Tuesday, October 2, 2012
11:00 AM - 12:30 PM

405 – Redefining the Corporate Form for the 21st Century

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General Counsel
New Island Capital

Will Fitzpatrick
General Counsel
Omidyar Network

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Eric Talley
Professor of Law, Co-Director, Berkeley Center for Law, Business and the Economy
University of California, Berkeley School of Law

Faculty Biographies

Jordan Breslow
General Counsel
New Island Capital

Will Fitzpatrick
General Counsel
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Suz Mac Cormac

Diana L. Reed is senior counsel for PPG Industries, Inc. in Pittsburgh, PA. Her responsibilities include management of toxic and environmental tort litigation, counsel for product stewardship functions, and management of litigation hold and e-discovery activities.

Prior to joining PPG, Ms. Reed was a partner in the Pittsburgh law firm of Thorp, Reed & Armstrong.

Ms. Reed received an AB from Bryn Mawr College, and her law degree from Temple University School of Law where she was editor-in-chief of the *Temple Law Quarterly*. She served as law clerk to the Hon. Maurice B. Cohill, Jr. of the United States District Court for the Western District of Pennsylvania.

Ms. Reed is a trustee of Washington & Jefferson College in Washington, PA and a member of the board of visitors of Vanderbilt Divinity School.

Eric Talley
Professor of Law, Co-Director, Berkeley Center for Law, Business and the Economy
University of California, Berkeley School of Law

Panel #405: Redefining the Corporate Form for the 21st Century

October 2, 2012 (11:00 AM - 12:30 PM)

Version 3.0 (August 28, 2012)

PANEL ABSTRACT: New corporate forms including Flexible Purpose Corporations, B Corps and L3Cs are being introduced in California and other states. Explore the positives and negatives of each new corporate form and how they differ from traditional corporations, LLCs and partnerships. These new forms represent an exciting shift in corporate law that promises to have a major impact on how businesses operate now and in the future. Learn why corporate form is important for environmental sustainability as well as traditional economic goals. Uncover the realities based on the California and Delaware Corporations Codes and case law beyond the marketing and PR interpretation dominating the press.

Panelists:

- Jordan Breslow, General Counsel, New Island Capital
- Will Fitzpatrick, General Counsel, Omidyar Network
- Preston DuFauchard, California Department of Corporations Commissioner (2006-11)
- Susan Mac Cormac, Partner, Morrison & Foerster, LLP
- Eric Talley, Professor of Law, University of California at Berkeley

Here's my most recent sketch to frame our discussion. I'll be filling it in with questions over the next few weeks – please send me redlined versions of this document suggesting questions that you would like to have placed into the script. If you feel particularly comfortable taking on particular topics (whether included below or not), please let me know.

Outline

1. Welcome and Introduction of Panelists

- Synopsis of brief bios for each panelist

2. The 20,000-foot view

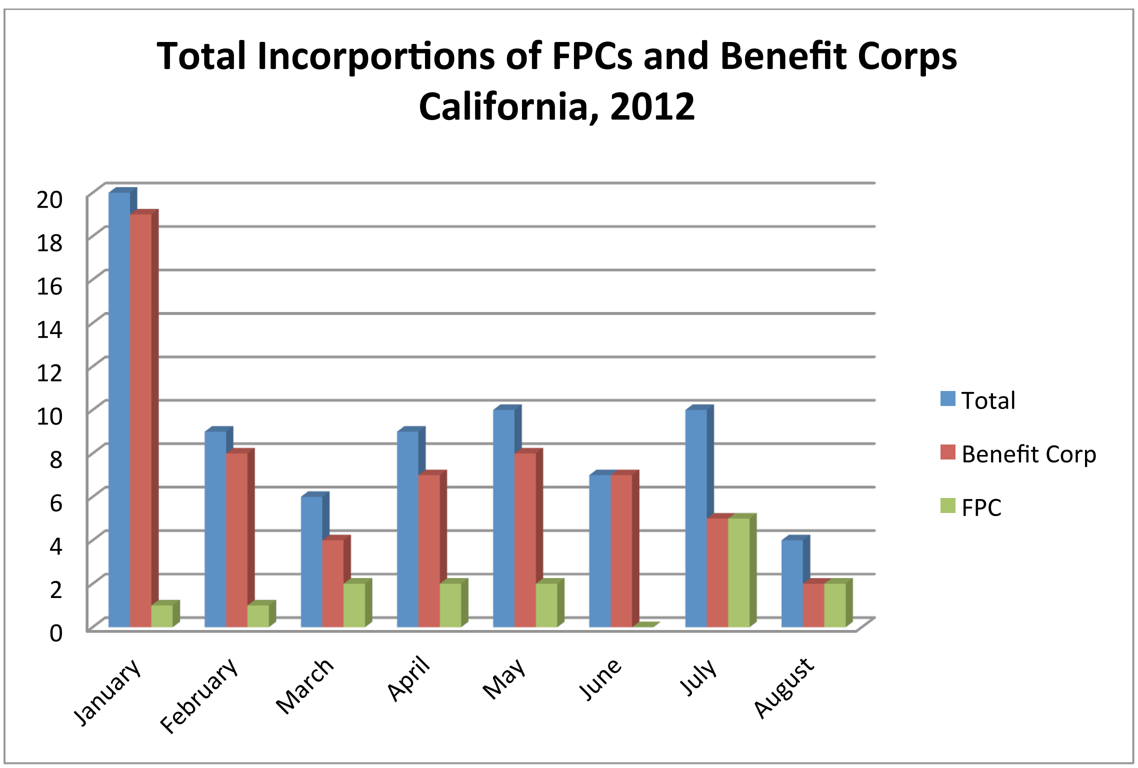
- Why the emergence of new corporate forms now? (Panel – concise answers at this stage)

3. What, exactly, is new about these forms? That is, what do these new forms do that pre-existing forms and/or doctrine could not do?

- How many of these characteristics are already available to plain-vanilla for-profit corporations?
- Statement of purpose in charter / bylaw provisions
- Business Judgment Rule
- Practical plasticity of shareholder primacy arguments
- Constituency statutes
- M&A Context (Unocal / Revlon duties)
- Other legal forms (L3Cs, non-profits, etc.)

4. Current State of Legislative Play:

- Overview of states with legislation in place
  - Comparison of existing regimes across (Talley will distribute comparison table)
  - States with active bills in the pipeline
- A Report on a Natural Experiment: California's competing benefit / FPC statutes
  - Highlight key differences
  - Synopsis of data on take-up rates in California (first eight months)
    - Relative popularity of FPC/Benefit Corp (data from Cal. Corps Comm'n)
    - Conversions by month; by industry; by geographic location
    - VC Valuations of companies



5. Are there any dangers associated with the explicit recognition of multiple corporate goals?

- Proliferation of defenses available to officers/directors?
- Managerial Entrenchment?
- More stonewalling / lax management?

6. Investing in Benefit Corps / FPCs

- Attractiveness relative to alternatives (e.g., plain-vanilla C corps)?
    - Evidence of any P/E discounts?
    - Evidence of other forms of profitability (e.g., greater productivity / employee loyalty?)
    - Evidence for lower expected returns (negative α?) – need not follow from P/E discount.
    - Evidence of different forms of systemic risk (higher / lower β?)
- Do institutional investors face particular challenges in making these sorts of investments?
    - E.g., ERISA prudence and fiduciary duty constraints
    - Other constraints?

7. Assessing Fidelity with Public Purpose (Panel)

- Most Benefit Corp. statutes require an annual, audited assessment of compliance with public purpose; but legislation gives little guidance on best practices for conducting such an analysis.
- What templates are emerging as best practices for such assessments?
    - [Possibly discuss a case study or two]
- How to deal with public purposes that seem vague or amorphous? ("Eliminate Evil-Doing", or "Be Publicly Awesome")

8. Takeover Bids, and Contests for control

- Freedom to "just say no" to extremely attractive monetary offers?
    - What constitutes preclusive or coercive tactics (a la Unitrin)?
- Assuming sale is desirable, what do *Revlon* duties look like: how does a board discharge them?
    - Fairness opinions, and who issues them?
    - Are two separate fairness opinions needed (FMV and adherence to purpose)
    - Is it problematic to use the same outside advisor for both fairness opinions?

9. Concluding Remarks

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Redefining the Corporate Form for the 21st Century (Session 405)

Jordan Breslow (New Island Capital)
Will Fitzpatrick (Omidyar Network)
Susan Mac Cormac (Morrison & Foester)
Eric Talley (UC Berkeley)

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Outline

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- Introduction
- The View from 20,000 Feet
- Understanding the magnitude of the trend – across states, and among firms.
- Investing in Benefit Corps / FPCs
- Assessing Fidelity to Public Purpose
- Mergers, Acquisitions, Takeovers, and Contests for Control

2

The Legal View from 20,000 Feet

- What, exactly, are these new forms as legal entities?
  - FPC/BenCorp/L3C
  - Why their emergence now?
- How (if at all) is their legal structure distinct from conventional forms, as well as from one another?
- What can't one accomplish with a plain-vanilla "C" corporation?
- Statement of purpose in charter / bylaw provisions
- Business Judgment Rule
- Practical plasticity of shareholder primacy arguments
- Constituency statutes
- M&A Context (Unocal / Revlon duties)
- Other legal forms (L3Cs, non-profits, etc.)

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Corporate Focus on Sustainability

- For 15 years or more, corporations of all sizes have become increasingly engaged with social and environmental issues.
  - Environmental Sustainability
  - CSR (Corporate Social Responsibility)
  - ESG (Environmental, Social, and Governance)
- **Traditional corporations** have been setting up non-profits (Google.org) and engaging in more robust and integrated CSR and sustainability programs.
- Major **consulting firms** like McKenzie have joined boutique firms like BSR and Green Order in advising the *Fortune* 500 on how to become more environmentally sustainable.
- **Private equity firms** like KKR and Carlyle are joining forces with the Environmental Defense Fund to review Environmental, Social, and Governance (ESG) factors to create value and unlock opportunities in their potential investments.

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Corporate Trends – Shareholder Resolutions

- **Shareholder resolutions** (submitted under **Rule 14a-8(i) of the Securities Exchange Act of 1934**) on environmental concerns and sustainability reports remain the most common, and fastest growing, type of resolutions.
- Social and environmental resolutions have increased 50% in the last 10 years, with more than 400 filed in both 2010 and 2011.
- Climate change and fossil fuel production alone had a record breaking 109 shareholder resolutions filed with 81 U.S. and Canadian companies in 2011.
- "Support for social and environmental resolutions has become increasingly mainstream." – Michael Passoff, CEO of Proxy Impact
  - In 2011, there was 21.4% average approval for these proposals, the first time this support level had reached the 20% mark.

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Corporate Trends – Measurement of Sustainability Impact

- Increasing emphasis (particularly with impact investors) on measuring the social/environmental return on investment (SROI).
- One example, the **Sustainable and Responsible Investing (SRI)** index, examines the corporate social responsibility of stocks and mutual funds, and currently encompasses an estimated $3.07 trillion out of $25.2 trillion in the U.S. investment marketplace.
- As of 2010, there were 250 socially screened mutual fund products in the U.S., with assets of $316.1 billion.
- Nearly one out of every eight dollars under professional management in the United States today is involved in sustainable and responsible investing.

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Corporate Trends – Sustainability Reporting

- **Voluntary reporting initiatives** have collected and made publicly available company performance data on many ESG factors, and most major corporations produce annual Corporate Sustainability Reports
- Widespread use of the **Global Reporting Initiative** standards, but there are over 100 reporting standards for sustainability.
- KKR's comprehensive ESG analysis program led them to begin releasing Sustainability Reports on their Green portfolio.
- The need for integrated sustainability accounting standards has lead to creation of the new **Sustainability Accounting Standards Board (SASB).**
- The SASB will create industry-based key performance indicators suitable for disclosure in standard filings such as the Form 10-K, establishing standards for integrated reporting that are concise, comparable within an industry, and relevant to all 35,000 publicly listed companies in the U.S.

