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## Public(ly Oriented) Companies: B Corporations and the Delaware Stakeholder Provision Dilemma

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# Public(ly Oriented) Companies: B Corporations and the Delaware Stakeholder Provision Dilemma

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## I. INTRODUCTION

The money changers have fled from their high seats in the temple of our civilization. We may now restore that temple to the ancient truths. The measure of the restoration lies in the extent to which we apply social values more noble than mere monetary profit.

— Franklin D. Roosevelt,  
following the Wall Street Crash of 1929<sup>1</sup>

During his 2007 commencement address at Harvard University, Bill Gates called on the graduates to invent “a more creative capitalism” where “we can stretch the reach of market forces so that more people can make a profit, or at least make a living, serving people who are suffering from the worst inequities.”<sup>2</sup> A number of entrepreneurs, including those that started online bookstore Better World Books (“BWB”), are doing their best to create a more creative capitalism.<sup>3</sup> BWB sells approximately 10,000 books a day and brought in \$30 million in revenue in 2010.<sup>4</sup> BWB sells its products to return a profit and to improve worldwide literacy directly. It increases literacy by funding book drives and collecting used books and textbooks (through a network of over 1,800 college campuses and partnerships with over 2,000 libraries nationwide) that it distributes to less-developed countries.<sup>5</sup> Since its founding in 2003, the company has converted more than 53 million books into over \$9.46 million in funding for literacy and education. In the process, it has diverted more than 26,000 tons of books from landfills.<sup>6</sup>

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1. Franklin D. Roosevelt, First Inaugural Address (Mar. 4, 1933) (transcript available in the National Archives), *available at* <http://arcweb.archives.gov/arc/action/ExternalIdSearch?id=197333>.

2. Bill Gates, Address at Harvard Commencement (June 7, 2007), in *HARV. GAZETTE*, June 2007, *available at* <http://news.harvard.edu/gazette/story/2007/06/remarks-of-bill-gates-harvard-commencement-2007/>.

3. The founders of BWB were selected as *Business Week's* “Most Promising Social Entrepreneurs” in 2009. Nick Lieber, *The Most Promising Social Entrepreneurs*, BLOOMBERG BUSINESSWEEK, May 1, 2009, [http://www.businessweek.com/smallbiz/content/may2009/sb2009051\\_730988.htm?chan=smallbiz\\_smallbiz+index+page\\_top+small+business+stories](http://www.businessweek.com/smallbiz/content/may2009/sb2009051_730988.htm?chan=smallbiz_smallbiz+index+page_top+small+business+stories).

4. *Overview: The Online Bookstore With a Soul*, BETTER WORLD BOOKS, <http://www.betterworldbooks.com/info.aspx?f=facts> (last visited Apr. 18, 2011).

5. *Id.*

6. *Id.*

Companies like BWB that measure value creation as a combination of profits and impact on people, the environment, or both<sup>7</sup> are emerging in increasing numbers. These entities, referred to collectively as social enterprises, are taking on roles that have traditionally been played by governmental and nonprofit entities. But, unlike their nonprofit counterparts, social enterprises seek simultaneously to have a positive impact on society *and* return a profit. Their idealistic pursuit is not without obstacles, however. Many social entrepreneurs (as the founders of social enterprises are called) claim that corporate law is ill-suited and outdated for their entities.<sup>8</sup> Others find it hard to differentiate their socially oriented enterprises from companies that merely claim to benefit society, complicating their efforts to attract capital from socially oriented investors.

One of the most creative attempts to help social enterprises overcome the legal and marketing challenges they face is the Certified B Corporation, an innovation created by 501(c)(3) nonprofit B Lab. The “B” in B Corporation stands for “Beneficial.”<sup>9</sup> B Corporation status is a third-party certification for companies, similar to the Leadership in Energy and Environmental Design (“LEED”) certification for environmentally friendly buildings.<sup>10</sup> The designation of a company as a B Corporation provides third-party verification that it operates in a socially and environmentally responsible manner.<sup>11</sup>

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7. Frequently, social enterprises are said to have a “double bottom-line” or a “triple bottom-line.” A company with a double bottom-line measures its success by profit and commitment to people, whether employees or members of the community. Those with a triple bottom-line measure their success similarly, but also take into consideration the environment. Thomas Kelley, *Law and Choice of Entity on the Social Enterprise Frontier*, 84 TUL. L. REV. 337, 339–45 (2009). For a broader discussion, see Alissa Mickels, Note, *Beyond Corporate Social Responsibility: Reconciling the Ideals of a For-Benefit Corporation with Director Fiduciary Duties in the U.S. and Europe*, 32 HASTINGS INT’L & COMP. L. REV. 271, 274 (2009), although it should be noted that Mickels confuses double bottom-line for triple bottom-line, and vice versa.

8. See, e.g., Megan Scudellari, *The Profits of Nonprofit*, 25 SCIENTIST 54 (2011), available at <http://f1000scientist.com/article/display/57891/> (quoting OneWorld Health Founder Victoria Hale as stating that “[t]echnology is way advanced, and it’s the business models that are lagging way behind, limiting what social entrepreneurs are able to accomplish.” OneWorld Health was the first nonprofit pharmaceutical company in the United States.).

9. Hannah Clark Steiman, *A New Kind of Company*, INC.COM, July 1, 2007, <http://www.inc.com/magazine/20070701/priority-a-new-kind-of-company.html>.

10. LEED is an internationally recognized green building certification system providing third-party verification that a building or community was designed and built using strategies aimed at improving performance across a variety of environmental quality metrics: energy savings, water efficiency, CO<sub>2</sub> emissions reduction, improved indoor environmental quality, stewardship of resources, and sensitivity to their impact. *Intro—What LEED Is*, U.S. GREEN BUILDING COUNCIL, <http://www.usgbc.org/DisplayPage.aspx?CMSPageID=1988> (last visited Mar. 26, 2011).

11. Steiman, *supra* note 9.

This verification, in turn, helps the company distinguish itself and attract like-minded consumers and investors.<sup>12</sup>

Unlike with C and S corporations, B Lab's B Corporations are not a legal distinction, and have no official tax status. As a result, any for-profit entity can seek B Corporation certification.<sup>13</sup> However, it must comply with B Lab's two primary certification requirements. First, a company must "meet comprehensive and transparent social and environmental performance standards" set by B Lab.<sup>14</sup> Second, it must amend its governing documents to incorporate consideration of the interests of employees, the community, and the environment, among others.<sup>15</sup>

According to B Lab, becoming a B Corporation has implications for investment and profit. Companies enjoy the marketing advantage of being recognized by a third party as socially responsible. For example, third-party certification may help companies differentiate themselves from a growing barrage of companies claiming to prioritize community and environmental interests. Certification thus improves their ability to attract investment from socially responsible investors ("SRIs") and consumers.<sup>16</sup> SRIs seek to maximize a balance of financial return and social good.<sup>17</sup> Becoming a B Corporation may also help corporate directors reconcile their duties to shareholders and their desires to help non-shareholder constituencies, such as employees and the greater community. In addition, incorporating social and environmental values into their governing documents may better position companies to ensure that those values survive new investors, new management, and new owners.<sup>18</sup> For these and other

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12. *Id.*

13. Among others, a B Corporation may be incorporated as a C corporation, S corporation, LLC, partnership, LLP, LP, sole proprietorship, or cooperative. *Legal Roadmap*, B CORPORATION.NET, <http://survey.bcorporation.net/become/legal.php> (last visited May 11, 2011). Nonprofit entities cannot receive B Corporation certification.

14. *About Certified B Corps*, B CORPORATION.NET, <http://www.bcorporation.net/about> (last visited Mar. 26, 2011).

15. *Legal Framework*, B CORPORATION.NET, <http://www.bcorporation.net/become/legal> (last visited May 11, 2011); Steiman, *supra* note 9. The choice of organizational form is not a determinative factor in B Corporation certification, so long as the company seeking certification is a for-profit entity.

16. *The Business Case for Becoming a B Corporation*, B CORPORATION.NET, [http://www.bcorporation.net/resources/bcorp/documents/The%20Business%20Case\\_Become%20a%20B%20Corporation1.pdf](http://www.bcorporation.net/resources/bcorp/documents/The%20Business%20Case_Become%20a%20B%20Corporation1.pdf) (last visited Mar. 26, 2011).

17. See generally Steven J. Schueth, *Socially Responsible Investing in the U.S.*, 43 J. BUS. ETHICS 189 (2003).

18. *Legal Framework*, *supra* note 15.

reasons, 407 companies, generating \$1.91 billion collectively in revenues, have already become Certified B Corporations.<sup>19</sup>

But, while B Lab's creation has garnered an impressive amount of excitement, it has also raised a number of legal issues that directors of corporations considering B Corporation certification need to understand better before making the move.<sup>20</sup> The imperative question that this Note addresses is whether current Delaware C corporation law allows a charter provision obligating directorial consideration of stakeholders' interests.<sup>21</sup> B Corporation certification requires directors to amend their charter to include a provision obligating them to consider the interests of various stakeholder constituencies in discharging their duties at all times.<sup>22</sup> But under *Revlon v. MacAndrews, Inc.*, Delaware has long held that directors may not consider the interests of stakeholders once it is clear that the corporation is "for sale."<sup>23</sup> Because Delaware is the United States' legal center of commerce,<sup>24</sup> and because Delaware corporate law serves as the model for many other jurisdictions, B Corporations'

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19. BCORPORATION.NET, <http://www.bcorporation.net> (last visited May. 9, 2011).

20. Some examples of important unanswered questions surrounding B Corporations this Note does not address include: (a) Does the inclusion of "B" stakeholders in a certificate of incorporation create only contractual duties to stakeholders and fiduciary duties to the entity's stockholders?; (b) May the business judgment rule serve as a shield for all directorial decisionmaking (or directorial decisions) in a B Corporation or only those that affect purchasers of equity in the corporation?; (c) Is it likely that institutional investors in a public corporation would gain sufficient voting support to amend the certificate of incorporation in order to pursue a B certification?; and (d) May a B Corporation be formed in the face of an existing "constituency statute" that provides that directors may consider "other constituencies" in the event of a threatened change of control? Ann E. Conaway, *Lessons to Be Learned: How the Policy of Freedom of Contract in Delaware's Alternative Entity Law Might Inform Delaware's General Corporation Law*, 33 DEL. J. CORP. L. 789, 794 & n.16 (2008).

21. The term "stakeholder" is sometimes used in legal literature as a synonym for a shareholder, but for the purposes of this Note, a stakeholder is a person or group not owning shares in an enterprise but affected by or having an interest in its operations, such as current and retired employees, the suppliers and customers of a company or its subsidiaries, and the communities and society in which the company or its subsidiaries operate.

22. *Legal Framework*, *supra* note 15.

23. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).

