

WILL PUBLIC BENEFIT COMPANIES COMMIT SECURITIES FRAUD?

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I. INTRODUCTION

At least since the Business Roundtable's 2019 statement on the purpose of a corporation,¹ there has been substantial interest in shifting businesses away from shareholder wealth maximization. Such change might happen not only through reform of the governance of existing corporate giants but through the entrepreneurial ventures that may eventually become public companies. If a commitment to social responsibility is part of the culture of a new firm from the start, that commitment may develop deep roots that shape decision-making as the firm becomes successful and grows.

There has been a longstanding debate about whether the corporate form permits managers to pursue ends broader than shareholder wealth maximization. The law places barriers in front of corporate managers when they seek to benefit society rather than focus mainly on increasing the value of the corporation's equity.² Many states have thus created the option for entrepreneurs to form a different kind of entity, a Public Benefit Corporation (PBC), governed by law explicitly permitting managers of a business to also pursue social ends.

Michael Dorff has written an important book that both critically examines the potential of PBCs and provides guidance to the next generation of entrepreneurs as to how they can achieve social good through their work.³ His book thoroughly and critically examines the state law governing PBCs while making a compelling case that rational entrepreneurs should take into account stakeholder interests in building their businesses.

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1. *Statement on the Purpose of a Corporation*, BUS. ROUNDTABLE, <https://opportunity.businessroundtable.org/ourcommitment/> (last visited Jan. 9, 2025).

2. See STEPHEN M. BAINBRIDGE, *THE PROFIT MOTIVE: DEFENDING SHAREHOLDER VALUE MAXIMIZATION* 64 (2023).

3. See MICHAEL B. DORFF, *BECOMING A PUBLIC BENEFIT CORPORATION: EXPRESS YOUR VALUES, ENERGIZE STAKEHOLDERS, MAKE THE WORLD A BETTER PLACE* 5-6 (2024).

Dorff mainly examines issues of importance to the thousands of founders who may be considering whether to use a PBC or a corporation at the initial stages of starting a new business. There are only a few PBCs that have achieved public company status by selling stock widely to investors.⁴ At the time his book was written, there was a limited amount that could be said about public PBCs. In order for PBCs to have a substantial impact, at least some PBCs will need to achieve and maintain success as public companies. The importance of the PBC may be modest if it is a form of business organization that is mainly used by companies that stay small.

This review supplements Dorff's account by examining evidence from recent court filings and decisions to evaluate whether public PBCs can be expected to maintain their commitment to social purpose when they become subject to the pressures of public company status. It is difficult to directly observe how public PBC managers make decisions. However, because public companies must comply with stringent federal disclosure and anti-fraud statutes, it is possible to glean some information about public PBCs when they are subject to class actions alleging securities fraud filed by investors in federal court.

About a fifth of the public PBCs listed in Dorff's book are defendants in federal securities class actions.⁵ Several of these cases have generated decisions on motions to dismiss. Courts have so far declined to dismiss some of these lawsuits and in doing so have pointed to PBC disclosures that may be materially misleading. One decision found sufficient allegations to support a strong inference that PBC managers acted with fraudulent intent to deceive investors.⁶ In another instance, a public PBC was subject not only to a private lawsuit but also an SEC enforcement proceeding that it settled for \$30 million.⁷ This is a small sample, but it suggests that PBCs may be similar to public corporations in terms of the pressure they face to issue misleading statements.

Will PBCs commit securities fraud? Certainly, some PBCs will deceive investors despite their public commitment to social purpose. The initial evidence indicates that public PBCs are vulnerable to allegations of securities fraud, and some of those allegations may have merit. This is not a reason to conclude that PBCs do not have the potential to change the business world.

4. *Id.* at 166.

5. *See infra* note 31.

6. *See* Order Re Motion to Dismiss at 2, *Shankar v. Zymergen, Inc.*, No. 21-CV-06028-VC, 2022 WL 17259057 (N.D. Cal. Nov. 29, 2022).

7. *See* Press Release, SEC, SEC Charges Zymergen Inc. With Misleading IPO Investors About Company's Market Potential and Sales Prospects (Sept. 13, 2024), <https://www.sec.gov/newsroom/press-releases/2024-129>.

