

NECESSITY IS THE MOTHER OF INVENTION: A RENEWED CALL TO ENGAGE THE SEC ON SOCIAL DISCLOSURE

Alexandra Leavy*

Corporate law in the United States is undergoing a significant but understated revolution. Delaware is one of nineteen states to adopt the benefit corporation, a corporate form that legally facilitates the pursuit of both financial and social ends. While the existing state statutes incorporate mandatory disclosure regimes, they lack the enforcement mechanisms necessary to guarantee the accuracy of benefit reports and are not sufficiently uniform to allow investors to make informed decisions. As such, this Note argues that the Securities and Exchange Commission (“SEC” or “Commission”) ought to amend its proxy disclosure and periodic reporting rules to ensure that registrants incorporated under benefit statutes provide substantial information about their social impact.

Mandatory social disclosure has been rejected in the past—the condition of “materiality” has long governed corporate disclosure. The recent enactment of the Delaware benefit corporation suggests that some benefit corporations will become public companies. Thus, for the first time, social impact has become a legal obligation of corporate status, effectively expanding the scope of what is “material” to investors. The SEC’s broad investor protection mandate and

* J.D. Candidate 2015, Columbia Law School; B.A. 2010, University of Pennsylvania. The author would like to thank Professor Harvey J. Goldschmid for his unwavering support and guidance throughout the writing process. She would also like to thank Professor Robert J. Jackson, Jr. for much-needed inspiration and the entire *Columbia Business Law Review* staff for their assistance in preparing this Note for publication. Finally, she would like to thank her parents for their unconditional support throughout law school and all of her other pursuits.

its history of regulating financial disclosure put the Commission in the best position to introduce a social impact disclosure regime for publicly traded benefit corporations. Such a regime has the ability to preserve the benefit corporation as a legitimate corporate form and, importantly, legitimize its dual mission of purpose and profits.

I.	Introduction	464
II.	The Emergence of the Benefit Corporation.....	468
	A. The Traditional For-Profit/Nonprofit Divide	468
	B. Preexisting Hybrid Forms.....	476
	1. The Low-Profit Limited Liability Company ("L3C")	476
	2. The Flexible Purpose Corporation ("FPC")....	479
	3. The Social Purpose Corporation ("SPC")	482
	C. The Public Benefit Corporation ("B-Corp").....	483
III.	Investor Protections for Public Benefit Corporations.....	488
	A. Corporate Social Responsibility and the Traditional Corporate Form.....	490
	B. The Securities Acts and Current SEC Disclosure Rules	496
IV.	A Proposed Benefit Regime for the SEC	502
V.	Conclusion.....	510

I. INTRODUCTION

On July 17, 2013, Delaware became the nineteenth state to pass legislation adopting the public benefit corporation ("B-Corp") as a legal corporate form.¹ Some might argue the

¹ These states include Arizona, Arkansas, California, Colorado, Delaware, Hawaii, Illinois, Louisiana, Maryland, Massachusetts, Nevada, New Jersey, New York, Oregon, Pennsylvania (HB 1616), Rhode Island, South Carolina, Vermont, Virginia, and the District of Columbia. *State by State Legislative Status*, BENEFIT CORP INFO. CTR., <http://www.benefitcorp.net/state-by-state-legislative-status> (last visited Apr. 23, 2014).

United States is heading towards a corporate revolution.² This type of change has not occurred since the introduction of the limited liability company (“LLC”) in the 1970s—and even then it took more than twenty years for every state to pass legislation adopting the LLC form.³ Today, LLC formation outpaces corporate formation by almost two to one.⁴ No doubt, passage of B-Corp legislation in Delaware marks a significant milestone; the state is home to half of all publicly traded companies,⁵ most venture-backed businesses, and nearly two-thirds of Fortune 500 companies.⁶ It is a signal to remaining states that the business community believes in choice and has confidence in the potential of businesses to be a force for social change.⁷ Governor Jack Markell remarked that many businesses “feel understandably constrained by existing corporate law that recognizes only one legitimate corporate purpose—to maximize value for shareholders.”⁸ The public benefit corporation will counter the “plague of short termism” that led our country to financial disaster six years ago by mandating that directors balance the interests of

² See Robert T. Esposito, *The Social Enterprise Revolution in Corporate Law: A Primer on Emerging Corporate Entities in Europe and the United States and the Case for the Benefit Corporation*, 4 WM. & MARY BUS. L. REV. 639, 642 (2013).

