STRANGE CREATURES: A HYBRID APPROACH TO FIDUCIARY DUTY IN BENEFIT CORPORATIONS

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Benefit corporations, or "B-corps," represent a new corporate legal form designed to accommodate the dual profit-making and public benefit goals of the social enterprise movement. A B-corp commits to pursue public benefit purposes in its articles of incorporation. Over the past year and a half, six states (including California and New York) have passed legislation that recognizes and regulates B-corps as a distinct species of business corporation. While these new statutes are well-intentioned, they create divided loyalties for corporate directors. B-corp statutes also appear to impose on B-corp directors a fiduciary duty in addition to the traditional duties of care and loyalty. However, the statutes fail to identify this duty and provide little guidance to courts called on to adjudicate claims for breach. This Note analyzes the treatment of directors' fiduciary duties in recently enacted B-corp statutes and in model legislation on which the statutes are based. This Note argues that B-corp directors owe an additional "duty of obedience" to the benefit purposes of the corporation, similar to that of directors of nonprofit organizations. Shareholders—and in some states, non-shareholder constituencies—may have derivative standing to sue for a breach of this duty. This Note also examines how the duty of obedience alters the factors that B-corp directors must consider in the context of a change-of-control transaction.

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> And Chee-Chee very proudly took the animal inside and showed him to the Doctor. "What in the world is it?'" asked John Dolittle, gazing at the strange creature. "Lord save us!" cried the duck. "How does it make up its mind?" "It doesn't look to me as though it had any," said Jip, the dog. "This, Doctor," said Chee-Chee, "is the pushmi-pullyu—the rarest animal of the African jungles, the only two-headed beast in the world!"[1]

I. INTRODUCTION

A. Social Enterprise and a New Corporate Form

In its pursuit of both business and public benefit aims, a social enterprise bears an obvious resemblance to Dr. Dolittle's famed two-headed llama.[2] Social enterprises seek to generate profits to reduce their reliance on charitable contributions and use business management techniques to maximize their operating efficiency.[3] Social entrepreneurs

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[1] HUGH LOFTING, THE STORY OF DOCTOR DOLITTLE 75 (Centenary ed., Bantam Doubleday Books 1998) (1920).

[2] *See, e.g.*, Stephanie Strom, *Hybrid Model for Nonprofits Hits Snags*, N.Y. TIMES, Oct. 25, 2010, at B1, *available at* http://www.nytimes.com/2010/10/26/business/26hybrid.html?pagewanted=all.

[3] *See* BRUCE R. HOPKINS, THE LAW OF TAX-EXEMPT ORGANIZATIONS 124 (9th ed. 2007) (describing social entrepreneurialism as "the open and accepted conduct of businesses by exempt organizations, on a for-profit basis, to the end of supplementing or even supplanting charitable contributions and grants"); COMMUNITY WEALTH VENTURES, INC., SOCIAL ENTERPRISE: A PORTRAIT OF THE FIELD 1 (2010), *available at* http://www.communitywealth.com/pdf-doc/Field%20Study%20FINAL%207.14.2010.pdf (describing a social enterprise as "an organization . . . that advances a social mission through market-based strategies"). *See generally* Barbara K. Bucholtz, *Doing Well by Doing Good and Vice Versa: Self-Sustaining NGO/Nonprofit Organizations*, 17 J.L. & POL'Y 403 (2009) (addressing the increased adoption of business approaches by nonprofit organizations); James J. Fishman, *Wrong Way Corrigan and Recent Developments in the Nonprofit Landscape: A Need for New Legal Approaches*, 76 FORDHAM L. REV. 567 (2007) (arguing that traditional nonprofit legal doctrines have not been successful); Thomas Kelley, *Law*

reject traditional boundaries between the business and nonprofit sectors. Led by corporate titans like Bill Gates, social entrepreneurs see themselves as business people, trying to deliver both financial and social benefits to a "double bottom line."[4]

The acceleration of the social enterprise movement[5] is creating new challenges for business lawyers. Existing legal doctrines and entity structures cannot adequately meet the

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and Choice of Entity on the Social Enterprise Frontier, 84 TUL. L. REV. 337, 340–41 (2009) (discussing the need for new legal structures).

[4] Kelley, *supra* note 3, at 339. Some social entrepreneurs speak of a "triple bottom line" which includes environmental benefits in addition to financial and social goals. *See id.*; John M. Conley & Cynthia A. Williams, *Engage, Embed, and Embellish: Theory Versus Practice in the Corporate Social Responsibility Movement*, 31 J. CORP. L. 1, 24 (2005).

[5] Several developments have spurred increased interest in social enterprises and socially responsible business practices in recent years. First, several high profile corporate philanthropic projects demonstrated the vast resources available to businesses to pursue socially beneficial goals. Perhaps the best example was the 2006 creation by Google, Inc. of a separate for-profit corporation, to invest in "planet-saving" products and to lobby Congress for policies to promote environmentally friendly technologies. *See Google.org—About Us*, GOOGLE.ORG, http://www.google.o rg/about.html (last visited Dec. 1, 2011); Kelley, *supra* note 3, at 344. Second, the global financial crisis called into question the traditional view that society was well-served by corporations whose only goal was to maximize shareholder value. *See* Celia R. Taylor, *Carpe Crisis: Capitalizing on the Breakdown of Capitalism to Consider the Creation of Social Businesses*, 54 N.Y.L. SCH. L. REV. 743, 745 (2009) (arguing that the global financial crisis created an opportunity to rethink the traditional role of businesses in advancing social welfare). Third, well-publicized scandals in the nonprofit sector suggested that charitable activities might be better conducted under the supervision of professional managers with access to business resources and infrastructure. *See* Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631, 633–35 (1998) (discussing improper use of funds by the presidents of the United Way of America and Adelphi University and other conversion transactions in the nonprofit sector). *But see* HOPKINS, *supra* note 3, at 124 (noting that tax-exempt organizations have long engaged in businesses that further their exempt purposes); Fishman, *supra* note 3, at 603–06 (arguing that social enterprise is merely a repackaging of old ideas about how to combine business and charitable aims).

needs of what are essentially hybrid organizations that fulfill both for-profit and nonprofit functions.[6] Social entrepreneurs are demanding new corporate forms and legal structures to facilitate their transformative plans.[7] As a result, states are passing new corporate organizational statutes[8] in an attempt to accommodate social enterprises.[9]

Benefit corporations, or "B-corps,"[10] represent the most recent[11] attempt to provide a legal structure specifically

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[6] Kelley, *supra* note 3, at 340–41. *See also Transcript of the January 19, 2007 ABA Tax Section Exempt Orgs. Comm. Meeting*, 56 EXEMPT ORG. TAX REV. 21, 60–61 (2007).

[7] Kelley, *supra* note 3, at 340–41. *See also* Robert A. Wexler, *Social Enterprise: A Legal Context*, 54 EXEMPT ORG. TAX REV. 233, 236, 244 (2006) (noting the legal challenges that social enterprises face due to their hybrid nature).

[8] *See, e.g.*, 2008 Vt. Acts & Resolves 106 (codified at VT. STAT. ANN. tit. 11, § 3001 (2011)) (authorizing the creation of low profit limited liability companies (or "L3C's")). An L3C is able to raise money from charitable foundations and then leverage those funds with money from for-profit private investors. *See* Daniel S. Kleinberger, *A Myth Deconstructed: The "Emperor's New Clothes" on the Low Profit Limited Liability Company* (William Mitchell Coll. of Law Legal Studies Research Paper Series, Working Paper No. 2010-03, 2010), *available at* http://ssrn.com/abstract=1554045 (discussing the Vermont L3C statute in detail and arguing that the structure is unnecessary and confusing).

[9] *See* Michael D. Gottesman, *From Cobblestones to Pavement: The Legal Road Forward for the Creation of Hybrid Social Organizations*, 26 YALE L. & POL'Y REV. 345, 351–58 (2007) (discussing various emerging legal structures).

[10] B-corps are not to be confused with "public benefit corporations." The latter are chartered by individual state statutes and typically provide a particular set of services to the public, such as operating a transportation system or public utility. *See, e.g.*, N.Y. PUB. AUTH. LAW § 1263 (McKinney 2011) (chartering the Metropolitan Transportation Authority (MTA) which operates the New York City subway system, among other activities). Public benefit corporations do share certain qualities with B-corps. In particular, public benefit corporations are chartered with a specific set of purposes that govern their activities. *See, e.g.*, Greene v. Long Island R.R. Co., 280 F.3d 224, 236 (2d Cir. 2002) (considering the powers and authority of the MTA in the context of its chartered purposes). *See also infra* notes 127–28 and accompanying text.

[11] As of September 30, 2011, five states had enacted B-corp legislation (Maryland and Vermont in 2010, and New Jersey, Virginia, and Hawaii in

suited for social enterprises.[12] B-corps are business corporations that also commit to provide benefits to the general public and/or to the environment. A B-corp differs from an ordinary "C" corporation in that it specifies its intended social benefits ("benefit purposes"), and commits to consider the interests of nonshareholder groups ("corporate constituencies"), in its corporate charter.[13] B-corps represent an extension of the accepted view that businesses may pursue social objectives such as corporate philanthropy even as they seek to maximize profits.[14]

While B-corps have noble aspirations, this new corporate form can only succeed if principles of fiduciary duty can reconcile the inevitable conflicts between business objectives and social obligations.[15] Imagine a hypothetical[16] B-corp—

2011). New York's B-corp bill passed both houses of the state legislature in June 2011 and, as of December 1, 2011, was awaiting the governor's signature. The California Assembly passed a B-corp bill in August 2011, and the governor signed it into law in October 2011. As of December 1, 2011, B-corp legislation was pending in four additional states (Colorado, Michigan, North Carolina, and Pennsylvania). *See infra* notes 21–25 and accompanying text. This Note focuses primarily on the Hawaii, Maryland, New Jersey, Vermont, and Virginia statutes and the text of the New York bill.

[12] *See* Gottesman, *supra* note 9, at 355–56 (but noting also that B-corps may fall within the framework of existing corporate law); Judd F. Sneirson, *Green is Good: Sustainability, Profitability, and a New Paradigm for Corporate Governance*, 94 IOWA L. REV. 987, 1017–18 & n.159 (2009) (comparing B-corp designation absent statutory authority to other private certification programs, such as "LEED" status for "green buildings").

[13] Persons who may benefit from a B-corp's benefit purposes and corporate constituencies whose interests B-corp directors are required to consider represent two distinct groups. *See infra* notes 28–29 and accompanying text.

[14] *See* PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01 (2005) (noting that all businesses may devote a "reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes").

[15] *See* Christopher M. Bruner, *The Enduring Ambivalence of Corporate Law*, 59 ALA. L. REV. 1385, 1449 (2008) (noting the "misgivings" that corporate law has about the "consistency of shareholders' interests and incentives with those of society at large").

say, an ice cream company called "Good & Tasty, Inc."—which writes the B-corp commitments into its corporate charter. In one scenario, the company does well for its investors even as it does good for society, and it issues shares to the public. A foreign conglomerate, with little interest in social benefits and no intention of keeping Good & Tasty's factories running, offers to acquire the company at a substantial premium to the share price. In another scenario, Good & Tasty fails to prosper and decides to jettison its social programs and to lay off employees to cut costs.

In the first scenario, shareholders sue to force the Good & Tasty board of directors to honor its *Revlon* duties to achieve the highest price.[17] Employees, the chambers of commerce of cities where the factories are located, and environmental groups[18] sue to enjoin the sale as a breach of directors'

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[16] This "hypothetical" is based in part on the real world experience of Ben & Jerry's, the Vermont ice cream maker famed for its social consciousness. In 1999, Dutch food conglomerate Unilever made an offer to acquire the company. The founders and other directors feared that the proposed sale would put the company's social mission in jeopardy. The founders assembled a group of investors to counter the Unilever offer but could not match Unilever's price. Shareholders of the publicly traded company sued and forced the board to fulfill its *Revlon* duties to achieve the highest value for shareholders. Unilever acquired Ben & Jerry's in April 2000. *See* Hannah Clark Steiman, *A New Type of Company: A "B" Corporation*, INC., July 1, 2007, at 25, *available at* http://www.inc.com/magazine/20070701/priority-a-new-kind-of-company.html (noting that the B-corp movement began, in part, in response to advice which Ben & Jerry's received that its directors could not consider nonshareholder interests). For a discussion of the tensions between business and social benefit purposes in another confectionary context (involving the Hershey Trust and The Hershey Company, which it controls), see *infra* notes 154 and 277.

[17] This assumes that the Good & Tasty board triggered such duties by deciding to proceed with a sale, possibly seeking a "white knight" who would commit to the company's social benefit purposes. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (noting the change in directors' fiduciary obligations once there had been a decision to sell the company).

[18] These represent "corporate constituencies" that would be set forth in the Good & Tasty corporate charter. *See infra* note 29 and accompanying text.

fiduciary duty. In the second scenario, these same groups sue to enjoin the changes in corporate strategy. Shareholders counter, seeking a declaratory judgment that the actions fulfill directors' duties to the corporation and its shareholders to maximize value.

How is a court to decide these issues? Do the fiduciary duties of the Good & Tasty directors differ from those of directors of ordinary business corporations, or does B-corp status merely provide a gloss on the traditional, recognized duties of care and loyalty?[19] To whom do duties of B-corp directors extend, and which parties have standing to sue? Does the takeover context make a difference?

B. Summary of Argument

This Note argues that directors of a B-corp have a duty distinct from the duties of directors of traditional business corporations and proposes a hybrid approach to adjudication of alleged breaches of this duty. Part II reviews the text and background of recent B-corp legislation to demonstrate that the statutes create an additional fiduciary duty and to consider issues of party standing based on variations in statutory text. Part III draws on jurisprudence in both the nonprofit and for-profit sectors to better define this new duty. Part A examines fiduciary duties in the purpose-driven nonprofit context to discern what this additional duty might be. Part B discusses elements of standing doctrine in both the nonprofit and for-profit sectors relevant to the new

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[19] For an argument that B-corp status has only a limited impact on directors' fiduciary duties, see Dana Brakman Reiser, *Benefit Corporations—A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591, 606 (2011) [hereinafter Reiser, *Sustainable Form*] (suggesting that the core duty of B-corp directors is to serve shareholder interests while simply *considering* the socially beneficial purposes of the corporation); Dana Brakman Reiser, *Governing and Financing Blended Enterprise* 16–17 (Brooklyn Law Sch. Legal Studies Research Papers Accepted Papers Series, Research Paper No. 183, 2010), *available at* http://ssrn.com/abstract=1557804 [hereinafter Reiser, *Blended Enterprise*] (discussing New York's proposed B-corp statute and concluding that it does not impose an added duty on directors).

constituencies identified in B-corp charters. Part C reviews aspects of both nonprofit and Delaware takeover law to suggest how the changed duties of B-corp directors may function in the context of control transactions. Part IV argues that B-corp directors owe an additional "duty of obedience" to the benefit purposes of the B-corp, that shareholders—and in some states, benefit constituencies—have derivative standing to sue for a breach of this duty, and that this duty alters the factors which B-corp directors must evaluate when they consider a change-of-control transaction. Part V concludes.

II. B-CORP STATUTES: PROBLEMS OF INTERPRETATION AND APPLICATION

A. New Statutes and New Questions for Directors

B-corps recently became creatures of statute for the first time,[20] and state legislative action is accelerating. Maryland adopted the first benefit corporations statute[21] in April 2010, and Vermont adopted a similar law[22] in May 2010. New Jersey, Virginia, and Hawaii enacted B-corp legislation during the first six months of 2011.[23] Both houses of the

[20] B-corps actually got their start in 2007 with the launch of a private certification program by a nonprofit organization, B-Lab. To earn the B-corp certification, a business must meet certain standards for social impact and adopt practices to ensure accountability, in addition to amending its organizing document to include a statement of benefit purposes and corporate constituencies. *See B Corporation–What is a B Corp?*, B CORPORATION.NET, http://www.bcorporation.net/about (last visited Dec. 1, 2011). As of December 1, 2011, B-Lab had certified more than 460 companies with $2.2 billion in annual revenue. *See B Corporation—B Corp Community*, B CORPORATION.NET, http://www.bcorporation.net/community (last visited Dec. 1, 2011).

[21] MD. CODE ANN., CORPS. & ASS'NS §§ 5-6C-01–5-6C-08 (West 2011).

[22] VT. STAT. ANN. tit. 11A, §§ 21.01–21.14 (2011).

[23] *See* HAW. REV. STAT. § 420D-5 (2011); N.J. STAT. ANN. §§ 14A:18-1–18-11 (West 2011); VA. CODE ANN. §§ 13.1-782–13.1-791 (2011). The Hawaii statute is unusual in that it refers to B-corps as "sustainable

New York Legislature passed a B-corp bill in June 2011 and sent it to the governor for signature, and the California Assembly passed a B-corp bill in August 2011 that was subsequently signed into law.[24] B-corp legislation is pending in four other states, including Michigan and Pennsylvania.[25]

States have based their B-corp statutes on model legislation drafted under the guidance of B-corp proponents (the "Model B-Corp Act" or the "Model Act")[26]—but to varying degrees.[27] Under the statutes, a corporation becomes a B-corp by adopting charter provisions that commit the corporation to create a "material positive impact on society and the environment" (a "general public benefit")[28] and to

business corporations" even though it generally uses the same "benefit" terminology as other states' B-corp statutes.

[24] *See* S.B. 79-A, 2011 Leg., Reg. Sess. (N.Y. 2011) (to be codified at N.Y. BUS. CORP. LAW §§ 720(a)(1)(C), 1702–1709); A.B. 361, 2011 Leg., Reg. Sess. (Cal. 2011). The sections in the New York bill correspond to new sections to be added to the New York Business Corporation Law. This Note focuses primarily on the six statutes enacted or bills passed as of June 2011 (i.e., including New York but excluding California).

