

# ENFORCING BENEFIT CORPORATION REPORTING

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## INTRODUCTION

Previous academic work on benefit corporation reporting has shown abysmal compliance rates with statutory requirements.<sup>1</sup> These studies note the near total lack of enforcement mechanisms within the studied state statutes. This article turns its attention to the increasing number of states that have included express punishments in their benefit corporation statutes for reporting failures. Part I reviews the literature on benefit corporation reporting and examines both the Model Benefit Corporation Legislation approach and the Delaware approach to the issue. Part II summarizes and compares the statutory provisions adopted in recent years by states to increase benefit reporting enforcement. Part III discusses the substance of the benefit reports and provides law and governance suggestions for improving social benefit. A brief conclusion ends the article.

### I. THE MODEL AND DELAWARE APPROACHES TO BENEFIT CORPORATION REPORTING

The Model Benefit Corporation Legislation (the “Model”), which is used as the template for the majority of benefit corporation laws in the

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<sup>1</sup> Maxime Verheyden, *Public Reporting by Benefit Corporations: Importance, Compliance, and Recommendations*, 14 HASTINGS BUS. L.J. 37, 94 (2018) (noting that the author’s “empirical study of benefit reporting has shown very low reporting rates in Oregon, Colorado, and Delaware, ranging from eight percent to fourteen percent.”); J. Haskell Murray, *An Early Report on Benefit Reports*, 118 W. VA. L. REV. 25, 34 (2015) (indicating an eight percent compliance rate among a pool of active benefit corporations in Virginia, New York, California, and Hawaii); J. Haskell Murray, *Examining Tennessee’s For-Profit Benefit Corporation Law*, 19 TRANSACTIONS: TENN. J. BUS. L. 325, 340 (2017) (finding zero percent compliance among active Tennessee for-profit benefit corporations in the first compliance cycle after the passage of the statute); see also Joan MacLeod Heminway, *Corporate Purpose and Litigation Risk in Publicly Held U.S. Benefit Corporations*, 40 SEATTLE U. L. REV. 611, 649 (2017) (noting that “compliance with benefit report filing requirements similarly appears to be wanting.”).

United States addresses reporting in sections 401 and 402.<sup>2</sup> Section 401 addresses the substantive content requirements of the benefit report and mandates the use of a third-party standard in evaluating social performance.<sup>3</sup> Section 402 requires public posting of the benefit report and filing of the report with the Secretary of State.<sup>4</sup> While most states largely track the Model's language, the requirement to file the benefit report with the Secretary of State is not included in most state statutes.<sup>5</sup> Neither Section 401 or 402 provide an express penalty for violating the statutory reporting requirements. Presumably, a benefit enforcement proceeding could be brought, but shareholders are the only affected stakeholders with standing to bring such a claim.<sup>6</sup> Even shareholders must own, at a minimum, 2% of the benefit corporation's stock or, in the alternative, 5% of the benefit corporation's parent company to bring a lawsuit for violating the statute.<sup>7</sup>

Delaware is not only the most popular state for business formation generally but has also managed to attract most of the largest benefit corporations as well.<sup>8</sup> The Delaware version of the benefit corporation form is called a "public benefit corporation" or "PBC," and Delaware has the most lenient of the reporting laws.<sup>9</sup> In Delaware, the PBC report must

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<sup>2</sup> MODEL BENEFIT CORP. LEGIS. §§ 401–402 (BENEFIT CORP. 2017).

<sup>3</sup> *Id.* § 401; see also Brett H. McDonnell, *Committing to Doing Good and Doing Well: Fiduciary Duty in Benefit Corporations*, 20 FORDHAM J. CORP. & FIN. L. 19, 33 (2014) (noting that "[t]hese public reports work as a commitment device within a reputational market-based strategy").

<sup>4</sup> MODEL BENEFIT CORP. LEGIS. § 402 (BENEFIT CORP. 2017).