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Traditional Corporate Forms

- Fiduciary Duties of Care and Loyalty
  - The primary guiding principles driving board decision-making are the duties of care and loyalty.
  - In general, the duty of care requires directors to be well informed and to carefully consider the issues before making a deliberate decision.
  - The duty of loyalty requires directors to place the interests of the corporation ahead of their own personal interests or the interests of other organizations with which they are closely linked.
  - These duties are owed by board and management to the shareholders of the company – not to other "stakeholders" (such as the employees, community, or environment); and focus decisions primarily, but not exclusively, on maximizing shareholder value.
  - Courts evaluate these primary fiduciary duties in light of the business judgment rule (BJR), which creates a safe harbor for directors and ordinarily affords them some flexibility.

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Traditional Corporate Forms

- Business Judgment Rule (BJR)
  - Fiduciary duties are tempered by the BJR, which generally permits directors to take action in the long-term interests of the corporation, and not solely based on improving short-term earnings.
  - Argument that corporations can invest as much in sustainability initiatives as they "invested" 5-10 years ago in executive compensation.
  - It is not malfeasance for directors to make decisions that do not maximize shareholder value, unless the decision was woefully uninformed or was tainted by self-interest.
  - However, because the BJR is judicially created and interpreted and there is considerable shareholder class action litigation, directors tend to apply risk-adverse interpretations.
  - Furthermore, the BJR does not afford sufficient protection in change of control situations when boards and management generally have a fiduciary duty to act solely in the interest of maximizing shareholder value (see Revlon and its prodigy, and the more recent Ebay case).

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Why a New Corporate Form?

- The focus by corporations on short-term profitability as opposed to longer-term sustainability initiatives is primarily driven by forces other than corporate form.
  - Quarterly Reporting – incentivizes and overemphasizes short-term decisions
  - Executive Compensation Structures – short-term actions disproportionately compensated and limited accountability for the long-term ramifications of decisions
  - Stock Market Trading – short-term investing dominates the market and leads to general instability that undermines executives seeking to create long-term value
- Furthermore, even if a company has a strong social mission at inception, there are difficulties "anchoring the mission" throughout the lifecycle of the company.
  - Additional rounds of financing often lead to "mission creep"
  - Change of control situations are a particular concern

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Historical Development of Solutions

- This topic is not new; a chapter was devoted to the failure of corporations to consider social factors in the "American Law Institute's Principles of Corporate Governance: Analysis and Recommendations."
- Recently, organizations both in the non-profit and the for-profit worlds have been "bending" their respective corporate forms to achieve multiple objectives.
- However, these approaches produce unsatisfactory results and create potential liability for managers with either shareholders (in the case of for-profits) or with the IRS or Attorney General (in the case of non-profits).
- Various new corporate forms are being considered and implemented through the U.S.

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"Hybrids"

- General term for when a non-profit sets up a for-profit subsidiary or vice-versa
- Also can refer to a close contractual relationship between the entities
- For-profits set up foundations (problems with arcane IRS rules)
- Non-profits (public charities) set up a for-profit, either majority (over 50%) or minority (20% or less) held
- Difficult to establish and maintain from both a legal and an operational perspective
  - Contracts between the two entities – e.g., paying for services, use of equipment, license of IP, income from rents and royalties, etc.
  - Issues with employee placement and compensation, as well as board overlap and oversight

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Constituency Statutes

- Initially adopted into legislation in the early 1980s as anti-takeover mechanisms.
- Allow managers and directors to consider interests of stakeholders, other than only the shareholders, in carrying out their fiduciary duties.
- Currently, 31 states have language that corporations "shall" or "may" take into account the interest of non-shareholder groups (not California or Delaware).
- Have been attractive to proponents of sustainability, and increasingly used in the last 10 years to integrate corporate social responsibility into charter documents.
- However, there are serious risks associated with increased use of these statutes.

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Low Profit Limited Liability Company (L3C)

- L3C is statutory variant of the LLC considered in 21 states, and currently adopted in 8.
- Principally designed to assist for-profit companies that have a primarily charitable purpose and hope to obtain program-related investments (PRIs) from foundations.
- Billed as a simple answer to a complex problem, these entities still have all of the issues of the LLC from an investment perspective and may not make PRI investments any easier.
- Both the L3C and LLC have limited capital market acceptance.

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Flexible Purpose Corporation (FPC)

- Signed into law by California Governor Brown in October 2011 and effective January 1, 2012.
- The bill was drafted by the Working Group on New Corporate Forms, a group of 10 corporate lawyers from big and small firms, academia, and members of the Corporations Committee of the State Bar.
- Creates a new "safe harbor" in addition to the business judgment rule and requires boards and management to consider environmental and social factors in addition to shareholder value in both the ordinary course of business and change of control situations.
- Protects boards and management from shareholder liability in connection taking action in furtherance of social/ environmental goals.

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Benefit Corporation

- Arose from the B Lab "B Corporation" certification process.
  - Companies can self-audit their socially responsible practices under the B Lab standards and then pay a royalty to license the "B Corporation" mark for display.
- B Lab co-drafted what became the Benefit Corporation legislation.
- Various forms of this statute now exist in numerous states (see below); California's went effective on Jan. 1, 2012.
- There is significant variation in the Benefit Corporation legislation among the states, and often it was not integrated well with the preexisting corporate codes.
- Most Bar Associates have opposed the legislation in many states on technical and policy grounds.

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Understanding the Magnitude of the Trend

States Adopting Benefit Corp. or FPC Statutes (since 2010)

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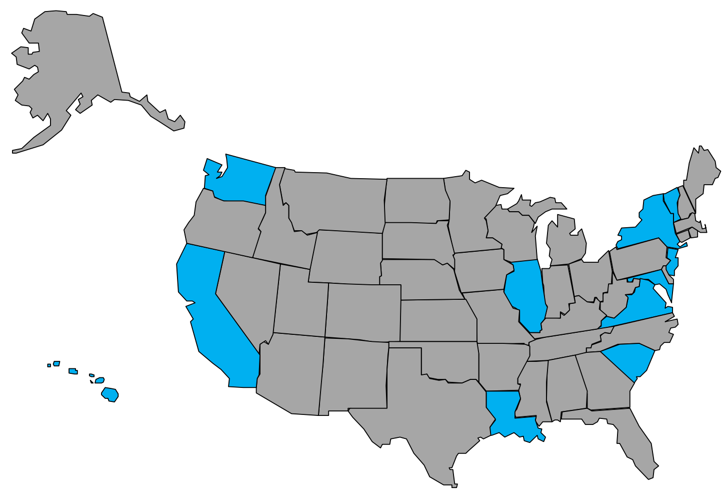

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A Scorecard of Adopting States' Statutes

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	Non-Shareholder Stakeholder Standing to Enforce?	Dissenting Shareholder Rights Protection?	Min. Status or 2/3 Vote (Default) Requirement to Change Purpose?	Creates New Officer or Director Oversight Position?	Third-Party Accountability Standards Required?	Enforcement Through Special Actions or Proceedings?	General Social Purpose Required?	Special Social Purpose Required?	Stock Certificate Notification Requirement?
California FPC	No	Yes	Yes	No	No	No	No	Yes	Yes
California BC	No	Yes	Yes	No	Yes	Yes	Yes	No	Yes
Hawaii BC	Unclear	No	Yes	Yes	Yes	No	Yes	No	No
Illinois BC	No	No	Yes	Yes	Yes	Yes	Yes	No	No
Louisiana BC	No	No	Yes	Yes	Yes	Yes	Yes	No	Yes
Maryland BC	No	No	No	No	Yes	No	Yes	No	Yes
New Jersey BC	Unclear	No	Yes	Yes	Yes	Yes	Yes	No	No
New York BC	No	No	Yes	No	Yes	No	Yes	No	Yes
South Carolina BC	No	Yes	Yes	Yes	Yes	Yes	Yes	No	No
Vermont BC	No	No	Yes	Yes	Yes	Yes	Yes	No	No
Virginia BC	No	No	Yes	No	Yes	Yes	Yes	No	No
Washington FPC	No	Yes	Yes	No	No	No	No	Yes	Yes

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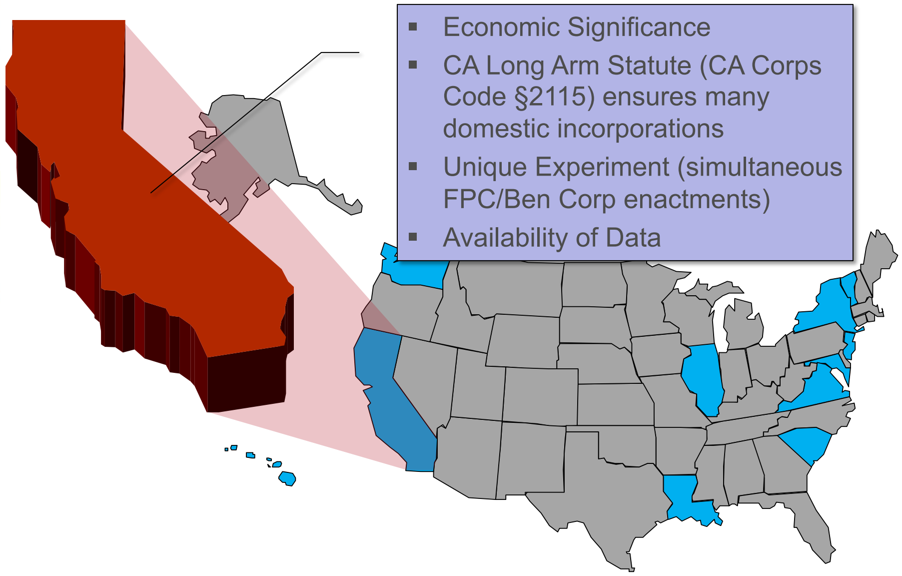
California: Unique among adopting states

- Economic Significance
- CA Long Arm Statute (CA Corps Code §2115) ensures many domestic incorporations
- Unique Experiment (simultaneous FPC/Ben Corp enactments)
- Availability of Data



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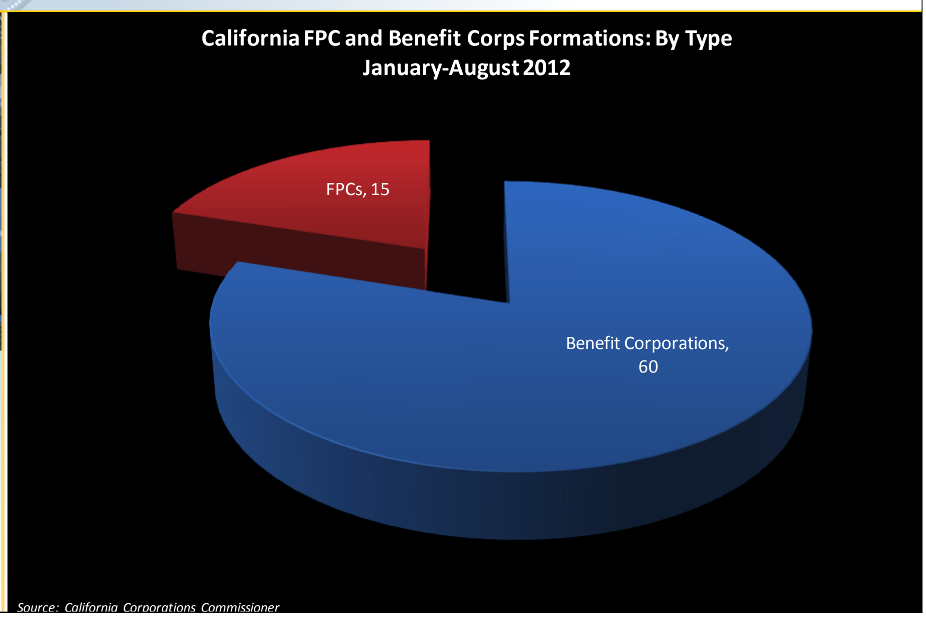
Aggregate Take-up in 2012



