THE BENEFIT CORPORATION: AN ECONOMIC ANALYSIS WITH RECOMMENDATIONS TO COURTS, BOARDS, AND LEGISLATURES

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INTRODUCTION

> Formal rules can complement and increase the effectiveness of informal constraints. They may lower information, monitoring, and enforcement costs and hence make informal constraints possible solutions to more complex exchange. Formal rules also may be enacted to modify, revise, or replace informal constraints.[1]

The benefit corporation legislation can be seen as a system of new formal rules, which at once seeks to complement and increase the effectiveness of the "corporate social responsibility" and "sustainable business" trends, and also disrupt the longstanding, informal constraint of shareholder wealth maximization. This legislation is designed to reduce transaction costs for both consumers and investors who subscribe to the "ethical consumer" and "impact investing" trends, respectively. This Article offers an analysis that describes key challenges of the legislation and prescribes some best-guess answers for how to address such challenges.

In so doing, this Article begins with a brief analysis of the history and norms of corporate governance—the dominant paradigms of thought and theories of corporate existence—and discusses how they gave rise to the benefit corporation. It then analyzes the predominant views on corporate governance today, institutionalized in that venerable State of Delaware's statutes and precedents. The Article then critically analyzes the benefit corporation's key elements and poses key questions that create uncertainty for courts to resolve. The Article concludes by describing how courts might optimally resolve these uncertainties and defining some processes and procedures that boards of directors may use to mitigate exposure. It also makes some recommendations to legislatures regarding whether to adopt certain provisions, and it ultimately recommends that legislatures pass this legislation for a litany of reasons, the most important of which is that the legislation

[1] DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 46–47 (1990) (citation omitted).

creates an opportunity to develop needed changes to the corporate governance architecture in order to reduce transaction costs in the long run, and it facilitates this new form of corporate governance, which addresses the rising demands of today's markets.

A. A Brief History of Corporate Governance Theory and Law

Since Ronald Coase penned *The Nature of the Firm* in 1937,[2] legal scholars and economists have debated the theory of the firm and essentially addressed two key questions: (1) what are the means of corporate governance (i.e., who owns the decision-making power); and (2) what are the ends of corporate governance (i.e., whose interests should prevail)?[3] Formulations of answers to the former can be categorized into the following camps: shareholder primacy (stating that shareholders own the corporation and directors and officers are mere fiduciaries of the shareholders' interests); the contractarian model (stating that shareholders are only one of several factors of production wound together in the contracts of the firm, but directors and officers are contractual agents of the shareholders); and managerialism (stating that a corporation is a bureaucratic hierarchy with autonomous professional managers who may pursue whatever interests they choose, and shareholders are nonentities).[4] Formulations of answers to the latter may be categorized into two camps: stakeholderists, who claim that directors and officers ought consider *all* corporate constituencies in corporate decision making, and shareholder-primacy advocates, who, while claiming that shareholders are the proper owners of the corporation, also claim that shareholders are the proper beneficiaries of director and officer fiduciary duties.[5] The director-primacy theory of the firm arose within the last decade and posits that boards of directors—not shareholders or managers—control the corporation, and it also asserts that shareholders are the appropriate beneficiaries of director fiduciary duties, and that directors ought to be accountable for maximizing shareholder wealth.[6] Proponents of stakeholder interests typically assert that corporate governance should be treated as a subject of public law and that the separation of ownership and control requires regulation in order to achieve public

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[2] R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

[3] Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 549–50 (2003).

[4] *Id.* at 547–48.

[5] *Id.* at 547–49.

[6] *Id.* at 550.

outcomes unrelated to private profitability.[7] Proponents of shareholder wealth maximization, unsurprisingly, view corporate governance as a subject of private law such that the separation of ownership and control does not justify state intervention.[8]

While many corporations are not subject to a separation of ownership from control today,[9] the predominance of that separation throughout the development of corporate governance law has greatly influenced its present state.[10] Corporations at the time of the American Revolution were almost exclusively public or semi-public in nature (e.g., formed for the purpose of building a public good, like a canal or railroad, not "public" in the "publicly held" sense that *public corporation* has come to mean today).[11] Grants of limited liability for the operators of these businesses came by royal charter or special legislative act, but generally, even these semi-public corporations were subject to English company law, which did not grant limited liability.[12] In the eighteenth century, the law of joint stock companies was developed through common law, which denied limited liability to shareholders,[13] and the Bubble Act of 1720 made it a criminal offense for an unincorporated company to presume to act as a corporation.[14] Around 1844, English corporations law and

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7 *Id.* at 549.

8 *Id.*

9 Closely held corporations constitute over 99% of the corporations in the United States. *See* ROBERT T. SLEE, PRIVATE CAPITAL MARKETS: VALUATION, CAPITALIZATION, AND TRANSFER OF PRIVATE BUSINESS INTERESTS 27 (2d ed. 2011). In closely held corporations, shareholders are typically able to exercise a great deal of control over the management team and affairs of the company, and for the roughly 1% of corporations that are publicly traded, institutional investors have gained increasing shares of ownership over the past five decades such that their control over management increasingly looks more like shareholder control over management in a closely held corporation. *See* Arthur R. Pinto, *An Overview of United States Corporate Governance in Publicly Traded Corporations*, 58 AM. J. COMP. L. (SUPPLEMENT) 257, 259–60 (2010); *see also id.* at 260 n.15 ("In 1950, 91% of equity was held by households. In 1996, the figure was approximately 48%. Pension funds held 22% of all equities." (citing N.Y. STOCK EXCH., FACT BOOK FOR THE YEAR 1996, at 59 (1997))); *id.* ("Institutional investors as a whole have increased their share of U.S. equity markets to 51.4% in the year 2000 then to 61.2% in 2005." (citing Press Release, Conference Bd., U.S. Institutional Investors Continue to Boost Ownership of U.S. Corporations (Jan. 22, 2007), *available at* http://web.archive.org/web/20070205020337/http://www.conference-board.org/utilities/pressDetail.cfm?press_ID=3046)). The decline of the separation between ownership and control could leave institutional investors with enhanced power to influence their corporations. *See* Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 815–16 (1992).

10 *See* ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 4–5 (1933).

11 E. Merrick Dodd, *The Evolution of Limited Liability in American Industry: Massachusetts*, 61 HARV. L. REV. 1351, 1351 (1948).

12 *Id.*

13 *Id.* at 1351 n.1.

14 Bubble Act of 1720, 1719, 6 Geo. 1, c. 18, § 18 (Eng.).

American corporations law diverged; the Joint Stock Companies Act[15] required registration of all partnerships that had transferable shares and more than twenty-five members, and once registered, conferred to them all the usual corporate privileges *except* that of limited liability for shareholders.[16] Meanwhile, in Massachusetts, between 1809 and 1830, special (non-semi-public) charters were granted with great liberality, but limited liability for investors still did not apply. The period of 1830 to 1850 saw widespread growth in the number of limited liability charters proffered to non-semi-public corporations,[17] and from 1851 onward self-incorporation under the general act was permitted and the restrictions with respect to size were generally limited.[18]

1. *Corporate Governance Norms and the Ends of Business*

Today, for-profit stock corporations need not be formed for any public or semi-public purpose, and they generally may be formed for any purpose other than the violation of an existing law.[19] The grant of limited liability to investors in any of today's non-public-purpose-oriented corporations is important because the directors and officers of the corporation remain on the hook for the deeds of the corporation, while the shareholders do not. Yet, corporate governance law still largely requires corporations to behave in a way that is procedurally designed to maximize shareholder wealth,[20] or at least has led corporations to behave in such a way that shareholder wealth maximization has become widely regarded as a norm.[21]

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15 Joint Stock Companies Act, 1844, 7 & 8 Vict., c. 110 (Eng.).

16 Dodd, *supra* note 11, at 1351 n.1.

17 *Id.* at 1353.

18 *Id.*

19 *See, e.g.*, DEL. CODE ANN. tit. 8, § 101(b) (West 2006) ("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."). Some states also do not require a statement of public purpose in corporate articles. *See, e.g.*, *id.* § 102.

20 This Article believes this duty-based argument is tenable. The frequent counterargument demands a case that says directors must maximize shareholder wealth in a day-to-day context. A reasonable response might demand a case where economic harm to shareholders or the corporation is *not* claimed in a breach-of-duty action. If breach-of-duty claims *only* arise in contexts where the value of stock is harmed, what else could the duty be other than to refrain from actions that are not designed to promote that value (or at least prevent harm to it)? The duty is certainly not to anything *other than* the pursuit of shareholder wealth maximization. For an example of the common counterarguments to the existence of the duty to maximize shareholder wealth, see Todd Henderson, *The Shareholder Wealth Maximization Myth*, TRUTH ON MARKET (July 27, 2010), http://truthonthemarket.com/2010/07/27/the-shareholder-wealth-maximization-myth.

21 The term *shareholder primacy norm* has come into wide use. *See, e.g.*, William W. Bratton & Joseph A. McCahery, *Regulatory Competition, Regulatory Capture, and Corporate Self-Regulation*, 73 N.C. L. REV. 1861, 1875 n.41 (1995); Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and*

Influential jurisprudential scholar Hans Kelsen is perhaps best known for propounding the view that:

> The concepts of "duty" and "right" (or entitlement) are intimately connected with the functions of norms. "A norm commands a certain behaviour" is equivalent to "A norm imposes a duty to behave in this way." "A person is 'duty-bound' or has a 'duty' to behave in a certain way" is equivalent to "There is a valid norm commanding this behaviour." A duty is not something distinct from a norm: it *is* the norm in its relation to the subject whose behaviour is commanded.[22]

Although there has been some academic debate about whether shareholder primacy is in fact a norm,[23] it is easy to see why such a norm would develop: the only persons who may bring action against a corporation for failure to pursue its proper purposes are shareholders, a group of individuals who have a clear and obvious economic incentive to protect their own interests in the form of maximizing their wealth. One dissenting scholar pointed to the passage of constituency statutes, which allow directorial consideration of nonshareholder interests, as evidence that the shareholder wealth maximization norm does not exist.[24] But the opposite view is more persuasive: why would over half of the states in the United States need to pass constituency statutes if the shareholder wealth maximization norm—nay, duty—did not exist?[25] The prevailing view, even today, is that despite any decision-making leeway provided by the constituency statutes, nonshareholder stakeholder interests may be considered only insofar as they relate rationally to the interests of the corporation and therefore its shareholders: nonshareholder stakeholder interests may be considered only as a means to the shareholder wealth maximization end, not as an end in and of themselves.[26]

Corporate Law, 68 TEX. L. REV. 865, 880 (1990). Occasionally, the term *shareholder wealth maximization norm* is employed instead. *See, e.g.*, Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1423 (1993).

22 HANS KELSEN, GENERAL THEORY OF NORMS 133 (Michael Hartney trans., 1991).

23 *See* D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 278–79 (1998).

24 *Id.* at 289.

25 By the mid-1990s, over half of the United States (twenty-nine states) had constituency statutes. *See* Ronn S. Davids, Comment, *Constituency Statutes: An Appropriate Vehicle for Addressing Transition Costs?*, 28 COLUM. J.L. & SOC. PROBS. 145, 156 n.47 (1995) (listing the twenty-nine states and their respective constituency statutes). Pennsylvania was the first to adopt a constituency statute, which allowed managers to, "[while] considering the best interests of the corporation, consider the effects of any action upon employe[e]s, suppliers and customers of the corporation, communities in which offices or other establishments of the corporation are located and all other pertinent factors." 1983 Pa. Laws 395.

26 We explore this matter further *infra* in Part I. While this is an issue technically still open for debate, the fact that there is debate creates litigation risks that boards of directors may not feel comfortable undertaking. *See* William H. Clark, Jr. & Elizabeth K. Babson, *How Benefit Corporations Are Redefining the*

This stakeholder-allergic development of corporate governance law is not without reason. In *The Morality of Law*, Lon Fuller wisely declared that "the morality of duty starts at the bottom. It lays down the basic rules without which an ordered society is impossible, or without which an ordered society directed toward certain specific goals must fail of its mark."[27] For Fuller, duty should have prescribed only what was necessary to put man "safely on the road to purposeful and creative activity."[28] But the rise of the benefit corporation, as an empirical gesture, indicates that the basic rules toward which corporate governance has been evolving for the last two hundred years have allowed directorial duties to fall short of what is necessary for an ordered society, or at least a well-ordered one. The corporate governance failures of Enron and Worldcom, followed by the latest failures in the ongoing economic crisis that began in 2008; the indiscriminate use of dwindling resources; global climate change; and social fallout from the inevitable vicissitudes of the capitalist economy, are all matters that cannot be resolved within a narrow view of shareholder wealth maximization. There are those who see the rise of the benefit corporation as the overreaching arm of progressives who wish to interpose greater government oversight into corporate governance;[29] but the more accurate view may be that the rise of the benefit corporation simply presents a much needed option for those who wish to incorporate values-based decision making into their business practices and procedures. It also marks a return to a corporate form in which the limitation on investor liability is given in exchange for enterprises that are dedicated to benefitting the society and environment in which the enterprise operates. For too long, American corporate governance jurisprudence has espoused Locke but forgotten the Lockean proviso;[30] lauded Smith's Invisible Hand,[31] but ignored his *Theory of*

Purpose of Business Corporations, 38 WM. MITCHELL L. REV. 817, 828–29 (2012) (summarizing the constituency-statute issue).

[27] LON L. FULLER, THE MORALITY OF LAW 5–6 (rev. ed. 1969).

[28] *Id.* at 9.

[29] Were Fuller alive today, he may be one of them. And he would have company. *See* Bainbridge, *supra* note 21, at 1437 (asserting that enforcement of a multifiduciary duty would cause legal uncertainty for managers).

[30] JOHN LOCKE, TWO TREATISES OF GOVERNMENT 137 (Thomas I. Cook ed., Hafner Publ'g Co. 1947) (1690) ("Nor was this appropriation of any parcel of land by improving it any prejudice to any other man, since there was still enough and as good left, and more than the yet unprovided could use. So that, in effect, there was never the less left for others because of his enclosure for himself; for he that leaves as much as another can make use of does as good as take nothing at all. Nobody could think himself injured by the drinking of another man, though he took a good draught, who had a whole river of the same water left him to quench his thirst; and the case of land and water, where there is enough for both, is perfectly the same.").

Moral Sentiments.[32] The corporate governance debate has obsessed duty and left aspiration wanting.

In Fuller's words:

> As we consider the whole range of moral issues, we may conveniently imagine a kind of scale or yardstick which begins at the bottom with the most obvious demands of social living and extends upward to the highest reaches of human aspiration. Somewhere along this scale there is an invisible pointer that marks the dividing line where the pressure of duty leaves off and the challenge of excellence begins. The whole field of moral argument is dominated by a great undeclared war over the location of this pointer. There are those who struggle to push it upward; others work to pull it down. Those whom we regard as being unpleasantly—or at least, inconveniently—moralistic are forever trying to inch the pointer upward so as to expand the area of duty. Instead of inviting us to join them in realizing a pattern of life they consider worthy of human nature, they try to bludgeon us into a belief we are duty bound to embrace this pattern.[33]

Society has reevaluated the corporate governance yardstick. The benefit corporation is an invitation to seekers of an evolved interpretation. To date, fifteen states have passed laws establishing the benefit corporation, and more than 748 entrepreneurs have formed benefit corporations in an attempt to show that the needle can be pushed upward and, indeed, that the market wants to do so.[34]

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31 ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 423 (Edwin Cannan ed., Random House, Inc. 1937) (1776) ("By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it.").

32 ADAM SMITH, THE THEORY OF MORAL SENTIMENTS (1759).

33 FULLER, *supra* note 27, at 9–10.

34 *See State by State Legislative Status*, BENEFIT CORP. INFO. CENTER, http://benefitcorp.net/state-by-state-legislative-status (last visited May 14, 2013); CERTIFIED B CORP., http://www.bcorporation.net/ (last visited May 14, 2013).

2. *The Role of Delaware in Shaping the History of Corporate Governance*

For almost a century now, Delaware has been the most favored state of incorporation for corporations large and small, public and private.[35] It is widely "recognized as the world's incorporation capital."[36] The reasons for Delaware's most-favored-state status are multitudinous. There are reasons practical in nature: Delaware's corporation law is generally acknowledged to be the most advanced and flexible, and its General Assembly consistently amends it based on recommendations from the Delaware bar's Corporation Law Section; Delaware has a responsive and efficient secretary of state and Division of Corporations; and Delaware's Court of Chancery and corporate bar provide a high degree of sophistication and understanding, a well-established body of caselaw, and a great sense of predictability on which corporations can rely.[37] Many corporations also incorporate in Delaware for reasons that are strictly legal, such as Delaware's treatment of the following: board determinations, classified boards and removal of members of boards, board committees, liability of directors and officers, and appraisal rights.[38]

The benefits of these features become clearer when firms are comparatively valued across state lines. A February 2000 study of more than 4,400 publicly traded businesses showed that there was a quantifiable difference between the value of Delaware companies and companies incorporated elsewhere. In 1996, companies in Delaware traded at a 5% premium over comparable companies incorporated in other jurisdictions.[39] Chief Judge Frank Easterbrook of the United States Court of Appeals for the Seventh Circuit did well to ask that, if all of the flexibility and legal dogma attendant to forming in Delaware were really disadvantageous, why would so many sophisticated investors not only

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35 *See* Frank H. Easterbrook, *The Race for the Bottom in Corporate Governance*, 95 VA. L. REV. 685, 686 (2009); J. Robert Brown, *Delaware and the Race to the Bottom*, THERACETOTHEBOTTOM.ORG (Sept. 13, 2007, 1:30 PM), http://www.theracetothebottom.org/preemption-of-delaware-law/delaware-and-the-race-to-the-bottom.html ("As of April 2007, over 61% of all Fortune 500 companies were incorporated in Delaware, according to the Administrative Office of the Courts. Since 1973, 75 percent of all U.S. initial public offerings selected Delaware as their state of incorporation."); Francis Pileggi, *Why Delaware Courts Are America's Most Important to Businesses*, DEL. CORP. & COMMERCIAL LITIG. BLOG (Sept. 2, 2007), http://www.delawarelitigation.com/2007/09/articles/commentary/why-delaware-courts-are-americas-most-important-to-businesses.

36 Potter Anderson & Corroon LLP, *The Delaware Advantage*, *in* AVOIDING LANDMINES IN ACQUIRING THE DELAWARE PUBLIC COMPANY 1, 1 (2011).

37 *Id.* at 1–2.

38 *Id.* at 2–3, 5.

39 *Id.* at 1 n.1 (citing Steven Lipin, *Firms Incorporated in Delaware Are Valued More by Investors*, WALL ST. J., Feb. 28, 2000, at C21).

funnel all their money into Delaware companies, but value them at a premium just for being in Delaware?[40] It must be that investors appreciate the efficiency that directorial discretion and protection promotes within corporate governance when competent management is in place, because protecting and promoting the interests of shareholders is one feature that Delaware law does not have.[41]

Delaware's laws are the product of regulatory competition between the states and the federal government, which has resulted in a reduction of standards and requirements.[42] Adolf Berle and Gardiner Means commented on the trend toward flexible incorporation as early as 1932.[43] Even earlier, in New Jersey in 1911, then-governor Woodrow Wilson nobly tried urging for higher standards in his inaugural address:

> If I may speak very plainly, we are much too free with grants of charters to corporations in New Jersey: A corporation exists, not of natural right, but only by license of law, and the law, if we look at the matter in good conscience, is responsible for what it creates.
>
> I would urge, therefore, the imperative obligation of public policy and of public honesty we are under to effect such changes in the law of the State as will henceforth effectually prevent the abuse of the privilege of incorporation which has in recent years brought so much discredit upon our State.[44]

But a statute that would have made intercorporate stockholding more difficult was repealed because "this State loses a [franchise tax] revenue which is perfectly legitimate. . . . Such losses mean a serious depletion of the revenues of the State."[45] In Delaware today, over $709 million, or 21.6% of all the state's general fund revenue, comes from the corporate franchise tax and

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40 *See* Easterbrook, *supra* note 35, at 688.

41 *See* Brown, *supra* note 35.

42 *See* William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 663 (1974).

43 BERLE & MEANS, *supra* note 10, at 204 n.18 ("As significant of the trend towards that corporate mechanism with the broadest powers to the management, it is interesting to note the steady trend towards the states having a loose incorporation law.").

44 Woodrow Wilson, Inaugural Address as Governor of New Jersey (Jan. 17, 1911), *in* 2 THE PUBLIC PAPERS OF WOODROW WILSON: COLLEGE AND STATE 270, 273–74 (Ray Stannard Baker & William E. Dodd eds., 1925).

45 Louis K. Liggett Co. v. Lee, 288 U.S. 517, 559 n.37 (1933) (Brandeis, J., dissenting) (quoting COMM'N TO REVISE THE CORP. LAWS OF THE STATE OF N.J., REPORT TO THE LEGISLATURE SESSION OF 1917, at 7–8 (1917)).

related fees.[46] Corporations generated an additional $10 million for local governments and approximately $15 million in special-fund revenue.[47] William Cary, former Chairman of the U.S. Securities and Exchange Commission, wrote in 1974: "Delaware is both the sponsor and the victim of a system contributing to the deterioration of corporation standards. This unhappy state of affairs, stemming in great part from the movement toward the least common denominator, Delaware, seems to be developing on both the legislative and judicial fronts."[48]

Delaware remains the bedrock of corporate governance and the home of most incorporated businesses in America today, in large part because of the protection offered to directors and officers of Delaware corporations. But it is that same flexibility and protection that has given rise to the call for a new corporate form allowing companies to consider the general public benefit and holding the companies accountable for their claims to do so. At present, the shareholder wealth maximization norm forces directors of traditional corporations to question whether and to what extent they are allowed to consider stakeholder interests—namely, whether they may consider those interests for their own sake or only insofar as they benefit the immediate or apparent interests of shareholders. Moreover, the absence of an affirmative requirement to consider the general public benefit while operating their businesses leaves investors and consumers ill equipped to differentiate between corporations that are accountable for their claims of good-doing and those that simply have good marketing and "greenwash." It is for those reasons and others that the benefit corporation legislation was crafted and adopted by state legislatures in the early twenty-first century.

B. Why the Benefit Corporation Legislation Was Created and Adopted

Benefit corporations are the brainchild of the nonprofit B Lab.[49] B Lab's cofounders—Jay Coen Gilbert, Andrew Kassoy, and Bart Houlahan—worked closely with William Clark, a partner at Drinker Biddle & Reath and drafting author of the Model Business Corporations Act (MBCA),[50] to draft the Model

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46 Elizabeth Bennett, *Chief Justice Steele Keynote Speaker at Business Law Section Event*, DEL. L. WKLY., Aug. 22, 2007, at D1.

47 *Id.*

48 Cary, *supra* note 42, at 663.

49 *Passing Legislation*, CERTIFIED B CORP., http://www.bcorporation.net/what-are-b-corps/legislation (last visited May 12, 2013).

50 *William H. Clark, Jr.*, DRINKER BIDDLE, http://www.drinkerbiddle.com/people/attorneys/clark-william-h (last visited May 12, 2013).

Benefit Corporation Legislation,[51] which has been adopted in varying iterations in twelve states as of November 1, 2012.[52] Prior to forming B Lab, Jay, Bart, and Andrew were entrepreneurs, operators, and investors, and upon selling their business (Jay and Bart ran AND 1, a $250 million basketball footwear and apparel company) and readying for a life after a career in Wall Street private equity (Andrew was a partner at MSD Capital), the triumvirate formed B Lab in June 2006 to promote a new type of corporation that uses the power of business to solve social or environmental problems.[53] B Lab tells us that the B Corporation legal structure[54] is conceived to address two problems:

i. "[T]he existence of shareholder primacy which makes it difficult for corporations to take employee, community, and environmental interests into consideration when making decisions;" and

ii. "[T]he absence of transparent standards which makes it difficult for all of us to tell the difference between a 'good company' and just good marketing."[55]

On February 7, 2011, Jay Coen Gilbert testified before the Pennsylvania State Senate to urge the adoption of a benefit corporation statute.[56] His rationales for the legislation were as follows:

i. Over 50,000 businesses in the U.S. identify themselves as existing to create public benefit, not simply shareholder wealth. They strive to create quality jobs that improve quality of life in our communities. But they struggle with a

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51 *Model Benefit Corporation Legislation*, BENEFIT CORP. INFO. CENTER (Jan. 26, 2012), http://benefitcorp.org/storage/Model_Legislation.pdf.

