

Delaware Enacts Benefit Corporation Legislation

July 23, 2013

On July 17, 2013, Delaware Governor Jack Markell signed into law legislation enabling the formation of public benefit corporations in Delaware. In doing so, Delaware became the 19th state to enact this type of legislation; Massachusetts became the 10th state to do so in August 2012 when it enacted M.G.L Ch. 165E. Currently, 11 states are in the process of considering the enactment of benefit corporation legislation.

The Delaware public benefit corporation statute does not include a number of requirements that are imposed on benefit corporations formed in other jurisdictions. For this reason, the Delaware public benefit corporation may become a preferred choice of entity for social entrepreneurs.

The new law will become effective **August 1, 2013**.

This alert includes relevant background information regarding public benefit corporations, a summary of the key provisions of the new law, and a discussion of how Delaware's public benefit statute compares to similar statutes enacted in other states.

Background

The public benefit corporation is a relatively new form of corporate entity, first introduced in Maryland and Vermont in 2010. These for-profit entities are intended to operate in a responsible, socially conscious, and sustainable manner. The directors of a public benefit corporation have a fiduciary duty to conduct the affairs of the corporation for the benefit not only of stockholders, but also in the broader public interest and in the interest of those affected by the corporation's activities.

The business judgment rule generally protects decisions made by a corporation's directors. Under this rule, courts are reluctant to second-guess directors' corporate decisions. This changes in a takeover or change of control situation, however. In such cases, courts have been inclined to require that directors obtain the highest price possible in order to maximize the benefit to shareholders. This potentially jeopardizes or weakens the corporation's focus on social and/or environmental considerations.

The fiduciary discretion conferred on the directors of a public benefit corporation is intended to protect for-profit social enterprises whose mission is central to their existence. In addition, this fiduciary discretion is intended to combat "short-termism" in corporate decision making.

Proponents of benefit corporations believe that such entities are well-positioned to attract talent and customers who value progressive and sustainable enterprises and to tap into funding from investors who want to both realize a profit and support broader social goals.

Delaware is the legal home to more than one million legal entities, including many of the nation's largest businesses. Delaware's recognition of this new type of corporate entity effectively creates a valuable "seal of approval" on this new form and is expected to significantly affect the development of this area of corporate law.

The public benefit corporation legislation passed unanimously in the Delaware General Assembly.

Summary of the Delaware Public Benefit Corporation Statute

The legislation containing the provisions regarding public benefit corporations is contained in a new Subchapter XV of Title 8 of the Delaware General Corporation Law.

ORGANIZATIONAL DOCUMENTS

The certificate of incorporation and the name of the corporation must clearly indicate that the corporation is a public benefit corporation. This may be satisfied by including the phrase “public benefit corporation” in the legal name of the corporation, or including the abbreviation “P.B.C.” or “PBC” in the name.

In addition, a public benefit corporation must identify in its certificate of incorporation the specific public benefit(s) the corporation will promote. “Public benefit” for this purpose means a positive effect (or a reduction of negative effects) on one or more categories of persons, entities, communities or interests (other than stockholders, in their capacity as stockholders) including – but not limited to – effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature.

OTHER DOCUMENTS

All stock certificates and notices of meetings of a public benefit corporation must contain statements acknowledging that the corporation is a Delaware public benefit corporation.

CONVERSION OR MERGER TO BECOME A PUBLIC BENEFIT CORPORATION

A 90% affirmative vote of the outstanding shares of each class of a corporation’s stock, whether voting or non-voting, is required (i) to amend its certificate of incorporation to become a public benefit corporation or (ii) to merge or consolidate with or into another entity if, as a result, the corporation would become a domestic or foreign public benefit corporation or similar entity. The new statute also grants appraisal rights to any dissenting stockholder of a corporation that is not a public benefit corporation and becomes a public benefit corporation.

TERMINATION OF PUBLIC BENEFIT CORPORATION STATUS

A two-thirds affirmative vote of the outstanding shares of each class of a corporation’s stock, whether voting or non-voting, is required for actions that would terminate the public benefit status of the corporation.

Note that a Delaware nonstock corporation may not convert into or merge with a public benefit corporation.

Fiduciary Duties of Directors

The new law requires directors of public benefit corporations to manage the corporation in a manner that balances (i) the stockholders’ pecuniary interests, (ii) the interests of those materially affected by the corporation’s conduct, and (iii) the public benefit or public benefits identified in the corporation’s certificate of incorporation. This is referred to as a “tripartite balancing requirement” in the legislation’s official synopsis.

Directors of public benefit corporations receive significant protections against stockholder claims that challenge disinterested decisions. Such directors will be deemed to have satisfied the tripartite balancing requirement in connection with any corporate decision – and thus their duties to stockholders and the corporation – if the decision was both informed and disinterested and, in the words of the statute, “not such that no person of ordinary, sound judgment would approve.”

