

New York Benefit Corporations: A New Breed of Social Entrepreneurship

Deborah Buyer Law
58 East 11th Street, 8th Floor
New York, NY 10003
t:212-225-8483
f: 646-737-9953
email: deborah@deborahbuyerlaw.com
www.deborahbuyerlaw.com



Presentation Overview

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- Limitations of Traditional Corporations
- New York Constituency Statute
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New York Benefit Corporations

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Environment for Social Entrepreneurship

Consumers

- Increase in consumer purchasing decisions based on social and environmental responsibility.
- “Greenwashing” – Marketers use of socially-conscious terms, such as “green” or “sustainable” without specific standards.
- Evolution of industry certifications, such as “LEED”, “Organic”, “Fair Trade”, and “Energy Star”.

Investors

- Evolution and growth of “socially responsible investing”
 - Professional asset management market
 - Venture capital & private equity
 - Individual investors
- Approaches
 - Avoiding “sin” investments
 - “Impact investments” through targeted equity and debt investments

Entrepreneurs

- Increasing number of sustainable business associations, including Social Venture Network (<http://svn.org/>), Investors’ Circle (<http://www.investorscircle.net/>), Social Investment Forum (<http://ussif.org/>), Business Alliance for Local Living Economies (<http://www.livingeconomies.org/>)*
- Increase in Business School Social Entrepreneurship programs

*The author’s inclusion of the above listing is not an endorsement. This is not an exclusive list.

Limitations of Traditional Corporations

- Current state laws governing corporations make it difficult for businesses to take employee, community and environmental interests into consideration when making corporate decisions.
- Historical legal framework for corporations:
 - “A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.” *Dodge v. Ford* , 204 Mich. 459, 507; 170 NW 668, 684 (1919).
- In making decisions, a corporation’s Directors owe the following duties to the corporation:
 - Duty of Loyalty: Directors must pursue best interest of corporation over their own.
 - Duty of Care: Directors must exercise good business judgment and use ordinary care and prudence in operation of business.
- Directors may consider factors other than Shareholder value only to the extent permitted in the state’s “constituency statute”.

Limitations of Traditional Corporations

- In states without constituency statutes, ***including Delaware***, Directors are obligated to maximize Shareholder value.
- A public service mission which does not maximize economic value for Shareholders may be an invalid corporate purpose and inconsistent with Director fiduciary duties. *eBay Domestic Holdings, Inc. v. Newmark*, 36 A.2d 1 (Del. Ch. 2010).
- Types of Board of Director decisions (in ascending order of level of scrutiny):
 - Day-to-day decisions: Business Judgment rule
 - Defensive decisions (e.g., hostile takeover)
 - Change in control decision (e.g., sale)

Limitations of Traditional Corporations

- In states with constituency statutes, *including New York*, a Board of Directors may (but is not required) to consider the effects of a decision not only on the shareholders, but also on other defined “constituency groups”.
- In a hostile takeover situation, a constituency statute may permit a Board of Directors to favor of a deal that is better for the company’s employee and community over a deal with a higher purchase price that would be detrimental to the community.
- If there is no competing deal, a constituency statute may permit a board to reject a transaction based on its impact on the community.

New York Constituency Statute

New York's constituency statute permits Directors to consider the effects of a corporation's actions in the short-term or the long-term upon:

- (i) the prospects for potential growth, development, productivity and profitability of the corporation;
- (ii) the corporation's current employees;
- (iii) the corporation's retired employees and other beneficiaries receiving or entitled to receive retirement, welfare or similar benefits from or pursuant to any plan sponsored, or agreement entered into, by the corporation;
- (iv) the corporation's customers and creditors; and
- (v) the ability of the corporation to provide, as a going concern, goods, services, employment opportunities and employment benefits and otherwise to contribute to the communities in which it does business.