52 *See State by State Legislative Status*, *supra* note 34.

53 *See The Non-Profit Behind B Corps*, CERTIFIED B CORP., http://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps (last visited May 12, 2013).

54 *See Protect Your Mission*, CERTIFIED B CORP., http://www.bcorporation.net/become-a-b-corp/why-become-a-b-corp/protect-your-mission (last visited May 12, 2013). There has been much confusion on this issue. B Revolution Consulting hosts content listing the legal requirements for becoming B Corporation certified. *See Legal Strategy*, B REVOLUTION CONSULTING, http://www.brevolutionconsulting.com/consulting-services/legal-strategy (last visited May 12, 2013). B Corporations may be LLCs with specific language in the operating agreement; B Corporations may be traditional corporations with specific language adopted in their articles of incorporation; and finally, B Corporations may be benefit corporations. *See id.* The stated goals of B Lab's legal requirements are the same in each instance.

55 *Introducing the B Corporation*, B REVOLUTION CONSULTING 4 (May 15, 2012), http://www.brevolutionconsulting.com/assets/BCorp-Intro-pack.pdf.

56 Jay Coen Gilbert, Remarks on White/Leach Benefit Corporation Bill upon Introduction to the Pennsylvania State Senate 1 (Feb. 7, 2011).

capital market and corporate structures built for an old way of doing business.[57]

ii. After the latest round of economic and environmental crises, it's clear we need systemic solutions to the systemic problem that places the interests of shareholders over the interests of workers, community, and the environment. [We] can't change outcomes until we change the rules of the game. In short, we need new rules for a new economy.[58]

iii. Currently, individuals and groups seeking to establish organizations with a public mission can either organize themselves as not-for-profit corporations, or use a traditional for-profit corporate form. In the case of non-profits, there are numerous restrictions on the nature of their activities, and non-profits are thus extremely limited in their ability to attract capital to allow them to achieve their mission at scale. In the case of traditional for profit corporations, such businesses are generally required under the current statutory and case law to be conducted for the benefit of the shareholders to whom the directors owe a fiduciary duty to maximize shareholder value, thus limiting their ability to consider the interests of their employees, communities, or the environment.[59]

Elsewhere, Coen Gilbert has noted additional rationales for the legislation, including the benefit corporation's higher purpose as a potential source of innovation and psychological value for business leaders; greater accountability, namely a requirement to consider the stakeholders whom the business inevitably impacts; and more transparency, in the form of a requirement to share their progress toward achieving the publicly beneficial goals that they set out to accomplish.[60] B Lab's benefit corporation white paper focuses more on market trends—demand from consumers, investors, entrepreneurs, and job-seekers—as key drivers of the need for a new corporate form.[61] And other commentators, prior to the rise of the benefit corporation, also explicitly called

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57 *Id.* at 2.

58 *Id.*

59 *Id.* at 2–3.

60 *See* Jay Coen Gilbert, *Can I Get a Witness?! The Evolution of Capitalism*, HUFFINGTON POST (Sept. 27, 2011, 7:59 PM), http://www.huffingtonpost.com/jay-coen-gilbert/benefit-corporation-legislation-_b_976650.html.

61 *See* 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 2–5 (2012), *available at* http://www.benefitcorp.net/storage/documents/The_Need_and_Rationale_for_Benefit_Corporations_April_2012.pdf.

for a new private-sector legal entity to help solve the growing public-sector, social-services finance problem.[62]

The legislatures themselves have forwarded unique iterations of similar intentions in their legislative history. The California record is the least informative, merely stating that there was not yet a benefit corporation at the time the bill was proposed, that the bill would provide for one, and that the entity would have a list of features that were included in the actual bill.[63] The New York rationale is more informative, stating the following rationales:

i. Allow multipurpose business models: "Corporate leaders need to be able to shape business models that enable them to satisfy the demands of investors, employees and customers who increasingly demand that corporations serve both shareholders and society, considering the impact of their decisions on multiple stakeholders rather than maintaining a singular focus on short term maximization of financial profits."[64]

ii. Disrupt the shareholder primacy norm: "Currently, socially-minded companies are often left with the catch-22 of either not being able to earn a profit or opening their directors up to possible personal liability for decisions that do not maximize shareholder value or increasingly going to states other than New York that are pursuing this corporate form. This bill solves that dilemma."[65]

iii. Widen profit-oriented decision-making allowance[66]: "[The statute removes] legal impediments preventing businesses and investors from making their own decisions to use sustainability and social innovation as a competitive advantage;"[67]

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62 Arthur Wood, Transcript, *New Legal Structures to Address the Social Capital Famine*, 35 VT. L. REV. 45, 45–46 (2010).

63 *See* 2011 Cal. Legis. Serv. ch. 728, 1–2 (West) (codified at CAL. CORP. CODE § 14600 (West 2013)).

64 *S79A-2011: Authorizes the Incorporation of Benefit Corporations*, OPEN N.Y. SENATE, http://open.nysenate.gov/legislation/bill/S79A-2011 (last visited May 12, 2013).

65 *Id.*

66 This rationale in particular is one of the more interesting rationales. Although traditional corporations provide broad leeway to pursue nonshareholder interests as a competitive advantage *when profit is explicitly sought after*, traditional corporations preclude directors from "doing good for good's sake"—which may in fact, somewhat paradoxically, prove to create an economic, profit-maximizing competitive advantage. One of the most interesting aspects of the economic implications of the statute is whether doing good *without regard to shareholder interests* will actually result in long-run profitability and more sustainable shareholder gains.

67 *S79A-2011: Authorizes the Incorporation of Benefit Corporations*, *supra* note 64.

iv. Economic development: "Give[] New York a competitive advantage as a leading state by accelerating development of a new sector of the economy in New York by providing legal recognition for businesses that adopt higher standards of corporate purpose, accountability and transparency;"[68]

v. Lower risk: "Provide[] clarity to business leaders, general counsels and investors that the fiduciary duty of benefit corporations affirmatively includes creating public benefit;"[69]

vi. Expand directorial duties: "Expand[] shareholder rights to enforce this expanded definition of fiduciary duty, as well as a higher standard of conduct for directors to consider the impact of their decisions on both financial and non-financial interests;"[70]

vii. Transparency: "Include[] higher standards of transparency, requiring annual reporting to shareholders and the public about the corporation's social and environmental performance;"[71]

viii. Asset locking: "Help[] ensure that these corporations and the positive social and environmental impact they create are built to last beyond marketing trends, strong business cycles or existing corporate leadership by requiring a 3/4 majority vote of shareholders to remove these higher standards."[72]

Having now introduced in sufficient depth for our immediate purposes the academic paradigms of corporate governance, the historical development of American corporations law, and the rationales for the passage of benefit corporation legislation,[73] we will progress to explore the nuances of predominant Delaware corporate law in order to gain useful context for Part III's exploration of the complex issues raised by the benefit corporation statutes.

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68 *Id.*

69 *Id.*

70 *Id.*

71 *Id.*

72 *Id.*

73 This Article notes that, particularly on this issue (legislative intent), a thorough state-by-state analysis would be necessary to ascertain each state's intention with regard to each provision; such an analysis for all benefit corporation states would be a topic for another article in and of itself.

I. DELAWARE CORPORATION FIDUCIARY DUTIES AND CORPORATE GOVERNANCE

We here examine Delaware's corporate governance law for two purposes: first, to understand the context from which the benefit corporation sprang; second, to understand the wisdom and principles of Delaware's corporate governance law in order to ascertain how some of them may be applied to the benefit corporation form. The former is important because Delaware's law is in some ways procrustean. The latter is important because, as always, the old informs and shapes the new; and, we argue, failure to transfer some core principles would result in oppressive uncertainty that will chill the business model innovations the form is designed to promote.

A. Derivative and Direct Suit Mechanics

We begin with derivative and direct suit mechanics because the only way that the fiduciary duties of directors and officers of the corporation may be enforced is through intracorporate action. The state and federal governments and other nondirectors and nonshareholders have no right of action against the corporation for breach of a fiduciary duty; rather, the duty is to the corporation alone.[74] The prospect of shareholder action provides "a necessary check on the behavior of directors that serve in a fiduciary capacity to shareholders."[75] Richard Donaldson reasoned that:

> [Carriage return] derivative actions are intended to maintain the balance between the power of a Delaware corporation's board of directors to manage and direct others in the management of the company and the right of the company's shareholders to police the conduct of directors and officers who "may not [otherwise] hold themselves accountable to the corporation for their own wrongdoing.[76]

Typically, actions by shareholders against the corporation arise in one of two forms. First, when an action is brought by shareholders in order to remedy

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[74] Of course, the state and federal governments do have jurisdiction to sue a corporation for other matters (e.g., actions may be brought by the federal government against a corporation for breach of federal securities laws or federal environmental laws). Also, private actors may sue the corporation for torts or property damage.

[75] Agostino v. Hicks, 845 A.2d 1110, 1117 (Del. Ch. 2004).

[76] Richard Montgomery Donaldson, *Mapping Delaware's Elusive Divide: Clarification and Further Movement Toward a Merits-Based Analysis for Distinguishing Derivative and Direct Claims in* Agostino v. Hicks *and* Tooley v. Donaldson, Lufkin & Jenrette, Inc., 30 DEL. J. CORP. L. 389, 392 (2005) (alteration in original) (quoting *Agostino*, 845 A.2d at 1116).

or prevent a wrong *against the corporation*, the action is dubbed a *derivative action* because it derives from the wrong against the corporation.[77] Alternatively, when an action is brought by shareholders in order to remedy or prevent a wrong *against the plaintiffs*, the action is dubbed a *direct action* because it addresses the harm suffered directly by the shareholders, as distinct from the corporation itself.[78]

1. *Pleading a Direct Claim*

The distinction between a direct and a derivative action hinges on two questions: who suffered the alleged harm (the corporation or the stockholders), and who would receive the benefit of any recovery (the corporation or the stockholders)?[79] In order to state a direct claim, "the plaintiff must allege more than an injury resulting from a wrong to the corporation."[80] For example, in *Kramer v. Western Pacific Industries, Inc.*, Kramer filed a class action suit stating individual claims against the corporation, arguing that the class of shareholders (distinct and apart from the corporation) sustained injury when the corporation's compensation committee entered into termination agreements ("golden parachutes") with the corporation's principal executives.[81] The compensation committee's recorded reason for entering into the agreements was to ensure that management would be in a position to pursue acquisition proposals that were in the best interests of the shareholders rather than, for example, shunning such proposals in order to reap greater personal compensation by retaining control of the corporation and refusing to sell.[82] Kramer did not dispute the adequacy of the merger price negotiated by the board and its executives; rather, the complaint alleged that the executives' golden parachute stock options—as well as fees and expenses associated with the sale of Western Pacific—reduced the common shareholders' net distributive share of an otherwise adequate tender offer price paid.[83] Although the purported injury would have indeed injured the stockholders, the Delaware Supreme Court held that:

> Delaware courts have long recognized that actions charging "mismanagement which depress[] the value of stock [allege] a wrong

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77 *See, e.g.*, 19 AM. JUR. 2D *Corporations* § 1934 (2004).
78 *Id.*
79 Tooley v. Donaldson, Lufkin, & Jenrette, Inc., 845 A.2d 1031, 1033 (Del. 2004) (en banc).
80 Kramer v. W. Pac. Indus., Inc., 546 A.2d 348, 351 (Del. 1988).
81 *See id.* at 349–50.
82 *See id.* at 350.
83 *Id.* at 350 n.2.

> to the corporation; *i.e.*, the stockholders collectively, to be enforced by a derivative action." Thus, where a plaintiff shareholder claims that the value of his stock will deteriorate and that the value of his proportionate share of the stock will be decreased as a result of alleged director mismanagement, his cause of action is derivative in nature.
>
> A claim of mismanagement resulting in corporate waste, if proven, represents a direct wrong to the corporation that is indirectly experienced by all shareholders. Any devaluation of stock is shared collectively by all the shareholders, rather than independently by the plaintiff or any other individual shareholder. Thus, the wrong alleged is entirely derivative in nature.[84]

The Court then upheld the dismissal of Kramer's complaint for lack of standing and granted summary judgment to the corporation.[85]

It is important to note that, although Kramer's claim could only have been brought as a derivative action, Kramer would not have been able to gain standing as a derivative claimant suing on behalf of the corporation because the Delaware Supreme Court has held that, in order to maintain a derivative suit, "a plaintiff must be a shareholder at the time of the filing of the suit and must remain a shareholder throughout the litigation."[86] Because the corporation was being sold and neither of the *Lewis* merger exceptions applied,[87] Kramer would not have retained shareholder status post-sale and thus would have lacked standing for a derivative claim. So, particularly in the context of a merger, achieving direct or derivative standing can prove nebulous.

Kramer may have been more successful if he had been able to allege unfairness in the actual merger price, because unlike a shareholder claiming waste due to a golden parachute, "[a] stockholder who directly attacks the fairness or validity of a merger alleges an injury to the stockholders, not the corporation, and may pursue such a claim even after the merger at issue has been consummated."[88] The Delaware Supreme Court also noted that "[t]he problem is that it is often difficult to determine whether a stockholder is

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84 *Id.* at 353 (alterations in original) (internal citations omitted).
85 *Id.* at 355.
86 *Id.* at 354; *see also* DEL. CODE ANN. tit. 8, § 327 (West 2006).
87 *Kramer*, 546 A.2d at 354.
88 Parnes v. Bally Entm't Corp., 722 A.2d 1243, 1245 (Del. 1999) (en banc).

challenging the merger itself, or alleged wrongs associated with the merger, such as the award of golden parachute employment contracts."[89]

2. Derivative Actions and the Demand Requirement

Had Kramer retained ownership and been able to state his claim derivatively—or challenge the price and terms of the merger—he would have encountered a separate milieu of pleading requirements unique to such derivative claims. When a plaintiff stockholder brings suit derivatively, the corporation is the real party in interest and the stockholder is only a nominal plaintiff. The cause of action belongs to the corporation, not the stockholder individually, and the stockholder may enforce the legal right of the corporation *only through equity*, unless otherwise provided by statute.[90] Delaware law "empowers shareholders to protect affirmatively and directly—as opposed to indirectly through representative fiduciaries—the rights and interests of a company that otherwise would not be protected."[91] The derivative action was developed as a check on the board of directors' power to institute litigation on behalf of the corporation by permitting shareholders to bring suit against the corporation's governing body *on behalf of the corporation*. It allows shareholders to look after the well-being of the corporation's interests when the governing body fails to do so. Thus derivative actions serve an important purpose, particularly in protecting shareholders against officers and directors who place their interests ahead of those of the corporation.

However, the derivative pleading requirements defined in Rule 23.1 are more burdensome than the direct pleading requirements for two reasons. First, it requires adjudication to occur on behalf of the whole association and not just the individuals pursuing the claims. Second, it galvanizes a business's governing body to take action to redress injury suffered by the business.[92] Rule 23.1(a) achieves the latter by stating that, in a derivative action, the complaint must allege "*with particularity* the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable

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89 *Id.*

90 19 AM. JUR. 2D *Corporations* § 1949 (2004); *see also* Callanan v. Powers, 92 N.E. 747, 752–53 (N.Y. 1910) ("There was no remedy at law open to the plaintiff, for a representative action . . . . The plaintiff had no standing except in equity . . . ."); Burnham v. Brush, 26 N.Y.S.2d 397, 398 (Sup. Ct. 1941) ("The right of a stockholder of a corporation to bring suit to enforce, for the benefit of the corporation, a cause of action, which belongs to the corporation, is purely equitable." (internal quotation marks omitted)).

91 Donaldson, *supra* note 76, at 391–92.

92 *In re* Cencom Cable Income Partners, L.P. Litig., No. C.A. 14634, 2000 WL 130629, at *4 (Del. Ch. Jan. 27, 2000).

authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort."[93] This is the so-called demand requirement, which is not a feature of direct claim pleading requirements.[94] Stating the plaintiff's efforts to obtain action from the corporation prior to instituting litigation "is required unless there is reasonable doubt regarding the entity's disinterest or valid exercise of business judgment."[95] The demand requirement exists "first to insure that a stockholder exhausts his intracorporate remedies, and then to provide a safeguard against strike suits."[96] It is an extension of the "cardinal precept of the General Corporation Law of the State of Delaware . . . that directors, rather than shareholders, manage the business and affairs of the corporation."[97]

The Delaware courts have carved out two exceptions to the demand requirement, in which demand on the corporation would be futile. Reasonable doubt must exist that either the directors are disinterested and independent, or that the challenged transaction was a product of a valid business judgment.[98] In *Brehm v. Eisner*, the Delaware Supreme Court made clear that the test is disjunctive, and that only one prong of the *Aronson* futility test needed to be met to plead demand futility, though a total lack of one prong will lead to an enhanced burden for proving the other.[99] The "interestedness" component of the test analyzes whether "divided loyalties are present, or a director either has received, or is entitled to receive, a personal financial benefit from the challenged transaction which is not equally shared by the stockholders."[100] An example of this would be a pleading of specific facts showing that the transaction in question was entered into by the directors for the sole or primary purpose of entrenchment—retaining their role as board members or executives within the corporation. Absent a showing of interestedness, the court will proceed to the "valid exercise of business judgment" component of the test, which analyzes whether the action was taken on an informed basis and whether

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93 DEL. CH. CT. R. 23.1(a) (emphasis added).

94 *See* Loudon v. Archer–Daniels–Midland Co., 700 A.2d 135, 140 (Del. 1997) (en banc) ("In asserting direct claims, as distinct from stockholder derivative claims, the complaint need give only general notice of the claim asserted.").

95 *In re Cencom*, 2000 WL 130629, at *4.

96 Aronson v. Lewis, 473 A.2d 805, 811–12 (Del. 1984); *accord* Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984).

97 *Aronson*, 473 A.2d at 811.

98 *See* Brehm v. Eisner, 746 A.2d 244, 256 (Del. 2000) (en banc).

99 *Id.*

100 *Pogostin*, 480 A.2d at 624; *see also* Grobow v. Perot, 526 A.2d 914, 920 (Del. Ch. 1987), *aff'd*, 539 A.2d 180 (Del. 1988).

the directors honestly and in good faith believed that the action taken was in the best interests of the corporation.[101] The second prong is "directed to extreme cases in which despite the appearance of independence and disinterest a decision is so extreme or curious as to itself raise a legitimate ground to justify further inquiry and judicial review."[102]

A final caveat to the demand requirement and its exceptions is the role of the special litigation committee (SLC). In order to distance itself from a claim of interestedness, a board may appoint an SLC composed of disinterested directors and empower that committee to determine whether the proposed litigation is in the corporation's best interests and, where appropriate, settle the claim or seek dismissal.[103] Delaware courts have explained the benefit of SLCs.[104] Indeed, regardless of whether a plaintiff's demand is refused (i.e., the corporation refuses to institute the litigation plaintiff is demanding), or the demand requirement is excused (i.e., due to a conflict of interest, or failure of the board to exercise business judgment), Delaware law provides boards with the power to determine whether to initiate or refrain from entering into litigation.[105] However, the Delaware Supreme Court in *Zapata* held that "[t]he corporation should have the burden of proving [the SLC's] independence, good faith and . . . reasonable investigation."[106]

3. *Pleading a Derivative Action*

In addition to satisfying the "demand requirement" through either actual demand or demand futility, derivative plaintiffs in Delaware must also show they are adequate representatives of the corporation's stockholders before a Delaware court will recognize their standing to bring an action on behalf of the

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[101] *See In re* Walt Disney Co. Derivative Litig., 825 A.2d 275, 286 (Del. Ch. 2003).

[102] Kahn v. Tremont Corp., Civ. A. No. 12339, 1994 WL 162613, at *6 (Del. Ch. Apr. 22, 1994).

[103] *See* Carlton Invs. v. TLC Beatrice Int'l Holdings, Inc., Civ. A. No. 13950, 1997 WL 38130, at *2 n.2 (Del. Ch. Jan. 29, 1997).

[104] *See, e.g.*, Biondi v. Scrushy, 820 A.2d 1148, 1156 (Del. Ch. 2003) ("By forming a committee whose fairness and objectivity cannot be reasonably questioned, giving them the resources to retain advisors, and granting them the freedom to do a thorough investigation and to pursue claims against wrongdoers, the company can assuage concern among its stockholders and retain, through the SLC, control over any claims belonging to the company itself."), *aff'd sub nom. In re* Healthsouth Corp. S'holders Litig., 847 A.2d 1121 (2004).

[105] DEL. CODE ANN. tit. 8, § 141(a) (West Supp. 2012); *see also* Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981).

[106] *Zapata*, 430 A.2d at 788; *accord* Kaplan v. Wyatt, 499 A.2d 1184, 1188 (Del. 1985); *In re* Oracle Corp. Derivative Litig., 824 A.2d 917, 920 (Del. Ch. 2003); Lewis v. Fuqua, 502 A.2d 962, 967 (Del. Ch. 1985).

corporation and its stockholders.[107] In determining whether a derivative plaintiff will be an adequate representative, Delaware courts have mandated that eight nonexclusive factors shall be given consideration in determining whether a plaintiff is adequate:

> (1) Economic antagonisms between the plaintiff and the shareholders;
> (2) The remedy sought by the plaintiff;
> (3) Indications that the named plaintiff was not the driving force behind the litigation;
> (4) The plaintiff's lack of familiarity with the litigation;
> (5) Other litigation pending between the plaintiff and the defendant corporation;
> (6) The relative magnitude of the plaintiff's personal interest as compared to his interest in the derivative action itself;
> (7) The plaintiff's vindictiveness toward the defendant corporation; and
> (8) The degree of support the plaintiff is receiving from the shareholders he purported to represent.[108]

If there is a strong showing on any one factor, or a confluence of several factors indicating the derivative plaintiff is an inadequate representative, the court may disqualify the plaintiff. Thus, it is the plaintiff's burden to persuade

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[107] Delaware Chancery Court Rule 23.1 omits a requirement found in the Federal Rules of Civil Procedure. *Compare* FED. R. CIV. P. 23.1(a) ("The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of shareholders or members who are similarly situated in enforcing the right of the corporation or association."), *with* DEL. CH. CT. R. 23.1. The Delaware Court of Chancery has held that "a plaintiff shareholder in a derivative action must be qualified to serve in a fiduciary capacity as a representative of a class of persons similarly situated, whose interests are in plaintiff's hands and the redress of whose injuries is dependent upon his diligence, wisdom and integrity." Katz v. Plant Indus., Inc., Civ. A. No. 6407, 1981 WL 15148, at *1 (Del. Ch. Oct. 27, 1981) (citing Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541 (1949)); *see also In re* Dairy Mart Convenience Stores, Inc. Derivative Litig., Civ. A. No. 14713, 1997 WL 732467, at *3 (Del. Ch. Nov. 13, 1997); Steiner v. Meyerson, Civ. A. No. 13139, 1997 WL 349169, at *3 (Del. Ch. June 13, 1997); Youngman v. Tahmoush, 457 A.2d 376, 379 (Del. Ch. 1983) ("[T]he plaintiff in a derivative action must be qualified to serve in a fiduciary capacity as a representative of a class, whose interest is dependent upon the representative's adequate and fair prosecution.").

