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CORPORATE SOCIAL RESPONSIBILITY

Benefit Corporations: An Introduction



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Benefit corporations are relatively recent additions to the list of organizational forms available to founders. Their appearance can be traced to the growing popularity of the sustainable business movement, socially responsible investing, and the appeal for more corporate accountability. As demand for this corporate form increases, more states are adding benefit corporation statutes to their general business corporation laws. In general, benefit corporations preserve the general corporate form and are created under the applicable state corporate laws, but they also have additional features that set them apart from traditional business corporations, such as the promotion of higher standards of cor-

porate purposes. Generally, benefit corporation statutes weave social and public benefit goals into the organizational documents of the corporation and give legal protection to companies' leadership to consider a wider range of stakeholders other than shareholders, such as employees, the environment, and society at large. So far, 34 states have enacted some form of benefit corporation statute and additional states are considering similar amendments to their laws. [*Benefit Corporation State by State Status of Legislation*, B Lab.] The demand for this corporate form is certain to expand as more businesses realize advantages from the benefit corporation structure, such as having a reputation as a highly respected business, reducing director liability through legal protections for considering the interests of all the business's stakeholders, and becoming more attractive to socially conscious investors,

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The authors would like to thank Kata Fustos for her contributions.

I. Benefit Corporation Statutes Are Tied to Corporate Law, But Also Contain Important Modifications.

Since Maryland became the first state in 2010 to pass benefit corporation legislation, 33 other states have created laws to allow the formation of benefit corporations. [*Id.*] Many state benefit corporation laws are based on and modify the Model Benefit Corporation Legislation. [Notable exceptions are the benefit corporation laws of Colorado, Delaware, Puerto Rico, and Tennessee. Corporate Law Resource Center – Benefit

Corporation Act: State-by-State Summary, Bloomberg BNA (last visited Jan. 11, 2018).] There are roughly 5,000 benefit corporations as of the beginning of 2018, according to Forbes magazine, including Patagonia, Kickstarter, and Laureate Education, the first benefit corporation that became publicly listed in early 2017.

State benefit corporation statutes are linked to state corporate codes and expand traditional corporate requirements. [See, e.g., Model Benefit Corporation Legislation § 101 (Apr. 17, 2017).] Benefit corporations are formed and operate in accordance with general business corporation law. All applicable state corporate law applies to benefit corporations, except that benefit corporation statutes impose additional requirements on entities that choose the benefit corporation form, which requirements apply only to them and not to traditional business corporations.

Although no two corporations are the same, business corporations as a group are driven by the idea of maximizing value for their shareholders, who shape most of their corporate decisions. Although business corporations may choose “any lawful business or purpose” [See, e.g., Del. Code tit. 8, § 101(b) (2017).] as their mission, because directors owe strong fiduciary duties to the corporation’s shareholders, they inevitably lead to value maximization for shareholders as the sole corporate focus. [John Montgomery, *Mastering the Benefit Corporation*, American Bar Association (July 2016).] On the other hand, benefit corporations have the legal framework in which to expand their corporate mission beyond shareholder value maximization. Benefit corporations also “have a purpose of creating a general public benefit,” [Model Benefit Corporation Legislation § 201(a).] which can be any “material positive impact on society and the environment, taken as a whole, from [its] business and operations.” [Id. § 102 (defining “general public benefit”).] Benefit corporations also have the option of making certain specific public benefits central to their purpose, which they can formalize by enumerating the specific public benefits in their corporate charter. [Id. § 201(b). Under Delaware law, public benefit corporations must select at least one specific public benefit as its purpose. Del. Code tit. 8, § 362(a)(1).] These aspects of benefit corporations give more flexibility to directors and officers to act in the interests of all of the corporation’s stakeholders and direct them to regard the pursuit of public benefits as being in the “best interests of the benefit corporation.” [Model Benefit Corporation Legislation § 201(c).] Thus, the expanded considerations and wider range of stakeholders that benefit corporations are required to take into account allow benefit corporations to pursue their social, environmental, and ethical values without fear that shareholders will penalize directors for decisions that do not strictly maximize shareholder welfare.

II. The Three Pillars of Benefit Corporation Statutes.

The main aspects of benefit corporation statutes are built around the ideas of purpose, accountability, and transparency.

