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BENEFIT CORPORATIONS:
INCREASED OVERSIGHT THROUGH CREATION OF THE
BENEFIT CORPORATION COMMISSION

Thomas J. White III[†]

Abstract

Traditional for-profit and nonprofit corporate forms do not provide the appropriate framework for an organization pursuing both profits and social responsibility. In response, state legislatures have begun to take initiative by offering new business forms to accommodate for an increased demand in social responsibility. These hybrid forms seek to offer an organization the optimal platform by which to meet their dynamic goals. This Note will analyze the recently popular hybrid form of a benefit corporation. Further, this Note will dissect the Model Benefit Corporation Legislation and explain how benefit corporations provide a solution to the theory of shareholder wealth maximization. In closing, this Note will expose a deficiency in the model legislation and offer a solution to this deficiency. In particular, this Note will argue that the current enforceability and accountability provisions do not provide a sufficient assurance that all stakeholders' interests will be adequately protected.

INTRODUCTION

Recent trends have shown an increased interest in favor of economic and social responsibility. Consumers, now more than ever, are focused on the means used in the production of a product (or service), than the product itself.¹ In fact, assuming price and quality equal, eighty-seven percent of consumers would choose a product that has a good cause associated with it over one that does not.² This is compared to

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1. See William H. Clark, Jr. & Elizabeth K. Babson, *How Benefit Corporations Are Redefining the Purpose of Business Corporations*, 38 WM. MITCHELL L. REV. 817, 819 (2012) (“A significant and growing population of consumers already aligns its purchases with its values, and many more have become conscious of the issue.”).

2. *Cone Cause Evolution and Environmental Survey 7* (2007), <http://www.conecomm.com/2007-cause->

a sixty-six percent preference in 1993.³

Corporations have adjusted in an effort to match the increased demand in social responsibility. Consequently, the ill-famed “greenwashing” tactics emerged. Greenwashing occurs when “disinformation [is] disseminated by an organization so as to present an environmentally responsible public image.”⁴ Companies market themselves and their products as promoting environmental interests when in reality, many of the corporations do not act as advertised. Companies of all sizes are guilty—including many that are well established.⁵ For example, the Coca-Cola Company was under scrutiny in Denmark after marketing a so-called “PlantBottle.” The marketing consisted of environmentally friendly imagery intended to draw a stronger perception of the company’s concern for the environment than reality. The alleged PlantBottle was in fact only produced by a maximum of fifteen percent plant material—hardly deserving of the term PlantBottle.⁶

Popular buzzwords are stressed in a gluttonous manner. This chronic deception is leading to a decreasing trust by consumers.⁷ Consequently, companies holding true to their principles are not properly valued. Consumers, becoming increasingly aware of these deceptive facades, do not place as much of an emphasis on purported socially responsible missions. The more often these terms are thrown out with no regulation to assure accuracy, the less meaning and effect they actually have on consumers.⁸ As a result of this confusion, consumers may end up completely eliminating economic and social responsibility considerations from their purchase decisions.

Consumers are not the only stakeholders who prefer to support a company that pursues positive social impact goals rather than a company that focuses predominantly on increasing shareholder wealth. For instance, seventy-two percent of employees “want their employers to do more to support a cause or social issue.”⁹ Investors are also becoming more inclined to infuse their capital into socially responsible companies.¹⁰ Socially responsible investing (SRI)—investment that incorporates environmental, social and governance concerns—has grown tremendously in the past few years.¹¹ In 2007, SRI accounted for roughly eleven percent,

evolution-and-environmental-survey.

3. *Id.*

4. Jacob Vos, *Actions Speak Louder Than Words: Greenwashing in Corporate America*, 23 NOTRE DAME J.L. ETHICS & PUB. POL’Y 673, 674 (2009) (quoting *Greenwash*, CONCISE OXFORD ENGLISH DICTIONARY (Judy Pearsall ed., 10th ed. 2003)).

5. See, e.g., Christopher Zara, *Coca-Cola Company (KO) Busted For ‘Greenwashing’: PlantBottle Marketing Exaggerated Environmental Benefits, Says Consumer Report*, INT’L BUS. TIMES (Sep. 3, 2013, 3:18 PM), <http://www.ibtimes.com/coca-cola-company-ko-busted-greenwashing-plantbottle-marketing-exaggerated-environmental-benefits>.

6. *Id.*

7. Clark & Babson, *supra* note 1, at 820.

8. *Id.*

9. *Cone Cause Evolution and Environmental Survey*, *supra* note 2, at 11 (noting this is up from 52% in 2004).

10. See, e.g., Amy Bell, *Redefining Returns: The Impact of an Emerging Investment Model*, J.P. MORGAN, <https://www.jpmorgan.com/pages/jpmorgan/is/thought/magazine/2Q2013/Redefining>.

11. *See id.*

or \$2.71 trillion, of all assets under management.¹² In 2014, merely seven years later, SRI had increased to roughly \$21.4 trillion in professionally managed assets.¹³ Venture capital firms, which invest in risky start-up business ventures in hopes for a higher return, have even begun to take an interest in socially responsible investing.¹⁴ For example, in 2008 the well-renowned venture capital firm, Kleiner Perkins Caufield & Byers (KPCB), launched a \$500 million “Green Growth Fund” intended to help bring to market innovative solutions to the world’s debated climate crisis.¹⁵ “We believe green technologies are both the key to solving our energy crisis and a tremendous business opportunity,” said KPCB Partner John Doerr.¹⁶ KPCB, a high-profile organization that has invested in companies such as Amazon and Google, shows just how serious SRI has become, and how profits—even high returns—can still be made. DBL Investors, another San Francisco venture capital powerhouse, has also had a sweeping influence on the growth of impact investment. In fact, the name “DBL” itself stands for “double bottom line,”¹⁷ where the first bottom line is to make a profit, and the second—to make a difference. DBL conditions their investments on companies working with DBL to identify the social impact each company wants to make and requires a report on the progress every six months.¹⁸

Even entrepreneurs themselves are acquiring an increased interest in companies that are focused more around a social benefit. Entrepreneurs are willing to sacrifice potential financial returns in exchange for an overall increased positive impact on society.¹⁹ Prominent business schools, such as Harvard and Stanford, are expanding their social entrepreneurship programs and paving the way for inspired entrepreneurs.²⁰ Magazines, such as Forbes, now place social entrepreneurs in the spotlight

12. SOCIAL INVESTMENT FORUM, 2007 REPORT ON SOCIALLY RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES iv (2007).

13. GLOBAL SUSTAINABLE INVESTMENT ALLIANCE, 2014 GLOBAL SUSTAINABLE INVESTMENT REVIEW 7 (2014).

14. See Janet E. Kerr, *Sustainability Meets Profitability: The Convenient Truth of How the Business Judgment Rule Protects A Board's Decision to Engage in Social Entrepreneurship*, 29 CARDOZO L. REV. 623, 656-57 (2007).

15. Press Release, *KPCB Launches Green Growth Fund* (May 1, 2008), <http://www.kpcb.com/news/kpcb-launches-green-growth-fund>; see also Press Release, Kleiner, Perkins, Caufield & Byers, *Kleiner Perkins Caufield & Byers Awards First "KPCB Prize for Greentech Policy Innovators"* (July 18, 2007), http://www.csrwire.com/press_releases/17364-Kleiner-Perkins-Caufield-Byers-Awards-First-KPCB-Prize-for-Greentech-Policy-Innovators- (KPCB awards \$50,000 to entrepreneurs for their achievement in addressing environmental policies and programs aimed at stunting global warming).

16. Press Release, *KPCB Launches Green Growth Fund* (May 1, 2008), <http://www.kpcb.com/news/kpcb-launches-green-growth-fund>.

17. Sarah Max, *Venture Capital Firm Invests in Start-Ups With a Social Mission*, N.Y. TIMES (Oct. 27, 2014), http://dealbook.nytimes.com/2014/10/27/a-track-record-for-making-money-and-making-a-difference/?_r=0.

