Benefit Corporations: A Challenge in Corporate Governance

By Professor Mark J. Loewenstein
University of Colorado Law School
Boulder, Colorado

Submitted by

Thomas E. Rutledge
Stoll Keenon Ogden PLLC
Louisville, Kentucky

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By Mark J. Loewenstein*

Benefit corporations are a new form of business entity that is rapidly being adopted around the country. Though the legislation varies from jurisdiction to jurisdiction, most statutes are based on a model proposed and promoted by B Lab, itself a nonprofit corporation. The essence of these statutes is that, in making business judgments, the directors of a benefit corporation must consider the impact of their decisions on the environment and society. The model legislation, though, may create serious governance issues for the directors of benefit corporations that operate under these laws. This article analyzes the model legislation and identifies its weaknesses, particularly with respect to governance issues.

I. INTRODUCTION

An enduring question in corporate law is whether the law should encourage corporations to act in a more “socially responsible” way, that is, to sacrifice, or at least have the ability to sacrifice, some profit to achieve some social good, such as a healthier environment.1 On this view, the directors of a socially responsible corporation could opt to power the corporation’s factory or offices with renewable sources of energy, even if the cost exceeded that of a carbon-based fuel, and

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* Monfort Professor of Commercial Law, University of Colorado Law School. The author thanks the following for their helpful comments and suggestions: J. William Callison, Vic Fleischer, Herrick Lidstone, Avi Loewenstein, Susan MacCormac, Amy Schmitz, and Andrew Schwartz. The author is indebted to the members of the Colorado Bar Association Committee on Business Entity Legislation, with whom the author labored on legislation to authorize benefit corporations in Colorado, particularly J. William Callison, Robert Keatinge, Cathy Kendell, Herrick Lidstone, Beat Steiner, and Anthony van Westrum, brilliant lawyers all. Finally, the author thanks Angela Vichick for her excellent research assistance.

1. Many scholars recognize that the famous exchange of articles between Professors Berle and Dodd was critical in launching the debate on a corporation’s social responsibility. The debate is set forth in three articles by Berle and Dodd: A.A. Berle, Jr., Corporate Powers as Powers in Trust, 44 HARV. L. REV. 1049 (1931) (arguing that corporate managers should be constrained in their decision making); E. Merrick Dodd, Jr., For Whom Are Corporate Managers Trustees?, 45 HARV. L. REV. 1145 (1932) (arguing, contra to Berle, that corporate managers only owe a duty to their stockholders to make a profit); A.A. Berle, Jr., For Whom Corporate Managers Are Trustees: A Note, 45 HARV. L. REV. 1365 (1932) (countering Dodd by arguing that corporate managers affect more than just their stockholders and constraints on their actions are justified). The debate has not abated. See, e.g., David L. Engle, An Approach to Corporate Social Responsibility, 32 SMU. L. REV. 1, 7 n.26 (1979) (discussing the Berle-Dodd debate on corporate social responsibility); A.A. Sommer, Jr., Who Should the Corporation Serve? The Berle-Dodd Debate Revisited Sixty Years Later, 16 DEL. J. CORP. L. 33 (1991) (discussing constituency statutes and corporate social responsibility); C.A. Harwell Wells, The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century, 51 U. KAN. L. REV. 77 (2002) (giving an historical perspective).
not have to account to anyone for having made this choice. Although corporate law likely already allows directors to make such a decision, some nagging doubt persists in at least some jurisdictions as to whether directors can pursue a course of action that does not maximize shareholder value. In addition, corporate

