M&A UNDER DELAWARE'S PUBLIC BENEFIT CORPORATION STATUTE: A HYPOTHETICAL TOUR

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Abstract

Noting the enthusiastic initial response to Delaware's 2013 public benefit corporation statute, this Article presents a series of hypotheticals as vehicles for comment on issues that are likely to arise in the context of mergers and acquisitions of public benefit corporations. The Article first examines appraisal rights, concluding that such rights will be generally available to stockholders in public benefit corporations, and noting the potential for ambiguity in defining "fair value" where the corporation's purposes extend to public purposes as well as private profit. Next, the Article examines whether and to what extent "Revlon" duties and limitations on deal protection devices may be relaxed or modified in the context of the sale of a public benefit corporation. Finally, the Article examines whether and to what extent a commitment to promote the specified public purposes of a public benefit corporation can be made enforceable against the buyer of the corporation.

Introduction

Delaware's public benefit corporation legislation[1] became effective August 1, 2013, thereby allowing companies to incorporate as a Public Benefit Corporation (PBC). In addition, existing corporations can become PBCs or merge into PBCs.[2] A PBC is a for-profit corporation organized under a subchapter of the Delaware General Corporation Law (DGCL), the certificate of incorporation of which identifies a "public benefit" within its statement of purpose.[3] The statute defines a "public benefit" as "a positive effect (or

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[1] Del. Code Ann. tit. 8, §§ 361–68 (2013).

[2] *Id.* § 363(a) (providing for PBC status through merger, conversion, or amendment of the certificate of incorporation).

[3] *Id.* § 362(a).

reduction of negative effects) on 1 or more categories of persons, entities, communities or interests (other than stockholders in their capacities as stockholders) including, but not limited to, effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature."[4]

Delaware's companies and entrepreneurs are quickly taking advantage of the new corporate form. Seventeen businesses submitted the necessary paperwork to become PBCs the day the legislation went into effect.[5] Over fifty entities incorporated as or converted into PBCs in the first three months after the legislation became effective.[6]

Delaware's PBC statute, and the enactment of similar legislation in a variety of other states, has generated considerable analysis of the content and potential impact of these statutes.[7] Directly relevant case law, however, has not yet emerged. In an effort to anticipate potential litigation involving PBCs, this Article presents three hypothetical settings illustrating the issues that might arise in such litigation. All three settings involve the acquisition of a PBC because most routine challenges to the fiduciary conduct of traditional, for-profit corporations arise in the context of acquisitions.[8] As this Article demonstrates, PBCs exacerbate existing complexities in a legal terrain applicable to traditional, for-profit corporations.

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[4] *Id.* § 362(b).

[5] Press Release, State of Del., Governor Markell Registers Delaware's First Public Benefit Corporations (Aug. 1, 2014), http://news.delaware.gov/2013/08/01/governor-markell-registers-delawares-first-public-benefit-corporations. The seventeen entities that filed for PBC status on August 1, 2013 is a record for the number of companies that have filed for PBC status on the first day in the twenty jurisdictions that have enacted public benefit corporation legislation. *Id.*

[6] Alicia E. Plerhoples, *Delaware Public Benefit Corporations 90 Days Out: Who's Opting In?*, 14 U.C. Davis Bus. L. J. (forthcoming), *available at* http://ssrn.com/abstract=2377267 (cited with permission of the author). Professor Plerhoples identifies fifty-five PBCs that incorporated in Delaware from August 1–October 31, 2013 by cross-referencing the list of B-Corps on the B-Lab website, and the Delaware Department of State's Division of Corporations' searchable database of all entities registered in Delaware. *Id.* at 11–12, n.51.

[7] For a comprehensive overview of these statutes, see Corporate Laws Committee, ABA Business Law Section, *Benefit Corporation White Paper*, 68 Bus. Law. 1083 (2013). For other recent commentary on benefit corporations, *see generally* Dana Brackman Weiser, *Benefit Corporations — A Sustainable Form of Organization?*, 46 Wake Forest L. Rev. 591 (2011); J. William Callison, *Benefit Corporations, Innovation and Statutory Design*, 26 Regent U. L. Rev. 143 (2013–2014); J. Haskell Murray, *Defending Patagonia: Mergers & Acquisitions with Benefit Corporations*, 9 Hastings Bus. L.J. 485 (2013); Joseph Karl Grant, *When Making Money and Making a Sustainable and Societal Difference Collide: Will Benefit Corporations Succeed or Fail?*, 46 Ind. L. Rev. 581 (2013); Mark J. Loewenstein, *Benefit Corporations: A Challenge in Corporate Governance*, 68 Bus. Law. 1007 (2013).

[8] *See, e.g.*, Leo E. Strine, Jr. et al., *Putting Stockholders First, Not the First-Filed Complaint*, 69 Bus. Law. 1, 989–1010 (2013) ("In 2010 and 2011, 91 percent of all deals worth over $100 million were litigated, and these deals were targeted with an average of 5.1 lawsuits each.").

I. Hypothetical #1: Appraisal Rights in a PBC

Although, to the authors' knowledge, the situation has not yet occurred in Delaware, it is inevitable that a PBC will merge or consolidate in a manner that would trigger statutory appraisal rights. Appraisal in the PBC context raises several questions. First, are statutory appraisal rights available to a PBC stockholder who dissents from a merger and does not accept the merger consideration? Second, in an appraisal proceeding, how should the Court of Chancery consider the public benefit specified in a PBC's certificate of incorporation in making its fair value determination? To address these questions, we first introduce a hypothetical PBC. We then discuss whether the PBC legislation, or any other section in the DGCL, extends the statutory appraisal rights to PBCs. Finally, we analyze Delaware's appraisal mandate and apply it to the hypothetical PBC.

Hypothetical:

> UncleLunchMoney's PBC (ULM), a closely held Delaware PBC, operates a series of food trucks in and around Wilmington, Delaware. ULM specializes in selling hot Italian beef sandwiches and Chicago-style hot dogs sourced from local farmers who practice sustainable animal husbandry. ULM's certificate of incorporation identifies in its statement of purpose the following public benefit: "ULM is dedicated to eradicating hunger in the most underprivileged areas in rural America. To that end, ULM will donate one Italian beef sandwich to underprivileged children in the Mississippi Delta for every Italian beef sandwich sold at its food trucks."
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> ULM's success in and around Wilmington drew the attention of larger rivals. Paul Pride, the owner of Proud Paul's Hot Wings, Inc. (Proud Paul's), a chain of food trucks that sell Paul's Famous Hot Wings, spotted an opportunity to grow his business and to capitalize on massive synergies between Proud Paul's and ULM. Paul approached ULM's founder and controlling stockholder, James, and proposed to acquire ULM for $50 per share in an all-cash transaction.
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> James, who owned 75% of ULM's shares, took the offer to Henry and Sam, who each held 12.5% of the company's equity. James explained that he thought the proposal was fair in light of the fact that he had no plans to expand either the number of food trucks operated by ULM or the areas in which those food trucks operated.
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> Henry and Sam thought the proposal undervalued ULM and indicated that they would oppose the merger. They argued to James

that the merger price did not take into account either the company's costs in pursuing the public benefit or the value of the benefit created by ULM's food donations. They believe that they should receive value on at least one of these grounds. Sam feels especially indignant at the suggestion that Proud Paul's is not a PBC and objected to the notion that Proud Paul's could acquire ULM at a discount because of ULM's food donation program and then turn around to capture value from the cessation of the program.