The lesson of the securities class actions filed against public PBCs is that founders should be especially careful to ensure that their PBCs are ready before they venture into public markets.

II. DORFF'S BOOK

One of Dorff's primary concerns is whether PBCs can be held accountable for their social commitments. Without some way of ensuring that they are serving social ends, it is unclear that PBCs will operate much differently from profit-maximizing corporations. Dorff spends significant time carefully analyzing state law mechanisms that seek to ensure that PBCs are true to their mission.⁸

PBC investors can bring an action similar to a derivative suit if they believe that a PBC is not fulfilling its social purpose.⁹ Any holder of at least two percent of a class of PBC stock "may bring a benefit enforcement proceeding for any failure of the BC to create a general public benefit or any specific public benefit the BC has included in its corporate charter as part of its purpose."¹⁰

In addition, PBC law recognizes that transparency is essential to ensuring that PBCs fulfill their social mission.¹¹ The Model Act requires that a PBC prepare a "benefit report" on an annual basis that is available to the public and filed with the secretary of state.¹² Delaware requires a similar report for PBCs, but only on a biennial basis.¹³ The Delaware report is only available to shareholders rather than the general public.¹⁴ Delaware does not require the report to comply with any third-party standard.

PBCs have significant discretion in what they reveal in these reports.¹⁵ They could be similar in length and content to an SEC filing. They also may not disclose nearly as much.

Dorff is somewhat skeptical of the effectiveness of state law enforcement mechanisms in ensuring that PBCs create social benefits. One problem is that there are no penalties for the failure to file a benefit report.¹⁶

8. See DORFF, *supra* note 3, at 3.

9. *Id.* at 58.

10. *Id.*

11. *Id.* at 175.

12. *Id.* at 62.

13. *Id.* at 73.

14. *Id.* at 109.

15. *Id.* at 111.

16. *Id.* at 112.

Dorff thus concludes that state PBC law does “not contain good enforcement tools to ensure these companies pursue a social purpose.”¹⁷

As with corporations, state law governing PBC governance is supplemented by federal law that requires truthful disclosure if a PBC sells securities to the general public.¹⁸ Dorff identifies 14 PBCs that had gone public at the time he finished the book.¹⁹ Dorff observes that investors in such public PBCs will have access to more mechanisms for enforcement.²⁰

III. INCENTIVE TO COMMIT SECURITIES FRAUD

Corporate managers can mislead investors by issuing material misstatements about their company to investors. In doing so, they can induce investors to pay too much for the company’s stock. Some misrepresentations are issued by mistake. Other misrepresentations are made as part of a concerted scheme to commit securities fraud.

There are two explanations for why corporate managers commit securities fraud.²¹ The first is for personal gain. Securities fraud is another example of the agency costs problem in corporations. The corporation and its shareholders, the principal, must rely on managers, the agents, who can act disloyally. Managers may issue misleading information to temporarily inflate the company’s stock price to maximize the value of their personal stock compensation, even when doing so harms the corporation and its long-term shareholders. The second reason managers may deceive investors is to advance the interests of the corporation. Shareholders typically want a higher stock price, and it is the job of managers to achieve it. Disclosures that shade or hide the truth to meet short-term projections or hide bad news can be motivated by the desire to maintain or grow the corporation’s market value. Shareholders and corporate stakeholders benefit when the corporation has easier access to capital that comes from a higher stock price.

There is an argument that these two motivations for securities fraud will be less of a concern for PBC managers. The typical managers of a PBC will be less driven by personal profit than the managers of a for-profit corporation. They will be less likely to manage a PBC in a way that artificially inflates

17. *Id.* at 125.

18. *Id.* at 136. On the distinction between corporate and securities law, see James J. Park, *Reassessing the Distinction Between Corporate and Securities Law*, 64 UCLA L. REV. 116, 116 (2017).

19. See DORFF, *supra* note 3, at 166-67. In addition, there are subsidiaries of public companies that are PBCs. *Id.* at 191.

20. *Id.* at 204.

