

## **Benefit Corporation Laws: Del. Vs. Calif.**

*Law360, New York (August 21, 2013, 12:31 PM ET)* -- Benefit corporation law has been enacted in 19 states including Delaware, 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 and environmental purpose in addition to creating shareholder value. Without it, the company's responsibility is to maximize value to shareholders.

Entrepreneurs find the form attractive because it provides a simple and consistent platform to protect a corporate mission and balance it with shareholder value instead of creating complex and expensive corporate class structures, which are of limited value to protect the mission in certain circumstances.

To be successful, however, founders and investors must be aligned on core values, revenue objectives and exit strategies, perhaps, to a greater degree than with a general purpose corporations.

This is the first new corporate form with a national scope to be introduced into American law since the limited liability company 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. California is the largest state and has provided the country with the benefit corporation model legislation. Delaware differs from the model legislation in notable ways.

This article compares the two states. Citations to the CCC means the California Corporations Code and DGCL means the Delaware General Corporation Law.

### **What Is a Benefit Corporation?**

Benefit corporations fundamentally change how a company is permitted to act. A benefit corporation is a for-profit corporation, but in addition to creating value for its shareholders, it has three additional attributes: social purpose, accountability and transparency.

#### ***Social Purpose: A Difference in Specifics***

In addition to creating shareholder value like other for-profit companies, a benefit corporation must provide general public benefit. In California, this is defined as "a material positive impact on society and the environment taken as a whole." CCC 14601(c). The articles may (but are not required to) state a specific public benefit.

Specific examples include providing low-income individuals or communities with beneficial products or services, preserving the environment, promoting economic opportunity, improving health and promoting arts, science and knowledge. CCC 14601(e). The California General Corporation Law applies to benefit corporations except when in specific conflict. CCC 14600.

In Delaware, a benefit corporation must produce a general and specific public benefit and operate in a "responsible and sustainable manner." DGCL 362. "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.

A two-thirds vote is required to change the specific purpose in both states. CCC 14610(d); DGCL 363(c).

### ***Accountability: Performance Assessments Vary***

In California, the corporation must assess its overall social and environmental performance on a yearly basis using an independent third-party standard, many of which are free to the public. The assessment does not need to be audited or certified by a third party, however. CCC 14630.

The standard must be developed by an entity that has no material financial relationship with the corporation, and the criteria and standard development process must be publicly available. In addition, the amount and sources of financial support for the entity developing the standard must be publicly disclosed, along with any relationships that could reasonably be considered to present a potential conflict of interest. CCC 14601(g). The purpose of these requirements is to prevent the corporation from using an assessment tool that is self-serving.

The Delaware 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. DGCL 365.

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. This is one of the major differences from the model legislation. Still, the Delaware law gives a nod to best practices by making the third-party standard optional.

### ***Transparency: Different Options***

The California benefit corporation must report on its overall social and environmental performance to its shareholders and the public in an annual benefit report. The report must include the third-party standard selection process, the ways in which the benefit corporation pursued any general or specific public benefit during the year and any circumstances that hindered the creation of the public benefit. CCC 14630(a). The statement must be sent to shareholders and posted on the company's website annually within 120 days following the end of the fiscal year. CCC 14630(b) and (c).

The Delaware corporation must, by contrast, affirmatively identify itself as a public benefit corporation by including those words, or the abbreviation "P.B.C." or the designation "PBC", in its name. DGCL 362(c). California has no such requirement.

The Delaware benefit corporation must also, no less than biennially (annually in California), 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. DGCL 366(b).

The statement required by Delaware is similar to California but notably different. It must include the objectives the board of directors has established to promote such public benefit(s) and interests; the standards the board of directors adopted to measure the corporation's progress in promoting such public benefit(s) and interests; objective factual information based on those standards regarding the corporation's success in meeting the objectives for promoting such public benefit(s) and interests; and an assessment of the corporation's success in meeting the objectives and promoting such public benefit(s) and interests.

The charter documents, however, may require that the corporation provide the statement more frequently than biennially, make it available to the public, use an independent third-party standard in connection or attain a periodic third-party certification addressing the corporation's promotion of the public benefit(s) identified in the certificate of incorporation and/or the best interests of those materially affected by the corporation's conduct. DGCL 366(c).

Once an optional provision is adopted, a two-thirds vote of shareholders is required to terminate it. DGCL 363(c). These options appear to be intended to allow a Delaware benefit corporation to structure itself according to the model legislation if it wishes.

### **Incorporating, Merging or Converting a Benefit Corporation**

The California articles of the corporation must state that the corporation is a benefit corporation and any optional specific public purposes. CCC 14602. Stock certificates must identify the corporation as a benefit corporation. CCC 14631.

By contrast, in Delaware, the certificate of incorporation must specify the required specific public benefit purpose(s) and any optional provisions noted above (which provision are built into the California statute). Provisions may also be included in the certificate of incorporation that 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 provide an indemnification right to directors.

In Delaware, stock certificates and notices to stockholders must note that the company is a benefit corporation. Conversion or merger into or out of a California benefit corporation requires at least a two-thirds vote of the outstanding shares. CCC 14603 and 14604. Dissenters' rights are available for those not voting in favor of the California conversion or merger. CCC 14604(d).

In Delaware, a 90-percent vote is required to convert or merge into a benefit corporation. DGCL 363(a). 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. DGCL 363(b) and (c).

### **Enforcement**

In California, if the corporation fails to pursue its public benefit purpose(s), assess its performance or issue the benefit report, the shareholders may bring an action in court to force the corporation to do so. No monetary damages are available in a derivative action, though the court may order reimbursement of attorneys' fees. CCC 14623.

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

### **Director's Duties**

In California, directors must perform their duties in good faith in a manner the director believes to be in the best interests of the corporation and with that care, including reasonable inquiry, as an ordinary prudent person in a like position would use under similar circumstances. CCC 14620(a).

Directors must consider the impacts of any action upon not only the shareholders but also upon employees, customers, the community, the environment, short- or long-term interests of the corporation and the ability of the corporation to accomplish its public benefit purpose. CCC 14620(b).

In discharging those duties, directors are not required to give priority to any particular factor or person unless the corporation so stated in its articles. CCC 14620(d). Directors of foreign corporations subject to CCC 2115 are not be subject to CCC 309 (director's fiduciary duties) and instead are subject to the duties under the laws of its jurisdiction of incorporation if those duties are "similar to" those prescribed by the California Benefit Corporation law. CCC 14620(j). The model legislation upon which most states premise their benefit corporation law would likely qualify under this definition, but with Delaware, this is less clear, though still arguably so.

DGCL 365(a) 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 director's decision is both informed and disinterested and not such that no person of ordinary, sound judgment would approve." DGCL 365(a). In both states, directors owe their duty to shareholders and not other stakeholders. CCC 14620(i); DGCL 365(b).

### **Tax and Contract Bid Preferences**

Benefit corporations, wherever their jurisdiction of incorporation, 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. It remains to be seen if other jurisdictions will offer incentives to the benefit corporation.

### **Conclusion**

The Delaware and California benefit corporation models embrace the principles of purpose, accountability and transparency in similar but different ways. Legal counsel should understand these different and nuanced approaches in order to assist new and ongoing enterprises with the best approach for their business. Each form provides a corporate structure that paves the way for a more sustainable economy where there is no long-term tradeoff between purpose and profit.

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