

New corporate form in Delaware

By Jonathan Storper

A seismic shift has occurred in American corporate law. On Thursday, Delaware will become the 19th state to permit the incorporation of, and merger or conversion into, a benefit corporation. Benefit corporation law has also been enacted in California, New York, New Jersey, Vermont, Maryland, Virginia, Louisiana, South Carolina, Arizona, Arkansas, Colorado, Massachusetts, Nevada, Oregon, Hawaii, Illinois, Rhode Island, Vermont and the District of Columbia. Ten other states have introduced the legislation.

For the first time, this new corporate form provides a legal basis for companies to have a positive social purpose in addition to creating shareholder value. Without it, arguably, the company's sole fiduciary responsibility is to maximize value to shareholders. This is the first new corporate form with a national scope to be introduced into American law since the LLC in 1977. Delaware is of particular significance because it is the recognized leader in corporate law and over half of all public companies are domiciled there.

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General and specific public benefit purpose

Benefit corporations fundamentally change how a company is permitted to act. Pursuant to Delaware General Corporation Law (DGCL) Section 362, in addition to creating shareholder value like other for-profit companies, a benefit corporation must produce a general and specific public benefit and operate in a responsible and sustainable manner. "Public benefit" means a positive effect (or reduction of negative effects) on one or more categories of persons, entities, communities or interests (other than stockholders in their capacities as stockholders) of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious,

scientific or technological nature.

Section 365(a) of the DGCL provides that the board of directors must manage the corporation in a manner that balances the "pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct, and the specific public benefit or public benefits" identified by the corporation. Directors satisfy these modified duties "if such [a] director's decision is both informed and disinterested and not such that no person of ordinary, sound judgment would approve." DGCL Section 365(c). Directors duties may be enforced by stockholders and not other stakeholders.

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Accountability

The corporation must consider the impact of its actions upon not only the shareholders, but also the promotion of the company's public benefit purpose and the best interests of those materially affected by the corporation's conduct. Unlike the model legislation promulgated in other states (including California), Delaware benefit corporations do not have to assess such impacts using an independent third-party assessment standard, unless so specified in the corporation's certificate of incorporation. Otherwise, the board is empowered to make such assessment on its own.

Transparency

The corporation must identify itself as a public benefit corporation by including those words, or the abbreviation "P.B.C." or the designation "PBC," in its name. The Delaware benefit corporation must also, no less than biennially, provide its stockholders with a statement as to the corporation's promotion of the public benefit identified in the certificate of incorporation and

the best interests of those materially affected by the corporation's conduct. The statement must include: (i) the objectives the board of directors has established to promote such public benefits and interests; (ii) the standards the board of directors adopted to measure the corporation's progress in promoting such public benefits and interests; (iii) objective factual information based on those standards regarding the corporation's success in meeting the objectives for promoting such public benefits and interests; and (iv) an assessment of the corporation's success in meeting the objectives and promoting such public benefits and interests. The charter documents, however, may require that the corporation (i) provide the statement more frequently than biennially and/or make it available to the public, and/or (ii) use an independent third-party standard in connection with and/or attain a periodic third-party certification addressing the corporation's promotion of the public benefits identified in the certificate of incorporation and/or the best interests of those materially affected by the corporation's conduct. Once an optional provision is adopted, a two-thirds vote of shareholders is required to terminate it.

Incorporating, merging or converting a public benefit corporation

Incorporating as a Delaware corporation is relatively simple. A certificate of incorporation is filed with the Delaware secretary of state specifying the public benefit purposes and any optional provisions noted above. Provisions may also be included in the certificate of incorporation that (i) disinterested decisions by directors will not constitute an act or omission not in good faith or breach of the duty of loyalty for monetary damages, or (ii) provide an indemnification right to directors. Stock certificates and notices to stockholders must note the company is a benefit corporation. A 90 percent vote is required to convert or merge into a benefit corporation. Those not voting to convert or merge into, or merge out of, a benefit corporation are entitled to appraisal rights; that is, the right to have their shares purchased for

fair market value. A two-thirds vote is required to convert from or merge out of a benefit corporation. There are no appraisal rights converting from a benefit corporation.

Enforcement

DGCL Section 367 authorizes stockholders to sue derivatively to enforce the duties of directors, but only by stockholders individually or collectively who own (i) at least 2 percent of the corporation's outstanding share, or (ii) the lesser of 2 percent of the outstanding shares with a market value of at least 2 million dollars where the corporation is listed on a national securities exchange.

Tax and contract bid preferences

Benefit corporations may elect to be a subchapter "C" or an "S" corporation for tax purposes. The city of San Francisco offers a city contract bidding preference to benefit corporations of 4 percent. The press release by the ordinance's sponsor announcing the bid preference states that the city of San Francisco has enacted the bid preference ordinance as a way to demonstrate San Francisco's "commitment to sustainability, economic innovation, and social entrepreneurialism." Philadelphia offers a tax benefit to these corporations as well.

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Benefit corporations, embracing purpose, accountability, and transparency, represent the new breed of capitalism in the U.S. As the first new corporate form in over 35 years, the benefit corporation structure paves the way for a new sustainable economy where there is no long term tradeoff between purpose and profit.

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