SOCIAL PURPOSE CORPORATIONS

Proposed New Chapter 23B.20 Fact Sheet October 31, 2011

SUMMARY

The proposed new Chapter 23B.20 of the Revised Code of Washington would authorize the creation of a new type of business corporation in Washington, the "social purpose corporation," designed to facilitate the organization of companies in Washington with greater flexibility for combining profitability with a broader social or environmental purpose.

BACKGROUND

A number of years ago, Ben Cohen and Jerry Greenfield, founders of Ben & Jerry's Ice Cream, told the Associated Press that because Ben & Jerry's was organized as a traditional corporation, it had no legal standing to resist Unilever's lucrative takeover offer for the company in 2000. This was because, at least in the context of a merger, laws applicable to Ben & Jerry's traditional corporate form required it to pursue the maximization of shareholder value above all other missions or purposes. Since that time, many organizations have emerged in support of creating a new form of business entity that would allow a company to dedicate itself to pursuing a social mission as well as maximizing shareholder value. In connection with this effort, some have favored creating a new class of corporation allowing companies to pursue both returns for investors and the achievement of some other social or environmental purpose.

Some commentators have expressed the belief that the use of the traditional corporate form to pursue both a social mission as well as profitability can create the risk of potential liability for managers and the risk that investors will shift the company away from the social purpose. In addition, these commentators believe the traditional corporate form provides no means to ensure transparency or accountability with respect to the managers' success in pursuing the social purpose.

The use of a traditional corporation could create potential risk for corporate directors making decisions on the basis of a social purpose or mission in certain situations, if it is done at the expense of maximizing financial returns for shareholders. This is because corporate directors generally have a duty in these situations, such as when approving a sale or merger of the company, to act solely in the interest of maximizing shareholder value.

The traditional corporate form also could present a risk for entrepreneurs and investors seeking to maintain the social mission of the entity during the life of an early-stage company. This is because new investors may shift the company away from the original social mission over time in favor of additional profitability or some other mission.

In addition, even if the risk of director liability could be eliminated and a means for maintaining the social mission of an entity were possible using the traditional corporate form, there would be no way to ensure transparency or accountability to shareholders with respect to the company's success in pursuing the social mission. This is because the traditional corporation statutes do not require the disclosure of information surrounding a company's efforts to achieve any mission.

DESIGNATED PURPOSE CORPORATIONS UNDER PROPOSED 23B.20

Proposed new Chapter 23B.20 would authorize the creation of a new type of business corporation in Washington, the "social purpose corporation." This new chapter would retain for social purpose corporations the for-profit philosophy of the traditional business corporation along with its statutory certainty and standardization, but would address the issues noted above by (1) providing directors and officers considerable flexibility in their decisions and actions, both within and outside of the ordinary course of business, when prioritizing any of the purposes of the corporation over others purposes, including, in appropriate circumstances, favoring the achievement of a social purpose over the economic interests of the shareholders; (2) anchoring the social purpose by requiring a supermajority vote to materially alter or eliminate the social purpose; and (3) facilitating transparency through communications to shareholders regarding the social purpose, including the corporation's efforts intended to promote the social purpose.

The social purpose corporation would be different from a corporation organized in Washington under the current Revised Code of Washington in the following principal ways:

- 1. Each social purpose corporation must be organized to carry out its business in a manner intended to pursue a general social purpose. The general social purpose, which must be set forth in the articles of incorporation, is to promote positive short-term or long-term effects of, or minimize adverse short-term or long-term effects of, the corporation's activities upon certain constituencies. These constituencies must include one or more of (a) the corporation's employees, suppliers or customers; (b) the local, state, national or world community; or (c) the environment.
- 2. In addition to the general social purpose, a social purpose corporation may designate one or more specific social purposes that directors and officers may consider in addition to creating economic value for shareholders when determining what is in the best interests of the social purpose corporation and its shareholders with respect to decisions about operations, policies and transactions.
- 3. Directors and officers of social purpose corporations are afforded considerable flexibility in their decisions and actions, both within and outside of the ordinary course of business. Such decisions and actions need not necessarily favor any one purpose over any other (including creating economic value for shareholders), including when such decisions and actions involve transactions such as the sale or merger of the corporation.
- 4. The social purpose is "anchored" in the social purpose corporation by the requirement of a 2/3 super-majority vote of shareholders to materially alter or eliminate any of the designated social purposes, whether through amendment of the articles of incorporation, sale, merger or otherwise.
- 5. The social purpose corporation would provide transparency and communication to its shareholders with respect to the decision-making and actions of directors and officers and the corporate actions taken by the social purpose corporation through an annual "social purpose report," which would include a narrative discussion concerning the social purpose, including the corporation's efforts intended to promote its social purpose.

