July 6, 2020), https://www.americanbar.org/groups/litigation/committees/commercial-business/articles/2020/is-the-force-majeure-with-you-coronavirus-contracts/ [https://perma.cc/69BZ-GYAK].

[207] *See* Paula M. Bagger, *The Importance of Force Majeure Clauses in the COVID-19 Era*, AM. BAR ASS'N (Mar. 25, 2021), https://www.americanbar.org/groups/litigation/committees/commercial-business/boilerplate-contracts/force-majeure-clauses-contracts-covid-19/.

because of a pandemic or related government orders.[208] The nature and extent of the state of emergency declarations, stay-at-home orders, travel restrictions, nonessential business closures, and lockdowns have been described as unprecedented. Contracting parties frequently anticipate risks based on the past—things that have gone wrong before. It may therefore have proven difficult for them to anticipate and plan for these "unprecedented" events, which may explain why many of them did not.

Even those parties who did include a force majeure clause may have neglected to include the necessary language to trigger the clause, such as "pandemic" or "government shutdown orders."[209] The absence of these key words may prevent the application of the clause, which depends on contract interpretation of the words that the parties chose.[210] The result is that "very few contracting parties will be able to point to a specific term in their Force Majeure clause that covers the present situation."[211]

The second concern relates to trade-offs. Even if contracting parties have information, they need to agree on what to do based on that information. For example, legal counsel now advise clients to include contract provisions that address the COVID-19 pandemic and, possibly, as default language going forward.[212] But such a provision does not protect all parties equally. In a retail lease, for example, a tenant may prefer a force majeure clause that would suspend its obligation to pay upon the onset of a pandemic; for that reason, the landlord may not prefer such a clause. Depending on the nature of the government order, the landlord may still be able to perform—and may prefer to

[208] However, some commentators have pointed out that pandemics have occurred before—and may occur again—such that the risks were not completely unknown to the parties. *See* Andrew A. Schwartz, *Contracts and COVID-19*, 73 STAN. L. REV. ONLINE 48, 48 (2020).

[209] *See* Jamie Furia & Justin Corbalis, *Mounting a Successful COVID-19 Force Majeure Argument*, LAW360 (Sept. 25, 2020, 4:00 PM), https://www.law360.com/commercialcontracts/articles/1312711 ("[A]ny party seeking to excuse its contractual obligations based on a force majeure event must carefully connect the dots between the cause — whether a government order or the effects of the pandemic — and the frustration of the specific conduct sought to be relieved."); Schwartz, *supra* note 208, at 56-67 (identifying over two thousand cases involving force majeure clauses but none involving word "pandemic" and only seventy-four involving "epidemic"); Daniel Sharma, *Coronavirus: The Second Wave and Force Majeure*, DLA PIPER (Dec. 9, 2020), https://www.dlapiper.com/en/germany/insights/publications/2020/12/covid-19-the-second-wave-and-force-majeure/ [https://perma.cc/F6X9-KJVK] (distinguishing between "epidemic" and "pandemic" for triggering application of force majeure clause).

[210] *See* Sharma, *supra* note 209 ("Whether a force majeure clause is applicable in a particular case, and what its consequences would be, depends primarily on the wording of the clause. Courts have held that force majeure clauses are to be interpreted in a narrow sense and that performance under a contract is ordinarily excused only if the event preventing performance is explicitly mentioned in the force majeure clause.").

[211] Schwartz, *supra* note 208, at 57.

[212] *See, e.g.*, *id.* at 58 ("Now that the risk of pandemics has become salient, we are certain to see parties add terms like 'epidemic' and 'pandemic' to Force Majeure clauses in future contracts, as many commentators are now recommending.").

do so—while the tenant no longer finds its contract desirable or its obligation feasible. The question is: Who gets stuck with the cost of a rental property that is, at least temporarily, invaluable: tenant or landlord? A force majeure clause that addresses the pandemic can shift the cost from tenant to landlord, but the landlord may negotiate for something in exchange for such cost shifting.[213] This is the trade-off challenge: risk management tools are going to lead to different distributional outcomes for the two parties. In order to reach agreement despite these different preferences, contract parties trade various "carrots and sticks" pertaining to the clause or agreement.