[25] The states are Colorado, Michigan, North Carolina, and Pennsylvania. *See* S.B. 11-005, 68th Leg., 1st Sess. (Col. 2011); S.B. 360, 2011 Leg., Reg. Sess. (Mich. 2011); S.B. 26, 2011 Leg., Reg. Sess. (N.C. 2011); S.B. 433, 2011 Leg., Reg. Sess. (Pa. 2011).

[26] A Philadelphia law firm, working with the Pennsylvania Bar Association, drafted the model legislation as a proposed amendment to the state's business corporation law. *See* TITLE 15/BUS. ASS'NS COMM. OF THE SECTION ON BUS. LAW OF THE PA. BAR ASS'N, PROVISIONS RELATING TO THE INCORPORATION AND GOVERNANCE OF BENEFIT CORPORATIONS (the "MODEL B-CORP ACT") (2009). This draft was introduced as the proposed Pennsylvania B-corp statute in February 2011.

[27] For example, the Maryland statute and the New York bill omit provisions in the Model B-Corp Act that address party standing and rights of action against directors. *See infra* notes 63–64 and accompanying text. Also, the state statutes enacted to date take a variety of approaches to director duties in a takeover context. *See infra* notes 70–74 and accompanying text.

[28] *See* HAW. REV. STAT. § 420D-5(a); MD. CODE ANN., CORPS. & ASS'NS §§ 5-6C-01, 5-6C-06 (West 2011); N.J. STAT. ANN. §§ 14A:18-1, 14A:18-5; VT. STAT. ANN. tit. 11A, §§ 21.03, 21.08 (2011); VA. CODE ANN. § 13.1-787(A); N.Y. S.B. 79-A § 1706(a). The B-corp achieves the "general public benefit" through activities that create "specific public benefits" which the corporation may (but need not) set forth in its articles of incorporation or

consider the interests of nonshareholder corporate constituencies[29] in addition to the interests of shareholders. Like the Model Act, the statutes passed to date all treat B-corps as a type of business corporation.[30]

The framers of the Model B-Corp Act and state B-corp legislation intend for B-corps to assume concrete responsibilities to society not shared by ordinary business corporations.[31] B-corp proponents suggest that the adoption of benefit purposes "redefines" the fiduciary duty of directors to require consideration of nonfinancial interests and nonshareholder constituencies when making decisions.[32]

by-laws. The Maryland statute provides the following examples of specific public benefits: (1) providing beneficial products or services; (2) promoting economic opportunity beyond the creation of jobs in the ordinary course of business; (3) preserving the environment; (4) improving human health; (5) promoting the arts, sciences or advancement of knowledge; and (6) providing capital to other organizations with a public purpose. MD. CODE ANN., CORPS. & ASS'NS § 5-6C-01(c), (d). *See also* N.J. STAT. ANN. § 14A:18-1 (setting forth the same list of examples); VT. STAT. ANN. tit. 11A, § 21.03(a)(6) (same); VA. CODE ANN. § 13.1-782 (same); N.Y. S.B. 79-A § 1702(e) (same). The Hawaii statute lists the same examples of specific public benefits, but adds a lengthy provision concerning the use of patent rights to foster job creation in the United States, and to promote fair labor standards and environmental protection "nationally and internationally." HAW. REV. STAT. § 420D-5(b).

[29] Corporate constituencies are listed in a separate section of the statutes that addresses the duties of directors. In addition to shareholders, these groups include employees of the B-corp and its suppliers, customers of the B-corp, communities in which its facilities are located, and "the local and global environment." MD. CODE ANN., CORPS. & ASS'NS § 5-6C-07(a)(1). *See also* HAW. REV. STAT. § 420D-5(b) (setting forth the same list of examples); N.J. STAT. ANN. § 14A:18-6(a) (same); VT. STAT. ANN. tit. 11A, § 21.09(a)(1) (same); VA. CODE ANN. § 13.1-788(A) (same); N.Y. S.B. 79-A § 1707(a) (same).

[30] For example, Maryland codified its B-corp law under Title 5 of its Corporations and Associations Law, entitled "Special Types of Corporations." Other states have typically added provisions to their business corporations statutes.

[31] *See, e.g.*, MODEL B-CORP ACT § 3301 cmt. 1 (noting that these responsibilities are enforceable as a result of the provisions adopted in the corporate charter).

[32] B-LAB, *Benefit Corporation—Legal Provisions and FAQs* 1 (2010), *available at* http://www.bcorporation.net/resources/bcorp/documents/Bene

Language in the charter which equates benefit purposes with the "best interests of the benefit corporation" is meant to accomplish this redefinition.[33] But the Model B-Corp Act and state statutes generally provide little guidance as to the scope of this expanded fiduciary duty.[34] Also, some of the statutes decline to address the issue of party standing to enforce this expanded duty.[35] Lastly, the statutes provide little guidance to directors in the context of control transactions, when the interests of shareholders are most likely to conflict with those of other benefit constituencies.[36]

1. The Model B-Corp Act

The Model B-Corp Act is a good starting point for a consideration of B-corp legislation, since it has provided the basic framework for all of the state statutes passed to date or currently under consideration. The Model Act comprises four proposed subchapters to be added to a state's business

fit%20Corporation%20-%20Legal%20Provisions%20and%20FAQ.pdf. This "redefinition" of fiduciary duty is meant to address three legal problems. First, the statement of benefit purposes is supposed to put nonshareholder considerations on an equal footing with shareholder interests as directors make ordinary course operating decisions. Second, in the thirty-one states which have corporate "constituency statutes" (which allow directors to consider the interests of nonshareholders), it provides clarity on directors' duties that is lacking due to scarce case law. Third, in the nineteen states which lack such statutes, the statement of benefit purposes is meant to allow directors faced with offers to purchase the company to escape their so-called *Revlon* duty to take the highest offer, regardless of the impact on nonfinancial interests. *Id. See also supra* note 17.

[33] *See* MODEL B-CORP ACT § 3311(c). The drafting committee noted that it was not necessary for B-corp charters to include this provision, because it is automatically in the best interest of the corporation for the directors to pursue any purpose set forth in the charter. However, the language was recommended as a way to emphasize the mandatory nature of the public benefit commitment.

[34] *See infra* notes 47–49, 61–62 and accompanying text.

[35] *See infra* notes 64–65 and accompanying text.

[36] *See infra* notes 74–76 and accompanying text. B-Lab notes that the "greatest impediments" to businesses considering nonshareholder interests "exist in liquidity scenarios." B-LAB, *supra* note 32, at 1. *See also supra* note 16; *infra* note 277.

corporation statute.[37] These subchapters cover the process to become a B-corp,[38] the meaning of benefit purposes,[39] the standard of accountability for officers and directors,[40] and the added reporting requirements to ensure transparency.[41] The Model Act's subchapter on accountability contains most of the provisions relevant to an evaluation of fiduciary duty.

The Model Act provision defining the standard of care for directors appears to add to the parties to whom directors owe the existing duty of care. The provision comprises both a mandatory list of interests which directors must consider and a permissive list of additional considerations.[42] Also, the Model Act confers on new corporate constituencies status equal to that enjoyed by shareholders and the corporation itself, whose interests directors must take into account even absent B-corp legislation.[43] The consideration of non-shareholder interests does not violate directors' duty of care

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[37] The Model Act attempts to clarify its relationship with other provisions of the business corporation statute. *See* MODEL B-CORP ACT § 3301(c) (noting that while a benefit corporation may simultaneously be subject to other chapters of the business corporation law, the specific benefit corporation provisions are controlling).

[38] MODEL B-CORP ACT §§ 3301–05. The Act provides both for newly formed B-corps and for existing companies to make the "B" election by amending their articles of incorporation. *Id.* §§ 3303, 3304(a).

[39] *Id.* § 3311.

[40] *Id.* §§ 3321–25.

[41] *Id.* § 3331 (setting forth the requirement that a B-corp deliver an "annual benefit report" to shareholders describing the manner in which it has pursued its stated benefit purposes).

[42] *Compare id.* § 3321(a)(1) (listing parties on whose interests directors "*shall* consider the effects of any action upon" (emphasis added)), *with id.* § 3321(a)(2) (listing other factors which directors "*may* consider" (emphasis added)).

[43] *See id.* § 3321(a)(1) (listing employees of the B-corp and its suppliers, customers of the B-corp, the community in which the B-corps operations are located, and the environment, together with the corporation itself and its shareholders as groups whose interests shall be considered by the directors); § 3321(a)(3) (stating that directors "*shall not be required* to give priority to the interests of any particular person or group"—including shareholders—over those of any other person or group unless otherwise provided in the corporate charter (emphasis added)).

to shareholders.[44] Moreover, directors have no personal liability for consideration of nonshareholder interests provided that such actions also satisfy the ordinary standard of care.[45]

The Model Act also suggests the creation of a new duty concerning the corporation's benefit purposes, but only indirectly. The provision for director accountability does not mention benefit purposes at all, and actually omits language addressing benefit purposes found in the standard of conduct for corporate officers.[46] However, the director provision assumes that directors will consider the "best interests of the benefit corporation"[47] which include the creation of general and specific public benefits set forth in the statement of corporate purposes.[48] The Model Act drafting committee noted that the provision confirming that benefit purposes are "in the best interests of the benefit corporation" is surplusage, since any purpose set forth in the charter is by definition in the interest of the corporation. However, the drafting committee added the provision due to the "importance" of the creation of public benefit to a B-corp.[49]

The Model Act attempts to limit party standing by creating a new cause of action specific to B-corps: a "benefit enforcement proceeding."[50] The Model Act limits enforcement of the duties of officers and directors under the B-corp statute to this proceeding.[51] The Model Act confines benefit enforcement standing to the B-corp's directors and to

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[44] *Id.* § 3321(b)(1) (noting that the consideration of nonshareholder interests "shall not constitute a violation" of the ordinary standard of care). *See also* 15 PA. CONS. STAT. ANN. § 1712 (2011) (describing the duty of care).

[45] MODEL B-CORP ACT § 3321(c).

[46] *See id.* § 3323(a)(2) (requiring an officer to consider the interests of corporate constituencies "when . . . it reasonably appears to the officer that the matter may have a material effect on . . . the creation of a general or specific public benefit by the benefit corporation . . . .").

[47] *Id.* § 3321(a).

[48] *Id.* § 3311(c). *See also supra* note 33 and accompanying text.

[49] *Id.* § 3311 cmt. 1.

[50] *See id.* § 3302(a) (defining a benefit enforcement proceeding).

[51] *Id.* § 3325(a).

shareholders of either the B-corp or its corporate parent, all of whom may only bring suit on a derivative basis.[52] This provision also refers to "duties of directors and officers under this chapter" and thus implies that there are additional duties which arise by virtue of B-corp status. At the same time, the provision suggests that public benefit purposes represent or create a class of enforceable duties separate from other duties of B-corp directors, without defining the relationship between those two sets of duties.[53]

The Model Act allocates responsibility for B-corp takeover activity to both directors and shareholders. Under the mandatory part of the standard of conduct provision, directors must consider the possibility that the best interests of the corporation will be served by rejecting a takeover proposal and remaining independent.[54] Under the permissive part, directors may consider the "resources, intent and conduct (past, stated and potential)" of an acquirer.[55] Also, directors are not required to give priority to the interests of any one enumerated group (i.e. shareholders) over any other group—a provision that the drafting committee intended to address decision-making in a takeover context.[56] For their part, shareholders bear a special burden to approve a change in B-corp status as a result of a takeover. The Model Act requires a supermajority

[52] *Id.* § 3325(b) (providing also that the corporation itself may bring suit on a direct basis). The drafting committee comment for this provision notes, somewhat vaguely, that the standing limitation is "similar, although slightly different" as compared to the standing limitations for ordinary business corporations.

[53] *Id.* § 3302(a) (describing the cause of action as "(1) failure to pursue the general public benefit purpose of the benefit corporation or any specific benefit purpose set forth in its articles; *or* (2) violation of a duty or standard of conduct under this chapter . . . ." (emphasis added)).

[54] *Id.* § 3321(a)(1)(vi).

[55] *Id.* § 3321(a)(2)(i).

[56] *Id.* § 3321(a)(3). The drafting committee comment to this section, stating that its provisions make *Revlon* inapplicable to Pennsylvania corporations, suggests that the lack of priority is addressed, at least in part, to a takeover context.

"minimum status vote"[57] *by the B-corp target* to approve an acquisition where the surviving entity would not be a B-corp[58] and *by the target that is not a B-corp* if the surviving corporation would be one.[59] The framers of the Model Act were evidently aware of the implications of B-corp status in a takeover context, and it is surprising that many states have taken different approaches.

2. Variations in Text of State Statutes

All of the enacted B-corp statutes contain roughly similar language to that of the Model Act mandating the consideration of the interests of nonshareholder constituencies.[60] The state statutes also echo the surplusage in the Model act equating benefit purposes with the best interest of the corporation.[61] Consequently, to the extent that the Model Act may add to the parties to whom a duty of care is owed and may create a new duty concerning benefit purposes, the new state laws have the same effect in actual practice.[62]

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[57] The "minimum status vote" required to determine post-merger B-corp status imposes two additional voting requirements. First, holders of every class or series of shares are entitled to vote, regardless of any limitations on voting rights in the articles of incorporation. Second, a vote of two-thirds of all shares of each class is required to approve the corporate action. *Id.* § 3302(a).

[58] *Id.* § 3305(b).

[59] *Id.* § 3304(b).

[60] *See, e.g.*, HAW. REV. STAT. § 420D-6(a) (2011) (requiring directors to consider the interests of certain specified constituencies in addition to stockholders, and permitting the consideration of other interests and factors); MD. CODE ANN., CORPS. & ASS'NS § 5-6C-07(a) (West 2011) (same); N.J. STAT. ANN. § 14A:18-6(a) (West 2011) (same); VT. STAT. ANN. tit. 11A, § 21.09(a) (2011) (same); VA. CODE ANN. § 13.1-788(A) (2011) (same); S.B. 79-A, 2011 Leg., Reg. Sess. § 1707(a) (N.Y. 2011) (to be codified at N.Y. BUS. CORP. LAW § 1707(a)) (same).

[61] *See, e.g.*, HAW. REV. STAT. § 420D-5(c) (stating that the creation of general and specific public benefits is in the best interest of the corporation); MD. CODE ANN., CORPS. & ASS'NS § 5-6C-06(c) (same); N.J. STAT. ANN. § 14A:18-6(c) (same); VT. STAT. ANN. tit. 11A, § 21.08(c) (same); VA. CODE ANN. § 13.1-787(B) (same); N.Y. S.B. 79-A § 1706(c) (same).

[62] *See supra* notes 46–49 and accompanying text.

However, states have not followed the Model Act's approach with respect to standing. For example, the Maryland and Hawaii statutes, and the New York bill, omit the provision for a "benefit enforcement proceeding" entirely.[63] These states compensate for this omission with provisions not found in the Model Act which attempt to limit the duty of care in the B-corp context. Maryland and New York offer a one sentence disclaimer that a B-corp director does not have a duty to any person that is a beneficiary of the corporation's public benefit purposes.[64] However, they say nothing about a duty to the named nonshareholder constituencies whose interests directors must consider. The Hawaii statute permits shareholders and directors to bring direct and derivative claims to enforce general or specific benefit purposes.[65] However, Hawaii does not limit enforcement of benefit purposes to such an action, nor does it limit standing to shareholders and directors.

To the extent that these deviations from the text of the Model Act were deliberate,[66] they may suggest that

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[63] In contrast, New Jersey, Vermont, and Virginia use the Model Act definition of a benefit enforcement proceeding almost verbatim, similarly suggesting that benefit purposes and other duties may be enforced separately. *See* N.J. STAT. ANN. § 14A:18-10 (defining a cause of action as a failure to pursue a benefit purpose *or* violation of a duty) (emphasis added); VT. STAT. ANN. tit. 11A, § 21.13(c)(1), (c)(2) (same); VA. CODE ANN. § 13.1-782 (same). *See also supra* notes 50–52 and accompanying text.

[64] *See* MD. CODE ANN., CORPS. & ASS'NS § 5-6C-07(b); N.Y. S.B. 79-A § 1707(c). The "no duty" provision in the bill that New York enacted replaced a somewhat vague statement in the bill first introduced in 2010. *See* S.B. 7855-B § 1707(c) (N.Y. 2010) (providing that a B-corp director has the same fiduciary duties as a director of an ordinary business corporation "except to the extent those duties are inconsistent" with the provisions of the B-corp statute). The Vermont statute also includes a "no duty" provision, but adds a statement that a director *does* have a duty to persons entitled to bring a benefit enforcement proceeding. *See* VT. STAT. ANN. tit. 11A, § 21.09(e).

[65] HAW. REV. STAT. § 420D-10.

[66] The Maryland Benefit Corporations Act made its way through the state legislature virtually unchanged. *See* First and Second Readings S.B. 690, H.B. 1009, 2010 Leg., Reg. Sess. (Md. 2010). The New York bill is virtually identical to one passed by the New York Senate (but not by the

legislators in some states intend to expand B-corp fiduciary duty and party standing beyond what the framers of the Model Act contemplated.[67] Because the "no duty" provisions are limited to the beneficiaries of public purposes, nonshareholder corporate constituencies named in the Maryland statute and the New York bill may have standing to sue if their interests are not considered.[68] The Virginia statute and the New York bill also facilitate derivative standing by including language (not found in the Model Act) which requires directors to consider the effect of their actions on "the ability of the benefit corporation to accomplish its general and any specific public benefit purpose."[69]

Like the Model Act, most of the state statutes attempt to address the duty of B-corp directors in the context of control transactions, but their treatment of the issue varies considerably. The Model Act both requires directors to consider whether the interests of the corporation are best served by its continued independence and permits directors to consider the intent and conduct of an acquirer.[70] The

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Assembly) in 2010, which itself had few revisions from the original bill introduced.

