

THE NEXT BIG THING: FLEXIBLE PURPOSE CORPORATIONS

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INTRODUCTION

Over the past few years, jurisdictions across the country have enacted specialized organizational forms to house social enterprises. Social enterprises are entities dedicated to a blended mission of earning profits for owners and promoting social good. They are neither typical businesses, concentrated on the bottom line of profit, nor traditional charities, geared toward achieving some mission of

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good for society. Their founders instead see value in blending both goals. They believe their social enterprises will be superior to traditional businesses by considering and internalizing the social costs they produce.¹ They believe social enterprises more efficiently produce social goods than traditional charities by applying business methods to this important work.² Yet, these social entrepreneurs worry traditional organizational forms designed for either businesses or charities will constrain their ability to achieve the gains they see in blended mission enterprises.³ Legislatures have obviously been convinced. Since 2008, lawmakers in nearly one-third of U.S. jurisdictions have enacted enabling legislation providing one or more specialized forms designed to house social enterprises.⁴ Thus far, these specialized forms have taken three distinct types, the latest of which is the subject of this Article: the flexible purpose corporation.

1. See, e.g., Julie Battilana et al., *In Search of the Hybrid Ideal*, STAN. SOC. INNOVATION REV., Summer 2012, at 51, 52 (describing the desire of social entrepreneurs to exploit the positive externalities of linking social value and revenue creation).

2. See, e.g., Kyle Westaway, *New Legal Structures for 'Social Entrepreneurs'*, WALL ST. J. (Dec. 12, 2011, 12:42 PM), <http://online.wsj.com/article/SB10001424052970203413304577088604063391944.html> (“Social entrepreneurs believe a business can be part of the solution to some of the world’s greatest challenges.”); see also DAN PALLOTTA, UNCHARITABLE: HOW RESTRAINTS ON NONPROFITS UNDERMINE THEIR POTENTIAL 35–127 (2008) (arguing that greater social good would be gained by allowing charities to follow a range of practices typically identified with for-profit enterprises); Charles R. Bronfman & Jeffrey R. Solomon, *Should Philanthropies Operate Like Businesses? Yes: Good Intentions Aren’t Enough*, WALL ST. J., Nov. 28, 2011, at R1, R4 (“Adhering to sound business principles makes a nonprofit more likely to accomplish its mission, not less.”). But see Garry W. Jenkins, *Who’s Afraid of Philanthrocapitalism?*, 61 CASE W. RES. L. REV. 753 (2011) (challenging the benefit of applying business methods and techniques in philanthropy and traditional nonprofits).

3. Battilana et al., *supra* note 1, at 52 (describing the “confusing dilemma” facing social entrepreneurs confronted with only pure for-profit and nonprofit organizational forms); Heerad Sabeti, *The For-Benefit Enterprise*, HARV. BUS. REV. (Nov. 2011), <http://hbr.org/2011/11/the-for-benefit-enterprise/ar/1> (lamenting that “socially minded entrepreneurs end up shoehorning their vision into one structure or the other and accepting burdensome trade-offs in the process”); Thomas Kelley, *Law and Choice of Entity on the Social Enterprise Frontier*, 84 TUL. L. REV. 337, 363–64 (2009).

I am sympathetic to the view that corporate law would not prevent adopters of a standard for-profit corporation from pursuing both business and non-business goals. See, e.g., LYNN STOUT, THE SHAREHOLDER VALUE MYTH 25–31 (2012); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 738–47 (2005). This, however, clearly is not the perception from which social enterprise form creators and enthusiasts are working.

4. See generally *Laws*, AMS. FOR CMTY. DEV. (last visited Nov. 25, 2012), <http://americansforcommunitydevelopment.org/laws.html> (listing nine states and two Native American tribes with L3C statutes); *State by State Legislative Status—Benefit Corporation*, B LAB, <http://www.benefitcorp.net/state-by-state-legislative-status> (last visited Nov. 25, 2012) (listing twelve states with benefit corporation statutes, three of which also have L3C legislation); CAL. CORP. CODE §§ 2500–3503 (West 2012).

Part I places the flexible purpose corporation (“FPC”) in the broader context of other specialized legal forms established to house social enterprise. Part II explores the FPC in greater depth. After explaining the genesis of its enabling legislation, this Part details and critiques its major provisions. These components segregate the FPC form from traditional for-profit and nonprofit corporations. The statutes structure FPCs’ operations, guide their fiduciaries, and empower their shareholders with enforcement rights. Part III summarizes my evaluation of these attributes and compares them with relevant aspects of other specialized forms for social enterprise. Part IV briefly concludes.

I. THE FPC IN CONTEXT

The flexible purpose corporation became available under the California Corporate Flexibility Act of 2011 (the “FPC statute”).⁵ It joined its (only slightly) older colleagues: the low-profit limited liability company (“L3C”) inaugurated by Vermont in 2008⁶ and the benefit corporation first adopted by Maryland in 2010.⁷ Since their initial adoption, these forms have each been adopted by several other jurisdictions and proposed in still others.⁸ These later adoptions are not identical to the originals, though sufficient overlap exists to examine the L3C and benefit corporation as archetypes. Shortly after California adopted its FPC statute, Washington approved legislation enabling a Social Purpose Corporation form, which shares some, though by no means all, of the elements of the FPC.⁹ Other

5. See S.B. 201, 2011–2012 Legis. Sess. (Cal. 2011) (approved by Governor Jerry Brown on Oct. 9, 2011); see also Stephanie Strom, *A Quest for Hybrid Companies That Profit, But Can Tap Charity*, N.Y. TIMES, Oct. 13, 2011, at B1, B2 (reporting that “California is the latest state to adopt a statute permitting what is called a flexible-purpose corporation, new companies that are part social benefit and part low-profit entities” and comparing that statute with low-profit limited liability company (“L3C”) and benefit corporation law adoptions in other jurisdictions).

6. See VT. STAT. ANN. tit. 11 § 3001(27) (2012); see also *Low-Profit Limited Liability Company*, VT. SECRETARY ST. CORP. DIVISION, http://www.sec.state.vt.us/corps/dobiz/llc/llc_l3c.htm (last visited Nov. 16, 2012) (“A low-profit LLC is a new type of company, called an ‘L3C.’ Vermont is the first state to enact this new type of company.”).

7. MD. CODE ANN., CORPS. & ASS’NS §§ 5-6C-01 to -08 (LexisNexis 2012).

8. For current listings of L3C and benefit corporation enabling legislation enactments, see *Laws*, *supra* note 4 and *State by State Legislative Status*, *supra* note 4 respectively. See also Carter G. Bishop, *Fifty State Series: L3C & B Corporation Legislation Table* (Suffolk Univ. Law Sch. Research Paper, No. 10-11, 2012), available at <http://ssrn.com/abstract=1561783> (analyzing the contents of legislation); J. Haskell Murray, *Benefit Corporations—State Statute Comparison Chart* (Regent Univ. Sch. of Law, 2011) (unpublished chart), available at <http://ssrn.com/abstract=1988556> (analyzing the contents of benefit corporation statutes).

9. See generally H.B. 2239, 2011–12 Leg., 2012 Reg. Sess. (Wash. 2012).

state legislatures have considered new forms that share features with the FPC,¹⁰ and other countries have implemented yet further models.¹¹ To situate the FPC form in context, without overwhelming the reader with details on too many jurisdiction-specific enactments, this Part will discuss the major features of the L3C and benefit corporation in brief.

The low-profit limited liability company operates like a standard limited liability company (“LLC”) with only a handful of deviations. All of these changes address the specialized purposes adopting entities must pursue. Specifically, L3Cs must “significantly further[] the accomplishment of one or more charitable or educational purposes within the meaning of” the Internal Revenue Code sections defining charitable contributions,¹² and “no significant purpose of the company is the production of income or property.”¹³ That said, an L3C that actually produces significant income or capital appreciation will not be disqualified from this status by virtue of those facts alone.¹⁴

Other than these adaptations of the L3Cs’ purposes, the statutes typically subject them to ordinary for-profit LLC law. Their governance structures are highly flexible, subject to private ordering by an operating agreement. In contrast to the benefit corporation and the FPC to be described below, L3Cs have no special disclosure obligations, no expressly modified fiduciary duties,¹⁵ and no

10. *E.g.*, S.B. 62, 117th Gen. Assemb., Reg. Sess. (Ind. 2012); H.F. 697, 87th Leg., Reg. Sess. (Minn. 2011).