18. *Id.*

19. See Steven Munch, *Improving the Benefit Corporation: How Traditional Governance Mechanisms Can Enhance the Innovative New Business Form*, 7 NW. J. L. & SOC. POL'Y 170, 174 (2012); see also *B Corps: Firms with Benefits*, ECONOMIST (Jan. 7, 2012), <http://www.economist.com/node/21542432> (noting that Patagonia, a well-known outdoor-clothing company, was one of the first organizations to take advantage of benefit corporation legislation in California).

20. *America's Best Colleges for Entrepreneurs, Best for Social Entrepreneurs*, CNNMONEY.COM, http://money.cnn.com/galleries/2007/fsb/0708/gallery.bestcolleges_social.fsb/5 (last visited Feb. 1, 2015).

through recognition programs such as “30 for 30”—commending the top thirty social entrepreneurs globally each year.²¹ One rising company that has caused a major disruption in the auto industry is Tesla Motors. Tesla was founded in 2003 under the assumption that electric cars could be more efficient than traditional gasoline-powered cars.²² The mission of Tesla: “accelerate the world’s transition to sustainable transport.”²³ Tesla Motors went public in June of 2010 and as of January 2015 has a market cap just short of \$25 billion.²⁴ Tesla’s success as a major market influencer verifies just how much impact the socially responsible initiative is having on entrepreneurs.

In response to this increased desire for socially responsible organizations, legislatures have adopted a number of options outside traditional entity formation. This Note will focus on the option of forming as a Benefit Corporation. On October 1, 2010, Maryland became the first state to enact benefit corporation legislation.²⁵ Since then, twenty-seven states have passed similar legislation and fourteen are in the process.²⁶

Benefit Corporation legislation is still in its infancy. At this time, it is not clear what effect the implementation of benefit corporation legislation will have on corporate law. Some critics argue this new entity is unnecessary.²⁷ This Note examines the ultimate viability of benefit corporations by delving into the mechanics of the model legislation. It offers a suggestion for improving the current framework of benefit corporation laws to better align with the purpose of the legislation.

Part I introduces corporate law as it exists today, and the alternatives provided outside benefit corporation legislation. Part II introduces the key components of benefit corporation statutes and highlights the major differences compared to the alternative options listed in Part I.B. Part III exposes a defect in the Model Benefit Corporation Legislation regarding inadequate representation of non-shareholder stakeholders and proposes the establishment of a state commission as a regulator.

I. EXISTING CORPORATE LAW

Generally, or at least traditionally, there has been a dichotomy between for-profit and nonprofit entities in state corporate law.²⁸ This binary organizational system may have been sufficient to meet the needs of businesses historically. How-

21. Erin Carlyle & Prerna Sinha, *Social Entrepreneurs*, FORBES, <http://www.forbes.com/special-report/2014/30-under-30/social-entrepreneurs.html>.

22. *About Tesla*, TESLA MOTORS, <http://www.teslamotors.com/about> (last visited Feb. 1, 2015).

23. *See id.*

24. *TSLA: Summary for Tesla Motors, Inc.*, YAHOO! FINANCE, <http://finance.yahoo.com/q?s=tsla&q1=1> (last visited Feb. 27, 2015).

25. *See State by State Legislative Status*, BENEFIT CORP. INFORMATION CENTER, <http://www.benefitcorp.net/state-by-state-legislative-status> (last visited Feb. 1, 2015).

26. *Id.*

27. *See, e.g.*, Briana Cummings, *Benefit Corporations: How to Enforce A Mandate to Promote the Public Interest*, 112 COLUM. L. REV. 578, 588 (2012).

28. Dana Brakman Reiser, *Governing and Financing Blended Enterprise*, 85 CHI.-KENT L. REV. 619 (2010).

ever, this model does not provide a sustainable framework to accommodate the emerging interest to blur the line between for-profits and nonprofits.²⁹ The gap between for-profits and nonprofits has led to an increasing failure of state law to set appropriate accountability and transparency standards by which to evaluate these multi-purposed entities.³⁰

A. Shareholder Wealth Maximization

While it is true that socially engaged entrepreneurs can incorporate their organization as a nonprofit, certain restrictions impose limitations on nonprofit corporations.³¹ In turn, many entrepreneurs are opting to form their organizations as for-profit entities.³² However, forming as a for-profit corporation also has its disadvantages. One major disadvantage relates to the theory of shareholder wealth maximization.

In the for-profit world, a well-debated theory concerns shareholder wealth maximization. In 1919, the Michigan Supreme Court issued the seminal case, *Dodge v. Ford*, stating:

A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.³³

The Michigan Supreme Court is not the only court to dictate the shareholder wealth maximization theory.³⁴ Although a staple in many corporate law classes, some critics have argued that shareholder wealth maximization is a myth, and that existing corporate law allows corporate decision-makers, such as directors, to take stakeholders other than shareholders into consideration.³⁵ Despite these contentions, *Dodge v. Ford* and its progeny remain good law and the theory of shareholder wealth maximization continues to be accepted.³⁶ Further, even if shareholder wealth maximization is a myth, the fact that agents of the corporation *can* consider the interests of other stakeholders does not mean that they *will* consider such interests. In

29. Felicia R. Resor, *Benefit Corporation Legislation*, 12 WYO. L. REV. 91, 92 (2012) (citation omitted).

30. *Id.* at 93.

31. *See infra* Part I.B.

32. William H. Clark, Jr., et al., THE NEED AND RATIONALE FOR THE BENEFIT CORPORATION: WHY IT IS THE LEGAL FORM THAT BEST ADDRESSES THE NEEDS OF SOCIAL ENTREPRENEURS, INVESTORS, AND, ULTIMATELY, THE PUBLIC 2, 4-5, 7 (2012) [hereinafter Benefit Corp. White Paper], available at http://benefitcorp.net/storage/documents/Benefit_Corporation_White_Paper_1_18_2013.pdf.

33. *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919).

34. *See, e.g.*, *Katz v. Oak Indus. Inc.*, 508 A.2d 873, 879 (Del. Ch. 1986); *Long v. Norwood Hills Corp.*, 380 S.W.2d 451, 475-76 (Mo. Ct. App. 1964); *Granada Invs., Inc. v. DWG Corp.*, 823 F. Supp. 448, 459 (N.D. Ohio 1993).

35. *See* Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford*, 3 VA. L. & BUS. REV. 163, 166 (2008) (arguing that “*Dodge v. Ford* is a mistake” and “a doctrinal oddity largely irrelevant to corporate law and corporate practice”); Cummings, *supra* note 27, at 587 (noting that neither the MBCA nor Delaware statutes affirmatively state corporate officers must maximize shareholder wealth).

36. Clark & Babson, *supra* note 1, at 825-26 (citing Stephen M. Bainbridge, *Corporation Law and Economics* §9.2, at 413 (2002)).

practice, general and outside counsel do not recommend agents take such action when legal analysis surrounding the issue is scarce.³⁷ Therefore, modern corporate law, in some capacity, focuses on shareholder wealth maximization to the detriment of social responsibility.

A 2010 opinion issued in Delaware serves as a recent affirmation of the tenacious theory of shareholder wealth maximization. *eBay Domestic Holdings, Inc. v. Newmark*³⁸ involved a dispute between the founders of Craigslist, the leading online classifieds site in the United States, and eBay as a new shareholder.³⁹ Although Craigslist was formed as a for-profit corporation, Craig Newmark and James Buckmaster, the majority shareholders, operated the company largely as a community service.⁴⁰ In fact, Craigslist never focused on monetizing their website—at least nowhere near the level of most of their competitors.⁴¹ In contrast, eBay, the online auction website, had quite a different approach, focusing on gaining market share and maximizing profits.⁴² eBay saw opportunity in Craigslist and made an investment to become a minority shareholder of Craigslist, allowing eBay to appoint a director to the board.⁴³ The relationship went south when Newmark and Buckmaster realized eBay had invested with the primary objective of making Craigslist a subsidiary of eBay.⁴⁴ eBay eventually sued claiming that Newmark and Buckmaster violated their duties as majority shareholders and directors.⁴⁵ The court found for eBay, noting that there was no evidence of “a sufficient connection between the craigslist ‘culture’ [] and the promotion of stockholder value.”⁴⁶ The court reasoned:

The corporate form in which craigslist operates, however, is not an appropriate vehicle for purely philanthropic ends, at least not when there are other stockholders interested in realizing a return on their investment. Jim and Craig opted to form [C]raigslist, Inc. as a *for-profit Delaware corporation* and voluntarily accepted millions of dollars from eBay. . . . Having chosen a for-profit corporate form, the craigslist directors are bound by the fiduciary duties and standards that accompany that form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders Thus, I cannot accept as valid for the purposes of implementing [] a corporate policy that specifically, clearly, and admittedly seeks *not* to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders.⁴⁷

The appropriate standard of conduct for the agents of a corporation may depend

37. Benefit Corp. White Paper, *supra* note 32, at 13.

38. *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1 (Del. Ch. 2010).