[67] This conclusion represents an extension of a canon of statutory interpretation which says that the omission of language in one part of a statute that is used in another part is deemed to be significant. *See, e.g.*, Keene Corp. v. United States, 508 U.S. 200, 208 (1994) (noting the presumption that where Congress uses disparate language, both inclusions and exclusions express legislative intent). Given that state B-corp statutes were largely patterned after the Model B-Corp Act, omissions of language in the Model Act should provide some evidence of legislative intent.

[68] *See* MD. CODE ANN., CORPS. & ASS'NS § 5-6C-07(a)(1); N.Y. S.B. 79-A § 1702(e). Beneficiaries of *specific* public purposes are also not covered by the "no duty" provisions, and may arguably claim standing. Specific public benefits contribute to the creation of a general public benefit, and include providing beneficial products and services, promoting economic opportunity beyond the creation of jobs in the ordinary course of business, improving human health, and promoting arts, sciences or the advancement of human knowledge. *See supra* note 28.

[69] *See* VA. CODE ANN. § 13.1-788(A)(1)(g) (2011); N.Y. S.B. 79-A § 1707(a)(1)(A).

[70] MODEL B-CORP ACT § 3321(a)(1)(vi), (a)(2)(i) (2009).

Virginia statute and the New York bill include both the mandatory and permissive Model Act acquisition provisions.[71] Vermont and New Jersey require consideration of the benefits of independence, but do not directly permit consideration of the acquirer's intentions.[72] Hawaii does not mandate consideration of the benefits of continued corporate independence, listing independence and the intentions of a potential acquirer as permissive considerations.[73] Maryland remains largely silent on B-corp takeovers and simply incorporates by reference a provision of the state's business corporation law concerning control transactions.[74]

Maryland's open-ended approach to B-corp takeover considerations has something in common with all of the other enacted statutes. None of the statutes offers any guidance to directors on how to balance competing B-corp interests in the context of a sale of the corporation, as in the Good & Tasty hypothetical discussed above.[75] Most of the statutes simply echo a Model Act provision that states that directors generally need not give priority to the interests of any group listed in the mandatory and permissive lists of corporate constituencies over the interests of any other

[71] *See* VA. CODE ANN. § 13.1-788(A)(1)(f), (A)(2)(a); N.Y. S.B. 79-A § 1707(a)(1)(G), (a)(2)(A).

[72] N.J. STAT. ANN. § 14A:18-5(a)(6) (West 2011); VT. STAT. ANN. tit. 11A, § 21.09(a)(1)(F) (2011). The New Jersey statute replaces the Model Act's consideration of acquirer intent with consideration of matters set forth in the state's corporate constituency statute. It also only allows directors to consider the benefits of corporate independence, which is thus accorded both mandatory and permissive consideration under the statute. *See* N.J. STAT. ANN. § 14A:18-6(b)(1), 14A:6-1.

[73] HAW. REV. STAT. § 420D-6(a)(2)(E), (a)(2)(G) (2011).

[74] *See* MD. CODE ANN., CORPS. & ASS'NS § 2-405.1(f) (West 2011) (providing that a director does not owe a higher duty in the case of a potential sale of the company). *See also id.* § 5-6C-02(a) (stating that the provisions of the state's general corporation law apply to B-corps, with certain exceptions).

[75] The Maryland statute actually suggests that the provision in its business corporation statute that governs a control transaction may not apply at all if a B-corp statutory provision "clearly requires otherwise." *Id.* § 5-6C-02(a).

named groups.[76] Legislators apparently intended this approach to relieve B-corp directors of potential liability for favoring the interests of nonshareholder constituencies over the interests of shareholders.[77] However, this approach is insufficient given that B-corps remain a species of business corporation owned by shareholders who would typically assume that their interests would be directors' highest priority in considering a sale of the company.[78] While some shareholders might accept the fact they had purchased stock with notice that directors need not place a high priority on shareholder value, others would undoubtedly take issue with a decision by directors to sell for less than top value.

3. B-Corp and Corporate Constituency Statutes Distinguished

A comparison of B-corp legislation with corporate constituency statutes, both as drafted and as interpreted by the courts, demonstrates that directors assume an additional fiduciary duty when they elect B-corp status.[79] If Good & Tasty had incorporated in a state with a constituency statute, its directors would have been able to consider the interests of nonshareholders even without the B-corp

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[76] *See* MODEL B-CORP ACT § 3321(a)(3) (2009) (providing, however, that a B-corp may bind directors to a prioritization of interests set forth in its articles of incorporation); *see also* N.J. STAT. ANN. § 14A:18-6(c) (same); VT. STAT. ANN. tit. 11A, § 21.09(a)(3) (same); VA. CODE ANN. § 13.1-788(A)(3) (same); N.Y. S.B. 79-A § 1707(a)(3) (same). The Maryland and Hawaii statutes omit this language and are otherwise silent on the relative priorities directors should assign to shareholder and other interests.

[77] Eliminating potential liability for directors has been one of the principle motivating factors behind B-corp legislation. *See infra* notes 118–20 and accompanying text.

[78] Those B-corp statutes that provide for a "benefit enforcement proceeding" support this assumption in that they identify shareholders as the only corporate constituency that may sue for a breach of directors' fiduciary duties. *See supra* notes 50–52 and accompanying text.

[79] The drafting committee for the Model B-Corp Act noted its relationship to the earlier statutes. *See* MODEL B-CORP ACT § 3321 cmt. 1 (noting that the provision makes mandatory what would otherwise be permissive under the Pennsylvania constituency statute).

election, and they could argue that value maximization was not their sole legitimate concern.[80] The groups whose interests directors in states with constituency statutes may consider are essentially the same as those whose interests directors must consider under the Model B-Corp Act and the state statutes.[81] Pennsylvania passed the first corporate constituency statute in 1983,[82] and its text served as a model for many of the thirty other states that have passed similar legislation.[83] Many of the states that have enacted or are considering B-corp legislation already have a constituency statute[84]—further evidence that B-corp legislation is intended to have a more concrete impact on directors' duties.[85]

[80] Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 16 (1992). *See also* John C. Alexander et al., *Nonshareholder Constituency Statutes and Shareholder Wealth: A Note*, 21 J. OF BANKING & FIN. 417 (1997) (finding that the statutes have a small but significantly negative effect on shareholder value); Anthony Bisconti, *The Double Bottom Line: Can Constituency Statutes Protect Socially Responsible Corporations Stuck in* Revlon *Land?*, 42 LOY. L.A. L. REV. 765 (2009) (proposing a framework for interpreting the statutes); Brett H. McDonnell, *Corporate Constituency Statutes and Employee Governance*, 30 WM. MITCHELL L. REV. 1227 (2004) (arguing that the statutes create a fiduciary duty favoring employees); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579 (1992) (arguing that the statutes impose an enforceable duty on directors not to harm the interests of named nonshareholder constituencies).

[81] *See* MD. CODE ANN., CORPS. & ASS'NS § 5-6C-07(a)(1) (West 2011); VT. STAT. ANN. tit. 11A, § 21.09(a)(1); *supra* note 29.

[82] 15 PA. CONS. STAT. ANN. § 1715(a) (2011). The text of the Pennsylvania constituency statute is virtually identical to the list of considerations mandated by the Model B-Corp Act. *See supra* notes 28–29 and accompanying text.

[83] Orts, *supra* note 80, at 27.

[84] *See, e.g.*, HAW. REV. STAT. § 414-221(b) (2011); N.J. STAT. ANN. § 14A:6-14(4) (West 2011); N.Y. BUS. CORP. LAW § 717(b) (McKinney 2011); 15 PA. CONS. STAT. ANN. § 1715(a); VT. STAT. ANN. tit. 11A, § 8.30(a)(3).

[85] It is also worth noting that a constituency "statute" generally represented a single clause added to a state's preexisting codification of the duty of care. *See, e.g.*, N.Y. BUS. CORP. LAW § 717(b) (adding a list of factors and constituencies which directors may consider to a provision

Most commentators agree that constituency statutes did not impose on directors any duty to the newly recognized constituencies,[86] either because of the presence of specific limiting language, or the absence of legislative history that would suggest that legislators intended such a significant change.[87] Most of the constituency statutes state clearly that being named as a corporate constituent does not give a party a cause of action against the corporation's directors.[88] Some statutes are silent on the question,[89] but in the absence of a definite statement of a new duty, courts have been reluctant to impose one.

Despite the fact that some thirty-one states and the District of Columbia currently have constituency statutes, case law interpreting them is relatively scarce. An early Pennsylvania case held that it was "proper" under the statute for directors to consider the effects of a successful tender offer on the target company's "employees, customers, and community."[90] Confronted with a choice between a hostile takeover and a "white knight," corporate directors may base their decisions on "social issues" and need not confine their considerations to the offer price.[91] More

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dealing primarily with the duties of directors and the required standard of care). B-corp statutes, by contrast, comprise new chapters to states' business corporation laws. *See supra* note 38 and accompanying text.

[86] Orts, *supra* note 80, at 83.

[87] This latter argument appears to rest on the "dog that did not bark" canon of statutory interpretation, which holds that failure of a legislature to state that it intended a dramatic change in the law means that no such change occurred. *See, e.g.*, Mont. Wilderness Ass'n v. U.S. Forest Serv., No. 80-3374 (9th Cir. May 14, 1981), *rev'd*, 655 F.2d 951 (9th Cir. 1981).

[88] *See, e.g.*, N.Y. BUS. CORP. LAW § 717(b) (stating that the constituency language does not create any duty for directors).

[89] *See, e.g.*, VT. STAT. ANN. tit. 11A, § 8.30(a)(3) (listing possible corporate constituencies without comment on directors' duty to them or their potential standing).

[90] Baron v. Strawbridge & Clothier, 646 F. Supp. 690, 697 (E.D. Pa. 1986).

[91] Keyser v. Commonwealth Nat'l Fin. Corp., 675 F. Supp. 238, 265 (M.D. Pa. 1987) (noting that directors had expressed concerns for employees during their evaluation of the competing offers and felt that employment would be greater with the "white knight" bidder).

recently, Pennsylvania courts have held that an analysis of the interests of nonshareholder constituencies may be synonymous with the "best interest of the corporation" test that the state applies in evaluating a possible breach of fiduciary duties by majority shareholders.[92] Courts in other constituency statute jurisdictions have similarly upheld consideration of nonshareholder interests.[93] But in none of these cases has it been suggested that a constituency statute gives rise to a duty that would create an independent cause of action for nonshareholders.[94]

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[92] Stilwell Value Partners v. Prudential Mut. Holding Co., No. 06-4432, 2008 U.S. Dist. LEXIS 34095, at *39–44 (E.D. Pa. Apr. 24, 2008) (citing Ferber v. Am. Lamp Corp., 469 A.2d 1046 (Pa. 1983)).

[93] *See, e.g.*, Ga.-Pac. Corp. v. Great N. Nekoosa Corp., 727 F. Supp. 31, 33 (D. Me. 1989) (citing the state's constituency statute in support of directors' decision to delay a shareholder vote on the redemption of a poison pill); Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984, 1016 (E.D. Wis. 1989) (upholding a decision by a board not to redeem a "poison pill" shareholder rights plan in the face of a hostile tender offer based, in part, on the interests of "other constituencies"). Courts have also suggested that constituency language may shape fiduciary duty in other ways. For example, a Georgia court held that the list of nonshareholder constituencies in a corporate charter provision adopting the statute excluded other parties not named from directors' consideration. *See In re* Munford, Inc. v. Valuation Research Corp., 98 F.3d 604, 611 (11th Cir. 1996) (applying Georgia law and holding that the charter language did not create a cause of action for creditors because they were "not identified as persons to whom due consideration is owed"). An Indiana court noted that the combination of a corporate constituency clause taken together with a "willful or reckless" standard for fiduciary breach essentially imposes a "lower, quasi-negligence standard for director liability." Murray v. CONSECO, Inc., 766 N.E.2d 38, 44 (Ind. Ct. App. 2002). *See also* IND. CODE § 23-1-35-1-(d)–(g) (2011) (setting forth the Indiana constituency statute and a recklessness formulation for the breach of the duty of care).

[94] Despite courts' treatment of constituency statutes, there are strong arguments that nonshareholder constituencies can sue for a breach of some type of duty, absent specific statutory preclusion of such a suit. *See* David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223, 256–60 (1991) (arguing that constituency statutes created a new fiduciary duty not to harm nonshareholder interests which may be enforced by nonshareholder suits). *See also id.* at 260 n.139 (arguing that a

B-corp legislation differs from constituency statutes in three important respects, which suggest that it imposes a duty where constituency statutes do not. First, the statutory text governing B-corp charter provisions clearly mandates directors' consideration of the interests of corporate constituencies.[95] Constituency statutes are permissive and do not mandate director consideration of nonshareholder interests.[96] In fact, constituency statutes are careful to avoid inadvertently imposing a new duty. For example, "opt-in" provisions in many of the statutes require corporate directors and shareholders to approve charter amendments electing to subject the company to the constituency provision.[97] These elective provisions are frequently redundant, since most statutes also state that directors have no obligation to any corporate constituency.[98]

nonshareholder who could claim harm would have a direct cause of action because the harm would be distinct from any injury to the corporation).

[95] New York makes explicit the distinction between its B-corp bill and its corporate constituency statute. *See* S.B. 79-A, 2011 Leg., Reg. Sess. § 1707(b)(2) (N.Y. 2011) (to be codified at N.Y. BUS. CORP. LAW § 1707(b)(2)) (providing that a B-corp directors' consideration of interests and factors relating to named constituencies is "in addition to the *ability*" of directors to consider these interests under the constituency statute) (emphasis added).

[96] For many years, the Connecticut constituency statute was the sole exception among otherwise permissive constituency statutes, providing that a director "shall consider" the interests of such other stakeholders as employees, customers, and creditors as well as "community and societal considerations." The state amended its constituency statute in 1997 to replace "shall" with "may." *See* CONN. GEN. STAT. § 33-756(d) (2011).

[97] *See, e.g.*, GA. CODE ANN. § 14-2-202(b)(5) (2011) (providing that a corporation's articles of incorporation may include the permissive formulation of constituency statute language). This suggests that the failure of the corporation to include the language in its charter leaves consideration of nonshareholder constituencies *ultra vires*, or outside the power of the corporation. *See* Orts, *supra* note 80, at 30.

[98] *See, e.g.*, N.Y. BUS. CORP. LAW § 717(b) (McKinney 2011) (noting that the statute does not "create any duties owed by any director to any person or entity to consider or afford any particular weight" to the specified constituency interests); 15 PA. CONS. STAT. ANN. § 1715(b) (2011) (stating that directors are not required to view the interest of any particular group as "dominant" or "controlling").

Second, the purposes of the two sets of statutes are quite different. The general sense of the constituency statutes is that they were meant primarily to appease groups threatened by takeover activity but were only expected to have a limited deterrent effect.[99] States adopted constituency statutes to provide directors of local companies with additional flexibility to reject unsolicited offers from out-of-state acquirers, as a result of the corporate takeover "frenzy" of the first half of the 1980s.[100] The protection of in-state jobs was a particularly important motive.[101] A number of the constituency statutes only permit directors to consider interests other than those of shareholders when making decisions that would affect corporate control.[102] By contrast, provisions in the Model Act and state B-corp statutes that

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[99] Pennsylvania appears to have acknowledged the limited practical effect of its constituency statute. The state added explicit anti-takeover provisions to its Business Corporation Law less than a decade after it enacted the statute. *See* Pennsylvania Anti-Takeover Act of 1990, 1990 Pa. Laws 129 (codified at 15 PA. CONS. STAT. ANN. § 1715(a)(2), (a)(3) (West 1995)). *See also* Armstrong World Indus., Inc. v. Adams, No. 90-2920, 1991 U.S. Dist. LEXIS 6371 (E.D. Pa. May 10, 1991) (considering a constitutional challenge to the anti-takeover statute, but dismissing for lack of ripeness since the plaintiff corporation was not the target of an actual takeover attempt).

[100] *See* Linda J. Oswald, *Shareholders v. Stakeholders: Evaluating Corporate Constituency Statutes Under the Takings Clause*, 24 J. CORP. L. 1 (1998).

[101] The New York constituency statute makes this motivation particularly apparent. *See* N.Y. BUS. CORP. LAW § 717(b) (listing among the permitted constituencies "the corporation's current employees; . . . the corporation's retired employees; . . . and . . . employment opportunities and employment benefits . . . .").

[102] *See, e.g.*, CONN. GEN. STAT. §§ 33-756(d), 33-817 (2011) (limiting the constituency provision to actions relating to a plan of merger, business combination, or significant asset sale). The New York constituency statute, by contrast, specifies that it applies in the context of a control transaction, but also suggests that it may apply to other decisions by directors as well. *See* N.Y. BUS. CORP. LAW § 717(b) ("including, without limitation," a control transaction as a circumstance where the statute would apply).

address control transactions are only one part of the statutory scheme.[103]

Third, constituency statutes did not provide for or contemplate any change in the basic purposes of a corporation as set forth in its charter. By contrast, B-corp benefit purposes are equated under the statutes with "the best interests of the corporation" and are not subject to the "no duty" disclaimer as set forth in the Model B-Corp Act and some state statutes.[104] This makes the benefit purposes a much more potent driver of fiduciary duty than the consideration of nonshareholder interests merely permitted under corporate constituency statutes.

B. Legislators' Consideration of Fiduciary Duty

While legislators may not have provided textual clarity on fiduciary duty, there is ample evidence that they intend B-corp statutes to accommodate the social enterprise structure by changing the duties of traditional business corporation directors. The background of the first two B-corp statutes, enacted in Maryland[105] and Vermont,[106] suggests that

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[103] *See supra* notes 54–56, 76–78 and accompanying text.

