1-1-2015

A Skeptic's View of Benefit Corporations

Kent Greenfield
kent.greenfield@bc.edu

A SKEPTIC'S VIEW OF BENEFIT CORPORATIONS

Kent Greenfield[*]

The harm that can flow from businesses pursuing profits above all else has become more obvious over the last few years. The global financial crisis, the Deep Horizon well disaster, and the factory collapse of Bangladesh all show the dangers of allowing businesses to focus on profit while ignoring externalities and potential risks.

We are in the midst of a historical moment in which some of the core ideas of business, and of the law that governs it, is being reconsidered. What are corporations for? Do they owe responsibilities to stakeholders other than shareholders? To society in general?

There is something of a bandwagon effect occurring now around the notion that a narrow focus in corporate boardrooms on shareholder interest and shareholder profit is not only bad for society as a whole but also bad for shareholders. An article in the *Harvard Business Review* last year proclaimed that "there's a growing body of evidence . . . that the companies that are most successful at maximizing shareholder value over time are those that aim toward goals other than maximizing shareholder value. Employees and customers often know more about and have more of a long-term commitment to a company than shareholders do."[1] Joe Nocera, a popular, non-business, essayist in *The New York Times* wrote that "it feels as if we are at the dawn of a new movement—one aimed at overturning the hegemony of shareholder value."[2]

This rethinking is most obvious around the issue of "benefit corporations," a new type of business classification increasingly popular around the country. Benefit corporations are for-profit corporations that are also required to create "a material, positive impact on society and the environment and to meet higher

---

[*] Kent Greenfield is Professor of Law and Dean's Research Scholar at Boston College Law School, where he teaches courses in business law and constitutional law. He is the former chair of the Business Associations Section of the Association of American Law Schools and the author of the book THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES.

[1] Justin Fox & Jay W. Lorsch, *What Good Are Shareholders?*, 90 HARV. BUS. REV. 49, 57 (2012).

[2] Joe Nocera, *Down with Shareholder Value*, N.Y. TIMES, Aug. 10, 2010, *available at* http://www.nytimes.com/2012/08/11/opinion/nocera-down-with-shareholder-value.html?_r=0.

standards of accountability and transparency."[3] At the time of this writing, eighteen states—including Massachusetts, Rhode Island, and Vermont—have adopted legislation allowing corporations to opt-in to the benefit corporation framework of obligations. Even Delaware, the most popular state for business incorporations, recently adopted a benefit corporation statute.

The supporters of benefit corporations argue that the framework will liberate businesses from the market demands of Wall Street and the legal demands of shareholder plaintiffs seeking to hold management accountable for decisions that fail to put shareholder interests first. They also say that companies choosing the status can brand themselves as green and society-minded. (Patagonia recently opted-in to benefit corporation status, a good test for this branding strategy.)

My own work as a legal scholar for almost two decades has focused on the very problems that motivate the move toward benefit corporations. I believe short-term shareholder focus creates risks for both corporations and society. I have argued that the fiduciary duties of corporations and their managers should run toward a broader set of the company stakeholders.

But I am a skeptic of benefit corporations. Here's why.

* <u>They are voluntary</u>. Once corporations opt-in to the framework, a set of requirements kick in. But the decision to opt-in is voluntary, which means that the corporations that most need the strictures of the framework are the least likely to opt-in.

* <u>They are based on a misreading of the law</u>. Under current law, courts are quite deferential to the decisions of management. Under the "business judgment rule," courts will only set aside the decisions of management if they are tainted with self-interest or grossly misinformed. (And then only rarely.) So under current law, if a board wants to support charitable causes, pay employees more, or voluntarily reduce pollutive emissions, there is no doubt that they can do so without fearing legal recourse.

* <u>They don't add much.</u> What's more, most states make this freedom explicit in the corporate statute. In Massachusetts, for example, the statute for run-of-the mill business corporations includes a provision stating that directors may, in discharging their duties, "consider the interests of the corporation's employees, suppliers, creditors and customers, the economy of the state, the

---

[3] BENEFIT CORP INFORMATION CENTER (Jan. 11, 2014), http://www.benefitcorp.net.

region and the nation, community and societal considerations, and the long-term and short-term interests of the corporation and its shareholders."[4] The problem, then, is not that managers are not permitted to act with an ~~an~~ eye toward society. The problem is that they are not required to do so. Benefits corporation statutes do not solve this problem.