Both of these concerns can compromise the implementation of the "duty to contract" proposed in this Article. Corporate leaders may argue that they encounter even greater information costs when designing contracts to protect stakeholders. They may claim ignorance as to how a contractual obligation may impact stakeholders who they cannot identify ex ante. They may similarly claim ignorance as to how to address this information deficit; the optimal strategy remains unknown ex ante and, consequently, is difficult to prescribe through explicit contractual obligations. There is also a trade-off problem because there is no one at the bargaining table to trade something in exchange for contractual protections for stakeholders. In the landlord example above, the tenant may agree to pay a higher rent or a larger deposit in order to include a force majeure clause that would protect it in the event of a pandemic. In the stakeholder example, neither contracting party may benefit from including stakeholder protections. It is not in their interest to do so—instead, it may impose costs—and there is no one at the bargaining table to "trade" them a corresponding benefit for providing such contractual protection.

There are three responses to these concerns. First, information costs are manageable because these contracts are not novel. Corporations have previously entered into data-sharing agreements, lease agreements, supply agreements, acquisition agreements, arbitration agreements, employment agreements, and many others—all of which have documented risks to stakeholders. Management is also under increasing pressure to remain informed about various risks to the corporation created by its own conduct. For example, the United Nations Guiding Principles require that companies engage in human rights due diligence which "should include assessing actual and potential human rights impacts, integrating and acting upon the findings, tracking responses, and communicating how impacts are addressed."[214] A number of countries around the world have

[213] *See, e.g.*, *id.* at 59 ("Contract negotiations are dynamic, and your counterparties will respond if you seek to include 'pandemic' to [sic] the Force Majeure clauses contained in future contracts. All else being equal, they will offer a lower price, because you are foisting the risk of nonperformance on to them."); Matthew Jennejohn, Julian Nyarko & Eric Talley, *Contractual Evolution*, 89 U. CHI. L. REV. (forthcoming 2022) (manuscript at 17-18) (explaining that, in exchange for pandemic carve-out in material adverse effect clause, "counsel for the buyer would likely be unwilling to accept a pandemic carve-out without extracting a buyer-friendly provision as a quid pro quo").

[214] U.N. Office of the High Comm'r for Hum. Rts., Rep. on the Guiding Principles on

implemented—or are considering—laws that would require covered companies to engage in such human rights due diligence.[215] A number of corporate scholars have also argued that assessing risk of stakeholder harms is part of fiduciary duties.[216] Therefore, corporate managers cannot claim ignorance of risks that they impose on stakeholders. Instead, they must gather this information under many circumstances, which, in turn, will lower the information costs associated with implementing this duty.

The trade-off concern is similarly unpersuasive. The incentive for stakeholder protection is provided by a legal duty as opposed to bargained-for benefits. The fact that contracting parties have little incentive to consider—let alone negotiate around—third-party interests only supports the need for a legal duty that applies to those at the bargaining table. Incentives are not static; they can be altered through new "carrots" and "sticks." And when there are limited carrots available at the bargaining table to incentivize stakeholder protection, this legal duty provides a stick. Hence, the need for a legal duty; the duty supplies the incentive that is otherwise absent at the negotiating table. Even if stakeholders are not present to offer corporations benefits in exchange for protection, the legal duty is present to threaten sanctions if corporations fail to consider this protection themselves.

The final response is that contracting parties already encounter these challenges in the contracting process and find strategies to manage them so as not to preclude agreement. They can also employ those strategies with respect to stakeholder protection. For example, contracting parties resort to the use of relational norms, judicial interpretation, and strategic ambiguous language to introduce sufficient flexibility to respond to contingencies post contract formation.[217] Interfirm collaborations often raise similar concerns when "[t]he precise goal and manner of achieving it only become clear in the course of the

Business and Human Rights, at 17, U.N. Doc. HR/PUB/11/04 (2011).

[215] *See Mandatory Due Diligence*, BUS. & HUM. RTS. RES. CTR., https://www.business-humanrights.org/en/big-issues/mandatory-due-diligence/ [https://perma.cc/VM3V-HRZV] (last visited Mar. 16, 2022).

[216] *See, e.g.*, Gadinis & Miazad, *supra* note 28, at 1459 ("[C]ourts should recognize ESG as an essential part of boards' monitoring mission."); David Millon, *Human Rights and Delaware Corporate Law*, 25 PAC. MCGEORGE GLOB. BUS. & DEV. L.J. 173, 182-86 (2012) (discussing potential legal and reputational risk associated with human rights violations abroad and risk management responsibility of boards of directors).

