



Balancing Profits against the Greater Good: Benefit Corporations, B-Certified Corporations, and Low-Profit LLCs

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In the past, business entities were traditionally limited to two principle types: for-profit and not-for-profit companies. For-profit entities (through their directors) owe a fiduciary duty to owners to generate profits and maximize the asset value of the entity. In contrast, not-for-profit entities must forego profits, but instead focus on specific altruistic goals. Recently, however, this binary choice has been augmented with more flexible legal forms that provide opportunities for new mission-driven companies and socially conscious entrepreneurs.

Beginning in 2008, states began adopting legislation to recognize Benefit Corporations (B Corps) and Low-Profit Limited Liability Companies (L3Cs) as legal forms that allow for-profit enterprises to consider “triple bottom line” accountability in decision-making. Using triple bottom line accountability means that B-Corps and L3Cs can focus on benefits to society and/or the environment, as well as economic return to owners in decision-making. While the concept of triple bottom line accountability has been discussed since the mid-1990s,¹ there is a trend to recognize, by statute and certification, the fundamental shift in fiduciary duties such accountability creates. As of publication, twelve states have passed B-Corp legislation and nine states have passed L3C legislation.² Additionally, a new process exists to certify any for-profit entity motivated by returns other than just economics (B-Certification).

Benefit Corporations (B Corps)

States that have adopted B Corp legislation have largely based their B Corp statutes on model legislation (the “Model B Corp Act” or the “Model Act”) – but to varying degrees.³ Under the statutes enacted to date, a corporation becomes a B Corp by adopting charter provisions that compel the corporation to create a “material positive impact on society and the environment” (a “general public

benefit”)⁴ and consider the interests of non-shareholder “corporate constituencies”⁵ in addition to the interests of shareholders.

The intent expressed in the Model Act (and state B Corp enactments to date) is for B Corps to assume specific responsibilities to society not shared by ordinary for-profit business corporations.⁶ The assumption of such responsibilities redefines the fiduciary duty of directors, in that it requires directors to consider nonfinancial interests and non-shareholder constituencies when making decisions.⁷ But the Model B Corp Act and state statutes generally provide little guidance as to the scope of this expanded fiduciary duties imposed upon corporate directors and management. Also, some of the statutes decline to address the issue of party standing to enforce this expanded duty. And perhaps most surprisingly, the statutes currently in effect provide little guidance to directors when the interests of shareholders are most likely to conflict with those of other benefit constituencies.

States generally enact the Model B Corp Act by amendment to their current business corporation act, adding four new subchapters. These new subchapters cover the process of becoming a B Corp (by statement in or amendment to the articles of incorporation), the meaning of benefit purposes, the standard of accountability for officers and directors (adding parties/constituencies to whom directors owe, or permissively may owe, a duty of care beyond the owners of the entity), and the added reporting requirements to assure transparency.⁸ Perhaps most importantly from a legal perspective, the Model B Corp Act explicitly states that the consideration of non-shareholder interests does not violate a director’s duty of care to shareholders.⁹

B Certification

In addition to new state statutes providing legal recognition to B Corps, there is a certification process for any corporation that chooses to consider non-shareholder interests (B-Certified Corporations or B-Certification). This certification process does not change the legal status of the corporation or the legal duties of the directors of the corporation, but rather rates the corporation on its inclusion of non-shareholder/non-financial elements in operations and decision-making. The certification program is administered by B Lab.¹⁰ **The stated mission of B Lab is to (1) certify and support corporations who achieve a minimum score on the B Ratings System and expand the responsibilities of their corporation to include consideration of the interests of employees, community, and environment; and (2) build mission-aligned capital markets and tax, procurement, and investment incentives for B-Certified corporations.**¹¹ **Acceptance into and continued participation in the B-Certification program are at the sole discretion of B Lab and its Board of Directors.**¹² The crux of the B-Certification designation is an entity's commitment that a B-Certified company's management must consider the interests of employees, the community, and the environment in all corporate decision-making.