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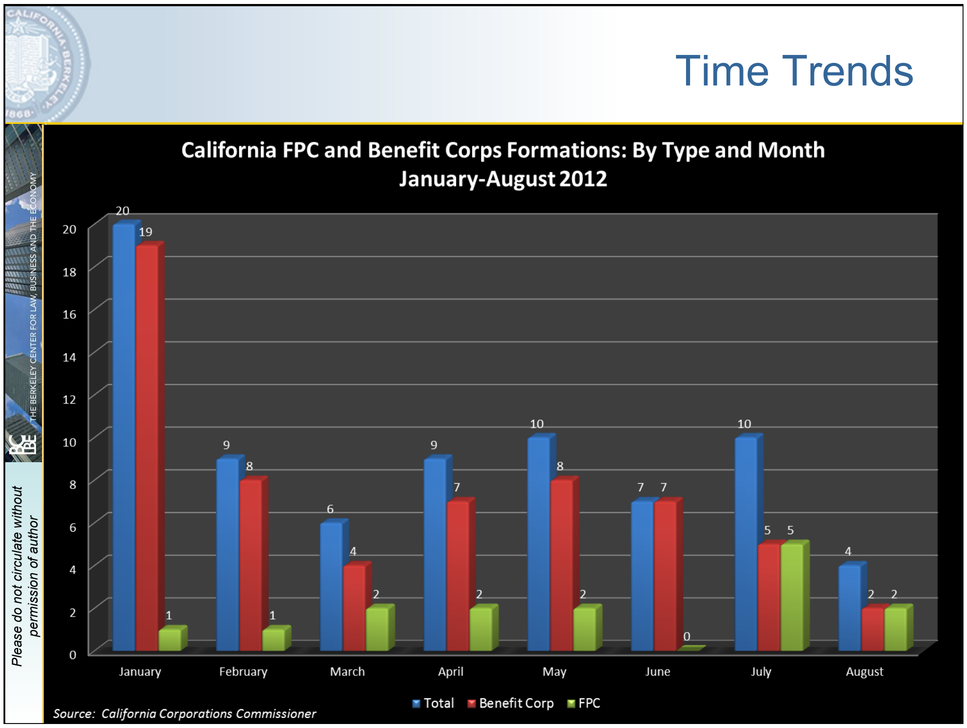
Time Trends
California FPC and Benefit Corps Formations: By Type and Month
January-August 2012
January
February
March
April
May
June
July
August
Total
Benefit Corp
FPC
Source: California Corporations Commissioner
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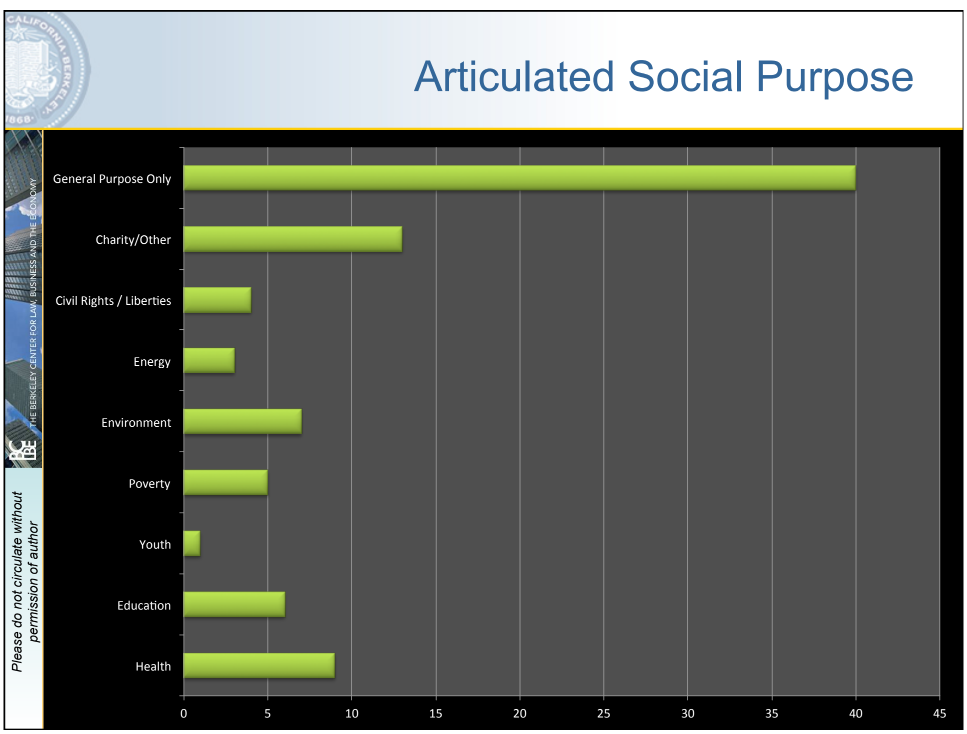
Articulated Social Purpose
General Purpose Only
Charity/Other
Civil Rights / Liberties
Energy
Environment
Poverty
Youth
Education
Health
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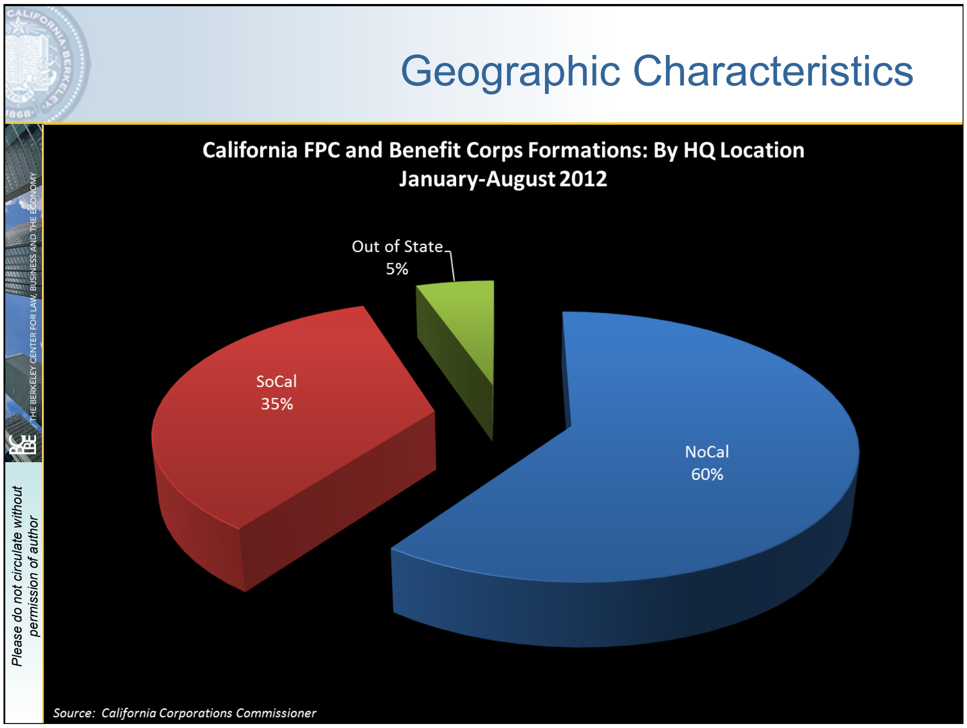
Geographic Characteristics
California FPC and Benefit Corps Formations: By HQ Location
January-August 2012
Out of State
5%
SoCal
35%
NoCal
60%
Source: California Corporations Commissioner
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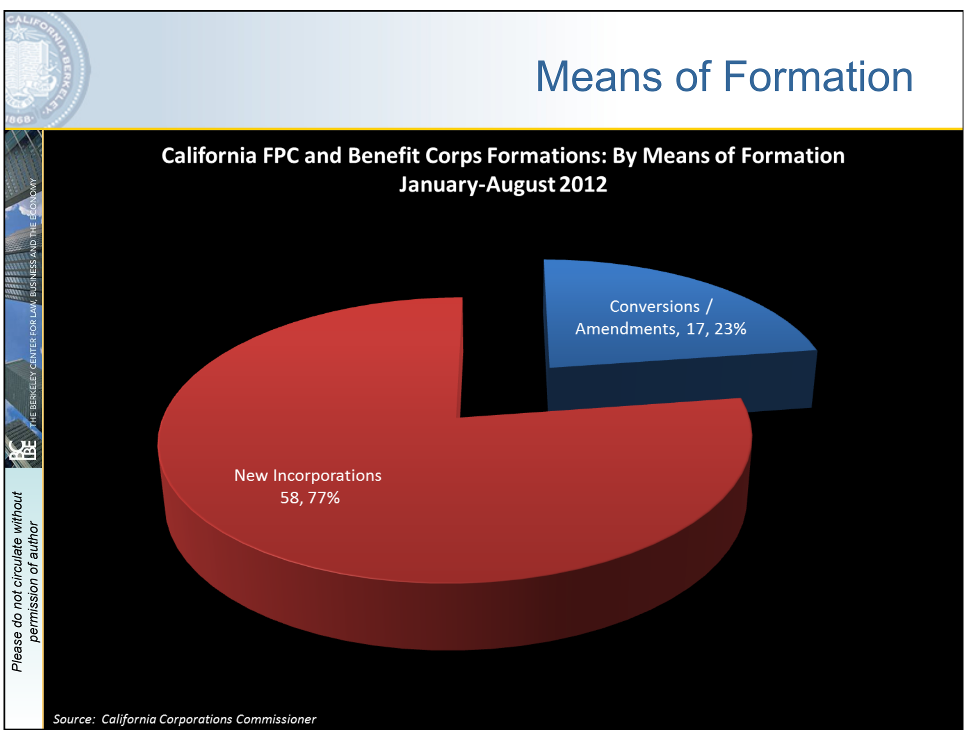
Means of Formation
California FPC and Benefit Corps Formations: By Means of Formation
January-August 2012
Conversions / Amendments, 17, 23%
New Incorporations
58, 77%
Source: California Corporations Commissioner
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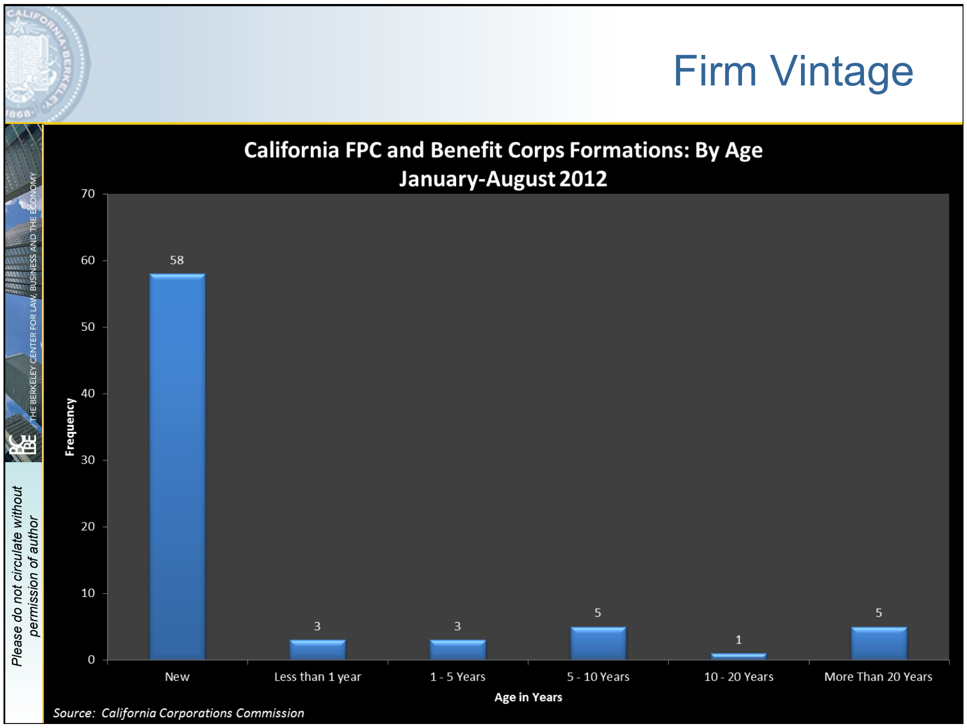
Firm Vintage
California FPC and Benefit Corps Formations: By Age
January-August 2012
Frequency
70
60
50
40
30
20
10
0
58
3
3
5
1
5
New
Less than 1 year
1 - 5 Years
5 - 10 Years
10 - 20 Years
More Than 20 Years
Age in Years
Source: California Corporations Commission
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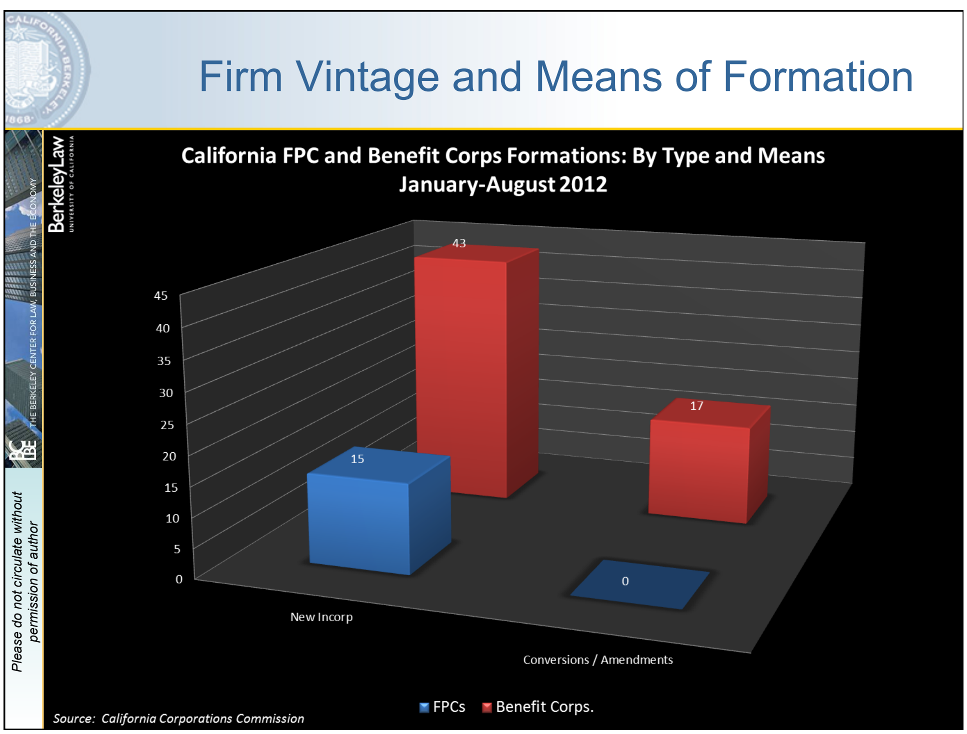
Firm Vintage and Means of Formation
California FPC and Benefit Corps Formations: By Type and Means
January-August 2012
45
40
35
30
25
20
15
10
5
0
43
15
17
0
New Incorp
Conversions / Amendments
FPCs
Benefit Corps.
Source: California Corporations Commission
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Investing in Benefit Corps / FPCs

