Benefit Corporations: A Persisting and Heightened Conflict for Directors

Gil Lan*

NOTE: A finalized version of this essay is published in 21 JOURNAL OF LAW, BUSINESS & ETHICS 113 (2015)

In the United States, social enterprises are commonly based upon the goal of operating a business that prioritizes the attainment of social good over profit maximization.[1] Although this concept has a long history in the U.S., it is only recently that state legislatures have provided a new corporate form – the benefit corporation[2] – to promote the pursuit of social enterprise. In this essay, I submit that benefit corporation legislation, despite its good intentions, results in a potential heightened sense of conflict for ethically-minded directors who seek to advance the best interests of their corporations. Further, the conflict that is faced by benefit corporation directors is significantly different than those faced by their traditional corporation counterparts.

The increasing prominence of the U.S. social enterprise movement is evidenced by the recent proliferation of benefit corporation legislation – currently, over 27 states have enacted some form of benefit corporation legislation.[3] Although there are slight differences, substantively the benefit corporation statutes of these states are very similar (many of which are based on a model developed by B Lab, a non-profit organization).[4] Unlike charities or other not-for-profit entities, benefit corporations do not prohibit the distribution of profit to investors such as shareholders but, instead, mandate that directors consider the benefit corporation's stated social mission when making managerial decisions.[5] In so doing, benefit corporation legislation attempts to side-step the decades of U.S. debate over whether directors of the traditional

---

* Assistant Professor, Law and Business Department, Ted Rogers School of Management, Ryerson University. The author thanks the editors of the Journal of Law, Business & Ethics for their helpful suggestions including the provision of names for the three problems associated with benefit corporations discussed in this essay. The author is also grateful to his colleagues Asher Alkoby and Chris MacDonald for their insightful comments on earlier drafts of this essay.

[1] *See, e.g.*, *About Social Enterprise*, SOCIAL ENTERPRISE ALLIANCE, https://www.se-alliance.org/about#ourrole (last visited Oct.5, 2014) ("Social enterprises are businesses whose primary purpose is the common good. They use the methods and disciplines of business and the power of the marketplace to advance their social, environmental and human justice agendas.").

[2] *See generally* William H. Clark & Elizabeth K. Babson, *How Benefit Corporations are Redefining the Purpose of Business Corporations*, 38 WM. MITCHELL L. REV. 817 (2012) (discussing the recent appearance of benefit corporations and its impact).

[3] *See Legislation*, B LAB, http://www.bcorporation.net/what-are-b-corps/legislation (last visited Oct.5, 2014), (also noting that 14 states are currently considering passing benefit-corporation legislation and that Delaware, an extremely important jurisdiction for corporations, recently passed its own form of benefit corporation legislation).

[4] *See* Janine S. Hiller, *The Benefit Corporation and Corporate Social Responsibility*, 118 J. BUS. ETHICS 287 (2013) (summarizing the various forms of benefit-corporation legislation).

[5] *Id.* at 292.

Electronic copy available at: https://ssrn.com/abstract=3731215

corporation breach their fiduciary duty if they consider values other than shareholder wealth maximization[6] (which is often conflated with profit maximization). In fact, benefit corporation statutes commonly state that directors will not be liable if they consider a broader constituent of stakeholders or values beyond shareholder value.[7] This is significant because of the perception by social entrepreneurs that traditional for-profit corporations restricted their ability to engage in social enterprise by exposing them to legal liability for deviating from shareholder value maximization norms.[8]

Statutorily mandating that directors "consider" socially-minded values as part of the corporation's mission is praise-worthy from a progressive perspective. Yet this approach creates three related problems with respect to directors' duties. The first problem is the "No Guidance Problem." These statutes provide no guidance to directors regarding how to choose or prioritize between the various stakeholder considerations before them. The legislation simply lists the relevant considerations in broad terms.[9] From a skeptical perspective, such vagueness could simply serve as a cloak for self-interested directors who further their own agenda under the guise of some abstract notion of public benefit.[10] However, the focus of this essay is not on the self-interested director, an important topic which has already been addressed by scholars. I focus on the ethically minded director who seeks to discharge her duty to advance the best interests of the benefit corporation in good faith. The lack of guidance also poses a problem for the ethical director because she is now required to choose between various stakeholder interests. The uncertainty engendered not only poses a dilemma for the director but also negatively impacts the corporation since managerial decision-making resources may be disproportionately devoted to stakeholder balancing instead of operational matters.