11. *See, e.g.*, Dana Brakman Reiser, *Governing and Financing Blended Enterprise*, 85 CHI.-KENT L. REV. 619, 630–36 (2010) [hereinafter Brakman Reiser, *Governing and Financing*] (discussing the United Kingdom’s community interest company (“CIC”)); Matthew F. Doeringer, Note, *Fostering Social Enterprise: A Historical and International Analysis*, 20 DUKE J. COMP. & INT’L L. 291, 306–16 (2010) (describing the CIC in the U.K and the Belgian Société à Finalité Sociale).

12. VT. STAT. ANN. tit. 11 § 3001(27)(A).

13. *Id.* § 3001(27)(B).

14. *See id.* In addition, L3Cs may not be formed to “accomplish one or more political or legislative purposes,” again as defined by the tax code. *Id.* § 3001(27)(C).

15. Some commentators argue adapted duties for L3C fiduciaries are created by statutory implication. *See, e.g.*, J. Haskell Murray & Edward I. Hwang, *Purpose with Profit: Governance, Enforcement, Capital-Raising and Capital-Locking in Low-Profit Limited Liability Companies*, 66 U. MIAMI L. REV. 1, 39–40 (2011); John Tyler, *Negating the Legal Problem of Having “Two Masters”: A Framework for L3C Fiduciary Duties and Accountability*, 35 VT. L. REV. 117, 141 (2010). Others, including myself, argue that L3C statutes leave fiduciary obligations dangerously uncertain. *See* Dana Brakman Reiser, *Blended Enterprise and the Dual Mission Dilemma*, 35 VT. L. REV. 105, 109–11 (2010) [hereinafter Brakman Reiser, *Blended Enterprise*]; Brakman Reiser, *Governing and Financing*, *supra* note 11, at 623–30; Dana Brakman Reiser, *Theorizing Forms for Social Enterprise*, EMORY L.J. (forthcoming 2012) (manuscript at 18–19) [hereinafter Brakman Reiser, *Theorizing Forms*]; J. William Callison & Allan W. Vestal, *The L3C Illusion: Why Low-Profit*

limitations on change of status. In fact, an L3C ceases to exist as such, and transforms immediately into an ordinary LLC, if at any time it no longer meets the special purpose requirements.¹⁶ This transformation occurs by operation of law. The entity need not file any documents indicating the change, managers and members have no official input, and no regulator is involved.¹⁷

When compared to the L3C, the statutory framework establishing the benefit corporation is both more extensive and more rigid. This is due, in part, to the fact that benefit corporations borrow the for-profit corporate form as a starting point. The signature innovation of the benefit corporation form, however, is its reliance upon “third-party standards.”¹⁸ These standards play a powerful role, as benefit corporations must: (1) frame their required public benefit purposes with reference to them, and (2) issue reports to shareholders and the public evaluating their achievements according to them. Benefit corporation statutes differ in the level of detail at which they define the content of such standards. For example, California’s statute defines a third-party standard as “a comprehensive assessment of the impact of the business and the business’s operations upon” a broad range of stakeholder groups.¹⁹ In contrast, Maryland’s legislation requires only a generic “standard for defining, reporting, and addressing best practices in corporate social and environmental performance.”²⁰ All benefit corporation statutes demand that third-party standards be developed by transparent, independent entities.²¹

Limited Liability Companies Will Not Stimulate Socially Optimal Private Foundation Investment In Entrepreneurial Ventures, 35 VT. L. REV. 273, 286–89 (2010).

16. See, e.g., VT. STAT. ANN. tit. 11 § 3001(27)(D).

17. A more detailed account and critique of the L3C form can be found in Brakman Reiser, *Governing and Financing*, *supra* note 11, at 620–30.

18. See Dana Brakman Reiser, *Benefit Corporations—A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591, 592, 600–03 (2011) [hereinafter Brakman Reiser, *Benefit Corporations*]; J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*, 2 AM. U. BUS. L. REV. 1, 21 (2012) [hereinafter Murray, *Choose Your Own Master*]; J. William Callison, *Putting New Sheets on a Procrustean Bed: How Benefit Corporations Address Fiduciary Duties, the Dangers Created, and Suggestions for Change*, 2 AM. U. BUS. L. REV. 85, 90–91, 94 (2012) [hereinafter Callison, *Procrustean Bed*].

19. See, e.g., CAL. CORP. CODE § 14601(g). References in this Article will cite legislation as adopted by various jurisdictions as examples, rather than the model statute drafted by benefit corporation proponents. This model statute can be consulted at MODEL BENEFIT CORP. LEGIS. (B Lab 2012), available at http://benefitcorp.org/storage/Model_Legislation.pdf. For a thorough description and evaluation of the benefit corporation form, see generally Brakman Reiser, *Benefit Corporations*, *supra* note 18.

20. MD. CODE ANN., CORPS. & ASS’NS § 5-6C-01(e).

21. See, e.g., *id.*; N.J. STAT. ANN. § 14A:18-1 (West 2012); VA. CODE ANN. § 13.1-782 (Supp. 2012).

Benefit corporation statutes also make several important revisions to standard for-profit corporate governance arrangements. Benefit corporation directors must consider a very broad range of non-shareholder stakeholder interests when making decisions.²² Benefit corporations must report to shareholders and the public on their pursuit and achievement of their public benefit purposes.²³ With this information in hand, benefit corporation shareholders can sue fiduciaries to hold them to their expanded duties, sometimes using new enforcement actions created under the statutes.²⁴ Shareholders also must approve adoption or abandonment of benefit corporation status by a supermajority vote.²⁵

The L3C and the benefit corporation represent poles on a spectrum of flexibility. On the one hand, the L3C allows almost complete contractual freedom to order a social enterprise as founders might desire. The statutory scheme imposes no new obligations on fiduciaries and no disclosure requirements. It is a status that may be taken on and thrown off with ease, merely by changing the purposes the entity pursues. On the other hand, the benefit corporation provides a comprehensive set of “off-the-rack” governance arrangements, many of which cannot be varied by adopters. It enlists the assistance of third-party standard setters to develop metrics to gauge the public benefit bona fides of adopting entities. It also varies fiduciary duties, creates reporting obligations, and empowers shareholders with voting and litigation rights. As the next Part will describe, the FPC sits somewhere between these two poles, offering significant flexibility and discretion for founders and directors, but paired with expansive rights, powers, and protections for shareholder investors.²⁶

22. See, e.g., MD. CODE ANN., CORPS. & ASS'NS § 5-6C-07 (requiring directors to consider impact of their decisions on employees, customers, the community, society, and the local and global environment); VT. STAT. ANN. tit. 11A, § 21.09 (similar).

23. See, e.g., VA. CODE ANN. § 13.1-791; HAW. REV. STAT. ANN. § 420D-11 (2011).

24. See, e.g., N.J. STAT. ANN. § 14A:18-10; LA. REV. STAT. ANN. § 1825 (2012).

25. See, e.g., N.Y. BUS. CORP. LAW § 1705 (McKinney 2012); A277, 119th Gen. Assemb., Reg. Sess. (S.C. 2012) (to be codified at S.C. CODE ANN. § 33-38-230).

26. For analyses of the FPC comparing it with other forms, see Eric Talley, *Corporate Form and Social Entrepreneurship: A Status Report from California (and Beyond)* (U.C. Berkeley Pub. Law Research Paper No. 2144567), available at <http://ssrn.com/abstract=2144567>; Robert T. Esposito, *The Social Enterprise Revolution in Corporate Law: A Primer on Hybrid Corporate Entities in Europe and the United States and the Case for the Benefit Corporation*, WM. & MARY L. REV. (forthcoming 2013) (manuscript at 54–57), available at <http://ssrn.com/abstract=2134022>.

II. THE FPC IN DEPTH

The history of the FPC actually begins not with the L3C or benefit corporation, but rather with the 2008 proposal of a constituency statute for California.²⁷ Constituency statutes permit for-profit corporate directors to consider the interests of non-shareholder stakeholders when making decisions, dislodging any real or perceived legal requirement to maximize shareholder value.²⁸ Some constituency statutes limit this broadened directorial discretion to the takeover context, but others apply it more comprehensively to directorial action.²⁹ Over thirty U.S. jurisdictions now have constituency statutes of one type or another.³⁰ California does not. In 2008, State Senator Mark Leno and others sought to change that. He sponsored a bill granting for-profit corporate directors the option to consider the interests of various stakeholder groups, along with the long- and short-term interests of shareholders in both ordinary and change of control situations.³¹ In the view of the bill's proponents, a constituency statute was pivotal to attract and maintain socially-responsible businesses in California.³²

Important representatives of the business community opposed the bill. For example, both the state bar's Business Section and the California Chamber of Commerce argued it was unnecessary and threatened to undermine directors' accountability.³³ Although the bill passed both houses of the state legislature without their support, then-Governor Schwarzenegger ultimately vetoed it. His veto

27. This Part will discuss the California FPC. If the experiences of the L3C and benefit corporation are any guide, the California approach will be considered and may be adopted, with small or significant variations, by other jurisdictions. If they do, future work can examine these emendations. At this early stage, the California statute is the appropriate model.