James sincerely believed that the offer properly valued ULM and resolved to push ahead with the merger. Henry and Sam delivered an appraisal demand to ULM before the stockholder vote, voted their shares against the merger, refused the merger consideration and otherwise followed the procedure for perfecting their statutory appraisal rights. After receiving Henry and Sam's appraisal demand, James replied by letter and asserted that Henry and Sam were not entitled to statutory appraisal rights because ULM was a PBC. Henry and Sam then promptly filed a petition for appraisal in the Delaware Court of Chancery.

Analysis

1. *Do Henry and Sam, as Stockholders of a Delaware PBC, Have Statutory Appraisal Rights?*

If Henry and Sam file a petition for appraisal, the first question the court must answer is whether they have a statutory right to appraisal. Delaware's appraisal statute grants the statutory appraisal remedy only in limited circumstances, including: the merger of a closely held company where no market is available; cash-out mergers; short-form mergers regardless of the consideration;[9] and when a corporation converts or merges into a PBC.[10] The sale of ULM to Proud Paul's is a cash-out merger of a closely held PBC. As a result, Henry and Sam would be entitled to the appraisal remedy if ULM were a for-profit corporation.

Delaware's PBC legislation, like the Model Benefit Corporation Legislation,[11] does not directly address whether dissenting stockholders of PBC are entitled to statutory appraisal rights.[12] Nevertheless, dissenting stock-

[9] tit. 8, § 262(b); *see* Lawrence A. Hamermesh & Michael L. Wachter, *The Fair Value of Cornfields in Delaware Appraisal Law*, 31 J. Corp. L. 119, 128–30 (2005) (providing description of the types of mergers that trigger statutory appraisal remedy).

[10] tit. 8, § 363(b).

[11] Model Benefit Corp. Leg. (Apr, 10, 2013), *available at* http://benefitcorp.net/storage/documents/Model_Benefit_Corporation_Legislation.pdf.

[12] Whereas the PBC legislation expressly grants appraisal rights to dissenting stockholders of a corporation that amends its certificate of incorporation to become a PBC or that merges or consolidates into a public benefit corporation and part of the consideration is equity in a PBC

holders of PBCs do have appraisal rights. The PBC legislation states that PBCs are "subject in all respects" to the provisions of "this chapter"—that is, the DGCL—except to the extent the PBC legislation imposes additional or different requirements.[13] The PBC legislation is located in a subchapter within the same chapter 1, of title 8 of the Delaware Code, as Delaware's statutory appraisal statute.[14] Since PBCs are "subject in all respects" to the provisions of chapter 1 of the DGCL except as otherwise indicated in the PBC subchapter and the PBC statute is silent with regard to appraisal rights for dissenting stockholders of a PBC,[15] it follows that Delaware's general appraisal statute applies to PBCs.

2. *What is the "Fair Value" of a PBC's Stock?*

a. *In General*

Henry and Sam, as PBC stockholders who perfected their appraisal rights, are entitled to the statutory appraisal remedy. In other words, they are entitled to the judicially determined "fair value" of their stock.[16] Indeed, "the basic concept of value under the appraisal statue is that the stockholder is entitled to be paid for that which has been taken from him, viz., his proportionate interest in a going concern."[17] Section 262(h) of the DGCL provides that, in an appraisal proceeding:

> [T]he Court shall determine the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with interest, if any, to be paid upon the amount determined to be the fair value. In determining such fair value, the Court shall take into account all relevant factors.[18]

In other words, section 262(h) requires the court to make an independent determination of the fair value of the shares subject to appraisal.[19] Fair

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or similar entity, the PBC legislation does not expound upon the appraisal rights of stockholders of PBCs. *See* tit. 8, § 363(b). The statute also requires that 90% of the outstanding shares of stock for each class of stock of the corporation of which there are outstanding shares, whether voting or nonvoting, vote to approve amending the certificate of incorporation to adopt a public benefit or the merging or consolidation into a PBC or similar entity. *Id.* § 363(a).

[13] *Id.* § 361.

[14] *Id.* §§ 361–68.

[15] *Id.*

[16] Paskill Corp. v. Alcoma Corp., 747 A.2d 549, 552 (Del. 2000).

[17] Tri-Continental Corp. v. Battye, 74 A.2d 71, 72 (Del. 1950); *see also* Paskill Corp., 747 A.2d at 553.

[18] tit. 8, § 262(h).

[19] *See, e.g.*, Highfields Capital, Ltd. v. AXA Fin., Inc., 939 A.2d 34, 42 (Del. Ch. 2007) (noting that, in an appraisal proceeding, the court must "determine the fair value of 100% of the corporation [and award] the dissenting stockholder his proportionate share of that value") (quoting Cavalier Oil Corp. v. Harnett, CIV.A. 7959, 1988 WL 15816, at *9 (Del. Ch. Feb. 22, 1988), *aff'd* 564 A.2d 1137 (Del. 1989)).

value, in the context of an appraisal proceeding, is the "value to a stockholder of the firm as a going concern, as opposed to the firm's value in the context of an acquisition or transaction."[20] In determining fair value, the court takes into account "the 'operative reality' of the company at the time of the merger"[21] and all other relevant factors affecting the value of the company, including the nature of the enterprise.[22]

An appraisal proceeding often becomes a battle of the experts. Both sides bear the burden of proving their valuation. The court is free to adopt, in whole or in part, one expert's valuation contentions, or the court may create its own.[23] If neither side proves its valuation, the court must exercise its independent judgment to determine the fair value of shares.[24] Proof of value may be shown by "any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court."[25] The valuation methods typically relied on by the court in an appraisal proceeding include a discounted cash flow (DCF) analysis, comparable companies analysis, and a comparable transaction analysis.[26] In certain limited circumstances, the court may consider the merger price as a strong indication of "fair value."[27]

b. *How Will the Court Treat the Public Benefit In an Appraisal Proceeding?*

One issue the court will have to grapple with in an appraisal proceeding involving a PBC is how to treat a PBC's public benefit. One approach the

[20] Merion Capital, L.P. v. 3M Cogent, Inc., No. 6247–VCP, 2013 WL 3793896, at *3 (Del. Ch. July 8, 2013) (quoting Golden v. Telecom, Inc. v. Global GT LP, 11 A.3d 214, 217 (Del. 2010)); *see* Rapid-American Corp. v. Harris, 603 A.2d 796, 802 (Del. 1992) (citations omitted) (noting that it is "axiomatic" under Delaware law that dissenting stockholders are entitled to receive "fair value representing their proportionate interested in a going concern"); tit. 8, § 262(h).

[21] *E.g.*, Highfields Capital, Ltd., 939 A.2d at 42 (Del. Ch. 2007) (quoting M.G. Bancorp., Inc. v. LeBeau, 737 A.2d 513, 525 (Del. 1999)).

[22] Merion Capital, L.P., 2013 WL 3793896, at *3 ("One of the most important factors to consider is the very 'nature of the enterprise' subject to the appraisal proceeding.") (quoting Rapid-American Corp., 603 A.2d at 805).

[23] Huff Fund Inv. P'ship v. CKx, Inc., No. 6844–VCG, 2013 WL 5878807, at *9 (Del. Ch. Nov. 1, 2013) ("This Court has the latitude to select one of the parties' valuation models as its general framework, or fashion its own, to determine fair value in an appraisal proceeding.") (quoting Cede & Co. v. Technicolor, Inc., 684 A.2d 289, 299 (Del. 1996)).

[24] Merion Capital, L.P., 2013 WL 3793896, at *4.

[25] Weinberger v. UOP, 457 A.2d 701, 713 (Del. 1983).

[26] Merion Capital, L.P., 2013 WL 3793896, at *4.

