Benefit Corporations: A Case Study in the Issues of Implementation and Adoption of the Fastest Growing Business Form in the United States

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Abstract: Due to growing consumer demand for mission-driven businesses, new corporate forms have emerged over the past decade in the United States. The Benefit Corporation is the fastest-growing of these new forms. Benefit Corporations are for-profit, but allow the firm to declare a “social purpose/benefit” in its articles of incorporation and permit the firm to pursue the benefit in tandem with increasing shareholder value. This paper first attempts to evaluate how effectively states have implemented this legislation. This paper extrapolates potential problems in the irregularities of visibility and record-keeping across the various states through the analysis of data accessibility and legislative differences. Irregularities in the public rollout of this legislation affect the transparency of Benefit Corporations and, as a result, the ability for stakeholders to hold the firm accountable. Complicating these issues is the fact that Benefit Corporation advocacy is largely centralized in a few third party organizations. This paper examines some of the downfalls of such conflated public/private involvement in implementing successful innovative business structures.

Key Words: benefit corporation, benefit reports, third party assessment, transparency

I. The Rise of Social Business and Benefit Corporations

The United States in the past thirty or more years has seen an expansion in the assortment of companies that consider themselves “mission-driven” to the point that their mission and values occasionally motivated decisions that have
mitigated, if not negatively impacted, the company’s financial bottom line. But, these companies—Ben & Jerry’s, Newman’s Own, etc.—were historical outliers that sooner or later encountered unique legal or other issues due to their different priorities and accountabilities. However, the desire and demand for social and community-driven business has only continued to grow in the United States, thus creating a need to establish business and legislative protections.

Defined by the Social Enterprise Alliance, a social enterprise is “an organization or initiative that marries the social mission of a nonprofit or government program with the market-driven approach of a business” (Social Enterprise Alliance 2016). In more practical terms, social enterprises’ primary objective is not just maximization of shareholder wealth; it also incorporates social concerns. The important difference here from nonprofits is that the organizations pursue their alternative social objectives through a traditional business-like strategy of earning income, rather than relying solely upon others’ benevolence (Blount and Nunley 2015).

The rise of social enterprise is indicative of shifting consumer trends and demands. While American consumers have long maintained a healthy skepticism about business goals, the 2008 financial crisis may have soured many on unabashedly for-profit ventures1 (Lofft, Maniar, and Rosenberg 2012). A large marketplace has emerged from consumer and investor demand for companies that put public purpose before profit in their business (Etheridge 2015). In addition, millennials2 constitute an increasingly large share of the consumer base and are often the most sought-after demographic. Therefore, millennials regularly represent “ground zero” for trends in consumption and advertising from which other demographics feel the ramifications either directly or indirectly. And the millennial demographic is placing unprecedented emphasis on the mission and values of a company (Sharp 2014). Millennials want to hear about the relevant social or environmental impact of the products they purchase, and will often pay more for products with a commitment to addressing these issues (Smith and Brower 2012). In fact, a recent study suggests that 87 percent of ALL consumers, regardless of age, indicated that they would switch to a socially responsible brand when price and quality are equal (Khatib 2015). This trend may be most obvious in the food service industry, where mission-committed companies like Chipotle and Starbucks continue to post impressive returns while others struggle for reinvention, often resorting to mimicking the sincerity of their counterparts (Lee Yohn 2014).

This surge of social enterprise growth is capitalizing on the normalization of legal operational structures that value social or environmental goals as
equally important as financial ones. Legal precedent discouraging managers from prioritizing any value above shareholder profit has given businesses pause when it comes taking certain social enterprise risks. Therefore, states have decided to codify specific legislation as a means of protection for these social entrepreneurs. There have been several different manifestations of social enterprise in business law legislation. These hybrid organizations include Low-Profit Limited Liability Companies (L3Cs), Flexible Purpose Corporations, Social Purpose Corporations, Benefit Limited Liability Companies (LLCs) and Benefit Corporations (Tyler et al. 2015). Now legally available as a business form in thirty-one of the American states and in the District of Columbia (and recently established in Italy), Benefit Corporations are quickly emerging as the leading form of social enterprise. Hence, this paper focuses upon this legal form in particular (Benefit Corporation 2016).