[217] *See, e.g.*, Al-Najjar, *supra* note 106, at 435 (discussing roles of ambiguous language, "reputation, conventions, property rights over physical assets, or the legal system" in introducing flexibility); Hadfield, *supra* note 98, at 957 ("A rational decisionmaker, aware of the problems of control and opportunism, simply would not enter into a contract so incomplete if it represented the entirety of expected obligations and commitments. Instead, I argue, franchisee and franchisor enter into a 'franchise relationship' in reliance on commonly understood features of that relationship which fill in the gaps of the written contract and create an understanding of the full range of commitments involved."); Scott & Triantis, *supra* note 202, at 197 (discussing use of broad standards to shift costs to judicial interpretation, which has informational advantage of post-contract-formation reality).

parties' collaboration."[218] The solution is that many contracting parties incorporate an "information regime [that] allows for the joint interpretation of ambiguity, and makes observable to the parties those actions that would be opaque in an unstructured, informal exchange. This heightened, mutual observability allows the parties to learn about their respective capabilities as well as their disposition to cooperate."[219] Many parties, such as those operating in innovative industries, also specify formal governance and decision-making procedures in the contract that would allow the parties to respond to new information in a manner that preserves their collaboration, including processes for dispute resolution.[220] Similarly, franchise contracts "do[] not specify the details of the many transactions that will take place within the framework of the basic exchange."[221] Instead of "spelling out every decision *ex ante*, [a franchise contract] designs a decisionmaking structure and assigns to the franchisor responsibility for responding to market conditions as they arise and to the franchisee responsibility for compliance."[222]

Contracting parties can use similar strategies to protect stakeholder interests even when they do not have access to all the information that may be useful in crafting such protection. In fact, parties could use contract design as a means of augmenting the information they claim not to possess. The stakeholder impact assessments discussed in Part III can help to identify: (a) stakeholders who may be negatively impacted by one or more contractual obligations, including identifying the obligation; (b) the nature of the impact; and (c) the extent or gravity of the impact, including its duration.[223] If this practice were regularized,

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[218] Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice, and Doctrine*, 110 COLUM. L. REV. 1377, 1385 (2010); *id.* at 1391 ("Formal enforcement can break down, however, where the optimal actions for each party depend on the future state that materializes. Uncertainty about the future makes specifying most future states—let alone the appropriate action that is to be taken if they occur—prohibitively costly or impossible.").

[219] *Id.* at 1403.

[220] *Id.*

[221] Hadfield, *supra* note 98, at 946.

[222] *Id.* at 948.

[223] At least one recent proposal sought to mandate information about ranked risk assessments. The Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act of 2019 sought to require issuers of securities to provide a human rights disclosure that would identify human rights risks and impacts "that are known or should be known," and rank the identified risks and impacts based on severity. Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act of 2019, 116th Cong. § 3 (discussion draft July 2, 2019), https://financialservices.house.gov/uploadedfiles/bills-116pih-corphuman.pdf [https://perma.cc/H9JB-JAAG]. The proposal also clarified that issuers' rankings should account for the gravity and extent of the risks and harms as well as any challenges of remedying potential harms. *Id.* This proposal was not formally filed during the 116th Congress and, so far, has not been introduced during the current legislative session. However, the House of Representatives passed legislation in June 2021 that would require the SEC to "conduct a study about the value to investors of . . . information about the human rights

it would encourage contracting parties to fully assess the impact of their bilateral relations on those not at the bargaining table. This step reduces the information deficit because each party may be aware of stakeholder impacts that the other is not. For example, in a cross-border deal, each party may be better able to assess the stakeholder impacts in its own jurisdiction. This step of the negotiation process would encourage the parties to share information of which they are aware. This information-sharing stage could also encourage parties to consult with potential stakeholders to complete the impact assessment. As such, this step would not only encourage contracting parties to exchange information with each other but would also incentivize them to gather information not in their possession.