- Attractiveness relative to alternatives (e.g., plain-vanilla C corps)?
  - Ease & Efficiency of organization (e.g., setting up hybrid FP / NP structures)
  - Evidence of any P/E discounts? Lower expected returns (negative α)? Different forms of systemic risk (higher / lower β)?
  - Evidence of other forms of profitability (e.g., greater productivity / employee loyalty?)
- Do institutional investors face idiosyncratic challenges in investing in FPCs/Benefit Corps?
  - E.g., ERISA prudence and fiduciary duty constraints
- Other constraints?

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Assessing Fidelity with Public Purpose

- Most Benefit Corp. statutes require an annual, audited assessment of compliance with public purpose; but legislation gives little guidance on best practices for conducting such an analysis.
- What templates / metrics are likely to emerge as best practices for such assessments?
- How to deal with public purposes that seem too vague or abstract for measurement? ("Eliminate Evil-Doing", or "Maximizing Excellence")

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Fiduciary Duties & Acquisitions

- How do board members / officers satisfy their fiduciary duties of care / loyalty?
  - How to trade off profit against social goals?
  - How best to become informed of consequences of decisions?
- M&A, and bids for control
  - Freedom to “stiff arm” extremely attractive monetary offers? What constitutes preclusive or coercive tactics (*a la Unocal / Unitrin*)?
- Assuming sale seems desirable, what do *Revlon* duties look like, & how does a board discharge them?
  - One or two fairness opinions? If two, can the same outside advisor produce both?
  - How to treat conditional offers (target must convert to C-corp as condition precedent to closing)?
  - Seller-side post-closing indemnification provisions?

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Flexible Purpose Corporations
The Future of Sustainable Capitalism

Susan Mac Cormac
Partner, Morrison & Foerster LLP

Corporate Focus on Sustainability

"Our belief is what's good for society has to be good for business and what's good for business has to be good for society."
– Indra Nooyi, CEO of PepsiCo

"The moral of the story here is sustainable solutions are the best for creating jobs, creating economic growth and creating better lives."
– Bob Diamond, CEO of Barclays

"The business case for environmental management has never been stronger."
– Henry Kravis, co-founder of private equity giant KKR

There is a clear trend in corporate governance toward increased attention to the environmental and social impacts of business operations.

Corporate Focus on Sustainability

- For 15 years or more, corporations of all sizes have become increasingly engaged with social and environmental issues.
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- Climate change and fossil fuel production alone had a record breaking 109 shareholder resolutions filed with 81 U.S. and Canadian companies in 2011.
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  - In 2011, there was 21.4% average approval for these proposals, the first time this support level had reached the 20% mark.

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  - Widespread use of the **Global Reporting Initiative** standards, but there are over 100 reporting standards for sustainability.
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- The need for integrated sustainability accounting standards has lead to creation of the new **Sustainability Accounting Standards Board (SASB).**
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Why a New Corporate Form?

- The focus by corporations on short-term profitability as opposed to longer-term sustainability initiatives is primarily driven by forces other than corporate form.
  - Quarterly Reporting – incentivizes and overemphasizes short-term decisions
  - Executive Compensation Structures – short-term actions disproportionately compensated and limited accountability for the long-term ramifications of decisions
  - Stock Market Trading – short-term investing dominates the market and leads to general instability that undermines executives seeking to create long-term value
- Furthermore, even if a company has a strong social mission at inception, there are difficulties "anchoring the mission" throughout the lifecycle of the company.
  - Additional rounds of financing often lead to "mission creep"
  - Change of control situations are a particular concern

Why a New Corporate Form?

- Time is of the essence.
  - Why? Institutionalized mispricing of natural resources and continued failure to price externalities.
    - "Water is not the new oil. Its value is greater than oil. Our mispricing of water leads to vulnerable water infrastructure and unsustainable water loss."
    - The need for freshwater at **Dow Chemical** has led them to partner with The Nature Conservancy to assess the value of water and the role that ecosystems play in maintaining water flow. Scientists, engineers, and economists from both organizations are working together to analyze the various services that nature provides to our operations and the community.
  - The progressive nature of climate change requires preventative, rather than reactionary solutions.

Why a New Corporate Form?

"Incremental change will prove insufficient to mainstream Sustainable Capitalism by 2020. So, like an artist at the easel, our goal is not to make superficial touch-ups…. We are calling for a fresh canvas on which, together, we can paint a new picture of our future."

– 2012 Generation Investment

Historical Development of Solutions

- This topic is not new; a chapter was devoted to the failure of corporations to consider social factors in the "American Law Institute's Principles of Corporate Governance: Analysis and Recommendations."
- Recently, organizations both in the non-profit and the for-profit worlds have been "bending" their respective corporate forms to achieve multiple objectives.
- However, these approaches produce unsatisfactory results and create potential liability for managers with either shareholders (in the case of for-profits) or with the IRS or Attorney General (in the case of non-profits).
- Various new corporate forms are being considered and implemented through the U.S.

"Hybrids"

- General term for when a non-profit sets up a for-profit subsidiary or vice-versa
- Also can refer to a close contractual relationship between the entities
- For-profits set up foundations (problems with arcane IRS rules)
- Non-profits (public charities) set up a for-profit, either majority (over 50%) or minority (20% or less) held
- Difficult to establish and maintain from both a legal and an operational perspective
  - Contracts between the two entities – *e.g.*, paying for services, use of equipment, license of IP, income from rents and royalties, etc.
  - Issues with employee placement and compensation, as well as board overlap and oversight

Constituency Statutes

- Initially adopted into legislation in the early 1980s as anti-takeover mechanisms.
- Allow managers and directors to consider interests of stakeholders, other than only the shareholders, in carrying out their fiduciary duties.
- Currently, 31 states have language that corporations "shall" or "may" take into account the interest of non-shareholder groups (not California or Delaware).
- Have been attractive to proponents of sustainability, and increasingly used in the last 10 years to integrate corporate social responsibility into charter documents.
- However, there are serious risks associated with increased use of these statutes.

Constituency Statutes

- Problems with using constituency statutes to promote sustainability:
  - Accountability
    - No disclosure requirements with respect to the use of resources for social and environmental purposes
    - No guidance regarding weighting of various purposes in decision-making
  - Litigation Risk
    - No case law to date
    - Questions regarding whether the constituency statute trumps the fiduciary duties of boards and managements to *shareholders*
    - Questions about enforceability by shareholders and other stakeholders (and whether or not stakeholders can have standing)
    - With long-arm statutes, the charter may not be upheld in other states (especially California)

Low Profit Limited Liability Company (L3C)

- L3C is statutory variant of the LLC considered in 21 states, and currently adopted in 8.
- Principally designed to assist for-profit companies that have a *primarily* charitable purpose and hope to obtain program-related investments (PRIs) from foundations.
- Billed as a simple answer to a complex problem, these entities still have all of the issues of the LLC from an investment perspective and may not make PRI investments any easier.
- Both the L3C and LLC have limited capital market acceptance.

Flexible Purpose Corporation (FPC)

- Signed into law by California Governor Brown in October 2011 and effective January 1, 2012.
- The bill was drafted by the Working Group on New Corporate Forms, a group of 10 corporate lawyers from big and small firms, academia, and members of the Corporations Committee of the State Bar.
- Creates a new "safe harbor" in addition to the business judgment rule and requires boards and management to consider environmental and social factors in addition to shareholder value in both the ordinary course of business and change of control situations.
- Protects boards and management from shareholder liability in connection taking action in furtherance of social/environmental goals.