BCL§ 717(b)(2)(i)-(v)

Limitations of Nonprofit Organizations

- Must be organized for charitable purposes
- No shareholders
- Prohibited from distributing profits to owners
- Limited debt financing
- Compensation limitations
- Complexity of hybrid structures
- IRS oversight
- Significant disclosure requirements

Limitations of Other Corporate Structures

- LLCs
 - Governed largely by operating agreement
 - Less opportunity for venture and private equity investment than traditional corporations
- L3Cs
 - Available in 8 states: Illinois, Louisiana, Maine, Michigan, North Carolina, Utah, Vermont, and Wyoming.**
 - Similar to LLC but recognizes that social mission takes priority over profit objective.
- Flexible Purpose Corporations
 - California only (California Corporate Flexibility Act, 2011)
 - Permits companies to pursue “special purpose” beyond maximizing shareholder value

**805 ILL. COMP. STAT. § 180/1-26; LA. REV. STAT. ANN. § 12:1302 (2011); ME. REV. STAT. ANN. tit. 9, § 1611 (2011); MICH. COMP. LAWS § 450.4101 (2011); N.C. GEN. STAT. § 57C-2-01 (2011); UTAH CODE ANN. § 48-2c-412 (West 2011); VT. STAT. ANN. tit. 11 § 3001(27); WYO. STAT. ANN. § 17-15-102(a)(ix).

Benefit Corporations: An Overview

- 7 states have passed Benefit Corporation (B Corp) legislation:
 - Maryland, Vermont, New Jersey, Virginia Hawaii, California and New York***
- Additional states have introduced B Corp bills:
 - Michigan, Pennsylvania and North Carolina****
- According to BNA, there are currently 517 registered benefit corporations representing \$2.9 billion in revenue.
- The Benefit Corporation movement was spearheaded by B Lab, a non-profit that developed the concept of benefit corporations. According to their website, B Lab seeks to drive systematic change through the following initiatives:
 - Building a community of Certified B Corps so the public can differentiate between “good companies” and just good marketing.
 - Accelerating the growth of the impact investing asset class.
 - Promoting legislation creating benefit corporations.

***MD. CODE ANN., CORPS. & ASS'NS § 5-6C-01 (2011); N.J. STAT. ANN. § 14A:18- 1 (2011); VT. STAT. ANN. tit. 11A, § 21.02 (2011); VA. CODE ANN. § 13.1-782 (2011); S.B. 1462, 26th Leg., Reg. Sess. (Haw. 2011); CAL. CORP. CODE § 14600 et. Seq.; S.B. 79-A, 2011-2012 Gen. Assemb., Reg. Sess. (N.Y. 2011).

****S.B. 360, 96th Leg., Reg. Sess. (Mich. 2011); S.B. 26, 2011-2012 Gen. Assemb., Reg. Sess. (N.C. 2011); S.B. 433, 2011-2012 Gen. Assemb., Reg. Sess. (Pa. 2011).

Benefit Corporations: An Overview

- B Corps utilize a “triple bottom line” approach to business, traditionally characterized as focusing on “People, Profits, Planet”.
- General Requirements of B Corp Legislation:
 - Corporate purpose to create a material positive impact on society and the environment;
 - Expanded fiduciary duties of directors requiring consideration of non-financial interests; and
 - Obligation to report on overall social and environmental performance as assessed against a comprehensive, credible, independent and transparent third-party standard.
- Benefit corporations provide the following protections:
 - Directors have a legal defense to Shareholder lawsuits if, for example, the B Corp decides to safeguard workers’ rights or protect the environment, and the company’s profits drop.
 - B Corps also enable Shareholders to hold Directors accountable for a company’s failure to create a material positive impact on society or consider the impact of decisions on employees, community and the environment.
 - B Corps generally cannot be sold to non-benefit corporations without approval of a supermajority of Shareholders, and B Corps cannot be forced into hostile takeovers that would change the company’s mission.
- B Corp laws are generally untested, so it is too soon to tell how the protections will actually work.

