ADVISORY

SULLIVAN & WORCESTER LLP CORPORATE ADVISORY

Balancing the Public Good and Stockholder Value: Delaware Permits Formation of Public Benefit Corporations

As of August 1, 2013, Delaware has a new type of entity: the public benefit corporation (PBC). With 17 businesses submitting the paperwork necessary to become a public benefit corporation, filings in Delaware exceeded those in any other jurisdiction on the first day of eligibility to form a PBC. Well known companies, such as Campbell Soup Company brand Plum Organics, have filed in Delaware to become a PBC.

Nineteen other jurisdictions, including New York, Massachusetts, and Washington D.C. have enacted similar legislation.

A benefit corporation is a for-profit entity which is managed not only for the pecuniary interests of its stockholders but also for the benefit of other persons, entities, communities or interests.

NEW ENTITY

The Delaware General Corporation Law (DGCL) was amended to add new Subchapter XV, Public Benefit Corporations.[1] Under the DGCL, a PBC is a for-profit corporation organized under the DGCL that is intended to produce a public benefit and to operate in a responsible and sustainable manner. In the certificate of incorporation, a PBC must (i) identify one or more specific public benefits to be promoted by the corporation, and (ii) state within its heading that it is a public benefit corporation.

Under the DGCL, "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), including effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature.

IF YOU WOULD LIKE ADDITIONAL INFORMATION, PLEASE CONTACT:

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[1] http://delcode.delaware.gov/title8/c001/sc15/

DUTIES OF DIRECTORS

Subchapter XV imposes on directors of PBCs a three-part balancing requirement.

The board of directors of a PBC must manage the business and affairs of the PBC 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 identified in its certificate of incorporation.

A PBC director does not have any duty to persons on account of any interest of such persons in the public benefit identified in the corporation's certificate of incorporation or on account of any interest materially affected by the corporation's conduct.

PERIODIC STATEMENTS AND THIRD PARTY CERTIFICATION

PBCs must include in every notice of a meeting of stockholders a statement to the effect that it is a PBC formed pursuant to Subchapter XV of the DGCL.

At least once every two years, a PBC must provide its stockholders with a statement as to the corporation's promotion of the public benefit identified in the certificate of incorporation and of the best interests of those materially affected by the corporation's conduct.

The statement must include:

- the objectives established by the board of directors to promote such public benefit and interests;
- the standards adopted by the board of directors to measure the corporation's progress in promoting such public benefit and interests;
- objective factual information based on those standards regarding the corporation's success in meeting the objectives for promoting such public benefit and interests; and
- an assessment of the corporation's success in meeting the objectives and promoting such public benefit and interests.

The certificate of incorporation or bylaws of a PBC may require that the corporation:

- provide the statement more frequently than biennially;
- make the statement available to the public; and/or
- use a third-party standard in connection with and/or attain a periodic third-party certification, such as Certified B Corporation as certified by B Lab, addressing the corporation's promotion of the public benefit identified in the certificate of incorporation and/or the best interests of those materially affected by the corporation's conduct.

DERIVATIVE SUITS

Stockholders of a PBC owning individually or collectively at least 2% of the PBC's outstanding shares or, in the case of a corporation with shares listed on a national securities exchange, the lesser of 2% of the outstanding shares or shares of at least two million dollars in market value, may maintain a derivative lawsuit to enforce the duties of the PBC directors.

CONVERTING TO A PBC

A corporation may not, without the approval of 90% of the outstanding shares of each class of stock of the corporation, convert to a PBC.

Any stockholder of a corporation that has not voted in favor of such corporation's conversion to a PBC is entitled to appraisal rights.

FUNDING A PBC

Many are skeptical of the overall usefulness of benefit corporations; after all, boards of directors of corporations are permitted to consider interests other than stockholder interests when making decisions; therefore, wouldn't companies that mandate they do so be less attractive investments to potential investors? Others see Delaware as part of a growing trend of more and more companies seeking to legitimize purposes beyond merely generating profit and maximizing stockholder value.

Some socially responsible or mission driven investors may seek out investment opportunities in benefit corporations. In other instances, being a benefit corporation may add legitimacy to a company's claims of being responsible, which may make it more attractive to customers, employees, and investors.

The Securities and Exchange Commission's impending lifting of the ban on general solicitation and general advertising in private offerings, which will be effective on September 23, 2013, will increase corporate access to the pool of potential investors.[2] This will allow socially responsible companies greater access to socially responsible investors.

The three-part balancing of interests may force PBCs to take a longer term view, instead of focusing in the short-term on share price, which, with the rise of secondary markets, is no longer just an issue for public companies.

A NOTE ON DELAWARE

We believe that despite the number of jurisdictions now permitting the formation of benefit corporations, most companies will choose to form in Delaware.

In addition to Delaware's well settled corporate law, the Delaware PBC statute has fewer requirements than many of the jurisdictions which have enacted similar legislation.

For example, Delaware does not require the designation of a benefit director, a director who oversees and reports on the corporation's benefit goals, as is required in Massachusetts and Washington D.C. Instead of once a year as required by Massachusetts, New York and Washington D.C., Delaware requires PBCs to prepare a benefit statement, discussed above, every two years. As part of its benefit statement, New York and Washington D.C. require a benefit corporation to assess its performance against an independent and transparent third-party standard, whereas the use of third-party certification is optional in Delaware. Finally, Massachusetts, New York and Washington D.C. require the benefit statement to be filed in such jurisdiction and to be made available on the corporation's website, whereas Delaware does not.

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To obtain further information about benefit corporations, choice of entity, entity formation, or the DGCL, please contact the lawyer at Sullivan & Worcester LLP with whom you regularly consult, or the lawyer listed above.

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[2] See our advisory, SEC Lifts Ban on General Solicitation and Proposes New Rules for Private Offerings.