The second problem is the "Expanded Conflict of Interest Problem." I submit that the first problem (No Guidance) is compounded by a potentially heightened sense of conflict that exists in the benefit corporation. In the traditional corporation, the classical director's conflict of

---

[6] For a discussion of this long-standing debate see Lisa M. Fairfax, *The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms*, 31 J. CORP. L. 675 (2006); *see also* Ian B. Lee, *Efficiency and Ethics in the Debate about Shareholder Privacy*, 31 DEL. J. CORP. L. 533 (2006) (arguing that corporate law does not and should not remain focused on shareholder primacy).

[7]Clark & Babson, *supra* note 2 at 848. *See also, e.g.*, VT. STAT. ANN. Tit. 11A § 21.09(b)-(d) (stating in broad terms that directors will not be liable for consideration of broader stakeholder interests).

[8] The situation faced by the founders of Ben and Jerry's is now a classic example of this dilemma, *see* Antony Page & Robert A. Katz, *Freezing Out Ben & Jerry: Corporate Law and the Sale of a Social Enterprise Icon*, 35 VT. L. REV. (2011).

[9] The model legislation, upon which many state benefit corporation statutes are derived, merely lists the relevant considerations. *See Model Benefit Corporation Legislation*, B LAB (Apr. 10, 2013), *available at* http://benefitcorp.net/storage/documents/Model_Benefit_Corporation_Legislation.pdf (§ 301 states that the relevant interests include "shareholders," "employees," "customers," the "community" and "environment," as well as "short-term and long-term interests of the benefit corporation"). *See also* Hiller, *supra* note 4 at 293-94 (discussing the considerations required of directors).

[10] For an analogous observation regarding the traditional corporation see, *e.g.,* Andrew Keay, *Stakeholder Theory in Corporate Law: Has it Got What it Takes?*, 9 RICH. J. GLOBAL L. & BUS. 249, 277-290 (2010).

Electronic copy available at: https://ssrn.com/abstract=3731215

interest addressed by the law has been the self-interested director profiting at the expense of the corporation.[11] For example, a director who causes the corporation to purchase goods from a business that she owns would be in a conflict of interest because the director's interest (selling the goods at the highest price) runs counter the corporation's interest (obtaining the goods at the lowest price). For this reason, the law has imposed fiduciary duties in these situations upon the director to act in the corporation's best interest.[12] Since shareholders have a stake in the corporation's fate, including the depletion of assets or profits by directors, it is not surprising that the law allows them to bring a derivative action on behalf of the corporation to enforce the director's fiduciary duties.

However, the situation in a benefit corporation has an interesting twist. Since the law requires the director of a benefit corporation to consider public benefits,[13] there lies the real potential for a subtle but significant conflict of interest to arise. This conflict arises from the director's own interest in being re-elected by incumbent shareholders who may perhaps value their own monetary gain *over the stated mission of the benefit corporation*. For example, assume there has been a financial recession and shareholders who were once quite generously-minded now desire to recoup some of their investment in a benefit corporation. These shareholders might voice a desire to be paid dividends.[14] What if the director, having considered all stakeholders, comes to the conclusion that the benefit corporation's best interest is served by investing in pollution-reducing measures at its factory?[15] What if the director proposes that these measures will be funded by laying off some employees and not declaring dividends in the upcoming fiscal year?

From a legal liability perspective, the legislation makes it clear that directors will not be liable for their consideration of public benefits.[16] However, despite the inclusion of broader stakeholder values in a benefit corporation, ultimately, it is only the shareholders who elect the board of directors.[17] Failure to keep shareholders happy, regardless of what the benefit corporation's articles might say, can result in the director losing her position at the next shareholder meeting. The drafting of benefit corporation legislation makes it relatively easy for the director to side with shareholders in this hypothetical because the law only requires that the

---

[11] *See* Andrew Gold, *The New Concept of Loyalty in Corporate Law*, 43 U.C. DAVIS L. REV. 457, 459 (2009) ("A director's duty of loyalty has long been a core feature of corporate jurisprudence. The standard features of this loyalty requirement are also straightforward: it is typically implicated when directors engage in self-dealing or when they take personal benefits if those benefits are not shared with all of the shareholders.").

[12] *Cf. id.* at 460.

[13] Clark & Babson, *supra* note 2 at 840.

[14] For a general discussion of director's discretion to issue dividends see FRANKLIN A. GEVURTZ, HORNBOOK SERIES: CORPORATION LAW, 153-157, (2d ed. 2010).