[108] *Katz*, 1981 WL 15148, at *2; *see also* MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc., Civ. A. No. 8126, 1985 WL 21129, at *4 (Del. Ch. Oct. 9, 1985); Scopas Tech. Co. v. Lord, No. 7559, 1984 WL 8266, at *310 (Del. Ch. Nov. 20, 1984); *Youngman*, 457 A.2d at 379–80.

the court that the representatives will serve as adequate curators of the interests of the class.[109]

4. The Delaware Pleading Standard

Aside from pleading the standing requirements in a direct or derivative action, a plaintiff—whether derivative or direct—must satisfy Delaware's "conceivability" pleading standard in order to survive a motion to dismiss the suit. Despite the United States Supreme Court's shift from a "possibility" standard to a "plausibility" standard for the Federal Rules of Civil Procedure,[110] the Delaware Supreme Court held as recently as 2011 that, in cases involving Delaware law, "until this Court decides otherwise or a change is duly effected through the Civil Rules process, the governing pleading standard in Delaware to survive a motion to dismiss is reasonable 'conceivability.'"[111] The conceivability standard is "more akin to 'possibility,' while the federal 'plausibility' standard falls somewhere beyond mere 'possibility' but short of 'probability.'"[112] Thus, the tendency of the Delaware courts is to entertain an action where the factual truth of the claim is merely possible, and the courts will not invite judges to draw on judicial experience and common sense to determine whether a complaint states a plausible claim for relief.[113]

B. Fiduciary Duties: General Principles and "For-Benefit" Contours

Fiduciary duties consist exclusively of the duty of loyalty and the duty of care,[114] which apply not intermittently, but at all times.[115] These duties are supplemented by the business judgment rule, the doctrine of corporate waste, the duty of candor, and the duty to act in good faith—each of which intersects

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[109] *See In re* TD Banknorth S'holders Litig., Civ. A. No. 2557–VCL, 2008 WL 2897102, at *2–3 (Del. Ch. July 29, 2008); *see also* FED. R. CIV. P. 23(a)(4).

[110] *See* Ashcroft v. Iqbal, 556 U.S. 662, 667–78 (2009); Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 556 (2007).

[111] Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Holdings LLC, 27 A.3d 531, 537 (Del. 2011) (en banc).

[112] *Id.* at 537 n.13.

[113] *See id.* at 537.

[114] *See* Emerald Partners v. Berlin, 787 A.2d 85, 90 (Del. 2001); Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998) (en banc); Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993). *But see* Stone v. Ritter, 911 A.2d 362, 369–70 (Del. 2006) (en banc); Leo E. Strine, Jr. et al., *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law* (Harvard John M. Olin Ctr. for Law, Econ., & Bus., Discussion Paper No. 630, 2009) (describing good faith as only a subset/component of the duty of loyalty).

[115] *E.g.*, *Emerald Partners*, 787 A.2d at 90; *Malone*, 722 A.2d at 10.

with the fiduciary duties, in a sense, and are constituent components of the duties. An additional important caveat in Delaware is the Delaware General Corporation Law's broad leeway to allow corporations to wholly indemnify directors and officers for all breaches of fiduciary duty except those breaches that are found to be in bad faith.[116] Corporations may elect to implement this sort of indemnification to minimize litigation and encourage directors' ability to undertake innovative or risky strategies, pursue new lines of business, or explore alternative business models that may have little empirical support or justification. Without such indemnification, directors are bound to the "most scrupulous observance of [the director's] duty . . . to protect the interests of the corporation . . . [and] also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it."[117]

1. The Duty of Loyalty

The modern duty of loyalty arises from the fact that shareholders of large corporations are virtually powerless to affect control of the corporation, so the directors are charged with the duty to protect shareholder investments by their direction of the corporation's management, given that the true owners of the equity of the corporation are the shareholders. The duty of loyalty has several components: the duty to act in good faith, the prohibition on directors standing on both sides of a transaction, and the prohibition on directors deriving any personal benefit through self-dealing.[118]

Every director owes a duty to act in what he or she believes to be the best interests of the corporation's shareholders. This includes a duty *not* to act in a manner adverse to those shareholder interests by putting a personal interest ahead of the shareholders' interest. To show that a director has breached his or her duty of loyalty, a plaintiff must prove that he or she engaged in a self-dealing transaction. If a majority of directors are personally conflicted, or a conflicted director or minority of the board dominates decision making, then the board will have the burden to defend the challenged transaction by showing

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116 *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (West Supp. 2012) (allowing for exculpation of directors from monetary damages); *id.* § 145 (allowing for indemnification of directors).

117 Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

118 Anadarko Petrol. Corp. v. Panhandle E. Corp., 545 A.2d 1171, 1174 (Del. 1988).

that it meets the requirements of "entire fairness" to the company and its shareholders.[119]

2. *The Duty to Act in Good Faith*

Failure to act in good faith does not result *ipso facto* in directorial liability to the corporation; indeed, it cannot on its own result in liability, unlike breaches of the duties of care and loyalty.[120] However, failure to act in good faith is a necessary condition to breach the duty of either care or loyalty.[121] In *In re Walt Disney Co. Derivative Litigation*, the Delaware Supreme Court stated that lack of good faith may be evident where a director "intentionally acts with a purpose other than that of advancing the best interests of the corporation . . . or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties."[122]

The duty of good faith is one with an elusive definition, and is often described only as the absence of bad faith.[123] "Bad faith will be inferred where the decision is so beyond the bounds of reasonable judgment that it seems essentially inexplicable on any [other] ground."[124] Bad faith has also been defined as irrationality, which "may tend to show that [a] decision is not made

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119 WACHTELL, LIPTON, ROSEN & KATZ, TAKEOVER LAW AND PRACTICE 17 (2011); *see, e.g.*, Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1341 (Del. 1987); *In re* PNB Holding Co. S'holders Litig., Civ. A. No. 28–N, 2006 WL 2403999 (Del. Ch. Aug. 18, 2006) (subjecting a transaction to an entire-fairness review when most public shareholders were cashed out but some shareholders—including the directors—continued as shareholders of the recapitalized company); Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988) (holding that actions by the board, taken after a consent solicitation had begun and designed to thwart the dissident shareholder's goal of obtaining majority representation on the board, violated the board's fiduciary duty); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986) (noting that "where a self-interested corporate fiduciary has set the terms of a transaction and caused its effectuation, it will be required to establish the entire fairness of the transaction to a reviewing court's satisfaction").

120 Stone v. Ritter, 911 A.2d 362, 369–70 (Del. 2006) (en banc); *see also* Clark W. Furlow, *Good Faith, Fiduciary Duties, and the Business Judgment Rule in Delaware*, 2009 UTAH L. REV. 1061, 1066.

121 *Stone*, 911 A.2d at 369–70.

122 906 A.2d 27, 67 (Del. 2006) (en banc).

123 *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 753 (Del. Ch. 2005) ("Decisions from the Delaware Supreme Court and the Court of Chancery are far from clear with respect to whether there is a separate fiduciary duty of good faith."), *aff'd*, 906 A.2d 27 (Del. 2006).

124 *In re* Rexene Corp. S'holders Litig., Civ. A. Nos. 10,897, 11,300, 1991 WL 77529, at *350 (Del. Ch. May 8, 1991) (alteration in original) (quoting *In re* J.P. Stevens & Co. S'holders Litig., 542 A.2d 770, 780 (Del. Ch. 1988)) (internal quotation marks omitted), *aff'd sub nom.* Eichorn v. Rexene Corp., 604 A.2d 416 (Del. 1991) (mem.).

in good faith, which is a key ingredient of the business judgment rule."[125] Directors breach their duty to act in good faith if they "consciously and intentionally disregard[] their responsibilities, adopting a 'we don't care about the risks' attitude concerning a material corporate decision . . . . [or by showing] [k]nowing or deliberate indifference."[126] As this Article explores in greater detail below, it is unclear whether a knowing, deliberate, and explicit prioritization of nonshareholder interests at the expense of shareholder interests might constitute such deliberate indifference and consequently be regarded as bad faith. That determination may well change based on the standard of analysis applied by the courts.

Notably, in Delaware, liability for a *good faith breach* of the duty of care may be waived if the corporation opts in; but breaches involving the duty of loyalty, acts or omissions *not in good* faith, and impersonal property benefit can never be waived through the Delaware exculpation statute.[127]

3. *The Duty of Care*

The board of directors of a corporation has a duty to exercise due care. Due care is evaluated in reference to a "gross negligence" standard.[128] Within this context, "gross negligence has been defined as reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason."[129] Director liability for a breach of the duty of care may arise in two different contexts: (1) when a board decision results in a loss because the decision was ill-advised or negligent; or (2) when a corporate loss arises from the failure of the board to act in circumstances where due care would have arguably prevented the loss.[130]

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125 Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) (en banc); *see also* White v. Panic, 783 A.2d 543, 554 n.36 (Del. 2001) (en banc) ("To prevail on a waste claim or a bad faith claim, the plaintiff must overcome the general presumption of good faith by showing that the board's decision was so egregious or irrational that it could not have been based on a valid assessment of the corporation's best interests.").

126 *In re* Walt Disney Co. Derivative Litig., 825 A.2d 275, 289 (Del. Ch. 2003) (emphasis omitted); *see also* Bodell v. Gen. Gas & Elec. Corp., 140 A. 264 (Del. 1927); Cole v. Nat'l Cash Credit Ass'n, 156 A. 183, 188 (Del. Ch. 1931); Allaun v. Consol. Oil Co., 147 A. 257, 261 (Del. Ch. 1929).

127 *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (West Supp. 2012).

128 Benihana of Tokyo, Inc. v. Benihana, Inc., 891 A.2d 150, 192 (Del. Ch. 2005) ("Director liability for breaching the duty of care 'is predicated upon concepts of gross negligence.'" (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

129 *Id.* (internal quotation marks omitted).

130 *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967–68 (Del. Ch. 1996) ("First, such liability may be said to follow *from a board decision* that results in a loss because that decision was ill advised or 'negligent.' Second, liability to the corporation for a loss may be said to arise from an *unconsidered failure of the board to act* in circumstances in which due attention would, arguably, have prevented the loss. The first

The question of how—and whether—the business judgment rule ought to be applied to contexts in which boards promote nonstockholder interests or stakeholder interests has been raised elsewhere.[131] The Delaware Court of Chancery recently held that "[w]hen director decisions are reviewed under the business judgment rule, [the court] will not question *rational* judgments about how promoting non-stockholder interests—be it through making a charitable contribution, paying employees higher salaries and benefits, or more general norms like promoting a particular corporate culture—ultimately promote stockholder value."[132] However, in light of Delaware courts' construction of *rational* in other contexts, it is not clear whether *rational* may be construed to require that decision making be targeted at generation of shareholder value. After all, a board may not deliberately choose to waste the corporation's assets by dedicating them to some explicit purpose other than the promotion of shareholder value, which may be seen as mutually exclusive or even directly opposed to promoting shareholder value.

4. *The Doctrine of Corporate Waste*

The business judgment rule, which protects a board-approved decision, can be overturned if a plaintiff can show that the directors "were grossly negligent in failing to inform themselves, or that the decision of the Board was so irrational that it could not have been the reasonable exercise of the business judgment of the Board."[133] "To illustrate, if a board of directors authorizes the

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class of cases will typically be subject to review under the director-protective business judgment rule, assuming the decision made was the product of *a process* that was *either* deliberately considered in good faith or was otherwise rational. What should be understood, but may not widely be understood by courts or commentators who are not often required to face such questions, is that compliance with a director's duty of care can never appropriately be judicially determined by reference to *the content of the board decision* that leads to a corporate loss, apart from consideration of the good faith *or* rationality of the process employed. That is, whether a judge or jury considering the matter after the fact, believes a decision substantively wrong, or degrees of wrong extending through 'stupid' to 'egregious' or 'irrational,' provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in *a good faith* effort to advance corporate interests. To employ a different rule—one that permitted an 'objective' evaluation of the decision—would expose directors to substantive second guessing by ill-equipped judges or juries, which would, in the long-run, be injurious to investor interests. Thus, the business judgment rule is process oriented and informed by a deep respect for all *good faith* board decisions." (footnotes omitted) (citations omitted)).

131 *See* Lisa M. Fairfax, *Making the Corporation Safe for Shareholder Democracy*, 69 OHIO ST. L.J. 53 (2008); Steven J. Haymore, Note, *Public(ly Oriented) Companies: B Corporations and the Delaware Stakeholder Provision Dilemma*, 64 VAND. L. REV. 1311 (2011).

132 eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 33 (Del. Ch. 2010) (emphasis added).

133 Sullivan v. Hammer, Civ. A. No. 10823, 1990 WL 114223, at *1632 (Del. Ch. Aug. 14, 1990), *aff'd sub nom.* Kahn v. Sullivan, 594 A.2d 48 (Del. 1991).

issuance of stock for no or grossly inadequate consideration, the corporation is directly injured and shareholders are injured derivatively."[134] Moreover, in *Agostino v. Hicks*, the Delaware Court of Chancery entertained allegations that shareholders were injured by a subscription agreement for a financing deal that "precluded the pursuit of other value-maximizing transactions."[135] In that case, the court did not find in the plaintiffs' favor because there was no alternative value-maximizing opportunity on the horizon.[136] Such may not be the case when considering corporate philanthropic donation: the ready alternative is to simply donate less. Indeed, "waste entails [any] exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade."[137]

"Most often the claim is associated with a transfer of corporate assets that serves no corporate purpose; or for which no consideration at all is received. Such a transfer is in effect a gift."[138] With regard to what will constitute a corporate purpose, we have already discussed that no existing Delaware caselaw has found that benefitting corporate "outsiders" (nonshareholder stakeholders such as the employees, community, or environment) falls within a corporation's de jure purposes.[139] Rather, corporate purposes are defined with regard to corporate "insiders," (i.e., shareholders).[140] With regard to consideration and the percentage of assets or revenues that a corporation may donate, courts may look to the prevailing rate in the industry.[141] In *Grogan v. O'Neil*, the shareholders stated a derivative claim of corporate waste by alleging that the directors accepted an offer of a purchase of the corporation's assets—made by director group—that was less than half of the fair market value of corporate assets, and the U.S. District Court for the District of Kansas,

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134 Avacus Partners, L.P. v. Brian, Civ. A. No. 11001, 1990 WL 161909, at *1438 (Del. Ch. Oct. 24, 1990).

135 845 A.2d 1110, 1115 (Del. Ch. 2004).

136 *See id.* at 1123.

137 Lewis v. Vogelstein, 699 A.2d 327, 336 (Del. Ch. 1997); *see also* Brehm v. Eisner, 746 A.2d 244, 259 n.49 (Del. 2000) (en banc) (citing Lori B. Marino, Comment, *Executive Compensation and the Misplaced Emphasis on Increasing Shareholder Access to the Proxy*, 147 U. PA. L. REV. 1205, 1235 (1999)); Grobow v. Perot, 539 A.2d 180, 189 (Del. 1988); Saxe v. Brady, 184 A.2d 602, 611 (Del. Ch. 1962).

138 *Lewis*, 699 A.2d at 336.

139 *See supra* Intro. B.

140 *See supra* Intro. B.

141 In *Saxe*, the court looked to the prevailing rate in the industry when examining whether paying an advisory fee constituted waste. 184 A.2d at 611 ("What support for their position can plaintiffs draw from the rate of the advisory fee? First it may be observed that if the flat ½ of 1% rate prevailed throughout the industry, this would be a very weighty consideration in determining the question of excessiveness.").

applying Delaware law, found that the claim satisfied pleading standards.[142] The Delaware courts may adopt a similar "market-standard" approach when examining donation percentages. At any rate, such donations typically must be rationalized back to the corporation's de jure purpose of maximizing shareholder wealth.

In *Sullivan v. Hammer*, the Delaware Court of Chancery found that the board of a corporation had not breached its duty to its shareholders when it made charitable contributions to a related museum, despite the fact that the plaintiff's complaint alleged that "certain individual [directors] . . . had breached their duty of care" by authorizing "expenditures and commitments with respect to the Museum."[143] In addition, a recent law journal note stated that "directors can connect virtually every business decision to a rationally related benefit to the company, *absent waste of corporate proceeds*."[144]

But when *rationality* is defined as relating back to the company's economic profitability, it may well be considered waste to give away a substantial portion of corporate proceeds *for giving's sake*. If the decision-making process of the board is directed not toward promoting stockholder value, but rather toward making a charitable contribution, paying employees higher salaries and benefits, or promoting a particular corporate culture *explicitly as an end in itself*, it is not clear that the decision would be permissible given the current formulation of the doctrine of waste. Courts could construe it as irrational, and a shareholder that does not share the charitable, employee, or cultural sympathies of the board may bring an action for the corporation's misuse of its assets for an "illegitimate" purpose. In other words, while *eBay Domestic Holdings* stood for the proposition that Delaware courts will review business-judgment-rule decisions under the presumption that promoting nonstockholder interests ultimately promotes shareholder value,[145] it is not clear whether that presumption could be rebutted by evidence in the corporate record that showed the board explicitly chose to *not* promote shareholder value and *instead* chose to promote nonstockholder interests. It seems likely that such a decision would be deemed corporate waste under the current formulation because a court is unlikely to presume something that is directly at odds with the facts on the

142 *See* 292 F. Supp. 2d 1282, 1291 (D. Kan. 2003).

143 Sullivan v. Hammer, Civ. A. No. 10823, 1990 WL 114223, at *1626 (Del. Ch. Aug. 14, 1990), *aff'd sub nom.* Kahn v. Sullivan, 594 A.2d 48 (Del. 1991).

144 Haymore, *supra* note 131, at 1327–28 (emphasis added).

145 *See* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 33 (Del. Ch. 2010).

record.[146] Notably, this precludes corporations from doing good when such good would not benefit the shareholder interest.

5. The Duty to Be Informed

Another way boards may fail to meet the duty of care while undertaking corporate social responsibility or corporate philanthropic endeavors is to fail to be informed. The duty of care for directors includes "an affirmative duty" to protect the *financial interests* of the corporation and its stockholders and "proceed with a critical eye in assessing information."[147] If the board "act[s] so far without information that they can be said to have passed an unintelligent and unadvised judgment," courts may deprive the board of the protections of the business judgment rule.[148] So, if a board fails to adequately gather information on the recipients of its corporate philanthropy, or vet a corporate social responsibility campaign thoroughly, neither of which fails to enhance shareholder profitability, a resulting shareholder derivative action for a director's breach of the duty of care may succeed not on the grounds that the director acted irrationally, but that the director acted without appropriate information.

C. Fiduciary Duties: Lifecycle Analysis

1. Day-to-Day Activities

Day-to-day decision making by boards of directors of Delaware corporations is governed by the business judgment rule—in recognition of the statutory rule that states: "The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors . . . ."[149] The business judgment rule itself is "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[150] It is designed to ensure that directors are able to

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146 This is, in the authors' view, the key distinction between the decision in *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919), and all the decisions since that have allowed, to some extent or another, consideration and pursuit of nonshareholder interests.

147 Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (en banc), *overruled on other grounds by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009) (en banc).

148 Gimbel v. Signal Cos., 316 A.2d 599, 615 (Del. Ch. 1974) (quoting Mitchell v. Highland-W. Glass Co., 167 A. 831, 833 (Del. Ch. 1933)) (internal quotation marks omitted).

149 DEL. CODE ANN. tit. 8, § 141(a) (West Supp. 2012).

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

take risks in pursuit of corporate interests, without fearing *personal* liability for potential losses stemming from their decisions because they are acting as agents of the corporation.[151]

The seminal case of *Aronson v. Lewis* stated that, for the business judgment rule to apply, some prerequisites must be met. The first regards "interestedness." Directors cannot be on both sides of a transaction, and directors cannot expect to derive any *personal* financial benefit from the transaction.[152] If an interested director interest is present, and the transaction is not approved by a majority consisting of the disinterested directors, the business judgment rule will not apply.[153] Second, directors have a duty to inform themselves, prior to making a business decision, "of all material information reasonably available to them."[154] Finally, the directors must actually make a decision for the rule to apply.[155]

When the business judgment rule applies, director liability is predicated upon concepts of gross negligence.[156] In order to circumvent the business judgment rule's protection of directorial decision making, plaintiff shareholders must show either that making a demand would be futile, or that a demand has been made and the board's decision to not take action should not be respected by the courts.[157]

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151 For a discussion of corporate risk taking and the business judgment rule, see David Rosenberg, *Supplying the Adverb: The Future of Corporate Risk-Taking and the Business Judgment Rule*, 6 BERKELEY BUS. L.J. 216 (2009).

152 *Aronson*, 473 A.2d at 812.

153 *Id.* (citing DEL. CODE ANN. tit. 8, § 144(a)(1)).

154 *Id.*

155 *Id.* at 813 ("[I]t has no role where directors have either abdicated their functions, or absent a conscious decision, failed to act.").

156 *Id.* at 812; *see also id.* at 812 n.6 ("While the Delaware cases have not been precise in articulating the standard by which the exercise of business judgment is governed, a long line of Delaware cases holds that director liability is predicated on a standard which is less exacting than simple negligence."); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 722 (Del. 1971) ("fraud or gross overreaching"); Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883, 887 (Del. 1970) ("gross and palpable overreaching"); Warshaw v. Calhoun, 221 A.2d 487, 492–93 (Del. 1966) ("bad faith . . . [or] a gross abuse of discretion"); Moskowitz v. Bantrell, 190 A.2d 749, 750 (Del. 1963) ("fraud or gross abuse of discretion"); Penn Mart Realty Co. v. Becker, 298 A.2d 349, 351 (Del. Ch. 1972) ("[D]irectors may breach their fiduciary duty . . . by being grossly negligent . . . ."); Kors v. Carey, 158 A.2d 136, 140 (Del. Ch. 1960) ("fraud, misconduct or abuse of discretion"); Allaun v. Consol. Oil Co., 147 A. 257, 261 (Del. Ch. 1929) ("reckless indifference to or a deliberate disregard . . . of stockholders").

157 *See supra* Part I.A.2; *see also* Carole F. Wilder, Comment, *The Demand Requirement and the Business Judgment Rule: Synergistic Procedural Obstacles to Shareholder Derivative Suits*, 5 PACE L. REV. 633 (1985).

2. *Bidder Activity and Unsolicited Bids*

When a Delaware corporation receives a bid from another entity, the board encounters duties distinct from those arising in the day-to-day context. The Delaware courts have evolved rules balancing the concern that directors may leverage takeover opportunities to award themselves lavish golden parachutes at the expense of the corporation, or turn down an attractive offer in order to retain employment and compensation benefits, with the principle that the board of directors manages the business and affairs of the corporation.

Under the *Unitrin*, *Paramount Communications Inc. v. QVC Network Inc.*, and *Paramount Communications Inc. v. Time Inc*. trilogy, a board does not have a duty to accept an unsolicited offer or to negotiate with bidders.[158] However, under *Unocal* and *In re Lear Corp. Shareholder Litigation*, the board *does* have an obligation to the corporation to *consider* legitimate proposals and to determine, on a fully informed good-faith basis, whether acceptance of such proposals would be in the best interests of the corporation and its stockholders—but *only if* the offer was public or hostile.[159] In *Unocal*, the offer was a "casual pass" or "non-public bear hug," which did not require the board to discuss, negotiate, or disclose the offer.[160]

3. *Defensive Measures*

In hostile takeover scenarios, target companies will sometimes implement a shareholder rights plan, colloquially known as a "poison pill," to dissuade purchasers that the target views as unfavorable. Generally, a poison pill will give target company shareholders the right to purchase more shares at a discount if a single shareholder purchases a specified percentage of the target's shares outstanding.

In order to determine what standard of review Delaware courts should apply in analyzing a poison pill's validity within the context of a shareholder derivative action, one must first consider whether the pill's adoption constituted a defensive act.[161] In *Unitrin*, the parties mutually agreed that the

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158 Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1376 (Del. 1995); Paramount Commc'ns, Inc. v. QVC Network Inc., 637 A.2d 34, 48 (Del. 1994); Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1150–51 (Del. 1990).

