Insight

The Benefit Corporation: Does It Benefit For-Profit Entrepreneurs?

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According to B Lab, a nonprofit whose mission is to use the power of business to solve social and environmental problems, the "benefit corporation," a new variant of the traditional legal form of the American public corporation has been enacted into law in 15 states and the District of Columbia since 2010. Moreover, benefit corporation legislation has been recently introduced in a dozen state legislatures.

Why all this public policy interest in the benefit corporation? A primary motivation is the growing phenomenon of for-profit social entrepreneurs – what *Forbes* magazine defines "as a person who uses business to solve social issues." Net Impact, a San Francisco-based nonprofit, is illustrative of the growth of for-profit social entrepreneurs. Established to use business to improve the world, Net Impact presently has some 15,000 student and professional members in over 240 chapters.

Advocates of the benefit corporate form argue that it offers a legal alternative to the traditional public corporation structure. The latter is said to not be designed to address the needs of for-profit entrepreneurs whose social and environmental purpose is central to their businesses existence. The three major provisions common in benefit corporation legislation include: a corporate purpose to create a material positive impact on the greater society; expanded fiduciary duties of directors requiring consideration of non-financial interests; and an obligation to report on the entity's overall social and environmental performance as assessed against a credible, independent and transparent third-party standard.

The shareholder maximization perspective, often identified with the traditional view of the American public corporation, was famously argued by Nobel Prize winning economist Milton Friedman who posited that the social responsibility of business is to maximize profits for owners or shareholders while operating within the basic rules of society, embodied both in law and ethical custom. In contrast, the stakeholder management perspective, a non-traditional view of the modern corporation, refers to persons and groups that affect, or are affected by, a business enterprise's decisions, policies, and operations. Stakeholders, for example, may consist of creditors, customers, distributors, employees, governments, industry associations, the media, non-governmental organizations, shareholders, and suppliers. The benefit corporation statute explicitly adopts a stakeholder perspective in identifying to whom the enterprise is to socially benefit, including those with a non-financial interest in the corporate entity.

While the shareholder maximization perspective was initially advanced by economists, the evidence to support its primacy in corporation law is spurious. As Harvard Law Professor Lynn Stout, a corporation law scholar argues in her recent book, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public*, "U.S. corporate law does not, and never has, required directors of public corporations to maximize shareholder value." Thus, from a corporate governance perspective, corporation law does not require managers or directors to adhere to maximizing shareholder value as their prime directive. Furthermore, under the business judgment rule, directors are given wide latitude (and limited liability) in what and whom they consider in their decision-making, as long they take all reasonable measures to evaluate their decisions. Moreover, 33 states have passed constituency statutes which explicitly permit directors to consider non-shareholder stakeholders, such as communities, consumers, creditors, and employees, in fulfilling their fiduciary duties. The operative word in these statutes is they “may” consider the interests of stakeholders other than shareholders, but are not mandated to consider their interests.

Yet serious questions remain about benefit corporation requirements. Is this alleged need by for-profit social entrepreneurs for legal “certainty” outweighed by the mandatory requirements under Benefit Corporation Model Legislation for directors and management to consider the effects of any action or inaction upon a list of stakeholders? Even though the benefit corporation is required to deliver an annual benefit report that includes a “credible” third-party assessment of its overall social and environmental performance to shareholders and to state government, how is the benefit corporation held accountable for maintaining its legal corporate form? What of the threat of shareholders' rights to bring legal action against a director or officer of the benefit corporation because they failed to create the specific public benefit purposes, or failed to adequately consider the interests of the various stakeholders identified in the statute, or failed to meet the transparency requirements set forth in the statute?

In considering the benefit corporation form, for-profit social entrepreneurs need to carefully evaluate their incorporation options, as this decision potentially may place limitations on their business plans and opportunities. Under the business judgment rule, the existing Model Business Corporation Act allows board directors the flexibility to consider the interests of non-shareholder constituencies. Under constituency statutes, board directors have the flexibility to consider, or not consider, a variety of stakeholder interests. Board decision-making flexibility is critical for directors to effectively carry out their fiduciary duties and responsibilities, including assessing those relevant stakeholder interests sustaining the corporation's long-term economic viability.

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