28. See Lisa Fairfax, *Doing Well While Doing Good: Reassessing the Scope of Directors' Fiduciary Obligations in For-Profit Corporations with Non-Shareholder Beneficiaries*, 59 WASH. & LEE L. REV. 409, 460–61 (2002); Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 27–29 (1992); Tyler, *supra* note 15, at 132.

29. See Tyler, *supra* note 15, at 133; see also Orts, *supra* note 28, at 30–31.

30. See Tyler, *supra* note 15, at 132; see also Fairfax, *supra* note 28, at 460–61 (placing the count at thirty-two in an earlier work).

31. See CAL. S. JUDICIARY COMM., AB 2944 BILL ANALYSIS (2008), available at http://www.leginfo.ca.gov/pub/07-08/bill/asm/ab_2901-2950/ab_2944_cfa_20080611_123248_sen_comm.html.

32. See *id.* (“California has the highest concentration of corporations trying to practice business responsibly, but the lack of a constituency statute is an impediment to these corporations as they grow and seek investment capital, threatening California’s leadership position.”).

33. See *id.* (quoting comments by the bar association and chamber of commerce in discussing the views of the bill’s opponents).

message grounded his action in the need for caution in the “serious matter” of corporate governance, but “urge[d] the Legislature to consider and study new styles of corporate governance that can offer alternatives to the current model, but that maintain the vital shareholder protections that have helped turn California into the economic powerhouse of the world.”³⁴

The bill lacked sufficient support to obtain a legislative override, but its significant success and the governor’s message buoyed a group of California lawyers to try to create a specialized legal form to house social enterprises.³⁵ They formed a working group of ten and together engaged in an extensive drafting process to develop the bill that became the Corporate Flexibility Act, sponsored by State Senator Mark DeSaulnier and passed unanimously by the Senate and in substantially similar form by a large majority in the Assembly.³⁶ Governor Jerry Brown signed it into law and it took effect, enabling entities to register as FPCs, beginning January 1, 2012.³⁷

The FPC uses the California corporate form as its foundation.³⁸ But, like all specialized forms recently developed to house social

34. Arnold Schwarzenegger, *AB 2994 Veto Message*, OFFICIAL CAL. LEGIS. INFO. (Sept. 30, 2008), http://www.leginfo.ca.gov/pub/07-08/bill/asm/_ab_2901-2950/ab_2944_vt_20080930.html.

35. W. Derrick Britt, R. Todd Johnson & Susan H. MacCormac, *Proposed Amendments to the California Corporations Code for a New Corporate Form: The Flexible Purpose Corporation and Senate Bill 201—Frequently Asked Questions*, BUS. FOR GOOD (Feb. 23, 2011), <http://businessforgood.blogspot.com/2011/03/frequently-asked-questions-proposed.html>.

36. The Working Group members are W. Derrick Britt (Co-chair), Partner, Doty, Barlow, Britt, and Thomas, LLP; R. Todd Johnson (Co-chair), Partner, Jones Day; Susan H. MacCormac (Co-chair), Partner, Morrison Foerster; Keith Paul Bishop, Partner, Allen Matkins Leck Gamble & Mallory LLP; Edward A. Deibert, Director, Howard Rice Nemerovski Canady Falk & Rabkin; William P. Fitzpatrick, General Counsel, Omidyar Network; Steven K. Hazen, Retired, Former Vice-Chair for Legislation of the State Bar of California Business Law Section; David M. Hernand, Partner, Gibson, Dunn & Crutcher LLP; Jay A. Mitchell, Director, Organizations and Transactions Clinic, Stanford Law School and former chief corporate counsel of Levi Strauss & Co.; and Robert A. Wexler, Partner, Adler & Colvin. *See id.*

37. The registration process utilized by the Secretary of State makes it difficult to obtain a precise count of current FPCs. *See* E-mail from Business Filings, California Secretary of State, to Rachel Seelig (Feb. 22, 2012, 7:58 P.M.) (on file with author) (providing a list of the fifteen entities who had filed to form or change status to either FPC or benefit corporation status: The Ideal World; Prometheus Civic Technologies, FPC; Strozzi Institute; Great Pacific Iron Works; Lost Arrow Corporation; Patagonia, Inc.; Opticos Design, Inc.; Give Something Back, Inc.; JP & Sun, Inc.; Thinkshift; Dopehut; The University of the Brain; Farm From a Box, Inc.; Search Inside Yourself Leadership Initiative Inc.; and Patagonia Provisions Inc.). *See also* Talley, *supra* note 26, at 6–7 fig. 1 & 12 n.15 (reporting results of the only empirical study to date whereby data collected with the help of the California Commissioner of Corporations showed fifteen entities had registered as FPCs between January and August 2012).

38. *See* CAL. CORP. CODE § 2501.

enterprises, the FPC builds on its original model. Its additions work to segregate the new form from existing ones, guide the conduct of entities operating as FPCs, and provide channels for enforcement.

A. Segregating FPCs

Only entities adopting FPC status may access its permission to brazenly pursue both profit and social good, and founders and shareholders together guard admission to it. To become an FPC, a corporation must include the term “flexible purpose corporation” or an abbreviation in its name, and it must identify its particular special purpose or purposes in its articles of incorporation.³⁹ The breadth of FPCs’ permitted purposes is striking. The statute not only expressly allows FPCs to pursue charitable purposes like those of traditional nonprofits,⁴⁰ but also permits adopting entities to choose to pursue the interests of the broadest range of non-shareholder stakeholders.⁴¹ These include employers, suppliers, customers, creditors, the community, society, and the environment.⁴² This broad vision of the social “good” FPCs might pursue places the definition of that contested term, and the discretion over what type of purpose their entities will pursue, precisely and exclusively in the hands of the founders.⁴³

At the very beginning of an FPC’s life cycle, however, we see too its reliance on disclosure to shareholders. The flexible-purpose quality of an adopting corporation must be broadcast in its very name. Investors need look no further than an FPC’s foundational documents to learn toward precisely what other kinds of ends its leaders might sacrifice returns. Neither shareholders nor any member of the public should mistake an FPC for a traditional for-profit corporation, or a nonprofit one for that matter.

39. *Id.* § 2602.

40. *See id.* § 2602(b)(2)(A) (permitting an FPC to cite among its special purposes “[o]ne or more charitable or public purpose activities that a nonprofit public benefit corporation is authorized to carry out”).

41. *See id.* § 2602(b)(2)(B) (allowing an FPC to adopt a special “purpose of promoting positive short-term or long-term effects of, or minimizing adverse short-term or long-term effects of” its activities on “employees, suppliers, customers, and creditors, [t]he community and society, [or] . . . [t]he environment”).

42. *See id.*

43. Unlike benefit corporation statutes, the FPC framework does not require adopting entities to apply a third-party standard to evaluate their pursuit of social good. *Compare id.* § 2602(b), with VA. CODE ANN. § 13.1-782 (requiring benefit corporations to pursue a general public benefit, defined as “a material positive impact on society and the environment taken as a whole, as measured by a third-party standard, from the business and operations of a benefit corporation”).

Once an FPC has been created, changing this status also requires both prompting by its leaders and substantial buy-in from shareholders. If directors propose any amendment to the articles that would “materially alter any special purpose of the flexible purpose corporation,” two-thirds of the outstanding shares of each class of shareholders must approve it.⁴⁴ Indeed, this heightened threshold applies even if article amendments would result in a corporation still qualifying as an FPC, but pursuing a different special purpose or purposes than before.⁴⁵ It likewise requires shareholder consensus when a corporate transaction would affect a change in the purpose or flexible purpose status.⁴⁶

The breadth of special purposes the statute permits suggests that changes in purpose within the FPC umbrella are quite possible. Consider Edify FPC, a hypothetical FPC formed to pursue profits and social good by providing low-cost educational services to children of the working poor. Its directors could propose an article amendment to transform the entity’s purposes to the pursuit of profits and the promotion of the long-term positive effects of its activities on its employees by offering its educational services at higher prices to children of more affluent parents. Greater revenues would offset investments in professional development and higher wages for employees. The new emphasis on benefitting employees is a special purpose clearly permitted by the FPC statute, but is a considerable change of focus from its former mission of educating needy kids. The FPC statute takes no position on the relative merits of these different purposes,⁴⁷ but requires shareholders to approve such a change by a large majority.