159 Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946, 955–56 (Del. 1985); *In re* Lear Corp. S'holder Litig., 967 A.2d 640, 649 (Del. Ch. 2008).

160 *See* WACHTELL, LIPTON, ROSEN & KATZ, *supra* note 119.

161 *Unitrin*, 651 A.2d at 1372.

poison pill constituted a defensive measure taken in response to American General's public bid to purchase the company.[162] In order to avoid having a pill be considered defensive (and thus subject to heightened scrutiny), the board should record in its meeting minutes material, rational, alternative justifications for adopting the pill (e.g., to preplan for the contingency of a hostile takeover in the future). In recording minutes regarding the adoption of the pill, the secretary should note that the directors believe their long-term strategy will generate greater wealth for stockholders than the current market or available buyout prices would reflect. According to *Moran v. Household International, Inc.*, doing so "might reduce the risk that . . . management will fail to exercise reasonable judgment" under the pressure of a future takeover bid.[163] In such circumstances, Delaware courts will apply the business judgment rule, in accordance with *Warner Communications, Inc. v. Murdoch*, so long as the plan does not disenfranchise stockholders and thereby impinge the stockholder democracy.[164]

However, if a Court considers a poison pill to be a defensive measure (e.g., in response to a hostile bid), Delaware courts would apply the *Unocal* standard because of the inherent conflict of interest at play in a takeover setting: when a board may be acting in its own interest (to stay in control) rather than in the interests of the corporation and its shareholders. Under the *Unocal* "enhanced scrutiny" standard, the board must meet the two-part burden articulated in *Unocal* in order to receive the protection of the business judgment rule.[165] First, the board must demonstrate that it had reasonable grounds for believing the tender offer posed a danger to corporate policy and effectiveness.[166] Second, the board must show that the defensive response taken was reasonable with regard to the threat posed.[167] If the board satisfies the two-prong *Unocal* test, then the traditional business judgment rule will be applied to shield the director's defensive action.

162 *See id.*
163 500 A.2d 1346, 1350 (Del. 1985).
164 581 F. Supp. 1482, 1491 (D. Del. 1984).
165 Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946, 954–55 (Del. 1985).
166 *Id.*
167 *Id.*

II. THE BENEFIT CORPORATION STATUTES

A. Key Features

1. Statutory Positioning

The benefit corporation laws of each state position the benefit corporation statutory regime within the context of the state's general corporations law,[168] unlike the flexible purpose corporation (FPC), which has been adopted as a standalone entity with no necessary relationship to the general corporations law.[169] This is advantageous for the benefit corporation because it allows each state's body of corporate governance law—most of which is useful to the operation of any business—to still apply to benefit corporations. Moreover, it allows the benefit corporation's body of corporate governance law to interact with and, to the extent that they are consistent, be updated by the cases and developments in other areas of the state's corporate governance law. While the benefit corporation statute is new, and therefore inheres some legal risk in the uncertainty of how courts will interpret the statute, there is, arguably, comparatively much less risk than in an FPC because the benefit corporation statute still sits upon the bedrock of the remainder of the corporate governance laws.

However, the integrated positioning of the benefit corporation statute is also disadvantageous because it lends little guidance as to how and whether the benefit corporation's purposes and duties will be integrated into the existing corporate governance legal architecture, particularly the duty of care and duty of loyalty. Famously, Lon Fuller announced, through his protagonist Rex, the eight ways any legal system could fail; the fifth route to failure was contradictions in the law, and the seventh was unstable legislation.[170] Failed integration may flow from either of the two. With regard to the former, it is clear that benefit corporation duties must contradict with some of the general principles of corporate governance, not the least of which is the shareholder primacy norm. The benefit corporation, after all, explicitly creates an

[168] *See, e.g.*, CAL. CORP. CODE § 14600 (West 2013); HAW. REV. STAT. § 420D-1 (2012); 805 ILL. COMP. STAT. ANN. 40/1 (West Supp. 2012); LA. REV. STAT. ANN. § 12:1802 (2013); MD. CODE ANN., CORPS. & ASS'NS § 5-6C-02 (West Supp. 2012); MASS. GEN. LAWS ANN. ch. 156E, § 3 (West Supp. 2012); N.J. STAT. ANN. § 14A:18-2 (West Supp. 2012); N.Y. BUS. CORP. LAW § 1701 (McKinney Supp. 2012); S.C. CODE ANN. § 33-38-120 (Supp. 2012); VT. STAT. ANN. tit. 11A, § 21.02 (West Supp. 2012); VA. CODE ANN. § 13.1-783 (West Supp. 2012).

[169] *See* CAL. CORP. CODE § 2502.

[170] FULLER, *supra* note 27, at 33–41.

affirmative duty to consider nonshareholders and gives directors no explicit preference in the weighing of all the stakeholders. With regard to the latter, the uncertainty surrounding the role of the beneficial purposes of the benefit corporation, and the role of the directorial duty to consider stakeholders, threatens the benefit corporation's viability as much as would poor lawmaking itself with regard to those two features. Jurisdictional variance with regard to the duties and purposes of the benefit corporation may lend further confusion and anxiety to benefit corporation directors who are trying to navigate their duties on a daily basis, as outcomes in one state will not have precedential value in another (though, of course, wiser ones may carry persuasive value).

2. *General Public Benefit Purpose*

General public benefit is one of the statutory elements that has been defined uniformly across all the adopting jurisdictions to mean "a material positive impact on society and the environment, taken as a whole, as assessed against a third-party standard, from the business and operations of a benefit corporation."[171] We have three primary concerns with this portion of the statute. First, it is ambiguous: *material* is not defined; *society* and *environment* are words conjuring enormous concepts so nebulous and extensive that it is difficult to know their actual or intended limits; and *as assessed against* is also vague because it does not specify whether the benefit corporation must *accomplish* its general public benefit purpose as assessed against the third-party standard, as the "purpose of *creating* a general public benefit" language suggests. Will a benefit corporation that fails to meet its third-party standard's requirements also fail to uphold its purpose of creating general public benefit? Or, is the threshold duty of a benefit corporation simply to find a third-party standard to assess its pursuit of its material impacts?

This ambiguity leads to the second concern: it is not clear whether this section is intended to create new duties (e.g., to consider sui generis the general public benefit purpose in directorial decision making), or whether consideration of the statutorily defined stakeholders would be both necessary *and* sufficient to evidence pursuit of this purpose. If there is not a duty to create the general public benefit, why mention it as a purpose of the corporation at all?

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[171] *E.g.*, CAL. CORP. CODE § 14601(c); *accord* N.Y. BUS. CORP. LAW § 1702(b).

Finally, it is not clear how this purpose will relate to the traditional shareholder primacy norm—the de facto shareholder wealth maximization purpose of a traditional corporation. Nor is it clear how the general public benefit purpose would relate to any of the other specific public benefit purposes if the enterprise chose to articulate them.

3. *Specific Public Benefit Purpose*

The construction of each benefit corporation's statute states a list that defines what a specific public benefit "includes." It leaves open some question as to whether the list is exclusive, and courts may interpret it to be. But this approach is unlikely, as use of the word *includes* implies recognition that the legislature considered that there may be iterations of a specific, public purpose that are *excluded* from the list in the statute. It is likely that the legislature would have utilized more precise language if it intended for the list to be exclusive in nature.

There are several open questions with regard to specific public benefit. These questions mimic the concerns regarding the general public benefit provisions—ambiguity, duty, and relation to the shareholder wealth maximization norm. With regard to ambiguity, the articulated, specific public benefits could mean different things to different people. Take, for example, *preserving the local environment*. One shareholder may wish to see a local stream restored; another may wish to see a park built. The corporation's limited assets may only be able to support one of two—or many—viable projects that might satisfy an objective understanding of the language. There is an additional objectivity-related concern with regard to articulated specific public benefits: what will courts and state agencies accept as valid statements of specific public benefit? Should benefitting *any* stakeholder class be allowed?

4. *Purpose Positioning*

Every benefit corporation statute addresses the issue of purpose primacy: which, if any, of the purposes of the corporation shall control?[172] This matter is of particular importance to the benefit corporation corporate governance

[172] *See, e.g.*, CAL. CORP. CODE § 14610; HAW. REV. STAT. § 420D-5(a), (c); 805 ILL. COMP. STAT. ANN. 40/3.01; LA. REV. STAT. ANN. § 12:1811; MD. CODE ANN., CORPS. & ASS'NS § 5-6C-06; N.J. STAT. ANN. § 14A:18-5; N.Y. BUS. CORP. LAW § 1706; 15 PA. CONS. STAT. ANN. § 3301 (West Supp. 2013); S.C. CODE ANN. § 33-38-300; VT. STAT. ANN. tit. 11A, § 21.08; VA. CODE ANN. § 13.1-787(A)–(B); *see also Model Benefit Corporation Legislation*, *supra* note 51, § 201.

regime because it determines how the general public benefit, specific public benefit, and shareholder primacy norms will interact. Only one state has adopted an anchored purpose structure,[173] and unfortunately, the legislative history surrounding the benefit corporation bills are wanting for discussion of legislative intent. Court interpretations of the purpose structure provisions could yield a wide range of results, summarized here:

> Option One: The general public benefit necessarily controls all other purposes.[174] This construction is unlikely in any state other than New York because other states' statutes explicitly state, uniformly, that "[the general public benefit] purpose is in addition to, and may be a limitation on, the corporation's [traditional] purpose . . . and any specific purpose set forth in its articles."[175]
>
> Option Two: The general public benefit necessarily limits, but does not control, all other purposes. This construction is unlikely for the same reason as Option One.
>
> Option Three: The general public benefit may limit and control, but does not necessarily control, all other purposes. This construction is adopted in ten of the eleven states that have passed the legislation so far.[176] It makes no explicit mention of the shareholder primacy norm or public benefit creation's relation to it. Depending on courts' interpretations, this construction could allow specific public benefits to control over the shareholder primacy norm, but it does not necessitate that result. The construction could also *require* that iterated, specific public benefits control over the shareholder primacy norm, on the theory that specific public benefits deserve preferential treatment similar to that of general public benefit. Or, it could *require* the traditional shareholder primacy norm to supersede any articulated specific public benefit. Lastly, of course, it could judiciously allow boards of directors to customize the structure of their purposes on an anchored or ongoing basis, with the caveat that none of them may supersede the general public benefit purpose. This approach would allow benefit corporations to opt in to general public benefit primacy through their own policies and bylaws if they so choose.

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173 *See* N.Y. BUS. CORP. LAW § 1706 (stating that the general public benefit shall limit and control).

174 *See id.* This is New York's mandated approach.

175 *See, e.g.*, CAL. CORP. CODE § 14610(a).

176 *See, e.g.*, *id.* § 14610; HAW. REV. STAT. § 420D-5(a), (c); 805 ILL. COMP. STAT. ANN. 40/3.01; LA. REV. STAT. ANN. § 12:1811; MD. CODE ANN., CORPS. & ASS'NS § 5-6C-06; N.J. STAT. ANN. § 14A:18-5; 15 PA. CONS. STAT. ANN. § 3311; S.C. CODE ANN. § 33-38-300; VT. STAT. ANN. tit. 11A, § 21.08; VA. CODE ANN. § 13.1-787(A), (B).

> Option Four: The general public benefit does not necessarily limit or control any other purposes. This interpretation is unlikely; the legislature created an entirely new corporate entity for the reason of allowing and compelling an additional purpose.[177] A court then interpreting the enabling statute as providing that purpose with no controlling or limiting power would be an effective disavowal of the statute itself.

Within each of the first two options lies the question of whether the specific public purpose(s) of the corporation, if iterated in the articles of incorporation, will supersede the shareholder primacy norm. One thing the legislation categorically does not permit is the subversion or equation of general public benefit to an iterated, specific public benefit; all statutes mandate, in varying language, that "[t]he identification of a specific public benefit under this [paragraph] does not limit the obligation of a benefit corporation to create general public benefit."[178]

There is much popular commentary, and some legislative evidence,[179] to indicate the extent to which the legislatures intended to disrupt the shareholder primacy norm.[180] Did they intend to abolish it completely—is there no fiduciary duty whatsoever to preserve and enhance the corporate treasury? Such an intention or interpretation would be irresponsible, as even nonprofit corporations are required to utilize their assets judiciously.[181]

5. *Annual Reporting and the Third-Party Standard*

There has been a good deal of misinformation circulated with regard to the benefit corporation's third-party standard requirements.[182] We use this section

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177 *See, e.g.*, N.Y. BUS. CORP. LAW § 1706.

178 *E.g.*, CAL. CORP. CODE § 14610(b).

179 *See supra* notes 66–72 and accompanying text.

180 *See supra* notes 54–61.

181 Rules like the "prudent man investment rule" require nonprofits to invest conservatively. For example, the seminal case, *Harvard College v. Amory*, 26 Mass. (9 Pick.) 446 (1830), stated that trustees ought "to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested." *Id.* at 469.

182 Robert R. Keatinge is a leading propagandist. *See* Robert R. Keatinge, *L3Cs and Benefit Corporations: Magical Thinking, Exceptionalism, and Greenwash in the Development of State Business Organization Law*, July 23, 2012, at 23–24, *available at* Westlaw, VCU0723 ALI-ABA 119 (stating (1) that the benefit corporation law permits corporations to add "public benefits" to their purpose *only if* they adopt a set of standards adopted by a private organization "that is defined in recondite and specific terms that appear only to define B Lab Compan[ies]," (2) that "B Lab does not actually publish the standards, but requires those wishing to know whether they meet them to submit to an assessment by B Lab by registering information with B Lab,"

of the Article to clarify misconceptions regarding the content of the third-party standard provisions and their relation to the rest of benefit corporation corporate governance.

One of the most widely misunderstood aspects of the third-party standard provisions regards the benefit corporation's relationship to B Lab and B Corporation certification. First, no statute requires a benefit corporation to use the B Corporation impact assessment or become B Corporation certified. Rather, each of the statutes sets out a robust set of criteria for determining whether a third-party standard will qualify.[183] The following features are the most notable:

- The standard must be comprehensive in assessing the impact of the business on the corporation's consideration of the stakeholders, which is defined in the "director duties" section of the statute.[184]
- The standard must be developed by an entity that is independent; these provisions are some of the most robust in the entire statute and attempt to eliminate any potential conflicts of interest between standard-setters and standard-users.[185]
- The standard must be developed using a multistakeholder approach, including a public comment period, and the standard must also access the "necessary and appropriate" expertise to assess social and environmental performance.[186]
- Finally, the statutes contain a set of sunlight provisions, which detail all the elements of the third party and its standard that must be publicly disclosed.[187]

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(3) that B Lab "will tell the [benefit corporation] whether it thinks they are accomplishing beneficial things," (4) that the process is "opaque," (5) that "to the extent management [is] concerned that their potential exposure, the only way to demonstrate their goodness is to obtain a B Lab certification," (6) that B Corporation certification "can entail paying B Lab several thousand dollars a year," (7) that a benefit corporation "may not do a single good but must provide both social and environmental benefits, so that if one wished only to remedy an environmental problem, in order to qualify as a benefit corporation it would have to do other social goods to be determined by the standard setter," (8) that "a corporation wishing to clean up a stream, in order to avoid litigation, might also be required to contribute [to] a political action committee espousing social good as determined by the standard setter," and (9) that "[t]he benefit corporation statute essentially not only gives a state imprimatur to private standard setters, but effectively allows them to establish the terms of state corporate law").

183 *See, e.g.*, CAL. CORP. CODE § 14601(g).

184 *Id.* § 14601(g)(1).

185 *Id.* § 14601(g)(2).

186 *Id.* § 14601(g)(3).

187 *See id.* § 14601(g)(4).

In our opinion, this section as a whole gives courts a great deal of substance through which to analyze third-party standards and determine whether a benefit corporation has chosen a standard that well-suits the intentions of the statute—an undertaking that courts *are* well-equipped to pursue. The primary benefit of such a well-crafted section of the statute is that it does not force courts into the difficult dilemma of measuring and determining the outcomes, but rather gives courts the tools necessary to analyze whether a benefit corporation has selected a standards organization that will satisfy the statute and its purposes.

The standards impact benefit corporation governance in two key ways. First, benefit corporations have a statutory purpose of creating "[g]eneral public benefit," defined as "a material positive impact on society and the environment, taken as a whole, *as assessed against a third-party standard*, from the business and operations of [the] benefit corporation."[188] Second, benefit corporations must deliver to each shareholder an annual benefit report that includes a narrative description of all the board's processes and rationales for selecting the third-party standard that was used to prepare the benefit report, the ways in which the benefit corporation pursued a general public benefit during the year, the extent to which that general public benefit was created, and an assessment of the overall social and environmental performance of the benefit corporation, prepared in accordance with a third-party standard.[189]

It is essential to note that the statutes explicitly state that the assessment "does not need to be audited or certified by a third party."[190] While the benefit corporation's purpose of creating general public benefit might appear to require it to *create* a "material positive *impact . . . as assessed against a third-party standard*,"[191] we argue below that the corporation's *purpose* of "creating" general public benefit should require only *processes* designed to produce general public benefit, *not* actual public benefit *outcomes*. Moreover, we do not recommend that courts require those processes to be tailored to suit selected third-party standards. Indeed, many of the qualifying standards do not

188 *See, e.g.*, *id.* § 14601(c) (emphasis added).
189 *See, e.g.*, *id.* § 14630.
190 *Id.* § 14630(a)(D)(2).
191 *Id.* § 14601(c) (emphasis added).

actually provide "certification," but rather simply provide an assessment tool or framework for self-assessment.[192]

B. Pleading a Direct or Derivative Claim for Failure to Consider

In the context of a benefit corporation suit for breach of fiduciary duties, pleading a claim will pose challenges distinct and additional to those posed by the traditional standing and direct–derivative convolution exemplified in *Kramer v. Western Pacific Industries, Inc*.[193] First, the litigation incentives that apply when bringing an action against a traditional corporation may not apply in the context of a benefit corporation.

1. Litigation Incentives: Undermotivation

It is foreseeable that a board of directors' failure to consider the statutorily defined stakeholders may not result in immediate economic injury to the corporation.[194] Indeed, in such a scenario, it is actually *likely* that the corporation may have *disregarded* the stakeholders in favor of some strategy (perhaps one that even harmed stakeholders) that led to greater profitability. This is an—or perhaps the—issue that the benefit corporation legislation is designed to remedy.[195] Although the statute provides some accountability to stakeholder interests by requiring directors to consider stakeholders' interests, it is not clear that there will be any *economic* incentive for the shareholders to bring suit to enforce the directors' duties to do so. After all, most statutes declare that there will not be a monetary award available for directors' failure to create a public benefit.[196]

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[192] *See* Dan Osusky, *Assessing Impact: A Guide to Third Party Standards for Benefit Corporations*, B REVOLUTION CONSULTING 6–10 (Aug. 1, 2012), http://www.brevolutionconsulting.com/assets/Assessing-Impact-A-Guide-to-Third-Party-Standards-for-Benefit-Corporations.pdf.

[193] 546 A.2d 348, 351–53 (Del. 1988).

[194] This injury is typically defined as lowering the economic value of the corporation; for public corporations, this is typically analyzed through the lens of share price.

[195] *See S79A-2011: Authorizes the Incorporation of Benefit Corporations*, *supra* note 64.

[196] *See, e.g.*, CAL. CORP. CODE § 14623; HAW. REV. STAT. § 420D-10 (2012); 805 ILL. COMP. STAT. ANN. 40/4.10 (West Supp. 2012); LA. REV. STAT. ANN. §§ 12:1803(a)(4), 12:1825 (2012); MASS. GEN. LAWS ANN. ch. 156E, § 23 (West Supp. 2012); N.J. STAT. ANN. § 14A:18-10 (West Supp. 2012); S.C. CODE ANN. § 33-38-410 (Supp. 2012); VT. STAT. ANN. tit. 11A, § 21.13 (West Supp. 2012); VA. CODE ANN. § 13.1-790 (West Supp. 2012); *see also Model Benefit Corporation Legislation*, *supra* note 51, § 305.

Although other statutes do not preclude monetary damage awards against directors or the corporation,[197] even if courts do allow a monetary award for failure of directors to consider stakeholders' interests, it is unclear how that award would be evaluated and whether shareholders—or the corporation itself—would be benefitted or harmed by the award in any traditional economic sense. Indeed, forcing the corporation to pay a fee may harm the corporation's balance sheet and profitability, damaging the shareholders' economic interest in the corporation, while also making the corporation less financially capable of pursuing programs and policies that may benefit stakeholders. Even if there is no prospective economic harm to a plaintiff shareholder for bringing an action for the board's failure to consider stakeholder interests, the stakeholders will have to rely on the corporation's shareholders' benevolence and magnanimity to enforce the duties. We should call this the problem of *undermotivation*.

2. *Litigation Incentives: Overmotivation*

An additional layer to the economic incentive problem arises when shareholders are stakeholders.[198] Here, it becomes less clear that the economic incentive to sue for a failure to consider the stakeholder group is aligned with the interests of the corporation as a whole. Is the suit for the directors' failure to consider the stakeholder interests within the interests of the corporation, or is the suit to try to force the board to take action not in the corporation's best interests, but rather in the narrow interest of a particular stakeholder group? This is the problem of *overmotivation*: stakeholder shareholders will have an incentive to bring suit even when the suit is not in the best interests of the corporation.

To deal with the problem of overmotivation in a derivative suit, Delaware evolved eight nonexclusive factors to determine whether a plaintiff in a

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197 Both the New York and Maryland benefit corporation statutes neglect to include the standard "Benefit Enforcement Proceeding" sections, which include the monetary damage limitation language. *But see S79A-2011: Authorizes the Incorporation of Benefit Corporations*, *supra* note 64 ("Currently, socially-minded companies are often left with the catch-22 of either not being able to earn a profit or opening their directors up to possible personal liability for decisions that do not maximize shareholder value or increasingly going to states other than New York that are pursuing this corporate form. This bill solves that dilemma."). If the statute is explicitly intended to *reduce* personal liability for decisions that do not maximize shareholder value, it may be contradictory for courts to allow monetary damages for stakeholder-maximizing, shareholder-diminishing decisions.

198 For example, when a supplier owns part of a benefit corporation purchaser, employees own shares, or a local foundation chartered to preserve park lands purchases an equity stake in a benefit corporation located adjacent to the park lands.

derivative suit was an adequate representative of the corporation's interests.[199] The first of the eight factors is whether there were "[e]conomic antagonisms between the plaintiff and the corporation."[200] Such a factor may adequately discern whether plaintiffs should be disqualified in an overmotivation scenario, where there is an additional, noncorporate incentive to bring the action. But that factor alone will not distinguish between proper plaintiffs who have a legitimate interest in enforcing the directors' duty to consider when they have failed in that regard, from conflicted plaintiffs who wish to coerce directors into taking an action that is beneficial to the stakeholder but harmful to the interests of the overall corporation.

3. *Stating a Harm*

A third issue stems from the first incentive problem, that of undermotivation: without economic injury, not only is there a likely lack of motivation, but also a key element to any claim for breach of fiduciary duties may be left unfulfilled. In Delaware, at least, there is no per se rule allowing damages for breaches of fiduciary duty.[201] Although the Delaware Supreme Court had previously written that "[i]n Delaware existing law and policy have evolved into a virtual *per se* rule of damages for breach of the fiduciary duty of disclosure,"[202] later opinions interpreted that dictum to stand only for scenarios when "directors have breached their disclosure duties in a corporate transaction that has in turn caused impairment to the economic or voting rights of stockholders."[203] Thus, claims for breach of fiduciary duty must typically flow from some actual injury to the shareholder or the corporation in order to become viable. Yet, it is incredibly difficult to imagine a scenario in which actual injury could be pleaded as a result of a failure by a benefit corporation board of directors to consider stakeholders when a traditional corporation would not be similarly harmed by the same failure to consider stakeholders.