Directors also receive broad protection under the new law against claims based on interests other than those of stockholders. Directors are not liable as to claims asserted on account of (i) any claimed interest in the public benefits identified in the certificate of incorporation or (ii) any claimed interest of those materially affected by the corporation’s conduct.

Public benefit corporations may also include a provision in their certificates of incorporation that any disinterested decision by directors shall not constitute an act or omission not in good faith or breach of the duty of loyalty for purposes of imposing monetary liability pursuant to any provision adopted pursuant to D.G.C. L. § 102(b)(7) or determining indemnification rights pursuant to D.G.C.L. § 145.

Stockholders of a public benefit corporations may sue derivatively to enforce the directors’ duty to meet the tripartite balancing requirement but only if at the time suit is filed those stockholders individually or collectively own (i) at least 2% of the corporation’s outstanding shares, or (ii) as to corporations with shares listed on a national securities exchange, the lesser of (i) 2% of the outstanding shares or (ii) shares with a market value of at least \$2 million.

At least every two years, a Delaware public benefit corporation must issue to stockholders a statement as to the corporation's promotion of the public benefit(s) identified in the certificate of incorporation and of the best interests of those materially affected by the corporation's conduct. This statement must include the following information:

- The objectives that the board of directors has established to promote such public benefit(s) and interests;
- The standards the board of directors has 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 successes in meeting the objectives established by the board of directors; and
- An assessment of the corporation's success in meeting the objectives established by the board of directors and in promoting such public benefit(s) and interests.

In certain other jurisdictions, this statement is referred to as the corporation's "benefit report".

The certificate of incorporation or bylaws of a public benefit corporation may impose additional requirements in connection with the statement, but they are not required by statute. Specifically, the charter or bylaws may require the corporation to (i) provide the statement more frequently than once every two years, (ii) make the statement available to the public and/or (iii) use a third party standard in connection with/or obtain third party certification addressing the corporation's promotion of the public benefit(s) identified in its charter and/or the best interests of those materially affected by the corporation's conduct.

Assessment of the New Law

A Delaware public benefit corporation may be an attractive choice of entity for social entrepreneurs and carries certain advantages compared to benefit corporations formed under the laws of other states.

The Delaware law does not include requirements that are imposed on benefit corporations formed in certain other states. For example, Delaware does not require:

- The appointment of a benefit director and/or a benefit officer charged with overseeing and assessing the corporation's efforts to promote its stated public benefit(s);
- The directors to consider the impact of *each* corporate decision on multiple stakeholders (e.g., shareholders, employees, customers, suppliers, the community, the environment);
- The public disclosure of the benefit report and/or the submission of the benefit report to the secretary of state;
- The use of a third party standard or a third party assessment in connection with the benefit report; or
- The annual publication of a benefit report.

On the other hand, a Delaware public benefit corporation must state in its certificate of incorporation the specific public benefit(s) that it will promote, while the statute in certain other states, including Massachusetts, merely requires that the purposes of the benefit corporation include creating a general public benefit and leave the naming of specific public benefits optional.

In addition, the tripartite balancing requirement described above imposes an affirmative duty on the directors of a Delaware public benefit corporation to *balance* the interests of stockholders with the interests of those materially affected by the corporation's conduct and the specific public benefit(s) identified in the corporation's charter. It remains to be seen what this balancing will look like in practice – especially in situations where stockholder interests are adverse to the specific public benefit(s) named in the charter. Other states, including Massachusetts, merely provide that no one stakeholder's interests need be prioritized over those of another stakeholder but do not impose a specific requirement to balance stockholder interests with other stakeholders.

Converting to public benefit corporation status in Delaware – by amending the corporation's charter or via merger or consolidation – is subject to a higher bar than in other states. In Delaware, the conversion requires the affirmative vote of 90% of all classes of shares, whereas in many other states such a conversion merely requires the approval of two-thirds of all classes of shares.

Converting out of public benefit corporation status follows the two-third threshold found in the benefit corporation statutes of other

states.

Unlike certain other states, a public benefit corporation formed in Delaware must identify itself as such in its legal name by using the phrase “public benefit corporation” or by using the abbreviation “P.B.C.” or “PBC”. The legislation in many other states does not include this requirement and in fact refers to this type of entity as a “benefit corporation” as opposed to the Delaware practice of referring to it as a “public benefit corporation.”

Over time, this practice of referring to *public* benefit corporations as such or as PBCs may eliminate some of the confusion that has arising between benefit corporations (a creation of state statute) and “B Corps” (which is short for “Beneficial Corporations”), which are business entities certified as socially responsible by B Lab, Inc., a nonprofit corporation that promotes sustainable, socially responsible businesses.

Conclusion

The flexibility conferred under the Delaware public benefit corporation law combined with the weight and credibility of Delaware as a home to a significant percentage of the businesses in the United States, may make the Delaware public benefit corporation a compelling option for social entrepreneurs.

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