24. More than 850,000 businesses are incorporated in Delaware, representing more than fifty percent of all publicly traded corporations and sixty-three percent of the Fortune 500. Division of Corporations, *About Agency*, DEL. DEPT OF STATE, <http://www.corp.delaware.gov/aboutagency.shtml> (last visited Mar. 26, 2011). While at present no publicly traded corporation has registered to become a B Corporation, the success of B Lab's mission to effect widespread social change may increase with more involvement from publicly traded corporations. See Bill Gates, Chairman, Microsoft Corp., Remarks at the World Economic Forum 2008: A New Approach to Capitalism in the 21st Century (Jan. 24, 2008), *available at* <http://www.microsoft.com/presspass/exec/billg/speeches/2008/01-24wefdavos.msp> (suggesting that "the largest companies . . . should lead the way" in making a profit while serving the poor).

future success may depend on the compatibility of B Lab's stakeholder charter provision requirement and Delaware C corporation law. Therefore, this Note restricts its analysis to the Delaware General Corporation Law and Delaware C corporation case law.<sup>25</sup>

This Note addresses the need for Delaware and other states to recognize the difference between the best interests of SRIs—a balance of profits and social impact—and the best interests of traditional investors—maximized profit with the least risk. It argues that, in limited circumstances, Delaware should permit stakeholder charter provisions that require consideration of the best interests of SRIs, instead of imposing traditional *Revlon* duties. Part II of this Note provides background information regarding the emergence of social entrepreneurship—the use of entrepreneurial business principles to create, organize, and manage a venture designed to effect social change—and the advent of the B Corporation as an important player in the field. Part III analyzes how current Delaware corporate law would likely deal with B Lab's proposed stakeholder charter provision. An exploration of Delaware statutory and case law will show that, while such a provision is likely permissible in the day-to-day operational context, it is problematic in the change-of-control context. Part IV critiques current Delaware law and argues that it fails to address the realities of modern shareholders' motives. Specifically, Delaware general corporate law fails to recognize that a substantial number of investors reject the traditional notion of profit maximization and instead seek to maximize a balance of social impact and profit. Part V presents the institutionalized stakeholder interest dilemma and explains why current approaches to the stakeholder interest debate are inappropriate to resolve this dilemma. Part VI then proposes a solution for Delaware courts that asks whether the stakeholder charter provision is in the best interests of each corporation's shareholders. Part VII concludes by reemphasizing that, because current Delaware corporate law is ill-suited to address the

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25. The consideration of whether B Corporations comply with Delaware alternative entity law is beyond the scope of this Note. In Delaware, "alternative entity" refers to those business organizations that are both not incorporated and historically contractual in nature, rather than statutory or regulatory entities. Thus, partnerships, limited liability partnerships (LLPs), limited partnerships (LPs), limited liability limited partnerships (LLLPs), LLCs, statutory trusts, and uniform unincorporated associations qualify as "alternative entities." Conaway, *supra* note 20, at 790 n.2. Presumably, however, B Corporations formed as alternative entities comply with current Delaware law on charter provisions because of their ability to eliminate fiduciary duties through charter provisions. See, e.g., DEL. CODE ANN. tit. 6, § 18-1101(c) (2005) (permitting the elimination of fiduciary duties in LLCs); *id.* § 17-1101(d) (permitting the elimination of fiduciary duties in LPs).

emerging field of social enterprise, Delaware courts should review director decisionmaking under a 'Unocal plus shareholder awareness' standard instead of under *Revlon* when companies with stakeholder charter provisions enter a change-of-control transaction.

## II. PRIVATE ENTERPRISES WITH PUBLIC PURPOSES: THE RISE OF SOCIAL ENTREPRENEURSHIP AND B CORPORATIONS

### A. *The Emergence of Social Entrepreneurship*

B Corporations can best be understood within the context of the broader social entrepreneurship movement. Social entrepreneurs are individuals and organizations that bring to social problems the same kind of determination, creativity, and resourcefulness that traditional entrepreneurs display.<sup>26</sup> The entities social entrepreneurs create are referred to as social enterprises, which are social-mission-oriented entities that employ market-based strategies to simultaneously return a profit and achieve their mission.<sup>27</sup> Social enterprises come in all shapes and sizes, and range from nonprofits with business models to C corporations with social responsibility missions.<sup>28</sup> Social entrepreneurs today, however, are increasingly launching social enterprises as for-profit corporations rather than nonprofits.<sup>29</sup>

The language of "social entrepreneurship" emerged in the 1980s from the work of Bill Drayton at Ashoka and Ed Skloot at New Ventures.<sup>30</sup> The phenomenon of social entrepreneurship, however, existed before the 1980s.<sup>31</sup> One prime example of a pre-1980s social entrepreneur is Muhammad Yunus, recipient of the 2006 Nobel Peace Prize.<sup>32</sup> In 1974, while visiting a poor village in his home country of

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26. J. Gregory Dees, *Taking Social Entrepreneurship Seriously*, 44 SOCIETY 3, 24 (2007).

27. Academics from various fields who study social entrepreneurship have yet to settle on one definition of "social enterprise." See Kelley, *supra* note 7, at 340 n.7 (noting the disagreement). Like Professor Kelley's definition, this definition refers to the entities through which social entrepreneurs conduct their affairs. *Id.*

28. OneWorld Health, the first U.S. pharmaceutical social enterprise, is a 501(c)(3) nonprofit. Better World Books, discussed *supra* notes 3–6 and accompanying text, is an example of a C corporation social enterprise.

29. See Kelley, *supra* note 7, at 343, 354 (noting the increased tendency to select for-profit models).

30. Dees, *supra* note 26, at 24.

31. J. Gregory Dees, The Meaning of "Social Entrepreneurship" 1 (Oct. 31, 1998), available at [http://www.caseatduke.org/documents/dees\\_sedef.pdf](http://www.caseatduke.org/documents/dees_sedef.pdf).

32. Dees, *supra* note 26, at 24.



Bangladesh, Yunus started making very small loans to impoverished women in need of capital for activities ranging from making bamboo stools to buying a dairy cow.<sup>33</sup> In so doing, Yunus discovered that he could alleviate the burdens weighing on the impoverished while making a profit.<sup>34</sup> After local banks refused his requests to make the loans, Yunus founded Grameen Bank in 1976 in an attempt to provide credit to Bangladeshis who needed capital the most.<sup>35</sup> Since its inception, Grameen has extended uncollateralized small loans (referred to as microcredit) to 8.35 million borrowers, most of whom are women.<sup>36</sup> Grameen claims a ninety-seven percent repayment rate, and has been profitable nearly every year.<sup>37</sup>

But, while the roots of social entrepreneurship stretch back at least a few decades, it was not until the late 1990s and 2000s that social entrepreneurship started receiving widespread acceptance.<sup>38</sup> In 2005, the United Kingdom passed a law establishing a new kind of company specifically designed for social entrepreneurs, known as a Community Interest Company.<sup>39</sup> In 2007, Harvard University Professor and renowned commentator David Gergen described social entrepreneurship as “one of the hottest movements” among young people in the United States<sup>40</sup> and “the most important movement since the civil rights movement.”<sup>41</sup> In 2008, *Business Week* began publishing an annual list of the most promising social entrepreneurs, and claimed that “[s]ocial entrepreneurship isn’t a niche corner of the business

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33. Connie Bruck, *Millions for Millions*, NEW YORKER, Oct. 30, 2006, available at [http://www.newyorker.com/archive/2006/10/30/061030fa\\_fact1](http://www.newyorker.com/archive/2006/10/30/061030fa_fact1).

34. *Id.*

35. *Id.*

36. *Introduction*, GRAMEEN BANK, [http://www.grameen-info.org/index.php?option=com\\_content&task=view&id=16&Itemid=112](http://www.grameen-info.org/index.php?option=com_content&task=view&id=16&Itemid=112) (last visited Mar. 26, 2011).

37. *FAQ*, GRAMEEN BANK, [http://www.grameen-info.org/index.php?option=com\\_easyfaq&task=cat&catid=80&Itemid=200](http://www.grameen-info.org/index.php?option=com_easyfaq&task=cat&catid=80&Itemid=200) (last visited Mar. 26, 2011).

38. See Dees, *supra* note 26, at 24 (“[Social entrepreneurship] has come into its own in the last decade, capturing the imaginations of many thoughtful observers.”); Jamie Robertson, *Social Entrepreneurs: Making Money for the Common Good?*, BBC, Jan. 18, 2011, <http://www.bbc.co.uk/news/business-12182223> (claiming the number of social entrepreneurs today is “swelling”).

39. *About Us*, COMMUNITY INTEREST COMPANIES, <http://www.cicregulator.gov.uk/aboutUs.shtml> (last visited Mar. 26, 2011) (discussing the Companies (Audit, Investigations, and Community Enterprise) Act, 2004, c. 27, § 26).

40. David Gergen, *The New Engines of Reform*, U.S. NEWS & WORLD REP., Feb. 20, 2006, at 48.

41. Andrew M. Wolk, *Advancing Social Entrepreneurship: Recommendations for Policy Makers and Government Agencies* 2 (2008), available at [http://www.rootcause.org/sites/rootcause.org/files/Advancing\\_Social\\_Entrepreneurship.pdf](http://www.rootcause.org/sites/rootcause.org/files/Advancing_Social_Entrepreneurship.pdf) (quoting David Gergen).

world anymore.”<sup>42</sup> President Obama recently created the White House Office of Social Innovation to increase investment in successful social enterprises.<sup>43</sup> Top business schools across the United States and Europe now offer social entrepreneurship courses and many have established centers and programs to study the phenomenon.<sup>44</sup>

Today, social entrepreneurs use business to create social and environmental value alongside profits in “nearly every sector of the economy.”<sup>45</sup> They attempt to tackle some of the most challenging social problems, including poverty,<sup>46</sup> access to clean water,<sup>47</sup> and the lack of adequate healthcare.<sup>48</sup>

Still, social entrepreneurs face many challenges. In a recent study of one hundred social entrepreneurs, those surveyed reported that their most pressing challenge was gaining access to investment capital.<sup>49</sup> Social enterprises seeking widespread change require significant capital investment, but social entrepreneurs are stuck

42. John Tozzi, *America's Most Promising Social Entrepreneurs*, BLOOMBERG BUSINESSWEEK, June 8, 2010, [http://www.businessweek.com/smallbiz/running\\_small\\_business/archives/2010/06/americas\\_most\\_promising\\_social\\_entrepreneurs.html](http://www.businessweek.com/smallbiz/running_small_business/archives/2010/06/americas_most_promising_social_entrepreneurs.html).

43. Clayton M. Christensen, *The White House Office of Social Innovation: A New Paradigm for Solving Social Problems*, HUFFINGTON POST, July 1, 2009, [http://www.huffingtonpost.com/clayton-m-christensen/the-white-house-office-on\\_b\\_223759.html](http://www.huffingtonpost.com/clayton-m-christensen/the-white-house-office-on_b_223759.html).