2. The question as to whether directors of a for-profit corporation have a fiduciary duty to maximize shareholder value is a question that has been explored extensively in legal literature, much of it recent, and it would serve no purpose to revisit that question here. See, e.g., Stephen M. Bainbridge, Corporation Law and Economics §§ 1-4(b), 9-2, 9-3 (2002); 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 7–41 (2012) [hereinafter White Paper], available at http://benefitcorp.net/storage/documents/The_Need_and_Rationale_for_Benefit_Corporations_April_2012.pdf; Lynn Stout, The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public 29 (2012) (arguing that directors are not legally obligated to maximize shareholder value, asserting that “courts refuse to hold directors of public corporations legally accountable for failing to maximize shareholder wealth”); Jonathan R. Macey, A Close Read of an Excellent Commentary on Dodge v. Ford, 3 VA. L. & BUS. REV. 177, 179 (2008); Ashley Schoenjahn, New Faces of Corporate Social Responsibility: Will New Entity Forms Allow Businesses to Do Good?, 37 J. CORP. L. 453, 455–59 (2012); Judd F. Sneirson, Green is Good: Sustainability, Profitability, and a New Paradigm for Corporate Governance, 94 IOWA L. REV. 987, 1001–03 (2009) (doubting that the sparse case law on the subject supports the notion of profit maximization). See also articles cited in supra note 1, each of which deals, more or less, with this question. As the authors establish, there is little case law supporting the principle that directors act in breach of their fiduciary duty if they fail to maximize shareholder value, and no case law that imposes liability on directors in a state that has a constituency statute described in infra note 3. But with regard to the lack of a duty to maximize shareholder value, see Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986) (holding that when a corporation is being sold the directors must act to maximize the value of the company for the stockholders’ benefit). If any doubt remains that a constituency statute does not adequately protect directors from liability, state law could easily and simply be amended to so provide. The supporters of benefit corporation legislation described in this article seek much more than to protect directors who elect to make socially responsible, but profit sacrificing, decisions; the supporters seek to require directors to make such decisions. It is, thus, inaccurate to argue, as some have, that benefit corporation legislation is needed because directors of traditional corporations are locked into a profit-maximizing paradigm. White Paper, supra, at 6.

3. Under the provisions of so-called “constituency statutes,” directors are free to consider the interests of corporate stakeholders other than shareholders when making business decisions. All but nineteen states have adopted constituency statutes, which vary from jurisdiction to jurisdiction. See, e.g., 805 ILL. COMP. STAT. ANN. 5/8.85 (West, Westlaw through P.A. 98-108, with the exception of P.A. 98-104, of the 2013 Reg. Sess.) (stating directors “may consider the effects of any action upon employees, suppliers and customers of the corporation or its subsidiaries, communities in which offices or other establishments of the corporation or its subsidiaries are located, and all other pertinent factors?”); N.Y. BUS. CORP. LAW § 717(b)(2)(i)–(v) (McKinney, Westlaw through L. 2013, chapters 1 to 57 and 60 to 110) (stating directors “shall be entitled to consider . . . the effects that the corporation’s actions may have in the short-term or in the long-term upon any of the following: (i) the prospects for potential growth, development, productivity and profitability of the corporation; (ii) the corporation’s current employees; (iii) the corporation’s retired employees and other beneficiaries receiving or entitled to receive retirement, welfare or similar benefits from or pursuant to any plan sponsored, or agreement entered into, by the corporation; (iv) the corporation’s customers and creditors; and (v) the ability of the corporation to provide, as a going concern, goods, services, employment opportunities and employment benefits and otherwise to contribute to the communities in which it does business”); 15 PA. CONS. STAT. ANN. § 1715(a)(1) (West, Westlaw through Regular Section Act 2013-11) (stating directors may consider “[t]he effects of any action upon any or all groups affected by such action, including shareholders, employees, suppliers, customers and creditors of the corporation, and upon communities in which offices or other establishments of the corporation are located”). In addition to these three states, some thirty other states have constituency statutes that protect directors who take into account non-shareholder concerns in their decision making. See Aug. REV. STAT. ANN. § 10-2702 (West, Westlaw through legislation effective June 20, 2013 of the First Regular Session of the Fifty-First Legislature); CONN. GEN. STAT. ANN. § 33-756(b) (West,
management faces non-legal incentives to maximize profits and stock price, such as executive compensation that is contingent on those matrices. While this doubt could be safely resolved with a rather simple amendment to the business corporation statute in those jurisdictions where it persists, a dedicated cadre of “social entrepreneurs” has embarked on a more ambitious path, to create a new form of for-profit corporation in which acting in a socially responsible fashion is not just an option for the electing corporation, but rather is its mission. Such corporations, which are sometimes called “benefit