[104] *See supra* notes 47–49, 61 and accompanying text.

[105] The background of the Maryland statute suggests that lawmakers intended to expand fiduciary duty, even if they gave little thought to what it meant in actual practice. The Maryland bill's senate sponsor, Jamie Raskin, stated his belief that by writing "benefit corporation" status into a company's certificate of incorporation, "a firm's directors . . . establish legal protection for their decision-making . . . ." Press Release, State Senator Jamie Raskin, Historic Benefit Corporation Law Takes Effect in Maryland (Oct. 1, 2010), *available at* http://dlcc.wiredforchange.com/o/6727/p/salsa/web/press_release/public/?press_release_KEY=575 [hereinafter Raskin Press Release]. But more focus was given to public relations considerations. Senator Raskin underscored the "immediate and remarkable branding opportunities" created by B-corp status, noting also that "Maryland is now the Delaware of Benefit corporations. Our doors are open for enlightened business." *Id.* The Maryland bill's Assembly sponsor hoped that hundreds of companies from around the country would choose to incorporate in Maryland so that they would be able to make the B-corp election. 2010 Session Report, Delegate Brian J. Feldman, http://brianjfeldman.com/news/2010/2010%20Session%20Report.htm. The Maryland legislation's sponsors were generally vague about its practical

legislators intended to do more than provide a gloss on existing fiduciary duties. The sponsors of the New York B-corp legislation specifically cited the social enterprise model when they introduced the bill in the state senate in 2010.[107]

Legislators were aware that B-corp status would somehow change fiduciary duty—and potentially impose a new one—even if they were not clear on what those changes would be. The sponsors of the New York B-corp bill referred to an "expanded definition of fiduciary duty" and a "fiduciary duty of benefit corporations [that] affirmatively includes creating public benefit."[108] Legislators also intend B-corp status to "expand the rights of shareholders to enforce this

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effects on the companies themselves, noting only that they would be able to "build a public ethos into the DNA of a corporate entity . . . ." Diane Mastrull, *Maryland Adopts New Socially Aware Corporation Law*, PHILA. INQUIRER, Apr. 15, 2010, at C1. In fact, the Maryland legislature's committee reports suggested that the effect on the business climate in the state would be "minimal." DEP'T OF LEGIS. SERVS., MD. GEN. ASSEMB., FISCAL AND POLICY NOTE: CORPORATIONS – BENEFIT CORPORATION I-8 (2010).

[106] The failure of Vermont legislators to consider problems of fiduciary duty in any detail may have been due partly to haste, as they appear to have attempted (unsuccessfully) to beat Maryland to the governor's pen. Passage of the Vermont B-corp law may have had some urgency given the important place that the social enterprise movement occupies in that state's business self-image. *See generally*, Elizabeth Schmidt, *Vermont's Social Hybrid Pioneers: Early Observations and Questions to Ponder* (Vt. L. Sch. Legal Studies Research Paper Series, Paper No. 10-53, 2010), *available at* http://ssrn.com/abstract=1656541. The B-corp bill was viewed as an act which "bolsters the Vermont brand." J. VT. H. OF REP. (Apr. 29, 2010) (Statement of Rep. Lorber), *available at* http://www.leg.state.vt.us/docs/2012/journal/hj110429.pdf. The Vermont B-corp bill had few amendments as it went through the legislative process.

[107] SPONSOR'S MEMORANDUM, S.B. 7855-B 1 (N.Y. 2010) [hereinafter SPONSOR'S MEMO] ("[C]orporate 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.").

[108] *Id. See also* Press Release, New York State Assembly, Assembly Passes Legislation to Allow Benefit Corporations (June 17, 2011), *available at* http://assembly.state.ny.us/Press/20110617a/ (noting that the bill imposes "a legal responsibility to stakeholders as well as shareholders" on companies which elect B-corp status).

expanded definition of fiduciary duty."[109] The fiduciary duty of B-corp directors is different from that "[u]nder general principles of corporate organization, [where] the directors of a corporation have a singular and enforceable duty to maximize shareholder profits."[110] The change in fiduciary duty is critical because the B-corp structure "preserves the private nature of corporations that choose it and relies on the governing structure of the corporation itself for enforcement."[111]

Legislators also intend B-corp directors to take on certain functions of directors of both for-profit and nonprofit corporations.[112] Because they have shareholders, B-corp directors share with traditional "C" corporation directors a duty to act in their best interests.[113] At the same time, directors' adoption of benefit purposes and the B-corp form resembles the formation of a nonprofit organization,[114] which would imply some change in directors' fiduciary duties.[115] Legislators see B-corp status as a way for a corporation to take on a social mission suited to a nonprofit corporation

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[109] INTRODUCER'S MEMORANDUM, S.B. 79-A 4 (N.Y. 2011) [hereinafter INTRODUCER'S MEMO].

[110] CONF. COMM. REP. 20, S.B. 298 (Haw. 2011).

[111] *Id.*

[112] *See* SPONSOR'S MEMO, *supra* note 107, at 1 (noting that "prior to the new designation, firms had to choose between for-profit and non-profit status. For-profit business corporations were required to pursue profit at every turn. A company that put an environmental objective, a community project or even the well-being of its workers ahead of the financial interests of its shareholders was exposing itself to liability . . . .").

[113] The assumption that shareholder interests are best served by profit maximization may be traced back at least as far as the Michigan Supreme Court's holding in *Dodge v. Ford Motor Co.*, 204 Mich. 459 (1919). *See also* ADOLPH A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932). *But see* Jonathan R. Macey, *A Close Read of an Excellent Commentary on* Dodge v. Ford, 3 VA. L. & BUS. REV. 177 (1998) (arguing that the principle is "widely accepted at the level of rhetoric but largely ignored as a matter of policy").

[114] *See infra* notes 125–28 and accompanying text.

[115] *See* Goldschmid, *supra* note 5, at 638–40 (discussing the duties of nonprofit directors).

without taking on a nonprofit organization's generally limited ability to attract capital.[116]

Finally, legislators intend B-corp status to remove the threat[117] that directors who consider interests other than profit maximization could be held personally liable by shareholders.[118] The Maryland bill's senate sponsor stated his belief that by writing "benefit corporation" status into a company's certificate of incorporation, "a firm's directors . . . establish legal protection for their decision-making . . . ."[119] New York legislators believe that the B-corp form resolves 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 . . . ."[120] Legislative efforts to shield B-corp directors from liability provide further evidence of a broadening of fiduciary duty and its importance to the effectiveness of this new corporate form.

III. B-CORP FIDUCIARY DUTY: BEYOND SHAREHOLDERS AND PROFITS

A. Nonprofit Directors and the Duty of Obedience

Nonprofit governance standards are highly relevant to B-corps, in part because legislators intend B-corps to bridge the gap between for-profit and nonprofit entities.[121] If Good & Tasty had incorporated as a nonprofit entity, its social

[116] *See* Al Harris, *Firms with Benefits*, RICHMOND BIZSENSE (Feb. 7, 2011), *available at* http://www.richmondbizsense.com/2011/02/07/firms-with-benefits/comment-page-1/ (commenting on the then pending Virginia B-corp bill).

[117] Vermont was prompted to take action in part by the events which led to the sale of Ben & Jerry's to Unilever in April 2000. *See supra* note 16.

[118] SPONSOR'S MEMO, *supra* note 107, at 1.

[119] Raskin Press Release, *supra* note 105.

[120] INTRODUCER'S MEMO, *supra* note 109, at 3.

[121] *See supra* note 112 and accompanying text.

benefit purposes would have formal legal recognition.[122] Nonprofit organizations, like B-corps, have a stated purpose or mission that is distinct from—and unlike B-corps, replaces—the profit motive.[123] Moreover, directors of nonprofit corporations tacitly acknowledge the public as a corporate constituency for whose benefit directors must act.[124]

If Good & Tasty had incorporated as a nonprofit entity, the company, like a B-corp, would have been required to state its social benefit mission in its organizational

[122] *See generally* MARION R. FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION 207 (2004) (discussing various aspects of state laws regulating nonprofit organizations). Most states that have enacted B-corp statutes have separate nonprofit corporation statutes. *See* HAW. REV. STAT. §§ 414D-1–324 (2011); N.J. STAT. ANN. §§ 15A:1-1–16-2 (West 2011); N.Y. NOT-FOR-PROFIT CORP. LAW §§ 101–1517 (2011); VT. STAT. ANN. tit. 11B, §§ 1.01–17.05 (2011). Maryland subjects nonprofit organizations to the state's general corporation law. *See* MD. CODE ANN., CORPS. & ASS'NS §§ 5-201–5-209 (West 2011). In the absence of a provision in a nonprofit corporation law, courts will generally look to the business corporation law of the state. *See, e.g.*, La. World Exposition v. Fed. Ins. Co., 858 F.2d 233 (5th Cir. 1988) (using business law cases to interpret a provision of the Louisiana nonprofit corporation statute); NAACP v. Golding, 679 A.2d 554, 559 (Md. 1996) (applying the business judgment rule to a Maryland nonprofit corporation).

[123] *See* I.R.C. § 501(c)(3) (2011) (defining the appropriate purposes of one common type of tax-exempt organization); Treas. Reg. § 1.501(c)(3)-(d)(2) (2008) (providing examples that range from "[r]elief of the poor" to the "erection or maintenance of public buildings"). Courts have also addressed the appropriate charitable activities of nonprofit organizations. For example, the Supreme Court has said that "[a] charitable use, where neither law nor public policy forbids, may be applied to almost anything that tends to promote the well-doing and well-being of social man." Ould v. Wash. Hosp., 95 U.S. 303, 311 (1877). *See also* Bob Jones Univ. v. United States, 461 U.S. 574, 586 (1983) (noting that federal tax exemption requires that an organization "serve a public purpose").

[124] MARILYN E. PHELAN, NONPROFIT ORGANIZATIONS: LAW AND TAXATION § 4.5 (2010). *See, e.g.*, Christiansen v. Nat'l Sav. & Trust Co., 683 F.2d 520, 528 (D.C. Cir. 1982) (discussing the extension of the duties of nonprofit trustees beyond the organization to the public at large).

documents.[125] Like the benefit statement and ongoing disclosure required of a B-corp, a nonprofit mission statement represents both a commitment to address a specific set of societal problems and notice to donors of the organization's intentions.[126]

As with for-profit corporations, the statement of limited corporate purposes serves two functions. First, the restriction of activities to those in furtherance of the stated purposes helps to ensure that the corporation will, in fact, pursue those purposes.[127] Second, the statement of specific purposes helps to ensure that the corporation will not "over-reach its chartered bounds."[128]

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[125] This requirement may be a matter of both federal and state law. The Internal Revenue Code requires that an entity be organized for certain recognized purposes to qualify for federal tax exemption. *See* Treas. Reg. § 1.501(c)(3)-1(b)(1)(i) (setting forth the so-called "organizational test," which requires that the organizing document set forth those purposes). States with separate nonprofit corporation laws also require a statement of specific purposes which serves as notice to both the public and to state regulators as to the organization's intended activities. *See, e.g.*, N.J. STAT. ANN. § 15A: 2-8; N.Y. NOT-FOR-PROFIT CORP. LAW § 402(a)(2); VT. STAT. ANN. tit. 11B, § 3.01. *But see* HAW. REV. STAT. ANN. §§ 414D-32(b), 51(a) (permitting, but not requiring, a nonprofit corporation to specify its corporate purposes, and allowing the corporation to engage in "any lawful activity" if it does not so specify).

[126] Jeremy Benjamin, *Reinvigorating Nonprofit Directors' Duty of Obedience*, 30 CARDOZO L. REV. 1677, 1682 (2009).

[127] *See* Rob Atkinson, *Obedience as the Foundation of Fiduciary Duty*, 34 J. CORP. L. 43, 55–57 (2008) [hereinafter Atkinson, *Obedience as the Foundation*] (discussing the historical origins of specific-purpose corporate charters). Early in the evolution of the corporate form, specific purpose charters were common as corporations became privately organized enterprises rather than companies chartered by the sovereign. Also, many early corporations fulfilled quasi-public functions, such as the operation of canals, utilities, and railroads, and committed to fulfilling these functions in their corporate charters.

[128] *Id.* Limited purposes permitted the state to enforce restrictions on a corporation's operations as beyond its chartered limits, or *ultra vires*. The *ultra vires* doctrine, which has languished in its application to business corporations, retains some vitality as a check on the ability of nonprofit directors to divert resources from the purposes for which they were intended. DANIEL L. KURTZ, BOARD LIABILITY: A GUIDE FOR NON-PROFIT DIRECTORS 85 & n.107 (1989).

The adoption of the statement of benefit purposes imposes on nonprofit directors a "duty of obedience"[129] to the corporate mission, in addition to the duties of care and loyalty which they share with for-profit directors.[130] The duty arises from the fact that nonprofits are organized and operated to conduct activities[131] to further specific stated purposes meant to benefit the public.[132] As one court noted, "[u]nlike business corporations whose ultimate objective is to make money, nonprofit corporations are defined by their specific objectives . . . ."[133] Moreover, even if a nonprofit

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[129] *See* KURTZ, *supra* note 128, at 84–85; *see also* Melanie DiPietro, *Duty of Obedience: A Medieval Explanation for Modern Nonprofit Governance Accountability*, 46 DUQ. L. REV. 99 (2005) (arguing that the duty of obedience is a more reliable mechanism than the duty of care to avoid scandal at nonprofit organizations and to ensure that they generate positive benefits for society).

[130] While the Model Nonprofit Corporation Act of 1964 had little to say on the subject, the Revised Model Nonprofit Corporation Act of 1987 proposed imposing the duty of care and the duty of loyalty on nonprofit directors. PHELAN, *supra* note 124, at § 4.2 (citing REV. MODEL NONPROFIT CORP. ACT (RMNCA) § 8.30(e) (1987)). The RMNCA standard of care for directors has three components (good faith, care that an ordinarily prudent person would exercise in like circumstances, and actions reasonably believed to be in the best interest of the corporation). At the same time, the RMNCA standard was intended to be broad enough to allow for subsequent interpretation by the courts. RMNCA § 8.30 cmt. pt.5. *See also* A.B.A. SECTION OF BUSINESS LAW, GUIDEBOOK FOR DIRECTORS OF NONPROFIT CORPORATIONS 21 (1993) ("The Duties of Care and Loyalty are . . . derived from a century of litigation principally involving business corporations and are equally applicable to nonprofit corporations . . . .").

[131] It has also been suggested that the core function of nonprofits in fulfilling their charitable purposes is to intermediate between the purchasers of a service (such donors to a homeless shelter) who are not the actual consumers of that service (the homeless themselves). *See* Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PENN. L. REV. 497, 504–09 (1981) (arguing that an intermediary is necessary because, in such third-party beneficiary circumstances, neither donors nor those benefitted are in a position to control the quality of the service provided).

[132] KURTZ, *supra* note 128, at 84.

[133] Manhattan Eye, Ear & Throat Hosp. v. Spitzer (*MEETH*), 715 N.Y.S.2d 575 (Sup. Ct. 1999). In *MEETH*, a nonprofit hospital, faced with declining revenues, sought judicial approval to close some of its facilities and to sell most of its assets. The court evaluated the sale under the two-

organization has members,[134] nonprofit directors do not owe them a fiduciary duty, and members should not be mistakenly equated with for-profit corporate shareholders.[135]

Nonprofit directors' duty of obedience[136] provides guidance as to the relationship of B-corp directors to the general and

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pronged test of § 511(d) of the New York Not-For-Profit Corporation Law which required both that the "consideration and the terms of the transaction are fair and reasonable" and that "the purposes of the corporation . . . will be promoted" by the sale of all or substantially all of the hospital's assets. *Id.* at 591–92. The court enjoined the sale on the grounds that the proposed transaction was not consistent with the organization's stated corporate purpose "to establish, provide, conduct, operate and maintain a hospital in the City, County and State of New York . . . ." The court held that the redeployment of the expected sale proceeds actually represented an entirely new mission, based in part on the hospital's plan to file an amendment to the purposes section of its certificate of incorporation. *Id.* at 594–95.

[134] The term "member" causes some confusion in the context of nonprofit corporations. Many nonprofit organizations have members who pay dues or have some other distinctive participation in the organization. Nonprofit corporation statutes, however, typically designate as a "member" one of a class created in the certificate of incorporation or bylaws of the corporation, typically with the right to vote in the election of directors. *See, e.g.*, N.Y. NOT-FOR-PROFIT CORP. LAW §§ 601–603 (2011).

[135] Shorter Coll. v. Baptist Convention of Ga., 614 S.E.2d 37, 42–43 (Ga. 2005).

