

# Student Commentary to Professor Murray: Educating a Benefit Corporation's Board of Directors on Reporting

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While a concept such as a benefit corporation seems promising for the future of business associations law, work like Professor Murray's is useful to analyze how it operates as a practical matter.<sup>1</sup> This comment will highlight aspects of the law that must be changed to ensure that benefit corporations can be fully effective. The somewhat bleak landscape of benefit corporation reporting is a great example of a weak spot in the law that can create problems for the entity's many constituencies it is designed to govern. This commentary will analyze the issue through the lens of a lawyer advising the board of directors of a benefit corporation on reporting requirements.

I believe a lawyer's ethical obligations are triggered by this issue. The Model Rules of Professional Conduct require that lawyers represent their clients with competence.<sup>2</sup> Competence "requires . . . thoroughness and preparation reasonably necessary for the representation."<sup>3</sup> Lawyers are also required to act with "reasonable diligence" in representation.<sup>4</sup> Both of these duties require informing a corporate client on legal duties and possible consequences for non-compliance.<sup>5</sup>

But how can a lawyer motivate a board of directors to comply with reporting requirements that, to a non-lawyer, probably seem tedious or a waste of time? In the book, *Leading Change*, the first of John Kotter's eight steps for implementing change is creating a sense of urgency.<sup>6</sup> A lawyer can create a sense of urgency by educating the board on what exactly is required by the statute and the penalties they may incur for failing to file. This conversation can be as approachable or formal as the situation demands. Whether it is through a spoken presentation or a written, step-by-step guide, the lawyer should cater this discussion to what is going to help a corporate client's board understand and act.

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<sup>1</sup> J. Haskell Murray, *Enforcing Benefit Corporation Reporting*, 23 TENN. J. BUS. L. (2022).

<sup>2</sup> MODEL RULES OF PRO. CONDUCT R. 1.1 (AM. BAR ASS'N 2020).

<sup>3</sup> *Id.*

<sup>4</sup> *Id.* at r. 1.3 (AM. BAR ASS'N 2020).

<sup>5</sup> MODEL RULES OF PRO. CONDUCT pmb. (AM. BAR ASS'N 2020).

<sup>6</sup> JOHN P. KOTTER, *LEADING CHANGE* 35 (2d ed. 2012).

In a Delaware public benefit corporation, the board must strike a balance between considering stockholder interests, the interests of those who are “materially affected” by its actions, and the corporation’s goal of social good that is listed in the certificate of incorporation.<sup>7</sup> The Model Benefit Corporation Legislation requires balancing shareholder interests, constituencies of the firm like customers or employees, and social and environmental welfare.<sup>8</sup> The board must consider each of these interests when making a decision about filing a report. In some cases, the only information customers or lower-level employees receive about the firm’s actual social impact will be through these reports.

The fiduciary duties of loyalty and care also apply to director action regarding reporting requirements. The duty of care requires fully informed decision making.<sup>9</sup> When making decisions about whether to file a report, the board should be fully informed on the timing of reporting, the contents of the report, and penalties for failing to file.<sup>10</sup> Delaware case law recognizes duties of oversight and good faith under the duty of loyalty,<sup>11</sup> with a failure to “exercise reasonable oversight” recognized as evidence of a lack of good faith.<sup>12</sup> I would pose the following question: is it not in bad faith to know of a legal requirement and blatantly not comply?

Depending on the client, it may be helpful to mention reputational concerns as well. A goods and services firm may attract customers due to their status as a benefit corporation. Knowledge that the firm is not complying with reporting requirements could lead customers to question whether the firm has simply chosen this entity as a method of virtue signaling. The idea that a firm is taking advantage of the marketing benefit of this entity when it is not willing to complete a report required or

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<sup>7</sup> DEL. CODE ANN. tit. 8, § 365(a) (2020).

<sup>8</sup> MODEL BENEFIT CORP. LEGIS. § 301(a)(1) (BENEFIT CORP. 2017).

<sup>9</sup> See *Smith v. Van Gorkom*, 488 A.2d 858, 872–73 (Del. 1985) (recognizing that “a director’s duty to exercise an informed business judgment” falls under the duty of care).

<sup>10</sup> *Id.* at 874.

<sup>11</sup> *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

<sup>12</sup> *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996) (recognizing oversight failure as evidence of a lack of good faith); *Ritter*, 911 A.2d at 370 (stating that the duty of loyalty is violated when directors act in bad faith or fail to exercise oversight).

encouraged by statute could drive customers away. In this case, it may be useful to present the B Lab “Certified B Corp” as a possible alternative.<sup>13</sup>

Additionally, stockholders’ interests must be considered by a benefit corporation’s directors. They also have a certain degree of power to hold directors accountable for their inaction. Completing and filing a report can potentially be a costly and time-consuming action. The stockholders, however, have the power to bring an enforcement suit to enforce the interest-balancing requirement mentioned above.<sup>14</sup> Stockholders also have the power to sue derivatively.<sup>15</sup> The directors should be advised that failure to file could open the firm up to litigation that could also carry great costs. Other penalties could include administrative dissolution or loss of benefit corporation status.<sup>16</sup> As Professor Murray states, losing benefit corporation status can be a “de minimis” cost for firms in certain jurisdictions.<sup>17</sup> Even so, the loss of status or administrative dissolution will create costs *and* result in the loss of the allure of benefit corporation status. Reincorporating or filing the paperwork to be reestablished as a benefit corporation may be costly and may lead to the reputational issues mentioned above.<sup>18</sup> Shareholders also have the power to elect and remove directors.<sup>19</sup> Mentioning this in the conversation may trigger a desire for self-preservation in a board member. Though this may have a minute effect on certain directors, this self-preservation desire could lead others to view reporting as a more vital task.

#### Conclusion

These are just the high points, but we, as lawyers, have a responsibility to make our clients aware of their legal duties and the possible consequences of failing to execute those duties. I believe that if we approach this in an educational manner, lawyers could have a positive effect on rates of report filing now and in the future as the law develops.

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<sup>13</sup> Murray, *supra* note 1, at 4. (“[T]he B Lab cost may capture some of the marketing value of social enterprise generally to companies.”).

<sup>14</sup> DEL. CODE ANN. tit. 8, § 367 (2020); MODEL BENEFIT CORP. LEGIS. § 305 (BENEFIT CORP. 2017).

<sup>15</sup> DEL. CODE ANN. tit. 8, § 327 (2020); MODEL BUS. CORP. ACT § 7.41 (AM. BAR ASS’N 2016).

<sup>16</sup> See generally Murray, *supra* note 1.

<sup>17</sup> *Id.* (noting Minnesota’s \$500 fine for reinstatement).

<sup>18</sup> *Id.*

<sup>19</sup> DEL. CODE ANN. tit. 8, §§ 141(k), 211(b) (2020); MODEL BUS. CORP. ACT §§ 8.03(c), 8.08 (AM. BAR ASS’N 2016).