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rather is its mission. Such corporations, which are sometimes called “benefit

White Paper, supra note 2, at 6. This statement is true enough, but if the problem is a narrow one of clarifying the fiduciary duties of directors, a new statute is hardly needed. Even in states with constituency statutes, the creation of a new corporate entity provides additional legal clarity that the fiduciary duty of directors of a benefit corporation includes consideration of stakeholder interests and that shareholders have the right to enforce that standard of consideration.
corporations," 5 are distinct from traditional corporations in a number of re-
spects and represent a radical transformation of corporate law—a transfor-
mation reflected in legislation  6 that has been introduced in twenty-three states to
date. Most of this legislation is based on a model act that is discussed more
fully below and referred to herein as the "Model Legislation." 7

It should be noted that benefit corporations are not nonprofit corporations
and are not formed under nonprofit corporation statutes. Traditionally, outside
of governments, nonprofit corporations have carried the weight of making the
world, or at least the United States, a better place. Apparently, however, the en-
trepreneurs behind the benefit corporation movement are dissatisfied with lim-
itations of the nonprofit corporation. Such entities have difficulty raising capital
because, by statute, they cannot pay dividends or otherwise make distributions
to their supporters, who often become the "members" of the nonprofit corpora-
tion. 8 Moreover, nonprofits are typically limited in their scope; they are religious
organizations, educational institutions, food banks, safe houses for abused women,
etc. and often are exempt from federal income taxes under section 501(c)(3) of the
Internal Revenue Code. The idea behind benefit corporations is more ambitious: to
motivate for-profit business corporations to have a positive impact on society and
the environment in addition to earning profits. The vision of its proponents may be
that with the promise of at least some return, investors may invest in such entities
and, gradually, as more and more corporations sign on to the benefit corporation
model, society and the environment will benefit. For zealots of the concept, profit
maximization then may become the exception, rather than the rule, in the for-
profit world.

The benefit corporation movement follows a growth of socially responsible
investing ("SRI") in the last three decades or so. As of 2010, companies that
had been, on some basis, identified as socially responsible represented roughly
10 percent of all domestic assets under management, approximately $2.3 trillion,
much of it in mutual funds. 9 SRI varies from manager to manager, but investors
who are committed to a certain sort of socially responsible investing are likely to
find a manager or fund that meets their criteria. 10 SRI represents a classic market
solution to the demand of investors for a certain type of investment. For the ad-
vocates of the benefit corporation, however, SRI is insufficient. Arguably, the
businesses that garner SRI funds may not be as socially responsible as they

5. Hawaii has decided to call its version of a benefit corporation a “sustainable business corpo-
racion.” HAW. REV. STAT. § 420D-2 (West, Westlaw through Act 140 of the 2013 Regular Session).
6. The Model Legislation is attached as Appendix A to the White Paper, supra note 2.
7. The states that adopted or rejected the Model Legislation are set out in infra notes 15 and 16,
respectively. It is noteworthy, as developed below, that no state has adopted the Model Legislation
without change and the Model Legislation itself has been modified from time to time.
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9. SOCIAL INV. FORUM FOUND., REPORT ON SOCIALLY RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES
10. See generally HOPE CONSULTING, STRATEGIES FOR SOCIAL CHANGE, MONEY FOR GOOD REPORT (2010),
available at http://www.hopeconsulting.us/wordpress/wp-content/uploads/2013/03/MFGI-Full_July-
2010.pdf.