This paper focuses specially on the issue of reporting and accountability for the Benefit Corporation model and breaks the issue down to four key questions. In the first question, we ask what is actually required by Benefit Corporation legislation for reporting. There are generally two major legislative choices currently operating in the United States: the Model Benefit Corporation Legislation (MBCL) that has been adopted by most states and Delaware’s Benefit Corporation legislation requirements. The second question is: How is transparency achieved under either of these legislative frameworks and how is it falling short? To answer this question we use empirical research about the actual number of states requiring a report and in what manner. And last we are critically considering the state enforcement and management mechanisms currently in place that also contribute to the issues of transparency.

II. Benefit Corporation Legislation

The Model Benefit Corporation Legislation (MBCL) provides the structure for the majority of states’ own Benefit Corporation laws (Benefit Corporation 2016). The crux of the legislation allows businesses that incorporate as Benefit Corporations legally to consider their social purpose in conjunction with, or even before, their financial purpose. The social purpose is described often as generating a “net material positive impact . . . on society, the environment, and the well-being of present and future generations” (Frederikson & Byron Law Firm 2014). Benefit Corporations must also provide some accountability by creating and publishing an annual Benefit Report, in addition to their traditional Annual Report, documenting how they have actually achieved their stated social purpose. The Benefit Report is important for current shareholders, potential
investors and the overall success of this form of social enterprise (Khatib 2015). The Benefit Reporting process is where the goal of this legislation is falling short of expectations.

The MBCL has two important components for purposes of transparency: (1) Benefit Corporations must publicly post an annual Benefit Report, and (2) Benefit Corporations must use a third party standard to measure social and environmental performance (Clark and Vranka 2013). Delaware adopted Benefit Corporation legislation in 2015 to much fanfare, given the number of organizations that incorporate in Delaware, but their legislation took a markedly different approach to transparency. In Delaware, the Benefit Corporation need only issue a Benefit Report biennially and only to shareholders (as opposed to MBCL’s requirement that the report be released annually to the public). Delaware organizations are also not required to use third party standards to assess compliance (Khatib 2015).

III. Benefit Corporation Transparency

The collection and accountability of the Benefit Reporting process is both misunderstood and unsuccessful. There are discrepancies in how and in what form Benefit Reports are collected at both the business and state levels. Furthermore, the current third party standard of evaluation presents serious problems for transparency and the long-term health of the Benefit Corporation experiment.

A. Benefit Reporting

One of the key features distinguishing Benefit Corporations from regular corporations is the publication of a Benefit Report. The Benefit Report is meant to explain to shareholders (and potential investors, media and consumers) how the established social purpose of the organization has been met in the prior year (or two years). When claims emerged that the Benefit Corporation would fall victim to “greenwashing,”9 the authors of the MBCL insisted that the Benefit Report would help avoid this pitfall (Clark and Vranka 2013). Alas, the actual reporting process has largely failed in practice. Research has shown that less than 10 percent of Benefit Corporations actually fulfill their reporting requirement (Murray 2015b). Many reasons exist for this failure. Some have argued that most Benefit Corporations are small organizations with limited resources to put towards meeting legal requirements (like Benefit Reports), and that there are high learning costs to incorporating new legal forms (Murray 2015b) (Van Alstine 2002). The larger issue seems to be the limited state government management and enforcement built into the Benefit Corporation legislation.
1. Research Question

After reading the Benefit Corporation legislation for several states, a troubling trend emerged concerning the required Benefit Reports. While each state that has passed Benefit Corporation legislation requires a Benefit Report, how such a report is to be made publicly available is far from clear. Therefore, I sought to identify which states required a Benefit Report to be submitted to the Secretary of State’s Office (SOS) or simply to be posted on the website of the business itself. If the state required the Benefit Corporation to post the Benefit Report on the organization’s website (or simply make it available should someone ask), I wished to identify whether a potential investor/consumer/reporter/researcher, etc., could find a list of Benefit Corporations in a given state to then search for each organization’s website.