[27] Huff Fund Inv. P'ship, 2013 WL 5878807, at *9 (adopting merger price as indication of fair value); Union Ill. 1995 Inv. Ltd. P'ship v. Union Fin. Group, Ltd., 847 A.2d 340, 357 (Del. Ch. 2004) (adopting merger price as best indicator of fair value in an appraisal proceeding); *see also* Global GT LP v. Golden Telecom, Inc., 993 A.2d 497, 507 (Del. Ch. 2010), *aff'd* 11 A.3d 214 (Del. 2010) (recognizing that "an arms-length merger price resulting from an effective market check is entitled to great weight in an appraisal"). *But see* Golden Telecom, Inc. v. Global GT LP, 11 A.3d 214, 218 (Del. 2010) (declining to adopt a *presumption* in favor of merger price as evidence of fair value).

court might take is simply to ignore the pecuniary value of the public benefit for purposes of making its fair value determination. Under this approach, the public benefit aspect of the corporation would essentially reduce the appraised value to the extent that the public benefit negatively affected earnings.[28] This approach is supported by and seems consistent with the case law interpreting section 262 of the DGCL.[29] It is also possible, however, that the court could find it appropriate to take the public benefit directly into account and award a separate pecuniary value for the creation of the public benefit. A court adopting this approach might "add back" the cost of pursuing the public benefit. The court could also attempt to measure directly the pecuniary value of the public benefit and include that in its fair value determination. While such an outcome may seem counterintuitive, courts may view it as consistent with the PBC statute's mandate that the directors owe duties solely to stockholders (and not public beneficiaries). Under this approach, in some sense, the loss of a share in a PBC merger represents the loss of both pecuniary value and the ability to contribute toward public benefits. Only an appraisal value that represented both elements would make the stockholder whole (at least where the stockholder had no assurance that the public benefit would be maintained post-merger).

(i) Pecuniary Value Approaches

Section 262(h) of the DGCL mandates that, in setting an appraisal value for ULM, the Court of Chancery must value it, and any other PBC, as a going concern based upon the operative reality of the company at the time of the merger taking into account all relevant factors including the nature of the enterprise.[30] If the court adopted a pure pecuniary value approach in valuing a PBC, it would value shares of the PBC based on its operative reality at the time of the merger, including the economic costs or benefits of pursuing the public benefit of the PBC. In a case like ULM's, the effect of pursuing the public benefit can be directly tied to the financial statements through the expense of the donated food, as well as expenses related to its sustainable sourcing and consideration of those materially affected by its conduct ("Benefit Costs"). Thus, the court would value the public benefit indirectly through its negative impact on revenues. This approach assigns no special value to the public benefit created and is seemingly consistent with both the goals of the appraisal remedy and the case law to the extent that "fair value" equates with pecuniary interests.

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[28] Although in some cases, the pursuit of a public benefit might positively affect a corporation's pecuniary value as well.

[29] *See supra* notes 19–22.

[30] Paskill Corp. v. Alcoma Corp., 747 A.2d 549, 553 (Del. 2000) ("[T]his Court has held that the corporation must be valued as an operating entity."); Cavalier Oil Corp. v. Harnett, 564 A.2d 1137, 1145 (Del. 1989).

In the case of ULM, a court adopting this approach would recognize that ULM's "operative reality" is that at the time of the merger it was a PBC subject to Benefit Costs. The direct impact of the food donation public benefit on ULM's appraisal valuation is its impact on ULM's earnings. ULM's Benefit Costs would result in lower profits than if they were not incurred, and all else being equal, lower profits would result in a lower valuation for ULM. Of course, the donations and pursuit of other public benefits may also increase a PBC's pecuniary value to stockholders by creating goodwill that increases sales and margins, and that benefit would be reflected in its historical financial statements and projections.

This approach seems consistent with the concept that the dissenting stockholder would prefer to maintain his position in the corporation as it is, and therefore is entitled to the value of the shares on that basis.[31] Had ULM not been sold, Henry and Sam would have maintained their investment in ULM, and ULM would have continued to donate a sandwich to children in the Mississippi Delta for every sandwich sold at its food trucks and otherwise balance the public benefit. Henry and Sam understood the effect of this conduct on their pecuniary interests when they decided to form a PBC.[32] To award Henry and Sam pecuniary value in an appraisal for the public benefit would arguably result in a windfall to Henry and Sam.

The pure pecuniary approach towards the appraisal of PBCs also finds support in section 262's mandate that the court take into account all relevant factors including the nature of the enterprise.[33] The court would consider that ULM is a PBC, an entity fundamentally different from a traditional corporation. ULM's stockholders agreed to invest in a PBC and to pursue a public benefit that, by its very nature, sacrifices some element of profit-making in order to create a public benefit.[34] The beneficiaries of ULM's specified public benefit are the children in the Mississippi Delta. If Henry and Sam had remained investors in ULM, the economic value of their stock would be subject to ULM's food donations. Accordingly, awarding Henry and Sam value for the public benefit would lead to an undesirable windfall and violate

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[31] Cavalier Oil Corp., 564 A.2d at 1145 ("The appraisal process is not intended to reconstruct a *pro forma* sale but to assume that the shareholder was willing to maintain his investment position, however slight, had the merger not occurred"); Paskill Corp., 747 A.2d at 552 (holding that Court of Chancery should have excluded any deduction for speculative future tax liabilities attributed to the sale of appreciated investment assets when the sale of appreciated investment assets was not a part of the company's operative reality on the date of the merger).

[32] tit. 8, § 362(a).

[33] *Id.* § 262(h); Paskill Corp., 747 A.2d at 557 (remanding to Court of Chancery to ascertain the nature of the enterprise); Tri-Continental Corp. v. Battye, 74 A.2d 71, 72 (Del. 1950) (accounting for status as a closed-end investment company with leverage); Merion Capital, L.P., 2013 WL 3793896, at *3.

[34] Alicia E. Plerhoples, *Can an Old Dog Learn New Tricks? Applying Traditional Corporate Law Principles to New Social Enterprise Legislation*, 13 Transactions: Tenn J. Bus. L. 221, 234 (2012) (commenting that company earnings are not the only bottom line of social enterprises).

the appraisal mandate by awarding stockholders more than their "proportionate interest in a going concern."[35]

(ii) An Argument for Awarding Value for the Public Benefit

Instead of assigning no pecuniary value to the public benefit created by a PBC, the court might determine that its fair value includes the PBC's public benefit. One argument that could possibly lead to this result is that stockholders own all the value of the PBC and have agreed, per the charter, to share that wealth with others. Notwithstanding the public benefit identified in a PBC's charter, the fiduciary duties of a director of a PBC run only to the stockholders. Indeed, only significant stockholders can file suit to challenge the directors' pursuit of the PBC's stated public benefit. The beneficiary of the stated public benefit may not file suit.[36] Even when a suit challenging the directors' pursuit of the public benefit has been filed, a director can demonstrate that he satisfied his duty to balance multiple constituencies identified in section 365(a) of the DGCL by showing that his decisions were "both informed and disinterested and not such that no person of ordinary sound judgment would approve."[37] Thus, since any public benefits rely on the good graces of the stockholders through the directors, a petitioner in an appraisal proceeding may argue that he should receive pecuniary value for the public benefits the PBC created.

If the court does decide to award pecuniary value for the public benefit, the court might try to factor the Benefit Costs into the analysis of the PBC's value. The court could also attempt to value the public benefit directly.

(1) Adjusting Value Based on the Benefit Costs

A court could factor the actual costs of pursuing the public benefits into the valuation analysis in order to award a pecuniary value that included those benefits. If the evidence suggested that the products donated could be sold, the court could project revenue and profit from the additional sales (historically and/or prospectively), and input those projections into a DCF or comparables valuation model. Alternatively, if the evidence suggested that the corporation's market could not absorb additional sales, the court could back the Benefit Costs out of historical results and projections, thereby enhancing historical and projected cash flow and profit. Of course, if stopping the donations were likely to decrease ULM's sales due to a loss of the goodwill those activities created, the appraised value would also have to be correspondingly adjusted.