First, the purpose of a benefit corporation will be tied to the public and private benefits that the benefit corporation adopts for its own mission as it aims to make a positive impact. Benefit corporations must strive to cre-

ate general public benefits and may also pick specific public benefits to incorporate into their charter, according to the Model Legislation. Under Delaware law, a benefit corporation (referred to as a “public benefit corporation”) identifies one or more specific public benefits in its charter to promote. [Del. Code tit. 8, § 362(a)(1).] Additionally, the Delaware statute instructs public benefit corporations to “operate in a responsible and sustainable manner.” [Id. § 362(a).]

Second, with respect to accountability, directors and officers of benefit corporations must consider the effects of corporate action or inaction on a wide range of stakeholders such as shareholders, employees, customers, and the environment, according to the Model Legislation. [Model Benefit Corporation Legislation, § 301(a).] Although directors must keep in mind a wide range of stakeholders under the Model Legislation, they owe no legal duty to beneficiaries of a public benefit. [Id. § 301(d).] Similarly, directors’ personal liability for monetary damages is limited by statute, and they are not responsible for the benefit corporation’s failure to create a public benefit. [Id. § 301(c).] Directors under the Model Legislation meet their duty under the statute if they make decisions in good faith; are not interested in the subject matter; are informed as they reasonably believe necessary; and rationally believe the decision is in the best interest of the benefit corporation. [Id. § 301(e).] Only shareholders of the benefit corporation may bring an action based on a claim that the benefit corporation failed to pursue a general or specific public benefit. [Id. § § 301(d), 305(c).]

Similarly, under the Delaware public benefit corporation statute, directors are accountable to a wider base of stakeholders than just the stockholders, but Delaware law has an additional feature whereby directors must balance the pecuniary interests of stockholders, the best interests of the stakeholders materially affected by the business’s conduct, and the public benefits identified in the public benefit corporation’s charter. [Del. Code tit. 8, § 365(a).] Delaware law further specifies that directors’ fiduciary duties are satisfied if directors act in a disinterested and informed manner and not in a way such that no person of ordinary, sound judgment would approve. [Id. § 365(b).] Similar to the Model Legislation, directors of Delaware public benefit corporations do not owe duties to the beneficiaries of the public benefit identified in the public benefit corporation’s charter. [Id.] Only stockholders holding at least 2 percent of the public benefit corporation’s outstanding stock (or shares valued at \$2 million or more of a publicly listed public benefit corporation) may initiate derivative suits to enforce directors’ duties. [Id. § 367.]

Third, the Model Legislation encourages transparency by requiring benefit corporations to prepare annual benefit reports to demonstrate the beneficial performance of the company. The benefit report must include: (1) the ways in which the benefit corporation pursued general and specific public benefits and what benefits were created as a result; (2) an assessment of the overall social and environmental performance of the benefit corporation against an independent third-party standard, plus a description of any connection between the entity that developed the standard and the benefit corporation that might affect the credibility of the standard; (3) the identities of any benefit directors/officers and their contact information; (4) the compensation paid to directors; and (5) the compliance state-

ment of a benefit director, if such a director is designated. [Model Benefit Corporation Legislation, § 401.] An essential part of the compliance statement is for the benefit corporation to demonstrate how it is creating public benefit, whether the benefit corporation acted according to its public benefit purposes, and whether the directors and officers considered all the factors and best interests of all stakeholders in discharging their duties. [*Id.* § 302(c).] Additionally, benefit corporations must disseminate the annual report to their shareholders, deliver a copy to the state secretary of state, and post it on their website. [*Id.* § 402.]

Under Delaware law, public benefit corporations must provide a statement to their stockholders at least every two years about the business's promotion of the chosen public benefit and the best interests of its stakeholders. [Del. Code tit. 8, § 366(b).] Such statement must include: (1) the objectives established by the board to promote public benefits; (2) the standards used by the board to measure progress in promoting the public benefit; (3) objective factual information based on the standards regarding the business's success of meeting its objectives; and (4) the overall assessment of the business's success in meeting its objectives and promoting the public benefit. [*Id.*] Unlike in Model Legislation states, Delaware public benefit corporations do not have to make their statements available publicly and they are not required to use an independent third-party standard to evaluate the public benefit corporation's progress in promoting the public benefits, but the Delaware statute explicitly permits a public benefit corporation to commit to such requirements in its charter. [*Id.* § 366(c).]

III. Incorporation and Amendment of Organizational Documents.

The two principal ways of becoming a benefit corporation are electing to do so at the time of incorporation or converting into a benefit corporation. Incorporation as a benefit corporation is likely simpler because it relies on the familiar formation rules as they relate to traditional business corporations. On the other hand, because benefit corporation as a corporate form is not available in every state — and where it is, state corporate and benefit corporation rules can vary widely — it is imperative that founders evaluate the nuances of the laws of their corporation's state of incorporation. Generally, incorporation under general corporate law involves filing the articles of incorporation with the state's secretary of state. In addition, both the Delaware statute and the Model Legislation require that the articles of incorporation contain a statement that the corporation is a benefit corporation. [*Id.* § 362(a)(2); Model Benefit Corporation Legislation, § 103.]