44. See, e.g., Diana Middleton, *M.B.A.s Seek Social Change*, WALL ST. J., Oct. 15, 2009, <http://online.wsj.com/article/SB10001424052748704107204574469602649140462.html> (discussing courses at Haas School of Business (Berkeley), Said School of Business (Oxford), Tuck School of Business (Dartmouth), and Johnson School of Business (Cornell)); *A Closer Look at Business Education: Social Entrepreneurship/Social Enterprise*, ASPEN INST., (Sept. 2006), available at <http://www.beyondgreypinstripes.org/pdf/sereport.pdf> (noting social entrepreneurship coursework at Columbia, Duke, London Business School, Notre Dame, and Berkeley, among others). The Center for Advancement of Social Entrepreneurship (“CASE”) at Duke’s Fuqua School of Business is but one example of an academic center supporting the research of social entrepreneurship. Belmont University offers undergraduate majors in the field, see Jenny Burns, *Belmont Opens Social Entrepreneur Center*, NASHVILLE BUS. J., Sept. 24, 2009, <http://www.bizjournals.com/nashville/stories/2009/09/21/daily36.html> (announcing the launch of Belmont’s undergraduate major in social entrepreneurship), while Samford University allows students to concentrate their major in Social Entrepreneurship or to minor in the same. *Academics: Undergraduate Majors & Minors*, SAMFORD, <http://www4.samford.edu/business/academics/majors-and-minors.php> (last visited Mar. 26, 2011).

45. Tozzi, *supra* note 42.

46. E.g., Christina Binkley, *Charity Gives Shoe Brand Extra Shine*, WALL ST. J., Apr. 1, 2010, <http://online.wsj.com/article/SB10001424052702304252704575155903198032336.html> (discussing the success of TOMS Shoes, a for-profit social enterprise that donates a pair of its shoes for every pair purchased); Robertson, *supra* note 38 (highlighting the work of Pants to Poverty, an underwear company that supports ethical production by Indian cotton farmers).

47. Robertson, *supra* note 38.

48. Scudellari, *supra* note 8 (highlighting work of the social enterprise OneWorld Health).

49. Kelley, *supra* note 7, at 352 (citing Allianz, Dupont, The Skoll Found. & SustainAbility, *Growing Opportunity: Entrepreneurial Solutions to Insoluble Problems* 4, 15 (2007), available at [http://www.sustainability.com/researchandadvocacy/reports\\_article.asp?id=937](http://www.sustainability.com/researchandadvocacy/reports_article.asp?id=937)).

between a rock and a hard place when it comes to attracting capital. On the one hand, if social enterprises form as tax-exempt nonprofits, they must reinvest all profits into the organization and there is no straightforward way for venture capitalists or other for-profit investors to receive a return on their investment.<sup>50</sup> On the other hand, if social enterprises form as for-profit entities, they gain more access to investors,<sup>51</sup> but may subject their directors to fiduciary duty liability for failing to maximize financial returns.<sup>52</sup> Thus, according to many social entrepreneurs, corporate laws inhibit social enterprises' ability to creatively and profitably solve society's challenges.<sup>53</sup>

### *B. Beneficial Corporations: Creative Capitalism*

B Lab primarily set out to resolve these capital considerations and legal challenges by creating the B Corporation.<sup>54</sup> Becoming a B Corporation may help raise capital from SRIs. B Corporation certification signals to investors (and consumers) that an enterprise is purpose-driven and seeks simultaneously to benefit shareholders and stakeholders, including creditors, employees, consumers, the environment, and the community in which the corporation operates.<sup>55</sup> As a result, a number of well-known companies have jumped on the B

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50. *Id.* at 353. As Kelley points out, nonprofits may also rely on debt financing, but lenders are often reluctant to make loans to nonprofits on competitive terms due to nonprofits' constrained ability to repay. *Id.* at 354.

51. Also, organizing as a for-profit entity likely forecloses the government as a source of funding and may limit funding from other traditional sources of nonprofit funding, such as foundations. *Id.* However, a number of foundations support for-profit social enterprises today, such as the Skoll Foundation and Ashoka.

52. *Id.* at 362.

53. *E.g.*, Scudellari, *supra* note 8 (quoting OneWorld Health Founder Victoria Hale as stating that "[t]echnology is way advanced, and it's the business models that are lagging way behind, limiting what social entrepreneurs are able to accomplish.").

54. Another innovative attempt to facilitate social enterprise is the L3C, or Low-Profit, Limited Liability Corporation. In 2008, Vermont became the first state to create an L3C statute. Daniel S. Kleinberger, *A Myth Deconstructed: The "Emperor's New Clothes" on the Low-Profit Limited Liability Corporation*, 35 DEL. J. CORP. L. 879, 880 (2010). At present, seven other states have passed L3C legislation. *Id.* While there remain a number of questions about the L3C, it appears to resolve effectively some of the challenges social entrepreneurs face. See Kelley, *supra* note 7, at 371–76. *Contra* Kleinberger, *supra*.

55. See Sarah Kuck, "B" Is for Beneficial: The B Corporation, WORLDCHANGING, May 22, 2008, <http://www.worldchanging.com/archives/008059.html>. Jay Coen Gilbert, one of B Lab's founders, said a goal of B Lab's is "to create a unified brand that makes it easy for consumers and investors to identify socially responsible businesses." Thomas J. Billitteri, *Mixing Mission and Business: Does Social Enterprise Need A New Legal Approach? Highlights from an Aspen Institute Roundtable*, ASPEN INST. (2007), available at <http://www.aspeninstitute.org/publications/mixing-mission-business-does-social-enterprise-need-new-legal-approach>.

train, including Seventh Generation, Better World Books, Method, Numi Tea, and King Arthur Flour.<sup>56</sup>

To become a B Corporation, a business entity must receive certification from B Lab.<sup>57</sup> B Lab certification involves three primary steps.<sup>58</sup> First, the business organization must earn a satisfactory grade on a survey devised by B Lab that tests the organization's commitment to socially responsible behavior such as "democratic decisionmaking, having good benefits, donating profits to charity, and being energy efficient."<sup>59</sup> Second, it must institutionalize its commitment to serving the interests of stakeholders by amending its articles of incorporation and other governing documents.<sup>60</sup> Third, the organization must sign a term sheet that commits the organization to submit documents and certification fees to B Lab.<sup>61</sup> Once a corporation earns its "B" designation, it is subject to random audits by B Lab.<sup>62</sup> B Lab's audits verify the accuracy of each company's response to the initial B survey, and are intended to ensure that companies' practices mirror their representations.<sup>63</sup> If an audit reveals that a company has intentionally misrepresented aspects of its business in the B survey, B Lab will publicly revoke the company's B Corporation certification.<sup>64</sup>

B Lab's social responsibility survey is the first system of its kind.<sup>65</sup> But what makes B Lab unique<sup>66</sup>—and raises so many legal issues—is its requirement that companies institutionalize their commitment to stakeholders. The specific amendment that B Lab

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56. *Community*, B CORPORATION.NET, <http://www.bcorporation.net/community> (last visited Mar. 26, 2011). To date, no Delaware C corporation has received B Corporation certification.

57. *Become a B Corporation*, B CORPORATION.NET, <http://www.bcorporation.net/become> (last visited Mar. 26, 2011).

58. Other requirements include completing an assessment review and filling out a so-called "Declaration of Interdependence" form. *Id.*

59. Steiman, *supra* note 9.

60. *Id.*

61. *Id.*

62. *Audits*, B CORPORATION.NET, <http://www.bcorporation.net/audits> (last visited Mar. 26, 2011).

63. *Id.*

64. *Id.*

65. Fair Trade Certification, developed by Fair Trade USA, preceded B Lab's B Corporation. However, Fair Trade Certification applies to *products* produced and exchanged through equitable trade practices, not to *entities* themselves. For more information about Fair Trade Certification, see *Certification and Your Business*, FAIR TRADE USA, <http://transfairusa.org/certification> (last visited Mar. 26, 2011).

66. The B Corporation charter provision is the first widespread attempt to encourage companies to include consideration for stakeholders in their governing documents.

recommends to institutionalize stakeholder interests requires that directors do the following:

Consider . . . the social, economic, legal, or other effects of any action on the current and retired employees, the suppliers and customers of the Company or its subsidiaries, and the communities and society in which the Company or its subsidiaries operate, (collectively, with the shareholders, the "*Stakeholders*") . . . [and] the effect of the Company's operations . . . on the environment and the economy of the state, the region, and the nation.<sup>67</sup>

The recommended provision also specifically addresses the role of directors in change-of-control transactions. The relevant portion states:

Notwithstanding the foregoing, any Director is entitled to rely upon the definition of "best interests" as set forth above in enforcing his or her rights hereunder and under state law, and such reliance shall not, absent another breach, be construed as a breach of a Director's fiduciary duty of care, even in the context of a Change in Control Transaction where, as a result of weighing other Stakeholders' interests, a Director determines to accept an offer, between two competing offers, with a lower price per share.<sup>68</sup>

Thus, according to the B Corporation stakeholder provision, directors in a target B Corporation may consider the interests of employees, customers, communities (both large and small), and the environment in choosing between competing acquisition offers, even when so doing results in a lower price per share.

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67. The full text of the recommended charter provisions reads as follows:

In discharging his or her duties, and in determining what is in the best interests of the Company and its shareholders, a Director shall consider such factors as the Director deems relevant, including, but not limited to, the long-term prospects and interests of the Company and its shareholders, and the social, economic, legal, or other effects of any action on the current and retired employees, the suppliers and customers of the Company or its subsidiaries, and the communities and society in which the Company or its subsidiaries operate, (collectively, with the shareholders, the "*Stakeholders*"), together with the short-term, as well as long-term, interests of its shareholders and the effect of the Company's operations (and its subsidiaries' operations) on the environment and the economy of the state, the region and the nation.

Nothing in this Article express or implied, is intended to create or shall create or grant any right in or for any person or any cause of action by or for any person.

Notwithstanding the foregoing, any Director is entitled to rely upon the definition of "best interests" as set forth above in enforcing his or her rights hereunder and under state law, and such reliance shall not, absent another breach, be construed as a breach of a Director's fiduciary duty of care, even in the context of a Change in Control Transaction where, as a result of weighing other Stakeholders' interests, a Director determines to accept an offer, between two competing offers, with a lower price per share.

BCorporation.net, <http://survey.bcorporation.net/become/legal.php> (under "Corporate Structure," select "C Corporation"; then under "State of incorporation," select any of the states listed *infra* note 156; then click "Next") (last visited Mar. 26, 2011).

68. *Id.*

If the board of directors of an existing Delaware C corporation decides to seek any amendment to the corporation's articles of incorporation, it must call for adoption by passing a resolution setting forth and recommending the proposed amendment, followed by a shareholder vote on the proposal.<sup>69</sup> Both the board and the shareholders must approve the amendment by a simple majority vote.<sup>70</sup> Section 242 of the Delaware General Corporation Law confers broad powers to amend a charter, subject to the requirement that the amended articles of incorporation contain only such provisions as would be lawful and proper in an original certificate.<sup>71</sup> Thus, whether the B Corporation stakeholder provision violates Delaware C corporation law depends on whether it could be included in original articles of incorporation. It remains to be seen whether stakeholder charter provisions similar to the B Corporation provision comply with the Delaware corporate law.

### III. HOW DELAWARE CORPORATE LAW MIGHT HANDLE INSTITUTIONALIZED STAKEHOLDER INTERESTS

As social entrepreneurs and B Corporations multiply, conflicts will likely occur between corporate law as it currently exists and the requirement that B Corporations consider stakeholder interests. Any provision included in a Delaware C corporation's charter must comply with the Delaware General Corporation Law.<sup>72</sup> After mandating the inclusion of certain information in a corporation's charter,<sup>73</sup> section 102(b)(1) of Delaware's General Corporation Law states in relevant part:

(b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation *may* also contain any or all of the following matters:

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69. DEL. CODE ANN. tit. 8, § 242 (2011); EDWARD P. WELCH & ANDREW J. TUREZYN, *FOLK ON THE DELAWARE GENERAL CORPORATION LAW 2009: FUNDAMENTALS* 599 (2009). Needless to say, the process of amending corporate governance documents varies by state.

