



## Benefit Corporation – Legal Provisions and FAQs

Four states, Maryland, Vermont, New Jersey, and Virginia have recently passed legislation creating a new kind of corporation, a Benefit Corporation, giving entrepreneurs and investors an additional choice when determining which corporate form is most suitable to achieve their objectives. A Benefit Corporation: 1) has a corporate purpose to create a material positive impact on society and the environment; 2) has an expanded fiduciary duty that requires consideration of non-financial interests when making decision; and 3) reports on its overall social and environmental performance as assessed against a third party standard.

### ***Benefit Corporation -- Major Provisions***

#### *Purpose*

- ✓ shall create **general public benefit** defined as a material positive impact on society and the environment, taken as a whole, as assessed against a third party standard
- ✓ shall have right to name specific public benefit purposes (e.g. 50% profits to charity, carbon neutral, 100% local sourcing, beneficial product to customers in poverty)
- ✓ the creation of public benefit is in the best interests of the Benefit Corporation

#### *Accountability*

- ✓ directors' duties are to make decisions in the best interests of the corporation
- ✓ directors and officers shall **consider** effect of decisions on shareholders and employees, suppliers, customers, community, environment (together the "Stakeholders")
  - not required to give priority to any particular stakeholder
  - have discretion to give priority to particular stakeholders consistent with general and any specific public benefit purposes
  - the same fiduciary duty must be met for day to day operating decisions and questions of liquidity/change of control

#### *Transparency*

- ✓ shall publish annual Benefit Report in accordance with a **third party standard** for defining, reporting, and assessing social and environmental performance, including assessment of successes and failures in achieving general and specific public benefit purpose and in considering effects of decisions on stakeholders
- ✓ third party standard defined as being comprehensive, credible, independent, and transparent
- ✓ Benefit Report delivered to: 1) all shareholders; 2) to public website with exclusion of proprietary data; and 3) Secretary of State with exclusion of proprietary data

#### *Right of Action*

- ✓ only shareholders and directors have right of action
- ✓ no third party right of action
- ✓ if Benefit Corporation is a subsidiary, >5% owners of parent have right of action
- ✓ Right of Action can be for 1) violation of or failure to pursue general or specific public benefit; 2) violation of duty or standard of conduct; 3) failure to meet transparency requirements

#### *Change of Control/Purpose/Structure*

- ✓ shall require 2/3 majority vote with dissenters rights

## ***Benefit Corporation – FAQs***

Why would a company want to become a Benefit corporation?

- ✓ Provides clarity to directors and officers that their fiduciary duty includes pursuing the creation of a material positive impact on society and the environment, even in liquidity scenarios;
- ✓ Offers safe harbor to its directors and officers to consider the interests of its workforce, its community, and the environment when making decisions, even in liquidity scenarios;
- ✓ Increases accountability to investors interested in a broader mission by 1) expanding shareholder rights to enforce this expanded definition of fiduciary duty and standard of consideration; and 2) requiring a 2/3 super-majority vote of shareholders to remove these higher standards;
- ✓ Differentiates the company in a confusing marketplace in which everyone is claiming to be a responsible or green business;

What are the legal impediments today preventing businesses from operating this way?

- ✓ The greatest impediments exist in liquidity scenarios.
  - When a company is ‘in play,’ directors’ discretion under the business judgment rule is narrowed as a result of the Revlon ruling in Delaware, requiring them to ‘take the highest offer’ regardless of the impact of that decision on non-financial interests. Even states with constituency statutes lack any case law in conflict with the Revlon decision.
- ✓ Impediments also exist in operating scenarios.
  - The best interests of the corporation are commonly equated with the financial interests of shareholders. Any decision by directors must be tied back to serving the financial interests of shareholders. This prevents directors from making decisions that consider both financial and non-financial interests. Milton Friedman’s seminal article stating that ‘the social responsibility of business is to increase profits’ has been absorbed into U.S. corporate culture and impacts how decisions are made.

In states with a constituency statute, can’t companies already do this?

- ✓ Constituency statutes are permissive and as a result directors ‘may’ consider non-financial interests. This also means that they ‘may not’. The objective of Benefit corporation legislation is to give shareholders the option to choose to require directors to consider non-financial interests.
- ✓ Constituency statutes have not achieved the other objectives of this legislation cited above.