21. For a fuller discussion of this point, see James J. Park, *Shareholder Wealth Maximization and Securities Fraud*, 72 DEPAUL L. REV. 395, 395 (2023).

the price of its stock so they can exit their investment. There will always be a few unscrupulous individuals who set up a PBC to steal from investors, but hopefully, such theft will be rare. Moreover, because the PBC will have a broader purpose than to maximize shareholder wealth, it should be less likely that PBC managers will try to issue misleading information about the PBC's financial performance. Their investors understand that the PBC will not maximize profits and will not pressure PBC managers to deliver ever-increasing earnings.

On the other hand, because they have committed to a social purpose, PBCs may face pressure to regularly issue statements relating to whether they are fulfilling that mission. PBC managers may not always be forthright about problems that prevent them from acting in a way consistent with their commitments. Socially-minded investors may scrutinize PBC statements more closely and be upset if they believe there is a divergence between those disclosures and reality. Even profit-maximizing corporations have recently seen an increase in litigation claiming that they misled investors about their commitment to social responsibility.²²

PBCs may be more likely to commit securities fraud when they go public than when they are private. The size and influence of a public company depends on its financial performance. In modern stock markets, a significant market valuation must be constantly earned by delivering strong results that support the belief that a company will generate profits in the future. In my own book, *The Valuation Treadmill: How Securities Fraud Threatens the Integrity of Public Companies*, I argue that the emergence of such pressures made securities fraud a systemic risk for public corporations.²³ Regardless of a public company's social purpose, it is subject to a valuation treadmill that will determine its success as a public corporation.

If the managers of a public PBC are subject to the same pressures as the managers of a public corporation, it is unclear that public PBCs will respond differently to such pressure. PBC managers may be concerned about the value of their personal investments in the PBC. Even if they are publicly minded, a substantial portion of their wealth will depend on maintaining the PBC's stock price. Even if a PBC investor is committed to social responsibility, does that mean that their interests would be served if the value of their investment becomes worthless?

22. See James J. Park, *ESG Securities Fraud*, 58 WAKE FOREST L. REV. 1149, 1149, 1151 (2023).

23. See JAMES J. PARK, *THE VALUATION TREADMILL: HOW SECURITIES FRAUD THREATENS THE INTEGRITY OF PUBLIC COMPANIES* 1-2 (2023).

Public PBC managers can face pressure to issue misleading information to defend the stock price of the PBC. If they do so with intent to deceive, they would be committing securities fraud.

IV. PUBLIC PBCS

Because a number of PBCs have gone public, we can examine how they react to pressures that may increase the likelihood they will commit securities fraud.²⁴ Investors have sued several PBCs for material misstatements, and initial court decisions indicate that there may be merit to some of these claims.

Public PBCs have generally performed poorly since the publication of Dorff's book. Of the fourteen public PBCs listed in the book,²⁵ ten have seen substantial declines in their stock price.²⁶ Two companies, AppHarvest and Zymergen have filed for bankruptcy.²⁷ Other public PBCs have lost sufficient value so that there is talk of a bankruptcy filing. Only three companies have been successful in maintaining substantial market valuations.²⁸

It should not be a surprise that many PBCs have faced struggles soon after going public. Many new public companies fail and have major setbacks in their first few years as reporting companies. Today's markets seem to favor the very largest technology giants rather than smaller companies laboring in industries that are not viewed as having significant growth potential.

The failure of many public PBCs highlights the pressures faced by public companies. Unless they convince investors that their financial performance will continue to be strong, they will not be able to continue as public corporations. Delivering strong quarterly and yearly financial performance

24. Modern securities regulation is built to address these pressures. See James J. Park, *The Need for Sarbanes-Oxley*, 78 BUS. LAW. 633, 633-35 (2023).

25. See DORFF, *supra* note 3, at 166.

26. These companies include Allbirds, AppHarvest, Broadway Financial, Coursera, Kronos Advanced Technologies, Lemonade, Planet, Warby Parker, Zevia, and Zymergen. See DORFF, *supra* note 3, at 238-39.

27. See Notice of Chapter 11 Bankruptcy Cases at 1, *In re Zymergen Inc.*, No. 23-11661(KBO) (Bankr. D. Del. Oct 23, 2023); Entry of Order Confirming the Second Amended Joint Plan of Liquidation, *In re AppHarvest Products, LLC.*, No. 23-90745 (CML) (Bankr. S.D. Tex. Dec. 5, 2023).