Proposed chapter 23B.20 is not intended to send a message to a traditional business corporation that has historically been a good corporate citizen and made contributions or committed other resources to the betterment of the community or society generally that such activities would no longer be appropriate. To the extent a director of a traditional business corporation is entitled to consider and give weight to any purpose as he or she deems relevant in discharging his or her duties as a director, proposed chapter

23B.20 will not change that entitlement. A traditional business corporation under RCW 23B.03.020 will still have the corporate power under the statute to make donations for the public welfare or for charitable, scientific, or educational purposes; to transact any lawful business that will aid governmental policy; or to make payments or donations, or do any other act, not inconsistent with law, that furthers the business and affairs of the corporation.

LEGISLATION IN OTHER STATES

Some forms of legislation adopted or considered in other states addressing alternative corporate forms are prescriptive rather than permissive in nature. For example, Vermont, Maryland, Virginia, and New Jersey have adopted statutes creating a new form of corporation called a "benefit corporation." Under these statutes, benefit corporations are required to create a "material positive impact on society and the environment" and may specify one or more "specific public benefits." This form of statute is prescriptive in nature. Among other requirements, this form of corporation would require a company's directors to consider the shareholders, employees, suppliers and customers, community and societal considerations, and the local and global environment when making <u>any</u> decision to act or not to act in a corporate capacity. This form of corporation would also require each company to make an assessment of its performance measured against a specified third-party standard. These statutes were based on proposed legislation created and promoted by B Lab, a Philadelphia-based non-profit, which has been lobbying state legislatures to pass such laws.

Several other states have been reported to be considering adopting statutes similar to the versions adopted by Vermont, Maryland, Virginia and New Jersey, including New York, Pennsylvania and Michigan.

California recently adopted amendments to its corporation statute that would provide for "flexible purpose corporations," which should be more similar to social purpose corporations under proposed 23B.20. Unlike Washington's proposed statute, however, California's flexible purpose corporation statute appears to blur the line between for-profit and nonprofit entities and will impose extensive and detailed disclosure obligations on all flexible purpose corporations regardless of the size or nature of individual entities. In addition, California simultaneously enacted another bill that permits the formation of "benefit corporations" under a statutory model similar to the model for which B Lab has been lobbying around the country. It would seem that having these two statutory schemes in California will be confusing for social/environmental purpose entrepreneurs and practitioners alike.

Consistent with the enabling nature of title 23B RCW, proposed chapter 23B.20 takes a permissive rather than prescriptive approach. Although each social purpose corporation must adopt the enumerated general social purpose, proposed chapter 23B.20 does not attempt to legislate corporate behavior. Rather, proposed chapter 23B.20 would enable each social purpose corporation to determine what corporate behavior is applicable to it by so stating in its articles of incorporation. For example, shareholders of a social purpose corporation can choose to require directors and officers to consider the impacts of each corporate action or proposed corporate action on one or more of the social purposes of the corporation. Similarly, shareholders may elect to require the corporation to furnish an annual assessment of the overall performance of the corporation with respect to the achievement of its social purposes, measured against a third-party standard. The flexibility of proposed chapter 23B.20 will accommodate all companies that want to combine pursuing a social mission with the traditional for-profit corporate form, ranging from those corporations that desire a more prescriptive model similar to the B Lab-inspired "B Corp" to those that desire a different model.

SUPPORT

From the spring of 2010 until the summer of 2011, the 13-member WSBA Corporate Act Revision Committee (CARC) worked on this proposal at which time CARC unanimously approved it and recommended that it be included as part of the 2012 Bar bill that the WSBA will present to the Washington Legislature. The CARC membership reflects a diverse background of interests and points of view, including several of the leading Washington corporate and securities lawyers, a representative of the Secretary of State, the General Counsel of a mature privately held Washington corporation, the General Counsel of a public company located in Eastern Washington, and a corporate law academic from each of the University of Washington and Seattle University as well as an ad hoc member who has represented the Washington lawyers who represent, or wish to represent, sustainable businesses. In September 2011, the Executive Committee of the WSBA Business Law Section unanimously approved proposed RCW 23B.20.