<sup>5</sup> J. Haskell Murray, *Corporate Forms of Social Enterprise: Comparing the State Statutes* (Jan. 15, 2015), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1988556](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1988556) (showing most benefit corporation state statutes do not require filing the benefit report with the secretary of state, even though the model legislation does).

<sup>6</sup> MODEL BENEFIT CORP. LEGIS. § 305 (BENEFIT CORP. 2017).

<sup>7</sup> *Id.*

<sup>8</sup> Robert Sprague & Aaron J. Lyttle, *Shareholder Primacy and the Business Judgment Rule: Arguments for Expanded Corporate Democracy*, 16 STAN. J.L. BUS. & FIN. 1, 42 n.8 (2010) ("Delaware corporate law is predominantly cited, as Delaware is the home of a majority of large, publicly traded corporations . . . and Delaware is considered to be the most popular state for incorporation . . . ."); *Benefit Corporations Raising Capital*, <https://benefitcorp.net/benefit-corporations-raising-capital> (showing the benefit corporations with the largest capital raises, most of which were incorporated in Delaware).

<sup>9</sup> J. Haskell Murray, *Social Enterprise Innovation: Delaware's Public Benefit Corporation Law*, 4 HARV. BUS. L. REV. 345, 354 (2014).

only be produced biennially, not annually.<sup>10</sup> Further, Delaware PBCs are not required to use a third-party standard in assessing social value and are not required to publicly post their reports.<sup>11</sup>

## II. IMPROVING ENFORCEMENT OF BENEFIT CORPORATION REPORTING

In contrast to the Model and Delaware approaches, six states provide express penalties in the event a benefit corporation fails to file a report within the applicable statutory period. These enforcement mechanisms can be grouped into three basic categories: (1) legal proceeding (with or without express provision for attorney fees); (2) loss of the use of benefit corporation status (with or without a fine for reinstatement); and (3) administrative dissolution.<sup>12</sup>

In the legal proceeding category, Minnesota allows shareholder appraisal if the failure to file the benefit report is shown to be intentional.<sup>13</sup> Nevada expressly allows a benefit enforcement proceeding for failure to produce a benefit report and may allow attorney fees if the failure is without justification.<sup>14</sup> Similarly, Florida's law allows a shareholder to initiate a proceeding by requesting a copy of the benefit report and, if one is so ordered, the court may require the benefit corporation to pay the shareholders' costs, including reasonable attorney fees.<sup>15</sup>

In the loss of status category, Massachusetts disallows holding the entity out publicly as a benefit corporation while delinquent on benefit reporting.<sup>16</sup> While Massachusetts does not appear to completely strip the legal status from the benefit corporation, it does attempt to limit any goodwill received from advertising the chosen entity type. Unfortunately,

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<sup>10</sup> DEL. CODE ANN. tit. 8, § 366 (West 2013).

<sup>11</sup> *Id.* (showing that use of a third-party standard and public posting of the report is expressly allowed but not required); see also, Alicia E. Plerhoples, *Delaware Public Benefit Corporations 90 Days Out: Who's Opting in?*, 14 U.C. DAVIS BUS. L.J. 247, 275 (2014) (noting the permissive nature of Delaware's public benefit corporation reporting law).

<sup>12</sup> Murray, *supra* note 5.

<sup>13</sup> MINN. STAT. ANN. § 304A.301 (West 2015); see also Brent J. Horton, *Rising to Their Full Potential: How A Uniform Disclosure Regime Will Empower Benefit Corporations*, 9 HARV. BUS. L. REV. 101, 127 (2019) (including Minnesota in a discussion of states with some express enforcement of statutory reporting requirements).

<sup>14</sup> NEV. REV. STAT. ANN. § 78B.190 (West 2014).

<sup>15</sup> FLA. STAT. ANN. § 607.613 (West 2014).

<sup>16</sup> MASS. GEN. LAWS ANN. ch. 156E, § 16 (West 2013).