28. These companies are Veeva, Amalgamated Bank, and United Therapeutics. See DORFF, *supra* note 3, at 77, 79, 237-39. Vital Farms has maintained its valuation, but it is a fairly small public corporation with a market capitalization of about \$1 billion.

will be essential for a public PBC to maintain a substantial market value.²⁹ A PBC that sees its stock price fall significantly will not be able to raise additional funds. Without such funds, it may not have sufficient liquidity to avoid bankruptcy. In bankruptcy, it will be difficult for the initial PBC managers to continue their control of the organization. Many PBCs and their managers will thus struggle to maintain a pure commitment to their social purpose when their survival as a public company is at stake.

A sharp decline in stock price will prompt an initial investigation of a public PBC for securities fraud. Enterprising plaintiffs' attorneys will scrutinize the PBC's disclosures to determine if there were any material misrepresentations. Angry investors will be easily persuaded to serve as plaintiffs in private lawsuits. Even if most of a PBC's investors are committed to social goals, so long as there are a few that are upset about losses, they can initiate a class action.³⁰ Given public PBC investor losses so far, it is not surprising that three of the fourteen public PBCs listed in Professor Dorff's book have been targeted by a federal securities class action.³¹ One of these companies was also subject to an SEC enforcement proceeding.³²

A. *Motions to Dismiss*

Not only have investors filed federal complaints against public PBCs, it is clear that some of these cases have merit. In two cases involving public PBCs, one brought pursuant to Section 11 and one brought pursuant to Rule

29. For a discussion of the pressure of quarterly projections, see James J. Park, *Do the Securities Laws Promote Short-Termism?*, 10 U.C. IRVINE L. REV. 991, 991 (2020).

30. See DORFF, *supra* note 3, at 72.

31. See, e.g., Amended Class Action Complaint for Violations of the Federal Securities Laws, *Shankar v. Zymergen Inc.*, No. 3:21-CV-06028-JD (N.D. Cal. Feb. 24, 2022); Second Consolidated Amended Class Action Complaint, *In re AppHarvest Sec. Litig.*, Case No. 21-cv-7985-LJL (Aug. 12, 2022); Class Action Complaint for Violations of Federal Securities Laws, *Jingua v. Allbirds, Inc.*, No. 3:23-cv-01811-AMO (N.D. Cal. Sept. 15, 2023). There is also a case that was filed against a company that is not a PBC but mentioned in the book as an example of a company that initially sought B-Lab certification. See Second Amended Consolidated Class Action For Violation Of The Federal Securities Law, *In re The Honest Company, Inc. Securities Litigation*, No. 2:21-CV-07405-MCS-PLA (C.D. Cal. Mar. 8, 2024). It is notable that only a minority of the 11 public PBCs that suffered substantial market declines have been subject to a securities class action.

32. See PRESS RELEASE, *supra* note 7.

10b-5, the complaint has survived a motion to dismiss.³³

1. Section 11

When a company sells stock to the public, it must file an extensive disclosure document with the SEC.³⁴ This registration statement describes essential information about the company that is used by investors to value the stock. If there are material misrepresentations in the registration statement, Section 11 of the Securities Act of 1933 gives investors the right to bring suit against the issuer and other parties, such as underwriters, to recover part of their losses.³⁵ Section 11 is a harsh statute in that it does not require the plaintiff to establish fraudulent intent.³⁶ Even if the misleading information was the result of a mistake, the issuer is liable for investor losses.

a. Zymergen

Zymergen faced a Section 11 suit soon after its IPO in April 2021, which valued the company at \$5.2 billion.³⁷ The company was formed in Delaware in 2013 to develop products using biological research on microbes.³⁸ Its main product at the time of the IPO, Hyaline, was an “optical film designed for electronics companies to use for display touch screens in personal devices and other applications and would allow customers to make robust foldable touchscreens and high density flexible printed circuits.”³⁹

The company made statements about the potential size of the market for Hyaline and the timeline for generating revenue that the plaintiff alleged were