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[35] Tri-Continental Corp., 74 A.2d at 72.
[36] tit. 8, § 365(b).
[37] *Id.*

(2) Awarding the Value of the Public Benefit

Alternatively, if the court were inclined to view the public benefit as an element of the "fair value" of dissenters' shares, it might attempt to value the public benefit directly rather than adding and subtracting back the Benefit Costs of pursuing the public benefit. This approach is problematic, as the chances of including speculative elements of value increase when attempting to measure the value of a public benefit.

In the case of ULM, this approach would value its food donations not in terms of the Benefit Costs, but rather on the benefit of having fewer hungry children. Any attempt to assign a pecuniary value to the public benefit created by a PBC is complicated at best, and in some circumstances, it would be nearly impossible to measure.[38] Furthermore, in conducting an appraisal valuation, the Court of Chancery may only use "generally accepted techniques used in the financial community and the courts."[39] The court should award value only for elements of value that are "known or susceptible to proof" and which are "not the product of speculation."[40] Valuing the impact of a public benefit, even an easily identifiable public benefit, would involve either speculative elements of value, the use of techniques that are not generally accepted in the financial community, or both, and the court is therefore unlikely to adopt this approach to value in an appraisal proceeding.

Marc J. Loewenstein recently highlighted some of the problems with describing the impact of a public benefit in the first instance and quantifying that impact in the second instance in his article, *Benefit Corporations: a Challenge to Corporate Governance*.[41] Indeed, even a seemingly simple public benefit to measure, like a decrease in carbon emissions from sourcing materials from local producers or manufacturers, is in reality much more complicated than it first appears. This measurement would involve not only a calculation of the reduction in carbon emissions from transporting the materials over a shorter distance, but would also need to account for any differences in carbon emissions from the supplier's production or manufacturing processes. Any difference in carbon emissions from the production of power used by the suppliers would also need to be included in calculating reductions in total carbon emissions. Further, a true measurement of the value of the public benefit created by a PBC might also take into account the

[38] It may be easier to measure the benefit of less hunger than to measure a public benefit like a deeper appreciation of the arts, promotion of religious values (see Hypothetical #2 below), or animal welfare (see Hypothetical #3 below).

[39] Weinberger v. UOP, 457 A.2d 701, 712–13 (Del. 1983).

[40] *Id.* at 713.

[41] Loewenstein, *supra* note 7, at 1017–19 (discussing the difficulty in describing the public benefit created by BBWoof, Inc., a Maryland benefit corporation that in addition to selling pet food and supplies "seeks to serve as a community resource for companion animals and their guardians" and "promotes its policy of carrying eco-friendly pet supplies, Fair Trade items and merchandise sourced from local and North American companies with a preference given to small manufacturers and minority owned businesses") (internal quotations omitted).

benefit to the manufacturers themselves. For example, if the local manufacturer is already wealthy, the marginal economic utility impact would be less than that for a foreign manufacturer who lives on less than a dollar per day.

Using ULM as an example highlights the difficulties in measuring impact, let alone assigning a monetary value to that impact. How would the court form a comprehensive measure of value of the impact of food donations to hungry children in the Mississippi Delta? A comprehensive measurement of the public benefit might first include calculating the impact of hunger on overall happiness and a child's ability to learn. It is immediately problematic for a court to measure a subjective benefit like increased happiness. However, even calculating the benefit from a child being able to learn more on a full stomach than an empty one is difficult. Not only must one first calculate the difference between what a well-nourished child and a hungry child can learn, but the next step likely would be to calculate the marginal economic output (presumably when the child matures into an adult) associated with the increased knowledge. Further, would and should the court take into account the costs and benefits of sourcing the meats from farmers practicing sustainable animal husbandry against sourcing the meat from farmers who do not engage in such practices? Moreover, how would the court address any negative externalities that arise from pursuing a public benefit? In the case of ULM, the food donations might provide the benefit of reducing hunger for children in the Mississippi Delta, but how will the court treat the costs of feeding children food that is high in fat and calories, as opposed to fruits and vegetables? Indeed, increased consumption of Italian beef sandwiches might result in elevated levels of cholesterol, increased instances of diabetes, or an increase in obesity. Should the costs of those externalities be considered in determining the impact of pursuing a public benefit? Indeed, as Loewenstein noted, the nuances and intricacies of calculating the overall impact of a public benefit results in a "costly, time consuming, and . . . nearly worthless" exercise.[42] Taking that procedure a step further and reducing the impacts of a public benefit to a single monetary value only increases the difficulty and speculation involved in that enterprise, and it is difficult to see how any comprehensive valuation of a public benefit would satisfy the evidentiary admissibility requirements in an appraisal proceeding.[43]

These difficulties suggest that if a court were to award appraisal value for public benefit, it would almost certainly focus on pecuniary value or how

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[42] *Id.* at 1018 (discussing how even a simplistic measurement like measuring the difference in carbon emissions involves many more complexities than at first realized).

[43] This lack of a comprehensive valuation model does not close the door to the possibility that this type of evidence may be admissible at some time in the future. It is possible that a new breed of benefit consultants or benefit accountants may emerge and develop a method for measuring the impact of a public benefit and reducing that impact to a monetary value. If this method becomes widely accepted within the financial community, the court may then adopt it in an appraisal proceeding. *See, e.g.*, Weinberger, 457 A.2d at 712–14 (liberalizing appropriate valuation methods beyond the Delaware Block Method).

Benefit Costs affect the valuation analysis, rather than actual benefit value. As suggested above, however, even this may seem troubling due to its windfall aspect. Nonetheless, it should be noted that if the acquiror's price is based on "as is" financial data, and the acquiror is not bound to provide similar public benefits and is thus able post-merger to extract higher profits by reducing or eliminating the public benefit, the acquiror would receive a windfall.

II. Hypothetical #2: How Do Directors Balance the Public Benefit and the Stockholder Profit Goal in a Sale of the Company?

Corporate lawyers are familiar with the fiduciary obligations of directors, and the enhanced judicial scrutiny, associated with a sale of the company.[44] How does the obligation of directors of a traditional, for-profit corporation to obtain the highest reasonably available price in a sale of the company translate, if at all, to the sale of a Delaware PBC?

Hypothetical[45]

> Praise Video, PBC was formed as a Delaware PBC in September 2013. Its certificate of incorporation identifies what it characterizes as a positive effect of a religious nature, namely "the promotion of the values articulated in the Confession of Faith in a Mennonite Perspective" (the Confession of Faith). Praise Video has engaged in the production and distribution of filmed and digital entertainment, of what its web site describes as a wholesome nature and an alternative to violent or sexually offensive entertainment generally offered by secular media. Originally limited to renditions of Bible stories, Praise Video's product lines have diversified, most recently (since 2003) into video games with Christian themes. Praise Video has enjoyed relatively modest but consistent financial success, with recent years' earnings averaging around $4 million (about $4 per share). At least 60% of that profit has been attributable to Praise Video's gaming division.
>
> Jacob Bissinger is CEO and a director of Praise Video. Along with Bissinger, Praise Video's directors (including the other individual defendants) and almost all of the other stockholders (ap-

[44] *See generally* Revlon, Inc. v. MacAndrews & Forbes, Inc., 506 A.2d 173 (Del. 1986); Paramount Commc'ns v. QVC Network Inc., 637 A.2d 34 (Del. 1993).

