

## 3.2 BENEFIT CORPORATION

### ADVANTAGES

- ✓ The same general advantages applicable to corporations also apply to benefit corporations
- ✓ Highlights and brands an organization as having a social or charitable purpose other than the maximization of profits
- ✓ May provide access to third parties, consumers, strategic partners, investors and others whose interests are aligned with the organization's social or charitable purposes
- ✓ Third-party certifications may provide some certainty to potential investors and strategic partners that the corporation is pursuing a social purpose

### DISADVANTAGES

- ☒ The same general disadvantages applicable to corporations also apply to benefit corporations
- ☒ Relatively new variation of corporation; impact on capital raising is not clear
- ☒ Extensive variation among state law with differences outweighing similarities resulting in a lack of standard model across states
- ☒ Lack of integration in many states between benefit corporation statutes and general corporation statutes results in ambiguity or potential conflicts
- ☒ Unrelated third parties may be able to bring claims in some states to enforce benefit corporation's mission
- ☒ Ambiguity in state statutes regarding duties of "benefit" director and discretion of board of directors and management to weigh different goals
- ☒ Potential confusion with certain third-party certification standards – such as the "B Corporation" from B Lab
- ☒ Third parties cannot easily identify benefit corporations as no requirement to explicitly designate "benefit corporation" in corporate name
- ☒ Third-party certification requirements provide significant power and authority to third-party providers of such certifications
- ☒ Extensive certification process and reporting requirements may be expensive and time consuming

### CASE STUDY

- ☒ May be difficult for a corporation with numerous shareholders to transition to/from status as a benefit corporation
- Patagonia, Inc., a California benefit corporation, is a leading designer of core outdoor apparel for climbing, snow sports, surfing and fly fishing. The company is noted for its commitment to authentic product quality, environmental responsibility and support for grassroots conservation. In addition, Patagonia is a founding member of 1% for the Planet and, through its Common Threads Partnership, takes back any Patagonia product ever made for recycling or down cycling. The company's commitment to transparency is exemplified by its interactive website, The Footprint Chronicles, which outlines the environmental and social footprint of Patagonia products. For more information, please visit <http://www.patagonia.com>.

### a) Overview

A benefit corporation is a new type of for-profit corporation currently recognized in 31 states and the District of Columbia.<sup>81</sup> Additional legislation is also proposed or pending in at least 8 other states. Benefit corporations are required to recognize a public benefit as one of their corporate purposes. In general, each state statute is based off of model benefit corporation legislation promulgated by B Labs, a third-party certification organization. While the model legislation provides uniformity in certain common approaches and concepts, there is significant variation among states in the requirements for and features of the benefit corporation. Key provisions that differ from state to state include:

- Whether there is a requirement to have a benefit director to serve on the board and the fiduciary duties of such director;
- The nature of benefit enforcement proceedings pursuant to which shareholders or third parties can sue to enforce the mission;
- Whether appraisal rights are available for dissenting shareholders; and
- Varying shareholder approval thresholds to alter a benefit corporation's mission or to convert into or out of benefit corporation status.

This summary does not identify the specific requirements and features in each state; for additional information, please consult the applicable state statute for the proposed state of incorporation.

While a typical for-profit corporation is generally required to operate for the purpose of generating shareholder value, a benefit corporation must also operate for a general public benefit that has a material positive impact on both society and the environment. According to most benefit corporation statutes, such impact must be measured by a statutorily defined third-party standard. In addition to a general public benefit, a benefit corporation is permitted (but not required) to recognize one or more specific public benefits. Generally, the benefit corporation may adopt one or more of the following seven purposes: (i) providing beneficial products or services to low income or underserved individuals or communities; (ii) promoting economic opportunity beyond job creation; (iii) preserving the environment; (iv) improving human health; (v) promoting the arts, sciences or knowledge; (vi) increasing capital flow to public benefit entities; and (vii) accomplishing other particular benefits for society or the environment.<sup>82</sup> A benefit corporation's decision to establish one or more specific public benefits should be informed by the goals of the applicable benefit corporation and the activities and operations proposed to attain such goals.