33. There is one suit against a public PBC that has not yet generated a final decision on whether the case can proceed past the motion to dismiss stage. Allbirds is the defendant in a Section 11 suit that was filed after its November 2021 IPO. Plaintiffs have alleged that its statements that it was “continuously seeking ways to engage” with consumers and that it was committed to “high quality and high performance” were misleading in light of company decisions to underinvest in core products. See Class Action Complaint for Violations of Federal Securities Laws at 3, *Jingua v. Allbirds, Inc.*, No. 3:23-cv-01811-AMO (N.D. Cal. Sept. 15, 2023). The initial complaint was dismissed but with leave to amend. See Order Granting Motion to Dismiss with Leave to Amend, *Shnyder v. Allbirds, Inc.*, No. 3:23-cv-01811-AMO (N.D. Cal. May 10, 2024). The plaintiffs then filed an amended complaint. See Consolidated Second Amended Complaint, *Jinghua v. Allbirds, Inc.*, No. 3:23-cv-01811-AMO (N.D. Cal. June 24, 2024).

34. See Registration Requirements for Securities, 15 U.S.C. § 78i(a) (2024).

35. See Civil Liabilities on Account of False Registration, 15 U.S.C. § 77k(a) (2024).

36. *Id.*

37. Order Instituting Cease-and-Desist Proceedings, Securities Act of 1933 Release No. 11303, ¶ 1 (Sept. 13, 2024).

38. See Amended and Reinstated Certificate of Incorporation of Zymergen, Inc.: A Public Benefit Corporation, SEC, (April 26, 2021), https://www.sec.gov/Archives/edgar/data/1645842/000114036121014347/nt10018776x15_ex3-1.htm.

39. Second Amended Class Action Complaint for Violations of Securities Laws at 5, *Wang v. Zymergen, Inc.*, Case No. 5:21-cv-06028-PCP (N.D. Cal. Mar. 4, 2024).

false. Less than four months after the IPO, the company acknowledged that the market for the product was significantly smaller than it had represented.⁴⁰ The company also acknowledged that the timeline it disclosed for generating revenue for the product was inaccurate.⁴¹

The district court agreed with the plaintiffs that there were sufficient allegations to conclude that the registration statement contained material misstatements.⁴² It pointed to the short timeframe between the filing of the registration statement and the acknowledgment that the information was incorrect. The fact that the company admitted to mistakes so soon after filing its disclosure supported the inference that the statements were false when they were included in the registration statement.⁴³ The complaint also noted that the SEC had initiated an investigation of the company.

The theory asserted against Zymergen was a fairly standard allegation that the company misled investors about one of its products. The success of technology companies often depends on their ability to successfully deliver a transformative breakthrough. Some companies set unrealistic goals and are reckless in describing the prospects of their technology.⁴⁴ When there are setbacks with a product, there is an incentive to hide bad news that will result in a dramatic adjustment to the company's stock price. If the allegations of the complaint are true, PBCs that develop new technologies face similar pressures.

The possibility that Zymergen issued a materially misleading statement is supported by the fact that the company settled an SEC enforcement action for \$30 million.⁴⁵ The SEC's complaint alleged that Zymergen conducted its IPO to raise needed funds after burning through \$800 million it raised through private offerings.⁴⁶ In addition to the misleading information about its primary product, the SEC alleged that Zymergen disseminated revenue projections it knew were false to research analysts.⁴⁷ These allegations could support the conclusion that Zymergen acted with fraudulent intent, but the

40. *Id.* at 4, 7.

41. *Id.* ¶¶ 11, 16.

42. Order re Motions to Dismiss at 2, *Shankar v. Zymergen Inc.*, No. 21-cv-06028-VC (2022), 2022 WL 17259057.

43. *Id.* at 3.

44. There is some evidence that Zymergen's prospects were uncertain from the start. See Angel Au-Yeung, *As Biology Manufacturing Company Zymergen Implodes, Correspondence with SEC Showed Early Doubts*, FORBES, (Aug. 3, 2021, 8:30 PM), <https://www.forbes.com/sites/angelaueung/2021/08/03/as-biology-manufacturing-company-zymergen-implodes-correspondence-with-sec-showed-early-doubts/>.

45. In re Zymergen, Inc., Securities Act Release No. 11303 (Sept. 13, 2024).

46. *Id.* ¶¶ 7-8.

47. *Id.* ¶ 23.