70. DEL. CODE ANN. tit. 8, § 242.

71. WELCH & TUREZYN, *supra* note 69, at 599.

72. DEL. CODE ANN. tit. 8, § 102(a)–(b).

73. Title 8, section 102(a) of the Delaware Code requires that a company seeking incorporation include the name of the corporation, the address of the corporation's registered office, the nature of the business or purposes to be conducted, the number of shares to be authorized, the name and mailing address of the incorporator(s), and the names and mailing addresses of the persons who are to serve as directors until the first annual meeting if the powers of the incorporator are to terminate upon the filing of the certificate of incorporation. § 102(a)(1)–(6).

(1) Any provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders, or any class of the stockholders, or the members of a nonstock corporation; if such provisions are not contrary to the laws of this State. Any provision which is required or permitted by any section of this chapter to be stated in the bylaws may instead be stated in the certificate of incorporation.<sup>74</sup>

Thus, the requisite inquiry for whether a provision may be included in a corporation's charter is whether the provision is (1) "for the management of the business and for the conduct of the affairs of the corporation" or "creating, defining, limiting and regulating the powers of the . . . directors" and (2) not "contrary to the laws of [the] State."<sup>75</sup> B Corporations' institutionalized stakeholder interest provisions, like all charter provisions, must meet these prerequisites.<sup>76</sup>

This Part begins by examining the first condition any charter amendment must meet in order to comply with Delaware corporate law. It then analyzes Delaware's treatment of stakeholder interests, including the possibility of institutionalizing those interests, in three main contexts: day-to-day operations, defending hostile takeover attempts, and change-of-control transactions.

#### *A. Requirement One: Management of the Business or Powers of the Directors*

Stakeholder charter provisions almost certainly satisfy the first requirement of section 102(b)(1). While Delaware has never addressed the specific question of whether stakeholder provisions relate to corporate governance, the threshold is so low that it can be said with reasonable certainty that stakeholder charter provisions satisfy the first prong of section 102(b)(1). Delaware courts have long interpreted the first prong of the 102(b)(1) test to include anything that "facilitate[s] corporate action,"<sup>77</sup> a threshold that in practice requires only that the provision relate to corporate governance.<sup>78</sup> Corporate governance is all about who has what power; it is about the relationship among various participants in determining the direction

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74. § 102(b)(1).

75. *Id.*

76. *Id.*

77. See *Frankel v. Donovan*, 120 A.2d 311, 316 (Del. Ch. 1956) ("Charter provisions which facilitate corporate action . . . are normally upheld by the court.").

78. See *Sagusa, Inc. v. Magellan Petroleum Corp.*, Civ.A. No. 12,977, 1993 WL 512487, at \*2 (Del. Ch. Dec. 1, 1993) ("[Section] 102(b)(1) . . . authorizes companies to include in their charters any corporate governance provisions that do not violate Delaware law.").

and performance of corporations.<sup>79</sup> The ability of directors to manage the decisions their business makes is at the heart of corporate governance.<sup>80</sup>

Stakeholder provisions, such as the recommended B Corporation provision, define and prescribe—and perhaps even create—directorial powers. The B Corporation provision, for example, requires directors to balance a number of considerations in discharging their duty of loyalty.<sup>81</sup> As such, it can hardly be argued that they do not satisfy the first part of section 102(b)(1). The more difficult question is whether they satisfy the second part of that section.

*B. Requirement Two: Do Stakeholder Provisions Violate Delaware Common Law?*

The second part of section 102(b)(1) makes clear that even if a provision deals with the management of the corporation or defines and limits the duties of directors, it may not be included in the charter “if such provisions are . . . contrary to the laws of [Delaware].”<sup>82</sup> Delaware common law has shaped the responsibilities that directors have with respect to shareholders and the corporations they serve.<sup>83</sup> The most clearly enunciated of these responsibilities are the fiduciary duties directors owe to the corporate entity and to its shareholders.<sup>84</sup> Fiduciary duties are, in essence, implicit contractual terms—“obligations to act in shareholders’ interests, when explicit contracts are silent, in the fashion the parties would have provided by contract had they been able to negotiate without transactions costs.”<sup>85</sup>

Delaware corporate law has long recognized two basic fiduciary duties for corporate directors: a duty of loyalty and a duty of care, both of which directors owe to the corporate entity itself and to its

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79. ROBERT A.G. MONKS & NELL MINOW, *CORPORATE GOVERNANCE* 3–4 (4th ed. 2008).

80. See DEL. CODE ANN. tit. 8, § 141(a) (“The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . .”).

81. See, for example, the language of the B Corporation provision reproduced *supra* note 67.

82. DEL. CODE ANN. tit. 8, § 102(b)(1).

83. Anthony Bisconti, Note, *The Double Bottom Line: Can Constituency Statutes Protect Socially Responsible Corporations Stuck in Revlon Land?*, 42 LOY. L.A. L. REV. 765, 772 (2009).

84. *Id.*

85. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 110 (1991).



shareholders.<sup>86</sup> Generally speaking, under the duty of loyalty, directors are required to pursue the best interests of the corporation and to place those interests above their own whenever those interests conflict.<sup>87</sup> Under the duty of care, directors must exercise good business judgment and use ordinary care and prudence in the operation of the business.<sup>88</sup> Because the standard of review for director decisions differs at different stages in a corporation's lifecycle, this Subpart analyzes Delaware's treatment of stakeholder interests in three main contexts: day-to-day operations, defending hostile takeover attempts, and change-of-control transactions.

### 1. Day-to-Day Decisionmaking: Business Judgment Rule

A stakeholder charter provision would most likely not cause Delaware B Corporation directors to violate their duties of loyalty and care when making day-to-day decisions. It is reasonably well settled in Delaware that corporations may take into consideration the interests of stakeholders in the day-to-day business context, unless an objecting party can show that such consideration was not in the long-run interest of the corporation.<sup>89</sup> "Day-to-day business" refers to the normal business operations of a corporation where directors "consider whether to authorize a particular course of action, activity, or

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86. See, e.g., *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939) (articulating directors' duties); see also *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984) ("The existence and exercise of [directors'] power carries with it certain fundamental fiduciary obligations to the corporation and its shareholders.").

87. See CHARLES R.T. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS 246 (5th ed. 2006) ("The core of this fiduciary duty is the requirement that a director favor the corporation's interests over her own whenever those interests conflict.").

88. *Id.* at 299.

89. See *Theodora Holding Corp. v. Henderson*, 257 A.2d 398, 405 (Del. Ch. 1969) (recognizing managers' rights to contribute corporate resources to socially beneficial ends in the context of charitable donations, provided they contribute to the long-term interests of shareholders); Robert A. Ragazzo, *Unifying the Law of Hostile Takeovers: Bridging the Unocal/Revlon Gap*, 35 ARIZ. L. REV. 989, 996 (1993) ("[T]he law has generally allowed directors to favor nonshareholder constituencies as long as the impact on shareholders is not excessive."); see also Kelley, *supra* note 7, at 350 ("Although there is still ample controversy over whether shareholder primacy ought to rule as the underlying principle of corporate decision making, it is reasonably well settled in most jurisdictions in the United States that corporations may take into consideration the interests of other, broader constituencies."). Still, Delaware courts have made clear that directors have a duty to maximize the long-term interests of the corporation. See *Katz v. Oak Indus., Inc.*, 508 A.2d 873, 879 (Del. Ch. 1989) ("It is the obligation for directors to attempt, within the law, to maximize the long-run interests of the corporation's stockholders . . .").

transaction.”<sup>90</sup> When reviewing decisions by directors in the day-to-day context, courts apply the business judgment rule absent bad faith or self-dealing.<sup>91</sup> In essence, the business judgment rule is a rebuttable presumption by courts that “in making a business decisions the directors of a corporation act[ ] on an informed basis, in good faith and in the honest belief that the action taken [is] in the best interests of the company.”<sup>92</sup> It is an acknowledgement that directors are better equipped than the courts to make business judgments.<sup>93</sup> Provided that “directors are entitled to the protection of the rule, then the courts should not interfere with or second-guess their decisions, though if they are not, then the courts scrutinize the decision as to its intrinsic fairness to the corporation and the corporation’s minority shareholders.”<sup>94</sup>

Delaware case law suggests that directors have substantial leeway to act in what they perceive to be the best interests of the corporation as an entity.<sup>95</sup> The Supreme Court of Delaware made clear that “[a] board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders.”<sup>96</sup> Under the “rationally related” test, as long as the director can show that the consideration of the stakeholder’s interests are rationally related to the long-term best interests of the company, the court will defer to the board’s business judgment.<sup>97</sup>

Meeting the requirements of the “rationally related” test is relatively easy for directors. For example, directors seeking to pay employees higher salaries can justify their decision by showing it is in the long-term best interests of the corporation because it promotes retention. In fact, directors can connect virtually every business decision to a rationally related benefit to the company, absent waste of

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90. See O’KELLEY & THOMPSON, *supra* note 87, at 303 (explaining that in the decisional setting, directors consider whether to authorize a particular course of action, activity or transaction).

91. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

92. *Id.* Judge Kent A. Jordan of the Third Circuit has referred to the business judgment rule as a *lens* through which a judge reviews decisionmaking, rather than a *rebuttable presumption*. IT Group Inc. v. D’Aniello, No. 02–10118, Civ.A. 04–1268–KAJ, 2005 WL 3050611, at \*8 n.10 (3d Cir. Nov. 15, 2005).

93. Gries Sports Enter., Inc. v. Cleveland Browns Football Co., 496 N.E.2d 959, 963–64 (Ohio 1986).

94. *Id.* at 963.

95. See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182–83 (Del. 1986).

96. *Id.* at 182 (citing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985)).

97. *Id.*; see also O’KELLEY & THOMPSON, *supra* note 87, at 242 (reiterating standard).

corporate proceeds.<sup>98</sup> As such, commentators have noted that, as long as you “[d]on’t jerk around any constituency too badly, . . . you’ll be ok.”<sup>99</sup>

Thus, the B Corporation charter provision most likely presents little issue for directors in the day-to-day context. As long as directors can show that their regard for the environment, community, or employees is rationally related to the long-term best interests of the company, they will receive the protections of the business judgment rule.<sup>100</sup> Considering the recent research by Goldman Sachs showing the long-term benefits higher employee compensation and consideration of other stakeholder interests have on share prices,<sup>101</sup> there is little reason to presume that B Corporation directors would violate their fiduciary duties to shareholders and to the corporation in the day-to-day context. Therefore, stakeholder provisions are not “contrary to the laws of [Delaware]” in the day-to-day business context.