Most current benefit corporation statutes require a benefit corporation to prepare an annual benefit report, which must be delivered or made available to each shareholder of the benefit corporation within 120 days following the end of each fiscal year (or at the same time as the benefit corporation provides other annual reports to shareholders). The assessment component of the annual benefit report provides shareholders with an evaluation of the benefit corporation's social and environmental performance during the year covered by the report. The assessment must be prepared in accordance with the third-party standard

<sup>81</sup> See <https://socontlawtracker.org/>. This figure does not include the state of Delaware as the Delaware public benefit corporation statute differs from the model legislation in significant ways.

<sup>82</sup> See, e.g., Cal. Corp. Code § 14601(e); H.R.S. § 420D –5; Md. Corp. Code Ann. § 5-6C-01(d); N.J. Stat. Ann. § 14A:18-1; Vt. Stat. Ann. 11A § 21.03(a)(6); Va. Code Ann. § 13.1-782; N.Y. SB 79-A § 1702(e); Pa. SB 433 § 3302(a). The State of Hawaii also recognizes as a specific public benefit the use of the right to exclude conferred by a patent to create or retain jobs in Hawaii or the United States, uphold fair labor standards or protect the environment.

selected by the benefit corporation (however the criteria in the legislation matches exactly with the B corporation standards leading some critics to claim the legislative model is designed to drive revenue to B Lab).

### **b) Organizational Structure**

The benefit corporation is a type of for-profit corporation. As such, the corporate form is the only available form of entity for this type of organization. See Section 2.3 of this Guide for more information about the structure of a corporation.

#### ***Board and Officer Composition Requirements***

Some benefit corporation statutes require that benefit corporations elect a benefit director to the board of directors. All states that require a benefit director indicate that such director must be independent, as independence is defined in such state's benefit corporation statute, and provide that each benefit corporation may, at its discretion, set forth in its charter documents additional qualifications for the benefit director.

The benefit director generally has, in addition to the powers and duties of the other directors on the benefit corporation's board, certain powers and duties relating to the preparation of the benefit corporation's annual benefit reports. In all states that require a benefit director, such director must prepare and include in each annual benefit report a statement or opinion regarding whether the benefit corporation acted in accordance with its general and, if applicable, specific public benefit purposes during the year covered by the report, and whether the directors and officers of the benefit corporation complied with their respective duties in connection with creating such public benefits during such year. Additionally, if the benefit director believes that the corporation and/or its directors or officers failed to act in accordance with the public benefit purposes of the corporation, then the statement or opinion must include a description of the ways in which the corporation and/or its directors or officers so failed.<sup>83</sup> It is important to note that most states that require the election of a benefit director also protect such benefit director from personal liability for acts done in his or her capacity as the benefit director (with exceptions for acts that constitute self-dealing, knowing violations of law and the like). The responsibilities of and protections afforded to a benefit director by statute in the states that require this role should be considered in determining whether and in what state to form a benefit corporation, since the role of benefit director may be difficult to fill if burdensome obligations or insufficient protections are provided by applicable statutes. In addition, such directors should consider how the additional fiduciary duties required for a benefit director may conflict with traditional fiduciary duties applied to directors of corporations generally.

In addition to a benefit director, some states permit benefit corporations to appoint a benefit officer, who would generally have duties relating to the creation of the corporation's general and, if applicable, specific public benefit. Most states that permit the appointment of a benefit officer require such officer to assist the benefit director in preparing the annual benefit report.<sup>84</sup>

<sup>83</sup> See, e.g., Cal. Corp. Code § 14621. Benefit corporation law in California does not require a benefit director, but requires that such a statement or opinion be made by all of the directors of the benefit corporation and included in each annual benefit report.

<sup>84</sup> See Vt. Stat. Ann. Tit. 11A § 21.12. Of the states that expressly permit the appointment of a benefit officer, only Vermont does not require such officer to assist in the preparation of the annual benefit report.

### c) Establishment Costs and Documentation

The formation procedures and costs associated with establishing a for-profit corporation are generally applicable to the formation of a benefit corporation. See Section 2.3 for more information about forming a for-profit corporation.

