

**Awash in a Sea of Confusion: Benefit Corporations, Social Enterprise, and the Fear of “Greenwashing” by Michelle J. Stecker**

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**Abstract:** Within the last five years, a majority of states enacted benefit corporation legislation, a new legal form of business that embraces the “triple-bottom line” of people, planet, and profit. Benefit corporation status provides legal protections for directors and officers, who may now balance social and environmental impact with shareholder returns; creates rich opportunities for social entrepreneurs; gives investors more socially responsible options; and offers a helpful designation for consumers. This paper describes the history and purpose of benefit corporations, evaluates their pros and cons, and argues that safeguards against greenwashing make benefit corporations a valuable business form for social enterprise.

**Keywords:** benefit corporations, social enterprise, social entrepreneurship, greenwashing, hybrid, nonprofit, sustainability, triple-bottom line, consumer protection, social responsibility, corporate culture, business law

**JEL Classification Codes:** D180, D210, K220, L310, M130, M140

At a breath-taking pace since 2010, the majority of states in the U.S. enacted benefit corporation legislation, creating a new for-profit form for business that embraces a “triple-bottom line” accounting and sustainability framework that measures social, environmental, and financial

performance, commonly referred to as “people, planet, and profits.”<sup>1</sup> No longer must corporations only maximize shareholder wealth. Benefit corporation directors and officers now have a fiduciary duty to pursue, consider, or weigh the triple-bottom line consequences of their decisions, and corporations must provide annual reports documenting how they are upholding those standards. Benefit corporations are blurring the lines between the nonprofit and for-profit sectors by embracing business as a vehicle for social good, and are quickly becoming the industry standard for social enterprise. Roughly 3,000 benefit corporations were registered as of December 2015 (Ensign-Barstow).<sup>2</sup> Nevada, which requires only “a simple check box on its corporation form” for benefit corporation registration, ranks first in the number of active benefit corporations with 750 (Cooney et al. 2014; Bennett).

The lack of consistency in state laws has created a patchwork of differing standards of accountability and transparency, to the detriment of directors and officers, social entrepreneurs, and consumers. However, effective safeguards are in place. This paper argues that benefit corporations are a strategic and helpful business form that social entrepreneurs, green businesses, millennials, consumers, and social-impact investors will continue to enthusiastically embrace.

### ***The Maximizing Profits or Pursuing Social Good Conundrum***

The widespread and long-held belief that corporations in the United States must primarily

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<sup>1</sup> In 1994, John Elkington coined the phrase “triple-bottom line” (The Economist 2009). “The TBL ‘captures the essence of sustainability by measuring the impact of an organization’s activities on the world ... including both its profitability and shareholder values and its social, human and environmental capital” (Slaper and Hall 2011).

<sup>2</sup> Although the low-profit limited liability company (L3C) business form was first to market in 2008, the adoption of “L3C legislation seems to have stagnated, whereas benefit corporation legislation is quickly spreading across the country” (Cooney 2014).

maximize shareholder wealth is a fixture in the minds and actions of corporate directors and officers. In the famous *Dodge v. Ford Motor Co.* case, the Michigan Supreme Court in 1919 compelled Ford to distribute corporate dividends to shareholders, even though the Dodge brothers were using the funds to start a company to directly compete with the Ford Motor Company (*Dodge v. Ford*). In contemporary times, courts and state legislatures have made it legal for corporations to donate to nonprofit organizations rather than funneling all profits to shareholders, and extended the business judgment rule granting wide discretionary authority to directors and officers upholding their fiduciary duties. Also, 33 states have passed constituency statutes that allow directors and officers to consider non-shareholder interests, including “customers, employees, suppliers, creditors, and the community at large” in their decision-making process (Luoma and Jasinski 2013, 123).<sup>3</sup>

Despite case law and the advent of statutory protections, the belief that corporations must maximize shareholder wealth is taught in law schools, cited by attorneys and the media, and embedded as a “nagging doubt” in the minds of corporate fiduciaries (Loewenstein 2014, 1008).<sup>4</sup> The high-profile case of the Vermont ice cream company Ben & Jerry’s, “forced” to “sell out” to the highest bidder while citing the maxim of shareholder profit, has provided a rallying cry and