The information-sharing stage assists both stakeholders and contracting parties. It assists stakeholders because it encourages contracting parties to consider the full extent of the costs of the exchange—including potential negative externalities. It also creates an opportunity for stakeholders to play a role in early contract negotiations by informing contracting parties about stakeholder impacts. This stage is in the interest of the parties because it encourages each party to share information that is in their possession about potential long-term risks. If this information is kept private, the party in possession of it can independently manage its consequences or even bargain around it without the counterparty's knowledge. Should the risk come to fruition, the better-informed party may be in a better position to cope with the consequences than the blindsided party. A stakeholder impact assessment can force the better-informed party to reveal information that is otherwise private, which can help both parties plan accordingly.[224] It can also help contracting parties to focus on issues that they may otherwise marginalize during contract negotiations, only for those issues to arise post contract formation. As such, it enables better contract planning at the initial stage.

commitments of issuers . . . including information about any principles used to evaluate risk, constituency consultation process, and supplier due diligence." Corporate Governance Improvement and Investor Protection Act, H.R. 1187, 117th Cong. § 605 (as passed by House of Representatives, June 16, 2021).

[224] For example, Ian Ayres and Robert Gertner explain that one source of contract incompleteness is strategic: "One party might strategically withhold information that would increase the total gains from contracting (the 'size of the pie') in order to increase her private share of the gains from contracting (her 'share of the pie')." Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 94 (1989). They argue that "[b]y changing the default rules of the game, lawmakers can importantly reduce the opportunities for this rent-seeking, strategic behavior" especially by including "penalty defaults that induce knowledgeable parties to reveal information by contracting around the default penalty." *Id.*

B. *Why Not Regulate?*

A second important objection is that the best way to protect stakeholders is through regulation and not contract design.[225] Many may prefer public regulation because it can also account for the negative effects of contracts on third parties and mandate that parties take certain precautions, limit their activities within prescribed parameters, or provide warnings to at-risk third parties. Public regulation may also provide a variety of enforcement mechanisms to ensure that contracting parties adhere to these limitations.

Regulation proponents may therefore worry that the focus on stakeholderism detracts from the prospect of such regulation and builds up hope in corporate self-regulation or other alternatives.[226] This Article is not intended to detract from regulatory efforts. But there are a number of difficulties with this faith in public law, including *information asymmetries*, *distributional concerns*, and *extraterritorial effects*. The first challenge deals with the comparative knowledge of the regulated versus the regulators regarding the underlying problem that gives rise to the need for regulation.[227] In the stakeholder context,

[225] *See, e.g.*, Bebchuk & Tallarita, *supra* note 11, at 95 ("Those who are deeply concerned about how corporations affect stakeholders . . . should support efforts to ensure that capitalism works well for all corporate stakeholders. In our view, the most effective way to do so is by adopting laws, regulations and government policies . . . aimed at protecting stakeholder groups.").

[226] *See, e.g.*, *id.* at 164 (criticizing stakeholderism for asking stakeholders to rely on "well-meaning corporate leaders using their discretion to incorporate stakeholder interests into their objectives").

[227] *See, e.g.*, Roberta Romano, *Regulating in the Dark*, *in* REGULATORY BREAKDOWN: THE CRISIS OF CONFIDENCE IN U.S. REGULATION 86, 87 (Cary Coglianese ed., 2012) (arguing that "regulators necessarily operate under considerable uncertainty and at a lag behind private actors" as "financial firms operate in a dynamic environment in which there are many unknowns and unknowables and state-of-the-art knowledge quickly obsolesces"). For example, in order to perform antitrust review of tech giants, the head of the Justice Department's antitrust division "assigned four attorneys and two staff economists to train in artificial intelligence and machine learning to better understand the work that technology companies do." Rob Copeland, *Breakup of Tech Giants 'on the Table,' U.S. Antitrust Chief Says*, WALL ST. J. (Oct. 22, 2019, 2:00 PM), https://www.wsj.com/articles/breakup-of-tech-giants-on-the-table-u-s-antitrustchief-says-11571765689. Even attempts to increase information flows can lead to the risk of regulatory capture, as Wendy Wagner discusses:

> In administrative law, the absence of limits on the quality, quantity, or content of information submitted to the agency makes the temptation to inundate the agency with reams of technical details and multiple arguments all but irresistible. Indeed, a variety of doctrinal and statutory incentives unwittingly encourage regulatory participants to load the administrative system with more and more information in ways that ultimately undermine pluralistic oversight by creating unfair advantages for those advocates who have the resources to engage in these excessive processes.