[136] The duty of obedience of nonprofit directors owes much to the law governing private and public trusts. *See* Atkinson, *Obedience as the Foundation*, *supra* note 127, at 66. Trust law itself predates modern general purpose corporation law by half a millennium. Prior to the evolution of governance standards for nonprofit organizations—and before the rise of the modern corporate structure—directors of charitable institutions were treated as trustees with fiduciary duties running to the public beneficiaries of the organization's mission. *See, e.g.*, Vidal v. Girard's Ex'rs, 43 U.S. 127, 190 (1844) (rejecting a challenge to a trust "for purposes confessedly charitable and beneficial to the city or the public" despite the absence of specific named beneficiaries). However, as nonprofit organizations availed themselves of the corporate form, corporate governance standards gradually replaced trust standards. *See* Evelyn Brody, *Charity Governance: What's Trust Law Got to Do With It?*, 80 CHI.-KENT L. REV. 641 (2005) (discussing the transition from trust to corporate governance principles).

specific benefit purposes they adopt.[137] The duty of obedience requires that directors "serve the beneficiary in the way that reasonable people would see as genuinely beneficial."[138] The duty of obedience also governs both earning and spending—and therefore the full range of an organization's activities for which the directors are responsible.[139] Nonprofit directors are so severely tied to the mission that their ability to amend the purposes of the organization is limited.[140] Nonprofit

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[137] Both trust and corporate law principles have influenced the appropriate standard by which courts judge directors' exercise of their duty of obedience to the corporate mission. A trust approach would impose strict liability on nonprofit directors for any breach of their fiduciary duties. *See, e.g.*, 15 PA. CONS. STAT. ANN. § 5547(a) (West 2011) (noting that nonprofit corporations hold assets "in trust" and holding directors to the same degree of accountability as if the entity was not incorporated). Some states applying trust doctrine have held directors liable based on a showing of ordinary negligence. *See, e.g.*, Lynch v. John M. Redfield Found., 9 Cal. App. 3d 293, 303 (Ct. App. 1970) (holding that nonprofit directors' decision to keep funds in a non-interest-bearing account for five years constituted ordinary negligence and holding them personally liable for the lost income). As corporate governance standards replaced trust principles in the nonprofit sector, the business judgment rule came to predominate, imposing a standard of care of gross negligence. The question of whether to treat nonprofit directors under harsher trust or more lenient corporate principles was first resolved in favor of the corporate approach by courts. *See, e.g.*, Stern v. Lucy Webb Hayes Nat'l Training Sch. for Deaconesses & Missionaries (*Sibley Hospital II*), 381 F. Supp. 1003, 1020 (D.D.C. 1974) (arguing for the adoption of a corporate standard for the duty of care as well as for a parallel duty of loyalty). States later adopted the corporate approach to nonprofit fiduciary duty by statute. For example, New York adopted a corporate approach to the duty of care shortly after *Sibley Hospital II*. *See* N.Y. NOT-FOR-PROFIT CORP. LAW § 717(a) (2011). *See also infra* note 264. *But see* Denise Ping Lee, *The Business Judgment Rule: Should It Protect Nonprofit Directors?*, 103 COLUM. L. REV. 925, 958 (2003) (arguing that the business judgment rule is not appropriate in a nonprofit context due to the absence of shareholders as a check on directors).

[138] Atkinson, *Obedience as the Foundation*, *supra* note 127, at 51 (quoting RESTATEMENT (THIRD) OF TRUSTS § 2 cmt. b (2003)).

[139] *Id.* at 65, 67–69.

[140] The limitation on the ability of fiduciaries to alter the charitable purposes of a nonprofit organization, combined with the perpetual existence of a corporation, gave rise to the doctrine of *cy pres*. The *cy pres*

directors share this particular limitation with B-corp directors, who must seek super-majority shareholder approval for changes to benefit purposes.[141]

B. Nonshareholder Constituencies and Party Standing

1. Nonprofit Standing

Nonprofit standing is based in large part on the trust principle that, once a donation is made, legal title of the funds passes to the directors of the nonprofit corporation in their role as trustees, while equitable title vests in those whom the donor planned to benefit.[142] As a result, the

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doctrine permits a court acting in equity to modify a charitable organization's purposes provided that three conditions are met. First, there must be a valid charitable trust or corporation or a gift to be used for a specific charitable purpose. Second, the donor must have intended to benefit the particular charitable object of the donee organization or to fulfill a specific charitable purpose designated with the donation. Third, it must be impossible, or impractical to carry out these charitable intentions. *See* FREMONT-SMITH, *supra* note 122, at 173. The *cy pres* doctrine is generally accepted as part of the common law of almost all U.S. states, including all states which have enacted B-corp legislation, although Hawaii limits application of the doctrine. *See* Internal Revenue Service, *The Cy Pres Doctrine: State Law and Dissolution of Charities* (1981), *available at* http://www.irs.gov/pub/irs-tege/eotopice81.pdf. The *cy pres* doctrine has a statutory basis in more than thirty states, including Maryland and New York. *See* MD. CODE. ANN., TRUSTS & EST. § 14-301 (West 2011); MD. CODE. ANN., CORPS. & ASS'NS § 5-209 (West 2011); N.Y. EST. POWERS & TRUSTS LAW § 8-1.1(c) (2011); N.Y. NOT-FOR-PROFIT CORP. LAW §§ 513(b), 522. Vermont no longer has a *cy pres* statute. *See* VT. STAT. ANN. tit. 14, § 2328 (repealed 2009). The *cy pres* doctrine requires the trustees or directors of a charitable organization, or the state attorney general, to apply to a court in order to change the organization's charitable mission. *See, e.g.*, *In re* Goehringer's Will, 329 N.Y.S.2d 516, 520–21 (Sur. Ct. 1972) (discussing the role of the court in responding to a *cy pres* petition).

[141] *See supra* note 57; *infra* note 186.

[142] RESTATEMENT (THIRD) OF TRUSTS § 2 cmt. d (2003). *See also* Benjamin, *supra* note 126, at 1697. Note that specific instructions by the donor, such as retaining a remainder in the property, can alter the vesting of legal and equitable title.

donor's interest in the property is extinguished, and the donor has no further standing to sue for a fiduciary breach.[143] In place of the donor, two groups may have standing to sue to enforce the benefit purposes of a nonprofit organization:[144] states' attorneys general and potential beneficiaries of the organization's mission.[145]

The general common law rule is that only a public officer, usually a state attorney general, has standing as *parens patriae* to sue to enforce an organization's charitable purpose on behalf of potential beneficiaries.[146] A number of states

[143] *See* G.G. BOGERT & G.T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 415 (3d ed. 2005). *But see* Rob Atkinson, *Unsettled Standing: Who (Else) Should Enforce the Duties of Charitable Fiduciaries?*, 23 J. CORP. L. 655, 668–69 (1998) [hereinafter Atkinson, *Unsettled Standing*] (suggesting that donor claims should be limited to restitution, and that donors should not be allowed to seek injunctive relief); Henry Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 873–74 (1980) (arguing that donors should have standing to sue during the years in which their contributions fund a nonprofit's programs).

[144] Some states analogize an organization's members to for-profit stockholders and grant members standing to bring a derivative suit. *See, e.g.*, N.Y. NOT-FOR-PROFIT CORP. LAW §§ 623(a), 720(b)(3) (granting derivative standing to members holding five percent or more of the organization's voting power); VT. STAT. ANN. tit. 11B, § 303(b) (2011) (permitting a member or members to challenge a nonprofit action as *ultra vires* in a derivative proceeding). With respect to shareholder standing to sue on a direct or derivative basis, see *infra* note 162 and accompanying text.

[145] There are, of course, other possible parties with standing to sue nonprofit directors for breach. For example, directors of a nonprofit organization can sue fellow directors for a breach of fiduciary duty. *See, e.g.*, Holt v. Coll. of Osteopathic Physicians & Surgeons, 394 P.2d 932, 937 (Cal. 1964) (en banc) (noting that trust principles which apply to charitable organizations permit one trustee to sue another to enjoin conduct which violates the trust). *See also* BOGERT & BOGERT, *supra* note 143, § 413.

[146] *See, e.g.*, Alco Gravure, Inc. v. Knapp Found., 479 N.E.2d, 752, 755–56 (N.Y. 1985). Like New York, the other states that have enacted B-corp legislation recognize the ability of the attorney general to sue on behalf of nonprofit beneficiaries. *See, e.g.*, O'Donnell v. Sardegna, 646 A.2d 398, 405 (Md. 1994) (noting the "general rule" that only an attorney general may sue for a breach of fiduciary duty by a nonprofit organization) (citation omitted); Pittstown Beagle Club v. Hale Mt. Fish & Game Club,

also provide statutory authority for government actions to compel nonprofit organizations to adhere to their charitable purposes.[147]

The common law rationale for granting standing to a public officer was based on the "inherent impossibility of establishing a distinct justiciable interest on the part of a member of a large and constantly shifting benefitted class."[148] The rule also stemmed from concerns that nonprofit organizations would be plagued by nuisance suits from parties without a tangible interest in the organization or its mission.[149] Because members of the public—including those who would benefit from the enforcement of the trust terms—might not be able to demonstrate a private cause of action, a suit by an attorney general is essentially one brought to enforce a public right.[150]

The standing of public officers, however, is not exclusive, and other parties may also sue a nonprofit organization absent a specific statutory preclusion.[151] Beneficiaries of an organization's charitable mission may have standing where "a particular group of people has a *special interest* in funds held for a charitable purpose, as when they are entitled to a

Inc., No. 302-9-03, 2006 Vt. Super LEXIS 29, at *17 (Vt. Sup. Ct. June 8, 2006) (noting that the attorney general may bring a direct suit to enjoin nonprofit actions that are *ultra vires*); Tauber v. Commonwealth, 499 S.E.2d 839, 842 (Va. 1998) (noting the "common law authority of the Attorney General to act on behalf of the public in matters involving charitable assets.") (citation omitted).

[147] *See, e.g.*, N.Y. NOT-FOR-PROFIT CORP. LAW § 112(a) (authorizing a number of special proceedings by the attorney general to police the operations of nonprofit organizations).

[148] Hooker v. Edes Home, 579 A.2d 608, 612 (D.C. 1990) (citation omitted).

[149] *See Alco Gravure*, 479 N.E.2d at 756.

[150] Mount Vernon Mortg. Corp. v. United States, 236 F.2d 724, 725 (D.C. Cir. 1956) (noting also that the United States was not suing on behalf of particular beneficiaries but rather in its capacity as *parens patriae*).

[151] *See* Consumers Union of U.S., Inc. v. State, 840 N.E.2d 68, 80 (N.Y. 2005) (noting that "the general rule may yield" and permit standing to beneficiaries in certain circumstances) (citing *Alco Gravure*, 479 N.E.2d at 755).

preference in the distribution of such funds and the class of potential beneficiaries is sharply defined and limited in number."[152] Intended beneficiaries may also have a special interest if the benefitted class is "distinct from members of the public at large."[153]

An identifiable "special interest" thus creates an exception to the general rule that members of the public do not have a private cause of action against a charitable organization.[154] The Restatement (Second) of Trusts defines those with a special interest as specific persons or entities that have been designated as charitable beneficiaries.[155] The

[152] *Alco Gravure*, 479 N.E.2d at 755 (emphasis added). In *Alco Gravure*, the defendant foundation was incorporated under New York's nonprofit corporation statute exclusively to provide financial assistance to employees of companies with which the founder had been involved. Employees sued to enjoin the corporation from changing its charitable purpose. The New York Court of Appeals held that the employees had standing to sue as individuals. *See also Consumers Union*, 840 N.E.2d 80 (noting that the *Alco Gravure* plaintiffs had standing because they were the primary named beneficiaries of a foundation's charitable purposes and so could seek to stop the foundation from adding new beneficiaries).

[153] *Edes Home*, 579 A.2d at 609.

[154] *See, e.g., In re* Milton Hershey School (*Hershey II*), 911 A.2d 1258, 1261 (Pa. 2006). In *Hershey II*, the alumni association of a school funded by the Hershey Trust sued on the grounds that the Trust was diverting funds away from its stated purpose to help orphaned children. The Supreme Court of Pennsylvania required that a litigant claiming a special interest "show a substantial, direct, and immediate interest in the outcome of the litigation." *Id.* at 1261–62. The court went on to define each of these requirements, noting that there is "a substantial interest if there is a discernible adverse effect to an interest other than that of the general citizenry. It is direct if there is harm to that interest. It is immediate if it is not a remote consequence of a judgment." *Id.* at 1262 (citations omitted). The court held that the association did not have standing, but that it could urge the state attorney general to sue on its behalf. There has been other litigation involving the Hershey Trust, and The Hershey Company, which the Trust controls, that highlights the tensions between business and social benefit purposes in a takeover context. *See infra* note 277.

[155] RESTATEMENT (SECOND) OF TRUSTS § 391 cmt. c (1959) (noting also that persons designated to receive preferential treatment over the general public by an organization serving charitable or education purposes have a special interest).

special interest exception mirrors the traditional requirement that a for-profit shareholder allege a "special injury" in order to sue on a direct, rather than derivative basis.[156]

Courts have traditionally distinguished between actual current (or "identified") beneficiaries, and possible future (or "unidentified") beneficiaries who are only representatives of the organization's targeted charitable class.[157] This distinction corresponds roughly to that which B-corp statutes make between "specific public benefits" and the "general public benefit."[158] Older cases typically denied standing to possible future beneficiaries.[159] However, more recently, courts have admitted the possibility that future beneficiaries may have standing if the class of potential beneficiaries is "sharply defined and limited in number."[160] A grant of standing to potential beneficiaries has been seen as appropriate where the policy reason for denying standing—to prevent nuisance litigation—was not applicable.[161]

2. Nonshareholder Standing in Other Contexts

Standing to sue directors of an ordinary business corporation is typically confined to the corporation itself, which may sue directly, and to shareholders, who may have either direct or derivative standing.[162] Shareholder standing

[156] Delaware courts, however, have rejected the "special injury" requirement for direct shareholder standing. *See infra* note 171.

[157] *Edes Home*, 579 A.2d at 612.

[158] *See supra* note 28 and accompanying text.

[159] *See, e.g.*, Revici v. Conf. of Jewish Material Claims Against Ger. Inc., 174 N.Y.S.2d 825, 828–29 (Sup. Ct. 1958) (denying standing to an individual victim of Nazi persecution, who sued an organization administering reparations payments, on the grounds that he was "one of the indefinite beneficiaries.") (citations omitted). The *Revici* court applied the trust standard to a New York nonprofit corporation despite the fact that it had legal members as well as a board of directors.

[160] *Alco Gravure*, 479 N.E.2d at 755 (citations omitted).

[161] *Edes Home*, 579 A.2d at 613. The plaintiffs in both *Alco Gravure* and *Edes Home* sought injunctive relief rather than damages.

[162] "Direct standing" denotes the ability of a shareholder to seek redress individually on her own behalf by a direct suit against corporate

is determined according to the law of the state of incorporation of the corporation. However, states that have enacted B-corp legislation generally follow Delaware law on issues of shareholder standing.[163] Delaware requires a shareholder claiming the right to sue directly to demonstrate that directors breached a duty owed to the shareholder and that she can prevail without proving an injury to the corporation.[164] Given the difficulty inherent in proving a separate injury, shareholders are generally confined to suing on a derivative basis,[165] a restriction followed by many of the B-corp statutes.[166]

directors. "Derivative standing" restricts a shareholder to suing on behalf of the corporation, as the only party that can claim an injury as a result of the directors' breach. *See generally* MELVIN A. EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS 930–31 (9th ed. 2005) (discussing the distinction between direct and derivative shareholder actions).

[163] *Compare* Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031, 1036 (Del. 2004) (holding that the determination of shareholder or derivative standing should be based solely on whether the corporation, or the stockholder suing individually, suffered the alleged harm, and who would receive the benefit of a favorable judgment), *with* Strougo v. Bassini, 282 F.3d 162, 169 (2d Cir. 2002) (applying Maryland law and holding that a shareholder lacks standing to pursue a claim for wrongs suffered by the corporation), *and* Abrams v. Donati, 489 N.E.2d 751, 751–52 (N.Y. 1985) (holding same under New York law).

[164] *Tooley*, 845 A.2d at 1036. *See also In re* Tyson Foods, Inc., 919 A.2d 563, 601 (Del. Ch. 2007) ("For a shareholder . . . to maintain a direct claim, he or she must identify an injury that is not dependent upon injury to the corporation."); Agostino v. Hicks, 845 A.2d 1110, 1122 n.54 (Del. Ch. 2004) (suggesting that the test for a direct cause of action should focus on the person or entity to whom the relevant duty is owed).

[165] Many alleged fiduciary breaches result in a loss of corporate value, where all stockholders are harmed in proportion to their ownership. In this case, their claim is derivative in nature. *See, e.g.*, Feldman v. Cutaia, 951 A.2d 727, 733 (Del. 2008) ("Where all of a corporation's stockholders are harmed and would recover *pro rata* in proportion with their ownership of the corporation's stock . . . then the claim is derivative in nature.") (citation omitted).

[166] *See* MODEL B-CORP ACT § 3325(b)(2)(i) (2009) (limiting shareholders to derivative actions to enforce benefit purposes); *see also* N.J. STAT. ANN. § 14A:18-10(b)(2)(b) (West 2011); VT. STAT. ANN. tit. 11A, § 21.13(b)(1) (2011) (permitting only "a shareholder that would otherwise be entitled to commence or maintain a proceeding in the right of the benefit corporation"

Delaware law offers three possible standing doctrines relevant to B-corp shareholders and nonshareholder constituencies. First, to the extent that the relief sought is declaratory, a shareholder may pursue an action directly.[167] In this context, the remedy the plaintiff seeks is confirmation that the board has abdicated its responsibility to the stockholders rather than recovery of damages on behalf of the corporation.[168] A plaintiff may therefore be permitted to pursue a direct action "based on 'the nature of the wrong alleged' and the relief that could result."[169]

Second, in contrast to constitutional standing doctrine, which requires a plaintiff to demonstrate a "particularized" injury,[170] a Delaware shareholder can pursue a claim for an injury that is undifferentiated from other parties. Delaware courts have expressly rejected the "special injury" requirement in a corporate context.[171] Some other state courts have held that if an alleged breach has an undifferentiated effect on shareholders, an individual shareholder cannot claim judicial standing.[172] However,

to bring an action, implying that such action must be brought on a derivative basis); VA. CODE ANN. § 13.1-790(B)(2)(b) (2011).

[167] *See, e.g.*, Grimes v. Donald, 673 A.2d 1207, 1212 (Del. 1996) (holding that a plaintiff seeking declaration of the invalidity of employment agreements, which the board had granted to certain officers, could pursue a direct action against the directors).

[168] *Tooley*, 845 A.2d at 1038.

[169] *Id.* (quoting Kramer v. W. Pac. Indus., Inc., 546 A.2d 348, 352 (Del. 1988)).