The charter of a benefit corporation must include the same elements as are required in the charter documents of a for-profit corporation in the applicable state. In addition, a benefit corporation's charter must expressly state that the corporation is a benefit corporation. A benefit corporation that adopts a permitted specific public benefit must also state the specific public benefit in its charter. In order to amend, add or delete a specific public benefit from a benefit corporation's charter, a statutorily defined minimum status vote must approve such change. In most states, the minimum vote required is the affirmative vote of at least two-thirds of the shareholders of each class or series of stock of the applicable benefit corporation entitled to vote on the matter.<sup>85</sup>

If an existing for-profit corporation desires to become a benefit corporation, its charter must be amended to state that it is a benefit corporation. According to most benefit corporation statutes, such a charter amendment must be approved by the statutorily defined minimum status vote in the applicable state of incorporation.<sup>86</sup>

### d) Liabilities

Because a benefit corporation is a type of corporation, its directors and officers are generally subject to and protected from the same kinds of personal liability as are directors and officers of corporations. Most states provide directors and officers with explicit protection from liability for pursuing the public benefit purpose established in the benefit corporation's charter. As a result, generally benefit corporation directors and officers should have no liability for pursuing a stated public benefit purpose at the expense of maximizing shareholder value. However, the extent of this protection varies from state to state, and there has been no litigation testing the limits of such protections.

Nearly all states expressly provide for a right of action against directors and officers of benefit corporations for a violation of their duties under the applicable state's benefit corporation statutes. This right of action, termed a "benefit enforcement proceeding," generally grants to certain identified parties the right to bring direct or derivative claims against directors and/or officers of a benefit corporation to enforce the general or specific public benefit purposes of the benefit corporation and the statutorily defined standards of conduct for the directors and officers (such standards of conduct are discussed below in part (e) of this Section). In many states, this benefit enforcement proceeding is the only type of action, proceeding or claim that may be brought or asserted against a benefit corporation or its directors or officers to enforce the benefit corporation law of the applicable state.

<sup>85</sup> See, e.g., Cal. Corp. Code §§ 14601(d), 14610(d); H.R.S. §§420D-2, -5; N.J. Stat. Ann. §§ 14A:18-1, 14A:18-5. Maryland, Virginia and Vermont do not separately define a minimum status vote in their benefit corporation statutes. The corporate law in Maryland generally requires the affirmative vote of 2/3 of all votes entitled to be cast in order to amend the charter of a corporation that has issued stock. Md. Corp. Code Ann. § 2-604(e). Similarly, the corporate law in Virginia generally requires the approval of 2/3 of each group of shareholders entitled to vote in order to amend a corporation's charter. Va. Code Ann. § 13:1-707(D). In Vermont, although the benefit corporation law does not separately define a "minimum status vote," approval of 2/3 of the shares entitled to be cast by shareholders or shareholder groups is required to amend a benefit corporation's charter to adopt a specific public benefit or to change its status as a benefit corporation. Vt. Stat. Ann. 11A § 21.08.

<sup>86</sup> See, e.g., Cal. Corp. Code §§ 14601(d), 14603(a); H.R.S. §§420D-2, -3; Md. Corp. Code Ann. §§ 2 604(e), 5-6C-03(b)

The parties permitted to bring a benefit enforcement proceeding against directors and officers of a benefit corporation generally include: (i) the benefit corporation itself; (ii) the shareholders of the benefit corporation; (iii) the directors of the benefit corporation; (iv) the holders of at least 5% (or 10% in certain states, including New Jersey and Vermont) of the stock or other equity ownership of an entity of which the benefit corporation is a subsidiary; or (v) other classes of individuals specifically identified in the benefit corporation's charter documents.<sup>87</sup> In addition, unrelated third parties may be able to bring claims in some states to enforce a benefit corporation's mission.

The founders of a benefit corporation should carefully consider the different degrees of liability protection set forth in the laws of each state in which the benefit corporation form is available in determining where to incorporate, since insufficient protections might dissuade directors and officers from serving on the board or management team of the benefit corporation. See also the discussion in "Director and Officers Standards of Conduct" below for a discussion of certain additional obligations of directors and officers of benefit corporations.