Wendy E. Wagner, *Administrative Law, Filter Failure, and Information Capture*, 59 DUKE L.J. 1321, 1328 (2010); *see also* Jonathan C. Lipson, *Against Regulatory Displacement: An Institutional Analysis of Financial Crises*, 17 U. PA. J. BUS. L. 673, 688-91 (2015) (reviewing critiques of "regulatory capture" and concluding that "capture presents a serious problem in corporate actors are frequently better informed than regulators about how their contemplated and current operations endanger stakeholders.[228] Risks only become common knowledge once they materialize into actual harm to a stakeholder, and at that point, we all know—including regulators. This information asymmetry complicates regulatory design that seeks to prevent the harm *before* it arises. Corporate actors are not only better informed about risks; they may also be better informed about the strategies needed to manage those risks.

The problems associated with regulatory solutions to stakeholder protection are further demonstrated by *distributional* and *extraterritorial* concerns. The distributional concern explains the frequent lack of political will to *do something*: elected officials are reluctant to champion legislative solutions when the costs are borne by their constituency but the direct benefits of the legislation pass to those outside the constituency. These are the distributional effects of legislation. Lawmaking is costly—informationally, financially, and politically. As discussed above, regulation is dependent on information, and it can prove costly—including financially—to gather, analyze, and use that information to inform legislation. Due to these costs, legislation may prove politically costly because it uses up a variety of resources that could be devoted to other issues. These limitations are further compounded when the beneficiaries are unknown, few, or abroad.[229] For example, the direct beneficiaries of supply chain legislation may be foreign workers in supply chains overseas or other vulnerable communities, rather than Americans.[230] Therefore, a legislative approach in the United States would commit valuable resources to the production of laws that would primarily benefit those who are not part of the body politic.

the regulation of financial services").

[228] *Cf.* Lipson, *supra* note 227, at 690 (explaining information asymmetry between financial regulators and private-sector risk managers as source of regulatory capture).

[229] *See, e.g.*, Johnston et al., *supra* note 142, at 41 ("First, the law may be irrelevant in situations where corporations produce externalities across borders, and outside the reach of (national) regulation. Second, it may be difficult for the regulator to identify social costs before they occur."); *id.* ("[Third, a]s production processes become more complex and supply chains become longer, regulation has to abandon general principles applicable to entire industries or the economy as a whole in favour of an approach, which differentiates between individual firms, and even individual activities. This third aspect of the trilemma greatly increases regulatory costs.").

[230] *E.g.*, Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act of 2019, 116th Cong. § 2 (discussion draft July 2, 2019), https://financialservices.house.gov/uploadedfiles/bills-116pih-corphuman.pdf [https://perma.cc/H9JB-JAAG] ("The human rights policies, practices, and impacts of publically [sic] traded companies in the United States are material to investors and the broader public interest in the short-term and long-term and should be disclosed to investors and the general public annually to help inform investment decision-making and support the public interest in ensuring publically [sic] traded companies in the United States do not cause or contribute to adverse human rights impacts in the United States or in other countries.").

This is a variant of the interest-leverage divergence problem discussed in Section I.C. Its earlier invocation explained the failure of *private* (or *market*) regulation of corporate misconduct: those with leverage over corporations (such as investors or consumers) do not have sufficient interest in sanctioning corporations for wrongful conduct because they are not the ones who bear the harms from that conduct.[231] As a result, market incentives frequently fail to curb corporate misconduct.[232] But this problem also arises in *public* regulation: those who bear the costs of public regulation (and therefore help to determine the demand for it) may not be the direct beneficiaries of the resulting laws. Even if legislators enacted such a law, they need to confront the issue of extraterritorial application of these laws to conduct in other countries. Such concerns ultimately proved fatal to attempts to hold companies liable for human rights abuses abroad through the Alien Tort Statute.[233] The combination of these additional factors may help to explain why we don't see more robust legislation protecting stakeholder groups in the supply chain or otherwise.