39. *Id.* at 7.

40. *Id.* at 8.

41. *Id.*

42. *Id.* at 9.

43. *Id.* at 11.

44. *See id.* at 14-16.

45. *Id.* at 25.

46. *Id.* at 34.

47. *Id.*

on the circumstances. For example, in Delaware, a court's standard of review depends on three general categories of decisions: (1) those made on a day-to-day basis; (2) those made as defensive measures; and (3) those made during change-of-control transactions.⁴⁸ The Craigslist example falls within the second category.

With respect to day-to-day decisions, Delaware law, along with most states, erects a hefty shield known as the business judgment rule. The business judgment rule is a rebuttable presumption that "in making a business decision the directors of a corporation act on an informed basis, in good faith, and in the honest belief that the action taken [is] in the best interests of the company."⁴⁹ Or in layman's terms, a default rule assuming a decision was lawful and is difficult to disprove. In this context, directors may have slightly more leeway in making socially responsible decisions regarding day-to-day issues. Even so, directors are well advised to refrain from any decision that does not increase shareholder value, and more critically, one that actually reduces shareholder value.

Moving down the ladder, directors acting to defend a hostile takeover are not afforded as much deference as they are with day-to-day decisions. Instead, the Delaware courts apply a modified standard of review before directors fall under the umbrella of the business judgment rule. Under this heightened standard, directors must show they were responding to a legitimate threat to corporate policy and effectiveness, and their response was "reasonable in relation to the threat posed."⁵⁰ Only then may the director hide behind the protection of the business judgment rule. To use *eBay* as an example, the Chancellor found that "purely philanthropic ends" of the mission-driven company was not a legitimate corporate policy that could be threatened,⁵¹ and the directors' decision could therefore not be protected by the business judgment rule.

The final category involves the scenario in which a change of control becomes certain, that is, the sale of the company becomes inevitable; here, a corporation enters "Revlon mode," subjecting directors to specific duties.⁵² At this point, the duty of a director evolves into the sole obligation to pursue a sale of the corporation for a price that will provide the greatest return to shareholders.⁵³ In effect, this means that shareholders are the exclusive stakeholders to be taken into consideration during this process. At this stage, directors have a high probability of liability if they take an action that places the interests of any other stakeholder over those of the shareholders. In sum, corporations formed as for-profit entities continue to face severe limitations in their pursuit of social responsibility regardless of the scenario.

48. See Steven J. Haymore, *Public(Ly Oriented) Companies: B Corporations and the Delaware Stakeholder Provision Dilemma*, 64 VAND. L. REV. 1311, 1324 (2011).

49. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

50. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

51. See eBay, 16 A.3d at 35.

52. Haymore, *supra* note 48, at 1332 ("A corporation enters Revlon mode when it undertakes a transaction that will either cause a change of control or break up the corporate entity." (citing Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 47 (Del. 1994)).

53. *Id.* at 1333 (quoting Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986)).

B. Current Alternatives to Forming as a Benefit Corporation

As a general matter, the legal framework of corporate law for social entrepreneurs can be broken down into two broad categories: corporations and limited liability companies (LLCs).

First, a social entrepreneur may elect to form his or her business as a corporation. Formation as a corporation may be attractive because it limits liability and allows easy access to capital.⁵⁴ However, nothing guarantees that the corporation will continue to act socially responsible when an incongruous relationship to profits exists.⁵⁵ Indeed, disapproving shareholders may elect to bring an action against the corporation anytime a stakeholder interest other than theirs is favored. Further, corporations generally involve double taxation and require strict adherence to corporate formalities.⁵⁶ Opting to form as a corporation, a social entrepreneur may choose the entity formation of a “traditional” corporation, nonprofit corporation, flexible purpose corporation, or a benefit corporation.⁵⁷

Compared to “traditional” corporations, nonprofits allow much greater leniency in pursuit of social responsibility.⁵⁸ The biggest perk of electing to form as a nonprofit corporation is the tax-exempt status the corporation may acquire. Section 501 of the Internal Revenue Code lists the requirements for obtaining tax-exempt status.⁵⁹ The most well known provision is §501(c)(3),⁶⁰ which is primarily known for its inclusion of charitable organizations.⁶¹ Despite the enticing allure of obtaining tax-exempt status, nonprofits do have some drawbacks. For starters, they have a more restricted access to capital and therefore must devote significant resources to fundraising.⁶² By definition, nonprofits are not for profit.⁶³ Section 501(c)(3) nonprofits exist without the ability to produce profits for investors—meaning all earnings must be used for the §501-defined purpose(s) spelled out in the articles of incorporation.⁶⁴ This vastly limits the number of individuals who are willing to invest.⁶⁵ Therefore, entrepreneurs wishing to get the best of both worlds—make

54. Munch, *supra* note 19, at 173.

55. *Id.*

56. Jonathan Ng, *New Legal Forms for Social Entrepreneurs: Analyzing Benefit Corporations* (2014) (on file with the Notre Dame Journal of Legislation).

57. *Id.*

58. Munch, *supra* note 19, at 174.

59. See 26 U.S.C.A. § 501 (West 2010).

60. *Id.*

61. *Id.* (“[The organization must be] organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation . . . and which does not participate in, or intervene in . . . any political campaign on behalf of (or in opposition to) any candidate for public office.”).

62. Munch, *supra* note 19, at 174.

63. 26 U.S.C.A. § 501(c)(3) (West 2010) (stating that none of the organizations profits can benefit a private shareholder or individual).

64. Thomas Kelley, *Law and Choice of Entity on the Social Enterprise Frontier*, 84 TUL. L. REV. 337, 353 (2009) (citing Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (as amended in 2008)).

65. See, e.g., *id.* at 353-54 (citations omitted).

money for investors and optimize corporate responsibility—are forced to settle with the exclusive pursuit of the latter when forming as a nonprofit corporation.

Another alternative to the traditional corporation is formation as a flexible purpose corporation. Largely, flexible purpose corporations are very similar to benefit corporations.⁶⁶ However, there are several distinctions worth noting. One notable difference between a flexible purpose corporation and a benefit corporation is that the latter requires a “general public benefit,” whereas the former merely requires a “special purpose.”⁶⁷ Directors of a benefit corporation are required by statute to consider the impact of their decision on a range of constituents, while a flexible purpose corporation merely requires directors to consider the impact of their action on any special purpose.⁶⁸ Benefit corporations and flexible purpose corporations are also subject to different standards of evaluation. For benefit corporations, the corporation’s pursuit of their defined purpose is required to be evaluated by a third-party standard.⁶⁹ In contrast, flexible purpose corporations are not required to be evaluated by a third-party standard.⁷⁰ Additionally, benefit corporation legislation provides a new cause of action, called a benefit enforcement proceeding,⁷¹ designed to instill adherence to the corporation’s purpose. Flexible purpose corporation legislation, on the other hand, places greater trust in the business judgment of the directors. Such legislation does not introduce any new right of action, but rather relies on the transparency requirements to provide the appropriate check on directorial decisions.⁷² In the end, benefit corporation legislation is better equipped for companies valuing social responsibility over access to traditional capital markets.⁷³

Second, a social entrepreneur may elect to form as an LLC. LLCs generally involve pass-through taxation, allow greater flexibility with respect to governance and management, but are more limited in their access to capital than corporations.⁷⁴ A social entrepreneur may elect to form as a traditional limited liability company or the newly created low-profit limited liability company (L3C).⁷⁵ L3Cs are similar to traditional LLCs but with an added focus on charitable goals.⁷⁶ The driver of L3Cs is program-related-investments (PRIs).⁷⁷ PRIs are investments made with the pur-

66. Resor, *supra* note 29, at 103.

67. W. Derrick Britt, R. Todd Johnson & Susan H. MacCormac, THE CALIFORNIA WORKING GROUP FOR NEW CORPORATE FORMS, FREQUENTLY ASKED QUESTIONS - PROPOSED AMENDMENTS TO THE CALIFORNIA CORPORATIONS CODE FOR A NEW CORPORATE FORM: THE FLEXIBLE PURPOSE CORPORATION AND SENATE BILL 201 (2011).