[170] *See* Bennett v. Spear, 520 U.S. 154, 167 (1997) (requiring the "invasion of a judicially cognizable interest which is . . . concrete and particularized" as a component of "injury in fact," which is part of the "irreducible constitutional minimum" requirement for standing); *infra* notes 178–81 and accompanying text.

[171] *Tooley*, 845 A.2d at 1035 (rejecting earlier holdings that required a shareholder bringing a direct action to demonstrate a "special injury . . . 'separate and distinct from that suffered by other shareholders, . . . or a wrong involving a contractual right of a shareholder . . . .'" (quoting Moran v. Household Int'l, Inc. 490 A.2d 1059, 1070 (Del. Ch. 1985), *aff'd*, 500 A.2d 1346 (Del. 1986))).

[172] *Cf.* King v. Douglass, 973 F. Supp. 707, 716 (S.D. Tex. 1996) (concluding—prior to *Tooley*—that Delaware law required a shareholder to

Maryland, New York, and other states that have passed B-corp legislation generally incline toward Delaware in this regard, and do not impose the "special injury" requirement.[173]

Third, Delaware's broad interpretation of derivative standing—"one of the most interesting and ingenious of accountability mechanisms for large formal organizations"[174]—may provide an effective mechanism for B-corp shareholders (and possibly nonshareholders) to enforce fiduciary duties of B-corp directors. For example, shareholders might claim that the failure of directors to manage a corporation to achieve its benefit purposes amounts to mismanagement of corporate assets, a claim for which recovery on behalf of the corporation would be appropriate.[175] Injury to many types of assets, including not only the corporation's funds and inventory, but also relationships with employees and customers, may give rise to a claim on behalf of the corporation.[176] Moreover, employees and customers rank equally with shareholders as parties whose interests B-corp directors must consider.[177] Because B-corp charters state that consideration of their interests is "in the best interest of the corporation," these nonshareholder constituencies might claim derivative standing as well.

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allege an injury "separate and distinct from other shareholders"); *In re* Nuveen Fund Litig., 855 F. Supp. 950, 954 (N.D. Ill. 1994) (denying standing under Minnesota law because the alleged "injury to each shareholder [was] of the same character") (citation omitted).

[173] *See* Strougo v. Bassini, 282 F.3d 162, 171 (2d Cir. 2002) (applying Maryland law and rejecting the "undifferentiated effect on shareholders standard" for standing) (citation omitted); Higgins v. N.Y. Stock Exch., Inc., 806 N.Y.S.2d 339, 348 (Sup. Ct. 2005) (noting that, while New York courts have not explicitly rejected the "undifferentiated harm" inquiry for shareholder standing, they have implicitly done so by allowing direct class action suits where there would be undifferentiated harm to class members and other shareholders) (citation omitted).

[174] *Kramer*, 546 A.2d at 351 (citation omitted).

[175] Bokat v. Getty Oil Co., 262 A.2d 246, 249 (Del. 1970).

[176] *Strougo*, 282 F.3d at 170 (citing Waller v. Waller, 49 A.2d 449, 452 (Md. 1946)).

[177] *See supra* notes 29, 43, 76 and accompanying text.

Constitutional standing doctrine provides another avenue for nonshareholder claims of standing. Constitutional standing doctrine recognizes that statutes may create legal obligations to specific parties that may confer standing on those parties as prospective litigants that they would otherwise lack.[178] These legal rights may be procedural as well as substantive.[179] However, a plaintiff who invokes a right created by statute must still demonstrate that the alleged injury "fall[s] within the zone of interests protected or regulated by the statutory provision . . . invoked in the suit."[180] The party seeking judicial relief must also be among those actually injured by the breach of the statutory requirement.[181]

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[178] *See* Lujan v. Defenders of Wildlife, 504 U.S. 555, 578 (1992) (noting that the injury required for a plaintiff to have standing "may exist solely by virtue of 'statutes creating legal rights, the invasion of which creates standing'" (quoting Warth v. Seldin, 422 U.S. 490, 500 (1975))).

[179] *Lujan*, 504 U.S. at 572 n.7 (noting that "procedural rights are special" and suggesting that "normal standards of redressability and immediacy" should be relaxed when a prospective plaintiff claims a procedural injury).

[180] Bennett v. Spear, 520 U.S. 154, 162 (1997) (citation omitted).

[181] Sierra Club v. Morton, 405 U.S. 727, 734–35 (1972).

C. Challenges and Conflicts in Control Transactions

1. Takeover Impact on Nonprofit Purposes

If Good & Tasty's success attracted a takeover proposal,[182] the company's directors—as well as its nonshareholder constituencies and beneficiaries of its stated public purposes—would confront a dilemma much like that of a nonprofit organization in a similar situation.[183] Nonprofit directors can see an acquiring entity as potentially coopting their organization's name, resources, and reputation for uses inconsistent with its stated purposes.[184] However, those purposes also impose on nonprofit directors a duty to evaluate whether the purposes can be better served by

[182] For purposes of examining the duties of nonprofit directors (or B-corp directors) the concept of a "takeover" should be viewed as encompassing more than an actual combination of two or more organizations. A takeover may also include an attempt by a group to take control of an organization's decision making process in order to change its purposes or mission. For example, during the 1990s, several groups attempted to gain control of the Sierra Club through ballot initiatives and the election of new directors. In 1996, a group which wanted the Sierra Club to oppose immigration (as a way to protect the environment through population control) mounted one such takeover attempt. The incumbent board took several steps to thwart the election of directors proposed by the insurgent group, and the group sued, claiming that these actions represented a breach of the incumbent directors' fiduciary duties to the organization. *See* Dana B. Reiser, *Nonprofit Takeovers: Regulating the Market for Mission Control*, 2006 B.Y.U. L. REV. 1181, 1201–12 (2006) [hereinafter Reiser, *Nonprofit Takeovers*]. The court held that the takeover represented a legitimate threat to the organization and that the incumbent directors' actions were protected by the business judgment rule. Statement of Decision and Order Granting Defendants' Motion for Summary Judgment and Denying Plaintiffs' Motion for Summary Judgment, Club Members for an Honest Election v. Sierra Club, No. 429277 (Cal. Super. Ct. Feb. 22, 2005). *See also* Reiser, *Nonprofit Takeovers*, *supra* at 1212 n.103.

[183] This was also the dilemma which confronted the founders and directors of Ben & Jerry's in the face of the Unilever takeover proposal. *See supra* note 16.

[184] Reiser, *Nonprofit Takeovers*, *supra* note 182, at 1184–85.

combining with the other entity rather than by remaining independent.[185]

Like a B-corp's benefit purposes,[186] the mission of a target nonprofit organization enjoys certain protections in a takeover context even absent any action by its directors. Trust principles applicable to nonprofit organizations suggest that an acquiring entity cannot change those purposes without the approval of either the organization's members or the appropriate state authorities.[187] In particular, the doctrine of *cy pres* and its codification in various state statutes limit the ability of an acquirer to change the mission of the target at will.[188] Without an amendment to the target's purposes, an acquirer may only choose among programs and policies that further its stated mission.[189] A combination between nonprofit organizations could also require judicial approval in addition to that of the directors if it was likely to change the use of restricted funds or of assets in general.[190]

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[185] PRINCIPLES OF THE LAW OF NONPROFIT ORGANIZATIONS § 320(b) cmt. (Tentative Draft No. 1, 2007) (noting that the duty of fiduciaries is not to keep a particular charitable entity in existence if merger or liquidation might better serve its charitable purposes).

[186] B-corp benefit purposes generally enjoy the protection of the "minimum status vote," the super-majority stockholder approval required to amend or abolish such purposes. *See supra* note 57. *See also, e.g.*, HAW. REV. STAT. § 420D-4(a) (2011) (requiring a vote of not less than two-thirds of outstanding shares to terminate B-corp status by amendment of the articles of incorporation); VT. STAT. ANN. tit. 11A, § 21.07(2) (2011) (same); S.B. 79-A, 2011 Leg., Reg. Sess. § 1706(d) (N.Y. 2011) (to be codified at N.Y. BUS. CORP. LAW § 1706(d)) (same).

[187] *See, e.g.*, N.Y. NOT-FOR-PROFIT CORP. LAW § 804(a) (2011).

[188] *See supra* note 140. *See also* Reiser, *Nonprofit Takeovers*, *supra* note 182, at 1186 & n.4 (but noting that the *cy pres* restriction applies only to tangible assets acquired and not to the name and goodwill of the target organization).

[189] *Id.* at 1185 & n.3 (but also noting that an acquirer could propose a charter amendment as part of the takeover process).

[190] *See, e.g.*, N.Y. NOT-FOR-PROFIT CORP. LAW § 513(b). *See also* REVISED MODEL NONPROFIT CORPORATION ACT § 11.07 (2008) (noting that property transferred in connection with a merger vests in the surviving

Despite these protections, nonprofit directors must fulfill their duty of obedience when evaluating a takeover proposal.[191] For example, directors of an animal protection organization fulfilled this duty when they adopted a policy restricting membership to thwart a takeover by a group which sought to change the organization's anti-hunting stance.[192] Similarly, directors of an organization whose charitable assets had been accumulated in and for the use of a particular community could reject a proposal to combine with an organization in a different community as a way to prevent a change in the use of assets.[193] More generally, nonprofit directors fulfill their duty of obedience by agreeing only to a truly "strategic" combination with another organization which has similar or complementary purposes.[194]

2. To Sell or Not to Sell a Business Corporation

Given the novelty of B-corp legislation, Good & Tasty's home state courts would not be able to draw on direct case

corporation, but remains subject to any conditions on use which existed prior to the merger).

[191] *See generally* KURTZ, *supra* note 128, at 64–65. *See also* Garry W. Jenkins, *The Powerful Possibilities of Nonprofit Mergers: Supporting Strategic Consolidation Through Law and Public Policy*, 74 S. CAL. L. REV. 1089, 1118 (2001) (suggesting that directors will have more opportunities to fulfill this duty as nonprofit mergers become more common).

[192] Royal Soc'y for the Prevention of Cruelty to Animals v. Attorney General, [2001] UKHRR (Ch) 905, (2002) 1 W.L.R. 448, 460–61. This case involved attempts by the Royal Society for the Prevention of Cruelty to Animals ("RSPCA") to prevent fox-hunting enthusiasts from enrolling as members of the organization. The RSPCA sought an advisory judicial opinion as to whether it could lawfully adopt a restrictive membership policy. A U.K. court applied a fiduciary standard that required the trustees of the organization to exercise their powers "for the purposes for which they are conferred in what they consider to be the best interests of the [S]ociety" and in good faith. *See also* Reiser, *Nonprofit Takeovers*, *supra* note 182, at 1225–27. U.K. nonprofit law assigns fiduciary duties to charitable trustees that are similar to those of directors of U.S. nonprofit organizations. *See id.* at 1214–15 & n.115.

[193] *See* Jenkins, *supra* note 191, at 1119.

[194] *Id.*

precedent in adjudicating a challenge to the actions of the company's directors in a sale. Courts faced with corporate governance matters of first impression typically look to Delaware,[195] particularly in the context of control transactions.[196] Delaware takeover law is useful in thinking through how B-corp directors confronted with an offer to sell the company should prioritize shareholder value and other considerations, particularly given the limited guidance that state B-corp statutes provide on this issue.[197]

Even traditionally shareholder-focused Delaware[198] permits the consideration of the interests of nonshareholder constituencies when a corporation is confronted with a takeover threat but has not decided to sell.[199] Nonshareholder constituencies recognized by Delaware include "customers, employees, and perhaps even the community generally"[200]—a list not unlike that set forth in the B-corp list of director duties.[201] The Delaware Supreme Court has noted that this ability to consider issues other than near-term value maximization stems from a board's "broad mandate . . . to set a corporate course of action, including time frame, designed to enhance corporate

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[195] *See, e.g.*, State Farm Mut. Auto. Ins. Co. v. Pate, 275 F.3d 666, 672 (7th Cir. 2001) (noting the nationwide application of Delaware corporate law and arguing that following the Delaware Supreme Court makes business law more consistent); Equitable Life Assurance Soc'y of the U.S. v. Poe, 143 F.3d 1013, 1017–18 (6th Cir. 1998) (deferring to the District Court of Delaware in the face of a circuit split on an obscure insurance issue).

[196] *See, e.g.*, *In re* Portec Rail Prods., Inc. S'holders Litig., Consol. Civil Action G.D.10-3547, G.D. 10-3562, G.D. 10-3982, 2010 Pa. Dist. & Cnty. Dec. LEXIS 157 (Pa. Com. Pl. Ct. Apr. 21, 2010) (applying West Virginia law and noting that West Virginia lacks an "anti-*Revlon*" constituency statute and therefore looks to Delaware precedent).

[197] *See supra* notes 75–78 and accompanying text.

[198] Delaware is one of the nineteen states that never adopted a corporate constituency statute.

[199] Unocal v. Mesa Petroleum, 493 A.2d 946, 955 (Del. 1985) (permitting directors confronted with a hostile takeover bid to consider "the impact on 'constituencies' other than shareholders").

[200] *Id.*

[201] *See supra* note 29.

profitability."[202] The interests of these other constituencies must still be rationally related to benefits that would accrue to the company and its shareholders.[203] However, this requirement is satisfied if directors can demonstrate that considerations other than near-term value relate to "a good faith concern for the welfare *of the corporation* and its stockholders."[204]

Once a corporate board has acknowledged that the company is for sale, Delaware holds that the duty of directors changes from the preservation of the corporate entity to the maximization of value for the sole benefit of the stockholders.[205] A board may no longer consider the interests of nonshareholder constituencies when it is actively pursuing a sale of the corporation rather than seeking to preserve the corporate enterprise through defensive tactics.[206] Also, in the context of a potential control transaction, directors' discharge of their fiduciary duties is subject to heightened scrutiny.[207]

The Delaware view of the corporate sale process is, however, rooted in the traditional assumption that "wealth maximization" is the sole concern of corporate directors—an assumption which has been criticized as both a matter of law and public policy.[208] Moreover, B-corp statutes leave open

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[202] Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1150 (Del. 1990). *See also id.* at 1154 ("Directors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy.").

[203] *Unocal*, 493 A.2d at 955.

[204] *Id.* (citing Cheff v. Mathes, 199 A.2d 548, 554–55 (Del. 1964) (emphasis added)).

[205] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (noting that once there had been a decision to sell the company, the "directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders").

[206] *Id.*

[207] *See* Mills Acquisition Co. v. Macmillan Inc., 559 A.2d 1261, 1281 (Del. 1989) (noting that, where ordinarily a board of directors may rely on information provided by management, "it may not avoid its active and direct duty of oversight in a matter as significant as the sale of corporate control").

[208] *See supra* note 113.

the prioritization of shareholder and nonshareholder interests, even in the context of a control transaction.

IV. A HYBRID APPROACH TO THE FIDUCIARY DUTY OF B-CORP DIRECTORS

A. A B-Corp Duty of Obedience to Benefit Purposes

As one court noted, the "correct analytical framework is essential to a proper review of challenges to the decision-making process of a corporate Board."[209] Imposing a duty of obedience on B-corp directors provides an analytical framework for challenges to the Good & Tasty board's decision either to ignore the company's benefit purposes or to sell the company.

A number of considerations strongly support the proposition that B-corp directors have a duty of obedience to a corporation's benefit purposes in addition to their duties of care and loyalty to the corporation. First, additional duties may be imposed by statute,[210] and the language of the B-corp laws passed to date suggests the imposition of such a duty. Like the Model B-Corp Act, state B-corp statutes all describe the creation of a public benefit as being the "purpose" of the corporation.[211] Moreover, the statutes state that the benefit

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[209] Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1374 (Del. 1995) (citing Nixon v. Blackwell, 626 A.2d 1366, 1375 (Del. 1993)).

[210] *See, e.g.*, N.Y. BUS. CORP. LAW § 717(a) (McKinney 2011) (imposing the duty of care on directors of New York business corporations).

[211] *See* MODEL B-CORP ACT § 3311(a) (2009) ("Every benefit corporation shall have the purpose of creating general public benefit."); *see also* HAW. REV. STAT. § 420D-5(a) (2011) ("Every sustainable business corporation shall have among its purposes the creation of a general public benefit."); MD. CODE ANN., CORPS. & ASS'NS § 5-6C-06(a)(1) (West 2011) ("Each benefit corporation shall have the purpose of creating a general public benefit."); N.J. STAT. ANN. § 14A:18-5(a) (West 2011) ("Every benefit corporation shall have the purpose of creating a general public benefit."); VT. STAT. ANN. tit. 11A, § 21.08(a) (2011) ("A benefit corporation shall have the purpose of creating general public benefit."); VA. CODE ANN. § 13.1-788(A) (2011) ("A benefit corporation shall have as one of its purposes the purpose of creating a general public benefit."); S.B. 79-A, 2011 Leg., Reg.

purposes are in addition to—and distinct from—the general business purposes of the corporation as a for-profit entity.[212] Finally, some of the statutes refer to the creation of this public benefit as an "obligation of a benefit corporation" which results from its adoption of benefit purposes[213] and which a new right of action may enforce.[214]

The similarity between B-corp benefit purposes and the charitable purposes of a nonprofit corporation also supports imposing a duty of obedience. B-corps are permitted to list specific public benefits they plan to pursue.[215] The examples of specific public benefits, and their supporting role in relation to the general benefit purpose, closely parallel the enumeration by a nonprofit organization of activities in furtherance of its tax-exempt purposes.[216] Also, like a nonprofit organization's statement of purposes, an amendment to the benefit purposes of a B-corp requires supermajority approvals to ensure that the ability to amend

Sess. § 1706(a) (N.Y. 2011) (to be codified at N.Y. BUS. CORP. LAW § 1706(a)) ("Every benefit corporation shall have a purpose of creating general public benefit.").