Why require the creation of ‘general public benefit’ rather than simply require the creation of one or more ‘specific public benefits’?

- ✓ Most importantly, responding to market demand from entrepreneurs, investors, consumers, and policy makers, the primary objective of this legislation is to create a new corporate form whose corporate purpose is to create benefit for society generally as well as shareholders.
- ✓ The ‘general public benefit’ purpose helps prevent abuse of this legislation by corporations interested in green-washing. Without the ‘general public benefit’ purpose, a corporation could name a single, narrow

'specific public benefit' purpose (e.g. keeping the river in back of the factory clean from toxic effluents) and then 'consider' and dismiss all other non-financial interests when making decisions.

Without more prescriptive performance standards than simply "creating a material positive impact on society and the environment", isn't this just a legalized form of green-washing?

- ✓ No. A company deciding to become a Benefit corporation has voluntarily agreed to meet higher standards of corporate purpose, accountability, and transparency about its overall business and operations, not simply in one specific area.
- Benefit corporations have incremental legal exposure to shareholders and directors who can bring a lawsuit for 1) failure to pursue a material positive impact on society and the environment as assessed against a third party standard; 2) violation of duty or standard of conduct to consider non-financial interests when making decisions; or 3) failure to meet the transparency requirements of the statute
- Benefit corporations are required to publish publicly an annual Benefit report on its overall social and environmental performance as assessed against a third party standard

Are there many third party standards for assessing overall corporate social and environmental performance?

- ✓ Yes. There are many third party standards organizations that meet the statutory criteria for a third party standard.
- ✓ The management, and ultimately, directors and shareholders, of Benefit Corporations are free to decide for themselves which of these or other standards they feel meet the statutory requirements and their needs.
- ✓ The Global Reporting Initiative (GRI), GreenSeal, Underwriters Laboratories (UL), ISO2600, Green America, and B Lab are a few well-known examples. In addition to the examples listed above, more than 100 'raters' of corporate sustainability practices are listed in the 'Rate the Raters' report published by the research and consulting firm SustainAbility. This list is available for free at <http://www.sustainability.com/library/rate-the-raters-phase-two>.

Won't preparing the annual Benefit report be overly costly and burdensome?

- ✓ No. Benefit Corporation legislation does not require a Benefit Corporation to use any particular third party standard to prepare its benefit report. Nor are they required to have that report certified or audited by a third party.
- ✓ Both GRI and B Lab offer companies the use of their reporting (GRI) and assessment (B Lab) tools for free. Particularly for smaller companies most likely to adopt Benefit corporation status, using B Lab's free Impact Assessment to generate an impact report generally takes only 1-2 hours. Over 1,000 companies are already issuing reports on their corporate social and environmental performance in accordance with GRI reporting standards and more than 1,000 companies are using B Lab's Impact Assessment.

What might a general counsel tell the Board they must do to meet the 'shall consider' standard of conduct?

- ✓ The board minutes of a Benefit corporation should show that the directors discussed the impacts of their decisions on the interests they are required to consider and that they were supplied with any information they requested to inform their consideration of those interests. When a material decision required the

Board to balance competing interests, the minutes, and the narrative statement in the annual Benefit report, should indicate how the Board reached its decision and the considerations that led to the decision.

What might a general counsel tell the Board they must do to meet the 'public benefit' standard?

- ✓ It is expected that case law will develop on the question of whether a Benefit corporation has met its 'public benefit' standard, and will likely consider both 1) how the directors considered the impact of their decisions on both financial and non-financial interests (i.e., the process followed) and 2) the level of performance demonstrated in the third party assessment of the corporation's social and environmental performance presented in the annual Benefit report (i.e., the results obtained).

Can Directors be held personally liable for monetary damages for failure of the Benefit Corporation to create general or specific public benefits?

- ✓ No. The law specifically states: "A director is not personally liable for monetary damages for failure of the benefit corporation to create general or specific public benefits."

Do Benefit Corporations have any special tax status?

- ✓ No. Benefit Corporations are treated like any other corporation for tax purposes.

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