

California Enacts Legislation Allowing Formation Of New “Benefit” Corporations

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Effective January 1, 2012, California added Corporations Code Sections 14600 to 14631 to its statutes allowing the formation of “benefit” corporations or “b” corporations. Benefit corporations are a new type of corporation formed for purposes which include a “general public benefit.” This purpose is in addition to, and may be a limitation on, the corporation’s purpose as set forth in its Articles of Incorporation.

What Is A “B” Corporation?

Benefit corporations are corporations formed under and governed by California’s General Corporation Law that elect to also be subject to the provisions of the Benefit Corporations Law.¹ Benefit corporations are distinct from California’s Non-Profit Corporation Law which allows for the formation of Public Benefit, Mutual Benefit and Religious Corporations.

A “general public benefit” means “a material positive impact on society and the environment, taken as a whole, as assessed against a third-party standard.” (Corporations Code Section 14601(c).) The Articles of Incorporation of a benefit corporation may also identify its purpose to include one or more specific public benefits. However, the identification of a specific public benefit may not limit the obligation of a benefit corporation to create a general public benefit. (Corporations Code Section 14610(b).)

Officers’ And Directors’ Duties Are Expanded To Require Consideration Of Interests Of Non-Financial Stakeholders

Whereas the directors of a typical for-profit corporation are charged with a duty to maximize corporate profits and share value for the benefit of its shareholders, the directors of a benefit corporation are *required* to consider the impacts of any action or proposed action upon *all* of the following:

- (1) The shareholders of the benefit corporation.
- (2) The employees and workforce of the benefit corporation and its subsidiaries and suppliers.

¹ An existing corporation formed under the General Corporation Law may elect to become a benefit corporation by amending its Articles of Incorporation to include, in its purpose clause, a statement that it is a benefit corporation; however, doing so will give any dissenting shareholder the right to have his or her shares repurchased at “fair market value.” (Corporations Code Section 14603.)

- (3) The interests of customers of the benefit corporation as beneficiaries of the general or specific public benefit purposes of the benefit corporation.
- (4) Community and societal considerations, including those of any community in which offices or facilities of the benefit corporation or its subsidiaries or suppliers are located.
- (5) The local and global environment.
- (6) The short-term and long-term interests of the benefit corporation, including benefits that may accrue to the benefit corporation from its long-term plans and the possibility that these interests may be best served by retaining control of the benefit corporation rather than selling or transferring control to another entity.²
- (7) The ability of the benefit corporation to accomplish its general, and any specific, public benefit purpose.

(Corporations Code Section 14620(b).)

Unless the benefit corporation has stated its intention to give priority to a specific public benefit purpose identified in the Articles, directors are not required to give priority to any one or more of the factors listed above or the interests of any particular person or group over any of the other factors listed above or the interests of any other person or group. (Corporations Code Section 14620(d).)

Each officer of a benefit corporation is also required to consider the interests and factors described above when (1) the officer has discretion to act with respect to a matter, or (2) it reasonably appears to the officer that the matter may have a material effect on (A) the creation of a general or specific public benefit by the benefit corporation, or (B) any of the interests or factors referred to in Section 14620(b) as outlined above. (Corporations Code Section 14622(a).)

Accountability – Third-Party Standard

A benefit corporation is required to select a third-party standard against which the corporation's success in fulfilling its general or any special public benefit is assessed.

“Third-party standard” means a standard for defining, reporting, and assessing overall corporate social and environmental performance. The standard must be a comprehensive assessment of the impact of the business and its operations upon the considerations listed in Section 14620(b), paragraphs (2) to (5). The standard must have been developed by an entity that has no material financial relationship with the benefit corporation or any of its subsidiaries and must satisfy both of the following requirements:

² Although this is only a single factor to be considered, it is unclear how this would be reconciled with the interests of shareholders presented with a financially beneficial merger or sale opportunity.

- (A) Not more than one-third of the members of the governing body of the entity whose third-party standard is designated as the benchmark are representatives of any of the following:
 - (i) Associations of businesses operating in a specific industry, the performance of whose members is measured by the standard.
 - (ii) Businesses from a specific industry or an association of businesses in that industry.
 - (iii) Businesses whose performance is assessed against the standard.
- (B) The entity is not materially financed by an association or business described in subparagraph (A).

The qualifying third-party standard must also have been developed by an entity that does both of the following:

- (A) Accesses necessary and appropriate expertise to assess overall corporate social and environmental performance, and
- (B) Uses a balanced multi-stakeholder approach, including a public comment period of at least 30 days to develop the standard.