Already-existing business corporations may also elect to become benefit corporations by modifying their articles of incorporation. In Delaware, corporations must amend their certificate of incorporation to state that the corporation is a public benefit corporation and also identify one or more specific public benefits as required by statute. [Del. Code tit. 8, § 363(a), 362(a).] This vote for an amendment in Delaware requires approval by two-thirds of the outstanding stock of the corporation. [*Id.* § 363(a).] Under the Model Legislation, existing corporations must amend their articles of in-

corporation to insert the statement that the corporation is a benefit corporation. [Model Benefit Corporation Legislation, § 104.] Such vote involves approval by at least two-thirds of the shareholders, but may be higher if state corporate law has a higher super-majority requirement to amend the articles or approve a fundamental corporate change. [*Id.* §§ 104, 102(defined "minimum status vote").]

IV. Benefit Corporations Are Not the Same as Certified B Corporations.

A common misconception about benefit corporations is that they are synonymous with certified B corporations. Although benefit corporations and certified B corporations are related and have similar accountability and transparency requirements, they are not the same concept and offer different benefits. As noted above, there are approximately 5,000 benefit corporations today and around 2,300 certified B corporations. Benefit corporations are legal corporate entities created under a particular state law. On the other hand, certified B corporations are businesses that meet the rigorous certification standards of "social and environmental performance, accountability, and transparency" developed by B Lab, a nonprofit organization. For an entity to be certified by B Lab, it has to satisfy a "legal requirement," among other requirements; incorporating as a benefit corporation is a way to satisfy such legal requirement. A certification by B Lab signals a commitment to socially and environmentally beneficial practices by the corporation, but certification alone does not offer legal protections for modifying traditional corporate behavior and does not offer a way to alter directors' fiduciary duties the way benefit corporation statutes do.

The paths to becoming a certified B corporation or a benefit corporation are different, as well. Certification by B Lab is available to all business entities, regardless of location, state law, and business form. On the other hand, benefit corporations are creatures of state laws, and they do not exist in states that have not passed benefit corporation statutes. Additionally, continuing certification by B Lab requires recertification every two years based on a standard that is constantly evolving, while benefit corporations elect their status once and do not have to re-elect it. Because of the operational and business implications of certification or incorporation as a benefit corporation, companies considering them should carefully evaluate their long-term goals and their legal options.

V. Advantages and Disadvantages of Benefit Corporations.

There are two primary, related advantages of operating a benefit corporation. First, benefit corporation statutes require the directors of benefit corporations to consider stakeholders other than shareholders. [*See, e.g.*, Model Benefit Corporation Legislation, § 301(a); Del. Code tit. 8, § 365(a).] This requirement, supported by the transparency and accountability aspects of the statutes, specifically rejects the notion that corporations must act to maximize shareholder value. [Model Benefit Corporation Legislation, § 301 cmt.] Thus, the benefit corporation structure aligns well with corporations that

have missions that focus on stakeholders other than shareholders.

The requirement to consider stakeholders other than shareholders has a corollary advantage: statutory protection for directors to make such considerations. While corporations other than benefit corporations may not, in many instances, consider factors other than maximizing shareholder value, [See, e.g., *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1 (Del. Ch. 2010); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).] such considerations are built into the statutory duties imposed on the directors of benefit corporations, and the decisions by benefit corporation directors with respect to the consideration of other stakeholders are entitled to the deference accorded to the business judgment of other corporate director decisions. [See, e.g., Model Benefit Corporation Legislation, § 301(e).] Benefit corporations are most ad-

vantageous, then, when decisions are required that may prioritize mission over maximization of financial value.

The primary disadvantages of becoming a benefit corporation are the potential burdens associated with adhering to the transparency and accountability requirements of the benefit corporation statutes. The benefit reports that are required will, of course, take time and effort to produce, and may provide negative insight into the benefit corporation's lack of progress regarding its mission. Additionally, benefit corporations are open to limited derivative actions alleging a failure of its directors to meet their expanded fiduciary duties. These same disadvantages, however, also help to prevent potential "greenwashing" by corporations hoping to take advantage of the goodwill associated with benefit corporations without any additional transparency or accountability.