## 2. Defending Hostile Takeovers: *Unocal*’s Heightened Standard of Review

A stakeholder charter provision may, but likely does not, cause Delaware B Corporation directors to violate their fiduciary duties when defending against hostile takeovers. A hostile takeover is an attempt to replace the control group of a company without its consent.<sup>102</sup> Potential acquirers gain control without the consent of the control group by either (1) making a tender offer seeking to buy

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98. This Note does not explore the limits of the doctrine of waste, which holds that when a director decision amounts to a waste of corporate assets, the director is not entitled to the protection of the business judgment rule. See *Lewis v. Vogelstein*, 699 A.2d 327, 336 (Del. Ch. 1997) (discussing standard for waste). The Delaware Supreme Court recently reiterated how high of a threshold claimants of corporate waste have to meet: “A claim of waste will arise only in the rare, ‘unconscionable case where directors irrationally squander or give away corporate assets.’” *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 74 (Del. 2006) (citation omitted).

99. Eric Talley, *On the Demise of Shareholder Primacy (Or, Murder on the James Trains Express)*, 75 S. CAL. L. REV. 1211, 1216 (2002).

100. This is, of course, assuming directors comply with their fiduciary duties of care and loyalty in all other respects. For comprehensive discussions about boards’ duties of care and loyalty, see *Smith v. Van Gorkom*, 488 A.2d 858, 872–74 (Del. 1985) (delineating the contours of the duty of care), and *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710–12 (Del. 1983) (discussing requirements of the duty of loyalty).

101. See, e.g., GOLDMAN SACHS GLOBAL INVESTMENT RESEARCH, GOLDMAN SACHS GRP. INC., INTRODUCING GS SUSTAIN 47, 50 (2007), [http://www.unglobalcompact.org/docs/summit2007/gse\\_gsg\\_embargoed\\_until030707pdf.pdf](http://www.unglobalcompact.org/docs/summit2007/gse_gsg_embargoed_until030707pdf.pdf) (showing that socially responsible companies, and those that pay their employees well, have a competitive advantage over their peers).

102. See O’KELLEY & THOMPSON, *supra* note 87, at 755.

sufficient shares to gain control of the board, or (2) launching a proxy fight seeking the authority to vote sufficient shares to gain control of the board of directors.<sup>103</sup> To combat attempts to usurp their power, boards of directors often employ various defensive tactics.<sup>104</sup>

Delaware courts apply a heightened standard of review for hostile takeover defensive tactics before directors enjoy the protections of the business judgment rule.<sup>105</sup> Under *Unocal Corp. v. Mesa Petroleum Co.*, Delaware courts will give directors the benefit of the business judgment rule only if the directors first demonstrate that they were responding to a legitimate threat to corporate policy and effectiveness, and that their response was “reasonable in relation to the threat posed.”<sup>106</sup> The board satisfies its burden to show a legitimate threat to corporate policy and effectiveness “by showing good faith and reasonable investigation.”<sup>107</sup> Courts give even more deference to board decisions regarding threats to the corporation when the board is comprised of a majority of outside independent directors.<sup>108</sup>

In determining how to reasonably respond to a perceived threat, *Unocal* explicitly states that a board may consider several factors, including the “impact on ‘constituencies’ other than shareholders (such as creditors, customers, employees, and perhaps even the community generally).”<sup>109</sup> Other factors that a board may

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103. *Id.*

104. *Id.* Some of the more popular defensive tactics used in the merger mania of the 1980s included poison pills, lock-up provisions, no-shop provisions, golden parachutes, and cancellation protection. *See id.* at 762–66 (describing alternative defensive strategies); *see also* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180–84 (Del. 1986) (ruling on the permissibility of each).

105. *See Unocal*, 493 A.2d at 954–55 (explaining the criteria directors must meet before enjoying the benefits of the business judgment rule). The reason for the higher standard of review for director decisionmaking when defending hostile takeovers is the “omnipresent specter” of entrenchment. *Id.* at 954. Entrenchment refers to an attempt by current directors to protect their position on the board even when doing so is at the expense of the best interests of the corporation. *See, e.g.,* Cheff v. Mathes, 199 A.2d 548, 554 (Del. 1964) (discussing entrenchment and noting that “if the board has acted solely or primarily because of the desire to perpetuate themselves in office, the use of corporate funds for such purposes is improper”).

106. *Unocal*, 493 A.2d at 954–55.

107. *Id.* at 955 (quoting *Cheff*, 199 A.2d at 555).

108. *See Panter v. Marshall Field & Co.*, 646 F.2d 271, 295 (7th Cir.1981) (“The presumption of good faith the business judgment rule affords is heightened when the majority of the board consists of independent outside directors.”); *Aronson v. Lewis*, 473 A.2d 805, 812, 815 (Del. 1984) (discussing the role of independent directors and deference in the context of demand futility); *Puma v. Marriott*, 283 A.2d 693, 695 (Del. Ch. 1971) (applying business judgment analysis and noting distinct independence of directors).

109. *Unocal*, 493 A.2d at 955.

consider include the inadequacy of the price of the tender offer, the nature and timing of the offer, any illegality, the risk of nonconsummation, and the quality of the securities being offered in the exchange.<sup>110</sup> The court in *Unocal*, however, did not explain the extent to which a corporation can consider the impact of a takeover threat on constituencies other than shareholders. In *Revlon, Inc. v. MacAndrews & Forbes Holding, Inc.*, the Delaware Supreme Court clarified the extent of director consideration of the "impact on 'constituencies' other than shareholders": "Concern for various corporate constituencies is proper when directors address a takeover threat, [but] that principle is limited by the requirement that there be some rationally related benefit accruing to the stockholders."<sup>111</sup> Thus, when defending against a takeover threat, directors' decisions to consider the social or environmental impact of a takeover are appropriate as long as doing so provides a "rationally related" benefit accruing to the shareholders.

The Delaware Supreme Court shed more light on the considerations of non-shareholder interests in *Paramount v. Time, Inc.*<sup>112</sup> There, Paramount attempted a hostile takeover of Time while the Time board was considering a merger with Warner.<sup>113</sup> The Time board had spent at least four years considering various options to allow Time to continue to operate.<sup>114</sup> Time's directors and executives zealously sought to preserve Time's "culture"—its perceived editorial integrity in journalism.<sup>115</sup> Time's board finally concluded that the corporation had to expand to survive, and that even though Paramount's tender offer was higher than Warner's, Warner was the best "fit" for Time to achieve its strategic objectives.<sup>116</sup> The Delaware Supreme Court held that the Time board's decision to merge with Warner, based at least in part on its cultural "fit" with Time, was entitled to the protection of the business judgment rule.<sup>117</sup> The court found that "[d]irectors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless

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110. *Id.* (citing Martin Lipton & Andrew R. Brownstein, *Takeover Responses and Directors' Responsibilities: An Update*, 1983 A.B.A. NAT'L INST. DYNAMICS CORP. CONTROL 7 (1983)).

111. 506 A.2d 173, 176 (Del. 1986).

112. *See Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1990).

113. *Id.* at 1146-48.

114. *See id.* at 1151-52 (explaining that Time's "deliberative approach" began in 1983-84 and ended when it decided to merge with Warner in 1988).

115. *Id.* at 1152.

116. *Id.*

117. *Id.*

there is clearly no basis to sustain the corporate strategy.”<sup>118</sup> The lesson from *Time* is clear: by ensuring the board develops a long-term strategy for their corporation before receiving hostile bids, directors will be able to later find protection by claiming that merging with company X or Y will threaten their corporate plan.<sup>119</sup> *Time* thus suggests that the preservation of a company’s long-term strategy can trump short-term profit interests and find protection under the business judgment rule.<sup>120</sup>

Even under a heightened *Unocal* standard of review, Delaware case law tends to uphold decisions by directors to consider the impact of a future takeover on non-shareholder constituencies;<sup>121</sup> the same reasoning would likely extend to B Corporations. B Corporation directors considering a hostile tender offer from an acquiring company could likely perceive a weaker commitment to non-shareholder interests as a threat to corporate policy and effectiveness.<sup>122</sup> As illustrated by *Time*, a threat to a deliberately conceived, long-term corporate culture may be a threat to corporate policy and effectiveness. Still, it is debatable whether a B Corporation’s commitment to social responsibility could constitute a protectable corporate policy for purposes of *Unocal* scrutiny.<sup>123</sup> If a B Corporation’s

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118. *Id.* at 1154 (citing *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986)).

119. *See id.* at 1152 (finding that the *Time* board’s decision to merge with Warner was entitled to the protection of the business judgment rule).

120. Barnali Choudhury, *Serving Two Masters: Incorporating Social Responsibility into the Corporate Paradigm*, 11 U. PA. J. BUS. L. 631, 657 (2009).

121. Ragazzo, *supra* note 89, at 996.

122. The argument that a company without a demonstrated strategy to consider social responsibility would threaten a target’s policy and effectiveness is especially compelling where the most significant component of the target’s business strategy is its commitment to stakeholders, as is often the case with B Corporations.

123. Following the drafting of this Note, the Court of Chancery of Delaware issued *eBay Domestic Holdings, Inc. v. Newmark*, No. 3705-CC, 2010 WL 3516473 (Del. Ch. Sept. 9, 2010), a distinguishable, but instructive, case on what constitutes a protectable corporate policy.

At issue in *eBay* was whether the directors of Craigslist breached their fiduciary duties to eBay, a minority shareholder, by approving a rights plan that restricted eBay’s ability to purchase additional shares and to sell its shares to third parties. *Id.* at \*1. In his opinion, Chancellor Chandler stated that Craigslist failed to demonstrate that eBay posed a threat to its corporate policy or effectiveness, the first prong of *Unocal* scrutiny. *Id.* at \*23. He reasoned that Craigslist failed to prove that its “public-service mission” constituted a “distinctly protectable . . . culture.” *Id.* at \*22–23. He further reasoned that even if Craigslist had a protectable culture, the Craigslist board “did not conclude in good faith that there was a sufficient connection between the [C]raigslist ‘culture’ (however amorphous and intangible it might be) and the promotion of stockholder value.” *Id.* at \*22. In dicta, Chancellor Chandler continued: “I cannot accept as valid for the purposes of implementing the Rights Plan a corporate policy that specifically, clearly, and admittedly seeks *not* to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders . . . .” *Id.* at \*23.

commitment to stakeholders is found to constitute a protectable culture, its board would comply with the first step under *Unocal* by investigating the threat thoroughly and in good faith.

To comply with the second step—to respond “reasonabl[y] in relation to the threat posed”—B Corporation directors would be able to consider the interests of employees, communities, and the environment as long as they could demonstrate a rationally related benefit to shareholders from each consideration.<sup>124</sup> As previously explained, directors have little difficulty satisfying this standard. Therefore, even under the heightened standard of review imposed on directors when defending hostile takeovers, B Corporation directors may consider the interests of non-shareholders. An obligatory stakeholder charter provision, then, may, but likely does not, cause directors to violate their fiduciary duties when defending hostile takeovers. It is more likely that stakeholder charter provisions violate director duties when it is obvious that a corporation is for sale.

