

Benefit Corporations: Who Enforces the Rules?

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Social entrepreneurs and policymakers have joined forces in recent years to enable new forms of corporate enterprise: hybrid for-profits that are more than just engines for pumping out shareholder profits.

California is in the forefront of this movement. The “benefit corporation” is one of two available models in this state for the “business-with-a-conscience.” We’ve written about these exciting hybrids [here](#), [here](#), [here](#) and [here](#).

The authorizing statute – California Corporations Code sections 14600 *et seq.* – includes special rules for directors. They must operate the business in a way that takes into account the impact on *multiple* stakeholders: employees, customers, suppliers, the community, and the environment. Unlike in the traditional for-profit corporate model, the shareholder is not the sole, or even the primary, focus.

Directors have duties of transparency as well. They must prepare an annual report that includes a comprehensive assessment of the successes and failures of the business in achieving its multiple purposes: profit, along with “general public benefit” and optional “special public benefits.” This yearly assessment must be made under an objective, independent, third-party standard.

Who Can Complain?

But what happens after the assessment is made, and the report is sent to shareholders and published on the business’s website?

Who gets to assess the assessment – and perhaps complain about shortcomings in performance? Despite the broad-range of interests and impacts that directors of California benefit corporations must consider, the only stakeholders with standing to complain are the shareholders, the directors, or the corporation itself. Employees, customers, or others, including members of the general public, have no legal standing to sue.

And the only vehicle by which they can complain is a “benefit enforcement proceeding.”

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No person may bring an action or assert a claim against a benefit corporation or its directors or officers under this chapter except in a benefit enforcement proceeding.” (Section 14623(a))

What is a Benefit Enforcement Proceeding?

The “benefit enforcement proceeding” is something like the type of proceeding that is available to shareholders of traditional for-profit corporations: a “shareholder derivative suit.” In that type of proceeding, a shareholder brings a lawsuit on behalf of the corporation, and asserts a valid claim on which the corporation has refused to act.

A “benefit enforcement proceeding” is the only method by which directors and officers of California benefit corporations can be called to answer on allegations they breached their duties to act in the best interests, and to accomplish the purposes, of the corporation; that is, to create “general public benefit” or one or more optional “specific public benefits.”

A benefit enforcement proceeding means a claim or action relating to any of the following:

- (1) Failure to pursue the general public benefit purpose of the benefit corporation or any specific public benefit purpose set forth in its articles.
- (2) Violation of a duty or standard of conduct imposed on a director pursuant to this part.
- (3) Failure of the benefit corporation to deliver or post an annual benefit report as required by Section 14630.

Who Can Sue?

This lawsuit against the directors or officers can be “directly” by the benefit corporation itself, or “derivatively” by (1) a director; (2) a shareholder; or (3) “a person or group of persons that owns beneficially or of record 5 percent or more of the equity interests in an entity of which the benefit corporation is a subsidiary.”

What Relief is Available?

The “benefit enforcement proceeding” doesn’t yield any money damages at all. The only possible remedy is injunctive relief: ordering the board of directors to do something or to refrain from doing something.

According to the statute, “[a] benefit corporation shall not be liable for monetary damages under this part for any failure of the benefit corporation to create a general or specific public benefit.”

But, in certain circumstances, the plaintiff can receive reimbursement for expenses: “If the court in a benefit enforcement proceeding finds that a failure to comply with this part was without justification, the court may award an amount sufficient to reimburse the plaintiff for the reasonable expenses incurred by the plaintiff, including attorney’s fees and expenses, in connection with the benefit enforcement proceeding.”