[212] *See* MD. CODE ANN., CORPS. & ASS'NS § 5-6C-06(a)(2) (noting that the benefit purpose may be in addition to, and a limitation on, "any lawful business" purpose otherwise adopted in the articles of incorporation); VT. STAT. ANN. tit. 11A, § 21.08(a) (same); N.J. STAT. ANN. § 14A:18-5(a) (same); VA. CODE ANN. § 13.1-787(A) (same). The New York bill also provides 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." N.Y. S.B. 79-A § 1706(a). The Hawaii statute does not address the potential conflict between benefit purposes and other business purposes.

[213] *See, e.g.*, MD. CODE ANN., CORPS. & ASS'NS § 5-6C-06(b); VT. STAT. ANN. tit. 11A, § 21.08(b).

[214] *See, e.g.*, HAW. REV. STAT. § 420D-10 (creating new right of action "to enforce corporate purposes" of a B-corp).

[215] *See* HAW. REV. STAT. § 420D-5(b) (listing examples of specific public benefits); MD. CODE ANN., CORPS. & ASS'NS § 5-6C-06(b) (same); N.J. STAT. ANN. § 14A:18-1 (same); VT. STAT. ANN. tit. 11A, § 21.08(b) (same); VA. CODE ANN. § 13.1-782 (same); N.Y. S.B. 79-A § 1702(e) (same).

[216] *See, e.g.*, Treas. Reg. § 1.501(c)(3)-(1)(d)(2) (2008); N.Y. NOT-FOR-PROFIT CORP. LAW §§ 201, 204. *See also supra* notes 123, 125, 127–28 and accompanying text.

does not substantially weaken the duty of obedience.[217] Moreover, a corporation's mission may be defined by what it actually does as well as by what it says it will do.[218] Consequently, the activities detailed in a B-corp's required annual benefit statement also serve to describe the ongoing purposes to which directors owe a duty.

To the extent that B-corps resemble nonprofit organizations in their adoption of benefit purposes, trust theory[219] would also suggest the creation of an additional duty. Public shareholders, who endow the corporation with capital, could be seen as "grantors" who name beneficiaries when they approve the adoption or amendment of articles of incorporation.[220] The naming of beneficiaries creates a duty[221] that runs to the benefit purpose because directors must "carry out the mandates of the indenture under which they operate."[222] Such a theory of director duty would substitute the list of benefit purposes in the articles of

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[217] *See* Benjamin, *supra* note 126, at 1691–92. The Hawaii, New Jersey, and Vermont B-corp statutes, and the New York bill, require "minimum status vote" approval of holders of two-thirds of the corporation's shares to add, amend, or delete a specific public benefit, unless a higher vote is otherwise required under the articles. *See* HAW. REV. STAT. §§ 420D-2, 5(d); N.J. STAT. ANN. §§ 14A:18-1, 18-5(d); VT. STAT. ANN. tit. 11A, § 21.08(d), (e); N.Y. S.B. 79-A §§ 1702(d), 1706(d). The Maryland and Virginia B-corp statutes require a two-thirds vote to change specific benefit purposes by incorporating by reference provisions of those states business corporation laws that govern any amendment to articles of incorporation. *See* MD. CODE ANN., CORPS. & ASS'NS §§ 5-6C-02(a), 2-604(e); VA. CODE ANN. §§ 13.1-787(C), 13.1-707(D).

[218] *See, e.g.*, *In re* Multiple Sclerosis Found. of N.Y., 496 N.E.2d 861 (N.Y. 1986) (noting the relevance of "the activities of the corporation in fact carried out under its charter" as well as the purposes stated in its articles of incorporation). *See also supra* note 41.

[219] *See supra* notes 136–37 and accompanying text.

[220] *See supra* note 13.

[221] *See* UNIF. TRUST CODE § 404 cmt. (amended 2006) 7C U.L.A. 484 ("The general purpose of trusts having identifiable beneficiaries is to benefit those beneficiaries in accordance with their interests as defined in the trust's terms . . . .").

[222] Commonwealth v. Barnes Found., 159 A.2d 500, 505 (Pa. 1960) (using trust language due to the structure of the nonprofit organization).

incorporation for the charitable purposes set forth in a trust indenture.

There are several possible arguments against the imposition of a duty of obedience on B-corp directors. First, the language of some of the statutes suggests an absence of legislative intent.[223] For example, several of the statutes attempt to protect B-corp directors from a possible expansion of their fiduciary duties by stating plainly those parties to whom no duty is owed.[224] However, B-corp statutes attempt to address only the issue of a duty to *persons*, and do not explicitly prohibit the imposition of a duty to the benefit purpose itself.[225] Moreover, the language in the Model Act and in many of the state statutes creating a "benefit enforcement proceeding" tacitly acknowledges that such a duty exists and is the basis for such a cause of action.[226]

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[223] *See* Reiser, *Blended Enterprise*, *supra* note 19, at 17 (asserting that the New York bill and the language it requires for a B-corp charter "both explicitly decline to create new rights of action in individuals to assert that directors did not sufficiently consider these non-shareholder interests or constituencies").

[224] The Vermont statute states that a B-corp director has a duty only to those persons who are entitled to bring a benefit enforcement proceeding (primarily shareholders) and that a director has no duty to the expected beneficiaries of the corporation's public purposes. VT. STAT. ANN. tit. 11A, § 21.09(e) (2011). The Maryland statute and the New York bill state that directors owe no duty to beneficiaries of a public benefit purpose. MD. CODE ANN., CORPS. & ASS'NS § 5-6C-07(b) (West 2011); S.B. 79-A, 2011 Leg., Reg. Sess. § 1707(c) (N.Y. 2011) (to be codified at N.Y. BUS. CORP. LAW § 1707(c)). However, the Maryland statute and the New York bill fail to exclude a duty to beneficiaries of specific benefit purposes or to corporate constituencies. *See supra* note 64 and accompanying text.

[225] The New York bill makes this distinction clear. *Compare* N.Y. S.B. 79-A § 1707(c) ("A director does not have a fiduciary duty to a person that is a beneficiary of the general or specific public benefit purposes . . . ."), *with id.* N.Y. BUS. CORP. LAW § 720(c) (McKinney 2011) (permitting an action against directors to force them to account for "the failure to pursue the general public benefit purpose of a benefit corporation or any specific public benefit set forth in its certificate of incorporation").

[226] For example, the Vermont statute defines a benefit enforcement proceeding, in part, as an action against a director or officer for a "failure to pursue the general public benefit purpose of the benefit corporation or any specific public benefit purpose set forth in its articles of

While Maryland applies a section of its business corporation law[227] rather than provide for a benefit enforcement proceeding, its courts have noted that the section is not the sole source of duties of corporate directors.[228] Likewise, the Maryland business corporation provision that bars direct claims against directors for breaches of the duty of care[229] is not meant to bar direct actions for breaches of other duties that directors may have.[230]

Second, the creation of any new duty, particularly one which would create a cause of action based on subjective assertions as to what could have been done, creates the possibility of nuisance litigation.[231] However, limiting standing to sue, whether on a direct or derivative basis, can mitigate this risk. Stringent standing limits have been effective in protecting nonprofit organizations against suits by disgruntled patrons for failure to execute on stated purposes.[232] Also, a plaintiff would have to allege a breach of the duty of obedience based on a single document: the corporation's statement of benefit purposes in its articles of incorporation. This would provide courts with a ready template with which to identify and dismiss frivolous litigation.[233]

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incorporation." VT. STAT. ANN. tit. 11A, § 21.13(c)(1). This is essentially the definition of a breach of the duty of obedience. *See* KURTZ, *supra* note 128, at 84–85; *supra* notes 116, 120 and accompanying text.

[227] MD. CODE ANN., CORPS. & ASS'NS § 2-405.1(a).

[228] Shenker v. Laureate Educ., Inc., 983 A.2d 408, 418 (Md. 2009). *See also id.* at 421 ("[I]n enacting § 2-405.1(a), the General Assembly did not seek to occupy the entire field of directorial duties, but instead intended to codify the duty of care . . . .").

[229] MD. CODE ANN., CORPS. & ASS'NS § 2-405.1(g).

[230] *See Shenker*, 983 A.2d at 426–27 (noting that both the text and legislative history of § 2-405.1(g) indicate that the provision was not intended to bar direct actions for breaches of duties other than those created by § 2-405.1 itself).

[231] *See* Va. Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1092 (1991) (discussing the "threat of vexatious litigation" concerning decisions of corporate directors).

[232] Benjamin, *supra* note 126, at 1696.

[233] *Id.* at 1701.

A third set of objections to the duty of obedience—often leveled in a nonprofit context—rests on practical grounds. Adding any duty which might increase directors' liability would dissuade competent and public spirited individuals from serving on B-corp boards of directors.[234] Also, nuisance litigation adds a cost which nonprofit organizations are ill-equipped to bear.[235] However, for-profit B-corps would typically have more financial resources than nonprofit organizations, allowing them to provide economic incentives to directors to serve and to pay legal costs or purchase liability insurance. Moreover, it may be assumed that a business corporation would have taken these issues into account before voluntarily electing[236] B-corp status and would have decided that they were manageable.

B. Shareholder and Nonshareholder Standing

The concept of judicial standing is "practical and functional" and designed to limit participation to those with a "genuine and legitimate interest."[237] The imposition of a duty of obedience would, at a minimum, permit Good & Tasty shareholders to sue on a derivative basis for a breach of that duty, since it runs to the corporation.[238] This is consistent with the text of both B-corp statutes that provide for benefit enforcement proceedings[239] and those which do

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[234] *See* Goldschmid, *supra* note 5, at 637.

[235] *See* Benjamin, *supra* note 126, at 1683.

[236] *See supra* note 38 and accompanying text.

[237] Office of Commc'n of the United Church of Christ v. FCC, 359 F.2d 994, 1002 (D.C. Cir. 1966).

[238] *See* KURTZ, *supra* note 128, at 84–85.

[239] The Vermont statute states that a director may be "liable *to the benefit corporation*" for acts or failures to act which would serve as the basis of a "benefit enforcement proceeding," such as a failure to pursue the benefit purposes. VT. STAT. ANN. tit. 11A, § 21.09(d) (2011) (emphasis added). *See also* N.J. STAT. ANN. § 14A:18-10(b)(2) (West 2011) (limiting shareholders to derivative actions to enforce benefit purposes). The Virginia statute expressly limits a benefit enforcement proceeding to an "action brought directly by a benefit corporation, or derivatively on behalf of a benefit corporation . . . ." VA. CODE ANN. § 13.1-782 (2011). Hawaii is unusual in permitting direct as well as derivative suits for a breach of a

not.[240] It is also consistent with nonprofit governance principles, which permit derivative actions by members on the part of the corporation for the restoration of corporate property or compensation for losses.[241]

The Model Act, and state statutes that incorporate its provision for a benefit enforcement proceeding, appear to foreclose the possibility of standing for nonshareholder constituencies.[242] The definition of a benefit enforcement proceeding is comprehensive and includes any action alleging a violation of a director's duty as defined in the B-corp statute.[243] These statutes permit only directors and shareholders to sue to enforce benefit purposes, limiting the

duty to corporate purposes. *See* HAW. REV. STAT. § 420D-10 (2011) (defining a broad "right of action" which allows shareholders and directors "to bring direct or derivative claims to enforce the general or specific public benefit purposes of the sustainable business corporation").

[240] While the Maryland statute and New York bill do not provide for a benefit enforcement proceeding, both states' business corporation laws permit derivate suits by reference. *See* MD. CODE ANN., CORPS. & ASS'NS § 2-405.1(g) (West 2011) (limiting enforcement of directors' duties to an action "by the corporation or in right of the corporation"); N.Y. BUS. CORP. LAW § 626(a) (McKinney 2011) (permitting derivative actions for a breach of fiduciary duty); *id.* § 719(a) (listing certain actions by directors that may result in liability to the corporation and give rise to derivative claims).

[241] PHELAN, *supra* note 124, at § 3.10. *See, e.g.*, Fontheim v. Walker, 122 N.Y.S.2d 642, 645–46 (App. Div. 1953) (noting, however, that a derivative plaintiff must do more than merely allege a disagreement with policies adopted by the directors).

[242] *See* Reiser, *Sustainable Form*, *supra* note 19, at 599 (noting language in some B-corp statutes that provides that directors owe no duty to the corporation's beneficiaries). A benefit constituency (such as a labor union) could, of course purchase stock and secure standing as a shareholder. However, it is unclear whether standing on this basis would entitle the constituency to sue for injunctive relief unrelated to shareholder status and possibly against the interests of other shareholders.

[243] *See* MODEL B-CORP ACT § 3302 (2009) (defining a benefit enforcement proceeding to include an action alleging "violation of a duty or standard of conduct *under this chapter*" (emphasis added)); *see also* N.J. STAT. ANN. § 14A:18-1; VT. STAT. ANN. tit. 11A, § 21.13(c)(2); VA. CODE ANN. §§ 13.1-782.

latter to derivative suits.[244] However, shareholders also appear to have the ability seek declaratory relief on a direct basis, despite this limitation.[245] These standing limitations are unfortunate in that they leave nonshareholder constituencies at the mercy of shareholders, who may not choose to enforce benefit purposes, which prove to be detrimental to the value of their investments.

However, there may be two ways in which nonshareholder constituencies can circumvent the limitations imposed by benefit enforcement proceeding provisions. Like the Model Act, the Vermont, New Jersey, and Virginia statutes also extend benefit enforcement standing to "such other persons as may be specified in the articles of incorporation of the benefit corporation," in addition to shareholders and directors.[246] This could include both the corporate constituencies listed in the provision governing the conduct of directors, as well as groups named in the corporation's list of specific benefit purposes.[247] Failing that, benefit constituencies could at least petition the

[244] *See* MODEL B-CORP ACT §§ 3302, 3325(b); *see also* N.J. STAT. ANN. §§ 14A:18-1, 18-10(b); VT. STAT. ANN. tit. 11A, § 21.13(b), (c); VA. CODE ANN. §§ 13.1-782, 13.1-790(B).

[245] *See supra* note 167 and accompanying text.

[246] MODEL B-CORP ACT § 3325(b)(2)(iv). *See also* N.J. STAT. ANN. § 14A:18-10(b)(2)(d); VT. STAT. ANN. tit. 11A, § 21.13(b)(4); VA. CODE ANN. § 13.1-790(B)(2)(c).

[247] *See, e.g.*, VT. STAT. ANN. tit. 11A, § 21.09(a)(1) (listing corporate constituencies that *must* be set forth in the articles of incorporation, including: "the employees and workforce" of the B-corp; "customers, to the extent they are beneficiaries of the general or specific public benefit" of the B-corp; and communities in which the B-corp has facilities); *id.* § 21.03(a)(6) (listing beneficiaries of specific public benefits which *may* be set forth in the articles of incorporation, including: "low income or underserved individuals or communities" and other entities with a public benefit purpose). *See also* N.J. STAT. ANN. 14A, § 18-6(a) (listing corporate constituencies); *id.* § 14A:18-1 (listing potential beneficiaries of specific public benefits); VA. CODE ANN. § 13.1-788(A) (listing corporate constituencies); *id.* § 13.1-782 (listing potential beneficiaries of specific public benefits). Note that a B-corp is not required to name specific benefit purposes or beneficiaries. This may indicate that naming them satisfies the requirement for benefit enforcement standing.

state attorney general on the grounds that the corporation is not living up to its public commitment, arguing that B-corp benefit enforcement provisions could not have been intended to foreclose government enforcement actions.

The possibility of standing for nonshareholder constituencies is clearer in the state B-corp statutes that do not limit the right of action to a benefit enforcement proceeding. Both Maryland and New York generally permit actions against B-corp directors by incorporating by reference provisions of their business corporation laws.[248] New York took the added step of adding a cause of action to require B-corp directors to account for their failure to pursue general or specific public benefit purposes set forth in the articles of incorporation.[249] Hawaii creates a broad right of action which permits shareholders to sue to enforce the requirement that directors consider the interests of nonshareholder constituencies, but does not expressly prohibit these constituencies from bringing suit on their own behalf.[250]

Statutes that lack the benefit enforcement proceeding limitations arguably offer derivative standing to Good & Tasty's employees, local communities where its factories are based, and possibly even beneficiaries of its social mission, as a result of their characterization of a B-corp's stated benefit purposes. These statutes state that the creation of a general public benefit, as well as any enumerated specific public benefits, is "in the best interests of the benefit

[248] The Maryland B-corp statute says that B-corp directors' duties to consider the interests of benefit constituencies are "in addition to the duties described in § 2-405.1" of its corporation law, which sets forth the duty of care. However, the Maryland statute does not say that this provision necessarily limits party standing. *See* MD. CODE ANN., CORPS. & ASS'NS § 5-6C-07(a) (West 2011); *id.* § 2-405.1(g) (providing that director duties under that section may only be enforced in a derivative action, without limiting such action to shareholders). The New York B-corp bill refers to a section of the state's Business Corporation Law that permits actions to "compel defendant [director] to account for his official conduct." N.Y. BUS. CORP. LAW § 720(a)(1) (McKinney 2011).

[249] N.Y. BUS. CORP. LAW § 720(a)(1)(C)(i).

[250] HAW. REV. STAT. § 420D-10 (2011).

corporation."[251] This formulation is identical to the test by which courts have upheld the right of directors to consider nonshareholder interests under states' permissive constituency statutes.[252] The mandatory nature of B-corp legislation could offer corporate or benefit constituencies (as well as shareholders) grounds for a derivative claim that the failure to obey benefit purposes was against the best interests of, and therefore injurious to, the corporation.[253]

Derivative standing of nonshareholder benefit constituencies should, however, be limited. A benefit constituency should only be able to sue derivatively if the party could satisfy the "special interest" test.[254] A benefit constituency plaintiff would have to do more than demonstrate that the party was a member of a group named in the purposes statement in the articles of incorporation. The plaintiff would have to demonstrate a benefit interest different from that of members of the group "at large."[255]

[251] MD. CODE ANN., CORPS. & ASS'NS § 5-6C-06(c); S.B. 79-A, 2011 Leg., Reg. Sess. § 1706(c) (N.Y. 2011) (to be codified at N.Y. BUS. CORP. LAW § 1706(c)). *See also* HAW. REV. STAT. § 420D-5(c).