2. Methodology

I began with an immensely helpful chart created by Prof. J. Haskell Murray at Belmont University that synthesized the legislation for the majority of Benefit Corporation friendly states (Murray 2015a). The chart detailed whether a Benefit Corporation must publicly post its Benefit Report, share the report with its shareholders, or file the Benefit Report with the state. Murray’s chart also specified whether there was any express penalty for not filing the Benefit Report (among many other facts). I updated the chart with the latest four states to add Benefit Corporation legislation. From October 2015 to January 2016, my research assistant began exploring the SOS websites for each of the 31 states. He evaluated whether a list of Benefit Corporations was publicly available via the SOS website in a database inquiry search or via a specific request to the office. If it was not immediately clear, he contacted the Secretary of State’s office via email and telephone. To start, he used the email addresses found on the SOS websites for information inquiries. If there was no email listed, if the email bounced back as “undeliverable,” or if he did not receive a response (or received an incomplete response), then he began contacting the SOS offices via the publicly listed telephone numbers on the respective websites. He asked whether a list of Benefit Corporations is available from the SOS office, and, if it was a state that collected Benefit Reports, he also asked whether those were publicly available. The summary of this information is in Table 1 (pp. 211–212).
3. Summary of Findings

What emerged from this data was picture in line with my hypothesis—namely, that there is weak state management in maintaining the transparency and accountability of Benefit Corporations.

Of the thirty-two states/districts with Benefit Corporation legislation, thirty of them require some form of public posting of the Benefit Report. This requirement is typically expressed as a demand that the website of each Benefit Corporation post the annual Benefit Report; or, if the Corporation does not have a website, that the Corporation make the report available to anyone who requests it. This requirement comes directly from the Model Benefit Corporation Legislation implemented by a majority of states. Delaware does not require public posting of the Benefit Report, but the state legislation is markedly more flexible and less stringent than the MBCL. The other state that does not require public posting of the Benefit Report is Minnesota, but Minnesota does require their General and Specific Benefit Corporations to file the reports with the SOS’s office. While the fact that 94 percent of states with Benefit Corporation legislation require a public posting of Benefit Reports sounds like an amazing tally in the transparency column, it is, in fact, quite deceiving. It is deceiving because we must also look at the enforcement mechanism to ensure that these Benefit Corporations are actually posting their Reports online. The data shows us that there is an express penalty for not meeting the Benefit Reporting requirement in only eight states.11 (Four of these enforcement states are states that require an SOS filing of the report and, therefore, have some means of knowing that there isn’t compliance.)

As previously mentioned, we know from other research that, if Benefit Report compliance is left up to each organization’s own understanding and commitment to the legislation, the actual compliance is below 10 percent (Murray 2015b).

Another important point from this data is the number of states that require the Benefit Corporation to file a Benefit Report annually with the SOS office—thirteen states or roughly 40 percent.12 This number is much more encouraging, as it provides the state a mechanism to actually ensure Benefit Reports are being produced and made available per the requirements of the legislation. However, only Minnesota, New Hampshire, and New Jersey provide enforcement by having the state administratively dissolve the Benefit Corporation if the Benefit Report is not submitted appropriately.13 Otherwise, the other ten states only allow enforcement proceedings by the shareholders in derivative suits.14 While it is important that shareholders receive the Benefit Reports, it is equally important that the state, potential investors, consumers, media and researchers are able to access the reports as well. Benefit Corporations are often small organizations,
and shareholders are typically a small handful of already heavily involved officers and directors in the organization (Cohen 2014, Pilon 2014, Nance and Vu 1993). By relying on shareholders to hold Benefit Corporations accountable in creating Benefit Reports, we are ignoring the fact that the shareholders often have a potential conflict of interest in this regard. The shareholders are often the ones leading the company and making the decisions about pursuing the firm’s social purpose and about whether to publish a Benefit Report. They may be more inclined to report that the corporation’s social purpose has been achieved because it is in the best interest of the company’s image even when the facts may belay that claim or to simply “miss” an annual benefit report publication if the organization has not necessarily met their duty. This inclination may sprout from a malicious intent to deceive or may simply emerge as a natural tendency for groupthink among corporate officers/founders to see success in all aspects of the business they run. (Leslie 2010) As with other forms of corporate regulation (i.e., SEC), the state/government needs to be the independent arbiter of enforcement to ensure that these reports are produced and made available to the public for actual transparency to exist in this corporate form.