68. *Id.*

69. MODEL BENEFIT CORP. LEGISLATION, § 401 (William Clark, Jr. 2014), available at <http://benefitcorp.net/attorneys/model-legislation>.

70. See, e.g., CAL. CORP. CODE § 2602 (West 2011).

71. MODEL BENEFIT CORP. LEGISLATION, § 305.

72. See, e.g., Britt, Johnson & MacCormac, *supra* note 67, at 10.

73. See *id.*

74. Jonathan Ng, New Legal Forms for Social Entrepreneurs: Analyzing Benefit Corporations (2014) (on file with the Notre Dame Journal of Legislation).

75. *Id.*

76. See Elizabeth Schmidt, *Vermont's Social Hybrid Pioneers: Early Observations and Questions to Ponder*, 35 VT. L. REV. 163, 163 (2010).

77. See *id.* (citing I.R.C. § 4944(c) (West 2010); Treas. Reg. § 53.4944-3(a) (2009)).

pose of furthering a private foundation's goals,⁷⁸ while ensuring the foundation's tax-exempt status is not jeopardized as a result of the investments.⁷⁹ LLCs are generally permitted to receive PRIs without forming as an L3C.⁸⁰ However, L3C formation reduces the donor's due diligence burden in verifying the organization is in compliance with federal law.⁸¹ Although L3Cs remain a viable alternative, opting to form as a corporation may still be a superior route for many social entrepreneurs to take. Corporations, through the issuance of securities, generally have a greater access to capital than LLCs. Further, a corporation is better suited for a company that intends to scale their operations in the future.⁸² Generally speaking, corporations provide much greater transferability and liquidity to shareholders than do LLCs.⁸³ In sum, both corporations and LLCs have unique advantages and disadvantages.

It should also be noted that constituency statutes may permit directors of corporations to consider the interests of stakeholders other than shareholders.⁸⁴ Initially, constituency statutes were adopted by legislatures as an antitakeover device.⁸⁵ Within such context, these statutes give directors the ability to consider constituents other than shareholders.⁸⁶ Inevitably, with the expanded interest in corporate responsibility, it could be argued that these statutes should be analyzed outside the hostile takeover context.⁸⁷ It is important to note, however, that the expansive power of directors is permissive and not mandatory.⁸⁸ In contrast, benefit corporations are affirmatively required to consider the interests of stakeholders other than shareholders.⁸⁹ Many of these constituency statutes also limit the "other" stakeholders to be taken into consideration.⁹⁰ A number of the valued stakeholders that must be considered under the model legislation are not included in the limited scope of the reciprocal constituency statute definition. Lastly, given the dearth of clear authority and case law, directors within constituency statute jurisdictions may be tentative to exercise their option to "consider" other constituents for fear of liability.⁹¹ Given

78. *Id.* at 165.

79. *Id.* at 163.

80. Resor, *supra* note 29, at 104 (citation omitted).

81. Schmidt, *supra* note 76, at 167.

82. Munch, *supra* note 19, at 175.

83. *See* Reiser, *supra* note 28, at 649-50.

84. Clark & Babson, *supra* note 1, at 828-29.

85. *See* Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 24 (1992).

86. Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 588 (1992).

87. Clark & Babson, *supra* note 1, at 829 (citations omitted).

88. Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 29 (1992).

89. *See* MODEL BENEFIT CORP. LEGISLATION, § 201(a).

90. *See, e.g.,* Alissa Mickels, Note, *Beyond Corporate Social Responsibility: Reconciling the Ideals of a For-Benefit Corporation with Director Fiduciary Duties in the U.S. and Europe*, 32 HASTINGS INT'L & COMP. L. REV. 271, 292 (2009) (noting that many constituency statutes limit stakeholders to customers, suppliers, employees or the community).

91. *See* Clark & Babson, *supra* note 1, at 832-33.

these deficiencies, constituency statutes really do not provide an adequate legal framework by which socially responsible organizations can operate.

Although benefit corporation legislation has only existed since 2010, the general concepts behind it have been around for quite some time. While the genesis of such legislation is complicated, it would seem a major influencer was the ineffective attempt to extend the application of existing constituency statutes outside their intended realm.

II. SOLUTION: BENEFIT CORPORATIONS

Benefit corporations strike a middle ground by amalgamating the concepts behind for-profit and nonprofit corporations. As exposed above, the purpose of a for-profit business can skew towards supporting shareholder wealth maximization to the loss of other stakeholders. In stark contrast, §501(c)(3) of the Internal Revenue Code specifically states that the net earnings of tax-exempt nonprofit may not benefit a private individual or shareholder.⁹² Between these two extremes, the hybrid legal status of a benefit corporation emerges. By blending the concepts of each, benefit corporation legislation attempts to blur the line between for-profit and non-profit corporations.⁹³ This new hybrid entity is a well-suited option for “double bottom line” companies—those that promise a financial return to their investors while also proactively pursuing public service.⁹⁴

Benefit corporation legislation addresses a whole host of concerns within traditional corporate law. For starters, the legislation addresses the issue of shareholder wealth maximization. The legislation seeks to accomplish this by placing various requirements with respect to the corporation’s internal governance.⁹⁵ Additionally, the legislation attempts to address greenwashing concerns.⁹⁶ Current corporate law does not have adequate social and environmental accountability standards by which to evaluate corporations on their professed socially responsible missions.⁹⁷ True value-driven companies fade into the muddied background as more and more organizations falsify and embellish their pursuit of social responsibility. Hence, benefit corporation legislation seeks to create a platform by which authentic mission-seeking corporations can shine.

A. Overview

Benefit corporation legislation is not the first attempt to create a hybrid entity.⁹⁸ Although other hybrid corporate forms exist, the purpose of this Note is not to ar-

92. 26 U.S.C.A. § 501 (2010).

93. Resor, *supra* note 29, at 100-01 (citation omitted).

94. Lisa M. Fairfax, *Achieving the Double Bottom Line: A Framework for Corporations Seeking to Deliver Profits and Public Services*, 9 STAN. J.L. BUS. & FIN. 199, 200 (2004).

95. See Resor, *supra* note 29, at 105.

96. See *id.*

97. *Id.*

98. See *supra* Part I.B.

gue which formation is superior. Instead, this Note dissects benefit corporation legislation and offers a suggestion for improvement. Inevitably, each state statute will vary in some capacity. Nevertheless, the core components are almost always integrated. The fountainhead of such legislation is the Model Benefit Corporation Legislation.⁹⁹ The following discussion will therefore analyze these core components as composed in the Model Benefit Corporation Legislation.