Massachusetts does not make clear how a benefit corporation will be punished if it continues to publicly hold itself out as a benefit corporation during this period. Minnesota's law more formally revokes the entity's legal status if it is 90 days or more overdue on filing its benefit report.<sup>17</sup> As might be expected, one study shows this requirement has led to one hundred percent reporting compliance by Minnesota benefit corporations, though it is unclear how many entities lost their status because of noncompliance.<sup>18</sup> Minnesota law allows easy reinstatement with payment of a \$500 fine within 30 days of the revocation.<sup>19</sup> New Hampshire formally strips benefit corporation status if the benefit corporation has not filed a benefit report for two years, but allows the entity to regain its status, without a fine, simply by filing the report.<sup>20</sup>

Finally, New Jersey law allows the secretary of state to administratively dissolve benefit corporations that have not filed timely benefit reports.<sup>21</sup> The New Jersey law does not make clear if there are any restrictions related to refiling.

While these statutory additions should be largely praised for attempting to give some teeth to the reporting requirements, they could be improved. Regarding legal proceedings, shareholders should not be the only stakeholders with standing. Benefit reports are produced largely for other stakeholders, as shareholders already have mechanisms like director voting and derivative lawsuits to ensure that their needs are addressed.<sup>22</sup> If the benefit reports are costly to produce or hurt the companies' image, shareholders may prefer the reports not be produced, leaving other stakeholders without a remedy. While the concern of frivolous litigation is

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<sup>17</sup> MINN. STAT. ANN. § 304A.301 (West 2015).

<sup>18</sup> Maxime Verheyden, *Public Reporting by Benefit Corporations: Importance, Compliance, and Recommendations*, 14 HASTINGS BUS. L.J. 37, 94 (2018) ("In Minnesota, compliance with the reporting requirement was perfect for the active public benefit corporations. The main difference with Oregon, Colorado, and Delaware is the fact that the Minnesota statute creates a strong enforcement mechanism, namely, filing of the report with the secretary of state's office and revocation of the public benefit corporation status upon a failure to do so.")

<sup>19</sup> MINN. STAT. ANN. § 304A.301 (West 2015).

<sup>20</sup> NEV. REV. STAT. ANN. § 78B.190 (West 2014).

<sup>21</sup> N.J. STAT. ANN. § 14A:18-11 (West 2013); *see also*, Dana Brakman Reiser, *Benefit Corporations—A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591, 604 (2011) (noting New Jersey's rules around benefit corporation reporting enforcement).

<sup>22</sup> MODEL BENEFIT CORP. LEGIS. § 305(c)(2) (BENEFIT CORP. 2017); *see also* DEL. CODE ANN. tit. 8, § 367 (West 2013).

generally trotted forward in arguments against stakeholder standing, this situation is easily avoided by the company simply providing the report each year. Reasonable attorney's fees should be included to ensure that claims can be brought without great expense to the stakeholders.

Regarding loss of status, a \$500 fine will be de minimis for some companies. While a scaled fine based on revenue or shareholders may be somewhat difficult to administrate, it would provide a more forceful deterrent. The scaled fee that B Lab uses to certify companies may be a useful standard, ranging from \$1000 to \$50,000 based on revenue.<sup>23</sup> While this is the cost of certification, not entity formation, the B Lab scaled fee may represent the minimum value firms expect social enterprise marketing to bring. Most consumers are not aware of the differences between a benefit corporation and a Certified B Corporation so matching the benefit report fine to the certification fee may be appropriate.<sup>24</sup> Companies should not be able to profit from the marketing value of the benefit corporation form while also failing to produce the required reports showing the social performance of the company.

Administrative dissolution or revocation of status is a useful enforcement mechanism but may be overly harsh without significant notice. Notice and fines for two years should be sufficient. Also, failure to file benefit reports should not be an easy way for companies to escape the benefit corporation entity form and stakeholders should reap the benefits of the scaled fines.