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<sup>3</sup> State constituency statutes were adopted in the 1980s and early 1990s to provide companies with a legal mechanism to “argue against a suitor in a hostile takeover” bid (Luoma and Jasinski 2013, 123). Delaware, home to “over 50% of publicly traded corporations and 63% of the Fortune 500,” does not have a constituency statute, which explains Delaware’s Court of Chancery ruling in *eBay Domestic Holdings, Inc. v. Newmark* that “a public-service mission which ‘seeks not to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders’ is an invalid corporate purpose and inconsistent with directors’ fiduciary duties” (Luoma and Jasinski 2013, 122; Clark et al. 2013, 11).

<sup>4</sup> Hemphill and Cullari argue that benefit corporations are “being enacted prophylactically, as a result of the perceived legal and marketing fears of mission-driven for-profit social entrepreneurs,” rather than justified in case law (2014, 8).

cautionary tale to green industries (Rosenberg 2011).<sup>5</sup> It was widely believed that Ben & Jerry's had no other choice but to sell to the highest bidder, or it would be sued (Geles 2015, B3). Since there is no bright line rule guiding directors and officers as to how much they may deviate from maximizing shareholder wealth, benefit corporations lend clarity to fiduciaries regarding their responsibilities to the corporation and shield them from potential shareholder lawsuits when they embrace a social mission to the detriment of profits.

### *The Growth of Social Enterprise: NPOs to "Business Not as Usual"*

In the 1980s and 1990s, the term social enterprise was used to describe a nonprofit organization that adopted business-like operational practices and looked "for creative ways to generate revenue" (Cummings 2012, 578; Dees 2001, 9). The number of nonprofits tripled from 1985 to 2004 to fill gaps during the Reagan Administration's push to privatize public sector work, achieve smaller government, and curtail social welfare programs (Arnsberger 2008; Stecker 2014, 351). Nonprofits sprang into action, but were increasingly less sustainable. Social enterprise techniques helped professionalize the management of the nonprofit sector, and many nonprofits sought out earned income opportunities to survive (Salamon 2012, 5). In an effort to be more sustainable, nonprofits were "behaving more like for-profit organizations" selling branded merchandise, charging fees for services, launching separate for-profit commercial enterprises, and creating innovative revenue streams (Dees 1998; Stecker 2014, 352).

At the same time, an increasing number of for-profit businesses adopted social missions

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<sup>5</sup> It is forcefully argued that Ben & Jerry's was not legally required to sell to Unilever (Page and Katz 2012). The 2000 sale of Ben & Jerry's to Unilever in Vermont, a constituency state, predated the creation of benefit corporations. However, in 2012, Ben & Jerry's became a certified B Corporation, upholding its social and environmental values (bcorporation.net).

similar to the traditional functions of nonprofit organizations. Taking a “business not as usual” stance, many businesses began to pursue a triple-bottom line approach. Parallel to this push, the corporate social responsibility (CSR) movement gained traction, with corporations embracing “the long-term economic benefits of socially responsible investment” (McDonnell 2014, 25). Social-impact investors, responding to consumer demand that corporations provide socially and environmentally responsible goods and services, view the emerging green market as an opportunity to make money (Salamon 2014).

This blurring of the nonprofit and for-profit sectors – with nonprofit organizations seeking to be more sustainable and businesslike, and for-profit businesses becoming more socially conscious – coupled with the legal uncertainty of how much for-profits can pursue social and environmental objections to the detriment of profits laid the groundwork for the introduction of benefit corporations.