[45] This hypothetical is drawn from the problem for the 2014 Ruby R. Vale Interschool Corporate Moot Court Competition held at Widener Law School on March 13–16, 2014. Lawrence A. Hamermesh, Widener L. Sch. (2014), http://law.widener.edu/CampusLife/ActivitiesandOrganizations/MootCourtHonorSocietyDelaware/~/media/Files/mootcourtde/vale2014/2014problem.ashx.

proximately 250 in all) are members of the Mennonite Church USA (the Church) or are related by blood or marriage to members of the Church.[46]

Early in 2013, anticipating retirement, Bissinger concluded that selling his Praise Video stock would be an important step. After Bissinger informed the board of directors of his decision, the board retained financial adviser Norman Stoltzfus to explore possible alternatives. The board instructed Stoltzfus in particular to explore possible transactions in which Praise Video's stockholders in addition to Bissinger would be able to liquidate their investment.

Stoltzfus identified a number of potential bidders, including Mercer Christian Publishing Co., which had made explicit its interest in acquiring and expanding Praise Video's gaming division. Mercer expressed the view that with a modest capital infusion and as a result of synergies with Mercer's own publications and gaming operations, Praise Video's customer base could be dramatically expanded. Mercer suggested that an acquisition of Praise Video at a price "north of $40" was a distinct possibility.

Upon being informed of Mercer's interest and its views about the potential acquisition, Stoltzfus reported to the Praise Video board in June on the results of his exploration of strategic alternatives. Following his report, the directors complimented Stoltzfus on the quality of his work. But when Bissinger inquired about how Mercer would achieve the synergies and enhanced revenues it had predicted, Stoltzfus indicated that considerable market growth might be anticipated in the area of combat-oriented video games. This indication provoked considerable consternation on the part of several of the directors, including Bissinger. They expressed their view that expansion into military-type games violated the religious obligation, expressed in formal Church doctrine, to "witness against all forms of violence, including war among nations, hostility among races and classes, abuse of children and women, violence between men and women, abortion, and capital punishment."

The board asked Stoltzfus to redouble his efforts to identify potential bidders who might be able to offer the best price while at the same time addressing the expressed concerns about the direction of future operation of the company's business. The board's

[46] Praise Video's certificate of incorporation includes a qualification provision, authorized under Del. Code Ann. tit. 8, § 141(b) (2013), requiring that all directors of the corporation be members of the Church. Upon consummation of the merger, Praise Video's certificate of incorporation, including the director qualification provision, will be replaced by the certificate of incorporation of Praise New Hope, Inc., which does not contain any similar qualification provision, nor does it contain any public benefit provision.

request to Stoltzfus to extend the search for potential bidders bore unexpected fruit: Francis Pennock, another Praise Video director, concluded that he could assemble a bid that would provide a price at least as great as what Mercer had preliminary suggested, while continuing to operate Praise Video's business as it had been operated to date, and without expanding into new, religiously questionable forms of digital entertainment. Consistent with that conclusion, Pennock and Miller Price formed New Hope Publishing Co. (New Hope)[47] and communicated to Stoltzfus an interest in submitting a bid to acquire Praise Video.

At this point, in mid-November 2013, and with unanimous approval of Praise Video's board (with Pennock abstaining and absenting himself from further deliberation), Stoltzfus directed Mercer, New Hope, and the three other potential bidders to submit their best bids (accompanied by forms of merger agreement and any other related documentation) by the close of business on December 5, 2013. Only Mercer and New Hope submitted bids, of \$50 per share and \$41 per share, respectively. Both bids were fully financed, and conditioned, as usual, on approval by Praise Video's stockholders. Despite Praise Video's request for it, neither bidder agreed that the company's post-merger certificate of incorporation would include the public benefit provision in Praise Video's existing charter. Both bidders demanded standard no-shop commitments, and both bidders proposed termination fees equal to about 3% of the enterprise value reflected in the bid.

New Hope, however, conditioned its bid on an additional concession: namely, the grant by Praise Video of an option (the Gaming Option) to acquire Praise Video's gaming division for \$18 million, payable in 5-year installment notes, if the New Hope merger failed to gain the necessary Praise Video stockholder approval.[48] New Hope recognized that it would be unlikely to be able to outbid Mercer from a financial point of view, yet it wanted assurance that even a bid that was significantly inferior from a financial perspective would still have a strong chance of succeeding. In support of its request for the Gaming Option, New Hope under-

[47] Pennock is a significant stockholder (approximately 20%) of New Hope, and plans to serve as Praise Video's CEO following the merger. New Hope's majority (80%) stockholder is Miller Price L.P., a Delaware limited partnership (Miller Price), which is engaged in venture capital investment focusing on portfolio companies that seek to balance financial gains with religious values. Isaac Miller, one of Miller Price's two principals, is a member of the Church, although his equal partner Stephen Price is not.

[48] More precisely, the Gaming Option becomes exercisable if (A) the merger agreement is terminated due to failure of Praise Video stockholders to approve it, and at or prior to the time of such termination a proposal to acquire Praise Video has been announced or made to Praise Video's board and not bona fide withdrawn, and (B) within twelve months of such termination Praise Video is acquired or enters into a definitive agreement to be acquired.

took that Pennock would be the CEO of Praise Video following an acquisition, and so long as he remained CEO he would operate Praise Video to the best of his ability in a manner consistent with the values of the Church. New Hope thus submitted the agreement embodying the Gaming Option to Praise Video as part of its bid package. The exercise price in the Gaming Option is about $12 million or some 40% below the actual $30 million value of the gaming division, an increment equivalent to about $12 per outstanding Praise Video share.

The directors of Praise Video met on December 9, 2013, for over seven hours, to evaluate and determine how to respond to the bids. Stoltzfus and the company's counsel painstakingly reviewed the background of the bidding process, and the likely impact of the Gaming Option.

As in the June 24 board meeting, Bissinger expressed deep concern about the prospect that Praise Video, after an acquisition by Mercer, would expand its operations into games with combat simulations. In addition, and even though they recognized the religious integrity of Mercer's stated mission, they expressed misgivings about the potential impact of Mercer's status as a wholly-owned subsidiary (and thus subject to the ultimate control) of Mercer Media, a secular, multinational media conglomerate.
According to the minutes of the December 9 board meeting, the Praise Video directors carefully evaluated the details of the New Hope and Mercer bids and voted (with Pennock absenting himself) to approve the New Hope bid because it appropriately balanced the stockholders' pecuniary interests, the best interests of those materially affected by Praise Video's conduct, and the public benefit identified in its certificate of incorporation. With respect to the Gaming Option, the Praise Video directors recognized that the acknowledged undervaluation reflected in the exercise price would likely encourage many Praise Video stockholders to vote in favor of the merger, even if they individually would have preferred Mercer's higher cash bid under the circumstances.

Analysis

Upon a challenge by a Praise Video stockholder who does not share the religious convictions of the directors, a court would have to determine whether the Praise Video directors sufficiently discharged their fiduciary duties. This question can be broken into at least two parts: (a) according to section 362(a) of the DGCL, have the directors acted "in a manner that balances the stockholders' pecuniary interests, the best interests of those materially affected by the corporation's conduct, and the public benefit or public benefits identified in its certificate of incorporation"?[49]; and (b) to what extent, if at all, does the corporation's PBC status dispense with the fiduciary limits on deal protection measures (like crown jewel options)[50] established under *Revlon* and its progeny?