New York Benefit Corporations: Legislation

- 7th state to enact B Corp legislation.
- NYS B Corp legislation (S. 79) was signed into law by Governor Cuomo on December 12, 2011. The legislation amends Article 17 of the NY Business Corporation Law (“BCL”). NYS B Corp law is effective February 10, 2012.
- The B Corp bill was proposed by the American Sustainable Business Council and B Lab.
- According to BNA, the following companies registered as B Corps on February 10, 2012: Agrodolce for Fast Foodies, Call2Action, Clay.com, Corn Cow Inc., eco, Greyston Bakery, On Belay Business Advisors, Outlier, Sahara Reporters, Singlebrook Technology, Stephen Vardin & Colleagues, Inc., and Strugatz Ventures.

New York Benefit Corporations: Formation

- A new corporation can incorporate as a B Corp by including in its Certificate of Incorporation that it is a Benefit Corporation. BCL §1703.
- An existing corporation may become a B Corp by amending its Certificate of Incorporation to add a statement that it is a Benefit Corporation, subject to the approval of a “Supermajority” of the shareholders. BCL §1704(A).
- A Supermajority vote requires the approval of at least a three-quarters of the shareholders. BCL §1702(D). The B Corp legislation also requires Supermajority shareholder approval of:
 - A merger or consolidation of a corporation that is not a B Corp, in which the surviving corporation will be a B Corp. BCL §1704(B)&(C).
 - Amendment of a B Corp’s Certificate of Incorporation to terminate its B Corp status. BCL §1705(A).
 - A merger or consolidation of a B Corp, in which the surviving corporation is not a B Corp. BCL §1705 (B)&(C).

New York Benefit Corporations: Purpose

- Every B Corp must have a purpose of creating “General Public Benefit”, which is defined as “a material positive impact on society and the environment, taken as a whole, assessed against a third-party standard, from the business and operations of a benefit corporation.” BCL §1702(B) and §1706(A)
- A B Corp may also identify one or more “Specific Public Benefits” in its Certificate of Incorporation, which may include any of the following:
 - Providing low-income or underserved individuals or communities with beneficial products or services;
 - Promoting economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business;
 - Preserving the environment;
 - Improving human health;
 - Promoting the arts, sciences or advancement of knowledge;
 - Increasing the flow of capital to entities with a public benefit purpose; or
 - The accomplishment of any other particular benefit for society or the environment.BCL §1702(E) and §1706(B).
- Specific Public Benefits may be added, amended or deleted in the Certificate of Incorporation by approval of a Supermajority of the shareholders. BCL §1706(D).

New York Benefit Corporations: Third Party Standard

- B Corps must have the success of their activities assessed against an *independent and transparent* recognized Third Party Standard for defining, reporting and assessing general public benefit. BCL §1702(B), (C) & (G).
- The independence prong requires that the third party have no material relationship with the B Corp (e.g., the third party cannot be a former employee within last three years, an immediate family member of an executive officer within last three years, or a 5% beneficial owner). BCL §1702(C) & (G)(1).
- The transparency prong requires that the following information about the standard be publicly available:
 - The factors considered when measuring performance;
 - The relative weightings of those factors; and
 - The identity of the persons who developed and control the changes to the standard, and the process by which such changes are made.BCL §1702(G)(2).

New York Benefit Corporations: Third Party Standard

- B Lab provides a comprehensive certification process to B Corps****. They assess benefit corporations by assigning scores to various areas of public benefit, and assigning weight to each factor based on the B Corp's size and industry. If the B Corp meets the minimum required score, it receives a becomes a Certified B Corporation. <http://www.bcorporation.net/>
- Other Third Party Standards include****:
 - Ceres Roadmap to Sustainability, <http://www.ceres.org/>
 - Food Alliance Certified, <http://www.foodalliance.org/>
 - Global Reporting Initiative, <https://www.globalreporting.org>
 - Good Guide Company Ratings, <http://goodguide.com>
 - Green America Business Network, <http://www.greenamerica.org/>
 - Green Seal Business Certification, <http://www.greenseal.org/>
 - ISO 26000, http://www.iso.org/iso/social_responsibility
 - People4Earth Business Framework, <http://www.people4earth.org/>
 - Sustainable Farm Certification, <http://sanstandards.org/>
 - Underwriters Laboratories, <http://www.ul.com/>
- The NYS law does not address the consequences of failing to meet a Third Party Standard or if a B Corp can “forum shop” for a Third Party Standard that will certify them.