[15] Generally speaking, the directors have managerial control over the corporation as is classically stated under Delaware law. *See* DEL. CODE ANN. tit. 8, § 141(a) (2014).

[16] *See* Clark & Babson, *supra* note 2 at 848-49

[17] *See, e.g.*, DEL. CODE ANN. tit. 8 § 211(b) (2014) (generally providing for the election of directors by shareholders).

Electronic copy available at: https://ssrn.com/abstract=3731215

director consider these other stakeholder values and does not prescribe any particular result.[18] Thus, the ambiguity behind the term "consider" can act as a screen where a self-interested director could side with shareholders against her actual consideration of what is in the best interest of the benefit corporation as expressed in its articles.

Yet, for the ethically-minded director, this poses a conflict of interest dilemma. The obligation to consider public benefits in managerial decisions is not merely the whim of the shareholders who incorporated the benefit corporation. It is part of the statute. Directors have an ethical obligation to also obey the law.[19] The legal requirement to "consider" should not be regarded as a sham but evidence of legislative intent that the director should do so in good faith.[20] If the director's good faith consideration of various stakeholder values runs contrary to the present shareholders' desires, the director is faced with the choice of placating the shareholders (thus, securing the director's own interest) versus the obligation to comply with the law (by making a consideration in good faith).[21] This is quite different from classical conflict of interest scenarios where self-interested director's actions could be clearly seen to run counter to shareholder interest. In this case, *the self-interest of the director is aligned with the shareholder interest versus the clearly stated general public interest* (as expressed in the statute as well as the corporation's own articles).

Thus, the third problem emerges: "The Unrepresented Public Interest Problem." The traditional method of imposing fiduciary duties to be enforced by primarily shareholders via derivative action is unlikely to be effective in the hypothetical presented here. Ironically, from the perspective of the general public interest, under benefit corporation legislation generally, the only persons who can bring a benefit-enforcement proceeding (i.e. to compel the corporation to pursue its stated public benefits) are shareholders, directors and the corporation itself[22] – again, hardly a realistic solution to the hypothetical presented here.

Is there a solution to this ethical quagmire for directors of benefit corporations?[23] There has been some advancement in the State of New York which now explicitly requires that benefit

---

[18] Clark & Babson, *supra* note 2, at 850.

[19] *Cf.* Gold, *supra* note 11, at 461 (noting that the director's duty of loyalty is constrained by "the legal bar on deception and illegality as a means to benefit shareholders").

[20] *Id. at* 484 (summarizing the duty of good faith and its connection to the duty of loyalty as articulated under Delaware corporate jurisprudence).

[21] *See* J. William Callison, *Benefit Corporations, Innovation and Statutory Design*, REGENT U. L. REV. 143, 153 (2013) ("Further, shareholders fire and hire directors and it is likely that when private shareholder benefit and broader public benefit collide, many directors will "follow the money" and align with shareholder interests.").

[22] *See* Hiller, *supra* note 4 at 294 (remarking that different states have slightly differing provisions while referring to B Lab's model legislation). In any event, the model legislation by B Lab states that public beneficiaries (i.e., non-shareholder stakeholders) do not have standing to sue unless specifically authorized in the articles or by-laws. *See* B Lab's Model Legislation, *supra* note 9, at § 305.

[23] Even in a traditional corporation, the challenge is formidable enough when one considers an ethical duty to account for the long-term sustainability of the corporation. *See* Bradford P. Anderson, *Corporate Sustainability: A Long-Term Perspective on Maximizing Shareholder Value,* J. L. BUS. & ETHICS, 155 (2014).

Electronic copy available at: https://ssrn.com/abstract=3731215

corporations give priority to public benefits over other considerations.[24] While this represents a modest advancement, it remains to be seen how well this actually will assist an ethically-minded director faced with re-election worries. Traditional common-law remedies, which centered on shareholder enfranchisement, appear to be ill-suited to deal with the hypothetical dilemma presented here. The shareholders' interests are protectable by statutory means, but there is no such protection for the general public interest. This suggests a research agenda for legal scholars that explores alternative governance structures such as a higher degree of government monitoring and more robust transparency that may detect whether ethically-minded directors are being punished by shareholders, directly or indirectly, for their adherence to benefit corporation legislation.

[24] For a short discussion, see Dana Brakman Reiser, *Theorizing Forms for Social Enterprise*, EMORY L. J. 681, 695-696 (2013).

Electronic copy available at: https://ssrn.com/abstract=3731215