1. The Balancing Act

Delaware case law has embraced the precept that in managing the affairs of the corporation, directors are required to pursue the maximization of stockholder gain. Even in managing the corporation's ordinary business affairs, directors may take into account interests other than stockholder gain, "provided there are rationally related benefits accruing to the stockholders."[51] And when the corporation is sold for cash, as in the hypothetical under discussion, the stockholder wealth maximization mandate becomes even clearer: "the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder."[52]

We would expect, however, that these precepts would operate differently in the case of a PBC. First, it seems clear that stockholder pecuniary gain is no longer the only permissible objective, and nothing in the PBC statute suggests that its balance requirement is limited to situations not involving the sale of the company. To the contrary, it seems likely that one of the motivating factors behind enactment of the PBC statute was the desire of entrepreneurs for assurance that in their vitally important, last period decision to sell the company, they could still bring to bear the considerations of public purpose that led them to create and operate the PBC. Moreover, and even in the context of a sale of the company, a court would likely have to reckon with the statutory rule that a director is protected from claims of breach of fiduciary duties if, when making the balancing decision, he or she is "both informed and disinterested" and such decision is "not such that no person of ordinary, sound judgment would approve."[53]

But despite that loose, deferential standard of review, will courts really abandon the level of scrutiny they have come to apply to a sale of the com-

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[49] tit. 8, § 362(a).

[50] An option granted to one bidder to acquire a uniquely important and valuable corporate asset (a crown jewel) at a price substantially below its value will tend to reduce the value of the corporation to a competing bidder and, if the value disparity is significant enough, will eliminate the other bidder's incentive to offer a superior bid. Thus, in Revlon itself, the court invalidated what it described as a "lock up option," granted to the board-favored bidder, to acquire two of Revlon's key divisions at a price that was $100–175 million below their value. Revlon Inc. v. MacAndrews & Forbes, Inc., 506 A.2d 173, 179 (Del. 1986). In this circumstance, the court concluded "the result of the lock-up was not to foster bidding, but to destroy it." *Id.* at 183.

[51] Revlon, 506 A.2d at 183; *see also* eBay Domestic Holdings, Inc. v. Newmark, 16 A. 3d 1, 33 (Del. Ch. 2010) ("Promoting, protecting, or pursuing non-stockholder considerations must lead at some point to value for stockholders.").

[52] Revlon, 506 A.2d at 182.

[53] tit. 8, § 365(b).

pany? To be sure, it seems nearly impossible for a court to second-guess director judgment about a tradeoff between stockholder pecuniary gain and accomplishment of the PBC's stated public benefit. In the hypothetical presented above, how could a court evaluate whether a "person of ordinary, sound judgment would approve" of foregoing 20% of the value of the company in order to preserve and promote a deeply held religious view?

On the other hand, the courts might appropriately examine the extent to which, once a sale of the company occurs, any meaningful, enforceable undertaking exists that assures the seller's board and stockholders that the public benefit will be achieved once the merger is accomplished.[54] In one sense, once the company is sold, the sellers no longer have any direct concern with how the company is operated: they no longer own it, and they certainly don't control it. In the hypothetical, the surviving corporation did not take on the selling company's public purpose charter provision, and there was no formal mechanism in place that afforded Praise Video and its stockholders any assurance that following the merger the business would continue to promote the company's pre-merger public purpose. There might have been a rational basis to believe that Pennock, the post-merger CEO, would be likely to promote that purpose, but there was no assurance as to how long he would continue as CEO. Would a court consider that rational basis sufficient, weighing in the statutory balance, to justify the board's preference for a $41 deal instead of a $50 deal, at a cost of about $9 million of stockholder pecuniary gain?

It is possible that courts might continue to apply the heightened *Revlon* standard with respect to the total value achieved in a change of control transaction.[55] Under this approach, even though the deferential section 365(b) standard would apply to allocating and balancing value among the stockholders and public beneficiaries, a court might apply a reasonableness standard to the total value maximizing process. Such a standard might create room for a challenge to the board's promotion of a lower-priced deal if they fail to secure effective commitment to continue, post-merger, promotion of the public benefit value that the board sought in selling the Praise Video to New Hope.

2. *Whither Deal Protections?*

In the sale of a traditional, for-profit Delaware corporation, deal protection measures (such as termination fees, no-shop provisions, and matching

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[54] That issue is the subject of the third hypothetical. *See infra* Part III.

[55] *See* Revlon, 506 A.2d at 184 ("[W]hen bidders make relatively similar offers, or dissolution of the company becomes inevitable, the directors cannot fulfill their enhanced *Unocal* duties by playing favorites with the contending factions. Market forces must be allowed to operate freely to bring the target's shareholders the best price available for their equity.").

rights) are common and regularly upheld.[56] Those measures are subject, however, to a now well-established standard of judicial review, known as "enhanced scrutiny," because they may implicate the stockholders' right to "effectively vote contrary to the initial recommendation of the board in favor of the transaction."[57] The *Unocal* formulation of the "enhanced scrutiny" standard of review, while easy to state—the directors must demonstrate that they reasonably perceived a threat to the corporation and that the challenged action was reasonable in relation to that threat[58]—presents some challenging issues when applied in the context of a PBC.

The first issue is whether the deferential standard of section 365(b), which provides that directors are deemed to have satisfied their "fiduciary duties to stockholders and the corporation" as long as their decisions were "both informed and disinterested and not such that no person of ordinary, sound judgment would approve" applies "to a decision implicating the balance requirement" among stockholders and public beneficiaries.[59] Put more bluntly, are directors of a PBC free to adopt deal protection measures of any deterrent effect they choose, as long as they can plausibly assert that they did so in an effort to balance pecuniary and public purposes? Or is the integrity of the stockholder vote as important in the PBC context as in the ordinary corporate situation, such that the rationale for enhanced judicial scrutiny would be present in the same degree and call for the same level of judicial scrutiny? While it appears that a deal protection device such as the Gaming Option implicates the balance requirement, it might be argued that the statute was only meant to address matters within board authority, and not to allow the board more authority or influence over matters that come within stockholder authority, such as votes on mergers, so that *Unocal* would still apply.

Assuming the stricter standard did apply, it is still the case that what might not constitute a cognizable threat to a traditional, for-profit corporation might well constitute such a threat to a PBC. If so, the range of permissibly identifiable threats to a PBC would extend to threats to the accomplishment of the PBC's stated public purpose, as well as threats of a more traditional, financial type. For example, the potential that Mercer would cause Praise Video to enter a line of business (combat simulation games) that would be inconsistent with the promotion of Mennonite values could be characterized as a threat to the corporation, given its identified public benefit. On the other hand, it could be argued that the "risk" of stockholders' voting down a transaction is no threat at all, and a deal protection device designed to prevent or inhibit such an outcome is impermissible. In-

[56] *E.g.*, *In re* Orchid Cellmark Inc. S'holder Litig., No. 6373-VCN, 2011 WL 1938253, at *6–7 (Del. Ch. May 12, 2011).

[57] Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 930 (Del. 2003).

[58] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

[59] tit. 8, § 365(b).

deed, it could be argued that since the balancing required for PBC's is inherently subjective, the shareholders' vote on a merger (expressing their judgment on the balance) is as, if not more, important than the directors' decision. Thus, there should be little or no hindrance to the stockholders of a PBC making the ultimate balancing decision by their votes on a proposed merger.

Likewise, in the setting of a traditional, for-profit corporation, courts will uphold a non-preclusive deal protection measure if it is demonstrated to be within a "range of reasonableness."[60] The standard is fairly deferential,[61] but one could well ask if it would be even looser in the case of a PBC. Finally, if judicial scrutiny of proportionality is appropriate, how will courts engage in an evaluation of proportionality and the significance of action to address a threat to the corporation's public purpose? This question is very similar to the one presented in Section I regarding the courts' ability or willingness to assess how the directors handle the statutorily required balancing of interests. In the hypothetical, would a reviewing court feel equipped to evaluate whether the Gaming Option's tendency to skew a stockholder vote in favor of the board-preferred New Hope merger was reasonable in relation to the benefit of avoiding a post-merger threat to Mennonite values? In such a case of evaluating the content and significance of religious beliefs, the answer is particularly likely to be no.[62]

III. Hypothetical #3: What Assurances do Stockholders of a PBC Have that the Company Will Continue to Promote the Specified Public Benefit Post-Merger?