****The author's inclusion of the above listings is not an endorsement of any certification or third party standard. This is not an exclusive list of certifications or third party standards.

New York Benefit Corporations: Benefit Report

- B Corps must deliver an annual “Benefit Report” to their shareholders. BCL §1708
- The annual Benefit Report must include in narrative form:
 - The process and rationale for selecting the Third Party Standard used to prepare the Benefit Report;
 - The ways in which the ways in which the B Corp pursued the General Public Benefit during the year and the extent to which General Public Benefit was created;
 - The ways in which the B Corp pursued any Specific Public Benefit included in its Certificate of Incorporation and the extent to which that Specific Public Benefit was created; and
 - Any circumstances that hindered the creation of its General or Specific Public Benefit.BCL §1708(A)(1).
- The annual Benefit Report must also include:
 - An assessment of the B Corp’s performance relative to its General Public Benefit purpose assessed against a Third Party Standard, and an assessment of the performance of the B Corp relative to its Specific Public Benefit Purpose; and
 - Information about director compensation and the names of 5% beneficial owners.BCL §1708(A)(2), (3) & (4).
- The Benefit Report must also be filed with the NYS Department of State and posted on the B Corp’s website (minus compensation & financial information). BCL §1708(C) & (D).
- B Corps must also meet any other applicable reporting requirements for corporations generally. BCL §1708(E).

New York Benefit Corporations: Conduct of Directors and Officers

- Directors and Officers of B Corps *must* consider the effects of any action upon *all of the following*:
 - The ability of the B Corp to accomplish its General and any Specific Benefit purposes;
 - The B Corp’s shareholders;
 - The employees and workforce of the B Corp and its subsidiaries and suppliers;
 - The B Corps customers as beneficiaries of its General or Specific Benefit purpose;
 - Community and societal considerations, including those of any community in which offices or facilities of the B Corp or its subsidiaries or suppliers are located;
 - The local and global environment; and
 - The short and long-term interests of the B Corp, including benefits that may accrue to the B Corp from its long-term plans and the possibility that those interests may be best served by the continued independence of the B Corp.
- BCL §1707(A)(1).

New York Benefit Corporations: Conduct of Directors and Officers

- B Corps are *required* to address their public benefit purpose in the Certificate of Incorporation. Thus, B Corp Directors and Officers *must* seek to achieve those benefit purposes in furthering the interests of the B Corp.
- Note: shareholder interests are only one factor to consider in B Corp decision-making.
- Directors and Officers are not required to give priority to the interests of any one person or group unless clearly stated in the B Corp's Certificate of Incorporation. BCL §1707(A)(3).
- In a potential sale or takeover of a B Corp, Directors and Officers may consider the resources, intent and conduct of those seeking to acquire control of the B Corp and any other pertinent factors or interests of any other group that they deem appropriate. BCL §1707(A)(2).

New York Benefit Corporations: Additional Considerations

- Enforcement
 - The new law amends Section 720(a)(1) of the BCL to state that an action may be brought against a Director or Officer of a B Corp for failure to pursue the B Corp's benefit purposes, the failure to deliver a Benefit Report or a general violation of the standards of conduct under Article 17 of the BCL.
- Taxes
 - There are no Federal, New York State or New York City tax provisions giving special treatment to B Corps.
- Amendment Bill
 - A bill currently pending in the NYS Legislature would amend the Supermajority requirements under the NYS B Corp law to two-thirds vote or a higher level specified in the Certificate of Incorporation.
 - See S. 6088-2011 (N.Y. 2012) (referred to Sen. Judiciary Comm., Jan. 18), A. 8907-2011 (N.Y. 2012) (passed).

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