### e) Governance and Regulatory Obligations

#### ***Annual Benefit Reports***

All current benefit corporation statutes require a benefit corporation to prepare an annual benefit report, which, except for a Minnesota benefit corporation, must be delivered or made available to each shareholder of the benefit corporation within 120 days following the end of each fiscal year (or at the same time as the benefit corporation provides other annual reports to shareholders). Additionally, benefit corporation law in some states requires that the annual benefit report be filed with the state in which the benefit corporation is incorporated. While the required content of an annual benefit report varies in each of the states that recognize the benefit corporation form, the law in all such states requires that the benefit report include a narrative and an assessment.<sup>88</sup>

The narrative of an annual benefit report generally requires a discussion of the manner in which the benefit corporation pursued a general and, if applicable, specific public benefit during the applicable year and the extent to which the benefit corporation created such public benefits. Further, the narrative must address any circumstances that hindered the benefit corporation's creation or promotion of a general or specific public benefit in the applicable year.

The assessment component of the annual benefit report provides shareholders with an evaluation of the benefit corporation's social and environmental performance during the year covered by the report. The assessment must be prepared in accordance with the third-party standard selected by the benefit corporation, applied consistently with such corporation's benefit reports in prior years. If the third-party standard is not consistently applied, then the benefit report must include an explanation of the reasons for the inconsistent application.

In addition to the narrative and the assessment, some states require additional types of information in an annual benefit report. For instance, in several states, a benefit report must include the names of all

<sup>87</sup> There are exceptions to each of these groups in certain states.

<sup>88</sup> <http://benefitcorp.net/sites/default/files/Benefit%20Corporations%20Chart.pdf>

individuals and entities owning 5% or more of the benefit corporation's outstanding shares. Similarly, most states require disclosure of directors' compensation in each benefit report. Additionally, a few states require that each benefit report include a statement of any connection between the benefit corporation and the organization that created its third-party standard. A careful review of the applicable laws in the state of incorporation is necessary to ensure that each annual benefit report includes all required information.

### ***Third-Party Standard***

The statutory requirements relating to the third-party standard used to measure a benefit corporation's social and environmental performance vary from state to state. The third-party standard must be developed by a person or organization that is independent from the applicable benefit corporation.<sup>89</sup> Generally, an independent party is one with no material relationship with the benefit corporation or its subsidiaries (either directly or as the owner or manager of an entity with a material relationship), where a material relationship exists when an individual has an employment relationship with the benefit corporation, has a family relationship with an officer of the benefit corporation, or owns a minimum of 5% of the outstanding stock or equity of the benefit corporation. Additionally, the third party standard must meet certain transparency requirements, such as making publicly available the factors considered when measuring performance, the relative weighing of such factors and the identity of persons and processes involved in developing and controlling the third party standard.<sup>90</sup> Some benefit corporation laws also require that the third party standard provide for a comprehensive assessment of the benefit corporation's impact on certain required or permitted considerations, and/or be developed by an organization that is experienced in social and environmental performance and allows public comment in developing the standard.

### ***Director and Officer Standards of Conduct***

All effective and pending benefit corporation legislation includes standards of conduct that must be followed by directors, and sometimes officers, of benefit corporations. In light of the additional public benefit purposes of such corporations, these standards of conduct generally take the form of certain considerations that directors and officers must take into account when taking corporate actions, and certain other considerations that directors and officers are permitted (but not required) to take into account when taking corporate actions.

In most states that recognize the benefit corporation form, the following factors must be considered by benefit corporation directors when taking corporate action: (i) the shareholders of the benefit corporation; (ii) the employees and workforce of the benefit corporation; (iii) the interests of customers as beneficiaries of the benefit corporation's public benefit purposes; (iv) community and societal considerations; (v) local and global environmental effects; (vi) the short-term and long-term interests of the benefit corporation itself; and (vii) the benefit corporation's ability to accomplish its public benefit purposes.

<sup>89</sup> See, e.g., H.R.S. §420D-2; Md. Corp. Code Ann. § 5-6C-01(c); N.J. Stat. Ann. § 14A:18-1. Notably, California requires that the third party standard be determined by an organization with no material financial relationship with the applicable benefit corporation, which is deemed to be the case when not more than 1/3 of the members of the governing body of the organization are representatives of an association or business whose performance is measured by such third party standard, and California law also requires that the organization is not materially financed by such an association or business. Cal. Corp. Code § 14601(g).