For example, when a traditional corporation fails to consider the local environment surrounding, say, its manufacturing facility, damage to the local

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[199] *See* MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc., Civ. A. No. 8126, 1985 WL 21129, at *4 (Del. Ch. Oct. 9, 1985); Scopas Tech. Co. v. Lord, No. 7559, 1984 WL 8266, at *310 (Del. Ch. Nov. 20, 1984); Youngman v. Tahmoush, 457 A.2d 376, 379–80 (Del. Ch. 1983); Katz v. Plant Indus., Inc., Civ. A. No. 6407, 1981 WL 15148, at *2 (Del. Ch. Oct. 27, 1981).

[200] R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 13.18 (3d ed. Supp. 2013).

[201] *See* Loudon v. Archer–Daniels–Midland Co., 700 A.2d 135, 138 (Del. 1997) (en banc).

[202] *In re* Tri-Star Pictures, Inc., Litig., 634 A.2d 319, 333 (Del. 1993).

[203] *Loudon*, 700 A.2d at 142.

environment may ensue; a local newspaper may cover the story about the resulting environmental damage and raise awareness about the corporation's unscrupulous practices; and as a consequence, consumers may boycott the company's goods, resulting in a decline in profitability and a consequent decrease in share value. Such an injury—an injury to the economic value of the corporation and, as a consequence, to the shareholders—is one that is just as recognizable for a traditional corporation as it is for a benefit corporation. But where there has been no actual economic injury to the corporation or its shareholders, no claim will lie within traditional pleading requirements. To find the enhanced accountability to purpose and stakeholders that is the *raison d'être* for the benefit corporation, courts will have to either allow claims that do not plead an injury to the corporation at all—at least in the traditional economic sense—or invent a new pleading requirement with a more expansive view of *injury* to the corporation. Without adjusted pleading requirements, courts will almost certainly find the pleadings for breaches of fiduciary duty difficult to evaluate.[204]

4. Remedies for Breach of the Duty to Consider

Remedies for breach of the duty to consider stakeholders will vary across jurisdictions.[205] Most notably, the New York and Maryland statutes fail to eliminate monetary damages for any new duties arising under their benefit corporation statutes;[206] the other nine states contain fairly standard language substantially similar to the following: "[The] benefit corporation shall not be liable for monetary damages under this part for any failure of the benefit corporation to create a general or specific public benefit."[207] While this creates a waiver for the monetary liability of the corporation, most of the statutes also contain mirroring provisions providing a similar wavier for individual directors.[208] While these provisions may, at first glance, appear to relegate benefit corporation plaintiffs to exclusively nonmonetary remedies, such as injunctions or restraining orders, the narrowing language "to create" may

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[204] For example, when a benefit corporation board of directors (1) knowingly harms the surrounding environment but does not breach any positive laws or cause any economic injury to the corporation; or (2) fails to consider the environment, but that failure of consideration results in no economic injury to the corporation.

[205] *Compare* N.Y. BUS. CORP. LAW § 1707 (McKinney Supp. 2012) (allowing monetary damages for *both* failure to create *and* failure to consider), *with* CAL. CORP. CODE § 14623(c) (West 2013) (disallowing monetary damages for failure to *either* create *or* consider).

[206] N.Y. BUS. CORP. LAW § 1706; MD. CODE ANN., CORPS. & ASS'NS § 5-6C-06 (West Supp. 2012).

[207] *See, e.g.*, CAL. CORP. CODE § 14623(c).

[208] *See, e.g.*, *id.* §§ 14620, 14622.

create a lesser constraint than initially appears. If, for example, section 14623(c) limits *only* suits for the *failure to create* a general or specific public benefit, as it appears on its face, it would not preclude—by statute, at least—monetary damages for suits brought for directors' and officers' *failure to consider* stakeholders (i.e., the duty created explicitly in section 14620(b)).[209] We discuss below our recommendation that courts follow legislative intent and construe a distinction between the duty to consider stakeholders and the traditional fiduciary duties of directors and officers, which require them to pursue the corporation's interests and, in the case of benefit corporations, explicitly include the creation of general public benefit (and potentially also specific public benefits). We assume here that the legislation means what it says and nothing else: that the monetary damages limitation does *not* constrain suits for a failure to *consider* stakeholders, but only the failure to create a general or specific public benefit.

Valuing the harm and providing a monetary remedy may still prove exceedingly difficult. When a benefit corporation director or officer fails to consider a stakeholder class, a shareholder member of that class or a member of the board of directors may elect to bring an action against the corporation for the alleged breach. For example, a benefit corporation may be approached by a potential purchaser that would like to strip the benefit corporation of its values and capture some of its constituent assets, such as a brand, intellectual property, a means of production, store location, or any other business element. Oftentimes, such acquisitions may result in lost jobs for employees of the target company, have a negative impact on the local community in which the target company was situated, and result in the degradation of upstream supplier businesses, if the target was a substantial purchaser. Those are just a few of the potential stakeholder injuries that may occur in an acquisition scenario. If the board failed to consider those stakeholder interests in its decision-making process, the statute may leave directors open to liability for monetary damages, but it is unclear how an injury *to the corporation's stakeholders* may be valued as a harm *to the corporation* in any viable economic sense. The literature on valuing social and environmental externalities is rife with admissions that externality valuation techniques are complex, sophisticated, and contradictory. This may lead courts to an inconsistent or inaccurate approach to valuation.

We also explore here a scenario to demonstrate the additional liabilities to which benefit corporations may be subject:

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[209] *Id.* §§ 14620(b), 14623(c).

> John and Jane (J&J) own a 500-acre farm on which they grow organic soybeans. Five years ago, Do-Good Farming (DGF), a benefit corporation, purchased land next to the J&J farm. DGF wants to become more profitable so it can donate a larger percentage of profits to charity, so it uses pesticides. Last year, J&J began experiencing problems with their organic certification; their organic soybean crop yield on land within 100 feet of the DGF land was only 25% of the yield on land more than 100 feet from the DGF land. It turns out the closer land was contaminated with pesticides blown over by the wind. J&J prove that DGF pesticides have seeped into the soil on J&J's farm, causing the contamination. J&J's average yield per acre was $1,000.00 in the last three years, but their yield on the damaged crop land was $250.00.

The question we would like to pose is, what, *if any*, damages would DGF be liable for *separate and additional to* the damages for which a *traditional* corporation would already be liable? On the facts above, any person—benefit corporation, corporation, individual human being, or otherwise—may be liable for any positive law violations (e.g., a toxic tort statute for imposing environmental harm, a common law damage to property, a tort for harm to individuals if the pesticides caused physical harm to them). This is not unique to benefit corporations, and there is no apparent distinction between a cause of action against a traditional corporation and a cause of action against a benefit corporation for a positive law violation. The stakeholders (e.g., J&J), who would likely be considered a "community" or "environmental" stakeholder, already possess extracorporate, positive law standing to enforce their rights and seek redress for injuries the wrongdoer has inflicted upon them. And if there were some intracorporate violation of duty or corporate policy when DGF decided to use the pesticides, the stakeholders would have no special standing to enforce those duties either.[210] The only distinction the benefit corporation statute provides is that shareholders—owners of the corporation's equity and therefore subject to value fluctuations consequent to litigation regarding the corporation's positive law violations—have the ability to enforce a duty to consider stakeholders.[211]

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210 The statutes explicitly deny any such supplementary right of enforcement. *See, e.g.*, *id.* § 14620(i) ("A director shall not have a fiduciary duty to a person that is a beneficiary of the general or specific public benefit purposes of a benefit corporation arising from the status of the person as a beneficiary."); *id.* § 14623(a) ("No person may bring an action or assert a claim against a benefit corporation or its directors or officers under this chapter except in a benefit enforcement proceeding.").

211 *See id.* § 14623(b) ("A benefit enforcement proceeding may be commenced or maintained only as follows: (1) Directly by the benefit corporation. (2) Derivatively by any of the following: (A) A shareholder. (B) A director. (C) A person or group of persons that owns beneficially or of record 5 percent or more of the

While we have discussed above the shareholders' incentives to enforce (or not enforce) this duty, we here narrowly address what the remedies might be if the shareholders did sue additionally and separately from a third-party suit against the corporation for the positive law violation(s). The key issue remains that the harm here is primarily to a third party; any harm *to the corporation* could be enforced through a traditional duty of care.

III. RECOMMENDATIONS

A. Recommendations to Courts

1. General Public Benefit: Ambiguity

With regard to the concern of ambiguity, this Article first notes that the general public benefit is an end that the benefit corporation has *a purpose* of creating. The statute does not impose, at least facially, a duty to *create* general public benefit.[212] As a consequence, the statute also does not impose a *duty to create* any of the constituent elements of the general public benefit's definition. Just as traditional corporations only sometimes achieve their purpose of creating shareholder wealth, benefit corporations will likewise fail often at *creating* general public benefit, despite commendable efforts *to pursue* the creation of general public benefit. With this in mind, this Article encourages courts to construe the general public benefit definitional provision as largely a constraint on the level to which courts should rely on third-party assessments as indicia of that pursuit. Put another way, this Article encourages courts to construe the general public benefit definition as a broad, purpose-empowering benefit corporation that innovates while attempting to solve social and environmental problems. Hamstringing benefit corporations into pursuing material, positive impacts on society and the environment only as *third-party standards understand such impacts* would unnecessarily and unwisely constrain this much-needed innovation.

To guide this understanding of the role of third-party assessment in the construction of benefit corporations' general public benefit purpose, this Article here fully expounds the definition by substituting transitively the definition of general public benefit[213] for the term *general public benefit* in the

equity interests in an entity of which the benefit corporation is a subsidiary. (D) Other persons as have been specified in the articles or bylaws of the benefit corporation.").

212 We discuss this in great detail below. *See infra* Part III.A.2.

213 *See, e.g.*, CAL. CORP. CODE § 14601(c).

purposes provision[214]: A benefit corporation shall have the purpose of creating a material positive impact on society and the environment, taken as a whole, as assessed against a third-party standard, from the business and operations of a benefit corporation. In this construction, the phrases "taken as a whole," "as assessed against a third-party standard," and "from the business and operations," all modify the phrase "material positive impact on society and the environment;" and the phrases "material, positive," and "on society and the environment" all modify the single word *impact*. As such, the general public benefit purpose is focused on and primarily concerned with the creation of *impacts*—impacts that are *material* and *positive* in their *effect* on society and the environment. This is the crux of the purpose.

This Article recommends that courts follow the principles of statutory interpretation and accordingly limit their reliance on third-party standards when interpreting the meaning of *general public benefit*. The benefit corporation has a purpose of creating impacts that are material and positive in nature and that affect society and the environment. Those impacts, thus modified, must be taken as a whole, assessed by a third-party standard, and stem from the business and operations of the benefit corporation. Nowhere does the statute prescribe that the third-party standard achieves talismanic status when interpreting the meaning of general public benefit and benefit corporations' pursuit of it. Ascribing such status to third-party standards would unduly constrain the creation of general public benefit by requiring benefit corporations to pursue what *standard setters* believe general public benefit to be.[215]

In the law of antitrust—a field also concerned with determining the limits of firms' profit-seeking behavior and balancing that behavior with the public interest—courts once ascribed a similar talismanic status to market-structure evidence that a merger would create or enhance market power as conclusive that the merger would reduce competition and harm consumers.[216] But

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214 *See, e.g.*, *id.* § 14610.

215 By their very nature, standard setters can only represent some iteration of general public benefit—an iteration that can be neither complete nor transferable between organizations. Standard setters are not omniscient. *See* Briana Cummings, Note, *Benefit Corporations: How to Enforce a Mandate to Promote the Public Interest*, 112 COLUM. L. REV. 578 (2012) (discussing benefit corporations and standards). In short, standard setters will always be imperfect in measuring organizations' creation of general public benefit, and the market should be allowed to compel the continuing development and improvement of those standards without a court-ordained prescription that benefit corporations must abide by their inherently imperfect measurements.

216 *See* Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

experience taught the courts—and administrative enforcers of the acts pertaining to antitrust—that such reliance precluded important counterbalancing evidence that such concentration might well enhance efficiency or prevent exits, each of which improves competition and benefits consumers.[217] Courts learned that evidence that initially appeared conclusive was only one aspect of a broader story, and that in order to protect the intent of the legislation, a broader look at the totality of the circumstances was required.

Here, courts face the appeal of a similar, overly simplistic sand trap. Certainly, courts could adopt the assessment results according to a third-party standard as conclusive, but such an approach would result in courts relying on a standard that is inherently imperfect in its evaluation of "material positive impacts on society and the environment." Because that clause is the primary subject of the general public benefit definition and, therefore, the purposes of the benefit corporation, courts should focus on whether the benefit corporation adopted policies and procedures attuned to creating such impacts as the benefit corporation understands them, and use third-party assessments as nonconclusive—though perhaps persuasive—indicia of whether the creation of such impacts were pursued.

With regard to "society and the environment," the limiting language on the clause is *taken as a whole*. This Article recommends courts construe this to mean, essentially, two things. First, that benefit corporations may not pursue material positive impacts on society *or* the environment, one to the exclusion of the other. A benefit corporation may not be formed to sell cookies and use profits to fund restoration of a local creek, but then ignore the health, safety, and wages of workers making the cookies, customers buying the cookies, and staff who are restoring the creek. To pursue social impact at the expense of environmental impact, or vice versa, would be inimical to the purposes of the legislation: to facilitate ventures that have "material positive impacts on society *and* the environment, *taken as a whole*."

Second, this Article realizes that pursuing such impacts in balance with one another, *taken as a whole*, is a difficult challenge, and one that scholars of business management are still in the process of studying. One of the most important insights is that the pursuit of those impacts can occur either through means, or ends, or both. As a consequence, this Article recommends that courts

[217] *See generally* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES (2010), *available at* http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf.

use a multifaceted approach to analyzing whether a corporation pursued "material positive impacts on society *and* the environment, *taken as a whole*":

	Means	Ends
Society		
Environment		

The strongest benefit corporations may pursue material positive impacts on society and the environment through both ends and means, but great material positive impacts may likewise be achieved by some calculated trade-off between means and ends. This Article recommends that courts simply require benefit corporations to adopt a decision-making process that incorporates each of these four factors. For example, a t-shirt business must incorporate consideration of its *social means* of production (e.g., does it pay its workers well?); its *environmental means* of production (e.g., is it ecologically efficient?); its *social ends* (e.g., does it donate to charity or provide shirts at low cost to disadvantaged populations?); and its *environmental ends* (e.g., does it upcycle old t-shirts into new products?). Notably, a given business model will likely be able to perform exceptionally well only on a few of the matrix quadrants, not all four.[218]

Material, in its business law iterations, is deeply intertwined with the lexicon of rationality and the field of contracts.[219] This Article questions whether a traditional view of materiality may undermine the principles upon which the benefit corporation is founded,[220] such as the theory that equates the definition of *material* to what, "[i]n the context of an 'efficient'

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[218] An environmental-ends company may pursue the conversion of waste into energy but struggle to incorporate an additional social mission into the model. Courts should still allow these enterprises to be benefit corporations.

[219] BLACK'S LAW DICTIONARY 998 (8th ed. 2004) (defining *material information* in the securities context as "[i]nformation that would be important to a reasonable investor in making an investment decision"); *id.* (defining *material* as being "[o]f such a nature that knowledge of the item would affect a person's decision-making," "significant," and "essential"); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 241 (1981) ("In determining whether a failure to render or to offer performance is material, the following circumstances are significant: (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected; (b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived; (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture; (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances; (e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.").

[220] *See* Gilbert, *supra* note 60; *The B Corporation: A Business Model for the New Economy*, CAPITAL INST. (Aug. 2012), http://capitalinstitute.org/node/171.

market, . . . translates into information that alters the price of a firm's stock."[221] Take, for example, the Diamond–Water Paradox[222] and the temporal limits of utility thinking[223]: benefit corporations are likely to price-in the "externalities" that other companies might relegate to later generations.[224] This "pricing-in" of externalities *is material* because it has measureable impacts on society and the environment, not because it affects the firm's asking price for a good, service, or the firm's stock price.[225] Thus, a construction of *material* that orients the definition toward the corporation, much less the effect on price, would be misguided.[226] More appropriate definitions and materiality frameworks may be found in modern stakeholder research.[227]

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[221] *In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1425 (3d Cir. 1997) ("In the context of an 'efficient' market, the concept of materiality translates into information that alters the price of the firm's stock."); *see also* Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970). Fama also noted that the efficient markets hypothesis could only be tested in conjunction with some theory of equilibrium. *See* Eugene F. Fama & James D. MacBeth, *Risk, Return, and Equilibrium: Empirical Tests*, 81 J. POL. ECON. 607 (1973).

[222] The Diamond–Water Paradox is a case in point for the paradox of market valuation, stating the contradiction that, although water is more useful than diamonds in terms of survival, diamonds command a higher price in the market. *See* SMITH, *supra* note 31, at 172–73.

[223] Traditional conceptions of utility measurement are limited to the preferences of decision makers, which are almost always temporally constrained and fail to consider future generations or external stakeholders. *See* ALFRED MARSHALL, PRINCIPLES OF ECONOMICS 92 (Prometheus Books 1997) (1920) ("Utility is taken to be correlative to Desire or Want. . . . [D]esires cannot be measured directly, but only indirectly by the outward phenomena to which they give rise: and that in those cases with which economics is chiefly concerned the measure is found in the price which a person is willing to pay for the fulfilment or satisfaction of his desire.").

[224] Marginalism explained that utility—and value—is related to consumption and supply. But the subjective valuation of a good by a consumer of a nonrenewable resource *today* is different from the valuation that same good would command from a consumer a generation closer to the resource's extinction. Marginal utility explains that the value of water will go up as water becomes scarcer, but it does not help humanity prevent massive bouts of dehydration-related deaths when prices skyrocket because an exponentially increasing number of consumers have been too narrow-minded for 200 years. In contrast, Seventh Generation—a benefit corporation—is an early adopter of operational strategies that help conserve resources.

[225] Well-known examples of externalities include pollution and the case of cows trampling a neighbors crops. *See* R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960); J.J. Laffont, *Externalities*, *in* THE NEW PALGRAVE DICTIONARY OF ECONOMICS (Steven N. Durlauf & Lawrence E. Blume eds., 2d ed. 2008).

[226] Pursuit of positive impacts may indeed decrease price in the short run, despite the fact that creation of such impacts are desirable for benefit corporations and within the intent of the legislation.

[227] *See* Ronald K. Mitchell, Bradley R. Agle & Donna J. Wood, *Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts*, 22 ACAD. MGMT. REV. 853 (1997); *see also* Benjamin A. Neville, Simon J. Bell & Bülent Mengüç, *Corporate Reputation, Stakeholders and the Social Performance-Financial Performance Relationship*, 39 EUR. J. MARKETING 1184 (2005) (U.K.).

2. *General Public Benefit: Duties*

With regard to the second concern, regarding the duties to *create* general public benefit, this Article notes that the model legislation explanatory comments illuminate the model legislation author's intention that the general public benefit *purpose* be *more expansive than* the *duty to consider* the specific constituencies listed in the "director duties" section of the statute.[228] The general public benefit purpose is merely informed by—not equated with—the consideration of stakeholders. This Article also notes that, as a matter of practical decision making, *purpose* ought to guide *consideration*.[229] As a consequence, this Article recommends, first, that the general public benefit purpose be interpreted sui generis as more expansive than the stakeholder consideration duties. This should allow boards to consider additional, nonmandated stakeholders where necessary or advantageous,[230] and to formulate their stakeholder-interest considerations in a way that relates to a broader concept of general public benefit purpose, if one exists.

This Article also recommends that courts *not* institute *new duties* to *create* general public benefit per se, but rather to construe the existing fiduciary duties of care and loyalty—when applied to a benefit corporation—to encompass the intracorporate considerations and processes requisite to uphold and pursue the public benefit purpose.[231] This Article adopts this view in light of 100 years of judicial wisdom in interpreting corporate purposes. For the past 100 years, the construction of the duty of care and duty of loyalty has progressed along a line known as the shareholder wealth maximization norm. That norm has informed the development of corporate governance law as we know it today, but quite importantly it has never materialized into a *separate* duty to maximize

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228 *See Model Benefit Corporation Legislation*, *supra* note 51, at 6 ("[T]he concept of general public benefit requires consideration of all of the effects of the business on society and the environment. What is involved in creating general public benefit is informed by section 301(a) which lists the specific interests that the directors of a benefit corporation are required to consider.").

229 Like beliefs and preferences in economic decision-making theory, benefit corporation *purposes* ought to constrain and determine directorial *choices*. "Economists typically take preferences to be predetermined or 'given' facts about individuals and not themselves in need of explanation or subject to rational appraisal. . . . Choice is rational when it is determined by a rational set of beliefs and preferences." DANIEL M. HAUSMAN & MICHAEL S. MCPHERSON, ECONOMIC ANALYSIS, MORAL PHILOSOPHY, AND PUBLIC POLICY 46 (2d ed. 2006).

230 The stakeholders listed in the statute are nonexclusive in nature, and businesses may wish to consider and weigh other stakeholders in pursuit of creating general public benefit. Courts should not limit or penalize the ingenuity of benefit corporations in public benefit creation by limiting acceptable stakeholder considerations. *See* CAL. CORP. CODE § 14620(b) (West 2013).

231 The statutes do not specify a duty to create general public benefit in the sections of the statute that describe benefit-related duties. *See id.* § 14620.

shareholder wealth. Rather, that norm and corporate purpose has been read into the fiduciary duties of loyalty and care and their progeny.[232] And that purpose has been construed, through the corporation's fiduciary duties, to require only that boards implement decision-making processes that are rational with regard to the corporation's interests.[233]

Likewise, this Article does not believe it would serve the interests and purposes of benefit corporations for courts to institute, without explicit legislative enactment, a separate *duty* to *create* general public benefit. While the waiver of monetary damages for a failure to create general public benefit may be read to indicate legislative intent to allow an action to "enforce" a benefit corporation's "duty" to create general public benefit, this Article finds that construction void for the reason of impossibility. Even the well-established shareholder wealth maximization norm has never required corporations to *actually create* shareholder wealth; such a duty would be impossible to uphold. The *norm*, in the instance of shareholder primacy, is *not* that shareholder's wealth is *actually maximized*; directors making good-faith, fiduciary-duty-compliant, perhaps even sound, directorial decisions regularly fail to maximize wealth or even maintain a business's profitability. That norm does not exist, and so under Kelsen's sound theory, neither can a duty to uphold that norm.[234] Such is the case.

Courts do not evaluate whether the wealth was maximized; they do not analyze alternative scenarios wherein the wealth of shareholders could have been better improved and then reprimand boards for sub-par outcomes.[235] Rather, courts analyze process and interests to ensure directors were not grossly negligent or unreasonable[236] in pursuit of shareholder wealth maximization. If a duty to *actually produce* wealth-maximizing outcomes actually existed, directorial decision making would be so chilled as to render corporations paralyzed. The duty is to aim the gun, not hit the target. And only in extreme scenarios will the court use whether the target was hit to determine

[232] *See supra* Part I.B (discussing the duty of care, as well as the "rational" language in duty analysis, and relating it to positive economic concepts).

[233] *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996).

[234] *See supra* Intro. 1.A.

[235] Delaware courts only enter into this analysis in sale-of-control scenarios, under the standard propounded in *Revlon*. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 183–85 (Del. 1986).

[236] *See supra* note 133 and accompanying text (discussing Delaware's "grossly negligent" standard of care); *see also* Frances T. v. Vil. Green Owners Ass'n, 723 P.2d 573, 585 (Cal. 1986) (in bank) (discussing California's "unreasonable" standard of care).

that the gun was not aimed properly. This Article wants directors to aim the gun and take the well-aimed shot; directors must analyze and mitigate, but ultimately undertake *risk in pursuit of* shareholder wealth maximization. The duty is not to produce the outcome, but to undertake its pursuit.