SEC's case only asserted claims under 17(a)(2) and (a)(3) of the Securities Act of 1933, which only require a showing of negligence.⁴⁸

Notably, Zymergen filed for bankruptcy. When so much market value is lost, judges may be more likely to conclude that allegations of securities fraud against the company have merit.⁴⁹ PBCs that see significant value destroyed may be more likely to be judged harshly by the courts and regulators.

b. The Honest Company

Investors also filed a Section 11 claim against The Honest Company, a public company discussed in Professor Dorff's book that is not a PBC but that has described its business in terms of a social mission of making safer baby products that are environmentally friendly.⁵⁰ The complaint argued that Honest's statements relating to its products were misleading.⁵¹ It claimed in its registration statement to be "dedicated to developing clean, sustainable, effective and thoughtfully designed products."⁵² It also disclosed that "[a]t the center of our product ecosystem are our diapers, which are a strategic consumer acquisition tool that acts as an entry point for our portfolio."⁵³ Plaintiffs argued that these statements were misleading given the number of customer complaints about the quality of the diapers.

A district court agreed that a motion to dismiss this claim should be denied.⁵⁴ It rejected the argument that Honest's statements were puffery that should not be taken literally. It agreed that the company misrepresented "the efficacy of Honest diapers as a vehicle for customer acquisition given customers' negative responses to Honest's new diaper product."⁵⁵

The securities class action against Honest illustrates how federal law permits private plaintiffs to question whether a company with a commitment to social responsibility is fulfilling its mission. Such companies will make representations about their commitment that will be scrutinized when they are not fulfilled. Public PBCs will likely face similar suits.

One view of the class action is that Honest misrepresented its dedication to consumers. On the other hand, in Honest's defense, the fact that there

48. *Id.* ¶¶ 5, 31.

49. *See, e.g.*, James J. Park, *Securities Class Actions and Bankrupt Companies*, 111 MICH. L. REV. 547 (2013).

50. *See generally* Second Amended Consolidated Class Action Complaint, In re The Honest Co. Sec. Litig., Case No. 2:21-cv-07405-CS-PLA (March 8, 2024).

51. *Id.* ¶¶ 6-8, 159.

52. *Id.* ¶ 113.

53. *Id.* ¶ 114.

54. Order Re: Motion to Dismiss at 13, In re The Honest Co. Sec. Litig., Case No. 2:21-cv-07405-CS-PLA (July 18, 2022).

55. *Id.* at 5.

were consumer complaints does not necessarily mean that the company was not committed to customers. Consumers can be difficult to satisfy. The difficulties faced by Honest illustrate how companies committed to social responsibility will be vulnerable to securities fraud allegations. They might be even more vulnerable than companies that do not make such commitments in their public disclosures.

2. Rule 10b-5

In addition to the decision permitting a case against a public PBC to proceed under Section 11, there is one decision finding that a plaintiff sufficiently alleged fraudulent intent for a case to proceed against a public PBC under Rule 10b-5. The defendant in that case was AppHarvest, which incorporated in Delaware as a PBC in January 2018 and became publicly traded in September 2020.⁵⁶ Plaintiffs filed a class action against AppHarvest in August 2021 after its stock price fell 29 percent after the company lowered its quarterly forecasts because it anticipated higher labor costs.⁵⁷

The complaint described AppHarvest as a “domestic producer of fruits and vegetables” that “grows all its crops indoors utilizing Controlled Environment Agriculture” rather than “traditional outdoor agriculture.”⁵⁸ Its sole growing facility is a 2.8 million square feet greenhouse located in Morehead, Kentucky.⁵⁹ It primarily grew tomatoes at the facility, which requires a trained workforce to properly harvest.⁶⁰

Because of the COVID-19 pandemic, the company was questioned about how the pandemic was affecting its workers. The company’s president represented in an interview in May 2021 that “COVID has not in any way impacted our operation,” and “we haven’t had any challenges with recruiting or staffing.”⁶¹ In February 2021 and March 2021, the company raised forecasts for its annual revenue.⁶² The company reaffirmed these forecasts in May 2021 and represented that it was “pleased by our fast start to the year, the encouraging operating and financial performance of our Morehead facility and our team’s ability to scale the business”⁶³

56. Second Consolidated Amended Class Action Complaint ¶¶ 28, 44, In re AppHarvest Sec. Litig., Case No. 21-cv-7985-LJL (Aug. 12, 2022).