If the state cannot create transparency in the Benefit Corporation form, then the media and the consumer need to be able to investigate and hold Benefit Corporations accountable for not achieving their stated purpose. This leads us to the last bit of data that is important from this chart. It is the number of states that make a list of Benefit Corporations available to the public via the state website or direct request of the SOS office. Twenty-five, or 78 percent, of the thirty-two states/districts with Benefit Corporation legislation make this list available. That number is slightly misleading, insofar as sixteen of the twenty-five require the searcher file a special request of the Secretary of State’s office and pay a fee. These requirements may be a real hurdle for some and limit transparency. In addition, of those twenty-five states, thirteen are states that do not require the Benefit Corporation to file the Benefit Report with the state. The only way the media/public would know how to find Benefit Corporations in the state and, subsequently, the Benefit Corporation’s websites and (one hopes) their Benefit reports is to use this type of list request. Otherwise, the ungainly process of finding random Benefit Corporations and their websites with Benefit Reports would be via word of mouth, lucky internet searches or dependence on third party assessment organizations that are often out of date, unreliable or limited to those organizations that use them for their assessment. This state of affairs is not an ideal or acceptable scenario for evaluating government legislation and maintaining any sense of accountability.
B. Third Party Standards and Assessment

The majority of Benefit Corporation legislation either suggests or requires a third party assessment/standard for purposes of evaluating whether a Benefit Corporation has met its stated social purpose. There are two major problems that have emerged: 1) the terms of what should be included in the Benefit Report are incredibly vague to the point of uselessness; and 2) the emerging third party standard bearer is frequently one organization, B Lab, an advocacy organization that may have some potential conflict of interests.

Section 401 of the Model Benefit Corporation Legislation requires the following from Benefit reports and is frequently copied verbatim in most state legislation:

(1) A narrative description of:
   (i) The ways in which the Benefit Corporation pursued general public Benefit during the year and the extent to which general public Benefit was created.
   (ii) Both:
      (A) the ways in which the Benefit Corporation pursued a specific public Benefit that the articles of incorporation state it is the purpose of the Benefit Corporation to create; and
      (B) the extent to which that specific public benefit was created.
   (iii) Any circumstances that have hindered the creation by the Benefit Corporation of general public benefit or specific public benefit.
   (iv) The process and rationale for selecting or changing the third-party standard used to prepare the Benefit Report.

(2) An assessment of the overall social and environmental performance of the Benefit Corporation against a third-party standard:
   (i) applied consistently with any application of that standard in prior Benefit Reports; or
   (ii) accompanied by an explanation of the reasons for:
      (A) any inconsistent application; or
      (B) the change to that standard from the one used in the immediately prior report.

If we look in more detail at the terms in this section, we see a statement such as “pursued general public benefit.” If an organization only has to pursue a public benefit versus actually ensure its creation, then does the simple act of incorporating as a Benefit Corporation, without actually achieving anything for a social purpose, satisfy that pursuit? We can break the language down even
further and ask what a “general public benefit” even means. We have seen organizations like for-profit universities re-incorporate as Benefit Corporations under the guise that they are working to provide education to adults (Lederman 2015). Education is, of course, a public benefit. But, for-profit universities have received lots of negative press for engaging in deceptive, aggressive and manipulative tactics to enroll as many students as possible without regard for students’ potential for success or ability to afford tuition (Edmonson 2016). Should these universities still qualify as Benefit Corporations? There is the dilemma, and the problem, with the status quo.

While some argue that the vagueness in the language is necessary given the breadth of possible organizations that might want to incorporate as Benefit Corporations, it is still possible to provide more explicit guidelines. I support other scholars’ suggestions that stakeholders should identify trends; and then the statutes would require Benefit Corporations to “commit to the chosen metrics for a set number of years” (Murray 2015b). I then expand on that suggestion and offer that legislators should look at the actual metrics used by third party assessors. What are these organizations that devote themselves to this type of assessment looking for? Those items can just as easily be incorporated in the legislative requirements. It is also not unreasonable to limit what qualifies as a “social” or “public” benefit. State governments should have a very clear understanding of what they mean by public benefit. Such an understanding may very well limit the number and type of organizations that qualify as Benefit Corporations. It is a quality over quantity argument. The MBCL provides a helpful comment on what may be included as providing a public benefit. The list includes:

(1) providing low-income or underserved individuals or communities with beneficial products or services; (2) promoting economic opportunity for individuals or communities beyond the creation of jobs in the ordinary course of business; (3) preserving the environment; (4) improving human health; (5) promoting the arts, sciences, or advancement of knowledge; (6) increasing the flow of capital to entities with a public Benefit purpose; and (7) conferring any other particular benefit on society or the environment.17

This list (minus subsection 7) constitutes a great start in understanding what the original purpose and hope was for Benefit Corporation legislation. It also helps provide better standards for assessing what may be included in a Benefit Report and how these specific purposes have been met.