### 3. For Sale: *Revlon* Mode

A stakeholder charter provision would almost certainly cause Delaware B Corporation directors to violate their fiduciary duties when their companies go up for sale. Under Delaware corporate law, directors’ duties change when it is clear a company is for sale—that is, in “*Revlon* mode.” A corporation enters *Revlon* mode when it undertakes a transaction that will either cause a change of control or break up the corporate entity.<sup>125</sup> In either circumstance, directors’ sole

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While Chancellor Chandler’s opinion may suggest that B Corporations’ commitment to stakeholders would not constitute a protectable “culture” that promotes shareholder value, it should not. Craigslist’s culture “reject[ed] any attempt to further monetize its services.” B Corporation certification does not require this sort of rejection of profit. Craigslist’s commitment to stakeholder interests was “amorphous,” whereas B Corporation certification is strong evidence that a company’s commitment to stakeholders is a clearly defined part of the corporation’s long-term strategy. Craigslist did not attempt to show that its public service mission rationally related to shareholder value, whereas B Corporation directors (and all other directors) can do so by relying on reports such as the one cited *supra* note 101. Additionally, *eBay* is a Court of Chancery opinion, not the Delaware Supreme Court’s. Thus, the debate about whether commitment to stakeholder interests constitutes a protectable corporate policy remains open.

124. This is, as long as directors also ensure the defensive measures they take are otherwise within the range of reasonableness. Defensive measures are within the range of reasonableness as long as they are not draconian and the cost imposed on the corporation by the defensive measure is not disproportionate to the benefit it provides. *See generally* *Paramount Commc’ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 49–50 (Del. 1994) (explaining that defensive measures were not reasonable because they included draconian and otherwise harmful provisions that, on balance, hurt Paramount more than they helped).

125. *Id.* at 47. *Revlon* duties are often implicated (1) when a company initiates an active bidding process to sell itself or to reorganize itself in a way that will clearly break up the

duty under Delaware corporate law becomes auctioneering: they must exercise their powers to secure the transaction that offers the highest price reasonably available to the shareholders.<sup>126</sup> Rather than seek to protect the best interests of both the corporation and the shareholders, *Revlon* requires directors to stop considering the interests of the corporate entity and instead focus exclusively on shareholder interests.<sup>127</sup>

What this means for stakeholder constituencies is that, under *Revlon*, directors may not consider how accepting different offers will affect their interests. The *Revlon* court explicitly stated that "concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress."<sup>128</sup> An open question exists about whether consideration of non-shareholder interests would be permissible if it furthered the auction process and somehow raised the offered share price. Such a scenario, however, is extremely unlikely

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company; or (2) when, in response to an active bidder's offer, a target company abandons its long-term strategy and seeks an alternative transaction with a white knight that will clearly break up the company. *Id.* (citing *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1990)). In corporate law, a "white knight" refers to someone with the potential to acquire a company that the board of directors prefers for one reason or another.

126. *E.g.*, *id.* at 43 ("The consequences of a sale of control impose special obligations on the directors of a corporation . . . reasonably to seek the transaction offering the best value reasonably available to the stockholders.").

The duty to seek the transaction with the best value reasonably available to shareholders originated from the famous case of *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986). In *Revlon*, the court was faced with the sale of Revlon in a bidding war between two companies seeking to take control of Revlon. *Id.* at 176–79. In an attempt to prevent the first hostile bidder from acquiring Revlon, the Revlon board used multiple defensive tactics aimed at enticing a different potential acquirer to bid for control of the corporation. Revlon granted a white knight, Forstmann, an option to purchase certain Revlon assets (the lock-up option), a promise to deal exclusively with him in the face of a takeover (the no-shop provision), and the payment of a \$25 million cancellation fee if the transaction was aborted.

The Delaware Supreme Court found that Revlon's defensive tactics worked to the detriment of Revlon shareholders because they effectively foreclosed the auction process. *Id.* at 185. Instead of encouraging more bidding participation, and thus driving up the price that each shareholder would gain, Revlon's defensive tactics so favored one party that any other reasonable party would have had no incentive to offer a higher price. *See id.* at 184 ("Revlon had dealt preferentially, and almost exclusively, with Forstmann throughout the contest. . . . Forstmann was given nearly every negotiating advantage that *Pantry Pride* had been denied . . ."). Since *Revlon*, the Delaware Supreme Court has continued to hold that when it is clear that a corporation is "for sale," directors breach their fiduciary duties unless they attempt to secure the highest price per share that is reasonably available to their shareholders.

127. *See id.* at 182 ("The duty of the board had thus changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit.").

128. *Id.* at 182.



and directors seeking this justification would face an uphill battle against the explicit language of *Revlon*.<sup>129</sup>

The B Corporation stakeholder provision is problematic at best for a Delaware corporation in *Revlon* mode. It places directors in an impossible situation: Delaware case law prohibits concern for the interests of non-shareholder constituencies, while directors are under a charter-obligated duty to consider the social, economic, and legal effects a change-of-control transaction will have on employees, suppliers and customers, the communities in which they operate, and even the environment. The B Corporation charter language goes even further and flat-out rejects *Revlon*'s edict: consideration of non-shareholder interests shall not, "absent another breach, be construed as a breach of a Director's fiduciary duty of care, *even in the context of a Change in Control Transaction* where, as a result of weighing other Stakeholders' interests, a Director determines to accept an offer, between two competing offers, with a lower price per share."<sup>130</sup>

To illustrate the dilemma a B Corporation director faces, assume that hypothetical Environmental Social Enterprise Corp., a Delaware-based C corporation, faces two competing leveraged buyout offers, one for \$50 a share from a company with a reputation of dumping toxic chemicals into rivers and one for \$40 from a company with green initiatives. *Revlon* obliges Environmental Social Enterprise Corp.'s directors to accept the offer from the chemical-dumping company, even though the new ownership would likely threaten its environmental mission. Thus, if a B Corporation incorporates in Delaware and finds itself in *Revlon* mode, its directors will invariably breach their fiduciary duties to the shareholders, notwithstanding the stakeholder charter provision.

However, it is not entirely clear that Delaware courts would apply *Revlon* to a B Corporation in the auction process. Neither *Revlon* itself nor any of the corporations since *Revlon* that have been sued for breach of *Revlon* duties has had a charter provision placing

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129. See *id.* ("A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders."); Leo E. Strine, Jr., *The Social Responsibility of Boards of Directors and Stockholders in Charge of Control Transactions: Is There Any "There" There?*, 75 S. CAL. L. REV. 1169, 1175 n.17 (2002) ("As a general matter, the *Revlon* case stands for the proposition that once a board of directors either decides to tell the company or engages in change of control transaction [sic], it must act to secure the highest immediate value reasonable attainable."). But see Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 983 (1992) ("[I]n [the up-for-sale] context, considering any factors other than shareholder wealth violates the board's fiduciary duties.").

130. See the language of the B Corporation provision reproduced *supra* note 67.

an affirmative obligation on directors to consider non-shareholder interests.<sup>131</sup> Under one view of Delaware corporate law, charters are explicit contracts between directors and shareholders.<sup>132</sup> When shareholders purchase stock in a corporation, they assent to, and are bound by, the terms of the corporation's charter. Under this view, shareholders might not be able to bring suit against B Corporation directors for considering non-shareholder interests because they assented to this consideration when they purchased shares.<sup>133</sup> Still, Delaware law does not permit corporate organic documents such as charters to redefine director fiduciary duties.<sup>134</sup> In general, a charter amendment may not derogate from common law rules if doing so conflicts with some settled public policy.<sup>135</sup> In light of the long-standing policy that directors must maximize shareholder wealth once a company is for sale,<sup>136</sup> Delaware courts would most likely find the B Corporation charter provision invalid because it conflicts with public policy. But should they?

#### IV. BLENDED VALUE: WHY DELAWARE COURTS SHOULD ALLOW B CORPORATION DIRECTORS TO CONSIDER STAKEHOLDER INTERESTS IN *REVLON* MODE

Delaware should allow B Corporation directors to consider stakeholder interests, even in *Revlon* mode, to allow directors to protect the "best interests" of B Corporation shareholders. While directors in *Revlon* mode can no longer seek to protect the corporate entity, they still have an affirmative obligation to protect the best interests of the shareholders. Directors' own views about the long-term interests of the target corporation are irrelevant because it will

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131. An internet search using Westlaw did not reveal any instances of a *Revlon* claim filed against a Delaware corporation with a charter-based obligation to consider nonshareholder interests.

132. WELCH & TUREZYN, *supra* note 69, § 242.2 (speaking about a charter in terms of being a contract both between shareholders and the corporation, and between shareholders themselves).

133. *See id.* (stating that Delaware corporate law assumes shareholders are aware of and consent to the terms found in a corporation's charter when they purchase shares).

134. Bainbridge, *supra* note 129, at 985.

135. *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 118 (Del. 1952); ERNEST L. FOLK, III, *THE DELAWARE GENERAL CORPORATION LAW: A COMMENTARY AND ANALYSIS* 10 (1972).

136. *See generally* *Paramount Commc'ns, Inc. v. QVC Network, Inc.* 637 A.2d 34, 47–48 (Del. 1994) ("There are few events that have a more significant impact on the stockholders than a sale of control or a corporate break-up. Each event represents a fundamental (and perhaps irrevocable) change in the nature of the corporate enterprise from a practical standpoint. It is the significance of each of these events that justifies: (a) focusing on the directors' obligation to seek the best value reasonably available to the stockholders; and (b) requiring a close scrutiny of board action which could be contrary to the stockholders' interests.").

cease to exist.<sup>137</sup> When the sale consists of a stock-for-stock exchange,<sup>138</sup> B Corporation shareholders will become shareholders in the new entity, and thus, how the new entity performs and operates will affect the best interests of the shareholders. Even when the sale involves the sale of shares, the views of shareholders are relevant because it is their money that they stand to gain or lose.

Generally speaking, the determination of what is in shareholders' "best interests" involves inquiry into what the bargaining parties would have wanted had they been able to freely negotiate without transaction costs.<sup>139</sup> In the context of a B Corporation change-of-control transaction, the relevant inquiry would be: Which offer would the B Corporation shareholders have accepted? Delaware courts conducting this inquiry apply a "reasonable person" standard.<sup>140</sup> As discussed in Part III, Delaware has long concluded that the best interests of reasonable shareholders, when it is clear the corporation will no longer exist, are to generate the most wealth at the least risk.

There is strong evidence to suggest that the vast majority of corporate shareholders would have bargained for the greatest financial return at the least risk.<sup>141</sup> This can be observed through equity offerings: companies with historically poor-performing stock struggle to find capital, while high-growth companies easily attract capital. Investment in ethical funds, although growing, is still only an

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137. See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (requiring directors to stop protecting the "corporate bastion").

138. A stock-for-stock exchange is when shareholders of the target corporation will receive stock in the acquiring corporation. Usually, the relative value of the stock in the new corporation is more valuable, a phenomenon referred to as a "share premium."

139. See Lawrence Scheinert, *Countering the Stoneridge Critics: The Prudence of Maintaining the Status Quo for Lawyer Liability Under Rule 10B-5*, 11 FLA. COASTAL L. REV. 1, 24 (2009) ("The corollary inquires into what the bargaining parties would have wanted had they been able to freely negotiate without transaction costs. This question yields the Pareto efficient outcome by approximating what the parties would have bargained for."). The Pareto method approximates what parties would have bargained for in order to achieve the most wealth for both parties.