Likewise, in the context of the benefit corporation's purpose of creating general public benefit, a duty to *actually create* such benefit would prove equally impossible to uphold, and litigating compliance with that duty would require courts to engage in an evaluation of public benefit outcomes that courts are ill equipped to undertake.[237] Instead, this Article takes into consideration that the benefit corporation statutes are broadly intended to disrupt the shareholder wealth maximization norm,[238] and the duties of care and loyalty—long the receptacles of that norm—should simply be adjusted to account for the new, *additional* purpose of the corporation. What we argue for here is adjustment and reconstruction, not abolishment and reinvention. For example, the duty of care should merely be adjusted to apply the appropriate level of care[239] to a now-required evaluation and consideration of the public benefit implications of any board-level decision. This reconstruction of the traditional duties of care and loyalty should occur *in addition to* the benefit corporation's unique and distinct directorial duty to consider the statutorily defined stakeholders.[240] The general public benefit purpose of the benefit corporation is ordinal to the statute-mandated duty of consideration: the duty of stakeholder consideration springs from and inheres within the general public benefit purpose of the corporation. As such, there should not be an *additional* duty to *create* nebulous general public benefit.

3. Purpose Structure

With regard to the concern of purpose structure, there are substantial jurisdictional differences that will affect courts' construction of the purpose

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[237] "Public benefit" outcome measurements are especially tricky. *See, e.g.*, DOUGLAS W. HUBBARD, HOW TO MEASURE ANYTHING: FINDING THE VALUE OF "INTANGIBLES" IN BUSINESS (2d ed. 2010); LAURA LANGBEIN, PUBLIC PROGRAM EVALUATION: A STATISTICAL GUIDE (2d ed. 2012); WILLIAM R. SHADISH, JR., THOMAS D. COOK & LAURA C. LEVITON, FOUNDATIONS OF PROGRAM EVALUATION: THEORIES OF PRACTICE (1991).

[238] *See S79A-2011: Authorizes the Incorporation of Benefit Corporations*, *supra* note 64 ("Currently, socially-minded companies are often left with the catch-22 of either not being able to earn a profit or opening their directors up to possible personal liability for decisions that do not maximize shareholder value or increasingly going to states other than New York that are pursuing this corporate form. This bill solves that dilemma."); *see also* Gilbert Remarks, *supra* note 56, at 2–3.

[239] *See Frances T.*, 723 P.2d at 585 (stating the "reasonable inquiry" standard in California).

[240] *See, e.g.*, N.Y. BUS. CORP. LAW § 1707(a) (McKinney Supp. 2012).

hierarchy.[241] The first point is that none of the statutes require that the general public benefit purpose be the *only* purpose of the benefit corporation, and that courts would be unwise to construe any of the legislation as requiring such a procrustean structure. An entity with that purpose structure already exists. It is called a nonprofit corporation, and it must be formed to pursue *exclusively* a charitable purpose to receive 501(c)(3) status, which courts have construed to mean *primarily* a charitable purpose.[242] And notably, no entrepreneur forms a nonprofit corporation without pursuing tax-exempt status because it would be impossible to raise non-donative capital for a corporation whose sole purpose was charitable and noneconomic in nature. To mire benefit corporations in the same procrustean structure would thwart the purposes of the legislation.

The second point is that the same is true for a profit or shareholder wealth maximization purpose: if courts require that pursuit of profits be the primary purpose, courts would derogate boards' abilities to uphold their statutory duty to consider stakeholders in any meaningful sense. Profit-primacy would require boards to consider stakeholders, but ultimately subvert stakeholder interests to that of profitability. Again, entrepreneurs already have this option available to them in an existing corporate form.

In states that do not have any particular purpose structure mandated by statute,[243] courts ought to leave enterprises free to structure their own purpose hierarchy in their bylaws or through tacit operating procedures. Mandating any single formulation of purpose hierarchy is unlikely to well-serve the variety of impact-driven enterprises that will avail themselves of these statutes. To achieve impact efficacy, for-benefit organizations need to remain flexible to financial and market trends, adapting to their competitive environment and leveraging impact-oriented goals *in synergy with* their profit-oriented strategies, rather than *regardless of* their profit-oriented strategies. In order to

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241 Most notably, New York requires that "[t]he purpose to create general public benefit *shall* be a limitation on the other purposes of the benefit corporation, and *shall* control over any inconsistent purpose of the benefit corporation." *Id.* § 1706(a) (emphasis added). Most other states are more flexible: in Maryland and California, for example, the statutes permit that the general public benefit purpose *may* be a limitation on the other purposes of the corporation. *See, e.g.*, CAL. CORP. CODE § 14610 (West 2013); MD. CODE ANN., CORPS. & ASS'NS § 5-6C-06 (West Supp. 2012).

242 For an example of an operation with strong commercial hues that was still considered "substantially related" to the purposes of the tax-exempt organization, such that the activities of the operation would not be taxable, see I.R.S. Priv. Ltr. Rul. 200151061 (Sept. 28, 2001), which concluded that "operation of [an] 18-hole golf [course] facility, and related snack bar and pro-shop, in conjunction with [a] golf [course] maintenance vocational program [was] substantially related to [the organization's] exempt purpose within the meaning of section 513 of the Code."

243 *See supra* Part II.A.4; *see also infra* Part III.C (including our recommendation to legislatures).

allow organizations the best probability of achieving profit-purpose harmony,[244] courts ought to merely require that the general public benefit purpose be a *substantial* purpose of the corporation, not a *primary*, *controlling*, or *exclusive* purpose of the corporation. Of course, a "substantial purpose" minimum must be set in order to preclude those entrepreneurs who might wish to tout their "benefit corporation" nature while simultaneously ignoring their public benefit purpose.

This Article now turns to how courts ought to make the *substantial purpose* determination in the context of a benefit enforcement proceeding.

4. Benefit Enforcement Proceeding: Substantial Purpose Analysis

In determining whether creating general public benefit is a substantial purpose of the corporation, this Article recommends that courts follow a strong line of corporate governance precedent and focus on the board of directors' decision-making *procedure*,[245] rather than decisional outcomes or ex post results. The law of tax-exempt organizations has evolved a more substantive approach[246] that is ill suited for the benefit corporation benefit enforcement setting. The tax-exempt-organization approach focuses on ensuring that tax-exempt organizations abide by the nondistribution constraint[247] and that any "commercial" activities of the tax-exempt organization are limited to an "insubstantial" role.[248] In contrast, the benefit corporation is a privately owned, for-profit corporation that may distribute its earnings to its shareholders,[249] and its activities will always be substantially commercial in nature *by necessity*.[250] As such, the tax-exempt-organization approach to evaluating the purposes of the organization would be an inappropriate starting point.

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[244] We here assume that profit is necessary to sustain purpose.

[245] *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967–68 (Del. Ch. 1996).

[246] *See, e.g.*, IHC Health Plans, Inc. v. Comm'r., 325 F.3d 1188, 1199–201 (10th Cir. 2003) (establishing a five-factor totality-of-circumstances analysis).

[247] For a thorough analysis of the ineffectiveness of this approach, see Evelyn Brody, *Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms*, 40 N.Y.L. SCH. L. REV. 457, 463–65 (1996).

[248] *See, e.g.*, *IHC Health Plans, Inc.*, 325 F.3d at 1194 (applying the "operational test" set forth in IRS regulations). We also note that adopting any single component of the tax-exempt-organization approach would lead to an unnecessarily narrow and superficial determination.

[249] *See* Brody, *supra* note 247, at 534–35. Applying Brody's analysis to benefit corporations reveals that providing ownership—and therefore agency—to investors in a benefit-driven enterprise could solve one important component of benefit-driven organizations' accountability to their mission.

[250] This is because benefit corporations will not be eligible to receive most grants from foundations. Foundation-giving to for-profit entities is taxed, whereas foundation-giving to nonprofit entities is not taxed. *See* I.R.C. § 4945(d)(4) (2006).

An effective assessment of an organization's actual benefit creation would necessarily result from a comprehensive evaluation of the business's operations—its products, employees, customers, suppliers, and distributors—as well as its governance and financial structure. Courts, as bodies tasked with interpreting laws, are not well-equipped to provide such an evaluation.[251] This is precisely the reason the legislation requires benefit corporations to abide by third-party reporting standards[252]: Courts are not tasked with developing the most advanced proprietary benefit measurement tools, but standard-setting organizations are.

Delaware courts, which are home to perhaps the most sophisticated and experienced corporate law jurists in the country, have abstained from intruding into the substantive decision-making processes of the corporate governing body unless there is evidence of bad faith, conflict of interest, or activity so irrational as to amount to a waste of corporate assets.[253] The wisdom of Delaware's process-oriented approach is no less applicable here than it is for regular corporations. To force courts into a substantive evaluation of the impact and business model of a social enterprise would result in courts substituting their own judgment for the judgment of the duly elected leaders of the business. If the most sophisticated judges in the country find themselves ill equipped to do so, it is hard to see how other, less sophisticated courts examining a burgeoning and even more complex area of business could possibly fit the bill.

This Article recommends that courts focus on the following four factors as an elements test[254]:

- Whether the board of directors undertakes an *informed consideration* of all the statutorily defined stakeholders;[255]

[251] *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 n.16 (Del. Ch. 1996).

[252] *Model Benefit Corporation Legislation*, *supra* note 51, § 401(a)(2).

[253] *See, e.g.*, Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1372–74 (Del. 1995) (discussing the use of enhanced judicial scrutiny when a board of directors' actions are defensive); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986) (discussing enhanced judicial scrutiny of a board's action because of the potential for conflict of interest); Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946, 954–55 (Del. 1985) (discussing the standards by which director action is judged and the potential for conflicts of interest).

[254] This Article addresses the pleading process and requirements and standard of review for this test below. The first two prongs of this test are designed to address, respectively, the statutory duty to consider stakeholders, and the statutory purpose of creating general public benefit. *See infra* Part III.A.5, A.7.

- Whether the board of directors' decision making *was rationalized*, at least in part, on public benefit grounds;
- Whether statutorily defined stakeholders were *actually* harmed; *and*
- Whether the statutorily defined stakeholders were harmed *as a result of* failures with regard to either of the first two elements.

In making this recommendation, this Article notes that if the board of directors can make a strong showing on both of the first two process-oriented elements, they have satisfied their duty. If they cannot make a strong showing on either of the two process-oriented elements, and the plaintiff has showed that some statutorily defined stakeholders have been harmed as a result, the board should be exposed to some liability. The theory here is that part of the board's decision-making apparatus is flawed, and that flaw has resulted in harm to stakeholders that the board is obligated to consider in their pursuit of creating general public benefit. If the board fails to consider the stakeholders or fails to make a decision at least in part on the implications its decision will have on them, it is hard to see how it could be upholding its duty to consider the stakeholders or its traditional duties construed with the pursuit of general public benefit in substance.

This Article encourages courts to limit their interpretations of public benefit purpose and consideration to this process-oriented analysis in light of Fuller's wisdom that "the morality of duty starts at the bottom."[256] Courts should lay the foundation upon which benefit corporations can innovate and aspire. The transparency required by the statute and furthered by third-party standards will allow these enterprises to compete on values, allowing the market rather than courts to urge them ever higher in their pursuits. On the other hand, a rule pushing the Fullerian duty needle too high will flat-line early-stage benefit corporation enterprises, chill capital investments, and undermine the financial sustainability of benefit corporations by constraining their ability to satisfy shareholders and earn profits. Indeed, this Article rejects any test that invokes upon courts nebulous questions regarding society's understanding of public benefit—questions that are more appropriately handled by legislatures. It is not

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[255] The Model Benefit Corporation Legislation comments indicate that the general public benefit is to be informed by the directorial consideration duties. *See Model Benefit Corporation Legislation*, *supra* note 51, at 6. For a discussion of these duties, see *infra* Part III.A.9.

[256] FULLER, *supra* note 27, at 5.

within the province or the powers of the courts to determine society's desires and understandings.[257]

This Article makes this process-oriented, substantial purpose recommendation with two important caveats. First, it is important to consider the role of the third-party standard. Because the statute defines *general public benefit* as "[a] material positive impact on society and the environment . . . assessed against a third-party standard,"[258] courts should incorporate into their first-element analysis an evaluation of the third-party ratings assessment performance—namely, companies' efforts to seek good, third-party assessors and to improve performance according to those assessments. However, courts should not take a myopic approach because assessments are necessarily flawed.[259] Also, benefit corporations may possess market or stakeholder knowledge that exceeds that of standards-setters in certain situations.[260] In scenarios where benefit corporation boards of directors can document policies and programs that pursue the general public benefit but may be at odds with the measurements of the standards-setters, courts should evaluate whether those policies and programs are *reasonably designed* to produce the general public benefit. But deference should be given to the board.

Second, there is a substantial danger that, like incorporators of traditional corporations, some who form benefit corporations will seek opportunities to defraud the corporate treasury and engage in nepotistic conflict transactions under the auspices of "creating general public benefit." Because of this danger,

[257] W. Coast Hotel Co. v. Parrish, 300 U.S. 379, 398 (1937) (quoting Nebbia v. New York, 291 U.S. 502, 537–38 (1934)) ("[T]imes without number we have said that the legislature is primarily the judge of the necessity of such an enactment, that every possible presumption is in favor of its validity, and that though the court may hold views inconsistent with the wisdom of the law, it may not be annulled unless palpably in excess of legislative power.").

[258] *Model Benefit Corporation Legislation*, *supra* note 51, § 102.

[259] A recent *Columbia Law Review* Note discusses some of the problems with third-party reporting regimes but ultimately misses the mark. *See* Cummings, *supra* note 215, at 598–613. The fact that third-party standards will always have blind spots and inadequacies does not mean that it is better to not report under them at all, or to not rely at all on the reports that arise under them. Statutorily mandated public comment periods, combined with competition for standards adoption, will allow benefit corporations the opportunity to shop for a standard that best measures their business models. Courts, equipped with the statute's robust third-party definition, will be well-positioned to spot and disallow sham standards. This Article does not see the author's recommendation of an "adaptive learning" model as necessarily inconsistent with the statute as it stands.

[260] Ultimately, standard-setters are tasked with developing frameworks for effectively measuring impacts. They are not tasked with acquiring intimate knowledge about a particular benefit corporation's market or stakeholders or problems that need resolving within it. Where local knowledge prescribes one course of action and the general framework prescribes another, it is beneficial to society to allow benefit corporations to serve the local needs they perceive through their intimacy with their market and stakeholders.

we now turn to the standard of scrutiny that courts should apply when analyzing claims regarding directors' benefit-related activities in a benefit enforcement proceeding.

5. *Benefit Enforcement Proceeding: Standard of Scrutiny*

Courts across the world have established a long line of precedent protecting directors from shareholder suits stemming from corporate losses on the theory that:

> [I]f directors bear any and all risk of the company resulting from unprofitable or harmful corporate transactions, it leads directors to overly conservative and risk averse behavior. It may prevent a company from taking certain risks, which are necessary to expand its business opportunity and attain continuous growth. In addition, judges do not necessarily have deep knowledge of a company's business. Excessive interventions by courts may result in unfair decisions.[261]

Based on that theory, courts in Delaware do not second-guess the directors' decisions if those decisions do not breach the standards of gross negligence or bad faith.[262]

While Delaware courts adopt this "corporate republic" theory of the corporation, such director protection has long been the nemesis of shareholder democracy advocates.[263] Shareholder democracy advocates state that:

> While shareholder primacy is a well-established norm within United States corporate law, the business judgment rule essentially holds directors blameless when they fail to maximize shareholder wealth. During the past century, control of the corporation has shifted from shareholders to managers. As a result, shareholders have little practical say in who runs the corporation, and they cannot usually

[261] Kenji Utsumi, *The Business Judgment Rule and Shareholder Derivative Suits in Japan: A Comparison with Those in the United States*, N.Y. INT'L L. REV., Winter 2001, at 129, 129.

[262] *See, e.g.*, *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 63 (Del. 2006) (en banc) (bad faith); Brehm v. Eisner, 746 A.2d 244, 259 (Del. 2000) (en banc) (gross negligence).

[263] Shareholder democracy advocates have repeatedly argued against director protection. *E.g.*, Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 836 (2005) (arguing that increasing shareholder power will improve corporate governance); A. A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931) (arguing that all of a corporation's powers are exercisable only for the benefit of the shareholders); Fairfax, *supra* note 131, at 56–57 (arguing that shareholder democracy ultimately benefits stakeholders because shareholders share some of stakeholders' interests).

> hold managers legally liable when those managers destroy shareholder wealth through incompetence.[264]

Meanwhile, defenders of corporate republican democracy state several reasons why denying greater access is beneficial and proper: "(1) access is unnecessary, (2) access does not serve, and may hurt, economic stability, (3) access hurts corporate performance, (4) access does not serve the goals of corporate democracy and fairness, plus there are (5) corporate responsibility concerns, (6) federalism concerns, and (7) workability concerns."[265]

There are two important elements of the debate for our discussion of the standard of scrutiny for benefit-related decisions. First, shareholder short-termism may have undesirable effects on nonshareholder stakeholders. Boards play an important role in mediating conflicts of interest between stakeholder groups, and enhanced shareholder powers result in a litigation threat that incentivizes boards to ignore nonshareholder stakeholders (who have no intracorporate standing) to the benefit of shareholders. Second, self-interested directors will have incentives to use the more expansive rendition of the benefit corporation's corporate purposes in order to effect programs and policies that serve their personal interests (financial or moral), which may not serve the interests of the corporation, its shareholders, or its other stakeholder constituencies.

In determining the appropriate standard of review for an alleged breach of benefit-related duties, this Article notes that the twelve benefit corporation states that have adopted the benefit enforcement proceeding clearly intend to provide shareholders with *greater* access to litigation tools: in this case, the ability to enforce directors' duties to consider stakeholders, pursue the purposes of the corporation, and deliver or post the annual report.[266] A director-protective "benefit judgment rule" running parallel to the business judgment rule would not obtain those ends and would leave the self-interested-directors concerns unaddressed. Likewise, a wholly intrusive doctrine might allow shareholders to manipulate the benefit enforcement proceeding to pursue short-term interests. Because the benefit enforcement proceeding's monetary waiver provisions will limit shareholder incentives to bring actions to enforce

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[264] Robert Sprague & Aaron J. Lyttle, *Shareholder Primacy and the Business Judgment Rule: Arguments for Expanded Corporate Democracy*, 16 STAN. J.L. BUS. & FIN. 1, 1 (2010).

[265] *Id.* at 23. For a synopsis and discussion of these arguments, see *id.* at 23–29.

[266] *See Model Benefit Corporation Legislation*, *supra* note 51, § 305. We note that this is the only way the benefit purposes and considerations—the *raison d'être* of the benefit corporation—may be enforced.

benefit-related duties,[267] this Article argues here for a less director-protective application of the business judgment rule—a benefit judgment rule—for day-to-day transactions and decision making.

Indeed, in order to reap the benefits of benefit-judgment-rule protection, this Article argues that boards should bear the burden of proof and courts should adopt a modified *Unocal–Unitrin* standard,[268] shifting the burden of proof to the board of directors for day-to-day scenarios. Rather than requiring plaintiffs to show that the conduct was defensive in nature,[269] courts should require benefit-enforcement-proceeding plaintiffs only to plead—under a conceivability standard[270]—the latter two elements of the four-element, benefit-enforcement-proceeding claim: that statutorily defined stakeholders were *actually* harmed *and* that the statutorily defined stakeholders were harmed *as a result of* failures with regard to either of the first two elements.[271] This Article notes that pleading a prima facie case on the matters of whether the board considered stakeholders and whether the board rationalized its decision based in part on general public benefit should be a relatively easy undertaking.[272] Once that case is pleaded, the burden shifts to the board to prove elements one and two. This Article emphasizes the recommendation detailed above: if the board cannot make a strong showing on either element one or two, the board should be exposed to liability and become subject to the remedies we explore below.[273]

Finally, in order to avoid injecting the court into corporate decision making, which is a significant danger when applying the intrusive *Unocal–*

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[267] *Id.* § 305(a)(2).

[268] *See* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1372–74 (Del. 1995) (explaining the *Unocal–Unitrin* standard).

[269] *See id.* ("Before a board of directors' action is subject to the *Unocal* standard of enhanced judicial scrutiny, the court must determine whether the particular conduct was defensive.").

[270] To provide a strong right for investors to enforce duties, we encourage courts to abide by a Delaware conceivability standard rather than the federal, heightened-plausibility standard. *Compare* Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Holdings LLC, 27 A.3d 531, 536–37 (Del. 2011) (en banc) (reaffirming Delaware courts' commitment to the conceivability standard in light of the federal plausibility standard), *with* Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009) (affirming federal use of the plausibility standard), *and* Bell Atl. Corp. v. Twombly, 550 U.S. 544, 556 (2007) (requiring plaintiffs to provide plausible grounds for supporting their claims).

[271] *See infra* Part III.A.4.

[272] States typically provide shareholders with a "right to inspect" books and records. *See, e.g.*, DEL. CODE ANN. tit. 8, § 220 (West Supp. 2012); N.Y. BUS. CORP. LAW § 624 (McKinney 2003). Empowered by the right to inspect, plaintiffs will be able to ascertain whether the corporation has kept an adequate record showing its considerations and rationale for decisions.

[273] *See infra* Part III.A.9.

Unitrin standard of review, this Article recommends that the standard applied to board decisions themselves must be one that places a substantial burden on the plaintiff to show that the directors breached their benefit-related duties. We believe the appropriate level of care is the Delaware gross-negligence standard.[274] This Article adopts this level-of-care recommendation for the following reasons:

- This *Unocal*-based standard of scrutiny will be applied in *all* benefit enforcement actions—even ones *without* defensive allegations. Forcing the court into the boardroom for all benefit-related decisions would inevitably result in poor business decision making by ill equipped courts.
- Litigation incentives may encourage shareholders to manipulate the enforcement proceeding and its equitable remedies to coerce boards into taking certain actions. Positive economic theory's premise that individuals will seek to maximize their utility tells us this is a likely route for sophisticated shareholders to take.
- Equitable injunctions for these matters will be extremely intrusive. They should only be reached upon satisfying a high standard of proof that directors acted outside the interests of the corporation, its shareholders, and the public benefit, and that the directors' action was guided by a grossly negligent failure to uphold their duties.

This Article concludes here by noting briefly that the third-party standard, to which the benefit corporation is accountable via the mandated annual report, will provide an additional layer of transparency and accountability. This component of the legislation, combined with the market-facing implications of harmful disclosures, warrants the above-described level of deference to boards when evaluating their consideration of public benefit.

6. *Benefit Enforcement Proceeding: Defensive Measures*

Whereas the traditional test for day-to-day decision making in a benefit corporation should be a modified *Unocal–Unitrin* standard of scrutiny[275] applied to the four-part elements test, the traditional *Unocal–Unitrin* substantive test[276] should be applied to scenarios involving defensive

274 Brehm v. Eisner, 746 A.2d 244, 259 (Del. 2000) (en banc).

275 *See infra* Part III.A.5.

276 Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1372–74 (Del. 1995).

measures. Of course, the test must be reconstrued to account for the additional purposes of the corporation, but the principles upon which the test is founded—concern over directors' self-interested attempts to retain control at the expense of shareholders or, in the case of benefit corporations, stakeholders—remain valid. Courts should be skeptical of benefit corporation board claims of pursuing public benefit in a given defensive measure when the board's record does not reflect actual consideration of public benefit and stakeholder interests in the reasoning and discussion of the board meeting.