B. Core Components

In an attempt to rectify the divergence of standards between benefit corporations and traditional corporations, benefit corporation legislation invokes three primary mechanisms: purpose, accountability, and transparency. First, a benefit corporation must have a purpose of creating “a general public benefit,”¹⁰⁰ *i.e.*, a “material positive impact on society and the environment.”¹⁰¹ In addition, the legislation permits identification of any optional specific public benefits to be included in the articles of incorporation.¹⁰² Second, directors of benefit corporations are statutorily required to consider the effects of their decisions on a defined list of stakeholders,¹⁰³ meaning they are not permitted to exclusively consider the effects on shareholders alone. Third, the benefit corporation must prepare an annual report of its overall social and environmental performance to be assessed against a comprehensive, credible, independent, and transparent third-party standard.¹⁰⁴

1. Purpose

The purpose of a benefit corporation may be broken down into two parts: (1) the mandatory general public benefit provision, and (2) an optional specific public benefit provision. To meet the corporate purpose standards, the following is required to be included in the articles of incorporation: “[the corporation] shall create general public benefit defined as a material positive impact on society and the environment, as assessed against a third party standard [and] shall have right to name specific public benefit purposes.”¹⁰⁵

The heart of the act imposes a mandatory requirement on all benefit corporations to “have a purpose of creating a general public benefit.”¹⁰⁶ As noted, a general public benefit is defined as a “material positive impact on society and the environment, taken as a whole . . . from the business and operations of a benefit corpora-

99. *Model Legislation*, BENEFIT CORP. INFORMATION CENTER, <http://benefitcorp.net/attorneys/model-legislation> (last visited Feb. 1, 2015).

100. MODEL BENEFIT CORP. LEGISLATION, § 201(a).

101. *Id.* § 102.

102. *Id.* § 201(b).

103. *Id.* § 301(a)(1).

104. *Id.* § 401(a)(2).

105. *What are the Requirements?*, BENEFIT CORP. INFORMATION CENTER, <http://benefitcorp.net/business/become-a-benefit-corporation/what-are-the-requirements> (last visited Feb. 1, 2015).

106. *See* MODEL BENEFIT CORP. LEGISLATION, § 201(a).

tion.”¹⁰⁷ This is a deviation from general corporations, which are broadly permitted to form for “any lawful purpose.”¹⁰⁸ The function of such a requirement serves to overcome the idea that financial interests of the corporation and the shareholders take priority over other stakeholders and interests.¹⁰⁹ This in turn permits agents of the corporation, in their respective roles, to exercise greater discretion in their corporate decision-making process outside the traditional confines of shareholder wealth maximization.¹¹⁰

Some commentators have criticized the definition of a “general public benefit” for being too vague, claiming that such an ambiguous definition generates a toothless piece of legislation.¹¹¹ Despite this, and aware of such concerns, the architects of the model legislation intentionally decided to leave the language broad. However, the drafters did include a tool to combat such a concern. This was accomplished by implementing a required third-party assessment, which will be addressed in more detail shortly. In effect, the model legislation attempts to strike a balance between identifying certain interests to be considered and granting the corporation flexibility.¹¹² By doing so, the legislation hopes to permit a benefit corporation the greatest flexibility reasonably possible.¹¹³

In addition to the required general public benefit purpose, a benefit corporation may elect to include specific public benefit purposes in its articles of incorporation. Such specific public benefits authorize a more tailored mission to be stapled into the heart of the company. This dualistic approach—between a general public benefit and specific public benefits—permits a benefit corporation to pursue any personal objectives it so desires, while guaranteeing the corporation pursues a general public benefit on the whole.¹¹⁴ The Model Benefit Corporation Legislation provides a non-exhaustive list of possible specific public benefits, including:

- (1) providing low-income or underserved individuals or communities with beneficial products or services;
- (2) promoting economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business;
- (3) protecting or restoring the environment;
- (4) improving human health;
- (5) promoting the arts, sciences, or advancement of knowledge;
- (6) increasing the flow of capital to entities with a purpose to benefit society or

107. *Id.* § 102.

108. *See, e.g.*, DEL. CODE ANN. tit. 8, § 101(b) (West 2011) (“A corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes, except as may otherwise be provided by the Constitution or other law of this State.”).

109. *How do I Create a General Public Benefit?*, BENEFIT CORP. INFORMATION CENTER, <http://benefitcorp.net/business/operate-as-a-benefit-corporation/how-do-i-create-general-public-benefit> (last visited Feb. 1, 2015).

110. *See id.*

111. Benefit Corp. White Paper, *supra* note 32, at 23.

112. *Id.*

113. *See id.* (discussing the disadvantages of a more restrictive definition).

114. Clark & Babson, *supra* note 1, at 841.

the environment; and

(7) conferring any other particular benefit on society or the environment.¹¹⁵

Should a corporation elect to eliminate, modify, or add a specific public benefit, the Model Benefit Corporation Legislation grants statutory authority to make such changes to the benefit corporation's articles of incorporation.¹¹⁶ However, to do so, the legislation requires the amendment to be adopted by at least a "minimum status vote."¹¹⁷ A minimum status vote is defined to require an affirmative vote of at least two-thirds of the votes that all shareholders are entitled to cast.¹¹⁸ The significance of this may become more involved, when, for instance, a change of control of the corporation comes in to place. Requiring a two-thirds vote to amend the articles may make it more difficult for a controlling shareholder to shift the corporate focus towards prioritizing profits and maximizing shareholder wealth.

2. Accountability

The standard of conduct for directors of benefit corporations is another major departure from general corporate law. Directors are given much more discretion in considering the effect of their decisions. Traditionally, a director's primary responsibility in exercising his or her discretion was to maximize shareholder wealth.¹¹⁹ In contrast, directors, officers, and committees of a benefit corporation shall consider the effects of their decisions not only with respect to shareholders, but also on a range of stakeholders. More specifically, directors of benefit corporations are required to consider the effects of any action or inaction upon:

(i) the shareholders of the benefit corporation; (ii) the employees and work force of the benefit corporation, its subsidiaries, and its suppliers; (iii) the interests of customers as beneficiaries of the general public benefit or specific public benefit purposes of the benefit corporation; (iv) community and societal factors, including those of each community in which offices or facilities of the benefit corporation, its subsidiaries, or its suppliers are located; (v) the local and global environment; (vi) the short-term and long-term interests of the benefit corporation, including benefits that may accrue to the benefit corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the benefit corporation; and (vii) the ability of the benefit corporation to accomplish its general public benefit purpose and any specific public benefit purpose.¹²⁰

It may be easier to view such considerations as expanding a director's fiduciary duties to include all "stakeholders," not just shareholders. A stakeholder is one who has an interest or concern with the business, but does not necessarily have an ownership interest in the business.¹²¹

115. MODEL BENEFIT CORP. LEGISLATION, § 102.

116. *Id.* § 201(d).

117. *Id.*

118. *Id.* § 102.

119. *See, e.g., Dodge v. Ford*, 170 N.W. 668, 684 (Mich. 1919).

120. MODEL BENEFIT CORP. LEGISLATION, § 301(a).

121. *Stakeholder*, BLACK'S LAW DICTIONARY (10th ed. 2014) available at Westlaw BLACKS.

Obviously not all stakeholders can be given equal treatment. One would think that in placing mandatory consideration of such stakeholders, the model legislation would address the concern of unequal treatment with an eye towards protection of stakeholders other than shareholders. However, the legislation establishes no requirement to place certain interests in priority of others.¹²² The only occasion in which certain interests must be given priority over others occurs when the articles of incorporation affirmatively demand such an approach.¹²³

The accountability requirements are not static, but rather involve an ongoing process.¹²⁴ Unfortunately, governmental oversight is not the primary engine of upholding adherence. Instead, benefit corporation legislation leaves the interpretation of “general public benefit” to third-party evaluators in the short term, and accountability to consumers in the long-term.¹²⁵ As explained below, transparency is intended to serve as the delegated tool for the market to ensure long-term adherence. However, although a step in the right direction, transparency alone will not be enough.