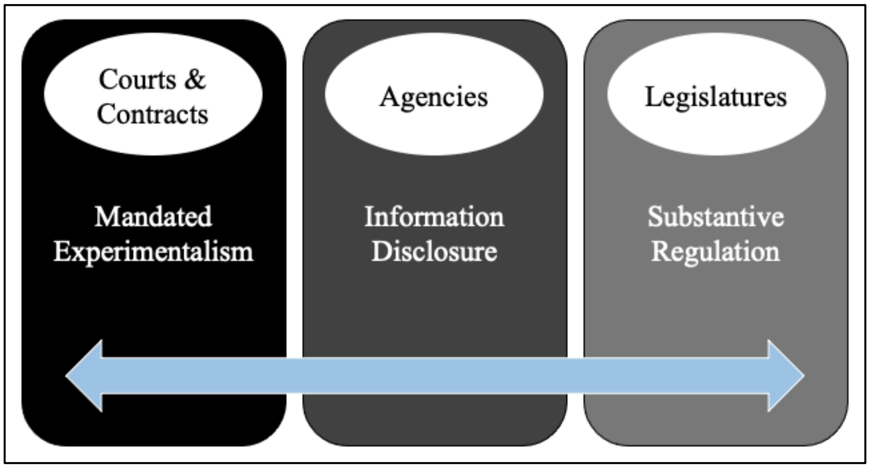
As illustrated below in Figure 2, contract design may address many of these challenges and facilitate—not impede—subsequent regulatory solutions through a progression of regulatory phases governed by different institutions. The remainder of this Section describes one approach in which contract design facilitates regulation. The first phase is "mandated experimentalism," in which courts enforce a duty to contract that requires corporate actors to engage in experimentation regarding the optimal solutions for addressing, mitigating, and eliminating risks to stakeholders. This is "mandated" because it is a recognized duty. It is "experimentalist" because the standard of care is only satisfied by reasonable contract design in light of contracting parties' knowledge.

[231] *See supra* Section I.C (explaining lack of interest convergence between shareholders and stakeholders).

[232] *Cf.* Bebchuk & Tallarita, *supra* note 11, at 119 (advocating for external regulation to address negative "environmental impact of a company's operations").

[233] *See* Kiobel v. Royal Dutch Petrol. Co., 569 U.S. 108, 124-25 (2013).

Figure 2. Example of Progressive Regulation Aided by Contract Design.



For example, imagine that Buyer and Supplier include in their contract a standard model clause that provides for monitoring and inspection rights of Buyer regarding Supplier's factories overseas.[234] Several months later, Buyer learns that Supplier is committing forced labor violations in its supply chain. An internal audit by Buyer reveals that Buyer's auditing practices, announced to Supplier prior to the visit, contributed to the forced labor violations by providing Supplier with several opportunities to hide its violations. Buyer now terminates its contract with Supplier and enters into a contract with a second supplier, Supplier 2. In its contract with Supplier 2, Buyer cannot satisfy the legal standard by using the same contract provisions it used in its previous contract with Supplier. It now knows that announced audits do not work; therefore, it must use its increased knowledge to design more effective clauses in its new contract with Supplier 2.

By mandating this experimentation, courts force corporate actors to accumulate knowledge about risks, impacts, causes, solutions, and the effectiveness of those solutions. Of course, that information does not help the regulatory process if it is known only to contracting parties. The second phase is thus concerned with information disclosure. Here, corporate actors are required to disclose information to the public (including legislators) about their attempted contractual design approaches and the effectiveness of those approaches.[235] As such, the combination of phase one (*mandated*

[234] *See supra* Section III.B.2 (providing example of contract language that would encourage information flows between corporations and suppliers, including through inspection rights).

[235] *See* U.N. OFF. OF THE HIGH COMM'R FOR HUM. RTS., *supra* note 135, at 33 ("Appropriate disclosure of the contract terms allows both parties to communicate transparently with those who will be affected by the project in an effort to reduce suspicion

experimentalism) and phase two (*information disclosure*) results in important information subsidies to legislators regarding the desired legislation.[236] By mandating disclosure, legislators do not need to speculate on what may work to protect stakeholders, nor do they need to invest time and resources to gather that information. Corporate actors have already gathered and tested various solutions through the first phase of mandated experimentalism. Legislators benefit from this knowledge when they mandate that corporations share what they have found through information disclosure.[237]

These two preliminary phases can facilitate a third phase of regulation (*substantive regulation*) when government actors benefit from the information that has been gathered and shared.[238] These information subsidies help to address some of the earlier concerns with regulatory solutions. The easiest benefit is that it helps address information asymmetries between the regulated and the regulator by forcing the former to share that information. But it improves the information sharing by also forcing corporate actors to gather information that they otherwise may not. In this way, the mandated experimentalism phase involves burden-shifting from the regulators to the regulated concerning the accumulation of knowledge needed to support meaningful regulation.