7. *Benefit Enforcement Proceeding: Pleading Harm and Other Pleading Dilemmas*

This Article begins here by recommending that benefit corporation shareholders should not be able to file a *direct* action under any sort of adapted pleading standard. Were individual shareholders allowed to somehow plead an alternative, noneconomic harm based on failure of the benefit corporation board to carry out its benefit-related duties, the structural incentives of the entity would become so convoluted and incalculable that any action by the director would be subject to claims of emotional distress or some other claim of similar nature. An action for fraud in the sale of securities is already available to shareholders if the terms of their investment (e.g., the purposes to which the investment was to be put) come into question.[277]

However, in the case of *derivative* actions, this Article notes that courts may need to adopt a more nuanced view of *loss* in their construction of the benefit corporation's benefit-related duties. Indeed, existing Delaware law requires traditional corporate liability to "follow *from a board decision* that results in a loss," meaning an economic loss to the corporation.[278] In the context of a benefit corporation, a failure to consider nonshareholder stakeholders is likely to result in at least a short-term *gain* to the corporation at the expense of stakeholders upon whom some negative externalities have been imposed. In order to solve this pleading dilemma, this Article recommends that courts adopt the test detailed above and pleading requirements with the following caveat.

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277 *See* 15 U.S.C. § 77k (2006).

278 *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996); *see also* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 33 (Del. Ch. 2010) (noting that consideration of nonstockholders must lead to value for stockholders).

The pleading of *harm to stakeholders* must only be construed as an indication of whether the corporation's management upheld its duties *to the corporation and its shareholders*, not as indication or construction of a *duty to the stakeholders*, a duty specifically disavowed by the model benefit corporation statute itself.[279] This stakeholder-harm-focused pleading standard, in combination with the proof requirements regarding the board's decision-making processes, is the most reliable and effective pleading standard to allow shareholders to bring action when the board has failed in its decision-making processes.

8. *Evaluating Monetary Damages for Injuries Flowing from Boards' Failure to Consider the Mandated Stakeholder Constituencies*

Above, this Article discussed that in failure-to-consider actions in Maryland and New York, directors may be liable for monetary damages resulting from their breach.[280] This Article here reinforces that it admonishes courts to *not* create an additional *duty* to *create* general public benefit, which may open another loophole through which monetary damages—and enhanced litigation risk—can flow. It is unclear why New York and Maryland, distinct from the other ten states that have passed the legislation, have failed to adopt the benefit enforcement provision that disallows monetary damages.[281] This Article also notes that neither statute eliminates benefit corporations' ability to opt in to the fairly standard section 301(c) indemnification allowance; benefit corporation directors in those states would not categorically be liable for monetary damages—depending on whether they opted in under section 301(c).[282]

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279 *Model Benefit Corporation Legislation*, *supra* note 51, § 305(a); *see also* CAL. CORP. CODE § 14620(i) (West 2013) ("A director shall not have a fiduciary duty to a person that is a beneficiary of the general or specific public benefit purposes of a benefit corporation arising from the status of the person as a beneficiary."). We note that a corollary concern exists about the convolution between the general public benefit and duty to consider: the statutory construction of this law leaves open the question of whether duties may be owed to the stakeholders who are the enumerated beneficiaries of the statutory duty to consider stakeholders.

280 *See supra* Part II.B.4.

281 *Compare Model Benefit Corporation Legislation*, *supra* note 51, § 305(a)(2) (stating that benefit corporations are not liable for monetary damages), *with* MD. CODE ANN., CORPS. & ASS'NS §§ 5-6C-01 to -08 (West Supp. 2012) (failing to disallow monetary damages), *and* N.Y. BUS. CORP. LAW §§ 1701–1709 (McKinney Supp. 2012) (failing to disallow monetary damages).

282 *Compare Model Benefit Corporation Legislation*, *supra* note 51, § 301(c) (exonerating officers from personal liability for monetary damages), *with* MD. CODE ANN., CORPS. & ASS'NS §§ 5-6C-01 to -08 (failing to exonerate officers from personal liability for monetary damages), *and* N.Y. BUS. CORP. LAW §§ 1701–1709 (failing to exonerate officers from personal liability for monetary damages).

If courts construe the legislation to allow judgment for monetary damages in the event of a breach of the directors' duty to consider, this Article notes that there appear to be two clear routes in evaluating claims for those monetary damages. The first option is simple: allow damages only for measurable and quantifiable economic harm done *to the corporation* (in the event of a derivative suit) or the shareholders (in the event of a direct suit). The advantage of this approach is that measuring damages can follow long lines of traditional precedent with well-established valuation tools. The disadvantage is that such a measurement would not include key costs that are likely intended to be included in such an action: the cost of externalities imposed upon external stakeholders.[283]

The second option would allow damages for negative externalities borne by stakeholders. In that instance, benefit corporations would be required to disgorge any profits that injured them as a result of their failure to consider the stakeholders. This would serve as a measure to offset economic incentives to engage in activities that pose a high potential for financial return to the corporation with some potential for downside, but where the majority of downside risk is borne by stakeholders external to the corporation. If courts implement this option, this Article recommends the following three-step process:

First, courts must evaluate the amount of harm caused by determining either the value of the negative externalities borne by stakeholders that were not, but ought to have been, considered; or the value of the corporation's wrongfully held, ill-gotten profits derived from the activities that harmed the stakeholder.[284] Courts should adopt the New York "lesser of two" rule in evaluating these damages.[285]

Second, damages should be disgorged from the directors to the corporation. The breaching directors disgorge the damages *to the corporation* on the "network" theory of the corporation.[286] These disgorged funds are resources the corporation should have held to use for stakeholder-considered activities.

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283 *See* Carl J. Dahlman, *The Problem of Externality*, 22 J.L. & ECON. 141, 141–42 (1979).

284 This latter measure should be reserved as a punitive deterrent in egregious cases.

285 *See* Hartshorn v. Chaddock, 31 N.E. 997, 998 (N.Y. 1892) (stating the property loss rule that the proper damages valuation is the lesser of the diminution in market value of the property or the cost of replacement, which is commonly known as the "lesser of two" rule).

286 For a discussion on fairness in terms of stakeholder treatment, see MARGARET M. BLAIR, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY (1995); R. EDWARD FREEMAN, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH (1984); Max B. E. Clarkson, *A*

Finally, along with the damages judgment, the court would also issue an injunction requiring the corporation to pursue its general public benefit and consider its stakeholders by dedicating the disgorged funds to programming designed to repair the injured stakeholder class.

This remedial process is designed to fill the gap between existing corporate law's set of incentives—of which damages are an important component—and those that the benefit corporation movement aspires to create. Benefit corporation remedies will be the latest iteration of the enhanced accountability standards toward which legal institutions have broadly been evolving for the past century.[287] Already, statutory and common law inventions have improved efficacy for repairing third parties who have been harmed by corporations.[288] These positive law creations are components of the trend toward greater accountability for acts and failures to act; they are further iterations of society's evolving understanding of rights and duties. Presently, institutionalized understandings exist in the form of positive law; the undefined gray area beyond which positive law has not yet evolved to serve our notions of justice[289] is home to "externalities"—costs and benefits bestowed upon those who should not have to bear them.[290] We view the benefit corporation legislation as an opportunity to incentivize the pursuit of Pareto-optimal transacting: by encouraging voluntary compensation for externalities and

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Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance, 20 ACAD. MGMT. REV. 92, 105–08, 110–13 (1995); Thomas Donaldson & Thomas W. Dunfee, *Toward a Unified Conception of Business Ethics: Integrative Social Contracts Theory*, 19 ACAD. MGMT. REV. 252, 254–64 (1994); Thomas Donaldson & Lee E. Preston, *The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications*, 20 ACAD. MGMT. REV. 65, 85–87 (1995); R. Edward Freeman, *The Politics of Stakeholder Theory: Some Future Directions*, 4 BUS. ETHICS Q. 409, 415–18 (1994); Robert A. Phillips, *Stakeholder Theory and a Principle of Fairness*, 7 BUS. ETHICS Q. 51, 52–54, 62–65 (1997).

287 *See* NORTH, *supra* note 1, at 46 ("The increasing complexity of societies would naturally raise the rate of return to the formalization of constraints."). Notably, the trend toward greater accountability—and formalization of rules regarding duties to repair harm—can be seen in the rise of strict liability and the development of emotional damages in tort, human rights regulations in public international law, and disclosure liability in securities and corporate governance regulations.

288 *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 15 U.S.C., 18 U.S.C., and 28 U.S.C.) (noting the goal of "improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws"); Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of the U.S. Code) (enacting sweeping changes in the regulatory instruments of the financial system in order to ensure accountability).

289 This includes both statutory law and common law precedents that will evolve according to new sets of facts that arise in the context of evolving social norms.

290 The existence of externalities results from imperfect pricing and informational uncertainty; the consequence of externalities are outcomes that are not socially optimal. Those who suffer from external costs do so involuntarily, while those who enjoy external benefits do so at no cost. *See* Dahlman, *supra* note 283, at 150–56.

allowing litigation for failure to compensate for externalities when the harm is so extensive as to invite action by shareholders,[291] we produce a scenario in which Kaldor–Hicks improvements may be made,[292] and any correlative decline in stakeholders' well-being will be more perfectly compensated.[293]

In order to explore this monetary damage award option for courts, this Article articulates a brief background on externalities before exploring the disadvantages and advantages of several externality valuation methods that courts may implement.

9. Additional Implications: The Duty of Care

This Article has recommended that courts reinterpret the duty of care in light of the general public benefit purpose of the benefit corporation. If courts adopt this approach, several aspects of the duty of care will be impacted. First, Delaware law focuses explicitly on the rationality of the decision-making processes employed.[294] This Article recommends that courts turn their attention from *rational* decision-making processes to *good faith* decision-making processes because of the economic theory from which courts' precedential use of *rational* gains its meaning.[295]

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[291] Shareholders will bring claims because either they are members of the stakeholder class that believes that stakeholder-beneficial litigation will ultimately result in stronger stakeholder ties and a reputational advantage that could create a return for shareholders or, perhaps, they are simply magnanimous.

[292] Using Kaldor–Hicks efficiency, an outcome is more efficient if those who are made better off could in theory compensate those who are made worse off, so that a Pareto-improving outcome results. For example, a voluntary exchange that creates pollution would be a Kaldor–Hicks improvement if the buyers and sellers are still willing to carry out the transaction even if they have to fully compensate the victims of the pollution.

[293] This Article notes that by creating a "liability rule" in the Calabresi–Melamed framework, courts may achieve more reliable and accurate (and therefore ultimately optimal) externality pricing. Transaction costs are likely to be high because of the power disparity between the corporation and the stakeholder, making a property rule ineffective. *See* James E. Krier & Stewart J. Schwab, Essay, *Property Rules and Liability Rules: The Cathedral in Another Light*, 70 N.Y.U. L. REV. 440, 442–43 (1995) (discussing Calabresi and Melamed's conception of liability and property rules).

[294] *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967–68 (Del. Ch. 1996).

[295] *See* MILTON FRIEDMAN, ESSAYS IN POSITIVE ECONOMICS 7 (1953) ("The ultimate goal of a positive science is the development of a 'theory' or 'hypothesis' that yields valid and meaningful (i.e., not truistic) predictions about phenomena not yet observed. Such a theory is, in general, a complex intermixture of two elements. In part, it is a 'language' designed to promote 'systematic and organized methods of reasoning.' In part, it is a body of substantive hypotheses designed to abstract essential features of complex reality." (footnote omitted)).

A fundamental assumption of positive economics is that rational individuals are exclusively self-interested,[296] and while this Article notes that this is a predictive tool that has served economists well in the past, old assumptions may not well serve this new governance model.[297] Moreover, it would be foolish to mire benefit corporation directors in a precedential dogma that thwarts the very purpose of the legislation—to allow individuals to act, not as economists assume them to act in order to make predictive models about broad-scale human behavior, but in the spirit of combined profit and public purpose for which they formed the benefit corporation. Courts should not require directorial decision making to be "rational" in the traditional sense because it would controvert that combined purpose, subverting the general public benefit to the shareholder primacy norm, as does the traditional corporation.

Rather, courts must reconstrue the duty of care to facilitate a new norm.[298] There is now a significant body of research showing the effects of moral norms on human behavior.[299] The cases of "efficiency wages" and "gift exchange," "a fair day's work for a fair day's pay," and norms of fair treatment among workers serve as ready examples of action-guiding moral claims that guide human behavior.[300] The benefit corporation legislation itself should be regarded as perhaps a premier example of this norm-guided behavior. Some economists regard these norm-based explanations as not sufficiently fundamental because a more complete picture would reveal that, ultimately, these norm-guided behaviors may be reduced to sophisticated self-interested choices.[301] But if benefit corporation incorporators form their businesses in

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296 *See* DANIEL M. HAUSMAN & MICHAEL S. MCPHERSON, ECONOMIC ANALYSIS AND MORAL PHILOSOPHY 42 (1996); *see also* ROBERT H. FRANK, PASSIONS WITHIN REASON: THE STRATEGIC ROLE OF THE EMOTIONS 2 n.* (1988) (equating rational behavior and self-interested behavior).

297 *See* FRIEDMAN, *supra* note 295, at 3–5 ("Confusion between positive and normative economics is to some extent inevitable. . . . Positive economics is in principle independent of any particular ethical position or normative judgments. As Keynes says, it deals with 'what is,' not with 'what ought to be.' Its task is to provide a system of generalizations that can be used to make correct predictions about the consequences of any change in circumstances. . . . Normative economics and the art of economics, on the other hand, cannot be independent of positive economics. Any policy conclusion necessarily rests on a prediction about the consequences of doing one thing rather than another, a prediction that must be based—implicitly or explicitly—on positive economics.").

298 *See* HAUSMAN & MCPHERSON, *supra* note 296, at 53 ("Moral norms are a subclass of social norms, which we take to be prescriptive rules regarding behavior which are shared among a group of people and which are partly sustained by the approval and disapproval of others." (citation omitted)).

299 *Id.* at 53–57.

300 *Id.*

301 *Id.* at 56.

order to pursue more sophisticated self-interested choices, courts should not constrain them in pursuing less sophisticated ones.

So, clearly the duty of care should not require strict profit maximization, even in the long run. If that is all incorporators desired, they could elect the traditional corporate form and rationalize their decisions to that end.[302] But to what extent can benefit corporation directors upend "profit maximization," or in traditional parlance, the rational and efficient use of corporate resources? What is the new prudence? What is the new efficacy? Many business programs across the United States are adopting curricula that teach business students how to blend business skills with values of social responsibility and environmental sustainability.[303] What is clear from the benefit corporation legislation is that, for benefit corporations, profitability is no longer an end in itself: through the interpretation of the legislation, courts and boards will be able to explore the proper balance between profitability and purpose.

Ronald Coase's acclaimed article, *The Problem of Social Cost*, noted that this is a problem of a reciprocal nature.[304] In the context of the benefit corporation, one's magnanimity may be another's waste of assets. In Coase's formulation, "[t]he problem is to avoid the more serious harm."[305] This Article discusses below that because of the duty to consider stakeholders, the doctrine of efficient breach may become null: in scenarios where the economically efficient breach of a contract may traditionally justify its actual breach in the context of a traditional corporation, the duty to consider stakeholders may preclude such a breach in the context of a benefit corporation. The same can be said for Coase's cattle problem: increasing herd size at the expense of a neighboring farmer's crops may be precluded in the context of a benefit corporation even if it would be more economically efficient to harm the crops, price the damages for the harm done into the price of the cattle, and

302 *See* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 33 (Del. Ch. 2010) ("When director decisions are reviewed under the business judgment rule, this Court will not question rational judgments about how promoting non-stockholder interests—be it through making a charitable contribution, paying employees higher salaries and benefits, or more general norms like promoting a particular corporate culture—ultimately promote stockholder value.").

303 Francesca Di Meglio, *Going Green: MBA Sustainability Programs*, BLOOMBERG BUSINESSWEEK (Apr. 17, 2012), http://www.businessweek.com/articles/2012-04-17/going-green-mba-sustainability-programs; *see also* GISELLE WEYBRECHT, THE SUSTAINABLE MBA: THE MANAGER'S GUIDE TO GREEN BUSINESS (2010) (providing a comprehensive exposition of some of these strategies).

304 Coase, *supra* note 225, at 2.

305 *Id.*

compensate the farmer precisely for the exact and full amount of the harm done.[306]

But here, we deal with a question separate from that concerning whether these intentional breach and damage scenarios could arise without breaching the *duty to consider* the statutorily defined stakeholders. We deal with what, under the benefit corporation *duty of care*, a board must consider in order to satisfy its duty to be informed and exercise good-faith judgment. This is a tenuous issue because we now reach the crux of positive and normative economics: assuming that the board knows that it is economically efficient to harm the neighbor or supplier, is it still *right* to do so? And, in determining whether it is economically efficient, what must be included in the considered costs?

Traditional proponents of normative economic theory[307] would presuppose that the former question is answered by the question itself—it is economically efficient, therefore it is right. This is justified by the fact that the neighboring farmer and supplier are both compensated fully for whatever harm was done to them, and that there is an economic surplus that would otherwise be wasted. But there may be further justification on the grounds of mitigating externalities. Richard Posner gave an example of an agreement to purchase 100,000 widgets custom-ground for use as components in a machine that business *A* manufactures; after taking delivery of 10,000 of those widgets, the market collapses and business *A* notifies the supplier that it is terminating the contract. At the time of notification, the supplier has not yet begun the custom grinding of the other 90,000 widgets but threatens to complete its performance under the contract and bill business *A* accordingly. Posner pointed out that today, the doctrine of mitigation of damages prevents the supplier from recovering any self-imposed damages after the notice of termination.[308]

On the one hand, the doctrine of efficient breach would result in an economically sound result—full and fair compensation for the harm of early termination imposed on the supplier, coupled with the freedom of the buyer to pursue a better market opportunity with his remaining assets. Additionally,

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306 *See id.* at 2–6.

307 Some examples include Judge Richard Posner, Milton Friedman, and Oliver Wendell Holmes. Holmes once famously said, “The only universal consequence of a legally binding promise is, that the law makes the promisor pay damages if the promised event does not come to pass. . . . [I]t leaves him free from interference until the time for fulfillment has gone by, and therefore free to break his contract.” OLIVER WENDELL HOLMES, JR., *Lecture VIII*, *in* THE COMMON LAW 289, 301 (1881).

308 RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 4.9, at 119 (6th ed. 2003).

halting creation of the widgets likely avoided a substantial amount of environmental resource waste external to the contract. Suppose that the custom-ground components had no use elsewhere, were of little scrap value, were not upcyclable, and were environmentally damaging once deposited in a landfill. The efficient breach outcome that makes the plaintiff as well off as before and the defendant better off satisfies, theoretically, the Pareto standards of efficiency: there is a net social gain between the contracting parties, and no one is left worse off.

On the other hand, suppose the supplier was driven out of business because he had committed all of his resources to this customer and, without receiving payment for the order, could not retool to capture a replacement opportunity to carry on the business. It is unclear whether expectation damages could truly repair the supplier for the time and struggle of recovering the damages through litigation (not just the attorneys' fees), much less the death of the business itself. A 1982 law review article demonstrated several problems with simple efficient-breach theory and noted that "it is extremely easy to introduce selected transaction costs to show that the model 'proves' what the modeler wants it to prove, while ignoring countless other transaction costs of equal or greater pertinence in the real world—costs yielding different conclusions."[309]

Another article gives helpful support as to what costs courts should require benefit corporations to consider when confronted with this dilemma.[310] We note simply that courts should require benefit corporations to evaluate alternative remedy schemes to appropriately compensate harmed stakeholders. Benefit corporations were invented to reduce transaction costs and negative externalities, so they must pursue efforts to do so.

B. Recommendations to Boards

1. Maintaining the General Public Benefit Purpose

Boards should adopt several practices in order to ensure that they maintain the pursuit of their statutory general public benefit purpose. First, in the organization's bylaws, they should set out broad ways that the corporation may create general public benefit. Then, they should ensure that board-level

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[309] Ian R. Macneil, *Efficient Breach of Contract: Circles in the Sky*, 68 VA. L. REV. 947, 950–53, 961 (1982).

[310] *See* Daniel Friedmann, *The Efficient Breach Fallacy*, 18 J. LEGAL STUD. 1, 6–8 (1989) (discussing the transaction costs not accounted for by efficient breach theory).

meetings articulate ways that the board considered these and other activities that are likely to promote the general public benefit. Boards should attempt to facilitate adoption of these activities with key managers.

Second, boards should articulate a concrete decision-making process. This Article recommends that, in the organization's bylaws, the board describe the process by which it will mediate prospective conflicts between the purposes of the corporation. If the board wishes to anchor a specific preference value to particular stakeholders, or establish a purpose hierarchy, the bylaws are the best place to articulate these decision-making policies. In formulating its decision-making process, the board should bear in mind the state's limiting language—in New York, general public benefit shall control the other purposes; in the other states, general public benefit may limit the other purposes.

Third, boards should record the actual consideration. In each board meeting, the board should explicitly record its consideration of each statutorily defined stakeholder and provide some substance as to how the stakeholder was considered in relation to the operations of the business. The board should also record consideration of its efforts to create general public benefit and any articulated specific public benefits.[311]

Fourth, boards should appoint a benefit director. This Article recommends this with some hesitation because some boards may take this recommendation to mean that only a single director should consider the general public benefit aspects of a corporation's activities and strategy. This is not what this Article means. Rather, this Article encourages the board to appoint a benefit director to assist with several tasks: selecting and monitoring the relationship with the third-party standard provider; orchestrating the annual reporting required by statute and any desired intermediate reporting; upholding the responsibility of monitoring compliance with the articulated decision-making process; ensuring

[311] This follows suit with New York's version of the model benefit corporation legislation. N.Y. BUS. CORP. LAW § 719(b) (McKinney 2003) ("A director who is present at a meeting of the board, or any committee thereof, when action specified in paragraph (a) is taken shall be presumed to have concurred in the action unless his dissent thereto shall be entered in the minutes of the meeting, or unless he shall submit his written dissent to the person acting as the secretary of the meeting before the adjournment thereof, or shall deliver or send by registered mail such dissent to the secretary of the corporation promptly after the adjournment of the meeting. Such right to dissent shall not apply to a director who voted in favor of such action. A director who is absent from a meeting of the board, or any committee thereof, when such action is taken shall be presumed to have concurred in the action unless he shall deliver or send by registered mail his dissent thereto to the secretary of the corporation or shall cause such dissent to be filed with the minutes of the proceedings of the board or committee within a reasonable time after learning of such action.").

accurate and prudent recording of benefit and stakeholder considerations; and guiding organizational strategy and board-level decision making on all matters related to general public benefit and articulated specific public benefits.

2. *Specifying Public Benefit Purposes*

Articulating specific public benefit purposes in the articles of incorporation of a benefit corporation is a double-edged sword. It ensures that the corporation is allowed to pursue activities in furtherance of that specific public benefit (since it is regarded as a purpose of the corporation), but it also makes the corporation susceptible to derivative actions for failure to consider the creation of that specific public benefit, or perhaps even for the failure to affirmatively create that specific public benefit (an approach we advise courts not to take). In order to mitigate risks related to board duties to consider the creation of a specific public benefit articulated in the benefit corporation's articles of incorporation, we recommend that boards take several actions.

First, boards should define in the bylaws each of the terms stated in the specific public benefit purpose. This should provide directors and officers clarity in understanding the purpose and carrying out policies, programs, and procedures designed to ensure pursuit of it.

Second, boards should ensure that one aspect of the decision-making process articulated in the bylaws adequately considers the pursuit of the specific public benefit purpose. Boards should consider in advance any conflicts of interest that may occur between the specific public benefit purpose and the other purposes of the corporation, and decide how those conflicts will be intermediated in the decision-making process.