The other glaring problem glossed over by many governments, and even some academics advocating for this corporate form, is the over-reliance on third
party organizations to monitor, enforce, and define the whole field of Benefit Corporations. The problem lies in the private nature of these auditing or monitoring organizations and their inherent potential for a conflict of interest in ensuring that Benefit Corporations exist and continue to exist, while also being the ones to monitor the organizations’ compliance. There are over 100 organizations that provide rating standards for corporate sustainability practices. For example, B Lab, Global Reporting Initiative (GRI), GreenSeal, Underwriters Laboratories, ISO2600 and Green America provide specific standards for Benefit Corporations (Benefit Corporation 2016). B Lab is the most popular of the third party standards used by Benefit Corporations (Etheridge 2015). It is important to note just how much B Lab has at stake in keeping Benefit Corporations operating.

B Lab is a nonprofit organization founded in 2006 and has been at the forefront of the Benefit Corporation idea. B Lab helped create the Model Benefit Corporation Legislation and has been a massive advocate in lobbying for its adoption across the country (Achermann, Forde, and Ouzas 2014). It offers a “B Corp” certification system and charges organizations money to assess their social and environmental performance with a view towards determining whether these organizations merit the “B Corp” label (Etheridge 2015). There has been some confusion between the “B Corp” label and a Benefit Corporation. The latter includes organizations that actually incorporate as a Benefit Corporation in a particular state with the relevant legislation. A “B Corp” is not necessarily a Benefit Corporation. A “B Corp” is simply a company that has met the certification standards of B Lab. Therefore, one can also have a Benefit Corporation that is not a “B Corp.” B Lab does, however, provide a free third party standard for Benefit Corporations to use for purposes of their Benefit Report requirements. Given B Lab’s role in drafting the MBCL, it is likely no accident then that the Model Legislation suggests the use of a third party standard as the means of evaluation and enforcement. There are other means by which a state may critically evaluate and enforce a Benefit Report. This may include creating a state (or, eventually, a Federal) department or sub-office within a Secretary of State.

Part of the issue with this reliance on B Lab and other third party assessors is the potential conflict of interest implicit in this reliance. The assessors wish to remain in business; and they can only do that by the continued interest in the idea of Benefit Corporations. While third party assessors may still make money by certifying “B Corps” and other such labels that exist outside of the legal/legislative appointment of a Benefit Corporations, the assessors still have a natural (and, on occasion, financial) inclination to support the continued growth of the official legalization of Benefit Corporations. This spread of legislative
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legitimacy brings more attention, positive marketing and potential future revenue streams for assessors like B Lab. Therefore, when Benefit Corporations look to these assessors for assistance with their Benefit Reports the assessors have an incentive to nurture and protect an offspring of their own business model.

The legislation leaves much to be desired when monitoring the third party assessment. For example, if a Benefit Corporation does not necessarily meet the standards of B Lab’s Benefit Report assessment, is B Lab required to report this failure to the Secretary of State? No, they are not legally required to do so under any of the thirty-two current state/district legislative formulas. But should they? Is it not in B Lab’s interest to ensure that Benefit Corporations continue to exist legally? Thus, a question exists about what incentive third party assessors have to be diligent about when denying Benefit Reports.

The other question centers on the transfer of governance power to a private organization. We know that when a Benefit Corporation uses B Lab (or any other third party assessment organization) to assess their Benefit Report and achievement of certain standards, B Lab has no legal requirement to report this non-compliance with the state/district government. But, do assessors deny the Benefit Report through their own internal standard procedures and thus deny the STATE’s “Benefit Corporation” status? It is only the state that can confer any corporate status. Thus, are legislators indicating they have passed this regulatory duty to a third party, private organization that has potentially conflicting motives? These are all serious questions that have not yet been answered by the legislation or subsequent case law.