Even with improved enforcement, the substance of the benefit report requirements remains weak. The model legislation provides only vague guidelines regarding an annual narrative about the pursuit of social good.<sup>25</sup> Specifically requiring that benefit corporations explain how their products and services fill a social need neglected by traditional profit-focused corporations could be helpful. Under the current model benefit

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<sup>23</sup> B LAB, *Sign Agreement and Pay Annual Fees*, <https://usca.bcorporation.net/certification> (last visited Feb. 7, 2022).

<sup>24</sup> B LAB, *Benefit Corporations & Certified B Corps*, <https://benefitcorp.net/businesses/benefit-corporations-and-certified-b-corps> (last visited Feb. 7, 2022).

<sup>25</sup> MODEL BENEFIT CORP. LEGIS. § 401 (BENEFIT CORP. 2017); *see also*, Brett H. McDonnell, *From Duty and Disclosure to Power and Participation in Social Enterprise*, 70 ALA. L. REV. 77, 96 (2018) (noting that the “reporting requirements leave it quite vague regarding how to measure the impact on the various interests,” but highlighting the threat of a lawsuit as a possible way to combat the “temptation to engage in greenwashing.”)

corporation legislation, using a third-party standard for the report is required, but there is virtually no guidance on sufficient standards other than a few vague words like “comprehensive,” “credible,” and “transparent.”<sup>26</sup> As noted above, Delaware does not even require use of a third-party standard in its benefit reporting, and only requires production of a benefit report every two years.<sup>27</sup> The legislative drafters, however, do not deserve significant blame for the vague requirements of benefit reporting because quantifying social good is quite difficult and a reporting statute likely could not capture all the needed nuance in relatively limited space.<sup>28</sup> Given the difficulty of measuring social good, other mechanisms for ensuring public benefit should be considered, and some of those mechanisms are discussed below in the next part.

### III. BEYOND BENEFIT CORPORATION REPORTING

In previous work, I have suggested the adoption of stakeholder representatives for large social enterprises.<sup>29</sup> Under this proposal, stakeholder representatives would be given power that tends to be reserved for shareholders in traditional corporations. Stakeholder groups would each elect a representative and collectively the stakeholder representatives would exercise rights such as electing directors, suing directors, and bringing books and records actions. The argument is that this shift in accountability from shareholders to all stakeholders (including shareholders) would appropriately shift the attention of directors of social

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<sup>26</sup> MODEL BENEFIT CORP. LEGIS. § 102 (BENEFIT CORP. 2017).

<sup>27</sup> DEL. CODE ANN. tit. 8, § 366 (West 2013) (use of a third-party standard is permitted but not required under Delaware law).

<sup>28</sup> Ofer Eldar, *Designing Business Forms to Pursue Social Goals*, 106 VA. L. REV. 937, 940 (2020) (“The problem is that it is extremely difficult to verify companies' social impact. Existing measures of social impact tend to be vague, include metrics that are difficult to quantify, and even mix shareholder protection metrics with environmental or societal ones. But if measurement is rarely available, how do we know that firms are pursuing social goals effectively?”); cf. Emilie Aguirre, *Beyond Profit*, 54 U.C. DAVIS L. REV. 2077, 2128 (2021) (noting “[s]ome accounts claim that the lack of robust social impact metrics is because it is too difficult to quantify social impact. But progress in sustainability metrics provides a counter-example. For example, SASB has developed robust, largely generalizable metrics that are gaining traction as the gold standard in assessing company performance in sustainability.”)