[252] *See, e.g.*, Stilwell Value Partners v. Prudential Mut. Holding Co., No. 06-4432, 2008 U.S. Dist. LEXIS 34095, at *42–44 (E.D. Pa. Apr. 24, 2008). *See also supra* notes 90–93.

[253] Courts have permitted benefit constituents to sue derivatively based solely on stated benefit purposes even absent an implied statutory command. *See, e.g.*, Stern v. Lucy Webb Hayes Nat'l Training Sch. for Deaconesses & Missionaries (*Sibley Hospital I*), 367 F. Supp. 536, 540 (D.D.C. 1973) (certifying users of a charitable hospital's services as a class because they had a sufficient "special interest"). Note that the *Sibley Hospital I* court did not specifically limit the beneficiaries to a derivative action, but suggested that they could pursue "an award of damages to be paid into the Hospital's funds . . . ." *Id.* *See also* Christiansen v. Nat'l Sav. & Trust Co., 683 F.2d 520, 528 (D.C. Cir. 1982) (noting that the patients in *Sibley Hospital I* were enforcing a duty of the hospital directors to the hospital and not to the patients themselves); O'Donnell v. Sardegna, 646 A.2d 398, 408 (Md. 1994) (examining the factors that the *Sibley Hospital I* court used to permit the beneficiaries to sue on a derivative basis).

[254] *See supra* notes 152–55 and accompanying text. The plaintiff would logically bear the burden of proof regarding special interest status at the pleading stage.

[255] For example, a plaintiff might satisfy the special interest requirement by demonstrating that she had received past benefits or had

Limiting nonshareholders to derivative actions would mean they would not also have to demonstrate an injury separate and distinct from that suffered by the corporation.[256]

While nonshareholder constituencies may claim derivative standing in certain B-corp states, direct standing is more problematic.[257] Members of benefit constituencies could show facts suggesting intentional acts by directors contrary to their benefit interests.[258] B-corp statutes may also create a legal relationship between named nonshareholder constituencies and the corporation that is a precondition for a direct cause of action.[259] Contract theory also supports a grant of direct standing to benefit constituencies in certain circumstances.[260] However,

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been specifically named in corporate documents as an intended beneficiary.

256 *See supra* note 164 and accompanying text.

257 Benefit constituencies could, of course, petition the state attorney general to sue for injunctive relief. *See supra* notes 145–50 and accompanying text.

258 *See, e.g.*, *Sibley Hospital I*, 367 F. Supp. at 536 (allowing hospital patients to sue directors); Zehner v. Alexander (*Wilson College*), No. 56, 1979 (Pa. Commw. Ct. 1979) (permitting college students to sue trustees). *But see* Sara R. Kusniak, *The Case for A.U. (Accountable Universities): Enforcing University Administrator Fiduciary Duties Through Student Derivative Suits*, 56 AM. U. L. REV. 129, 159 (2006) (arguing that *Sibley Hospital I* creates a potential right of action for beneficiaries of poorly regulated nonprofit organizations that is limited to derivative suits).

259 *See* Aronson v. Lewis, 473 A.2d 805, 810 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000) (noting that standing may arise as a matter of statute).

260 *See* Hansmann, *supra* note 131, at 509 (arguing that a donation to a nonprofit organization creates a contract between the two parties). Two strains of contract law support benefit constituency standing: the third party beneficiary doctrine and promissory estoppel. Under the former doctrine, benefit constituencies could be viewed as the beneficiaries of a contract between B-corp shareholders (substituting for the charitable donors in the Hansmann contract model) and the corporation, where the contract is completed by shareholder ratification of the benefit purposes. Under the latter doctrine, benefit constituencies might be able to demonstrate that they had acted to their detriment in reliance on a B-corp's statement of benefit purposes (presumably its specific benefit purposes). *See* Atkinson, *Unsettled Standing*, *supra* note 143, at 673–75.

provisions in some of the statutes that limit shareholder actions against B-corp directors to derivative suits[261] suggest legislators would be even less receptive to direct actions by nonshareholder constituencies.

The most fundamental objection to a grant of standing, derivative or otherwise, is that granting standing to "prospective and diffuse beneficiaries [would be] contrary to the entire standing doctrine."[262] However, B-corp benefit constituencies are more than merely prospective beneficiaries; they are the *intended* beneficiaries of the corporation's mission. At the same time, the application of the "special interest" requirement would address the issue of the diffuse nature of a benefit constituency class.

There are a number of judicial tools available to reduce the risk that extending standing to nonshareholder constituencies would bring down a plague of nuisance litigation on B-corps and their directors. First, the Good & Tasty directors should have the protection of the business judgment rule, provided that they act in good faith and in the absence of any conflict of interest.[263] The framers of the Model B-Corp Act and state legislators saw the business judgment rule as an appropriate way to counteract what they evidently recognized was an implicit expansion in directors' duties as a result of electing B-corp status.[264] The

However, to state a claim based on estoppel, a benefit constituency would essentially have to satisfy the requirements of the "special interest" doctrine.

261 *See supra* note 166 and accompanying text.

262 Benjamin, *supra* note 126, at 1701. *See also* Atkinson, *Unsettled Standing*, *supra* note 143, at 676 (arguing that standing in the context of a nonprofit organization must be analyzed differently than in a for-profit context because neither donors nor members "own" the organization in the manner of corporate shareholders).

263 *See* Atkinson, *Obedience as the Foundation*, *supra* note 127, at 50–51.

264 *See, e.g.*, MD. CODE ANN., CORPS. & ASS'NS § 2-405.1(e) (West 2011) (setting forth Maryland's codification of the business judgment presumption, incorporated by reference into that state's B-corp statute). The business judgment rule requires courts to apply a deferential standard of review to director's decisions (the "business judgment

business judgment rule's bar on judicial second-guessing would seem even more necessary for B-corp directors who must balance obedience to benefit purposes with profit-making concerns, than for directors of for-profit corporations.[265] The primary argument against the application of the business judgment rule in a nonprofit context—that charitable organizations lack shareholders and other market mechanisms to police director misconduct[266]—does not apply to B-corps.

standard") if the director can satisfy four conditions. In order to qualify for this judicial deference, a director must (1) have made a decision, (2) have been reasonably informed, (3) have acted in good faith, and (4) have had no financial interest in the matter. *See* EISENBERG, *supra* note 162, at 540. If the conditions are satisfied, then plaintiffs usually bear the burden of proving that the decision was not rational. *See, e.g.*, Selheimer v. Manganese Corp. of Am., 224 A.2d 634, 646 (Pa. 1966) (holding directors liable for a foolish investment decision because their conduct could not "be classified as mere negligence" and "defies explanation"). However, some courts hold that the plaintiff's burden is to prove gross negligence. *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985), *overruled on other grounds by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009) (noting that gross negligence is the standard to be applied in deciding whether directors' decisions were informed, and, if so, whether they may still be held liable for reaching the wrong decision). Courts in states that have passed B-corp legislation generally follow Delaware's formulation of the business judgment rule. *See, e.g.*, Yost v. Early, 589 A.2d 1291, 1298 (Md. 1991) (following Delaware in distinguishing the standard of care required of directors from the business judgment rule itself, which is a presumption that directors acted according to that standard); Robertson v. Mylan Labs., Inc., 848 A.2d 310, 325 (Vt. 2004) (noting that Vermont's business corporations law "[does] not grant courts authority to second-guess the wisdom of corporate business decisions . . . .") (citation omitted).

[265] The application of the business judgment rule in the context of a duty of obedience would be more complex, but need not be prohibitively so. For a B-corp director, a fifth condition would be added: that the directors gave informed consideration to the benefit purposes of the corporation. If a decision satisfied all of these conditions, then plaintiffs would bear the burden of proof that the decision was either irrational or grossly negligent with respect to *either or both* the business and benefit purposes of the corporation.

[266] *See* Ping Lee, *supra* note 137, at 958; Goldschmid, *supra* note 5, at 644–45.

The Good & Tasty directors should also enjoy the protection of other liability shields available to directors of both for-profit and nonprofit organizations.[267] Both Delaware corporate law and nonprofit law suggest that the burden of proof should be on both shareholder and nonshareholder plaintiffs in such suits if the conditions of the business judgment rule are satisfied.[268] Given the potential vagueness of the public benefit concept, a heightened evidentiary standard, requiring proof by "clear and convincing evidence" rather than just by a preponderance of the evidence,[269] may also be appropriate where either shareholder or nonshareholder plaintiffs allege a breach of the duty of obedience to benefit purposes. Maryland, Vermont, New York, and most other B-corp states also permit corporations to indemnify directors, absent a showing of bad faith or conflict of interest.[270] There is no reason that B-corp directors should not also be afforded these protections.

C. The Effect of a Sale on Benefit Purposes

Like nonprofit and for-profit takeover law,[271] the Model Act and state B-corp statutes recognize that control transactions raise particular issues with respect to the Good & Tasty directors' exercise of their fiduciary duties. The Model Act and the state statutes all relieve directors of any obligation to set one particular constituency's interests over

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[267] *See generally* FREMONT-SMITH, *supra* note 122, at 227–30.

[268] *See Van Gorkom*, 488 A.2d at 872.

[269] FREMONT-SMITH, *supra* note 122, at 230 (noting that four states have adopted this heightened evidentiary standard for suits against nonprofit directors).

[270] *See, e.g.*, MD. CODE ANN., CORPS. & ASS'NS §§ 2-405.2, 2-418 (West 2011) (permitting corporations to limit director liability and to indemnify directors); N.Y. BUS. CORP. LAW § 722 (McKinney 2011) (permitting indemnification of directors); *id.* § 724 (providing for court-mandated indemnification upon request by directors in certain circumstances); VT. STAT. ANN. tit. 11A, §§ 8.52, 8.56 (2011) (permitting indemnification of directors in general, and making indemnification mandatory in certain circumstances).

[271] *See supra* Parts III.C.1 and III.C.2.

those of any other.[272] At the same time, the fact that all of the statutes treat B-corps as a species of business corporation, as well as the standing provisions in some of the statutes, imply the primacy of shareholders. [273] None of the statutes adequately address the role that a duty to benefit purposes might play in a corporate sale.

Most of the B-corp statutes make it clear that the decision to reject a takeover offer may be based on commitments to nonshareholder constituencies and benefit purposes.[274] States' replacement of permissive constituency statute provisions with a mandate to consider other interests demonstrates legislative intent in this regard.[275] Delaware's recognition that directors of an ordinary business corporation may base a decision to reject a takeover offer on long-term strategy at the expense of near-term value provides further support for this approach.[276]

This leaves the question of how directors must fulfill their duty of obedience once they have decided to sell a B-corp, which is the very situation that gave rise to the B-corp movement.[277] There are two possible approaches to assess

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[272] *See supra* notes 76–78 and accompanying text.

[273] *See supra* notes 30, 51–52, 63 and accompanying text.

[274] *See supra* notes 70–73 and accompanying text.

[275] *See supra* notes 95–96 and accompanying text.

[276] *See* Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1150 (Del. 1990) ("[T]he question of 'long-term' versus 'short-term' values is largely irrelevant because directors, generally, are obliged to charter a course for a corporation which is in its best interest without regard to a fixed investment horizon.").

[277] *See supra* note 16. Like the sale of Ben & Jerry's, the attempted sale by The Hershey Trust of its controlling interest in The Hershey Company (formerly Hershey Foods Corporation) illustrates the tension between business and social benefit purposes in the context of a control transaction. Treated as a single entity, the two organizations together look surprisingly like a B-corp with multiple benefit constituencies. The mission of the Trust is to provide education and other benefits to orphaned children. Hershey, one of the world's leading candy manufacturers, has public shareholders and is an important employer in Pennsylvania. In 2002, the Trust proposed to sell its interest and triggered a corporate auction. This pitted the interests of Hershey shareholders and the orphans, both of whom would have benefitted from the sale, against the

whether the Good & Tasty directors have properly balanced duties to shareholders and to benefit purposes in choosing among different purchase offers.

One approach would be to permit directors to accept a lower offer if they believe that it better serves the company's benefit purposes. Courts' treatment of corporate constituency statutes[278]—which states adopted in response to corporate takeover activity[279]—supports this approach. The mandatory nature of B-corp statutes, when compared to permissive constituency statutes, suggests that directors must at a minimum consider whether a merger will actually

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interests of Hershey employees. The Pennsylvania attorney general sought (and secured) a special injunction in the Orphan's Court. In upholding the injunction, the Commonwealth Court of Pennsylvania used language that could be a blueprint for similar litigation in a B-corp context, regardless of whether a private party or an attorney general brings suit:

> The Attorney General has sufficiently carried his burden of proving the potential harm that he seeks to prevent, namely, the adverse economic and social impact against the public interest if a sale of Hershey Foods Corporation takes place, particularly in its effect on employees of the Corporation and the community of Derry Township. The persuasive thrust of the testimony . . . was that a sale of the controlling interest in Hershey Foods Corporation creates a likelihood that there will be reduction in the work force and that relocations of plant operations and closing of duplicate facilities will be matters of probable immediate consideration by the acquiring company. We would add that this Court is not required to be blind and deaf to that which has been commonplace information to the public during the recent past period of numerous mergers and acquisitions of public companies.

In re Milton Hershey School Trust (*Hershey I*), 807 A.2d 324, 331 (Pa. Commw. Ct. 2002). Only the fact that the Trust and Hershey were actually two separate legal entities saved the court from having to balance the interests of orphans against those of the candymaker's employees and local communities. *See id.* at 328–30 (discussing the divergent interests of different Hershey constituencies).

[278] *See supra* note 93 and accompanying text.

[279] *See* Millon, *supra* note 94, at 239.

harm the interests of benefit constituencies.[280] Nonprofit governance principles also suggest that B-corp directors have an obligation to weigh the extent to which competing takeover proposals actually further benefit purposes, even if this means not accepting the highest offer available.[281]

An alternative approach would both recognize the continued importance of shareholder interests in B-corps and the affirmative nature of the benefit purposes statement. Under this approach, directors would only be permitted to accept a lower offer over a higher one, based on a belief that the less generous acquirer would better promote benefit purposes, if they can demonstrate that the lower price still provides "fair value" to the shareholders.[282] This would be consistent with the intent of the statutes to ensure that the interests of nonshareholder constituencies and benefit purposes are considered in all contexts. However, it would also reduce the risk that a sale to a benefit-minded acquirer would actually harm shareholder interests.[283]

V. CONCLUSION

Defining the added fiduciary duty that directors accept when they elect B-corp status and how this duty may be

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[280] *See id.* at 257–59 (arguing that constituency statutes create, at a minimum, a cause of action that consideration of nonshareholder interests was not based on sufficient information); *id.* at 258 n.137 (arguing that constituency statutes also permit nonshareholders to claim that management decisions were self-interested or irrational, which would defeat the business judgment rule).

[281] *See supra* notes 191–94 and accompanying text.

[282] Courts, like corporate boards of directors, are routinely called on to assess whether merger consideration is fair, or what a fair price would have been in the context of a post-merger action for appraisal rights. *See, e.g.*, Andaloro v. PFPC Worldwide, Inc., No. 20336, 2005 Del. Ch. LEXIS 125 (Del. Ch. Aug. 19, 2005); Finkelstein v. Liberty Digital, Inc., No. 19598, 2005 Del. Ch. LEXIS 53 (Del. Ch. Apr. 25, 2005); *In re* Emerging Commc'ns, Inc. S'holders Litig., No. 16415, 2004 Del. Ch. LEXIS 70 (Del. Ch. May 3, 2004).

[283] *See* Millon, *supra* note 94, at 259 (arguing that disgruntled shareholders are likely to sue if directors use constituency statutes to sacrifice shareholder interests in favor of nonshareholders).

enforced is, first and foremost, of practical importance to the companies themselves. While the clear acknowledgement of a duty beyond that of directors of ordinary business corporations may create additional liability, it also defines the limits of liability and empowers B-corps to pursue their social missions. Legislators can—and should—call such strange corporate creatures into being. However, more is needed for this new corporate form to survive and thrive,[284] faced with a hostile legal environment that has traditionally recognized only profit motives and shareholder interests.[285]

An examination of B-corp fiduciary duty is also important because B-corps represent just one example of the new legal structures[286] created to accommodate the growing desire of entrepreneurs to pursue both business and social benefit goals. Social enterprise represents an emerging "fourth sector"[287] whose growth is hastening the need for new legal structures. In all of these types of hybrid entities, directors will have to balance a duty to generate a financial return for investor-owners with a duty to the beneficiaries of the social mission those owners have chosen to pursue.

A contemplation of the duties of corporate directors to nonshareholders is worthwhile even apart from the concerns of B-corps and social enterprises more generally. Directors of corporations that do not elect B-corp status or recognize any duty beyond the maximization of shareholders' financial returns need to be reminded, even as the memory of the recent financial crisis fades, that the traditional model of the business corporation is far from perfect.[288] Corporate directors should also remember that a business may still have a considerable impact on society—beneficial or otherwise—even without a provision in a corporate charter stating such a purpose.

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[284] The pushmi-pullyu, proud descendent of gazelles, chamois, and unicorns, is, after all extinct. *See* LOFTING, *supra* note 1, at 75–76.

[285] *See supra* notes 15–16, 113, 154, 277 and accompanying text.

[286] *See supra* notes 6–9 and accompanying text.

[287] *See* Kelley, *supra* note 3, at 376–77.

[288] *See* Taylor, *supra* note 5, at 771.