Regulatory information subsidies not only mitigate the first regulatory challenge—information asymmetries—but also the distributional challenge. By reducing information costs of regulation, information subsidies also help lower costs the constituency needs to bear to produce that regulation. By narrowing the gap between ex ante costs and ex post benefits, information subsidies

regarding the fairness of the contract terms and guard against unrealistic expectations. Thus, disclosure should be viewed as one part of any community engagement plan. Disclosure of the contract also promotes accountability of both parties to implement the promises agreed in the contract and notifies third parties of the rights and obligations of the parties to the contract." (citation omitted)). Some countries have adopted or proposed supply chain legislation that seeks information disclosure of both risks and effectiveness of corporate actors in addressing those risks. *See, e.g.*, Modern Slavery Act 2015, c. 30, § 54(5)(d)-(e) (UK) (recommending disclosure of "the parts of its business and supply chains where there is a risk of slavery and human trafficking taking place, and the steps it has taken to assess and manage that risk" and "its effectiveness in ensuring that slavery and human trafficking is not taking place in its business or supply chains, measured against such performance indicators as it considers appropriate"); Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act of 2019 § 3(s)(2)(F) ("[F]or any action taken, the assessment of the issuer of the efficacy of the action and a description of any outcomes of such action . . . .").

[236] *See generally* Michael C. Dorf & Charles F. Sabel, *A Constitution of Democratic Experimentalism*, 98 COLUM. L. REV. 267 (1998) (discussing benefits of "directly deliberative polyarchy" and "information pooling").

[237] *See* Martinez & Fletcher, *supra* note 29, at 899-900 (recommending that companies disclose strategies employed to meet diversity targets to help evaluate effectiveness of various strategies and allow companies to learn from one another's experiences).

[238] *See* Romano, *supra* note 227, at 104 (arguing in favor of financial regulatory mechanisms that encourage both regulatory experimentation and information sharing regarding effectiveness of that experimentation).

increase the acceptability of a particular regulation because, all other things equal, it will not cost as much to produce.

In this example, different institutions work together to increase the likelihood of the outcome some stakeholder advocates prefer: substantive regulations prescribing desired corporate conduct. But the road to that outcome is paved by the efforts of other institutions. The first phase is overseen by the courts and created by a "duty to contract"; this phase would not occur but for the role of the courts. This phase is also furnished by private contracting that introduces the experimentalist dimension. Critically, this contracting element establishes the foundation of information that will be passed through to regulators in the subsequent phases. Here, corporate actors, through their various contractual arrangements, will collect information about stakeholder risks, impacts, causes, solutions, and effectiveness. This information is then shared publicly through government-mandated information disclosure, and the disclosed information subsidizes the costs associated with reaching the final phase of substantive regulation, which will likely be undertaken by the legislature. As such, private contracting is not a substitute or competitor to public regulation; instead, it can serve as an important predicate condition that can increase the likelihood of reaching substantive regulation.

CONCLUSION

This Article proposes "contractual stakeholderism" to address both the needs of stakeholderism advocates, and the challenges raised by stakeholderism critics regarding the risk that stakeholderism is either inauthentic or impractical. It is not a perfect solution. Contracts are limited, trade-offs are unavoidable, and managerial agency costs remain. But this approach offers a way to meaningfully implement stakeholderism so that it will have real-life consequences for all those individuals who are routinely harmed by corporations' contractual choices. And that is a lot of people. By translating stakeholderism into actual contractual commitments—and not just empty rhetoric—this approach allows us to identify those companies that mean what they say when it comes to the welfare of their employees, customers, and communities. The contract is the proof of their commitment.

Aside from its practical consequences, this approach also reframes the *reasons* for protecting stakeholders. The basis for stakeholder protection matters because it can determine the quality and extent of that protection and at what cost. A business case can get us only so far. At some point, stakeholder protection will clash with business interest, but that conflict should not always end with stakeholders losing. Instead, it is important to shift stakeholder protection away from corporate or societal receipt of benefits and towards prevention of stakeholder harms. When corporations act in the world, it is only reasonable that we hold them accountable for the harms they cause. When these harms originate in the contracts they design and perform, it is equally reasonable to expect that a corporation's leaders will exercise their abilities to prevent those harms from arising in the first place.