FPC – Qualifying Special Purpose

- In its Articles of Incorporation, an FPC must state both the provision authorizing it to engage in any lawful activity **and** a provision specifying one or more of the following "Special Purposes":
  - (A) One or more charitable or public purpose activities that a non-profit public benefit corporation is authorized to carry out.
  - (B) The purpose of promoting positive short-term or long-term effects of, or minimizing adverse short-term or long-term effects of, the flexible purpose corporation's activities upon any of the following:
    - (i) The flexible purpose corporation's employees, suppliers, customers, and creditors.
    - (ii) The community and society.
    - (iii) The environment.
- This requirement is designed to put shareholders and potential shareholders on notice that the corporation will pursue agreed interests that may not align with profit maximization, depending on the directors' business judgment rule.

FPC – Protection from Liability

- Directors and officers are afforded considerable flexibility in their decisions and actions in regards to the Special Purpose, both within and outside of the ordinary course of business.
- They are not required to prioritize any one Special Purpose or shareholder value over the others in their decisions because existing case law applies that imposes a reasonableness and materiality standard.

FPC – Changing the Corporate Form or Altering Special Purpose

- Changing of the corporate form for both public and private companies requires a two-thirds vote of each class of shareholders.
- In addition, the Special Purpose is anchored by requiring a two-thirds vote of each class to change or remove the Special Purpose.
- The vote includes all classes of shares, regardless of whether that class is entitled to vote by the provisions of the articles, and the required vote may be increased beyond two-thirds in the articles.
- The FPC includes dissenters' rights in the event of a material change in the Special Purpose or conversion of the corporate form without consent.
- This supermajority voting requirement protects investors who made their decision to invest based in part on the Special Purpose.

FPC – Required Reporting

- Required to publicly disclose regular reports with objectives, goals, measurement, and reporting on the impact or "returns" of social/ environmental actions
- There are two types or required reports:
  - (1) Annual Reports (similar to 10-K reports)
  - (2) Special Reports, if there is any action that will have a material negative impact on returns or either your finances or Special Purpose (similar to 8-K reports)

FPC – Enforcement

- As fiduciary duties will now include the social/environmental purpose, shareholders have same rights as they do for normal corporations with respect to enforcement of the social/environmental purpose.
- No other "stakeholders" have enforcement rights.

Adoption of FPC

- Many states are considering the adoption of new corporate forms in an effort to support and encourage the convergence of business profitability and business sustainability.
- Versions of FPC were passed in Washington and are being considered in Colorado and by the ABA.
- Several FPCs have been set up in California to date, primarily used by small sustainability or Cleantech companies, for-profit subsidiaries of non-profits, and for-profit subsidiaries of large public companies.

Benefit Corporation

- Arose from the B Lab "B Corporation" certification process.
  - Companies can self-audit their socially responsible practices under the B Lab standards and then pay a royalty to license the "B Corporation" mark for display.
- B Lab co-drafted what became the Benefit Corporation legislation.
- Various forms of this statute now exist in seven states, most recently California as of January 1, 2012.
- There is significant variation in the Benefit Corporation legislation among the states, and often it was not integrated well with the preexisting corporate codes.
- Most Bar Associates have opposed the legislation in many states on technical and policy grounds.

Benefit Corporation – Variations Among States

	California	Hawaii	Maryland	New Jersey	New York	Vermont	Virginia
Application and Effect in General Corporate Code	Applies only to benefit corporations, provisions supersede general corporate code	No provision	Applies only to benefit corporations, provisions supersede general corporate code	No provision	Applies only to benefit corporations, provisions supersede general corporate code	Applies only to benefit corporations, provisions supersede general corporate code	Applies to all benefit corporations, no provision on effect in general corporate code
Reorganization	Merger/conversion w/ non-benefit corporation requires 2/3rds vote	Merger/conversion w/ non-benefit corporation requires 2/3rds vote	No provision	Merger/conversion w/ non-benefit corporation requires 2/3rds vote	Merger/conversion w/ non-benefit corporation requires 2/3rds vote	Merger/conversion w/ non-benefit corporation requires 2/3rds vote	No provision
Notice or Filing	Notice provision only	No provisions	Notice provision only	Filing provision only	Notice and Filing provisions	No provisions	No provisions
Board Composition	No provision	Benefit Director with reporting requirements	No provision	Benefit Director with reporting requirements	No provision	Benefit Director with reporting requirements	No provision
Officers Standards of Conduct	Considerations of directors when officer has discretion to act and it reasonably appears will have material effect on the general/specific benefit	Considerations of directors when officer has discretion to act and it reasonably appears will have material effect on the general/specific benefit	No provision	Considerations of directors when officer has discretion to act and it reasonably appears will have material effect on the general/specific benefit	No provision	Considerations of directors when officer has discretion to act and it reasonably appears will have material effect on the general/specific benefit	No provision
Right of Action	"Benefit Enforcement Proceeding" (definitio n allows for possibility of non-shareholder right of action)	Shareholders and directors have right to bring direct or derivative claims	No provision	"Benefit Enforcement Proceeding" (definitio n allows for possibility of non-shareholder right of action)	"An action may be brought against directors or officers" - no specifics on **who** may or may not bring the action	"Benefit Enforcement Proceeding" (definitio n allows for possibility of non-shareholder right of action)	"Benefit Enforcement Proceeding" (po ssibility of non-shareholder right of action)
Constituency Statute Used?	No	Yes	No	Yes	Yes	Yes	Yes

Benefit Corporation

- Establish by stating a "general public benefit" and, if desired, one or more of enumerated "specific public benefits" in Articles.
- The general public benefit is defined as "a material positive impact on society and the environment, take as a whole, as assessed against a third-party standard…"
- Unlike the FPC's broad Special Purpose language, this "materiality" requirement precludes the use of this corporate form by companies seeking to make incremental changes.
- Many believe the Benefit Corporation is generally designed for use by private companies focused on sustainability that avail themselves of socially responsible capital.

Benefit Corporation – Primary Issues

- The standards used to evaluate the materiality of the public benefits have no means to change over time.
- B Labs' "B Corporation" license standards have become a government mandate – think Standard & Poor's.
- In most states, a third party (i.e., B Labs) certifies compliances with the standards through an audit process. Fear of self-dealing in other states lead to severing these links in the California version of the legislation. Conversely, the board alone is now responsible for compliance and there are no provisions for outside oversight.
- Creation of a new cause of action. These "benefit enforcement proceedings" lack clarity and contain a real possibility of third-party claims by non-shareholders.

Washington’s New Corporate Form

- In Washington, the Bar’s Corporate Act Revision Committee deliberated between the various new corporate forms and chose to create one very similar to the FPC to “provide more flexibility to the socially responsible entrepreneur than that which is afforded by the comparable benefit corporation statutes.”
- This new form passed in March and went into effect on June 7, 2012.
- Major Features of the Social Purpose Corporation (SPC):
  - Permits for-profit corporations to pursue one or more social and/or environmental purposes while also creating economic value for shareholders.
  - Protects directors and officers from shareholder lawsuits in the event that social purposes take priority in the decision-making process by modifying the fiduciary duties to “consider and give weight to one or more of the social purposes of the corporation as the director deems relevant.”
  - Creation of an SPC or conversion from another corporate form requires 2/3rds vote of the shareholders, with dissenters’ rights.
  - Must make publically available Annual Progress Reports. (Not required to adopt third-party standard, but shareholders my choose to if desired.)

Journal of
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In This Issue: **Sustainable Financial Management**

New Corporate Forms: One Viable Solution to Advancing Environmental Sustainability

by Susan Mac Cormac and Heather Haney, Morrison and Foerster

Environmental sustainability will have a far greater impact on business than the internet, social media, and the "cloud" combined—a reality that should be recognized by boards, management, shareholders, and corporate lawyers alike. As Maurice Strong, the first Director General of the United Nations Environment Programme, explained, "After all, sustainability means running the global environment—Earth Inc.—like a corporation: with depreciation, amortization and maintenance accounts. In other words, keeping the asset whole, rather than undermining your natural capital."[1] Investors have started to recognize the impact of social and environmental factors on the overall well-being of a corporation and, in some cases, to measure the "social return on capital." And for their part, corporations are increasingly integrating corporate sustainability initiatives into their mainstream operations, with the understanding that there does not necessarily need to be a trade-off between environmental initiatives and profit maximization.

However, we believe that there is simply not enough time to watch and encourage the natural evolution of corporate board and management decisions. To be effective, many of the solutions to the pressing social and environmental problems facing our world today must be preventative rather than reactionary. While we are lawyers and not economists or scientists, we understand that institutionalized mispricing of natural resources and the continued failure to price externalities, combined with the progressive nature of climate change, requires the transformation of both business and law *as soon as possible*. And there is some good news on this front. In fact, there are actions that both are pragmatic and can serve to accelerate the necessary seismic shift toward sustainability. A recent report by Generation Investment recommends five critical areas on which business should focus to effect more rapid change: (1) identify and incorporate risks from stranded assets; (2) mandate integrated reporting; (3) end the default practice of issuing quarterly earnings reports; (4) align executive compensation structures with long-term sustainable performance; and (5) encourage long-term investing with loyalty-driven securities.[2] Embedded in one of these recommendations is the need to change the corporate form.

When we refer to "corporate form," we are really talking about the rules by which a company operates. The variations among corporate forms—sole proprietorships, partnerships, trusts, limited liability companies (LLCs), and corporations, to name a few—provide diverse financial and legal advantages. However, the vast majority of legal entities organize as corporations either in the state where they have primary operations or in Delaware.

When we advise our clients on what type of corporate form will best serve a particular business, three issues typically arise: liability, taxation, and access to capital. And 50 years after the publication of Rachel Carson's *Silent Spring*[3] educated the world about the impact of humanity's actions on the natural environment, corporate law has added a fourth threshold issue for consideration: the *purpose* of the entity beyond simply providing value for shareholders.

Over the last decade, a growing number of companies have started pursuing both returns for investors *and* the achievement of one or many social and environmental purposes. As a result, many non-profit and for-profit entities are "bending the arcs" of their respective corporate forms to achieve multiple or blended objectives. Although there have been some successes, many of the approaches adopted to date are unsatisfactory because they pose significant limitations and create risks and potential liability for boards and management.[4]

Traditional Corporate Form and Sustainability

Corporations of all sizes have become increasingly engaged with social and environmental issues. Major consulting firms like McKinsey and BCG have now joined the ranks of boutique firms like BSR and GreenOrder in advising the *Fortune* 500 on how to become more environmentally sustainable. Voluntary reporting initiatives, such as the Carbon Disclosure Project,[5] have collected and made public

1. Michael de Pencier, "Interview with Maurice Strong," *Corporate Knights: The Canadian Magazine for Responsible Business*, 2003, Vol. 2, No. 2, p. 15.
2. Generation Investment Management LLP (February 25, 2012) *Sustainable Capitalism*, p. 1.
3. Rachel L. Carson, *Silent Spring* (1962).
4. W. Derrick Britt, R. Todd Johnson, & Susan H. Mac Cormac (Sept. 2011) *Frequently Asked Questions, Proposed Amendments to the California Corporations Code for a New Corporate Form: The Flexible Purpose Corporation and Senate Bill 201*, p. 2-4.
5. The Carbon Disclosure Project (CDP) is an independent not-for-profit organization working to measure, disclose, manage, and share environmental information in order to drive greenhouse gas emissions reduction and sustainable water use by business and cities. *See*, *Carbon Disclosure Project*, available at https://www.cdproject.net/en-US/Pages/HomePage.aspx.

company performance data on various environmental metrics. Most major corporations also produce Corporate Sustainability Reports, explaining their annual accomplishments with respect to environmental sustainability, community, and social benefit initiatives. There is a clear trend in corporate governance toward increased attention to the environmental and social impacts of business operations. In fact, shareholder resolutions on issues of environmental sustainability are now the fastest growing category of resolutions (replacing executive compensation).