* They do not protect companies from market pressure. Because not all companies will choose to become benefit corporations, those that do will suffer competitive disadvantage in the capital market, at least in the short term. Some shareholders may accept the lower returns implicit in the benefit corporation framework, but most will not. So the cost of capital will be higher for benefit corporations than for their non-benefit competitors. The problem with this is that over time, a focus on values other than shareholder profit will appear to be hurtful to a company's fortunes. The way to make sure attentiveness to social needs won't hurt a company? Level the playing field to mandate such attentiveness by all corporations. This, of course, is not what benefit corporation statutes do.

* They might embolden other companies to act poorly. Advocates of benefit corporations say that without such a framework, companies might be punished for doing the right thing. As I explain above, I think that's a misreading of the law. But a lot of people believe it, and the creation of benefit corporation statutes will strengthen the misconception. The result? Companies that do not choose to become benefit corporations—that is, most of them—will be able to say to shareholder, consumer, and community activists that they should take their concerns elsewhere. In a way, a company's decision to not choose benefit corporation status will amount to a branding strategy as well, but the opposite of what the benefit corporation stands for. Wall Street will love it, and managers of those companies will be encouraged to act even worse than they do now.

* They distract from other, more fundamental changes. You've guessed by now that my problem with benefit corporations is not that they do too much but that they do too little. There are a range of more fundamental changes to corporate governance that are attainable in this historical moment, and I fear that an emphasis on benefit corporations will take the air out of the reform balloon. We could require all corporations to take into account the concerns and interests of all their important stakeholders; we could require corporations

[4] MASS. GEN. LAWS ch. 156D, § 8.30 (2004).

to tell the truth to their employees; we could require major corporations to include employee representatives on their boards, as is the case in many countries in Europe. These changes in corporate governance could create significant benefits to corporations and to society more broadly. A statute creating a new framework for some companies, and only those that choose it, is merely treading water.

* They might create weird free speech implications. Finally, I have an additional worry created by recent Supreme Court cases about free speech. The Court's 2010 decision in *Citizens United v. Federal Election Commission* protected the First Amendment rights of for-profit corporations to engage in political activity. Ten years earlier, the Court ruled in *Boy Scouts v. Dale* that some non-profits have a First Amendment right to have anti-discrimination laws not apply to them, if the forced inclusion of certain individuals would be against the group's beliefs. Now consider how these cases could work together in the context of a benefit corporation that stated a belief that, for example, homosexuality is an abomination (remember a certain fast-food chicken sandwich company?) or that the Affordable Care Act's mandate that companies provide health insurance that includes contraceptive care violates their belief in the sanctity of life. I think it is a reasonable fear that companies organized as benefit corporations could, if they chose to, claim a First Amendment-based exception to otherwise applicable anti-discrimination laws or insurance mandates. This would certainly be an unintended consequence of the benefit corporation statutes, but I think it is a real possibility that corporations win such cases in the near future.[5]

So all in all, I believe the motivation behind benefit corporations is nothing but laudable. I, too, believe that we need to figure out how to rein in the worst excesses of corporations, while empowering corporations and those who manage them to act with a broader and more robust sense of fiduciary duty. I, too, believe the current legal framework contains fundamental flaws.

---

[5] *See, e.g.*, Conestoga Wood Specialties Corp. v. Sec'y of U.S. Dep't of Health & Human Servs., 724 F.3d 377 (3d Cir. 2013) (holding, 2–1, that corporations may not claim Free Exercise rights), *cert. granted*, 134 S. Ct. 678 (2013). For a discussion concerning a corporation's nonfinancial interests, see *id.* at 389–405 (Jordan, J., dissenting) (arguing that some corporations have interests beyond the financial, pointing to benefit corporations to "undermine the narrow view that all for-profit corporations are concerned with profit maximization alone."). Conestoga Wood has been consolidated for Supreme Court review with Sebelius v. Hobby Lobby Stores, 723 F.3d 1114 (10th Cir. 2013); the cases were argued on March 25, 2014, but yet decided at the time of this writing.

But I am skeptical of the power of benefit corporation statutes to make genuine advances here. If we are in need of a genuine re-thinking, I think we need to be bolder.