3. Transparency

In an attempt to provide greater clarity to all stakeholders, a benefit corporation must produce an annual benefit report assessing its overall performance against a benchmark set by a third party.¹²⁶ The overarching purpose of the transparency requirement is to give stakeholders a better idea of the success (or failure) of the corporation in achieving a general public benefit, along with any specified public benefits.¹²⁷ The annual report is to include items such as: a description of the ways the benefit corporation benefited the general and specific public benefit goals, a self-assessment of the benefit corporation’s performance against the third-party standard, and compensation payments made to directors.¹²⁸

One would think the legislation would pronounce a defined third-party standard in order to provide the market with an objective point of comparison among benefit corporations. However, the model legislation does not prescribe a precisely defined third-party standard. Instead, the benefit corporation is given free range to hire a third-party to draft said standard. So long as the standard meets the statutory requirements, it will prove sufficient. The third party developing the standard must be a non-controlling entity with access to sufficient information in order to establish a

122. MODEL BENEFIT CORP. LEGISLATION, § 301(a)(3).

123. *Id.*

124. *What are the Requirements?*, BENEFIT CORP. INFORMATION CENTER, <http://benefitcorp.net/business/become-a-benefit-corporation/what-are-the-requirements> (last visited Feb. 1, 2015).

125. See Allison M. Snyder, *Holding Multinational Corporations Accountable: Is Non-Financial Disclosure the Answer?*, 2007 COLUM. BUS. L. REV. 565, 583-84 (2007).

126. MODEL BENEFIT CORP. LEGISLATION, § 401.

127. *How Do I Select a Third Party Standard?*, BENEFIT CORP. INFORMATION CENTER, <http://benefitcorp.net/business/operate-as-a-benefit-corporation/how-do-i-select-a-third-party-standard> (last visited at Feb. 1, 2015).

128. MODEL BENEFIT CORP. LEGISLATION, § 401(a).

credible and balanced standard.¹²⁹ The standard must assess the effects of the corporation's decisions on employees, suppliers, customers, community, and the environment—the stakeholders.¹³⁰ In addition, the benefit corporation is required to disclose the formula by which the standard is computed.¹³¹ The rationale behind such disclosure is to prevent “greenwashing.”¹³² However, despite disclosure of the formula for computing the standard, the average citizen will most likely remain perplexed.

The drafters expected that increased transparency would lead to several efficiencies. First, they believed that transparency would facilitate the due diligence process done by investors, and hopefully therefore, lead to increased investment.¹³³ Second, they believed this would permit consumers to have a better understanding of the companies they support.¹³⁴ Without such transparency, consumers were traditionally stuck with trusting their gut feelings as to whether a corporation really did what they said. Although a step in the right direction, the current transparency standards still do not provide an appropriate system by which to hold corporations accountable.¹³⁵ While the transparency requirements lead to increased availability of information regarding the corporation, more efficient and better results regarding corporate responsibility will not necessarily follow. Mere disclosure alone is not sufficient to hold corporations accountable. Accountability requires action. Within the framework erected by the drafters, action is left in the hands of the market. Therefore, the market must respond in a negative or positive fashion in order for transparency to prove useful. Unfortunately, and as explained later, the market is not an appropriate party to ensure corporate adherence and accountability.

C. Other Components

Outside the core components explained above, benefit corporations have several other distinct differences from traditional corporations. For starters, directors are affirmatively granted a broad scope of authority to consider stakeholders other than shareholders in their decisions. In addition, directors are exculpated from monetary liability. Lastly, standing is limited to those who have a right to bring a benefit enforcement proceeding.

1. Director Duties

Directors of benefit corporations maintain the same duties as directors of traditional corporations, but they are granted broader discretion to exercise their powers

129. *Id.* § 102. The Global Reporting Initiative (GRI), GreenSeal, Underwriters Laboratories (UL), ISO2600, Green America, and B Lab are a few of the third party standards organizations. Clark & Babson, *supra* note 1, at 845-46.

130. MODEL BENEFIT CORP. LEGISLATION, § 102.

131. *Id.* § 401(a).

132. *See* Clark & Babson, *supra* note 1, at 846.

133. *Id.* at 845.

134. *Id.*

135. *See infra* Part III.B.

with an eye towards general and specific public benefits. It is the role of the directors to ensure the benefit corporation pursues the goals required and stated in the articles of incorporation. Just as a director of a general corporation has a duty to act in good faith, and in a way that the director reasonably believes to be in the best interests of the corporation, so too does a director of a benefit corporation.¹³⁶ The key difference between the director of a general corporation and the director of a benefit corporation is that the latter is statutorily granted the power, in pursuing the best interests of the corporation, to factor general and specific public benefits into their decisions.¹³⁷

2. Director Liability

The model legislation offers directors a layer of insulation that their counterparts of general corporations do not enjoy—exculpation of personal liability with respect to monetary damages.¹³⁸ The model legislation affords a director, who makes a good faith decision, business judgment deference as long as the director: (1) does not have an interest in the subject; (2) is sufficiently informed on the subject to reasonably believe his or her decision is appropriate; and (3) rationally believes the decision to be in the best interests of the benefit corporation.¹³⁹ More importantly, the director or officer cannot be held personally liable for a failure to meet the general or specific public benefit, and is even free from liability for failure to pursue said benefits.¹⁴⁰ In other words, a director can never be financially liable to the benefit corporation for a failure to create, or even *pursue*, a general or specific public benefit. The rationale behind exculpating directors from monetary liability was to navigate benefit corporations towards injunctive relief in order to focus benefit corporations on respecting their obligations.¹⁴¹ It was also reasoned that such exculpation would eliminate director fear where there is no court precedent for which to quantify liability.¹⁴²

3. Right of Action

By and large, shareholders and directors are the only stakeholders permitted to bring a claim against the benefit corporation under the model legislation. Therefore, directors are safeguarded from suits brought directly by non-shareholder stakeholders of the benefit corporation. However, this does not mean third parties are entirely left out to dry. As a proxy, shareholders are expressly granted the right to bring a

136. See *What are my duties?*, BENEFIT CORP. INFORMATION CENTER, <http://benefitcorp.net/business/operate-as-a-benefit-corporation/what-are-my-duties> (last visited Feb. 1, 2015).

137. *Id.*

138. MODEL BENEFIT CORP. LEGISLATION, § 301(c).

139. *Id.* § 301(e).

140. *Id.* § 301(c).

141. *What are my liabilities?*, BENEFIT CORP. INFORMATION CENTER, <http://benefitcorp.net/business/operate-as-a-benefit-corporation/what-are-my-liabilities> (last visited Feb. 1, 2015).

142. *Id.*

legal action on behalf of a third party. Such claims are brought under a device known as a benefit enforcement proceeding. Those who do have standing can bring a benefit enforcement proceeding for the “failure [of the corporation] to pursue or create general public benefit or a specific public benefit set forth in its articles of incorporation,”¹⁴³ failure to consider various stakeholders, or failure to meet the transparency requirements.¹⁴⁴

Despite giving shareholders an expanded right of action, it should be emphasized that nothing in the legislation actually requires a shareholder to bring such an action on behalf of another stakeholder. Further, not all shareholders are permitted to bring an action. In conjunction with the elimination of other stakeholders’ rights to bring an action themselves, the mere right of a shareholder to bring an optional action has the neglectful effect of failing to provide adequate assurance that other stakeholders’ interests will be sufficiently represented. In hopes of attracting as many organizations as possible to form as a benefit corporation, the drafters consciously omitted the ability for a third-party stakeholder to directly bring a cause of action against the corporation.¹⁴⁵ They did so under the assumption that such unknown exposure would operate as an assured dissuasion to form as a benefit corporation.

III. BENEFIT CORPORATION COMMISSION

A. Issue: Inadequate Representation

As discussed above, third-party stakeholders are not granted authority to bring an action against a benefit corporation. Instead, the model legislation intends to limit standing to those who can bring a benefit enforcement proceeding.¹⁴⁶ A benefit enforcement proceeding is a right of action only for shareholders, directors, investors in the parent company of a benefit corporation subsidiary with a 5% or more equity interest, and persons specified in the company’s articles of incorporation.¹⁴⁷ Initially, this may appear to be a fair listing of parties that should be permitted to bring an action. However, at second glance, it becomes clear that most non-shareholder stakeholders’ interests are, for all intents and purposes, left at the mercy of the shareholders.¹⁴⁸ Despite having the ability to do so, nothing in the model legislation *requires* a shareholder to bring a suit against the benefit corporation in the name of other stakeholders.