As the preceding hypotheticals suggest, in the context of a sale of the corporation, many PBC stockholders may be concerned with preserving the values the PBC served and which animated their investment. Are there means for selling stockholders to perpetuate the PBC's adherence to its benefit purpose, and how effective will such measures be? This hypothetical explores these questions.

Hypothetical

> Pet Right Inc. founded by Joe and Mary, manufactures organic food for dogs and cats. Products are sold through animal

[60] Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361,1388. (Del. 1995).

[61] *See* Paul L. Regan, *What's Left of Unocal?*, 26 Del. J. Corp. L. 947, 967–69 (2001).

[62] Delaware courts have traditionally been reluctant to make theological determinations. *See* United Church of Lord Jesus Christ of Apostolic Faith v. Price, No. 6232, 1984 WL 19828, at *3 (Del. Ch. Oct. 23, 1984) (commenting that it is not within the province of Delaware courts to settle disputes that are "more theological than legal") (citing Bouchelle v. Trs. of Presbyterian Congregation at Head of Christiania in New Castle Cnty., 194 A. 100, 103 (Del. Ch. 1937)).

specialty stores and veterinary hospitals. Pet Right targets its marketing to consumers who believe their pets' consumption of meat or plant material raised with chemicals adversely affects the animals' long term health and life span. Customers are generally willing to pay a premium, and Pet Right has enjoyed high operating margins.

Joe and Mary are also significant supporters of no-kill animal shelters. Each volunteers at a local shelter one day a week. Since they started Pet Right, they have contributed approximately a third of the company's products to animal shelters. As Pet Right's business grew, the amount of food the company made available to shelters increased proportionately, and Joe and Mary were able to contribute food to an increasingly large number of shelters.

Growing demand for organic products from farms, including for human consumption, began to constrain the growth of Pet Right's business. Pet Right could not take on as many new customers as sought to buy its products, and was at times unable to supply all the product existing customers requested. Instead of meeting the commercial demand by reducing the amount of food donated to shelters, Joe and Mary decided to maintain the supply to shelters and increase prices to customers to curtail commercial demand.

After Delaware's PBC legislation became effective on August 1, 2013, Joe and Mary created New Pet Right PBC as a Delaware PBC. They merged Pet Right into New Pet Right PBC, with the latter as the surviving corporation, and then renamed it Pet Right PBC (PRPBC). The designated specific public purpose, pursuant to section 362(a)(1) of the DGCL, was to contribute to maintaining the ability of no-kill animal shelters to provide housing, food, medical care, and attention to homeless dogs and cats.

Due to continued strong demand for PRPBC's products, Joe and Mary were able to increase prices and generate substantial profits, while continuing their support for animal shelters. Major national pet food producers noticed the popularity of Pet Right products, and could estimate from store prices that PRPBC was significantly profitable. Gobble It Up Pet Foods (Gobble) approached Joe and Mary about acquiring PRPBC. After discussions, entry into a confidentiality agreement, and due diligence, Gobble offered Joe and Mary such a hefty price for PRPBC that they seriously entertained selling it.

One of their articulated goals in the acquisition negotiations was to maintain the company's support for animal shelters. They told Gobble they would moderate their price aspirations in return for Gobble's commitment to continue providing food to animal shelters. Gobble, noting that it already donated food to animal shelters around the country, expressed a general willingness to maintain PRPBC's continued donations to shelters, but said it had to have some flexibility to adjust practices to business demands over time.

Joe and Mary ultimately agreed to sell PRPBC to Gobble. The merger agreement, to which Joe, Mary, PRPBC, and Gobble were parties, provided among other things as follows:

1. Among the initial recitals was a statement that "Gobble acknowledges that from its inception PRPBC has provided significant support to no-kill animal shelters and both Sellers and Gobble desire that PRPBC continue to support no-kill animal shelters."
2. PRPBC would become a wholly-owned subsidiary of Gobble after the merger. Joe and Mary would have two of five seats on PRPBC's Board, and both would remain as PRPBC executives for one year, subject to extension by mutual agreement.
3. Gobble would not seek to amend PRPBC's certificate of incorporation, or otherwise change its PBC status, until ten years after the latter to pass on of Joe and Mary.
4. The business would be sold at a price 20% lower than Joe and Mary's financial advisor had counseled could be obtained in the market without the foregoing constraints.
5. Delaware law would govern interpretation and enforcement of the agreement and litigation of any such disputes must be brought in Delaware courts.

The Gobble/PRPBC marriage was successful. PRPBC added to Gobble's profitability, and Gobble continued contributing approximately a third of the Pet Right food production to shelters. A year later, however, Hungry Dog Corp. (HD) began a hostile tender offer for Gobble at a price that attracted such a large number of Gobble shares that its board negotiated a merger, with a go-shop period that ultimately did not result in a higher bid. Gobble became a wholly-owned subsidiary of HD, which replaced Gobble's board with members of HD's management. PRPBC remained a wholly-owned subsidiary of Gobble, and Joe and Mary remained on PRPBC's board, a majority of whose members now were HD executives.

HD quickly determined that it could increase Gobble's, and thereby its own, profitability by limiting PRPBC's largesse to shelters. HD's managers on PRPBC's board acted to reduce the percentage of Pet Right production contributed to shelters from 33% to 5%. HD then had PRPBC, which was enjoying enhanced cash flow from increased commercial sales of Pet Right foods, buy non-organic pet foods from HD at prices 20% above wholesale and donate that food to shelters. While the resulting quantity of food

PRPBC was contributing to shelters was about 75% of the pre-HD acquisition donations, if one valued Pet Right food at PRPBC's wholesale prices, PRPBC was contributing the functional equivalent of 12% of its food production to shelters.

Joe and Mary became incensed by the reduction in quantity and quality (in their perception) of pet food the company was now contributing to shelters. They consulted Angela Justice, the lawyer who had assisted them in converting Pet Right to a PBC and who had represented them in connection with Gobble's acquisition of PRPBC, about possible avenues for relief.

Analysis

1. Do Either HD, Gobble, or Both Owe Any Obligation to Joe and Mary?

For the purposes of this question, assume that Joe and Mary do not own HD stock. Joe and Mary's rights would depend on the provisions of the Gobble/PRPBC merger agreement. The agreement expressly provided that Gobble would not amend PRPBC's certificate of incorporation for a specified time, thereby continuing the benefit purpose of assisting no-kill animal shelters. HD has not amended the certificate of incorporation and has continued to provide such assistance, while changing the amount and manner of the assistance. Since the agreement was not specific on either point, Joe and Mary could only turn to the implied covenant of good faith and fair dealing, which inheres in every contract governed by Delaware law.[63] To succeed on an implied covenant claim, however, Joe and Mary would have to demonstrate that both they and Gobble had a more particular understanding of how Gobble would maintain PRPBC's benefit purpose and failed to express that understanding in the agreement. It would not be enough to show that with the benefit of hindsight Joe and Mary wished that they had bargained for a more specific provision governing how Gobble would continue PRPBC's animal shelter donations.[64] The success *vel non* of such a claim would depend on evidence of the course of negotiation of the merger and the agreement.[65]

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[63] *E.g.*, eCommerce Indus., Inc. v. MWA Intelligence, Inc., No. 7471-VCP, 2013 WL 562178, at *33 (Del. Ch. Sept. 30, 2013).

[64] *E.g.*, Winshall v. Viacom Int'l, Inc., 76 A.3d 808, 816 (Del. 2013).