Benefit Corporations and B-Certified corporations are often confused. Both are sometimes called B Corps. B-Certified corporations have gone through the B Lab certification process. A Benefit Corporation is a legal entity administered by the state of the entity's incorporation – such corporations do not need to be certified by B Lab.

Recognizing that entities domiciled in states that have not passed B Corp legislation could face challenges in reconciling adherence to the goal of B-Certification, B Lab states that “[d]ecisions by the board

of directors, managing members or general partners of [B-Certified] Corporations will be evaluated pursuant to standards of reasonableness, good faith and fair dealing within the relevant jurisdictions of organization.”¹³ In Tennessee, while corporations can add limiting language to their articles of incorporation consistent with B Lab principles, such language is merely an indication of intent to (and public notice to potential investors that the company will) consider non-economic matters in corporate decision-making and operations, the effect of which on the fiduciary duties of directors still being in question.

Low-Profit Limited Liability Companies (L3Cs)

Limited Liability Companies (LLCs) are statutory entities that allow owners to limit their personal liability while still providing for taxation as a partnership (i.e., favorable “pass-through” income tax treatment to the owner/member of the LLC). As of April, 2013 nine states have also adopted variations on their classic LLC statutes that allow for Low-Profit Limited Liability Companies (L3Cs).¹⁴ L3Cs have the same legal and tax characteristics as LLCs, but are specifically organized for one or more charitable or educational purposes (within the meaning of the Internal Revenue Code “IRC”).¹⁵ Most of the statutes require that the L3C must (i) significantly further a charitable or educational purpose and would not be formed except for that purpose, (ii) operate so that income production or asset appreciation is not a significant factor, and (iii) not participate in political or legislative activities. The charitable or educational purpose is usually defined in terms of “mission-driven” objectives of the L3C.

L3Cs can provide a modest return to investors and accumulate reasonable asset value. And, like B Corps, L3Cs have missions/constituencies beyond just the economic incentives of their shareholders/members. But perhaps the most useful

distinction of an L3C is that it can utilize an operating agreement executed by its members to essentially create a contractual agreement between the members as to the non-economic purposes of the L3C (which contractual commitment is missing in a B Corp). This should, conceptually, reduce the exposure of directors/managers for any decision-making that is not primarily motivated by financial returns.

L3Cs are specifically structured so that they can receive Program Related Investments (PRIs) from foundations while minimizing the risk of jeopardizing the foundations' tax-exempt status.¹⁶ Foundations are typically required to distribute 5% of their average net assets in support of their tax-exempt purposes. Outright distribution of monies by foundations in the form of charitable contributions reduces the net assets of the foundation (which can only then survive by making other investments to replenish the contributions). However through PRIs (in the form of loans, loan guaranties, lines of credit, or equity investments) a foundation can provide funds in support of tax-exempt purposes while still preserving net assets (providing a “multiplier effect” for those net assets through recycling monies granted through PRIs that are subsequently returned to the foundation via a PRI). PRIs must (i) have a primary purpose to accomplish a foundation charitable purpose, (ii) not have as a significant purpose the production of income or appreciation of asset value, and (iii) not support political or legislative – all of which are consistent with the statutory requirements of L3Cs. Unfortunately, most foundations seek further assurances from a L3C with respect to use of the funds granted and require legal authority that any specific grant will not jeopardize the tax status of the foundation (in the form of legal opinions, letter rulings from the Internal

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Revenue Service, etc.). Recent federal legislation has been proposed to reduce these complexities.¹⁷

Summary

Socially conscious entrepreneurs and current companies desiring to attract socially conscious investors, customers, and partners now have a variety of choices with respect to form of entity and manner of operation. Traditional corporations and LLCs can amend their organizational documents to expressly provide for considerations of non-financial elements in decision-making. Corporations can also go through the B-Certification process as evidence of actual compliance with, rather than mere aspiration to, such altruism. In states that have adopted B Corp or L3C legislation, there is now statutory authority to assure directors/managers that they will not be held accountable with respect to their fiduciary duties only for return on investment to, or asset valuation for, owners and can consider a broad spectrum of constituencies in their decision-making. The end result appears to be a growing trend among the states to adopt more flexible approaches that permit, but are not constrained, by profit motivation—a trend that provides a freer market economy within which the desire to profit is balanced with the desire to serve the common good. ■