C. *Recommendations to Legislatures*

1. *Do Not Adopt the New York Model of General Public Benefit Primacy*

There are three prospective advantages to the "shall control" construction of the New York statute.[312] First, it may create some certainty; wherever there is a trade-off between profitability and creating general public benefit, the New York benefit corporation must pursue the latter. Second, it may ensure that no particular constituency, by way of a specific public benefit iteration, could dominate the enterprise and its decision-making orientation. Third, and perhaps

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312 N.Y. BUS. CORP. LAW § 1706 (McKinney Supp. 2012).

most obviously, it may be desirable for moral reasons to have all purposes subordinated to the general public benefit: profit may only have value if it is used to benefit the general public. However, it is not clear that the prospective advantages of the New York structuring are achievable in practice.[313]

By way of comparison, this Article believes the "shall consider" construction of the directorial duties section is wise and just; it forces stakeholder interests into the boardroom—even when the board does not want them there—to prevent boards' short-sighted pursuit of profit and failed consideration of stakeholder outcomes.[314] The "shall control" language of the New York statute, on the other hand, pursues a more ambitious result. Rather than forcing the mere consideration into the boardroom, section 1706 determines the outcome of the meeting. It does not leave the board the option to creatively structure its purposes in consideration of stakeholder interests. Rather, it imposes general public benefit primacy on a benefit corporation. It forces benefit corporation enterprises to rationalize profitability—and any articulated specific public benefit—to the general public benefit purpose.

New York benefit corporations can pursue shareholder wealth maximization and specific public benefits *only insofar as* they serve the general public benefit purpose of the organization. This hierarchy becomes particularly discomfiting in light of the ambiguous nature of the general public benefit definition.[315] Sorting out what general public benefit means is a much more pressing question when that purpose becomes the controlling purpose of the enterprise. But even after that question is resolved, the board is left with the further task of then determining how it can maintain profitability while prioritizing its general public benefit purpose above all else.

There are two caveats to our analysis. First, some entrepreneurs may desire general public benefit primacy. It is likely that, due to the economic incentives related to shareholder litigation, boards of directors will pursue only that which

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313 *See* Letter from Nancy L. Sanborn, Chair, N.Y.C. Bar Comm. on Corp. Law, to Sheldon Silver, Speaker, N.Y. State Assembly, and Daniel L. Squadron, Member, N.Y. State Senate Comm. on Corps., Auths. & Comm'ns (Feb. 16, 2011), *available at* http://www.nycbar.org/pdf/report/uploads/20072008-LetteronA.14498BS.7855BAuthorizingtheIncorporationofBenefitCorporations.pdf. Indeed, the letter, which served as a report for the New York City Bar, recommended an entirely different approach that fits with our recommendations to courts on how to interpret other states' less restrictive statutes and our recommendations on whether to adopt this restrictive purpose structure.

314 *See supra* Part III.A.2 for a discussion of stakeholder considerations.

315 *See* N.Y. BUS. CORP. LAW § 1702(b) (defining *general public benefit* as a "material positive impact on society and the environment, taken as a whole, assessed against a third-party standard, from the business and operations of a benefit corporation").

the states set as the minimum duty to pursue the general public benefit. There will be no economic incentive to sue for failure to uphold general public benefit; there will be an incentive for failure to pursue profitability; and boards will want to mitigate that prospect for litigation. New York provides the option for incorporation under a statute that makes clear it was *not* a breach of the directors' duty if they decided to prioritize general public benefit—the directors were categorically mandated to do so by statute. It is not clear that entrepreneurs desirous of this result could not, however, achieve the same ends by incorporating in any of the other benefit corporation states and amending their benefit corporations' bylaws to include a general public-benefit-prioritizing, decision-making process. The consequence would appear to be the same, though perhaps there may be some branding benefit to incorporating in New York—a state that may become known for having the most ambitious benefit corporation statute to date.

The second caveat regards whether the statutory purpose formulation will have any consequence at all in practice. New York courts could, after all, adopt a construction of general public benefit primacy in which boards of directors could pursue short-term profitability in order to achieve long-term public benefit. This is the benefit corporation analogue to the *eBay Domestic Holdings, Inc. v. Newmark* presumption.[316] But, if courts were to adopt that construction, the impact of general public benefit primacy as a legislative regime would likely be negligible. It simply forces the board to invent a general public benefit rationalization for pursuing short-term profitability or specific public benefit opportunity. This works in traditional corporations because shareholders will likely oppose any actions that do not actually promote shareholder value. That incentive is not present in the benefit enforcement proceeding so an overbroad reading of the general public benefit allowance would result in decreased accountability, which is the opposite of the legislation's intended goal.

2. *Do Not Adopt the California Model of Choice-of-Law Cannibalization*

California law subjects to the state's corporate governance regime all foreign corporations in which 50% of shareholders of record have record addresses in California, and in which the average of property, payroll, and sales factors is more than 50%.[317] California law also lays out the directorial

316 *See* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 33 (Del. Ch. 2010).
317 CAL. CORP. CODE § 2115 (West 2013).

duties of boards of directors of traditional corporations in California.[318] California law also aims to require benefit corporations—or perhaps even B Corporations[319]—that are registered in foreign jurisdictions to abide by California's benefit corporation fiduciary duties body of law:

> A director of a foreign corporation that is subject to Section 2115 shall not be subject to Section 309 and shall be subject instead to this section if the director of the foreign corporation is subject to duties under its articles of incorporation, bylaws, or the law of its jurisdiction of incorporation similar to the duties of directors under this section.[320]

There may be an open question as to whether, under the Full Faith and Credit Clause of the U.S. Constitution, the State of California may effectively cannibalize another state's corporate governance principles for corporations residing in California upon the State's determination that they reside in California. The *Restatement (Second) Conflict of Laws* states that "[a] court, subject to constitutional restrictions, will follow a statutory directive of its own state on choice of law."[321] This Article leaves the debate on the constitutionality of California's law to a better-equipped analyst.

We will merely note here an example illustrating the level of complexity that this provision introduces:

> A business, Do Good Yonkers (DGY), sells trendy Yankees hats at a price premium and adopts the mission of providing an equally trendy Yankees hat to a youth in a developing country for every trendy DGY Yankees hat purchased in the United States. DGY, as an ambitious bunch, incorporates as a benefit corporation in the state of New York in order to avail itself of the most ambitious benefit corporation statute in the country. DGY, led by three Yonkers-based entrepreneurs owning the founding shares, then sells investments to four California residents and uses the capital to set up manufacturing operations in California. DGY decides to start selling their hats locally to fickle Dodgers fans in California, and at the end of the first fiscal year, the average of DGY's property, payroll, and sales factors is more than 50%. One of the investors, a Yonkers native who

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318 *Id.* § 309.

319 B-Corporation-certified corporations and LLCs are required to amend their governing documents and enter into a term-sheet agreement with B Lab regarding the duties to consider stakeholders. The duties arising therefrom may activate California law for California resident corporations. *Id.* § 14620(j). This would satisfy other requirements of California law. *See id.* § 2115(a).

320 *Id.* § 14620(j).

321 RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6, at 10 (1971).

> recently relocated to California, cannot stand that his prized Yankees hats are being worn by these dodgy Dodgers fans. He sues because he believes it is not in the public interest to sell Yankees hats to Dodgers fans—it's just not right. Will the public benefit primacy of New York's statute apply, forcing the directors into a more restrictive set of fiduciary duties? Or will Section 14620(j) allow DGY to submit to California's looser standard?

It is sufficient for our purposes to note that this sort of provision hinders the efficacy of the entire benefit corporation experiment by forcing deliberately choosing entrepreneurs into a governing body of law that is not in the anticipant interests of the parties. California's deviation from choice-of-law norms is likely to cause investor and director confusion resulting in litigation.

3. *Strike "As" from the General Public Benefit Language*

The simple word *as* in the general public benefit language,[322] when linked with the corporate purposes definition,[323] forces courts into a predicament where it may appear that they are required to rely on the third-party standard when evaluating whether a benefit corporation has pursued general public benefit. Such reliance on a nongovernmental entity is best reserved as a nonconclusive indication of whether a benefit corporation has pursued general public benefit because the standard will always be inherently inadequate, even if well-constructed (as the statute requires). In a standard's attempt to be objective, it will exclude qualitative general public benefit impacts that fall "off the radar" of the objective measurements.

Impact measurement has not yet reached the accuracy or precision of simple mathematics, and benefit corporation boards should be free to pursue solutions to social and environmental problems *as they see fit*, rather than being forced to adopt a draconian, procrustean mandate to pursue "general public benefit" as a standards organization sees it. Accordingly, courts should be free to find that boards have failed in their benefit-related duties despite performing well according to third-party standards, and, on the contrary, that they have performed their duties despite performing poorly according to a third-party standard. This is essential in order to foster innovation in solving social and environmental problems—the benefit corporations, not the standards organizations, are the innovators. Implicating a third-party standard in a

[322] *Model Benefit Corporation Legislation*, *supra* note 51, § 102.
[323] *Id.* § 201.

judicial evaluation of whether a benefit corporation pursued material positive impacts on society and the environment is inappropriate as a requirement. Eliminating *as* from the language would resolve this purposes problem.[324]

4. *Eliminate the Public Comment Period Limitation to Require Open Commenting*

The statutes of many states that have passed the legislation require the third-party standard to "use[] a balanced multistakeholder approach, including a public comment period of at least 30 days to develop the standard."[325] Public comment is an essential tool to facilitate transparency and feedback for standards seeking the approval of courts as suitable for benefit corporation usage. Where defects and flaws in the standard occur, public comment from users or would-be users highlight areas of opportunity for improvement. Importantly, courts can utilize publicly available feedback on standards to approximate how strong or flawed a standard is. If a suit occurs regarding pursuit of public purpose with regard to some element of operations evaluated by the entity's chosen third-party standard, public commenting can provide courts with information regarding the accuracy and suitability of the standard for evaluation on that particular aspect of impacts. Moreover, robust public commenting—and a standard-setter's response to that commenting—may give courts some indication as to whether the third-party standard meets other statutory requirements.

Although we admonish courts not to rely on third-party standards in determining whether a benefit corporation has pursued its public-benefit purpose, this Article does not see a reason to limit the availability of public commenting on a standard to a mere thirty days. Placing such a short minimum lifespan on the opportunity to comment limits the public's ability to hold standard-setters accountable and provides invaluable feedback to the standard-using community, as well as the courts themselves as they attempt to determine which standards meet the statutory definition. Accordingly, this Article recommends that legislatures modify the Model Act's thirty-day limitation to read as follows: "uses a balanced multistakeholder approach to develop the

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[324] The new definition would read: "'General public benefit' means a material positive impact on society and the environment, taken as a whole, assessed against a third-party standard, from the business and operations of a benefit corporation." This would allow courts to rely on the third-party standard as the situation calls for it.

[325] *See, e.g.*, CAL. CORP. CODE § 14601(g)(3)(B); *see also Model Benefit Corporation Legislation*, *supra* note 51, at 5 (requiring a "reasonable public comment period").

standard, including an *ongoing* opportunity for public comment through the standard-setter's website."

5. *Adopt the Benefit Corporation*

The benefit corporation, whatever its ambiguities, should be adopted because it is the best proposed solution so far to the corporate governance challenges at stake.[326] This Article here notes twenty reasons the benefit corporation legislation may be advantageous to the public good:

i. **Lowering of transaction costs**. Recent research on financial contract specialization shows that investors are reluctant to experiment with foreign investment terms and prefer to recycle familiar terms on a deal-to-deal basis.[327] The lack of a coherent corporate governance architecture in for-benefit corporations prior to the advent of the benefit corporation meant that social and sustainable business entrepreneurs faced two difficulties while raising capital. First, overcoming the stigma of having a "social enterprise" or "sustainable business," which to many implies a necessary trade-off between profit and impact but need not. Second, the potentially investment-killing hassle of negotiating specific contracts or investment devices would protect the mission of the enterprise down the road. The benefit corporation mitigates the latter by providing a cohesive architecture with which interested investors will become familiar over time.[328]

ii. **Investor familiarity**. Apart from lowering deal-to-deal transaction specialization costs, the benefit corporation will also mitigate the problem of investor unfamiliarity with impact-focused business models by providing a single, cohesive architecture to represent those models. And, if empirical evidence shows that benefit corporations, due to their unique architecture, are actually more profitable—or at least more financially stable—over the long run, investors will begin to seek them

[326] Dirk Sampselle, Social Enterprise: Choice of Legal Entity (Mar. 22, 2012) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2234882.

[327] *See* Ola Bengtsson & Dan Bernhardt, Different Problem, Same Solution: Contract-Specialization in Venture Capital (Mar. 13, 2012) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2021205.

[328] This Article notes the important work of Marcel Kahan and Michael Klausner, describing institutional learning externalities that would certainly apply to the new benefit corporation statutes. *See* Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779, 793 (2006); *see also* Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate")*, 83 VA. L. REV. 713, 719–25, 731–33 (1997).

out in greater numbers, unleashing a new wave of impact-focused, private-sector innovation.

iii. **Higher purpose allowed**. The general public benefit purpose of the benefit corporation presumably *allows* entrepreneurs to pursue a higher or beneficial purpose; this allowance advantage is particularly important because there is some debate about whether a traditional Delaware corporation may even insert language into its articles of incorporation in order to allow it to pursue some additional or alternative "public-oriented" purpose.[329]

iv. **Public benefit accountability**. The benefit corporation is the first entity to provide intracorporate means of holding a corporation accountable for pursuing a public purpose. This mechanism, which has proven effective in protecting shareholder interests, could vastly improve corporate accountability in pursuing public outcomes and thereby improve the efficacy of corporations in creating publicly beneficial outcomes.

v. **Stakeholder rights**. Although the benefit corporation (perhaps wisely) provides no private right of action for stakeholders to sue the corporation and creates no duty running to a stakeholder, benefit corporations—if operated by directors who act in good-faith furtherance of the beneficial purposes of the corporation—are likely to improve the well-being of stakeholders and provide greater protection for their rights. For example, the theory of efficient breach in contracts states that a party should be allowed to breach a contract and pay damages if doing so would be more economically efficient than performing under the contract.[330] In an instance where a traditional corporation, under the theory of efficient breach, could breach its contract with a supplier in favor of another supplier that offered better terms, a benefit corporation may not be able to do so due to its

329 DEL. CODE ANN. tit. 8, § 101(b) (West 2006) ("A corporation may be incorporated or organized . . . except as may otherwise be provided by the Constitution or other law of this State."). It is unclear whether a corporation could adopt language specifically rejecting or contradicting the Delaware courts' holdings in *Revlon* and *eBay*.

330 *See* Robert L. Birmingham, *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 RUTGERS L. REV. 273, 284 (1970) ("Repudiation of obligations should be encouraged where the promisor is able to profit from his default after placing his promisee in as good a position as he would have occupied had performance been rendered."). The theory was named by Charles J. Goetz and Robert E. Scott. *See* Charles J. Goetz & Robert E. Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554 (1977).

affirmative, statutorily mandated duty to consider stakeholders including suppliers. However, it is not clear whether the corporation could still elect to breach the contract after considering the supplier, either purely because the corporation would be financially healthier (a rule allowing benefit corporations to pursue profitability ahead of stakeholder wellbeing on a systematic or ad hoc basis) or because the corporation would be better able to carry out its beneficial purpose ex post (putting the saved money towards some new charitable cause which would have greater beneficial impact than upholding the agreement, or perhaps even choosing to pay that breach surplus to a local supplier which has a better, more impactful mission).

vi. **Joint Ventures with Tax Exempt Organizations (TEOs)**. Prior to the benefit corporation statutory regime, tax-exempt organizations seeking to carry out substantial commercial operations to generate revenue for their charitable missions were relegated to essentially two options: carry out the operations within the tax-exempt organization and risk losing its tax-exempt status, or establish a joint venture or subsidiary with a traditional for-profit corporation.[331] Given the debate on what purposes a traditional corporation must serve, there could be a substantial conflict of purpose between the nonprofit parent and the for-profit subsidiary. For example, perhaps the tax-exempt parent is chartered to alleviate health problems in Sudanese youth and it has established a for-profit subsidiary t-shirt manufacturing business in Sudan to provide health services and employment for the local communities. The for-profit entity—on the holding in *Revlon*—would, in a sale of control scenario, be forced to sell to the highest bidder, perhaps a corporation that manufactures clothing in that same community for less pay, in unhealthy working conditions, and with no health benefits. Alternatively, in a defensive-measures scenario, the for-profit entity may have to pay monetary damages for a loss resulting from a refusal to sell to a hostile bidder, even if the explicit reasoning not to sell was culture- or values-based.[332] Such a paradox of values could be avoided with a subsidiary benefit corporation.

vii. **Enhanced purpose verification**. The failure of state attorneys general to enforce nonprofit corporations' charitable purpose through a public

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331 *See* Sampselle, *supra* note 326.
332 *See* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010).

right of action is fairly notorious at this point.[333] Likewise, IRS tests do not truly evaluate whether a company is pursuing—much less achieving—the ends they set out to achieve.[334] The B Corporation certification, on the other hand, is substantive, evaluates over 200 aspects of a business's value chain, and requires a score of eighty before certification is awarded. While not all benefit corporations will elect B Corporation certification as their third-party standard, it is unlikely that the private right of action to hold businesses accountable to their public purpose would underperform public actors' efforts to enforce TEOs' pursuit of their charitable mission. And, more information will be disclosed to the public via a benefit corporation's annual report than is disclosed in a TEO's annual 990.

viii. **Mitigation of profit–purpose tension.** Although profit–purpose tension will be inherent within the daily and strategic decision making of every benefit corporation, the IRS's pitting of profit against purpose is avoided in the benefit corporation. A substantial purpose of the benefit corporation is allowed—and should be encouraged—to include the pursuit of profit. It has been a flaw in nonprofit directors' thinking that profit should not be central to a nonprofit's operations,[335] and that flaw is furthered if not founded in the IRS's commerciality doctrine and substantial purpose tests.

ix. **Lack of government intervention**. Because the B Corporation certification is administered by a nonprofit, nongovernmental organization (B Lab), the ends of benefit-corporation transparency and substantive-purpose evaluation are met without government intervention, allowing for the swift and steady improvement of independent performance metrics without cost to taxpayers. Moreover, the benefit corporation's affording of a private right of action to enforce consideration of stakeholders and pursuit of the general public benefit

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333 Brody, *supra* note 247.

334 IRS-exempt-organization purpose tests are limited to the organizational and operational tests, which focus narrowly on the legal language in the articles of incorporation, and on the budgeted revenues and expenditures of the company, respectively. No attention is paid to the wages the nonprofit's employees are paid; whether it supports its local economy; whether it takes into consideration the environment when carrying out its social programming or vice versa. The narrow lens of the IRS's TEO analysis makes for an easy formulaic application, but much is missed in the way of substantive evaluation of the operations of TEOs.

335 *See* JOHN ZIETLOW ET AL., FINANCIAL MANAGEMENT FOR NONPROFIT ORGANIZATIONS app. 1A (2007).

eliminates the need for socialized enforcement costs by way of the attorney general.

x. **Consumer-facing branding**. The benefit corporation allows mission-oriented businesses to communicate their distinctive legal status to the consumer public, providing consumers with an easy way to verify whether companies are likely sticking to their claims to do good.

xi. **Happier work environments**. Because benefit corporations are legally required to consider the interests of their employees, they are more likely to have happy work environments and attract the best talent.

xii. **Increased tax revenue**. Because benefit corporations are not tax-exempt organizations, benefit corporation entrepreneurship will result in more tax revenues for federal, state, and local governments. These ventures may not have otherwise been created; moreover, some tax-exempt organizations may wish to re-form as benefit corporations, or establish tax-paying benefit corporation subsidiaries to house earned-income strategies.

xiii. **Increased investment**. Philanthropists are likely to expand their investment portfolios to include impact-oriented assets.[336] Meanwhile, traditional investors will become educated on benefit corporations and potentially take interest in the sources of innovation that may flow from a public benefit guided enterprise. And early adopters of the already-forming impact-investing and mission-aligned capital segment will take greater interest in the certainty provided by a uniform benefit corporation law that makes impact investing more formulaic, predictable, and measureable.[337]

xiv. **Increased long-run profit stability**. The practices the benefit corporation legislation requires or at least encourages—strengthening stakeholder ties with groups like the communities that support the business, the employees, and the business's customers; eco-efficiency (which can drive down costs); and upholding heightened business

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336 *See* CREDIT SUISSE, INVESTING FOR IMPACT: HOW SOCIAL ENTREPRENEURSHIP IS REDEFINING THE MEANING OF RETURN 10 (2012), *available at* http://www.schwabfound.org/pdf/schwabfound/Investing_for_Impact.pdf.

337 Clearly, certainty will take time to evolve, as courts promulgate their rulings interpreting the statutes. But already reputable funding institutions are signing on to support B Corporations. *See What GIIRS Does*, GIIRS, http://giirs.org/about-giirs/about (last visited May 12, 2013).

ethics (if for no other reason than to avoid a derivative action for failure to consider stakeholders)—are likely to make benefit corporations more financially stable in the long run.

xv. **Improved innovation**. The benefit corporation legal entity allows directors and officers to pursue strategies that may appear more responsible but less profitable, spawning enhanced innovation for the public good. Additionally, this innovation may actually end up developing quite a lot of goodwill for the business, uncovering new market opportunities, or inspiring latent demanders to awaken to the virtues of the product or service, which could drive long-run profitability. Though those long-run profitable and sustainable strategies may be unquantifiable and "irrational" in the traditional sense, benefit corporations will be freed to pursue those strategies with less fear of direct or derivative action by the shareholders, spawning a new wave of public-benefit-focused innovation.

xvi. **Risk mitigation**. Benefit corporations are required to consider stakeholders, which is a proven risk mitigation strategy. Benefit corporations are also required to have a purpose of pursuing public benefit, which provides them with a greater opportunity to continue to focus on providing real value over the long run rather than taking measures that have high social or environmental costs and that could result in litigation or market damage.

xvii. **Purpose balancing**. Benefit corporations—by allowing a single entity to have and hold itself accountable to multiple purposes—provide a unique opportunity for corporations to discover a perfect harmony between impact and profit, high-minded purpose, and financial wellbeing. Such balancing is precluded in large part by traditional corporation law, which requires the shareholder interest to predominate. Now corporations may strive to achieve the same purpose–financial balance that individuals seek.

xviii. **Empowers investors**. The benefit corporation is the first entity to categorically give investors the power to protect and enforce mission. This empowerment is a useful tool not only for impact investors, but also for investors who want to see more stable returns over the long run.

xix. **Decreased greenwashing**. Benefit corporations, by providing increased accountability to *claims* of purpose, may limit or eventually eliminate greenwashing. The corporation's status will help consumers differentiate between businesses that are doing good in order to profit from doing good and businesses that are doing good for the sake of doing good (and standing by what they say they are doing).

xx. **Enlightenment**. With more businesses explicitly aimed at doing good in the world, we will be surrounded by products and services that inhere the best in humanity. We will be constantly reminded that it is not just important whether this product is best or good for us. Benefit corporations will encourage us to evaluate our purchases based on their impact for all of humanity and the environment. This is perhaps the greatest consequence of the legislation.

In conclusion, we reiterate Douglass North's insights regarding the role of economic institutions in human history:

> Institutions . . . are the humanly devised constraints that shape human interaction. . . . [T]hey structure incentives in human exchange . . . . Institutional change [therefore] shapes the way societies evolve through time and hence is the key to understanding historical change.[338]

Whatever uncertainty may inure to the benefit corporation legal entity in its present date, one thing does appear certain: it will participate, and perhaps serve as centerpiece, in the evolution of twentieth-century capitalist society to a twenty-first-century shared-value society.[339] This Article has encouraged courts and legislatures to facilitate the shared-value evolution by accepting the recommendations contained herein.

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338 NORTH, *supra* note 1, at 3.

339 We could not close without issuing the obligatory bow to Porter. *See* Michael E. Porter & Mark R. Kramer, *Creating Shared Value*, HARV. BUS. REV., Jan./Feb. 2011, at 62.