140. See *id.* at 25 ("[T]o determine what the parties would have wanted, the best approach is simply to ask what a reasonable person in their situation would want.").

141. A fundamental assumption of economists' models of the corporate and capital markets is that shareholders are interested in maximizing wealth and avoiding risk. Indeed, this is the basic premise of Market Portfolio Theory, the historically dominant investment theory. Legal scholars such as Stephen Bainbridge claim that maximization of profit promotes the best interests of shareholders because the more wealth that is created, the better it is for everyone. For more background on this topic, see EASTERBROOK AND FISCHER, *supra* note 85, at 43. See also Strine, *supra* note 129, at 1184–87 (discussing differing views and exposing the ethical considerations of them).

estimated nine percent of the total funds under management.<sup>142</sup> Further support for the wealth-maximization assumption is found in litigation behavior. Shareholders almost universally bring suits against directors when they believe a director decision has caused the economic value of their investment somehow to be jeopardized.<sup>143</sup> Rarely do social-responsibility-related shareholder proposals receive more than trivial support.<sup>144</sup> Thus, Delaware's long-standing policy—that the best interests of shareholders in a change-of-control transaction is receiving the highest price per share—appears to reflect the preferences of the high majority of investors.

Nonetheless, this broad assumption raises questions and may be inappropriate in the context of B Corporations. Is it an accurate assumption that the best interests of all shareholders in every change-of-control transaction is the same, namely an interest in maximized profit? Could there be some class of investors whose “best interests” do not involve an unqualified commitment to the highest price per share? Are there circumstances when it would be in shareholders' best interests to grant directors discretion to discriminate between competing acquirers based on their commitment to stakeholders, even when doing so might cause shareholders to lose profits? If there are such circumstances, should Delaware courts continue to prohibit directors from considering stakeholder constituencies in change-of-control transactions?

The theoretical problem with the reasonable person standard, as applied by Delaware and other states, is its uniformity: all investors are assumed to want the same thing. Of course, in reality, that is simply not true. Unlike traditional investors, SRIs seek to maximize a balance of financial return and social good.<sup>145</sup> SRIs

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142. Ian B. Lee, *Corporate Law, Profit Maximization, and the “Responsible” Shareholder*, 10 STAN. J.L. BUS. & FIN. 31, 53 n.189 (2005) (citing Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1268 (1999)). Ethical funds refer to funds under professional management that use social “screens” to avoid products that were not produced in a socially responsible manner and/or to encourage socially responsible practices. Williams, *supra*, 112 HARV. L. REV. at 1268.

143. See, e.g., *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 36 (Del. 1994) (“QVC and certain stockholders of Paramount commenced separate actions . . . against Paramount.”); *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1142 (Del. 1990) (explaining that shareholder plaintiffs argued that Time's board failed to maximize shareholder value); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

144. O'KELLEY & THOMPSON, *supra* note 87, at 221.

145. See Robertson, *supra* note 38 (discussing preferences of social investors). Of course, the preferences of investors do not separate perfectly into the dichotomy of so-called “traditional” investors and SRIs. In truth, investing preferences run a spectrum, and investing is less a trade-off between social and financial interest and more of an embedded value proposition composed of

express their values on issues like social justice and the environment through investing in companies that they believe will have a positive social impact.<sup>146</sup> They expect that companies will consider the impact business decisions will have on constituencies like employees, communities, and the environment.<sup>147</sup> Such an altruistic motive does not fit neatly within economic models of the corporation that provide justification for the uniform reasonable person standard.<sup>148</sup> If given the opportunity to bargain without transaction costs, most SRIs would want directors to consider how each business decision, especially major decisions such as mergers or takeovers, would affect other constituencies. Therefore, their best interests—especially in *Revlon* mode—are not obtaining the highest price per share, but rather achieving the maximum balance between share price and social impact.

An acknowledgement that different investors have different interests raises another problem: Shareholders in most corporations (and certainly all publicly traded corporations) are a combination of traditional and socially responsible investors, so how do courts simultaneously protect all shareholders' best interests? The short answer is they cannot protect them all. But courts could align their decisions more closely with modern realities of diversely interested shareholders by inquiring whether the supermajority of the shareholders is more traditional or is more socially responsible. The vast majority of companies that come before the courts will continue to consist of a supermajority of traditional investors. However, a small minority, including B Corporations, will consist of predominantly SRIs. In these limited circumstances, Delaware courts should permit directors to discriminate between potential acquirers based on the impact change-of-control transactions will have on other constituencies.

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both. Jed Emerson, *The Blended Value Proposition: Integrating Social and Financial Returns*, 45 CAL. MGMT. REV. 35, 38 (2003).

146. See Schueth, *supra* note 17, at 189 ("Socially conscious investors believe that they can make money and make a meaningful difference by consciously directing investment capital toward enterprises that contribute to a clean, healthy environment, treat people fairly, embrace equal opportunity, produce safe and useful products, and support efforts to promote world peace.").

147. *Id.*; Elizabeth Wine, *SRI Plows the Path to Profitability*, ON WALL ST., Aug. 1, 2009, at 28, available at [http://www.onwallstreet.com/ows\\_issues/2009\\_8/sri-plows-the-path-to-profitability-2663476-1.html](http://www.onwallstreet.com/ows_issues/2009_8/sri-plows-the-path-to-profitability-2663476-1.html).

148. See Lee, *supra* note 142, at 55 ("[S]ocially responsible investing is awkward for some economic theorists of the corporation because it contradicts the assumption of investor single-mindedness . . .").

Other commentators have also suggested that the views of shareholders should be relevant to courts. For example, Ian Lee makes a strong case for why the views of shareholders should be relevant to the exercise of managers' faculties: "In the exercise of managers' ethical faculties, the views of shareholders are . . . relevant because the shareholders have money at stake in a departure from profit maximization: the profits would otherwise be for their benefit."<sup>149</sup>

The sanctity of the corporate form will not be sacrificed by acknowledging the best interests of some investors, even in a sale context, are not maximized profits. The corporate form has facilitated more prosperity than any other economic form in human history, and Delaware courts would be unwise to shift their understanding of the form drastically. Major changes usually harm more than help, due in large part to the uncertainty they create. But the corporate form periodically needs incremental changes to ensure laws align with the realities of the modern marketplace.<sup>150</sup> More than ever, the market does not consist of investors seeking only financial prosperity; instead it includes a range of investors seeking to effect social change through their investment preferences.<sup>151</sup>

Such an acknowledgement may strengthen the corporate form. While Delaware has stated that directors should not have to focus on short-term profits,<sup>152</sup> the recent financial crisis exposed some of the pitfalls of the current corporate system.<sup>153</sup> Permitting directors to consider stakeholder interests in limited circumstances will help corporations again operate with the vision necessary to promote sustainable and long-term success, rather than focus exclusively on

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149. *Id.*

150. For example, the SEC recently made amendments to bring securities law in line with the "realities of the modern marketplace." Revisions of Limited Offering Exemptions in Regulation D, Securities Act Release No. 8828, 72 Fed. Reg. 45,116, 45,117 (proposed Aug. 10, 2007).

151. Emerson, *supra* note 145, at 35–39.

152. *Revlon, Inc. v. MacAndrews & Forbes Holdings*, 506 A.2d 173, 1150 (Del. 1985) ("[T]he question of 'long-term' versus 'short-term' values is largely irrelevant because directors, generally, are obliged to chart a course for a corporation which is in its best interests without regard to a fixed investment horizon.").

153. See Marjorie Kelly, *Not Just For Profit*, 54 STRATEGY & BUS. 1, 4 (2009), available at <http://www.bcorporation.net/resources/bcorp/documents/strategy+business.pdf> ("The financial meltdown of 2008 was a direct result of the pursuit of immediate profit by investment bankers and mortgage brokers who disregarded the impact of their actions on customers, on the larger economy, and indeed on stockholders and the company itself in the long term.").

quarterlies. Most jurisdictions have already recognized the need to address the shareholder-stakeholder debate.<sup>154</sup>

## V. THE INADEQUACY OF CURRENT STAKEHOLDER SOLUTIONS

While various states have adopted potential solutions to address the interests of stakeholders in the change-of-control context, these approaches do not serve the best interests of corporate shareholders. This Part considers and rejects two such proposals: (1) passing a constituency statute to amend a director's duty of care; and (2) incorporating as a benefit corporation in either Vermont or Maryland.

### A. Stakeholder Constituency Statutes

The most common "solution" to allow corporate directors to consider stakeholder interests is to pass a stakeholder constituency statute. In response to *Reylon*, a number of states passed constituency statutes.<sup>155</sup> Thirty-one states now have some version of the statute; Delaware, noticeably, does not.<sup>156</sup> Typically, constituency statutes exist as amendments to statutory statements of a director's duty of care.<sup>157</sup> In most cases, constituency statutes provide that in fulfilling managerial duties of care, directors may consider the effects of a decision not only on shareholders, but also on a list of other constituency groups.<sup>158</sup> These permissible constituency groups usually include employees, creditors, suppliers, consumers, and the community at large.<sup>159</sup>

The biggest problem with constituency statutes is that because they apply to *all* C corporations, they are often not in the best interests of *shareholders*. For example, denying a bid from the highest bidder, who believes firm value will increase if it shuts down a factory,

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154. For states' responses, see Part V and accompanying footnotes, *infra*.

155. See Bainbridge, *supra* note 129, at 993–94 (explaining that Indiana's constituency statute was "obviously drafted in response to a pair of Seventh Circuit decisions" agreeing with *Reylon*).

156. MODEL BUS. CORP. ACT ANN. 8–209 (2008) (noting that Arizona, Connecticut, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Massachusetts, Minnesota, Mississippi, Missouri, Nevada, New Jersey, New Mexico, New York, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Vermont, Wisconsin, and Wyoming have constituency statutes).

157. Conaway, *supra* note 20, at 794 n.16.

158. Bainbridge, *supra* note 129, at 986.

159. Conaway, *supra* note 20, at 794 n.16.

hurts shareholders' return on investment.<sup>160</sup> As explained in Part IV, the vast majority of shareholders still invest for the sole purpose of maximizing their financial return,<sup>161</sup> and while more and more investors would prefer directors consider the interests of employees, most still would not. Because constituency statutes do not distinguish among the varying interests of modern investors, they likely hurt more investors than they help. Constituency statutes may also hurt shareholders because they provide unchecked protection for self-interested directors.<sup>162</sup> Self-interested directors can always claim that their decision to accept one hostile offer instead of another was to protect employee jobs, when in fact that decision may have been motivated by entrenchment.<sup>163</sup>

If the Delaware legislature passed a constituency statute similar to those adopted by other states, not only would it hurt the majority of shareholders, it could also expose B Corporation directors to personal liability in the takeover context. This might occur because the interests protected in the B Corporation charter provision are different from the interests protected by existing constituency statutes. For example, the suggested B Corporation stakeholder charter provision states that directors "shall . . . consider . . . the effect of the Company's operations (and its subsidiaries' operations) on the environment,"<sup>164</sup> but current constituency statutes omit any protection for directors who base decisions on consideration for the environment.<sup>165</sup> If the Delaware legislature passed a similar constituency statute, corporate directors could not consider the effect of their decisions on the environment.<sup>166</sup> Therefore, the Delaware legislature should not pass a constituency statute because these statutes frequently cause directors to hurt shareholders' best interests and may not actually exculpate directors from personal liability.