<sup>29</sup> See generally, J. Haskell Murray, *Adopting Stakeholder Advisory Boards*, 54 AM. BUS. L.J. 61 (2017).

enterprises. This suggestion would keep a single board of directors and would likely lead to less bureaucracy than codetermination proposals with multiple boards.<sup>30</sup> In this proposal, each director would see herself as a champion for all stakeholders rather than as an advocate or defender of a single group.<sup>31</sup>

One additional way to ensure benefit corporation leaders are committed to social good is to cap the executive to employee pay ratio. With the current tax requirements on benefit corporations, entrepreneurs may use the entity form as pure marketing while doing virtually no social good. A cap on executive pay, as a ratio to typical employee pay, would significantly limit the exploitative uses of social enterprise. In large companies, executive pay is now over 300 times the average employee's wage.<sup>32</sup> While social enterprises should not be forced to have their executives reduce their pay to the lowest employees' wage, as Dan Price famously did at Gravity Payments, a 10:1 or even a 50:1 cap seems reasonable.<sup>33</sup> If benefit corporations are formed primarily to benefit

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<sup>30</sup> See Grant M. Hayden & Matthew T. Bodie, *Codetermination in Theory and Practice*, 73 FLA. L. REV. 321, 347-49 (2021) (claiming that conflict is not increased in German codetermination but noting additional boards and meetings).

<sup>31</sup> E. Norman Veasey, Christine T. Di Guglielmo, *How Many Masters Can A Director Serve? A Look at the Tensions Facing Constituency Directors*, 63 BUS. LAW. 761, 765 (2008) ("Where the interests of various constituencies do diverge—that is, where the corporation's interests do not serve as well as a proxy for the interests of the stockholding body as a whole, as in some 'end game' or 'bet the company' scenarios—a constituency director may need to evaluate whether that divergence may subject the director to a conflict. And if so, the director will need to consider what the director's course of action should be to 'do the right thing' as well as to avoid liability. In undertaking that evaluation, the director must first consider to whom he owes fiduciary duties. That question underlies the potential tension that constituency directors face in fulfilling both their fiduciary duties and their obligations to their constituencies."); accord Simone M. Sepe, *Intruders in the Boardroom: The Case of Constituency Directors*, 91 WASH. U. L. REV. 309, 343 (2013) (also noting conflicts faced by constituency directors).

<sup>32</sup> Lawrence Mishel and Jori Kandra, *CEO compensation surged 14% in 2019 to \$21.3 million CEOs now earn 320 times as much as a typical worker*, ECON. POL'Y INST., Aug. 18, 2020, <https://www.epi.org/publication/ceo-compensation-surged-14-in-2019-to-21-3-million-ceos-now-earn-320-times-as-much-as-a-typical-worker/> ("using the realized measure of CEO compensation, CEOs of major U.S. companies earned 21 times as much as the typical worker in 1965. This ratio grew to 31-to-1 in 1978 and 61-to-1 by 1989. It surged in the 1990s, hitting 366-to-1 in 2000.").

<sup>33</sup> Stephanie Hegarty, *The boss who put everyone on 70K*, BBC, Feb. 28, 2020, <https://www.bbc.com/news/stories-51332811> ("In 2015, the boss of a card payments company in Seattle [Dan Price] introduced a \$70,000 minimum salary for all of his 120 staff - and personally took a pay cut of \$1m [to \$70,000].").

society, executives should not balk at making “only” fifty times as much as their average employee. This one requirement would seriously signal to the market that benefit corporations are not just different in rhetoric, but they are also different in a practice that is quite important and personal to corporate leaders.

#### CONCLUSION

While state statutes have begun improving upon the almost nonexistent enforcement mechanisms around benefit corporation reporting, the current statutes remain insufficient to protect the interest of stakeholders. This essay suggests stakeholder standing for benefit enforcement proceedings regarding reporting, scaled fines for reporting noncompliance, and ultimately loss of benefit corporation status with significant payments to stakeholders. Still, even if reporting compliance improves the substantive requirements, these reports are vague and capturing the nuance of social good may be impossible. To address the difficulties of encouraging social good through reporting this essay suggests increasing stakeholder power in corporate governance and addressing executive/employee pay disparities. These proposed solutions are unlikely to ensure that benefit corporations will create social good, but they should go a long way toward checking executive power and reducing the temptation of financial exploitation.