[65] Delaware courts have not infrequently delved into the intricacies of merger negotiations. *See, e.g.*, United Rentals, Inc. v. RAM Holdings, Inc., 937 A.2d 810 (Del. Ch. 2007).

2. *Would It Matter if Joe and Mary Owned Stock of HD?*

Joe and Mary could seek to assert a triple derivative action to enforce PRPBC's charter. They would have had to own HD stock before the HD-installed Board of PRPBC implemented the changes that dissatisfied them.[66] If Joe and Mary attempted to satisfy the Rule 23.1 demand futility requirement by pleading a conflict between the obligations that directors of the three corporations owe to HD and PRPBC,[67] the Gobble and PRPBC boards could point to *Anadarko Petroleum Corp. v. Panhandle Eastern Corp.*,[68] which holds that directors of a wholly-owned subsidiary are obligated only to manage the subsidiary in the best interests of the parent and its shareholders. Thus, the HD directors owe their fiduciary obligations to HD rather than PRPBC and would assert they have no conflict. In any event, the PRPBC directors who are HD executives would assert that they in fact conducted the balancing that section 365 of the DGCL requires, and Joe and Mary simply disagree with their judgment. Joe and Mary would face an uphill climb to plead demand futility.

3. *If Joe and Mary Can Fashion Either Derivative or Direct Claims, What Relief is Possible?*

Whether a court would grant injunctive relief requiring a different balance among the pecuniary interests of HD and its shareholders, pursuit of PRPBC's specific public purpose, and the best interests of those materially affected by the corporation's conduct under section 365(a) is questionable. Substantively, section 365 gives PBC directors considerable flexibility; Mary and Joe would be hard-pressed to persuasively challenge the balance the PRPBC board struck. From a remedial perspective, an injunction would require the court to supervise for an extended period of time any different

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[66] DEL. CODE ANN. tit. 8, § 327 (2013); *see* Schreiber v. Bryan, 396 A.2d 512, 516 (Del. Ch. 1978).

[67] Court of Chancery Rule 23.1 prescribes what is commonly referred to as the demand requirement for maintaining a derivative action, i.e., a stockholder who wishes to assert a claim derivatively on behalf of a corporation must allege with particularity either the efforts the stockholder made to have the corporation assert the claim, or reasons why such efforts would be futile. *See generally* Aronson v. Lewis, 473 A.2d 805 (Del. 1984). To establish demand futility, the shareholder must allege particularized facts demonstrating a reasonable doubt that the directors at the time the case is brought are disinterested or independent, or that the challenged transaction is otherwise the product of a valid exercise of business judgment. *Id.* at 814. The demand requirement has generated an extensive body of case law, which is beyond the scope of this Article. *See generally* DONALD J. WOLFE & MICHAEL A. PITTENGER, *Corporate and Commercial Practice in the Delaware Court of Chancery* §902(b)(3) (6th ed. 2005). One means available to a shareholder-plaintiff to establish demand futility is to plead specific facts demonstrating that a majority of the directors are fiduciaries (e.g. officers, directors, general partners or managers) of an entity in addition to the corporation, and that the interests of that entity conflict with the interests of the corporation with regard to the subject matter of the suit. *See, e.g.,* Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984) ("Directorial interest exists whenever divided loyalties are present . . .").

[68] 545 A. 2d 1171, 1174 (Del. 1988).

balance it decided to impose, effectively putting the court in the position of continually overseeing the PRPBC directors, a supervisory task to which few courts aspire.[69] A provision in the Gobble/PRPBC merger agreement specifically acknowledging the availability of injunctive relief to enforce agreement terms could give the court some comfort in using its injunctive authority. A different approach might arise from other contexts in which the Court of Chancery has appointed a custodian or receiver empowered to make judgments when directors are deadlocked.[70] Such cases could serve as precedent for similar orders in PBC litigation.

As to damages, Joe and Mary might fashion a claim based on the difference between the fair market value of PRPBC when Gobble acquired it and the merger price, asserting that if Gobble, now owned by HD, will not honor the benefit commitment, Joe and Mary should be entitled to the price they could have otherwise obtained for PRPBC.

4. Was PRPBC Properly Constituted As A PBC?

If HD and its directors are named as defendants in a lawsuit, can they viably contend that PRPBC was never properly a PBC because its specific purpose does not qualify under section 362(b)? If PRPBC were never properly a PBC, then the PBC statute could not be asserted to govern the directors' conduct, and their only obligation would be to manage PRPBC for the benefit of HD and its stockholders.

The definition of "public benefit" in section 362(b) is "a positive effect . . . on 1 or more categories of persons, entities, communities or interests . . . " and uses examples drawn from human endeavors, "effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature."[71] Most of us likely would agree that caring for homeless animals is laudable, but does it fit within these categories? Are animals within "persons, entities, communities or interests"? An affirmative answer is the likely result. "Interests" is a flexible term that could be infused with a broad range of content, and could readily be seen as reflecting a legislative intent to be as liberal as possible with regard to permissible public benefits. Consequently, an effort to avoid PBC obligations by this type of technical statutory construction is not likely to succeed.

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[69] *See, e.g.*, Giuricich v. Emtrol Corp., 449 A.2d 232, 240 (Del. 1982) ("The involvement of the Court of Chancery and its custodian in a corporation's business and affairs should be kept to a minimum and should be exercised only insofar as the goals of fairness and justice . . . require.").

[70] *Cf., e.g.*, Marciano v. Nakash, 1987 WL 10523 (Del. Ch. Apr. 14, 1987) (deciding on the continuation of derivative claims when a custodian has been appointed).

[71] tit. 8, § 362(b).

5. *Takeaways for Drafting Subsequent Agreements.*

Selling stockholders of a PBC may want to not only assure that the acquirer will maintain the benefit provisions of the corporation's charter, but also continue to implement the benefit purpose substantially as the sellers did. Can sellers' counsel like Angela strengthen the provisions she negotiated for Joe and Mary in the Gobble/PRPBC merger agreement?

One improvement from the seller's perspective would be greater specificity as to how the corporation's business would be conducted post-merger. Here, for example, Joe and Mary could have sought a provision to the effect that Gobble would continue to donate one-third of food that PRPBC produces to animal shelters. A potential buyer, however, is likely to resist highly specific constraints on its post-merger management of the business. Such a provision becomes more difficult to enforce to the extent a buyer obtains greater flexibility to manage under varying business conditions.

An agreement provision expressly recognizing the permissibility of injunctive relief to enforce provisions intended to preserve the PBC's benefit mission would assist in an enforcement effort.

The standing issues described above could be resolved by a clause granting the sellers the right to enforce the public benefit provisions post-merger. Another means to empower an interested party to enforce the corporate mission would be a clause expressly conferring third-party beneficiary status on the recipients of the PBC's public benefit. For example, in this hypothetical, the agreement could contain a provision to the effect that the animal shelters receiving food from PRPBC at the time of the merger are intended beneficiaries of the agreement's provisions to maintain PRPBC as a PBC.

Conclusion

The enactment of Delaware's PBC statute ushered in a new form of business entity, created with rules of purpose and governance that differ markedly from the traditional for-profit corporation. As suggested in the hypothetical cases presented and discussed above, these new rules pose many unanswered questions in regard to mergers and acquisitions involving PBCs. To the extent that PBCs remain closely held by a cohesive group of like-minded stockholders with similar preferences regarding the balance between pecuniary gain and the corporation's stated public purpose, these questions likely can happily remain unanswered. If and when the ranks of PBCs become populated with more widely-held firms with disaggregated stockholders, however, courts are likely to address the questions posed above when they are called upon to resolve challenges to merger and acquisition transactions involving PBCs.