

Ford Couldn't, But You Can: Hybrid Corporations for Social Goals

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July 20, 2017



Henry Ford was not used to hearing “no.” But that is what the Michigan Supreme Court told him in 1919, when Ford tried to reinvest huge capital reserves of Ford Motor Company into wages and new facilities instead of shareholder dividends. Despite the “business judgment rule” that ordinarily prevents courts from overturning lawful business decisions, the Court did just that, finding that Ford altogether ignored the principle of maximizing shareholder value. Since this famous decision, business leaders have accepted shareholder value as the north star.

The idea that shareholder value was the *only* thing business leaders should care about was enshrined in the doctrines of Milton Friedman and the Chicago School of Economics - dominant for decades. But today’s business leaders often care about more: their employees, their customers, the environment, and their communities. When protecting these constituencies clashes with shareholder value, the custom has been to rely on the business judgment rule for protection by framing every decision as profit-maximizing regardless of true motive. Recognizing that semi-fiction, state legislatures have begun blessing “hybrid” corporations that operate for profit but may consider important outside concerns. In California, these are the “benefit” and “social purpose” corporations (“BC” and “SPC”). California introduced these hybrid forms beginning with the Corporate Flexibility Act of 2011, and has updated the law several times since. By way of example, two well-known benefit corporations are Kickstarter (Delaware) and Klean Kanteen (California). Though awareness of benefit and social purpose corporations has grown in the legal and business world, they still make up a tiny fraction of corporations overall.

BCs and SPCs are not non-profits, and they are taxed according to their general status (C or S corp.). Yet BC and SPC forms exist to protect business leaders whose choices defend important social values that may be in tension with a laser focus on maximizing profit.

As described by California’s Supreme Court, directors and officers have the duty “to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it.” *Bancroft-Whitney Co. v. Glen*, 64 Cal. 2d 327, 345 (1966). However, the statutes governing BCs and SPCs *require* directors and officers to consider matters above and beyond the shareholders’ profit interests. Because they *must* consider these matters, these statutes provide added protection from shareholders trying to impose liability for choices resulting in less-than-maximum profits.

Most California corporations have, in their articles of incorporation, generic statements of purpose that authorize the corporation to engage in all lawful activity. But BCs and SPCs must add statements about their public and social benefit purposes. The choice of language, particularly for SPCs, is critical in setting the scope of a director’s duties and protections.

BCs face stricter regulation than SPCs, are less flexible, and may give rise to greater exposure to claims than do SPCs. BCs provide more explicit statutory protections, however, for directors and officers who consider impacts on public stakeholders, particularly in the context of a potential

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takeover. SPCs are flexible, limited, and easier to administer. They offer more clarity to corporate leaders who can apply a more bright-line standard to corporate decisions than the very broad (almost limitless) set of concerns required to be considered by BCs

BCs must consider many different social values, but SPCs are largely free to pick and choose among permissible values. A BC must analyze the impact of its major business decisions and strategies on not only shareholders, but also the environment, and society. Because the SPC can have narrowly-tailored public benefit purposes, its officers' and directors' duties are limited to considering just impact on those listed purposes.

The relative novelty and infrequent use of the BC and SPC forms leaves doubt as to how the statutory standards will be applied by courts in the future. Most questions will be matters of first impression, meaning that a court has little guidance from precedent. However, these innovations in law show that entrepreneurs are, more and more, trying to straddle the line between economics and politics.