³ See Deborah Sweeney, *Are Benefit Corporations the New Limited Liability Company?*, HUFFPOST BUS. (Aug. 28, 2013, 5:02 PM), http://www.huffingtonpost.com/deborah-sweeney/are-benefit-corporations_b_3819590.html.

⁴ *Id.*

⁵ Daniel Fisher, *Delaware ‘Public Benefit Corporation’ Lets Directors Serve Three Masters Instead of One*, FORBES (July 16, 2013, 2:06 PM), <http://www.forbes.com/sites/danielfisher/2013/07/16/delaware-public-benefit-corporation-lets-directors-serve-three-masters-instead-of-one/>.

⁶ Mike Hower, *Record 17 Companies Register as Delaware’s First Benefit Corporations*, TRIPLE PUNDIT (Aug. 5, 2013), <http://www.triplepundit.com/2013/08/delaware-benefit-corporations/>.

⁷ See *id.*

⁸ Jack Markell, *A New Kind of Corporation to Harness the Power of Private Enterprise for Public Benefit*, HUFFPOST BUS. (July 22, 2013, 2:06 PM), http://www.huffingtonpost.com/gov-jack-markell/public-benefit-corporation_b_3635752.html.

shareholders against the interests of other stakeholders.⁹ While we cannot expect to see a rapid transformation of existing companies from traditional corporation (“C-Corp”) to benefit corporation status, we can expect new companies to incorporate as such.¹⁰

The benefit corporation is not the first type of entity to address demand for a legal form that facilitates the pursuit of both financial and social ends. The low-profit limited liability company (“L3C”) is a modified form of the LLC¹¹ that has been adopted in eight states.¹² Additionally, in January 2012, California enacted the Flexible Purpose Corporation (“Flex-C”), which allows companies to assume one or more special purposes they consider beneficial to society.¹³ In June 2012, Washington enacted a similar form, the Social Purpose Corporation, which allows companies to

⁹ Markell, *supra* note 8.

¹⁰ Under the Delaware statute, ninety percent of shareholders must approve a shift to public benefit status. See DEL. CODE ANN. tit. 8, § 363(a) (West, Westlaw through 2014 No. 95); cf. Kyle Westaway, *Benefit Corporations: Can Investors Have Their Cake and Eat It?*, GUARDIAN PROF. (Aug. 14, 2013, 1:21 PM), <http://www.theguardian.com/sustainable-business/benefit-corporations-sustainability-investors> (noting skepticism on the part of some investors who believe it is difficult to successfully pursue both profit and purpose).

¹¹ The primary aim of the L3C is to attract program-related investments (“PRIs”) from both the private and public sectors by taking advantage of the tax benefits already granted to PRIs. See Edward Xia, Note, *Can the L3C Spur Private Foundation Program-Related Investment?*, 2013 COLUM. BUS. L. REV. 242, 244 (2013). See also 26 U.S.C. § 4944(c) (2012).

¹² See Cass Brewer, *Hybrid Business Entities in 2014*, SOCENTLAW (Jan. 6, 2014), <http://socentlaw.com/2014/01/hybrid-business-entities-in-2014/>.