Some critics believe that the traditional corporate form maximizes profit for shareholders at the expense of other stakeholders, including the company's employees, the local community, and the natural environment.[6] Others contend that making socially responsible decisions can create competitive advantage, lead to a greater market share, and increase consumer and employee goodwill.[7] Furthermore, while it is a useful shorthand default for directors and management on how to make daily decisions, the duty to maximize shareholder value is not legally required in all cases.

The primary guiding principles driving board decision-making are the duties of care and loyalty. In general, the duty of care requires directors to be well informed and to carefully consider the issues before making a deliberate decision. The directors may rely on experts and officers for their information and can help ensure compliance by developing a process to consider all viable options. The duty of loyalty requires directors and management to place the interests of the corporation ahead of their own personal interests or the interests of other organizations with which they are closely linked.

The primary fiduciary duties are evaluated by courts in light of the "business judgment rule," which creates a safe harbor for boards and management and generally affords them considerable flexibility when considering environmental or social factors in defining the long-term best interests of the corporation and its shareholders. It is generally held not to be malfeasance for directors to make decisions in the ordinary course of business that do not maximize short-term shareholder value, unless there is a evidence that the board's decision was uninformed or tainted by self-interest.

However, the business judgment rule does not afford sufficient protection and flexibility to consider social or environmental factors in *all* decisions. For example, the rule does not offer protection in change-of-control situations when boards and management generally have a fiduciary duty to act exclusively in the interest of maximizing shareholder value.[8] Further, because the scope of the business judgment rule is judicially created and interpreted, and because litigation in this area is prevalent, directors and their lawyers tend to apply risk-averse constructions even where judicial guidance favors an expansive interpretation. This risk avoidance is more acute given the thousands of plaintiffs' lawyers who troll the results of the exchanges every day, looking for precipitous drops in stock prices that could give rise to shareholder class action litigation. As a result, boards of directors are typically hesitant to pursue alternative purposes if they could have a negative impact on short-term stock price.

In addition, various market and regulatory forces generate a greater emphasis on short-term shareholder returns. The practice of issuing quarterly earnings reports both encourages and places excessive internal emphasis on short-term decisions. Executive compensation structures often give too much weight to short-term actions and provide limited accountability for the long-term ramifications of decisions. Further, stock market trading is characterized in significant part by short-selling and other short-term investment strategies, leading to a general instability that undermines executives seeking to create long-term value. These market forces and compensation structures combined with the real and perceived limitations of the business judgment rule contribute to a continued emphasis on shareholder value and lack of innovation around blended value.

Even if founders and initial shareholders embrace a social or environmental mission at a company's inception, the traditional corporate form presents risks for the entrepreneur who seeks to maintain the mission throughout the lifecycle of the company. Investors can shift the company away from the original mission over time in favor of increased profitability, particularly in a change-of-control situation.[9] Although there are mechanisms to help "anchor the mission"—particularly effective are the use of LLCs and intellectual property

6. As heard in the classic case of *Dodge v. Ford Motor Co*, "A business corporation is organized and carried on primarily for the profit of the stockholders…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 nondistribution of profits among stockholders in order to devote them to other purposes"; more modernly, this is still the rhetoric in recent speeches and legal articles. *See*, *e.g.*, Senator Al Franken's speech at the Netroots Nation. "[I]t is literally malfeasance for a corporation not to do everything it legally can to maximize its profits." Milton Friedman, *The Social Responsibility of Business is to Increase Its Profits*, Perspectives in Business Ethics, (P. Hartman Ed., 2nd Edition) p. 260-296.

7. McWilliams, A., & Siegel, D. (January 2001) Corporate Social Responsibility: A Theory of the Firm Perspective, *Academy of Management Review*, 26(1), 117-127.

8. *See*, *e.g.*, *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, a takeover case in which the court held that in certain limited circumstances when the "sale" or "break-up" of the company is inevitable, the fiduciary obligation of the directors of the target corporation are narrowed significantly to the singular responsibility of maximizing immediate shareholder value by securing the highest price available. In this different frame, the conduct of the directors is not reviewed pursuant to the traditional business judgment rule. In this particular case, the target's board based some of their decisions out of a concern for the interests of creditors rather than shareholders, thus violating their fiduciary duties.

9. *See*, *e.g.*, *eBay Domestic Holdings, Inc. v. Newmark,* C.A. No. 3705-CC, 2010 Del. Ch. LEXIS 187 (Del. Ch. Sept. 9, 2010). Although not under a traditional change in control situation, the court rescinded a "Rights Plan" deployed as a poison pill by Craigslist allegedly in order to stave off eBay's threat to Craigslist's "corporate culture." The decision is the first of its kind to examine whether the protection of a purportedly unique "corporate culture," divorced from any effort to promote shareholder value, can justify implementation of a poison pill. The court held that the "[d]irectors of a for-profit Delaware corporation cannot deploy a rights plan to defend a business strategy that openly eschews stockholder wealth maximization—at least not consistently with the directors' fiduciary duties under Delaware law."

licenses, as opposed to the constituency statutes as referenced below—they can be too broad or unintentionally narrow. If too broad, the investors in the company are at risk from a "bad actor" director with too much power. On the other hand, if the mechanisms are too narrow, the mission may be ignored if they conflict with a director's fiduciary duties, or can be diluted or deleted entirely by amendment.

In the case of the traditional corporate form, transparency with respect to the social mission is also problematic. Regulations governing the traditional corporation provide for disclosure of corporate financial data but do not require disclosure of social mission performance data unless they are material to operations. Increased transparency in this area is essential to protect investors from director actions that waste corporate assets under the auspices of a social mission without accountability. Voluntary reporting, a current trend, particularly in the environmental emissions area, lacks the rigor necessary to appropriately assess performance. Without required disclosure and regular auditing, investors will find it difficult to compare companies because there is too much variation in the types of information disclosed and the methods used to calculate it.[10]

Even with these hurdles, many traditional corporations are promoting corporate social responsibility with some measure of success, particularly from a marketing perspective. There are now corporate social responsibility departments at most large corporations that, in many cases, set high standards for environmental sustainability. These corporations have gained consumer and employee goodwill, have increased their market share, and are able to actually provide increased wealth to their shareholders. Private equity firms like Carlyle are joining forces with the Environmental Defense Fund to review Environmental, Social, and Governance (ESG) factors in their investments to create value and unlock opportunities. One firm's comprehensive ESG analysis program led it to begin releasing Sustainability Reports on its Green portfolio, which claims to have achieved an estimated $160 million in cost savings by eight of their program companies in 2010.

However, the fact remains that corporate structure is not designed to *promote* corporate social responsibility, but merely allows it to exist within the safe harbor of the business judgment rule. We believe that, without any changes to the rules by which they operate, corporations will naturally evolve—as they have over the past 100 years—to more fully embrace environmental sustainability. Unfortunately, with respect to many of today's most pressing environmental problems—the result in large part of the mispricing of natural resources and failure to price certain externalities—time is of the essence. Continued failure to price environmental externalities has led to unsustainable use of natural resources and ineffective accounting for the costs of pollution.[11] For example, the American Society of Civil Engineers (ASCE) estimates a five-year shortfall of $108.6 billion for water and wastewater infrastructure in the United States alone.[12] As Amir Peleg, the Founder and CEO of water monitoring company TaKaDu recently stated, "Water is not the new oil. Its value is greater than oil. Our mispricing of water leads to vulnerable water infrastructure and unsustainable water loss."[13] This problem is exacerbated because many of the corporations that attempt to determine the true value of natural resources don't disclose (or even verify) their findings, either for fear that disclosure will cause their stock prices to plummet or, if they share information with their competitors to spread the risk and ensure consistent reporting across an industry, they will lose trade secret protection.[14]

For these reasons, we came to the conclusion back in 2001 that a new alternative needed to be provided for the corporate form in the United States.[15]

Emerging Alternatives

Discussion about changing and improving the corporate form to take into account social and environmental factors is *not* new. Some of the best corporate lawyers in the country came together in the late 1970s and labored for more than a decade to draft the American Law Institute's *Principles of Corporate Governance: Analysis and Recommendations*.[16] This publica-

10. The need for integrated sustainability accounting standards has led to the creation of the new Sustainability Accounting Standards Board (SASB). The SASB will create industry-based key performance indicators suitable for disclosure in standard filings such as the Form 10-K, establishing standards for integrated reporting that are concise, comparable within an industry, and relevant to all 35,000 publicaly listed companies in the U.S. For more details, *see* http://www.sasb.org.

11. *See*, *e.g.*, Nicolas Z. Muller, Robert Mendelsohn, and William Nordhaus (August 2011) *Environmental Accounting for Pollution in the United States Economy*, American Economic Review 101, p. 1649-1675.

12. American Society of Civil Engineers (ASCE) (2009) *2009 Report Card for America's Infrastructure*, p. 7, 25, and 57, available at http://www.infrastructurereportcard.org/sites/default/files/RC2009_full_report.pdf.

13. Tom Smith (September 30, 2011) *Low water prices lead to inefficient distribution and use*, available at http://www.proudgreenhome.com/blog/6529/Low-water-prices-lead-to-inefficient-distribution-and-use.

14. The U.S. Securities and Exchange Commission (SEC) provided companies with interpretive guidance on how existing disclosure requirements applied to climate change, but many corporations are still risk adverse to voluntary environmental disclosures. Securities and Exchange Commission (February 8, 2010) *Commission Guidance Regarding Disclosure Related to Climate Change*, 17 CFR Parts 211, 231, and 241, available at http://www.sec.gov/rules/interp/2010/33-9106.pdf.

15. Other countries have already taken enormous steps with corporate form and sustainability. In the United Kingdom, Community Interest Companies (known as C.I.C.'s) are quickly taking hold, with over 100 new CICs registered monthly, and over 6000 CICs on the Regulators' register as of Jan 2012. *See* http://www.cicassociation.org.uk/about/what-is-a-cic. Belgium created Social Purpose Companies, a statutory label for companies that meet certain special criteria, including having a central social purpose and not being operated for shareholder profit. Rosemary E. Fei, *Beyond Taxation: A Guide to Social Enterprise Vehicles*, (January/February 2011) Taxation of Exempts, Vol. 22/Issue 4. France, Portugal, Spain, and Greece offer a form of cooperative society with multiple stakeholders (including its employees) and a social mission corresponding to local needs and other countries, such as Finland, have established special registers of companies organized as social enterprises. Jacques Defourny & Marthe Nyssens, *Social Enterprise in Europe: Recent Trends and Developments*, (August 2008), Social Enterprise Journal Vol. 4/No. 3. Outside of Europe, South Africa's Johannesburg stock exchange now requires all companies, regardless of form, to issue integrated reports including their CSG factors for financial years starting on or after March 1, 2010 or explain why they are not doing so. *See*, *The Code for Responsible Investing in South Africa* (CRISA) (19 July 2011) available at http://www.iodsa.co.za/Portals/0/library/documents/CRISA_19_July_2011.pdf.

16. Principles of Corporate Governance: Analysis and Recommendations, The American Law Institute at Washington, D.C., 1994, publ. American Law Institute Publishers.

tion contains an entire chapter on the limitations of current corporate forms on social issues and includes recommendations on how corporate forms can or should be changed to improve relations between a corporation, its employees, and the broader community (and since this was before the movement initiated by Rachel Carson's *Silent Spring* had fully matured, the environmental purposes were not mentioned).[17] Over the past 15 years, innovators have expanded on the work of these early thought leaders to create several innovative solutions, each with its own advantages and drawbacks. These new corporate forms are discussed below in the historical order in which they were introduced to the market.