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160. This, of course, assumes that employees are not shareholders, which is often the case.

161. See *supra* Part IV.

162. Bainbridge, *supra* note 129, at 972.

163. *Id.*

164. See *supra* note 67.

165. Conaway, *supra* note 20, at 794 n.16.

166. The Delaware legislature could avoid this problem by becoming the first state to include director protection for the environment. This change alone, though, would still fail to protect B Corporation directors adequately. To do so, the Delaware legislature would also need to ensure that the non-shareholder interests enumerated in a constituency statute are the same as those interests enumerated in B Lab's charter provision. For example, it would also need to include language permitting consideration of "the effect of a company's operations on the economy of the state, the region and the nation."



*B. Benefit Corporation Legislation*

Another proposed solution is for Delaware to pass benefit corporation legislation. At present, four states—Maryland, New Jersey, Vermont, and Virginia—have passed legislation providing for the creation of benefit corporations.<sup>167</sup> Benefit corporations are distinct legal forms, independent from other corporate forms.<sup>168</sup> Under Maryland, New Jersey, Virginia, and Vermont law, a benefit corporation only has to be organized for the furthering of some “general public benefit.”<sup>169</sup> All four laws define general public benefit as “a material positive impact on society and the environment.”<sup>170</sup> In Maryland, New Jersey, Virginia, and Vermont, a beneficial corporation’s positive impact on society and the environment must be measured by a third party, such as B Lab.<sup>171</sup> Importantly, beneficial corporation legislation explicitly protects directors’ decisions seeking to further the corporation’s stated public interests. It does so through a provision stating that the creation of general public benefit is in the best interests of the benefit corporation,<sup>172</sup> and a provision exculpating directors from fiduciary duty violations for considering the interests of the general public.<sup>173</sup>

For those entities willing to form as a Maryland, New Jersey, Vermont, or Virginia benefit corporation, their directors will not likely face the director dilemma presented in this Note because the

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167. Maryland was the first state to pass benefit corporation legislation, doing so on April 13, 2010. MD. CODE ANN., CORPS. & ASS’NS § 5–6C (West 2010). Vermont followed by passing legislation on May 19, 2010. VT. STAT. ANN. tit. 11, § 21 (2010). Virginia and New Jersey passed similar legislation in early 2011. *Public Policy*, B CORPORATION.NET, <http://www.bcorporation.net/publicpolicy> (last visited Apr. 25, 2011). Other states that are currently considering benefit legislation include California, Colorado, Delaware, Pennsylvania, Maine, North Carolina, New York, and Oregon. Fiscal and Policy Note (Revised), S.B. 690, 2010 Gen. Assemb., Reg. Sess. (Md. 2010), available at [http://mlis.state.md.us/2010rs/fnotes/bil\\_0000/sb0690.pdf](http://mlis.state.md.us/2010rs/fnotes/bil_0000/sb0690.pdf). In New York, the Senate has approved a draft version.

168. At this point, it should be clear that B Lab’s Certified B Corporation and benefit corporation legislation differ in significant ways, most importantly because Certified B Corporations are not a legal status, while benefit corporations are.

169. MD. CODE ANN., CORPS. & ASS’NS, § 5–6C–01(C); N.J. STAT. ANN. § 14A:5(a); VA. CODE ANN. § 13.1–787(A); VT. STAT. ANN. tit. 11A, § 21.08(a).

170. MD. CODE ANN., CORPS. & ASS’NS, § 5–6C–01(C); N.J. STAT. ANN. § 14A:1; VA. CODE ANN. § 13.1–782; VT. STAT. ANN. tit. 11A, § 21.03(a)(4).

171. MD. CODE ANN., CORPS. & ASS’NS, § 5–6C–01(C); N.J. STAT. ANN. § 14A:11(a)(2); VA. CODE ANN. § 13.1–791(A)(2); VT. STAT. ANN. tit. 11A, § 21.03(a)(4).

172. *E.g.*, VT. STAT. ANN. tit. 11A, § 21.08(c).

173. *Id.*

legislation in each of these states was modeled after the recommended B Corporation charter language.<sup>174</sup>

Benefit corporation legislation is a significant step, and one deserving praise for its ingenuity.<sup>175</sup> However, the legislation does not apply to C corporation directors. The reasons for choosing one corporate form over another are beyond the scope of this Note, but companies planning to seek institutional investors would most likely not find this “solution” very useful: most institutional investors prefer investing in C corporations and shy away from companies formed as alternative entities. Presumably, applying this same reasoning, institutional investors would shy away from a company formed as a benefit corporation. Therefore, recent benefit corporation legislation appears to be useful for social entrepreneurs willing to forfeit the potential capital benefits of a C corporation, but useless for C corporation directors.

## VI. SOLUTION: BRINGING CORPORATE LAW IN LINE WITH THE REALITIES OF MODERN MARKET PRACTICE WITHOUT COMPROMISING SHAREHOLDER PROTECTION<sup>176</sup>

Delaware corporate law needs to adapt to the realities of investment preferences in modern market practice. While there have always been investors who invest based on their preferences, the number of investors today who seek to affect society through their investment choices has grown and continues to grow.<sup>177</sup> At the same time, the vast majority of investors still prefer to maximize their

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174. See *Public Policy*, B CORPORATION.NET, <http://www.bcorporation.net/publicpolicy> (last visited Apr. 25, 2011) (discussing and linking to model legislation created by an attorney for B Lab).

175. For more information about benefit corporation legislation, see Elizabeth Hang, Steven Haymore, Dirk Sampselle & Larry Vranka, *The Need and Rationale for the ‘Benefit Corporation’: Why it is the Right Legal Solution for Using the Power of Business to Solve Social Problems* (Apr. 1, 2011) (unpublished white paper) (on file with author).

176. In 2007, the SEC proposed revisions to the rules applicable to private and limited offerings. Revisions of Limited Offering Exemptions in Regulation D, Securities Act Release No. 8828, 72 Fed. Reg. 45,116 (proposed Aug. 10, 2007). The Commission’s objective was to clarify and modernize the rules to “bring them into line with the realities of modern market practice and communication technologies without compromising investor protection.” *Id.* at 45,117. This Part of the Note proposes revisions to director obligations under *Revlon* in a way that similarly attempts to bring corporate governance into line with the realities of the modern market practice while still maintaining protection of investors.

177. As of 2008, socially responsible investing accounted for nine percent of all investments in the market. Lee, *supra* note 142, at 53 n.189; see also Schueth, *supra* note 17.

financial return at the least risk.<sup>178</sup> The most appropriate solution then to the institutionalized stakeholder interest debate preserves the current protection afforded to traditional investors, while permitting socially responsible investors and the corporations they invest in to sacrifice profits for social impact.

In determining the best interests of shareholders in change-of-control transactions, however, Delaware courts should seek to ascertain the *economic* as well as *social* interests of the shareholders. To this end, Delaware courts should implement a different change-of-control standard of review for corporations with stakeholder charter provisions than *Revlon*. Under this new test, directors of general corporations with stakeholder charter provisions would receive the protections of the business judgment rule so long as they show that (1) a reasonable, unsophisticated investor would have been aware of the corporation's commitment to stakeholders even when it was clear the company was for sale;<sup>179</sup> (2) there was a threat to corporate policy and effectiveness; and (3) the response was reasonable in relation to the threat posed. Noticeably, this test involves a combination of the *Unocal* heightened scrutiny test with a new element attempting to ensure investors understand the risk they take—sacrificing profits in return for the prospect of social impact.

The determination of whether a reasonable investor would have been aware of the corporation's commitment to stakeholders is fact-specific, but directors should not be able to claim this protection unless the name and logo of the corporation indicates that it operates for the benefit of society as well as shareholders. The appropriate means of identification could include a small "B" within a circle, similar to the symbol for trademark or registered, as well as a phrase written below the corporation in small font: "A Beneficial Corporation." This symbol and accompanying phrase will serve as a useful identification to alert the public of the distinction between B Corporations and traditional corporations. Directors should also be required to include a provision in the prospectus and on the stock certificate explaining that beneficial corporation directors may accept

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178. "Traditional" investors accounted for approximately ninety-one percent of the market. See Schueth, *supra* note 17 (noting that socially responsible investors account for 9.4 percent).

179. This standard, admittedly, creates a legal fiction. Because of the practical impossibility of determining the specific preferences of individual investors, it is a presumption that a reasonable investor would notice and understand the significance of a company being a B Corporation. As awareness of B Corporations increases, this presumption will become more valid.

a lower price per share in the event of a sale if they believe doing so will be more beneficial to the enumerated stakeholders' interests.

Like under *Unocal* and *Time*, the "corporate policy and effectiveness" of B Corporations should include more than just a threat to profits. It should include a threat to the corporation's commitment to employees, creditors, and other stakeholders as enumerated by the charter. A corporation's response based on its threatened commitment to stakeholders, however, should not be deemed reasonable if a corporation accepts a lower price per share from a hostile bidder where it is clear that a higher financial offer will also create a higher social impact. In other words, to accept a lower offer, directors must show that the offer was more beneficial to the interests of the stakeholders enumerated in the charter.

"Social impact," for the purposes of change-of-control transactions, should be determined by the specific protections in the charter of the target corporation. Where the target corporation commits to protecting the interests of employees and the broader community as well as to operating in an environmentally friendly way, the standard for shareholder social welfare would be how committed the acquiring company is to the interests of the *target's* employees, the *target's* communities, and the *target's* environmental plan.<sup>180</sup>

## VII. CONCLUSION

The legal question presented by the Certified B Corporation stakeholder charter provision tackles the very heart of corporate law: For whose benefit should the corporation operate? Should the corporation exist exclusively to benefit shareholders or to benefit shareholders and society?<sup>181</sup> Delaware corporate law has taken a middle-of-the-road approach by permitting director consideration of non-shareholder interests until it is clear a corporation will change control or break up. In the takeover context, it remains to be seen how Delaware courts will react to the mandatory language of the stakeholder interest provision in B Corporation charters. Under *Revlon* and its progeny, however, Delaware courts most likely will

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180. Evidence of an acquirer's "commitment" to social responsibility may include provisions in charters or bylaws, company codes of conduct or ethics, and past practices, among others. Because of the inherent subjectivity of determining how committed potential acquirers are to the interests of a target B Corporation's stakeholders, courts should strongly defer to the judgment of B Corporation directors.

181. See, e.g., Joseph L. Weiner, *The Berle-Dodd Dialogue on the Concept of the Corporation*, 64 COLUM. L. REV. 1458 (1964) (summarizing the entirety of the seminal corporate purpose debate between Adolph E. Berle and E. Merrick Dodd).

deem the provisions to violate the directors' auctioneer duties. At the very least, the tension between *Reulon* and B Corporation charters makes for a difficult policy decision by Delaware judges. Rather than apply a bright-line rule to all investors, Delaware should adopt this Note's proposed test as a way to facilitate socially responsible investing while protecting the majority of investors who exclusively seek to profit financially.

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