57. *Id.* ¶ 21.

58. *Id.* ¶ 41.

59. *Id.* ¶¶ 1, 52.

60. *Id.* ¶ 3.

61. In re AppHarvest Sec. Litig., 684 F. Supp.3d 201, 260 (S.D.N.Y. 2023).

62. Second Consolidated Amended Class Action Complaint, In re AppHarvest Sec. Litig. ¶¶ 167, 173.

63. *Id.* ¶ 199.

The complaint alleged that these statements were materially false.⁶⁴ It claimed that AppHarvest did not adequately train its workers, resulting in a “shocking amount” of damaged goods.⁶⁵ Its main customer rejected a significantly higher percentage of its tomatoes than anticipated.⁶⁶ The company was having significant problems with retaining its workers, and the COVID-19 pandemic made it difficult to staff its facility.⁶⁷

The federal district court denied AppHarvest’s motion to dismiss.⁶⁸ It concluded that the company’s statements that its operations were productive and unaffected by COVID were materially false.⁶⁹ It also determined that there were sufficient allegations to support a strong inference that the company’s executives knew the statements were false.⁷⁰ The court cited allegations that the management team “participated in numerous meetings during which the problems with hiring, productivity, turnover, and AppHarvest’s underperformance relative to its forecasts were discussed.”⁷¹

The case against AppHarvest demonstrates that the good intention of helping local workers does not exempt a PBC from the pressure to downplay problems to investors. Public PBCs will find that they will be held accountable for their representations relating to the success of their efforts to manage stakeholders.

It is worth noting that AppHarvest went public through an acquisition by a Special Purpose Acquisition Corporation (SPAC) rather than through a traditional IPO.⁷² A SPAC raises funds from the public to make an unspecified acquisition, usually of a private company.⁷³ Because the SPAC’s shares are publicly traded, and the acquired company is its only asset, the SPAC’s stock price reflects the market value of the company.

A problem with going public through a SPAC is that the company does not go through the extensive due diligence by an underwriter and consultation

64. *Id.* ¶ 200.

65. *Id.* ¶¶ 78, 239.

66. *Id.* ¶ 96.

67. *Id.* ¶¶ 104-13.

68. The court did dismiss some of the complaint’s theories. In re AppHarvest Sec. Litig., 684 F. Supp.3d at 274.

69. *Id.* at 264.

70. *Id.* at 247-49.

71. *Id.* at 247.

72. Second Consolidated Amended Class Action Complaint, In re AppHarvest Sec. Litig. ¶ 44.

73. See Max Bazerman & Paresh Patel, *SPACS: What You Need to Know*, HARV. BUS. REV., <https://hbr.org/2021/07/spacs-what-you-need-to-know>.

with institutional investors that is standard for an IPO.⁷⁴ Some of the problems at AppHarvest might have been uncovered had the company gone through the exercise of a public offering. Moreover, the company may have felt pressure to hide its initial problems because it had rushed through the process of going public.⁷⁵

In a SPAC acquisition, the newly public company does not typically issue shares to the public and is not required to file a registration statement.⁷⁶ At the time when the AppHarvest case was filed, it was not clear that the company was subject to Section 11 liability.⁷⁷ The securities class action thus proceeded against AppHarvest under Rule 10b-5, which requires the plaintiff to make a higher showing of fraudulent intent.⁷⁸ It is notable that even under this higher standard the district court found sufficient allegations of deception to permit the case to go forward.

V. WHEN SHOULD PBCS GO PUBLIC?

The experience of the first wave of public PBCs raises concerns about whether PBCs can succeed as public companies. The poor performance of the majority of public PBCs demonstrates that a strong commitment to social responsibility is not in itself sufficient to create lasting market value. Some public PBCs may not have been sufficiently forthright about their troubles to investors. No matter how strong its public mission, a PBC will lose the trust of investors if it does not describe its business accurately.