Shareholders are given additional protections against loss of economic value in FPC conversions. The ultimate protection is afforded to shareholders opposing an FPC’s conversion to a nonprofit entity. Here, the statute demands that shareholders unanimously approve the transaction before adopting nonprofit status, which would terminate their rights to distributions.⁴⁸ Thus, a

44. CAL. CORP. CODE § 3000(b).

45. *Id.*

46. *See id.* §§ 3100, 3201.

47. *See* Britt, Johnson & MacCormac, *supra* note 35 (“The Working Group believes strongly, and unanimously, that the proposed approach provides the best manner for permitting what is now prohibited, in a manner that does not include the intellectual and technical complexity of defining ‘what is good’ . . .”).

48. *See* CAL. CORP. CODE § 3001 (requiring that such transactions “shall be approved by *all* of the outstanding shares of all classes”) (emphasis added).

single dissenting shareholder can stop an FPC from transforming into nonprofit entity.

The statute erects less daunting, but still considerable, barriers to conversions between FPC and ordinary for-profit status. At least two-thirds of each class of voting shares must approve any conversion by an ordinary for-profit corporation into an FPC or vice versa.⁴⁹ These supermajority voting rights ensure significant shareholder consensus will stand behind any shift into or out of FPC status, providing substantial protection to even sufficiently large minority shareholder groups. Moreover, even if an approving supermajority shareholder vote is secured, dissenters may opt to have their shares purchased by the corporation for “[t]he fair market value . . . determined as of the day before the first announcement of the terms of the proposed [transaction].”⁵⁰

This appraisal-type remedy appears better designed to protect dissenters in transactions converting entities into FPC form than away from it. Appraisal rights in a conversion from for-profit to FPC status can be seen as conventional protection for the economic rights of minorities.⁵¹ If shareholders invest in a traditional corporation and dissent from its conversion to an FPC to pursue special purposes along with profit, we can assume their concerns are financial—they fear their investment will lose economic value when it becomes a stake in an FPC rather than a traditional business entity. If we put aside the typically substantial costs of an appraisal proceeding, dissenters’ financial interests should be protected by requiring the converting corporation to cash them out at a price reflecting the value of the entity as a standard profit-centered business. This right to be cashed out by the corporation is particularly important to protect shareholders’ financial interests when there is no ready market for the dissenting investors’ shares.

49. *Id.* §§ 1152(d)(1), 3002, 3301.

50. *Id.* § 1300(a); *id.* § 1152(d)(2) (providing dissenting shareholders rights under Section 1300 in transactions converting traditional business entities into FPCs); *id.* § 3305 (providing dissenters rights under Section 1300 in transactions converting an FPC into another type of business entity).

51. See JAMES D. COX & THOMAS LEE HAZEN, *BUS. ORGS. L.* 636 (2011) (“in theory the ostensible purpose of the statutory appraisal remedy is to protect the minority and offer them a way out in case of fundamental changes . . .”); see also Hideki Kanda & Saul Levmore, *The Appraisal Remedy and the Goals of Corporate Law*, 32 *UCLA L. REV.* 429, 434 (1985) (describing the conventional rationale for appraisal as allowing dissenters to decamp from a corporation about to undergo a fundamental change with which they disagree). Modern authors critique this conventional view, however, due to the delay and expense involved in appraisal litigation. This issue will be addressed *infra*. See *infra* notes 54 & 55 and accompanying text.

The rationale for the statute's dissenters' rights as financial protection for shareholders opposed to conversion of FPCs to for-profits is considerably weaker. These shareholders could oppose an FPC to for-profit conversion purely on economic grounds. Perhaps they view social enterprises as more sustainable and therefore ultimately able to outperform solely profit-focused ones even on economic terms. At least in the short term, however, following a conversion from FPC to standard corporate status, one would expect former FPCs to cut costs and achieve greater profits. If so, dissenting shareholders could achieve financial protection by remaining invested through the conversion, after which they would gain from the pure for-profit's greater economic value. The problem, as is frequently the case in appraisal, is the likely lack of a market.⁵² For dissenting shareholders to protect their financial investment this way, they need to be able to realize the entity's value by accessing a market for post-conversion sale of their shares.⁵³ They can then use the funds they obtain through sale to make substitute investments. When the converted corporation does not have a market for its shares, however, an appraisal remedy could conceivably remain useful financial protection (again, setting aside its likely costs).

Its utility ultimately depends on whether courts can define and apply the fair market value concept to avoid undercompensating dissenters in FPC conversions. Imagine LocalCorp, a manufacturing concern founded as an FPC with a special purpose to pursue the long-term interests of its local community. LocalCorp's board of directors proposes a transaction that would lead to the abandonment of this special purpose. Although more than two-thirds of LocalCorp shareholders approve the transaction, ten percent vote against it. Consider a dissenting LocalCorp shareholder, Sarah, who purchased a share of the FPC for \$100. Sarah invested \$100 in LocalCorp because she valued the financial return she expected LocalCorp to produce for her at \$80, and she valued its commitment to further local community interests at \$20. Once freed of its obligation to pursue these local interests, LocalCorp could earn greater economic returns. For simplicity, we can assume its value as a pure for-profit

52. See Britt, Johnson & MacCormac, *supra* note 35 ("Dissenter's rights seemed particularly important in achieving the [FPC Working Group's] goal of ensuring that a change in form should cause no harm to shareholders or investors, particularly where the company involved is a private company with no liquidity for shareholders.").

53. Appraisal rights statutes often recognize the differing positions of dissenting shareholders by excepting those with marketable shares from their protections. See COX & HAZEN, *supra* note 51, at 640; see also Kanda & Levmore, *supra* note 51, at 432.

is \$100 per share. Perhaps LocalCorp would achieve these greater returns by more cheaply sourcing components outside its community or by transferring human or physical resources to a less costly location. Sarah does not want the company to move in this direction, but she has been outvoted. She fears there will not be a market for the converted entity's shares, and so she pursues her dissenters' rights.

Under the FPC statute, Sarah is entitled to the fair market value of her shares, valuing LocalCorp prior to the conversion's announcement. The question is: How will fair market value be defined? If appraisal provides Sarah \$100, it will go a long way toward protecting her financial interests. She might reinvest the \$100 in another locally-focused social enterprise. Alternatively, she might invest \$80 in a pure for-profit and invest in or donate \$20 to a community-focused entity. Assuming substitutes exist, she might engage in any number transactions to achieve her desired mix of profit and social good. On the other hand, if appraisal provides Sarah only \$80, valuing only the entity's purely economic returns pre-transaction, dissenting shareholders like Sarah are underprotected. They will have insufficient funds to avail themselves of substitutes for their FPC investment that has ceased to exist.

A court using the fair market value concept will need to be very nimble to avoid this outcome. It must not only determine the FPC's economic value, but also some price for the utility of the social good it generates, or at least the economic value foregone in generating that social good. Attempting to include appreciation in fair market value will add further complications. Valuations of appraisal rights in pure for-profits are already notoriously tricky.⁵⁴ Applying the concept in a transaction converting an FPC into a for-profit will be even more difficult.

Moreover, and perhaps most importantly, the appraisal tool can only offer cash as its remedy for lost social good production. But, there are some things money simply cannot buy. For FPC shareholders, the significant risks of a conversion transaction are non-financial; they fear the abandonment of the entity's special purpose. It seems far more likely that Sarah opposes LocalCorp's

54. See COX & HAZEN, *supra* note 51, at 641 ("The most difficult task in obtaining relief under appraisal statutes is establishing the fair value of the dissenting shares Legislatures and the courts have not been able to establish any definite measure or standard of value.").

conversion out of concern that it will abandon the local community, than out of fear that her financial investment will deteriorate. A remedy offering Sarah and other dissenters fair market value for their shares, valued at the moment before the conversion's announcement, may just be inapposite to these concerns.

Finally, any realistic assessment of the FPC dissenters' rights provisions must take into account the serious costs and delays associated with appraisal-type remedies. When these costs are factored back into the equation, it is highly unlikely that dissenters' rights will provide any shareholder with even purely financial protection. Perhaps this remedy should instead be understood as a means to review transactions without blocking them, possibly discovering fiduciary wrongdoing along the way.⁵⁵

Currently, FPC dissenters' rights look frustratingly like empty promises. A more aggressive appraisal-based remedy would set the cash out price after the transaction's announcement or completion, either by default or at the option of the dissenting shareholder. Alternatively, the statute could have provided novel, specialized remedies for shareholders frustrated by the loss of a converting FPC's devotion to its special purpose. It might have locked all or some portion of an FPC's assets into pursuing its special purpose for a period of time or indefinitely. The statute could have forced FPCs to pay some penalty on exit from FPC status. The drafters declined to take these steps or any other specialized remedial course, perhaps because locking in social mission in this way would make FPCs look and operate much more like nonprofits.