Finally, for the third-party standard to be valid, all of the following information regarding the standard must be publicly available:

- (A) The criteria considered when measuring the overall social and environmental performance of a business.
- (B) The relative weightings assigned to the criteria described in subparagraph (A).
- (C) The identity of the directors, officers, any material owners, and the governing body of the entity that developed, and controls revisions to, the standard.
- (D) The process by which revisions to the standard and changes to the membership of the governing body described in subparagraph (C) are made.
- (E) An accounting of the sources of financial support for the entity, with sufficient detail to disclose any relationships that could reasonably be considered to present a potential conflict of interest.

Annual Reporting Requirements

The law is written to promote transparency. Accordingly, directors of a benefit corporation are required to prepare an annual benefit report to its shareholders. (Corporations formed under the General Corporation Law are required to issue annual reports to shareholders only if the

corporation has more than 100 shareholders.) The report is to be sent annually to each shareholder within 120 days following the end of the corporation's fiscal year. The report must include a narrative description of all of the following:

- (A) The process and rationale for selecting the third-party standard used to prepare the benefit report.
- (B) The ways in which the benefit corporation pursued a general public benefit during the applicable year and the extent to which that general public benefit was created.
- (C) The ways in which the benefit corporation pursued any specific public benefit that the Articles state it is the purpose of the benefit corporation to create and the extent to which that specific public benefit was created.
- (D) Any circumstances that have hindered the creation by the benefit corporation of a general or specific public benefit.

(Corporations Code Section 14630.)

In addition, the annual report must include an assessment of the overall social and environmental performance of the benefit corporation, prepared in accordance with a third-party standard applied consistently with any application of that standard in prior benefit reports or accompanied by an explanation of the reasons for any inconsistent application. The assessment does not need to be audited or certified by a third-party. (Corporations Code Section 14630(a)(2).)

Next, the annual report must include the name of each person that owns five percent or more of the outstanding shares of the benefit corporation, either beneficially, to the extent known to the benefit corporation without independent investigation, or of record. (Corporations Code Section 14630(a)(3).) For those who prefer the corporate form because of the anonymity of shareholders, this disclosure requirement will be viewed as a negative.

Further, the annual benefit report must include a statement indicating whether, in the opinion of the Board of Directors, the benefit corporation failed to pursue its general, and any specific, public benefit purpose in all material respects during the period covered by the report. (Corporations Code Sections 14621(a) and (b).) If, in the opinion of the Board of Directors, the corporation failed to pursue its general, and any specific, public benefit purpose, the report shall also include a description of the ways in which the benefit corporation failed to pursue its general, and any specific, public benefit purpose. (Corporations Code Section 14630(a)(4).)

Finally, the report must disclose any connection between the entity that established the third-party standard, or its directors, officers, or material owners, and the benefit corporation, or its directors, officers, and material owners, including any financial or governance relationship that might materially affect the credibility of the objective assessment of the third-party standard. (Corporations Code Section 14630(a)(5).)

The corporation must post the annual benefit report on its website. If the corporation does not have a website, it is required to provide a copy of its report, without charge, to any person who requests it. (Corporations Code Section 14630(c).)

Benefit Enforcement Proceeding

A benefit corporation will not be liable for monetary damages for any failure of the benefit corporation to create a general or specific public benefit unless the court finds that a failure to comply with the Benefit Corporation Law was without justification. In that case, the court may award an amount sufficient to reimburse the plaintiff for the reasonable expenses incurred by the plaintiff, including attorney's fees and expenses, in connection with the benefit enforcement proceeding. However, the claim against a benefit corporation or its directors or officers may only be asserted in a benefit enforcement proceeding and commenced or maintained only as follows:

- (1) Directly by the benefit corporation.
- (2) Derivatively by any of the following:
 - (A) A shareholder.
 - (B) A director.
 - (C) A person or group of persons that owns beneficially or of record five percent or more of the equity interests in an entity of which the benefit corporation is a subsidiary.
 - (D) Other persons as have been specified in the Articles or Bylaws of the benefit corporation.

(Corporations Code Sections 14623(a) and (b).)

Terminating B Corporation Status And Potential Limitations On Future Merger Or Sale

A corporation formed as or adopting benefit corporation status may terminate such status at any time upon the vote of its shareholders; provided, however, that a shareholder disagreeing with such termination shall also be entitled to have his or her shares repurchased at fair market value. (Corporations Code Section 14604(a).)

Similarly, if a benefit corporation desires to enter into a transaction to sell, lease, convey, exchange, transfer, or otherwise dispose of all or substantially all of the corporation's assets, a dissenting shareholder can require the corporation to purchase his or her shares at fair market value. (Corporations Code Section 14604(d).) Since dissenter's rights do not otherwise arise in all sales transactions, this requirement could be viewed as another disadvantage of benefit corporation status.

Conclusion

California should be lauded for its adoption of this new corporate structure. It will be interesting to see how widely the structure is embraced by California entities and start-ups. While benefit corporations may enjoy market differentiation, and, hence, access to a greater pool of clients or customers, as well as capital, do these benefits outweigh the requirements and limitations?