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(Endnotes)

- ¹ SustainAbility & UNEP, *Trust Us: The Global Reporters 2002 Survey of Corporate Sustainability Reporting*, at 4 (2002); JOHN ELKINGTON, *CANNIBALS WITH FORKS: THE TRIPLE BOTTOM LINE OF 21ST CENTURY BUSINESS* (New Society Publishers 1998).
- ² For current status of B-Corp legislation, see generally <http://www.bcorporation.net/what-are-b-corps/legislation>. For current status of L3C legislation, see generally <http://www.americansforcommunitydevelopment.org/laws.html>.
- ³ For example, the state statutes enacted to date take a variety of approaches to the fiduciary duties of directors in a takeover context, which duty is typically to assure the best return on investment to shareholders.
- ⁴ See, e.g., HAW. REV. STAT. § 420D-5(a); MD. CODE ANN., Corps. & Ass'ns §§ 5-6C-01, 5-6C-06; N.J. STAT. ANN. §§ 14A:18-1, 14A:18-5; VT. STAT. ANN. tit. 11A, §§ 21.03, 21.08; VA. CODE ANN. § 13.1-787(A); N.Y. S.B. 79-A § 1706(a).
- ⁵ Corporate constituencies are listed in a separate section of the statutes that addresses the duties of directors. In addition to shareholders, these groups may include employees of the B Corp and its suppliers, customers of the B Corp, communities in which its facilities are located, and "the local and global environment." MD. CODE ANN., Corps. & Ass'ns § 5-6C-07(a)(1). See also HAW. REV. STAT. § 420D-5(b) (setting forth the same list of examples.); VT. STAT. ANN. tit. 11A, § 21.09(a)(1) (same); VA. CODE ANN. § 13.1-788(A) (same); N.Y. S.B. 79-A § 1707(a) (same).
- ⁶ See, e.g., Model B Corp Act § 3301 cmt. 1 (such additional responsibilities being enforceable as a result of amendments to the corporate charter).
- ⁷ There are currently over thirty states that have corporate constituency statutes, which allow directors to consider the interests of non-shareholders. However, in the other states which lack such statutes, directors are still faced with their so-called *Revlon* duty to obtain the maximize economic return (specifically with respect to change of ownership, but generally with respect to maximizing asset and return on investment to shareholders) regardless of the impact on nonfinancial interests.
- ⁸ See Model B Corp Act § 3321(a)(1) (listing employees of the B Corp and its suppliers, customers of the B Corp, the community in which the B Corps operations are located, and the environment, together with the corporation itself and its shareholders as groups whose interests shall be considered by the directors); § 3321(a)(3) (stating that directors "shall not be required to give priority to the interests of any particular person or group" — including shareholders — over those of any other person or group unless otherwise provided in the corporate charter (emphasis added)).
- ⁹ *Id.* § 3321(b)(1) (noting that the consideration of non-shareholder interests "shall not constitute a violation" of the ordinary standard of care). See also 15 PA. CONS. STAT. ANN. § 1712 (describing the duty of care).
- ¹⁰ B Lab, <http://www.bcorporation.net/>.
- ¹¹ B Lab, Make it Official, <http://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/make-it-official> (provides links to Term Sheets).
- ¹² *Id.*
- ¹³ *Id.* (emphasis added).
- ¹⁴ See http://www.intersector13c.com/l3c_tally.html for current states and number of L3Cs in existence.
- ¹⁵ Specifically, 26 U.S.C. § 170(c)(2)(B), defining charitable contributions.
- ¹⁶ See I.R.C. § 4944(c), defining the structure of a tax-exempt foundation, and I.R.C. § 170(c)(2)(B), defining the types of activities the foundation can support to sustain that tax-exempt status.
- ¹⁷ Philanthropic Facilitation Act of 2011. See generally Council on Foundations, Public Policy, Legislative Update, <http://www.cof.org/templates/311.cfm?ItemNumber=18426&navItemNumber=16117>.