In realizing its goal of segregating FPCs from traditional corporate forms, the FPC statute enlists both organizational leaders and shareholders in key roles. Founders can select from a broad range of charitable or other purposes. Yet, they must make their chosen special purposes abundantly clear to the public, and especially to shareholders. Founders or fiduciaries can propose the adoption or renunciation of FPC form. Shareholders, however, will temper their ability to act unilaterally through supermajority voting requirements and express, though imperfect, dissenters' rights.

B. Operating FPCs

This same pattern—discretion for fiduciaries with disclosure to shareholders tasked with enforcement—reappears in the statute's

55. See *id.* at 635–36; see also Kanda & Levmore, *supra* note 51, at 443–45. A more detailed discussion of fiduciary challenges appears *infra* Part II.C.2.

provisions regarding FPC operations. We can start with director discretion. The statute provides that:

In discharging his or her duties, a director may consider those factors, and give weight to those factors, as the director deems relevant, including the short-term and long-term prospects of the flexible purpose corporation, the best interests of the flexible purpose corporation and its shareholders, and the purposes of the flexible purpose corporation as set forth in its articles.⁵⁶

This language was intended to make clear that FPC directors may pursue purposes beyond, and even in conflict with, shareholder value maximization.⁵⁷ The FPC statute codifies protection from liability when directors carry out their duties within the confines of this additional discretion.⁵⁸ In addition, individual FPCs may limit or eliminate their directors' exposure to monetary damages by adopting exculpatory charter amendments.⁵⁹ Finally, the statute expressly disclaims any grant of standing to non-shareholder stakeholders to challenge directorial action.⁶⁰ FPC directors are permitted to consider their articulated purposes, but shareholders alone may challenge their operational decisions.⁶¹

Considering the FPC's origins, it is not surprising that constituency statutes share many of these attributes. Constituency statutes also broaden directors' permissible considerations beyond the perceived strictures of the shareholder value maximization norm.⁶² Constituency statutes, however, are also subject to a powerful, unintended consequences critique. By expanding directorial discretion so widely, they may allow directors to mask mismanagement and even malfeasance.⁶³ If the sweep of a

56. CAL. CORP. CODE § 2700(c).

57. Britt, Johnson & MacCormac, *supra* note 35.

58. *See* CAL. CORP. CODE § 2700(d).

59. *Id.*

60. *See id.* § 2700(f).

61. Although the statute expressly renounces any negation of the Attorney General's power to police charitable trusts, it states "a flexible purpose corporation shall not be deemed to hold any of its assets for the benefit of any party other than its shareholders" and does not contemplate creating any new supervisory role for existing regulators. *See id.* § 2700(e).

62. *See supra* notes 29 & 30 and accompanying text.

63. *See* Rutherford B. Campbell, Jr., *Corporate Fiduciary Principles for the Post-Contractarian Era*, 23 FLA. ST. U. L. REV. 561, 621-23 (1996) (making this criticism and noting the wider debate); Brett H. McDonnell, *Corporate Constituency Statutes and Employee Governance*, 30 WM. MITCHELL L. REV. 1227, 1231-36 (2004) (reviewing the literature on constituency statutes).

constituency statute is so broad that a director can claim almost any decision was made with the intent to better the lot of some non-shareholder stakeholder group, fiduciary obligations lose their teeth of potential monetary liability, or even the reputational impact of a serious public challenge. Paradoxically, this critique argues, constituency statutes leave directorial decisions essentially unconstrained.

The terms of constituency statutes vary considerably across jurisdictions, but in terms of this threat of unbridled discretion, the FPC statute's grant of discretion is narrow when compared with many of them. Even without a constituency statute, directors of a standard for-profit corporation would also have the discretion to consider its short- and long-term prospects. They are certainly and generally required to act "in the best interest of the corporation and its shareholders."⁶⁴ The FPC statute's grant of additional discretion is thus only its permission to consider the special purpose or purposes stated in an FPC's articles of incorporation. An FPC's directors may not seek shelter in the statute's grant of discretion by claiming to have pursued any non-shareholder interest referenced in the statute. Directors of an individual FPC receive only the additional latitude to pursue the particular special purpose stated in its charter.⁶⁵ This mutes somewhat the reservation that FPC directors' discretion will be unbounded and impossible to police.

In this respect, the FPC statute's grant of directorial discretion also compares favorably with that provided to directors of benefit corporations by many statutes enabling that form. For example, directors of benefit corporations in New Jersey must consider:

[T]he employees and workforce of the benefit corporation and its subsidiaries and suppliers, the interests of customers as beneficiaries of the general or specific public benefit purposes of the benefit corporation; community and societal considerations, including those of any

64. See, e.g., MODEL BUS. CORP. ACT. § 8.30(a) (2002) (requiring directors to "act: (1) in good faith, and (2) in a manner the director reasonably believes to be in the best interests of the corporation"). Numerous Delaware cases cite directors' duty to pursue the best interests of the corporation and its shareholders. See, e.g., *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993) ("[T]he duty of loyalty mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a . . . controlling shareholder . . ."); see also *Unocal Corp. v. Mesa Petrol. Co.*, 493 A.2d 946, 954 (Del. 1985) ("When a board addresses a pending takeover bid it has an obligation to determine whether the offer is in the best interests of the corporation and its shareholders. In that respect a board's duty is no different from any other responsibility it shoulders . . .").

65. See CAL. CORP. CODE § 2700(c).

community in which offices or facilities of the benefit corporation or its subsidiaries or suppliers are located; the local and global environment; and the short-term and long-term interests of the benefit corporation, including benefits that may accrue to the benefit corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the benefit corporation.⁶⁶

These benefit corporation directors may also consider “any other pertinent factors or the interests of any other group that they deem appropriate.”⁶⁷ There are three important points of comparison here. First, FPC directors are *permitted* to consider non-shareholder interests, while benefit corporation directors are *required* to consider them. Second, the non-shareholder interests FPC directors may choose to consider are limited to those special purposes stated in the FPC’s charter and thus on which their shareholders are particularly on notice. In contrast, benefit corporation directors are required to consider a range of non-shareholder interests as long as one’s proverbial arm, and there is no particular requirement to apprise their shareholders of which interests directors will prioritize. Third, benefit corporation directors are further authorized to consider *anything else they* deem relevant.

Commentators have noted the benefit corporation’s laundry list of mandatory considerations offers little guidance to directors and will hinder attempts to hold them accountable.⁶⁸ The greater specificity of purpose in an FPC softens, but does not entirely counteract, this critique. FPCs will always be formed for at least two purposes, to pursue a business and its special purpose. They may be formed for multiple purposes, if more than one special purpose is selected and disclosed. The statute does not require prioritization among any of these purposes. Thus, when an FPC’s various purposes come into conflict, it will be easy for its fiduciaries to defend their actions and difficult for shareholders to challenge them.

C. Policing FPCs

Indeed, it is shareholders who will engage in any challenges to an FPC’s operations. Their power to monitor and enforce is exclusive. The statute enables this policing by imposing disclosure

66. N.J. STAT. ANN. § 14A:18-6(a).

67. *Id.* § 14A:18-6(b).

68. See Brakman Reiser, *Benefit Corporations*, *supra* note 18, at 599–600; Callison, *Procrustean Bed*, *supra* note 18, at 106–08; Murray, *Choose Your Own Master*, *supra* note 18, at 27–34.

requirements on FPCs and empowering their shareholders with voting and litigation rights.

1. *Disclosure*

Under the statute, an FPC must engage in extensive reporting, beyond what would be required for a generic California for-profit corporation. Like in a standard for-profit, the FPC board must provide an annual report to shareholders, containing a balance sheet, income statement, and statement of cash flows.⁶⁹ An FPC's board must also include in its annual report to shareholders, however, "a management discussion and analysis (special purpose MD&A) concerning the flexible purpose corporation's stated purpose or purposes as set forth in its articles."⁷⁰ The board must also make the special purpose MD&A available on the FPC's website.⁷¹

The statute goes into considerable detail regarding the required contents of the special purpose MD&A. These reports will begin by "[i]dentif[ying] and discuss[ing] . . . the short-term and long-term objectives of the flexible purpose corporation relating to its special purpose or purposes" as well as changes in them over the past year.⁷² FPCs might respond to this requirement by stating vague ideals and platitudes, but the remaining items they must discuss demand greater specification. An FPC annual report must identify its recent and planned future "material actions" to pursue its special purpose objectives, including the intended impact of these actions.⁷³ For material actions taken during the relevant fiscal year, the report must also identify and discuss "the causal relationships between the actions and the reported outcomes, and the extent to which those actions achieved the special purpose objectives for the fiscal year."⁷⁴ Furthermore, the annual report must include substantial information

69. *See* CAL. CORP. CODE § 3500(a) (imposing these requirements on FPCs and mandating that these documents be "accompanied by any report thereon of independent accountants or, if there is no report, the certificate of an authorized officer of the flexible purpose corporation that the statements were prepared without audit from the books and records of the corporation"); *id.* § 1501(a)(1) (mandating similar reporting by for-profits).