Although a benefit corporation must consider all stakeholders, it is practically and legally responsible to only one—the shareholders. Leaving the protection of

143. MODEL BENEFIT CORP. LEGISLATION, § 305(a)(1).

144. *What are my liabilities?*, BENEFIT CORP. INFORMATION CENTER, <http://benefitcorp.net/business/operate-as-a-benefit-corporation/what-are-my-liabilities> (last visited Feb. 1, 2015).

145. *See id.*

146. MODEL BENEFIT CORP. LEGISLATION, § 305.

147. *Id.* § 305(c).

148. Christopher Lacovara, *Strange Creatures: A Hybrid Approach to Fiduciary Duty in Benefit Corporations*, 2011 COLUM. BUS. L. REV. 815, 870 (2011).

various stakeholders—such as employees, customers, community members, etc.—at the sole discretion of the shareholders virtually guarantees such interests will not be effectively represented. For starters, shareholders are almost always predominantly interested in maximizing their wealth. While it is likely that the average investor in a benefit corporation will have a higher level of compassion towards other stakeholders than the average investor in a traditional corporation, it does not seem rational to leave shareholders as the sole advocate of all other stakeholders. To illustrate, imagine a situation where shareholders are faced with a mutually exclusive decision to either represent other stakeholders at the expense of shareholder value, or to ignore consideration of other stakeholders and increase shareholder wealth. When faced with such a dilemma, the logical choice of an “altruistic” shareholder does not appear as clear. The preordained tension between shareholders and other stakeholders ensures that shareholders, at the very least, will be biased in their decision to bring an enforcement proceeding on behalf of another stakeholder. It could be argued that enforcement through shareholders is sufficient because any one shareholder could bring an action. However, this is a false assumption because the model legislation limits the shareholders’ right of action to those who own at least 2% of outstanding shares or 5% of a parent company.¹⁴⁹ This severely limits the number of shareholders who have the right to bring an action in the typical corporation that has hundreds, or even thousands of shareholders.

Regardless of the situation, it is difficult to argue that a financial stake does not serve as an added incentive. In contrast to traditional motives, a shareholder’s election to bring an enforcement proceeding for another stakeholder generally serves the shareholder no financial benefit. Therefore, other stakeholders will effectively be dependent on the moral fiber of shareholders. In addition, litigation is generally very expensive and time consuming. Coupled with the timing and expense considerations, a shareholder’s moral fiber does not serve as a reassuring prospect to rebut the hurdles a shareholder may face in serving as a vigilante for adequate representation of other stakeholders, especially in the absence a financial incentive.

B. Issue: Transparency Deficiency

Benefit corporation legislation places a heavy emphasis on transparency in the accountability department. Recent trends have shown a surge in revamping securities legislation across the board by amplifying accountability and transparency standards.¹⁵⁰ However, increased transparency, although a step in the right direction, is not enough to ensure fair and adequate representation of non-shareholder interests. Disclosure alone—whether voluntary or mandatory—will not prove effective in achieving the goal of producing more socially responsible corporations. The effectiveness of disclosure depends on the market’s reaction to the information disclosed. Therefore, to achieve the desired result, disclosure must impact the behavior

149. MODEL BENEFIT CORP. LEGISLATION, § 305(c).

150. Cummings, *supra* note 27, at 595-96 (citations omitted).

of market participants.¹⁵¹

A hefty portion of the required annual benefit report consists of non-financial information.¹⁵² Unfortunately, research has shown that the market is not an appropriate assessor of non-financial disclosures.¹⁵³ Further, the model legislation provides an ineffectual set of instructions on what must be included in the annual benefit report.¹⁵⁴ Such capacious guidelines permit a benefit corporation to use deceptive procedures (e.g., providing lengthy and confusing information) to conceal corporate shortcomings. Given the dissimilarity in issues involving social responsible information, it appears there is not a practical formula by which to standardize reporting requirements. In the traditional financial marketplace, wall-street analysts break down the complicated material for use by the general public.¹⁵⁵ However, at least at the moment, there are no such information traders to analyze corporate social responsibility data,¹⁵⁶ and with a very narrow opportunity for profit, it seems unlikely such analysts will emerge.¹⁵⁷ Therefore, it does not appear that disclosure of social data will prove as effective as disclosure of financial data—especially with the lack of information traders and standardization.

Moreover, consumer behavior studies have revealed consumer hypocrisy.¹⁵⁸ As explained above, consumers allege to place an increased emphasis on products associated with a “good cause.” However, data has shown that a very small percentage of consumers actually end up incorporating ethical consumption into their decision-making process.¹⁵⁹ While nearly 75% of individuals allege they would purchase an environmentally favorable product over one that is not, only 10-12% of those consumers actually purchase accordingly.¹⁶⁰ Such false pretenses would not be problematic if consumers, collectively the market, did not play a critical role in benefit corporation regulation. As noted, regulation of a benefit corporation’s adherence to its purposes is effectively left in the hands of “the market” in the long-term.¹⁶¹ Given the harsh-reality regarding consumer behavior, it is not reassuring that the market serves as the primary force in ensuring long-term adherence to the benefit corporation’s purposes.

151. Snyder, *supra* note 126, at 583-84.

152. See MODEL BENEFIT CORP. LEGISLATION, §401(a).

153. Snyder, *supra* note 126, at 611 (“Given the information’s qualitative nature, the ability of companies to control the dialogue, the lack of intermediaries to translate the data, and the limited responsiveness of consumers and investors alike, non-financial disclosure alone does not create movement in the market.”).

154. See MODEL BENEFIT CORP. LEGISLATION, § 401(a), (listing the annual benefit report requirements).

155. Snyder, *supra* note 126, at 612.

156. *Id.*

157. *Id.* at 582-83.

158. Dara O’Rourke, *Opportunities and Obstacles for Corporate Social Responsibility Reporting in Developing Countries* 23 (Corporate Social Responsibility Practice, Washington, D.C.: The World Bank Group, Working Paper, 2004), available at <http://nature.berkeley.edu/orourke/PDF/CSR-Reporting.pdf>.

159. *Id.*

160. Joel Makower, *Green Consumers-Myth or Reality?*, ORGANIC CONSUMERS ASSOCIATION (July/Aug. 2008), https://www.organicconsumers.org/old_articles/Organic/greenism.php.

161. See *supra* Part II.B.2.

C. Solution: Benefit Corporation Commission

The model legislation intentionally omitted most non-shareholder stakeholders' rights to bring a cause of action against a benefit corporation. The rationale behind this omission was the idea that such an expansive right of action would open the floodgates for nuisance litigation.¹⁶² In turn, the drafters reasoned that such unknown risk of liability would dissuade organizations from forming as a benefit corporation.¹⁶³ In the context of nonprofits, it makes sense to place severe limitations on a right of action given the nonprofits lack of resources to combat frivolous litigation.¹⁶⁴ However, in the for-profit arena, this reasoning does not seamlessly extend in application to a benefit corporation. Despite the increased financial solvency, it still does not seem appropriate to expose a benefit corporation to such vexatious litigation. Keeping the legislation as is, however, would leave other constituencies with out much faith in the sufficient protection of their interests. Therefore, a change must be made.

The model legislation should include a provision that establishes a state commission—the Benefit Corporation Commission (BCC)—to ensure benefit corporations meet the general public benefit standard, as well as any specific public benefits defined in the articles of incorporation. Through its all-encompassing composition, and as a representative, the Benefit Corporation Commission would strike an appropriate balance between ensuring adequate representation of all stakeholder interests and protection of the corporation from nuisance litigation. Such a commission would have no interest in pursuing litigation unless an issue posed legitimate concerns; and at the same time, a commission would not leave authentic claims out to dry simply because they may diminish shareholder wealth.