Hybrids

The first effort to address the limitations of existing corporate forms was the creation of "hybrid" structures, in which non-profit companies set up for-profit entities or vice-versa. There are various forms of hybrids. For example, a non-profit can establish a wholly-owned or majority-owned for-profit subsidiary, enter into a joint venture (typically in the form of a LLC) with a for-profit company, make a minority investment in a for-profit company, or establish a contractual relationship with a for-profit company. On the other hand, for-profit companies can set up non-profit foundations or otherwise contract with non-profits to provide products and services.

Hybrids have advantages in that they allow non-profits to enter into commercial activities via their for-profit affiliates and to receive revenues via services agreements, license revenues, or dividends. They can also attract funding from private, for-profit sources via their for-profit affiliates without jeopardizing the non-profit's charitable status.

However, there are significant constraints to the widespread adoption and use of these hybrid structures. For a non-profit to set up a majority-owned for-profit subsidiary, it must be a public charity (as opposed to a private foundation) with a broad funding base. In making minority equity investments, non-profits must comply with the complex project related investment (PRI) regulations. When it sets up a non-profit foundation, a for-profit company must navigate IRS rules that have evolved little during the past century or more. Moreover, all of these hybrid structures require additional resources such as fees for attorneys and other advisors that are sufficient to create and sustain two distinct legal entities. Issues also arise in connection with the need to document all of the commercial relationships between the entities and the work of employees who provide services to both organizations. Hybrids that do not secure competent tax and legal advice at the time of formation find themselves facing fines and even potentially loss of tax-exempt status.

Constituency Statutes

In response to the rash of corporate takeovers in the 1980s, states began to pass corporate constituency statutes that allowed managers and directors to consider the interests of a variety of stakeholders, and not just shareholders, in carrying out their fiduciary duties to the corporation. Currently, 33 states have passed "constituency statutes," which provide that boards and management "shall" or "may" take into account the interests of stakeholders such as employees, suppliers, consumers, and creditors, in addition to shareholders'.[18]

These statutes have been attractive to proponents of sustainability, and increasingly used as a means to integrate corporate social responsibility into the charter documents as well as the operational decisions of sustainable companies. However, the risks associated with this expanded use of constituency statutes are significant. First, their use by socially responsible companies has never been tested in court and there has been little or no attempt to reconcile the new duties with the traditional duties of care and loyalty owed to shareholders. Many believe that, if and when they are tested, these statutes will be found to be unenforceable, particularly in states like California that have long-arm statutes.[19] Second, there is no guidance with respect to how managers and directors should weigh the interests of varying constituencies. And there is no provision confirming that stakeholders representing such constituencies will have no cause of action to enforce their particular social or environmental interest. Finally, there are no means for companies that organize under the constituency statutes to report out or provide real accountability to shareholders on the socially responsible factors.

Low-Profit Limited Liability Company ("L3C")

The low-profit limited liability company ("L3C") is another alternative for pursuing profitability together with a special

17. Part II discusses the "Objective and Conduct of the Corporation" and states in §2.01, "Even if corporate profit and shareholder gain are not thereby enhanced, the corporation, in the conduct of its business…[m]ay take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business; and [m]ay devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes." *Id.* at p. 55.

18. *See*, *e.g.*, 805 Ill. Comp. Stat. 5 / 8.85 (2010) (stating directors "may…consider the effects of any action…upon employees, suppliers and customers of the corporation or its subsidiaries, communities in which offices or other establishments of the corporation or its subsidiaries are located, and all other pertinent factors"); N.Y. Bus. Corp. Law § 717(b)(2)(i)–(v) (Consol. 2011) ("[Directors] shall be entitled to consider…the effects that the corporation's actions may have in the short-term or in the long-term upon any of the following: (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."); and 15 Pa. Cons. Stat. Ann. § 1715(a)(1) (West 2011) ("[Directors may consider] [t]he effects of any action upon any or all groups affected by such action, including shareholders, employees, suppliers, customers and creditors of the corporation, and upon communities in which offices or other establishments of the corporation are located.").

19. Cal. Corp. Code §2115.

purpose. The L3C is a statutory variant of the limited liability company that has been considered in 21 states and adopted in nine.[20] However, the L3C is principally designed to assist for-profit companies that have a *primarily* charitable purpose and want to attract PRI investments from foundations.

The statutory changes that create the L3C were specifically written to dovetail with the IRS regulations regarding PRI investments for foundations.[21] Currently, foundations commit less than 1% of their assets to PRIs,[22] due to restrictive and esoteric IRS requirements on what types of entities may receive these funds and how the investment must be structured. By requiring that "the primary purpose of the organization must be charitable, with the production of income permitted to be a secondary purpose,"[23] L3Cs can receive both foundations' PRIs and investments from non-exempt parties to accomplish the L3C's primary charitable purpose. An L3C may offer lower rates of return to member owners, but it should be noted that these entities cannot obtain tax exemptions under IRS 501(c)(3).[24]

The L3C has been billed as a simple answer to a very complex problem, yet these entities retain all of the limitations of the LLC from an investment perspective and arguably do not effectively solve many of the complications associated with PRIs.[25] Institutional investors are often unwilling to bear the burden of reviewing the diverse operating agreements of LLCs. In addition, LLCs and L3Cs have limited capital market acceptance and multiple tax concerns as pass-through entities. Furthermore, with the PRI concerns, there is no IRS ruling or attorney tax letter on PRIs for either regular for-profit LLC or L3C entities, so this new form does not help with the "private benefit" issue.[26]

Finally, although it could be addressed in the operating agreement, the current drafts of model forms prepared for the L3C lack mission-anchoring mechanisms, decision-making protections for socially responsible management members, and transparency reporting obligations around the special purpose. There has been opposition from the ABA to the L3C; and many fear that because the characterization is definitional and not elective, any LLC that is set up traditionally and has a charitable purpose could be subject to the L3C requirements whether it intends to be or not.

Flexible Purpose Corporation[27]

On October 9, 2011, Governor Brown signed into law California Senate Bill 201, creating a new division of the California Corporations Code to authorize and regulate the formation and operation of a new form of corporate entity known as a Flexible Purpose Corporation (FPC).[28] The law went into effect on January 1, 2012, and as of the date of publication, approximately 20 companies have established as FPCs. The FPC creates a new "safe harbor" in addition to the business judgment rule that requires boards and management to consider environmental and social factors in addition to shareholder value, in both the ordinary course of business and change-of-control situations, and protects boards and management from shareholder liability in connection with those actions.

The bill was drafted by the Working Group on New Corporate Forms, a group of ten corporate lawyers including partners from large and small firms, a law professor from Stanford, a general counsel of an impact investor and foundation, and members of the Corporations Committee of the State Bar.[29] Originally convened by the three co-chairs, the members of the Working Group were invited based on their corporate law experience as well as their ability to represent

20. Illinois (805 ILCS 180), Louisiana (HB1421/Act417), Maine (H-819), Michigan (MCL 450.4101 et seq.), North Carolina (H769/SB308), Rhode Island (H5279), Utah (Tit. 48, Ch. 02c), Vermont (tit. 11, Ch. 21), and Wyoming (Tit. 17, Ch. 15).

21. *See*, *e.g.*, 805 ILCS 180/1-23(a) stating that "A low-profit limited liability company shall at all times significantly further the accomplishment of one or more charitable or educational purposes within the meaning of Section 170(c)(2)(B) of the Internal Revenue Code of 1986, 26 U.S.C. 170(c)(2)(B), or its successor, and would not have been formed but for the relationship to the accomplishment of such charitable or educational purposes," and MCL 450.4101 (2)(m)(i) requires "[t]he limited liability company significantly furthers the accomplishment of 1 or more charitable or educational purposes described in section 170(c)(2)(B) of the internal revenue code, 26 USC 170, and would not have been formed except to accomplish those charitable or educational purposes."

22. The Foundation Center tracks all PRI-makers identified via grantmaker surveys, reporting by foundations on their 990-PFs, and membership to the PRI Makers Network. Recently, the Foundation tracked 173 private and community foundations that made at least one PRI of $10,000 or more in 2006 or 2007 and found that their program-related investments totaled $742 million of the $91.9 billion (approximately 0.8%) in overall charitable distributions provided by foundations during this two-year time frame. Steve Lawrence, *Doing Good with Foundation Assets, An Updated Look at Program-related Investments*, in The Foundation Center, The PRI Directory: Charitable Loans and Other Program-related Investments by Foundations, New York: Foundation Center, 2010.

23. Americans for Community Development, authors of the L3C legislation, available at http://www.americansforcommunitydevelopment.org/faqs/faqs-significantportion.html.

24. *See*, I.R.C. §501(c)(3). For additional U.S. tax regulations and exemptions governing organizations, *see id.* §§ 501–515. Because L3Cs are designed to facilitate PRIs by foundations, these investments are governed by the tax rules governing PRIs rather than the rules governing charitable contributions. In fact, there have been strong criticisms of the tax implications of L3Cs. *See* J. William Callison & Allan W. Vestal, *The L3C Illusion: Why Low-Profit Limited Liability Companies Will Not Stimulate Socially Optimal Private Foundation Investment in Entrepreneurial Ventures*, 35 VT. L. REV. 273, 274 (2010) ("[W]ithout changes to federal PRI ['program-related investment' provisions for private foundations] rules, the L3C construct has little or no value. Indeed, the existence of the state law form, without matching federal income tax substance, is dangerous since the ill-advised may assume value and use the form.").

25. *See generally* Ann E. Conaway, *The Global Use of the Delaware Limited Liability Company for Socially-Driven Purposes*, 38 Wm. Mitchell L. Rev. 772 (2012) (discussing the creation and use of L3Cs and explaining "The Truth About L3C Legislation") and Daniel S. Kleinberger, *A Myth Deconstructed: The "Emperor's New Clothes" on the Low Profit Limited Liability Company*, 35 Del. J. Corp. L. 879 (2010).

26. William Callison, L3Cs: Useless Gadgets? Business Law Today Volume 19, Number 2 (2009).

27. One of the authors of this article, Susan Mac Cormac, was on the Working Group that drafted the FPC.

28. The State of Washington will likely soon adopt the "Social Benefit Corporation," a corporate form very similar to California's FPC. *Substitute Washington HB 2239*. The legislation was delivered to the Governor on March 6, 2012 and is expected to be signed into law. For current status of the bill, *see* http://e-lobbyist.com/gaits/WA/HB2239.

29. The members of the Working Group are W. Derrick Britt (Co-chair), Partner, Doty, Barlow, Britt, and Thomas, LLP; R. Todd Johnson (Co-chair), Partner, Jones Day; Susan H. Mac Cormac (Co-chair), Partner, Morrison Foerster; Keith Paul Bishop, Partner, Allen Matkins Leck Gamble & Mallory LLP; Edward A. Deibert, Director, Howard Rice Nemerovski Canady Falk & Rabkin; William P. Fitzpatrick, General Counsel, Omidyar Network; Steven K. Hazen, Retired, Former Vice-Chair for Legislation of the State Bar of California Business Law Section; David M. Hernand, Partner, Gibson Dunn & Crutcher LLP; Jay A. Mitchell, Director, Organizations and Transactions Clinic, Stanford Law School and former chief corporate counsel of Levi Strauss & Co.; and Robert A. Wexler, Partner, Adler & Colvin.

diverse perspectives and approaches to the various "friction points" encountered when creating hybrid organizations. Dedicated to creating a non-partisan and unbiased solution to the limitations of existing corporate forms, the Working Group worked by consensus and spent almost two years deliberating and drafting the proposed new division of the California Corporations Code.