70. *Id.* § 3500(b).

71. *Id.* The statute allows a board to redact or otherwise manage the public posting of its special purpose MD&A to avoid confidentiality breaches and leaves to each FPC the decision of precisely which electronic means it will use to give the public access to this document. *See id.*

72. *Id.* § 3500(b)(1).

73. *See id.* § 3500(b)(2)–(3).

74. *Id.* § 3500(b)(2).

about the FPC's recent and planned future expenditures.⁷⁵ Finally, the annual report must delve into "the process for selecting, and an identification and description of, the financial, operating, and other measures used by the flexible purpose corporation during the fiscal year for evaluating its performance in achieving its special purpose objectives."⁷⁶ It must explain why it chose the measures it did, and give the reasons for any changes it has made to the measures it used in the relevant period.⁷⁷

In addition to these robust annual reports, an FPC must also make a "special purpose current report" to shareholders and the public no later than forty-five days after any of several key events.⁷⁸ A current report must address any expenditure that arises without inclusion in a current annual report and that "has or is likely to have a material adverse impact on the flexible purpose corporation's results of operations or financial condition for a quarterly or annual fiscal period."⁷⁹ The board must also issue a current report if capital or operating expenditures (other than officer or director compensation) are made in a way not contemplated by its most recent annual disclosure.⁸⁰ Finally, the FPC must issue a current report if it deems one of its stated special purposes to be satisfied or decides not to pursue it any longer.⁸¹ These reports will keep diligent shareholders and the public up to date on material changes in the FPC's operations and activities between annual reports.

FPC shareholders seeking to exercise their enforcement prerogatives should find this rigorous level of disclosure helpful, but it may prove daunting for social entrepreneurs considering the form. The disclosure requirements not only outpace reporting required for traditional for-profits but also reporting demanded from alternative specialized forms. L3C statutes do not impose any specialized reporting obligations on adopting entities. Benefit corporation statutes vary somewhat in their reporting requirements, but even the most onerous are not as thorough and frequent as the FPC's.⁸²

75. *Id.* § 3500(b)(5) (requiring identification of current "material operating and capital expenditures . . . in furtherance of achieving the special purpose objectives" and a "good faith estimate" of future ones).

76. *Id.* § 3500(b)(4).

77. *See id.*

78. *See id.* § 3501.

79. *Id.* § 3501(b).

80. *See id.* § 3501(c)(1).

81. *Id.* § 3501(c)(2).

82. *See, e.g.,* N.J. STAT. ANN. § 14A:18-11.

The FPC statute, however, offers several components that may assuage founders' compliance concerns. First, the statute expressly states that its reporting standards do not require disclosure of every FPC purchase or plan.⁸³ Second, the consequences of failures to produce the required reports are limited. A fiduciary who causes reports to include false or misleading statements may be held liable,⁸⁴ but officers and directors are immunized against claims based on forward-looking statements made in good faith.⁸⁵ Even wholesale failure to produce reports typically triggers only a mandate to generate them, though if the failure to report is found "without justification," shareholders can recoup expenses incurred in challenging the failure, including attorney's fees.⁸⁶ Third, the statute establishes a presumption that all information required to be presented in a special purpose MD&A or current report has been provided if an FPC uses "best practices" to provide it.⁸⁷ The statute does not define these best practices, but instead leaves them to "emerge" over time.⁸⁸ Finally, any FPC with fewer than 100 shareholders can be relieved entirely of its obligation to produce special purpose MD&A and current reports if it obtains waivers from two-thirds of its outstanding shares.⁸⁹ At least in small and closely-held FPCs in which directors and shareholders overlap, one can expect waivers to be granted as a matter of course. Whether waivers will be easy to obtain in other types of FPCs will likely depend on the relative appetite of shareholders for disclosure as compared with their desire to limit compliance costs.

2. *Enforcement Tools*

Relying on information gleaned from the mandatory reports detailed above, shareholders alone will police FPCs' compliance with their blended missions and that of their fiduciaries. In this enforcement role, they have both legal and practical tools at their disposal. As shareholders, they are entitled to vote for directors and on certain major transactions and to bring derivative actions against FPC fiduciaries. In addition, the market could play an important

83. *See* CAL. CORP. CODE § 3502(a).

84. *See id.* § 3503.

85. *Id.* § 3502(d).

86. *See id.* § 3502(b).

87. *Id.*

88. *Id.*

89. *See id.* § 3502(h). This section parallels waiver provisions for for-profit corporations with fewer than 100 shareholders. *See id.* § 1501(a)(1).

enforcement role, as investors will buy or sell their shares depending on their confidence in the ability of an FPC investment to return both economic and social value.

As shareholders in other corporate settings, FPC shareholders can use their voting rights to enforce their preferences. Standard California corporate law applies to authorize FPC shareholders to elect and remove directors⁹⁰ and approve bylaws by a majority vote.⁹¹ FPC shareholders, however, have special and uniquely strong voting rights when an FPC wishes to remove its dedication to special purposes. Whether this result will be achieved through article amendment,⁹² merger,⁹³ or other transaction,⁹⁴ shareholders must consent by a two-thirds majority. Standard California for-profit corporations can often pursue these fundamental transactions with lesser investor consensus.⁹⁵ Thus, when it comes to protecting the blended mission legacy of an FPC from the ultimate threat of its abandonment, shareholders guard the gate. The information FPC shareholders obtain from annual and current reports, as well as transaction-specific disclosures, will help them to decide how to vote in these end-game scenarios.

Information about FPC operations will also assist shareholders in deciding whether to challenge the more everyday efforts and actions of their fiduciaries. They may do so through voting rights in director elections or through litigation. FPC shareholders may bring direct suits alleging individual harms, such as the FPC's failure to provide required access to information or to hold mandated votes.⁹⁶ In addition, the statute authorizes shareholders—and only shareholders⁹⁷—to bring suit derivatively on behalf of the FPC. These litigation rights are checked somewhat by the typical procedural steps shareholders must complete before derivative suits may be heard.⁹⁸ Still, at least nominally, derivative suit rights afford

90. *See id.* §§ 301(a), 303, 304.

91. *See id.* §§ 152, 211.

92. *See id.* § 3000(b).

93. *See id.* § 3201.

94. *See id.* §§ 3100, 3301(a)(2).

95. *See id.* §§ 1201, 181, 152 (requiring only the “affirmative vote of a majority of the outstanding shares entitled to vote” for a reorganization outside the FPC context).

96. FPC shareholders' rights here track those of ordinary shareholders. *See COX & HAZEN, supra* note 51, at 443–49 (describing the distinction between direct and derivative suits).

97. *See CAL. CORP. CODE* § 2900(b) (“No action may be instituted or maintained in right of any domestic or foreign flexible purpose corporation under this section by any party other than a shareholder of the flexible purpose corporation.”).

98. *See, e.g., id.* § 2900(c)(2), (d) (requiring that the plaintiff first inform the board

FPC shareholders authority to challenge directors' and officers' operations of their entities by challenging their fiduciary compliance.

Shareholders might claim fiduciary lapse when confronted with reports detailing their FPC's less than stellar achievements of special purposes or its undesirable expenditures. But, let us unpack this potential enforcement avenue a bit more carefully. Like in other corporate forms,⁹⁹ FPC shareholders will have little success in achieving redress through litigation unless the disappointing results or expenditures stem from a breach of loyalty. With loyalty breaches, a fiduciary has placed her own interest ahead of her corporation's interest, engaging in some transaction or activity that treats the corporation unfairly.¹⁰⁰ If an FPC shareholder makes allegations like these, she is likely to clear the procedural hurdles of derivative litigation, and a court should make a searching review of the activity or transaction to determine what the fiduciary gained and what the FPC may have lost.

