

LAW WEEK

COLORADO

Benefit Corporations: New Breed Or Old Wine In New Skins?

By **Herrick K. Lidstone, Jr.**
BURNS, FIGA & WILL

ONE OF THE ITEMS on Gov. John Hickenlooper's call for the recently completed special session of the Colorado General Assembly was benefit corporations. What are these entities and how do they fit into Colorado law?

Where do they come from?

In decision-making, directors of corporations formed under the Colorado Business Corporation Act and the business corporation laws of other states must meet the business judgment rule which requires, in part, that when making decisions on behalf of the corporation, directors do so in the best interests of the corporation and its shareholders — generally profit maximization.

A corporation may take into account other factors, such as the interests of employees, society or the environment; but it must be in the profit-making context. Many corporations advertise organically grown ingredients, sustainably grown coffee or contributions to local schools or charities. They do so in the name of marketing.

Some entrepreneurs may desire to institutionalize their socially or environmentally beneficial conduct. More importantly, some entrepreneurs may desire to protect the corporation from a purely economic decision should there be a takeover attempt by a company that may not have the same social or environmental objectives.

While it is possible that these social and environmental attributes can be documented in articles of incorporation or shareholder agreements, the benefit corporation specifically authorizes the directors, when making these decisions, to consider constituencies other than the shareholders and the profit maximization motive.

The origin of benefit corporations

The benefit corporation is an idea that was developed several years ago by B Lab Co. of Berwyn, Pa. It developed a trademark for business entities that meet its standards for goodness, a "B" in a circle. The certification process requires a multi-step review and ultimately a review by B Lab itself.

The cost of the certification depends on the business' revenues but is up to \$25,000 per year. Upon certification, the business may use the term "B Corp" and its mark. B Lab has certified 13 Colorado entities, including a Colorado cooperative, six Colorado limited liability companies and six Colorado corporations.

B Lab does not have a trademark on the name "benefit corporation" and in fact has sponsored legislation in a number of states,



including Colorado. Beginning in September 2009 a B Lab attorney commenced discussing benefit-corporation legislation with a group of Colorado attorneys who were considering other amendments to the state's business corporation act.

Without participation by the group of Colorado attorneys, Senate Bill 11-005 was introduced in the 2011 General Assembly, but (after amendments) the bill was pulled just before the first committee hearing.

Also without participation by the Colorado attorneys, the same sponsor introduced Senate Bill 12-182 at the end of the 2012 General Assembly. It was caught up in the issues surrounding civil-union legislation and was reintroduced during the special session as Senate Bill 12S-003. House Bill 12S-1007, supported by the Colorado Bar Association, was also introduced, but both died in the same House committee.

Colorado legislation

B Lab has promoted benefit corporations as a mechanism for giving corporations the flexibility to pursue socially desirable objectives while still attempting to make pecuniary profit. Unfortunately, the B Lab legislation as set forth in the Senate bill provided for inflexibility, complexity and costliness.

Among other things, the bill would require any corporation electing to be a benefit corporation to:

- Pursue a general public benefit for society and the environment without any ability to limit the nature of the general public benefit;
- Obtain an annual third party assessment from an entity that meets the standards contained in a page-and-a-half long definition that will only be satisfied by a few, or perhaps only one, existing standard;
- Have an independent benefit director on

the board of directors with the responsibility of assessing whether the benefit corporation accomplished its general public benefit and preparing and publishing an annual benefit report to the shareholders (which report is subject to a three page definition);

- Eliminate the business judgment rule in a manner that would leave no recourse to shareholders should the directors give, for example 100 percent priority to the general public benefit and nothing to the interests of the shareholders; and

- Provide for a benefit proceeding by which certain designated persons could challenge whether the directors adequately accomplished the general public benefit and any specific public benefit named in the articles of incorporation.

Unlike the Senate bill, the House bill:

- Allowed the shareholders to determine the nature of the benefit they wanted their corporation to pursue;

- Adopted the existing standard of care for directors but added another layer of issues (the shareholder-determined beneficial purpose) for the directors to consider in their decision-making; and

- Allowed the shareholders to determine whether they wanted to incur the expense of an independent benefit director, a third-party assessment, an annual benefit report, and to define their governance should they desire to do so.

The proponents of the Senate bill argued that the House bill was unacceptable because it was inconsistent with B Lab sponsored legislation. The group of Colorado attorneys agreed that the House bill would have opened up the benefit-corporation experience to a much larger number of Colorado corporations choosing to make that election, but in a manner inconsistent with B Lab's national marketing plan. The group also believes the future of benefit corporations is in greater flexibility and that the General Assembly should define the term "benefit corporation" in Colorado's best interests, not in the interests of a private company.

Importantly, all benefit corporations are not the same. There is variety even among the existing benefit-corporation statutes that have been adopted by different states. A benefit corporation adopted under Vermont law is not the same as a benefit corporation adopted under California law, and differs from a benefit corporation adopted under Hawaii law. Business corporations themselves are not the same from state to state. Each has variations adapted to that state and culture.

Thus, there is no need to make benefit corporation legislation the same around the

country. Shareholders of a Colorado corporation should be allowed to define their own structure, similar to a limited liability company.

Other benefit corporation issues

The group of Colorado attorneys have attempted to work with the sponsors and the proponents of benefit-corporation legislation to make it Colorado-centric, and the sponsor and B Lab accepted two of those provisions: dissenters' rights to shareholders of a corporation converting to a benefit corporation, and a provision that dealt with the interaction between Colorado Charitable Solicitations Act and the Colorado Securities Act.

Neither B Lab nor the proponents of the Senate bill have considered the potential impact of the Internal Revenue Code on benefit-corporation operations. It is unclear if benefit-corporation expenditures for their benefit purpose (as compared to their profit purpose) are entitled to a deduction under §162(a) of the code.

Neither B Lab nor the proponents of the Senate bill have attempted to craft a bill adequately defining the directors' fiduciary duties and standards of conduct. By mandating that the directors consider a wide range of duties in their decision-making process, the Senate bill and B Lab legislation leave the directors accountable to no one.

The way forward

There is still debate among the group of Colorado attorneys on the best manner of proceeding in anticipation of the 2013 General Assembly. Benefit corporations are of interest not only in Colorado but also nationally. The group will be working to define benefit-corporation legislation for Colorado that provides flexibility to the state's businesses that choose to elect benefit-corporation status.

If a Colorado benefit corporation wishes to meet the B Lab procedures for an assessment or a certification, they can do so.

If a Colorado benefit corporation desires a less complex approach but still wants to retain the ability to "do good" in a manner defined by the shareholders, it can do so.

In the end, Colorado does not need to adopt a law to support a private company's national marketing plan; it needs to adopt a law good for Colorado. •

— Herrick K. Lidstone, Jr., is a shareholder of Burns Figa & Will. He practices in the areas of business transactions, including partnership, limited liability company, and corporate law, federal and state securities compliance, and mergers and acquisitions. He can be reached at hklidstone@bfiwlaw.com