<sup>90</sup> Some benefit corporation laws, such as in California, Hawaii, New Jersey, Vermont and Pennsylvania, also require that the financial interests, if any, of the persons involved in developing and controlling the third party standard be identified in publicly available documentation. Cal. Corp. Code § 14601(g); H.R.S. §420D-2; N.J. Stat. Ann. § 14A:18-1; Vt. Stat. Ann. 11A § 21.03(a)(8); Pa. SB 433 § 3302(a).

Common permissible considerations – those that benefit corporation directors may (but are not required to) take into account when taking corporate action – include (i) the resources, intent and conduct of a person or entity seeking to acquire control of the benefit corporation, and (ii) a “catch all” category of other pertinent factors or interests of any other person or group that the directors deem appropriate to consider.

In their considerations of these required and permitted factors, most benefit corporation statutes provide that directors are not required to give priority to any such consideration or the interests of a particular group affected by any consideration unless the intention to allocate priority is expressly identified in the benefit corporations’ charter documents.<sup>91</sup>

In addition to the statutorily defined standards of conduct for benefit corporation officers, some states’ benefit corporation laws stipulate standards of conduct that must be followed by officers of a benefit corporation.<sup>92</sup> In such states, benefit corporation officers are generally required to take into account the required or permitted considerations of benefit corporation directors, as set forth by the law of the applicable state, when such officer has discretion to act on a matter and when it reasonably appears that the matter will have a material effect on the general or specific public benefits of the benefit corporation.<sup>93</sup> Those considering incorporating as a benefit corporation should conduct a thorough review of the standards of conduct for directors and officers in the state in which they incorporate to ensure a complete understanding of the items to be taken into account by the board and the management team in making operational and other corporate decisions.

#### f) Tax Treatment

Benefit corporations are subject to the same tax treatment as other for-profit corporations.<sup>94</sup> See Section 2.3 of this Guide for more information about the tax treatment of for-profit corporations.

#### g) Financing

All effective and proposed benefit corporation statutes include provisions that serve to notify potential investors, or other supporters, of the entity’s status as a benefit corporation. For instance, as discussed above, all benefit corporation laws require that the charter documents of the corporation expressly state that the entity is a benefit corporation. Additionally, some states require that all share certificates representing equity ownership of a benefit corporation include a legend indicating that the certificate represents ownership of the shares of a benefit corporation.

A benefit corporation will likely experience both advantages and disadvantages in its financing and fundraising efforts as compared to other for-profit corporations. Potential advantages include exposure to new groups of investors that have a particular interest in the public benefits pursued by the benefit corporation, and differentiation of the benefit corporation from other entities seeking funding. On the

<sup>91</sup> Exceptions include benefit corporation statutes in Hawaii and Maryland, which do not address whether or not priority may be allocated among the required and permitted considerations.

<sup>92</sup> For example, California, Hawaii, New Jersey, Vermont and Pennsylvania stipulate standards of conduct for officers of benefit corporations.

<sup>93</sup> H.R.S. §420D-8; N.J. Stat. Ann. § 14A:18-8; Vt. Stat. Ann. 11A § 21.11; Pa. SB 433 § 3323. A notable exception to this phrasing is the benefit corporation law in California, which requires officers to take into account such considerations when the officer has discretion to act on a matter OR when it reasonably appears that the matter will have a material effect on the general or specific public benefits of the benefit corporation. Cal. Corp. Code § 14622.

<sup>94</sup> See B Lab, “Benefit Corporation - FAQ”, available at <http://benefitcorp.net/faq>.

other hand, investors that receive or expect to receive an ownership interest in the company in exchange for their investment may be disincentivized from investing in benefit corporations because of the requirement that factors other than shareholder value be considered when making corporate decisions. The types of investors and supporters that are likely to contribute to the enterprise and the motivations of such investors and supporters are important to consider when deciding on the most appropriate entity form.

#### **h) Resources**

For additional information, visit:

<http://www.bcorporation.net/what-are-b-corps>.

<http://www.benefitcorp.net/>.

<http://www.sos.ca.gov/administration/agency-reports/flexible-purpose-and-benefit-corporations-agency-reports>.