FPC shareholders may, however, be unhappy with the management of a corporation even if no fiduciaries are being enriched at its expense. They may believe directors are trading off too much profit in order to pursue its special purposes, or that they are sacrificing too little profit in their pursuit. They may believe directors have made foolish, but not avaricious, business decisions. These poor choices cost the FPC resources it could have used to pursue either profit or social good. If generated and distributed to shareholders and the public, the voluminous and detailed special purpose MD&A and current reports might well reveal facts supporting such beliefs. But, FPC shareholders will not likely have financial incentives to bring legal claims for relief, as damage awards are unlikely and would be paid to the corporation. Further, it is hard to imagine the plaintiffs' bar taking up such cases. Even putting these practical impediments aside, shareholder derivative claims

of the impending lawsuit and furnish a bond, respectively).

99. See Geoffrey P. Miller, *A Modest Proposal For Fixing Delaware's Broken Duty of Care*, 2010 COLUM. BUS. L. REV. 319, 322–25 (2010) (setting forth various reasons why “the threat of money damages [for breach of a for-profit director's duty of care] has little or no force in Delaware”); Evelyn Brody, *The Limits of Charity Fiduciary Law*, 57 MD. L. REV. 1400, 1440–42 (1998) (bemoaning the law's propensity to focus on breaches of care rather than of loyalty, as “courts seem more willing to listen to duty-of-care complaints if the transaction is tainted by duty-of-loyalty implications”).

100. See COX & HAZEN, *supra* note 51, at 220–23 (describing directors' duties of loyalty); Brakman Reiser, *Theorizing Forms*, *supra* note 15, at 15.

alleging breaches of the duty of care based on these actions will almost invariably fail.¹⁰¹

If FPC directors make decisions with reasonable inquiry and information, without conflict of interest, and in good faith, courts will review their substance in a quite cursory fashion. The FPC statute imports language verbatim from California's codified business judgment rule, which protects directors from monetary liability for simple negligence.¹⁰² As in a standard for-profit, an individual FPC may adopt exculpatory charter amendments to further limit or eliminate its directors' exposure to monetary damages.¹⁰³ Further, FPC directors may use the state's common law business judgment rule to further "insulate from court intervention management decisions which are made by directors in good faith in what the directors believe is the organization's best interest" even in suits seeking injunctive relief.¹⁰⁴

Duty of care claims by FPC shareholders, however, face obstacles beyond those experienced by ordinary for-profit shareholders. These obstacles inhere in an FPC's blended mission and are exacerbated by the statute's director protections. Again, an example is instructive. Recall LocalCorp, our manufacturing concern founded as an FPC with a special purpose of pursuing the long-term interests of its local community along with profit for shareholders. Imagine its special purpose MD&A reveals that it declined to renew its largest contract with a local supplier in order to obtain an input more cheaply from an out-of-state vendor. This type of action would not trigger any voting rights for LocalCorp's shareholders, but the FPC appropriately disclosed the decision in a current report to shareholders. A group of LocalCorp shareholders might read this

101. For a discussion of how courts might apply good faith analysis or a revived fiduciary duty of obedience to consider such challenges across social enterprises, see Brakman Reiser, *Theorizing Forms*, *supra* note 15, at 17–18. Such a reading of FPC fiduciary duty would require interpretive enterprise by the courts, as suggestions of either route are entirely absent from the statute. Thus, they are beyond the scope of the current article.

102. Compare CAL. CORP. CODE § 309, with *id.* § 2700 (eliminating "liability based upon any alleged failure to discharge the person's obligations as a director" when a director performs her duties "in good faith, in a manner the director believes to be in the best interests of the [flexible purpose] corporation and its shareholders, and with that care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances") (bracketed language in FPC statute only). A recent federal case held that this California provision affords business judgment protection only to directors, and not to officers. See *FDIC v. Perry*, No. CV 11-5561, ODW (MRWx) 2012 WL 589569, at *1, *4 (C.D. Cal. Feb. 21, 2012).

103. See CAL. CORP. CODE § 2700(d).

104. See *Berg & Berg Enters., LLC v. Boyle*, 100 Cal. Rptr. 3d 875, 897 (Ct. App. 2009).

report, disapprove of the action, and bring a fiduciary duty challenge. Assuming the decision posed no conflicts of interest for fiduciaries, this claim seems most easily styled as a breach of the duty of care.¹⁰⁵ Perhaps shareholders would seek only injunctive relief, and we can assume *arguendo* that their claim would not be blocked by the demand requirement or stymied by the business judgment rule. Still, challenged directors could simply defend on grounds that in this decision they decided to pursue greater profit and would continue to pursue the FPC's special purposes in other ways. Essentially, the same scenario would play out if the decision ran in precisely the opposite direction, with the FPC throwing over a dependable out-of-state vendor for an upstart local one.

FPC directors' discretion to consider multiple non-prioritized purposes will frustrate shareholders' efforts to hold them accountable under the duty of care. Of course, this may be sensible, as courts' lack of expertise in business matters and the need to encourage responsible risk-taking by fiduciaries may justify deference to non-conflicted FPC decisions just as to those of for-profit directors. Moreover, there may be little impact from weaker review of FPC directorial decisions because standard corporate law limits this review so markedly already. But, at least wholly irrational decisions are theoretically the basis for potential scrutiny and liability in an ordinary for-profit. This "two masters" problem¹⁰⁶ makes even this minimal level of review more challenging for an FPC, though admittedly not as challenging as the virtually unlimited "masters" in a benefit corporation.¹⁰⁷

A shareholder, of course, may pursue one other option if she feels her FPC is not pursuing profit and social good in accordance with her preferences—exit. Rather than vote out the board or bring derivative litigation, our disgruntled LocalCorp shareholder may well prefer to

105. See Brakman Reiser, *Theorizing Forms*, *supra* note 15, at 15–17.

106. This shorthand has been used by virtually every author writing on specialized entities for social enterprise, including myself. See Carter G. Bishop, *The Low-Profit LLC (L3C): Program Related Investment By Proxy Or Perversion?*, 63 ARK. L. REV. 243, 243 (2010); Alicia E. Plerhoples, *Can an Old Dog Learn New Tricks—Applying Traditional Corporate Law Principles to New Social Enterprise Legislation*, 13 TENN. J. BUS. L. 221, 223 (2012); Callison & Vestal, *supra* note 15, at 288; Murray & Hwang, *supra* note 15, at 39–40; Brakman Reiser, *Blended Enterprise*, *supra* note 15, at 105; Linda O. Smiddy, *Corporate Creativity: The Vermont L3C & Other Developments in Social Entrepreneurship*, 35 VT. L. REV. 3, 7 (2010); Tyler, *supra* note 15 *passim*.

107. See Brakman Reiser, *Benefit Corporations*, *supra* note 18, at 599–600; Callison, *Procrustean Bed*, *supra* note 18, at 106–08; Murray, *Choose Your Own Master*, *supra* note 18, at 27–34.

sell her shares, end her involvement with LocalCorp, and seek out substitutes. Further, the fear of shareholders' divestiture may motivate fiduciaries to follow shareholder preferences. Yet, exit is effective to protect shareholders' interests and incentivize fiduciaries to align their actions with those interests only in the shadow of a market for FPC shares. Importantly, the reverse is also true. If no realistic market exists for FPC shares, directors will be less motivated to align their actions with shareholders' desires, and shareholders will have only the limited tools of voting or litigation to express their critiques of FPC management.¹⁰⁸ As a vibrant market for FPC shares is unlikely, at least for some time, the value of exit in enforcement is limited.

The exit rights of FPC shareholders bring to light one final important limitation on the statute's framework for monitoring these new entities. As noted earlier, when it comes to monitoring and enforcing the obligations of FPCs and their fiduciaries, shareholders stand alone.¹⁰⁹ Although the public may view posted annual reports and special purpose MD&As, the statute does not provide anyone but shareholders with legal tools for enforcement. Even members of classes particularly singled out for consideration in an FPC's articles of incorporation lack voting authority or standing to challenge the actions of its leaders.¹¹⁰

There can be good reasons to avoid general rights of participation or grants of standing to the public or even beneficiary classes in organizations formed to promote social good. In the somewhat analogous case of charities, public standing is rejected because litigious individuals opposed to the charitable mission of a particular entity might otherwise be motivated to bring damaging nuisance suits against it.¹¹¹ Such suits would drain charitable resources.¹¹²

108. See Plerhoples, *supra* note 106, at 257–58 (describing the potential accountability gap for directors in FPC control transactions).

109. See *supra* Part II.C.2.

110. Alicia Plerhoples describes this aspect of the FPC statute as embracing “shareholder primacy,” but a shareholder primacy norm uniquely sensitive to the combined profit and social good preferences FPC shareholders are assumed to hold. See Plerhoples, *supra* note 106, at 256 (“To the extent that investors in the flexible purpose corporation have non-economic interests, then those interests must be advanced along with the shareholders’ financial interests in order to uphold shareholder primacy.”).