### ***The History and Purpose of Benefit Corporations***

Social enterprises committed to “doing good and doing well” no longer have to choose between maximizing shareholder wealth in a for-profit structure or forgoing profits altogether in a nonprofit. In the last five years, thirty states and Washington D.C. passed legislation creating the benefit corporation form for corporations that want to care for society and the environment, while earning a profit.<sup>6</sup> A benefit corporation is closely related to a standard C corporation, with

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<sup>6</sup> To date, 30 states and D.C. adopted benefit corporation legislation; Washington State and Florida adopted social purpose corporations; California adopted the flexible purpose corporation; Maryland created benefit LLCs (benefit corporations in LCC form); and 8 states adopted low-profit limited liability companies called L3Cs (McDonnell 2014, 30; Benefit Corp). “As of July 2014, there were 998 benefit corporations in the US from Secretaries of State (SOS) office lists and 1,051 L3Cs counted by InterSector Partners as of

three important distinctions – it “voluntarily meets higher standards of corporate purpose, transparency, and accountability” (Benefitcorp).

Stating public benefit as its purpose in the articles of incorporation, a benefit corporation holds itself out to the world as committed to having a “material positive impact on society and the environment” or similar language.<sup>7</sup> Existing corporations can convert to benefit-corporation status.<sup>8</sup> In an effort to create transparency, all states require benefit corporations to draft public reports, usually annually, assessing and describing how the corporation is living up to its public benefit purpose against a third-party standard. Most states require “standards promulgated by an independent third-party” (McDonnell 2014, 30-31). Accountability is achieved through a new fiduciary duty, mandating directors and officers to balance, pursue, or consider, depending on the jurisdiction, “the impact of their decisions not only on shareholders but also on workers, community, and the environment” (Benefitcorp).

### *The Pros and Cons of Benefit Corporations*

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July 31, 2014;” note that “rates of LLC formation are typically much greater than C-Corporation rates.” (Cooney et al. 2014). Delaware and Nevada, popular places for business incorporations, not surprisingly have the most registered benefit corporations in the nation. Delaware had 408 active benefit corporations registered Oct. 30, 2015, (compared to fewer than 150 on July 31, 2014), and Nevada has 750 active benefit corporations registered Dec. 1, 2015, (compared to almost 400 on July 31, 2014) (Wright; Bennett; Cooney et al. 2014)). B Lab estimated there are roughly 3,000 benefit corporations in the U.S. as of December 8, 2015; the exact number of benefit corporations is unknown, because not all states track the number of benefit corporations, while others do not update lists for a variety of reasons (Ensign-Barstow).

<sup>7</sup> Delaware also requires the enumeration of one or more specific public benefits (Model Act § 102; Del. Code Ann. tit. 8, § 362(a)).

<sup>8</sup> This conversion happens through a percentage of shareholder votes, typically a supermajority of two-thirds, with Delaware requiring ninety percent (McDonnell 2014, 30).

Despite the promise of many “benefits” to society, there are few tangible benefits for benefit corporations choosing this business form, and there are numerous downsides, including higher administrative and legal costs, legal uncertainty, and greater exposure to lawsuits (McDonnell 2014). Fulfilling the higher burden or standards of transparency and accountability costs significant time and money. Hiring attorneys, administrative staff, and third-party auditors is costly, especially for startup social enterprises. Unfortunately, there are no state tax benefits or incentives to compensate for the expense of pursuing public benefits, and currently there are no tax incentives to attract investors who want to fund social enterprise. It is suggested that, “until such incentives exist, many social enterprises will continue to register under the more familiar for-profit or nonprofit forms” (Cooney et al. 2014).

Attorneys avoid legal uncertainty and advise clients not to take action in the absence of legal precedent. Benefit corporations are creatures of individual states; therefore, the laws governing them are different in every jurisdiction. It is impossible for directors and officers to know the boundaries of their fiduciary duties until case law is formed through a body of lawsuits and judicial opinions. For example, in Delaware, directors must “balance the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation’s conduct, and the specific public benefit or public benefits identified in its certificate of incorporation,” while other states require directors to *consider* or *pursue* public benefits (Del. Code Ann. Tit. 8 §, 365(b)).<sup>9</sup> With no legal precedent, it is impossible to know the extent to which a benefit corporation should balance, consider, or pursue public benefits. Benefit-corporation status may bring greater exposure to lawsuits through benefit enforcement proceedings, although most states

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<sup>9</sup> This is an example in which one word – balance, consider, or pursue – may lead courts to judge whether benefit corporations are meeting triple-bottom line obligations.

forbid monetary damages or awards and provide only injunctive remedies such as specific performance (McDonnell 2014, 35). Insurance premiums to protect directors and officers may be higher, since the corporation does not “fit within the usual [directors and officers] insurance framework, which divides the world between non-profit and commercial enterprises” (LaCroix 2012).