The failure of public PBCs to escape the pressure of public company status supports an argument I've made in my earlier work, that market pressure rather than ideology is the reason why the shareholder wealth maximization norm is such a force in public companies.⁷⁹ PBCs are premised in part on the view that committing to a broader social purpose will permit

74. Such procedures have value in ensuring that a company's market valuation rests on a solid foundation. See, e.g., James J. Park, *Investor Protection in an Age of Entrepreneurship*, 12 HARV. BUS. L. REV. 107 (2022).

75. There is some evidence that there was a rush to take AppHarvest public. See, e.g., Mason Adams, *AppHarvest Was Touted as Appalachia's Future. What Happened?*, WV Public Broadcasting (Feb. 14, 2024, 2:54 PM), <https://wvpublic.org/appharvest-was-touted-as-appalachias-future-what-happened/> (“[T]he biggest problem at AppHarvest seems to have been that it grew too big too fast.”).

76. See Special Purpose Acquisition Companies, Shell Companies, and Projections, 89 Fed. Reg. 14158, 14163 (Feb. 26, 2024) (to be codified at 17 C.F.R. pts. 210, 229, 230, 232, 230, 240 & 249).

77. *Id.* at 14164.

78. Second Consolidated Amended Class Action Complaint, In re AppHarvest Sec. Litig., ¶¶ 262, 344.

79. See James J. Park, *From Managers to Markets: Valuation and the Shareholder Wealth Maximization Norm*, 47 J. CORP. L. 435 (2022).

companies to do more than increase profits. That may be true for smaller companies without the ambition to expand. However, the early experience of public PBCs indicates that a commitment to a broader social purpose will not change the reality that investors value companies based on their economic performance.

On the other hand, there are also a handful of public PBCs that have created and maintained value. The most successful, Veeva and United Therapeutics, operate in the pharmaceuticals industry and have multi-billion-dollar valuations.⁸⁰ Their success may come from the fact that they combine a commitment to creating social benefit with the market power of successful drugs protected by patents.⁸¹ To the extent that other public PBCs can develop market power, they can also succeed as public companies.

The poor performance of public PBCs may reflect how challenging it is for smaller companies to establish themselves in public markets. Many new public companies see substantial stock price declines. AppHarvest is not the only SPAC transaction that has failed over the last few years.⁸² The fact that these declines have prompted shareholder litigation does not necessarily mean that PBC managers acted with fraudulent intent. Their troubles are typical for companies that are adjusting to the harsh scrutiny of stock markets.

Perhaps the lesson of the initial failure of public PBCs is that PBCs with ambitions to grow must develop strong market power as private companies before attempting to raise funds from the public. This is a hard pill to swallow because part of the point of a PBC is that it provides opportunities for individuals who want to profit by investing in a socially responsible business. If they remain private, PBCs will have limited ability to sell substantial amounts of securities to public investors. Many individuals will need to wait until the company has grown and gone public before they can invest, meaning that they will miss much of the gain in market value. However, in my view, such a system is preferable to one where investors routinely lose most of their investments in PBCs that are not yet ready to go public. Moreover, many investors committed to social responsibility may be content with a modest return so long as they are supporting a public company that has created both economic value and public benefit.

80. See *Veeva Public Benefit Corporation Report*, VEEVA SYS., <https://www.veeva.com/wp-content/uploads/2024/04/Veeva-2024-PBC-Report.pdf>.

81. See *United Therapeutics Public Benefit Corporation Report*, UNITED THERAPEUTICS CORP., <https://corporateresponsibility.unither.com/~media/Files/U/Unither-Corp/corporateresponsibility/unitedtherapeutics-corporateresponsibility-2023-lr.pdf>.

82. For a discussion of the importance of market power for public companies, see James J. Park, *Securities Regulation and Big Business*, 58 U.C. DAVIS L. REV. 489, 497-500 (2024).

VI. CONCLUSION

Michael Dorff has made an important contribution to the study of socially responsible businesses. One lesson of the book is that the law governing PBCs by itself will not determine whether they are successful in changing how businesses are governed. It will require markets to continue to evolve in a way that rewards businesses when they create public benefits for consumers, workers, and society. The allegations of material misrepresentations against public PBCs show that good intentions by themselves are not enough to create lasting market value. However, it is too early to tell whether PBCs will continue to evolve in ways that will enable them to succeed in public markets.