IV. Conclusion and Future Research

There is no doubt that the Benefit Corporation model was developed in direct response to consumer and employee demand for a different type of capitalism—a capitalism that sought to recognize that “doing good” could coexist with making money. But, as with most grand new experiments, change does not evolve perfectly. State legislators need to re-evaluate their Benefit Corporation legislation and consider adding more enforcement and transparency mechanisms for the greater success of the business form. We see from the data that certain states already require Benefit Reports to be submitted to the Secretary of State and threaten administrative dissolution with noncompliance. This requirement is an easily added requirement that would go far in ensuring Benefit Corporations at least know they need to consider how well they have achieved their professed social/beneficial purpose. Benefit Corporations should have to publish their reports in a form readily accessible by investors/reporters/consumers, etc. This
process would easily follow the model of the Annual Report already required of corporations. The next step in the evolution is to consider the third party assessment metrics. Third party organizations are a great place to start, but they should not be the only assessment models and enforcers. Of course, Benefit Corporations themselves are looking for better ways to distinguish their brand and mission and may want to take a “lead in this area . . . to find a good way to assess themselves credibly, [while finding] a good way to communicate that assessment to the market” (Steingard and Gilbert 2016). We should continue to evaluate the development of this new, popular business form so that it may succeed in contributing to this revolution of conscious capitalism.
Table 1: Comparison of State Statutes (Murray 2015a). Some data already collected from Murray chart but expanded and updated.

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Notes

Many thanks are given to Tim Rolph, my former research assistant and colleague at the Institute for Business and Professional Ethics at DePaul University, for his collection of data and assistance in developing the paper.

1. A Gallup Poll taken every year from 1973 through 2016 demonstrates that Americans’ confidence in business ranged from an all-time high of 34 percent to a low in 2009 of 16 percent (Gallup Poll 1973–2016).

2. Millennials are generally defined as those born between 1984–2004 (Bump 2014).


Some scholars argue that *Dodge* is not such a seminal case and is rarely applied. Prof. Lynn A. Stout argues that “courts regularly allow corporate directors to make business decisions that harm shareholders in order to benefit other corporate constituencies” and that courts primarily shield directors from liability under the business judgement rule so long as there is some possible future benefit, however unlikely, flowing to shareholders (Stout 2008). Others argue that “shareholder maximization operates as a controlling norm in corporations precisely because so many businesspeople believe that it is a legal requirement” (Koehn 2016: 19).


5. As of December 2016, Benefit Corporation legislation is being considered in Australia and Canada (Cooper 2016; Tobin 2014).

6. As of November 2016, seven additional states are working on Benefit Corporation legislation (Benefit Corporation 2016).

7. Washington, California, and Florida have a slight mix of the Delaware and MBCL legislation.

8. In Delaware, the Benefit Report does not need to be released to the public and is only required biannually (Benefit Corporation 2016).

9. “Greenwashing” refers to companies making deceptive, misleading and false environmental claims. It is a phenomena that appeared after consumers became more environmentally conscious and began to demand more environmentally friendly products. Companies wished to reap the Benefits of increased consumers for “green” products without actually creating one (Ho 2015).

10. Or bureaucratic equivalent. Washington D.C. requires that Benefit reports be submitted to the mayor’s office, for example (Benefit Corporation 2016).

12. Indiana; Washington, D.C.; Arizona; Arkansas; Pennsylvania; Rhode Island; South Carolina; Nebraska; Utah; Massachusetts; Minnesota; New Hampshire; New Jersey.


Some scholars have argued that immediate dissolution may not be the best enforcement, as it would allow an organization that wishes to change into a regular C Corp, a means to bypass the shareholders (Murray 2015b).


15. Oregon; Montana; Nevada; Delaware; Illinois; Idaho; West Virginia; Florida; Washington; Hawaii; New York; Vermont; Indiana; Washington, D.C.; Arizona; Arkansas; Pennsylvania; Rhode Island; South Carolina; Nebraska; Utah; Minnesota.


17. MODEL BENEFIT CORP. LEGISLATION §102(a).

References