Although the burdens are substantial, the benefits of this business form may outweigh the cons for many entrepreneurs and investors committed to socially responsible business practices. Investors clamor for opportunities to invest in social business and are willing to make less profit. Benefit corporations provide legal protection for directors and officers to pursue social good at the expense of corporate profit, and one more way for customers, who are willing to pay more for green products and services, to make sure they are not victims of greenwashing.

With the blurring of the social mission of the nonprofit and for-profit sectors, social enterprises are awash in a sea of money from investors. The traditional flood of philanthropic dollars flowing exclusively to nonprofits is slowing, with a range of investment support now funding “a wide assortment of social enterprises, cooperatives, and other hybrid organizations” (Salamon 2014, 5). Hundreds of billions of dollars are being invested to solve the world’s greatest problems, and the new frontiers of philanthropy are moving away from traditional approaches of grant-making and aggressively funding social enterprise. A 2009 J.P. Morgan Social Finance report estimated that the “global demand for social-impact investments” over ten years ranges from “\$400.6 billion to nearly \$1 trillion” in the fields of “housing, rural water supply, maternal health, primary education, and financial services” (Salamon 2014, 33). “The socially responsible investing (SRI) movement has grown over the past 30 years to represent nearly 10% of U.S. assets under management, or roughly \$2.3 trillion” (Clark et al. 2013, 3).



Rather than setting up a non-profit charitable foundation in December 2015, Mark Zuckerberg, co-founder of Facebook, formed a for-profit limited liability company (LLC) as a vehicle to give away \$45 billion of his wealth. An LLC can invest in for-profit companies, while “traditional non-profit organizations and foundations face restrictions on for-profit endeavors and political activity” (Eisinger 2015; Goel 2015). Most nonprofits do not have the scale to fix the pressing problems of the world; social enterprise must be part of the answer. Social entrepreneur and writer David Bornstein argues that relying on philanthropy to solve the world’s transportation problems is “an ‘adopt-a-highway’ approach” that just wouldn’t work; “governments and businesses *must* take the lead” (Bornstein 2013).

In short, investors and increasingly sophisticated consumers want to be certain that their dollars are supporting a green company (Clark et al. 2013, 2-4). Benefit corporations promote trust from external stakeholders who know legally enforceable duties provide one more layer of accountability and give managers acting in good faith guidance about competing interests (McDonnell 2014, 22). Benefit corporations provide an important legal protection or shield for directors and officers to weigh and consider the social and environmental impact of their decisions.

### ***Safeguards Against Greenwashing***

The fear of corporate greenwashing is a valid concern for socially conscious consumers and investors. With annual reports “not required to be verified, certified, or audited by a third party standard organization,” the lack of clear guidelines on the fiduciary duties of directors and officers, and the large amount of money at stake could be a recipe for disaster. However, safeguards are in place to quiet the fears of consumers and investors (Benefitcorp).

Benefit corporations that game the reporting requirement are committing fraud and “open themselves up to anti-fraud suits” under existing law; annual reports are a strategic and effective device “to police the accuracy” of corporate claims (McDonnell 2014, 33-34).<sup>10</sup> Similarly, directors and officers open themselves to lawsuits if derelict in their fiduciary duties to balance, consider, or pursue triple-bottom-line responsibilities (McDonnell 2014, 34). State laws grant the right – at a benefit enforcement proceeding – for shareholders, directors, officers, and the corporation to force the benefit corporation to comply with social and environmental standards. No state allows third parties to bring action.

Private individuals, employee whistle-blowers, media, consumer protection groups, social-impact investment firms, social and environmental organizations, government entities, and competing benefit corporations also serve as watchdogs over the conduct of benefit corporations. Social media and 24-hour news sources could easily bring corporations to their knees. Research has shown that “49% of Americans would boycott companies” that exhibit behavior detrimental to “the best interest of society,” while 86% of consumers would switch to a “socially responsible” brand if the product is equal in price and quality (Clark et al. 2013, 2).