¹³ Like the benefit corporation, the Flex-C permits directors to consider objectives other than the maximization of shareholder profit—objectives that often become *the* dominant consideration. Deborah Sweeney, *The Good of Flexible Purpose Corporations*, TRIPLE PUNDIT (Nov. 12, 2012), <http://www.triplepundit.com/2012/11/good-flexible-purpose-corporations/>.

pursue profits along with general and specific social goals of their choice.¹⁴

Notwithstanding these developments, the benefit corporation is the most popular of these hybrid forms. In addition to the nineteen aforementioned states that have already passed B-Corp legislation, fifteen have legislation currently pending.¹⁵ However, many critics have questioned whether the current B-Corp statutes are sufficiently detailed to ensure the legitimacy of the corporate form. They point to the benefit disclosure regimes required by all of the statutes and argue that, in allowing directors to determine the content and the breadth of the so-called “annual benefit reports,” the statutes do not contain measures to ensure that the reporting is accurate.¹⁶ While some statutes require the use of a third-party standard¹⁷ and others do not, directors may select and implement the standard in ways that frustrate its purpose.

the selection and use of the standard can be problematic.¹⁸ This Note adopts the critics’ position and suggests that a centralized disclosure regime is necessary to safeguard both the accuracy of annual benefit reports and the accountability of B-Corp directors.

This Note also reasons that, in light of the recent Delaware legislation, some B-Corps will become public

¹⁴ See *What are SPCs?*, SPCWA, <http://www.spcwa.com/what-are-spcs/> (last visited Apr. 23, 2014).

¹⁵ *State by State Legislative Status*, *supra* note 1.

¹⁶ See Esposito, *supra* note 2, at 701–02; Steven Munch, Note, *Improving the Benefit Corporation: How Traditional Governance Mechanisms Can Enhance the Innovative New Business Form*, 7 NW. J.L. & SOC. POL’Y 170, 194 (2012).

¹⁷ A third-party standard is defined as “a standard for defining, reporting, and assessing overall corporate social and environmental performance.” *How Do I Select a Third Party Standard?*, BENEFIT CORP INFO. CTR., <http://benefitcorp.net/third-party-standards> (last visited Apr. 23, 2014). See *infra* note 137 for examples of particular state statutes.

¹⁸ See Katherine R. Lofft, Purvi B. Maniar & Tamar R. Rosenberg, *Are Hybrids Really More Efficient? A ‘Drive-By’ Analysis of Alternative Company Structures*, BUS. L. TODAY, Sept. 2012, at 1, 2–3.

companies.¹⁹ As such, the Securities and Exchange Commission (“SEC”) should amend its proxy disclosure and periodic reporting rules to ensure that registrants incorporated under benefit statutes provide substantial information about their social impact. If the SEC were to create a uniform disclosure regime similar to the periodic reporting regime already in place for public companies, the public could confidently assess their socially conscious investment decisions and hold management accountable for its actions.

Part II of this Note outlines the history of the benefit corporation and the reasons for its emergence. It also analyzes existing hybrid forms and their deficiencies, both generally and in relation to their disclosure regimes. Part III discusses why the introduction of the benefit corporation calls for the expansion of investor protections. Section A provides an overview of corporate social responsibility (“CSR”) in the traditional corporate form and explains how corporations have been able to undertake such activity within the scope of directors’ prescribed fiduciary duties. Section B describes SEC disclosure rules and how they lack essential language obligating companies to provide substantive reports on their corporate social activities. Finally, Part IV describes a potential benefit disclosure regime for the SEC and addresses possible objections.

II. THE EMERGENCE OF THE BENEFIT CORPORATION

A. The Traditional For-Profit/Nonprofit Divide

The B-Corp and other hybrid forms are largely the product of the United States’ conventional approach to corporate structure, which has historically afforded

¹⁹ Any company that intends to issue a security, or securities, on a national exchange must register with the SEC and comply with periodic reporting requirements under the Securities and Exchange Act of 1934. *See* 15 U.S.C. §§ 78l, 78m (2012). This includes all issuers with assets exceeding \$10,000,000 and shareholders in excess of 2000 in number (500 if they are not accredited investors). *See id.* § 78l(g).