As explained, it can prove difficult for consumers, investors, and the market to demystify the sophisticated material benefit corporations are required to disclose.¹⁶⁵ Not only are such parties deprived of the expert analyst reports prepared for most publically traded corporations, but in many ways the information provided—given its qualitative nature—is more difficult to analyze than traditional financial data. With this in mind, it is more appropriate to delegate the task of dissecting the qualitative data to more well-trained eyes. Assuming the theory of economies of scale¹⁶⁶ to be true, establishing a Benefit Corporation Commission would serve as a major efficiency in corporate responsibility assessment. Delegating the task of analyzing the qualitative data to the BCC would present a steep learning curve. However, once the BCC had a set of procedures in place for evaluating benefit corporations, it would create efficiencies through a centralized process and alleviate much of the burden initially placed on the public.

Further, with new legislation comes uncertainty. Until case law begins to

162. MODEL BENEFIT CORP. LEGISLATION, § 305 cmt. at 20.

163. Benefit Corp. White Paper, *supra* note 32, at 21.

164. Lacovara, *supra* note 149, at 868 (citation omitted).

165. Dana Brakman Reiser, *Regulating Social Enterprise*, 14 U.C. DAVIS BUS. L.J. 231, 242 (2014).

166. *Economy of Scale*, BLACK'S LAW DICTIONARY (10th ed. 2014), available at Westlaw BLACKS (“[S]avings resulting from the greater efficiency of large-scale processes.”).

emerge, people are left to guess how certain ambiguities will be resolved. In response, the BCC could also serve as a catalyst for adding context to such ambiguities—such as the meaning of a “general public benefit.”

The composition and appointment process for the commissioners of the BCC should ensure that a range of stakeholders is properly represented. The respective state governor should appoint commissioners for a term determined by statute. A set term ensures a turnover to accommodate for evolving issues. This also safeguards specific benefit corporations from undue influence by individual commissioners. In selecting the commissioners, it is important to ensure a wide range of interests are represented. For example, it would not be appropriate to establish a commission that is strictly composed of benefit corporation directors or managers. Although such parties may be knowledgeable in the area, they do not serve as a comprehensive representative for the broad range of stakeholders affected by benefit corporations. Still, given such parties’ knowledge, the BCC should be composed at least partially of directors and managers of various benefit corporations. Overall, it is critical to ensure the Benefit Corporation Commission is comprised of members who represent the most comprehensive range of stakeholders. The statutory authorization should include such a requirement. For example, the provision authorizing the establishment of the Benefit Corporation Commission could include a clause requiring, “a majority of the commissioners represent a broad range of stakeholders.” This ensures that one class of stakeholders never dominates the BCC.

It should be noted that other alternatives to the standing issue have been proposed. One such proposal offers the suggestion to limit standing to those who have a “legitimate interest.”¹⁶⁷ For example, all stakeholders would be permitted to bring an action, but standing would be contingent upon such stakeholder showing an injury to a “legitimate interest.”¹⁶⁸ Although this may seem like a plausible alternative, the ambiguous term “legitimate interest” seems to provide, at most, a standard that is just as imprecise as the transparency requirements. This is compounded by the fact that a stakeholder’s “legitimate interest” will often be a non-financial interest, which is difficult to quantify. Further, courts would be left guessing as to the meaning of a “legitimate interest,” and such ambiguity would serve as an added inhibitor in an organizations decision to form as a benefit corporation.

A second proposed alternative to the standing issue suggests the use of the state’s attorney general. In the nonprofit context, standing is practically limited to two groups: the state’s attorney general and potential beneficiaries.¹⁶⁹ The rationale behind granting the state’s attorney general standing stems from the idea that it

167. Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 636 (1992).

168. *Id.* at 635-36.

169. Lacovara, *supra* note 149, at 850 (“The general common law rule is that only a public officer, usually a state attorney general, has standing as *parens patriae* to sue to enforce an organization’s charitable purpose on behalf of potential beneficiaries.”). *But see* *Alco Gravure, Inc. v. Knapp Found.*, 479 N.E.2d 752, 755 (N.Y. 1985) (holding that the organization’s beneficiaries may have standing if they can show a special interest in the funds).

would be difficult for parties to demonstrate a private cause of action.¹⁷⁰ It was further reasoned that such a restriction protects nonprofit corporations from nuisance litigation.¹⁷¹ Although a feasible alternative, extending the authority of the state's attorney general to include benefit corporations would not be as effective as establishing the Benefit Corporation Commission. For starters, the attorney general would not represent the broad spectrum of stakeholders affected by benefit corporations. Having a commission that is statutorily required to represent such broad interests ensures that a wide spectrum of stakeholders has the power to make an effective impact. This is not to say the state's attorney general would not do his or her best to ensure each stakeholder's interests are represented; but merely that a commission, composed of an array of stakeholders, would more than likely do a better job to ensure a comprehensive approach is taken. Further, it makes sense to have the attorney general involved in the nonprofit context because no individual stands to have a direct financial benefit. In contrast, a benefit corporation is set up to benefit shareholders—who do have a direct financial benefit. Lastly, given its qualitative nature, the complexity of the information would likely prove burdensome for the state's attorney general to enforce adherence, especially as the number of benefit corporations forming rapidly grows. In contrast, the BCC, as a commission tasked with the sole mission of evaluating benefit corporations, would be able to efficiently enforce adherence through economies of scale.

The BCC should be charged with assuring adherence to statutory requirements and bring an action against a benefit corporation for failure to comply. There are several options a state BCC would have in establishing the process by which to expose and penalize a noncompliant benefit corporation. One such option permits respective stakeholders to file a complaint with the BCC. Here, the BCC functions as the exclusive forum for third-party stakeholders to defend their interests. The BCC then investigates the legitimacy of the complaint and makes a determination on the appropriate discipline, if necessary. Another alternative is to leave the entire process to the BCC. In this manner, each benefit corporation is required to submit their annual benefit report to the BCC. To further streamline the process, the BCC could establish an objective template requiring each benefit corporation to modify their annual benefit report when submitting it for review. This would provide a much easier manner by which the BCC could objectively determine compliance. However, given the variability of information, this may be a difficult option to execute. In terms of reprimand, the BCC could implement discipline procedures of their own or it could opt to bring an action against the corporation. In fact, litigation could even be a level of the BCC's discipline procedure. Regardless of the disciplinary procedure chosen, the BCC should be equipped with an assortment of reprimands to penalize a benefit corporation in proportion to the violation.

By establishing the BCC, non-shareholder stakeholders are given a fairer chance to defend their interests while the drafters' fear of nuisance litigation is cabined. As an essential filter, the BCC prevents benefit corporations from bearing the

170. Lacovara, *supra* note 149, at 851 (citing *Hooker v. Edes Home*, 579 A.2d 608, 612 (D.C. 1990)).

171. *Id.*

costs of combatting frivolous lawsuits brought by third-party stakeholders. By requiring non-shareholder stakeholders to bring their issues to the BCC first, a benefit corporation does not have to become involved until the BCC decides the complaint poses a legitimate issue. Further, even if the BCC finds there to be a legitimate issue, it does not necessarily subject the benefit corporation to litigation. For instance, the BCC may decide to issue the benefit corporation some sort of private reprimand or fine. This would send a clear message to the benefit corporation to comply. The BCC could then issue more severe sanctions, or possibly initiate litigation, should the reprimanded benefit corporation fail to respect its duties.

IV. CONCLUSION

In conclusion, benefit corporation legislation should include a provision establishing a Benefit Corporation Commission charged with ensuring accountability for those stakeholders who do not have the privileged option to bring an action on their own behalf. While it is true that shareholders and directors can bring a lawsuit against the corporation in the name of other stakeholders, the shareholders or directors do not have sufficient incentives to adequately protect the interests of other stakeholders. In fact, shareholders may actually have a disincentive to protect other stakeholders when doing so would decrease shareholder wealth. Further, given the complex nature of socially responsible data, it does not seem promising that the markets reaction to the disclosure requirements will serve as the principal backstop in ensuring a benefit corporation's long-term compliance. Nevertheless, election to form as a benefit corporation would not be enticing if all stakeholders were given the right to bring an action against the corporation. Therefore, it seems the logical middle ground is to establish a third party, such as the BCC, to moderate effective enforcement and ensure representation of all stakeholders.