The nonprofit organization B Lab, founded in 2006 by Andrew Kassoy, Jay Coen Gilbert, and Bart Houlahan and based in Berwyn, Pennsylvania, sets the gold standard of safeguarding against greenwashing. Through its B Impact Assessment process and random on-site visits, B Lab makes sure that certified “B-Corps” are living up to a rigorous and comprehensive third-party standard.<sup>11</sup> Companies must receive a minimum assessment score of 80 out of 200 to be

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<sup>10</sup> Insurance policies for directors and officers “exclude claims involving fraud or personal enrichment,” thereby providing one more layer of accountability (McDonnell 2014, 57).

<sup>11</sup> B-Lab visits 10% of B Corporations every year; in a two-year cycle of certification a business has a 1 in 5 chance of being visited (B Lab).

certified for a two-year cycle, meet transparency requirements and legal standards, and sign a document declaring their commitment to “shared collective purpose” (B Lab). B-Lab has certified over 1,000 companies in 60 industries around the world, and provided model benefit corporation legislation and advocated for its passage (B Lab).<sup>12</sup>

The first company to place a Certified B-Corp logo on its product was King Arthur Flour, a Vermont benefit corporation owned and operated by its employees, in December 2007 (B Lab; Henderson 2013). Other well-known Certified B-Corps include Ben & Jerry’s, Patagonia, Etsy, Dansko, Rubicon, and Warby Parker (B Lab). Unfortunately, the terms “benefit corporations” and “B Corps or B Corporations” are used interchangeably, to the dismay of the B Corp Certification Lab (Sampselle 2012). B Corporation, although trademarked by B Lab, has arguably become generic and is even used in state legislation. “B Corporation” refers to the certification by the nonprofit B Lab, while “benefit corporation” is a legal status administered by the state. The confusing terminology makes it more difficult for consumers to navigate.

### *Conclusion*

Benefit corporations provide an important fourth sector hybrid space among nonprofits, for-profits, and government entities, and can easily work in cross-sector partnerships to solve the pressing problems of the world (Fourth Sector 2015; Stecker; Haigh et al. 2015, 63). Legal commentators and industry experts continue to debate whether there are enough safeguards in place to prevent corporate greenwashing, but with accountability and transparency mandates embedded in state legislation, a broad array of third-party watchdogs, and the B Lab Certification

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<sup>12</sup> The annual cost is from \$500 for companies making less than \$500,000 per year in sales to \$50,000+ for companies generating \$1 billion in sales (B Lab).

process gaining more traction, the Goldilocks of safeguards has been attained.

As McDonnell points out, drafters of legislation “have struck a sensible balance which largely manages to avoid being either too strong or too weak, and thus gives benefit corporations a way to commit to pursuing public benefits while still not scaring off managers and entrepreneurs with the threat of ruinous lawsuits” (McDonnell 2014, 58-59).<sup>13</sup> State legislatures are getting it right – there is enough risk of liability that managers must pay attention to legal duties, while not imposing such high risk or undue burdens to discourage shareholders, social entrepreneurs, and investors. Benefit corporations have a terrific competitive advantage in the market, and an opportunity to leverage consumer good will in marketing efforts. In order to get more traction with consumers and investors, more Certified B Corps need to join the ranks of B Lab and be vigorously promoted to the public.

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<sup>13</sup> Nass argues superior transparency and accountability are needed to prevent greenwashing, including greater statutory guidance, an audit requirement, government oversight, improvements to benefit enforcement proceedings, and expanding remedies (Nass 2014); Cummings argues that “accountability for performance of social goals should emphasize adaptive learning rather than fixed procedures or outcomes, and should emphasize accountability to self, professional peers, and ‘clients,’ rather than accountability to judges, ‘generalist’ auditors from government agencies or nonprofits, or the market” (Cummings 2012, 626); McDonnell argues the opposite (2014).

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