111. See MARION FREMONT-SMITH, *GOVERNING NONPROFIT ORGANIZATIONS* 333 (2004) (explaining that limits on standing are needed to “permit fiduciaries to function without unwarranted abuse and harassment”).

112. See Mary Grace Blasko et al., *Standing to Sue in the Charitable Sector*, 28 U.S.F. L. REV. 37, 42 (1993).

Moreover, the possibility of such litigation could exacerbate the difficulty charities already experience in attracting and retaining qualified directors and officers.¹¹³ These concerns have some resonance for social enterprises, and FPCs have the ready solution of shareholder standing to appear to solve the enforcement problem.

Whether exclusive shareholder enforcement is a satisfactory solution depends upon one's view of the interests an FPC should serve. At least at the outset, FPC shareholders should have preferences regarding its special purpose aligned with those expressed by the entity's founders and stated in its articles.¹¹⁴ Over time, however, shareholders' views on the desirability of the entity's special purpose, including their preference for its pursuit over profit, may change. If an FPC should be operated for the benefit of its shareholders, as their preferences change, the entity's course should change as well. On this view, exclusive shareholder monitoring is effective. In contrast, if one views a social enterprise as one imbued with an obligation to interests beyond its shareholders, exclusive monitoring by shareholders will not necessarily be effective to address special purpose failures.

Consider once again Edify FPC, formed to pursue profits and provide low-cost educational services to children of the working poor, the directors of which propose amending its articles to transform the entity's purposes to pursue profits and the long-term positive effects of its activities on its employees. The directors disclose to shareholders that this change of purpose will result in offering its educational services at higher prices to offset investments in professional development and higher wages for its employees. Shareholders, by more than a two-thirds majority, approve the change. Representatives of the children Edify FPC serves, the local educational community, or the public at large will have no role to play in this decision. If an FPC should be operated solely in the interest of its shareholders and their preferences regarding pursuit of its special purposes, this is proper. If creating an FPC, however, should create some ongoing obligation to consider the interests identified in its special purposes, as those interests or related stakeholders would view them, exclusive shareholder enforcement is insufficient.

113. See FREMONT-SMITH, *supra* note 111, at 325 (“[I]t would be impossible to manage charitable funds, or even to find individuals to take on the task, if the fiduciaries were to be constantly subject to harassing litigation.”) (emphasis added).

114. See Plerhoples, *supra* note 106, at 252–54.

Shareholders have an important legal role to play in enforcement of FPC obligations, especially in an end-game situation where change of status is contemplated. Unless strong consensus among shareholders approves a change, the FPC must retain its special purpose character. As far as enforcing the blended mission mandate against more ordinary hazards, though, shareholders remain the only enforcer and their legal tools are weak. Shareholders may contest an FPC's compliance with its special purpose obligations, and that of its directors, but will face many obstacles in securing monetary liability or even injunctive relief. Further, depending on one's view of the ultimate purpose of FPCs, policing by shareholders alone may be insufficiently protective of special purposes.

3. *Summary*

The FPC statute follows a market-driven approach to monitoring and enforcement. It demands that FPC founders state their mission clearly and disclose their actions comprehensively. Then, it authorizes shareholders alone to enforce, with relatively strong legal tools in end-game scenarios and relatively limp ones in ordinary situations. It remains uncertain whether incentives will be sufficient for FPC shareholders to digest and utilize the information they receive, and how effectively they will employ the legal and practical tools at their disposal to police FPCs' blended missions.

III. EVALUATING FPCs

The FPC provides an organizational form enabling founders to clearly articulate both profit and social goals. Its structures for segregating, operating, and policing FPCs, however, differ importantly from the prior L3C and benefit corporation forms. In all of these respects, the FPC statute relies on directors to act within broad discretion and shareholders to enforce based on extensive disclosures.

In segregating FPCs from other corporate forms, the FPC statute relies on founders' own specification of a special purpose or purposes in organizational documents, without recourse to or use of any third-party standard. The FPC's special purposes may be drawn from a broad range of potential interests and stakeholder groups, but they must be clearly identified and disclosed to shareholders and the public. Viewers of these disclosures can then make their own decisions about whether to involve themselves with a given FPC, through consumption of its products or services, employment or business dealings, or—most importantly—investment. Once created,

supermajority voting provisions create greater lock-in for an FPC's special purpose than would be found in an L3C form, through provisions similar to those imposed by benefit corporation statutes. FPC shareholders also possess dissenters' rights, a concept rarely found in other specialized forms,¹¹⁵ though one of potentially less value than may initially appear.

The FPC statute provides a substantial architecture for operating FPCs, which relies on an express grant of discretion to directors. These clear instructions on structure and decision-making contrast sharply with the L3C form. L3C adopters must design their governance arrangements individually by contract and will find no guidance in the statute on managing fiduciary obligations in a dual or multiple mission entity. The benefit corporation, as an incorporated form, provides an "off-the-rack" set of operating structures quite similar to the FPC. Its grant of discretion to directors is, however, importantly distinct. FPC directors may choose to consider the special purposes articulated in its articles, along with the interests of shareholders, in making decisions. Benefit corporation directors are required to consider a laundry list of divergent interests in making their decisions and are thereby given virtually absolute discretion.

To police FPCs, the statute relies exclusively on shareholders. To boost their effectiveness, shareholders are afforded uniquely comprehensive disclosures. Although the FPC statute takes several steps to reduce the burden of its disclosure requirements, they remain considerably more extensive than those demanded of benefit corporations and, again, involve no third-party standards. Few L3C statutes impose any disclosure requirements at all.

Armed with detailed information about FPC operations and achievements, shareholders are empowered to enforce the obligations of FPCs and their fiduciaries through voting and litigation rights. These enforcement tools far surpass those of L3C investors. They are similar to the enforcement rights of benefit corporation shareholders, though not identical. Both forms require supermajority shareholder approval for change of status, but their litigation mechanisms can differ. FPC shareholders may pursue fiduciary

115. The California and South Carolina benefit corporation statutes do provide dissenters' rights. Those under the California statute are identical to the dissenters' rights under the FPC statute. *See* CAL. CORP. CODE § 14604. The South Carolina statute provides its appraisal-type remedy only for shareholders of for-profits who dissent from a conversion to a benefit corporation. *See* A277, 119th Gen. Assemb., Reg. Sess. (S.C. 2012) (to be codified at S.C. CODE ANN. § 33-38-230). The Washington Social Purpose Corporation statute also contains an appraisal provision. *See* WASH. REV. CODE ANN. § 23B.25.120 (2012).

claims through typical derivative actions but are not granted access to a special enforcement process like the benefit enforcement proceeding.

CONCLUSION

We do not yet know if the FPC, or any other specialized form for social enterprise, will break out of the pack and become “the next big thing.” All of these forms are novel, and it will be some time before many of their provisions are interpreted and their usefulness is determined. Despite the early stage of their development and the variation in the details of their structures, they all face a common struggle. They all allow social entrepreneurs to articulate a blended mission to pursue profit and social good, but none offers a clear path to enforcement.¹¹⁶ To become a brand that attracts the capital social entrepreneurs desire, a specialized form will need to meet this serious enforcement challenge.¹¹⁷ For the FPC, experience will need to prove that exclusive policing by shareholders will—or even can—be effective in enforcing blended mission.

116. In the L3C, enforcement concerns arise because fiduciary duty is unclear and the entity can be effortlessly transformed into a standard LLC. See Brakman Reiser, *Blended Enterprise*, *supra* note 15, at 108–11; Brakman Reiser, *Governing and Financing*, *supra* note 11, at 650; Brakman Reiser, *Theorizing Forms*, *supra* note 15, at 18–19; Callison & Vestal, *supra* note 15, at 286–88. *But see* Murray & Hwang, *supra* note 15, at 39–40; Tyler, *supra* note 15, at 141 (viewing the L3C’s enforcement prospects more favorably). The benefit corporation grants virtually unbridled discretion to directors, shares the FPC’s problematic dependence on shareholder enforcement, and its reliance on third-party standards may set the stage for greenwashing. See Brakman Reiser, *Benefit Corporations*, *supra* note 18, at 611–17; Brakman Reiser, *Theorizing Forms*, *supra* note 15, at 20–28, 38–39; Callison, *Procrustean Bed*, *supra* note 18, at 94–97, 106–11; Murray, *Choose Your Own Master*, *supra* note 18, at 27–36.

117. See Brakman Reiser, *Theorizing Forms*, *supra* note 15, at 40.