The Working Group considered various possible names for the new corporate entity and, for a time, used the working name "H Corporation," with the "H" referring to hybrids. Ultimately, the Working Group settled on "Flexible Purpose Corporation" because it most closely described the new corporate form's differences from the traditional corporation formed under California's General Corporation Law (GCL).

FPCs are required to specify in their Articles of Incorporation (Articles) at least one "Special Purpose"[30] that directors and managers may consider in addition to traditional shareholder economic interests when determining what is in the best interests of the company and its shareholders. In general, decisions and actions that consider the multiple and potentially competing purposes of the FPC are protected from claims of waste or other breaches of fiduciary duties. FPC disclosure and transparency requirements protect investors from abuse of this expanded liability protection.

More specifically, the Flexible Purpose Corporation is different from a traditional corporation organized in California under the California Corporate Code in six defining ways: (1) the Articles must include one or more social or environmental purposes; (2) directors are protected from liability for decision-making involving trade-offs between profitability and the special purpose(s); (3) the special purpose mission may not be altered without the approval of two-thirds of each class of voting shares; (4) change of corporate form requires a vote of at least two-thirds of each class of voting shares; (5) shareholders cannot be forced into or out of an FPC without dissenters' rights; and (6) an FPC must provide annual reports communicating achievements toward its special purposes together with 8-K type reporting of actions that could have a material impact on economic or socially responsible returns.

One of the primary goals when developing the FPC was to have it "look and feel" as much as possible like a traditional corporation organized under the California Corporations Code to enable for-profit companies with a social and/or environmental goals to access traditional capital markets as well as "socially responsible" investment without increased risk. Initially, funding for FPCs has and will continue to come from impact investors[31] and wealthy individuals focused on sustainability. Second, there is considerable attraction toward use of FPCs by public charities that want to establish for-profit subsidiaries or affiliates to house commercial activities, but want to "anchor" their charitable mission on equal par with such affiliate's profit motive. In addition, private foundations have become increasingly interested in making socially responsible investments.[32] Some foundations that fund "mission-related investments" that are still prudent and lucrative, yet also seek to advance the foundation's mission, are attracted to FPCs—and to L3Cs and Benefit Corporations as well. However, none of these new corporate forms provide tax advantages or temper the PRI regulations that govern the investments. Finally, private equity and venture funds with a focus on cleantech and/or sustainability have expressed interest in FPCs. Some GPs of these funds recognize the greater operational efficiencies and potential for overall value enhancement that can come with well-managed FPCs, but they must first gain greater comfort with the risks associated with any new form and the impact on exit strategies. GPs may also initially be constrained by their LPs, even those who publicly tout a socially responsible agenda. However, that is likely to change in the not too distant future. A report discussing the critical role of the $20 trillion in assets held by institutional investors play in addressing the current environmental and social problems examined the practices of the largest U.S. institutional investors currently investing for both financial return and positive social and environmental impact. This report shows that these investors are earning a competitive rate of return and goes on to provide recommended policy changes to encourage institutional investors to embrace funding companies with a blended value.[33] Although the evolution of the spectrum will not happen overnight, we are confident that institutional investors will fund FPCs and see both financial and social returns.

The FPC has already been and will continue to be

30. The Special Purpose can be one or more charitable or public purpose activities that a non-profit public benefit corporation is authorized to carry out and/or promoting positive short-term or long-term effects of, or minimizing adverse short-term or long-term effects of, the FPC's activities upon its employees, suppliers, customers, creditors, the community and society, and/or the environment. Cal. Corp. Code §2602(b)(2).

31. "Impact investors" is a term used to describe any investors who include social and environmental factors in their investment decisions and require some measure of reporting on the social return on investment (SROI). Impact investors seek to enhance social benefits or environmental health as well as achieving financial returns.

32. For decades, many foundations have imposed negative screens on their investments to avoid investing in "bad actors" such as tobacco companies. *See e.g.*, *The Rockefeller Foundation Social Investing Guidelines*, available at http://www.rockefellerfoundation.org/uploads/files/af34dcb4-1000-4dde-9748-df58eafc7ae2.pdf.

33. Impact at Scale: Policy Innovation for Institutional Investment with Social and Environmental Benefit, is a collaboration between InSight at Pacific Community Ventures and the Initiative for Responsible Investment at Harvard University and is funded by The Rockefeller Foundation. The report explores the role of public policy in impacting investing for institutional asset owners and reveals government strategies to encourage this funding into the future. When examining current practices, the report "clearly demonstrates that Institutional Investments that have social and environmental value are also earning a competitive rate of financial return, allowing institutions to maintain their fiduciary duty while simultaneously having a social impact." Dr. Judith Rodin, President of the Rockefeller Foundation. Impact at Scale: Policy Innovation for Institutional Investment with Social and Environmental Benefit (February 2012).

adopted by several types of entities: small, socially responsible companies, subsidiaries of public companies, and for-profit subsidiaries of non-profit public charities. The authors' goal is to have FPCs eventually become a viable and well-used alternative form, capable of attracting mainstream capital, for both small sustainable companies as well as large publicly traded multi-nationals, to fundamentally shift the playing field in favor of environmental sustainability.

Benefit Corporation

The Benefit Corporation as a new corporate form arose out of the "B Corporation" certification process developed and marketed by B Labs.[34] This statutory corporate form contains advantages for companies that wish to pursue special purposes, but is often confused with B Lab's private system of certification for socially responsible companies.

The "B Corporation" certification process claims to differentiate between "good companies" and those that are simply involved in "greenwashing"[35] their products or processes. B Lab promotes the "B Corporation" certification, which allows for-profit entities to self-audit their socially responsible practices under the B Lab standards and then pay a royalty to license the B Corporation mark for display on products and materials. There are several other certifications for companies that want to distinguish themselves as socially and environmentally responsible; many of these are more comprehensive[36] and have more robust means of verification.[37]

Several years after the Working Group on New Corporate Forms was established and the year after the FPC legislation was introduced in California, B Lab co-drafted separate legislation with Bill Clark, a Pennsylvania attorney, designed to codify the B Lab standards. The first Benefit Corporation bill was signed into law on April 13, 2010 in Maryland. Similar statutes have been supported by B Lab, and various versions of this new class of corporation now exist in seven states, with the most recent passed in California on October 9, 2011, which became law on January 1, 2012 with the FPC.[38]

Benefit Corporation legislation varies significantly among the states; in fact, the differences among Benefit Corporations in the various states are more significant than the differences between the Benefit Corporation and the FPC in California. The Bar Associations in most of the states (including California) have opposed the legislation primarily on technical (but also on policy) grounds, reflecting the failure in many states to ensure that the new provisions do not conflict with other provisions of the corporation code.

In general, the Benefit Corporation is formed for the purpose of creating a "general public benefit," which is defined as "a material positive impact on society and the environment, taken as a whole, as assessed against a third-party standard…." This purpose is in addition to, and may be a limitation on, shareholder profits. Furthermore, a Benefit Corporation may also elect one or more enumerated "specific public benefits" that accomplish a particular benefit for society or the environment. The inclusion of additional specific public benefits does not limit the Benefit Corporation's obligations to create a general material public benefit. Unlike the FPC's broad Special Purpose language, the Benefit Corporation employs a "materiality" requirement for any benefit, an approach that may restrict larger corporations from converting into Benefit Corporations.

There are additional differences between the Benefit Corporation and FPC. One is that the third-party standards by which Benefit Corporations assess their annual sustainability actions. Although the definition of "third-party standard" has been strengthened over the various iterations of the legislation, Benefit Corporations must select a standard to compile their annual reports and have little ability to change the standard over time. In contrast, the FPC allows for its standards to evolve as the definitions and interpretations of common sustainability practices progress. Furthermore, perhaps the greatest difference between the two corporate forms is in their enforcement proceedings. The Benefit Corporation creates a new cause of action entitled a "benefit enforcement proceeding." This enforcement proceeding lacks clarity and contains a real possibility of third-party claims, as this new right of action can be initiated by stakeholders who own at least 5% of the equity interest in the Benefit Corporation's parent company or any other persons that are specified in the articles or bylaws of the Benefit Corporation.[39] Finally, at least in

34. "B Lab drives systemic change through three interrelated initiatives: 1. Building a community of Certified B Corporations…2. [Promoting the] use of B Lab's GIIRS Ratings & Analytics…[and] 3. Promoting legislation creating a new corporate form…." *B Lab–the non-profit behind B Corp.*, available at http://www.bcorporation.net/The-Non-Profit-behind-B-Corps.

35. "Greenwashing" is a term used to describe a form of public relations spin in which green marketing is deceptively used to promote the perception that an organization's aims and policies are environmentally friendly. *See* http://en.wikipedia.org/wiki/Greenwashing.

36. The Global Reporting Initiative (GRI) is one of the world's most prevalent standards for sustainability reporting, with over 3,500 companies from 60 countries participating to date. GRI's Sustainability Reporting Guidelines are technically robust and updated frequently, with G3 guidelines issued in 2006 and G4 guidelines currently in the public comment period and set to be released this year.

37. The ULE 880 uses a rigorous third-party audit of the organizational sustainability metrics, complementing existing self-reporting protocols and standards that address discrete sustainability issues. ULE 880: Sustainability for Manufacturing Organizations available at http://www.ul.com/global/eng/pages/offerings/businesses/environment/companyserv/SQProgram/EnterpriseStandards/UL880/.

38. Cal. Corp. Code §§ 14600–14631 (West 2011), S.B. 1462, 26th Leg., Reg. Sess. (Haw. 2011), Md. Code Ann., Corps. & Ass'ns § 5-6C-01 (West 2011), N.J. Stat. Ann. §§ 14A:18-1 to -11 (West 2011), N.Y. Bus. Corp. Law §§ 1701–1709 (Consol. 2011), VT. Stat. Ann. Tit. 11A, § 21.02 (2011), Va. Code Ann. § 13.1-782 (2011).

39. Cal. Corp. Code §1462.3(2)(C), (D).

California, the Benefit Corporation cannot be used by many categories of legal entities, including insurance companies, close corporations, and banks.[40] If the legislation is amended in California to address these and other technical issues, the Benefit Corporation may become a viable vehicle for small, socially responsible companies that do not need to avail themselves of mainstream capital.[41]

Conclusion

While the traditional corporate form may and likely will evolve over time, in the absence of the FPC and the Benefit Corporation, there is still risk of director liability, no satisfactory mechanism to anchor social mission, and no standardized transparency reporting obligations with respect to critical (and many would argue *material*) social and environmental factors. Many states are considering the adoption of new corporate forms in an effort to support and encourage the convergence of business profitability and business sustainability. The federalist system of the United States permits this unique moment in time for innovation and experimentation by the states to accomplish this objective. Changing the corporate form is one of the few solutions that we believe can and will accelerate the adoption of environmental sustainability initiatives at a rapid enough speed to effectively address the pressing social and environmental issues facing the world today. As a recent statement by Generation Management noted, "Incremental change will prove insufficient to mainstream Sustainable Capitalism by 2020. So, like an artist at the easel, our goal is not to make superficial touch-ups….We are calling for a fresh canvas on which, together, we can paint a new picture of our future."[42] We couldn't have said it better ourselves.

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40. Insurance companies, close corporations, and banks are subject to additional requirements when setting forth their articles of incorporation. The FPC legislation incorporates those requirements in Cal. Corp. Code §2602(b)(4), (5), (7). However, there are no similar provisions in the Benefit Corporation code.

41. Some companies that have established as Benefit Corporations are Blessed Coffee in Maryland, Give Something Back, Inc. in California, Patagonia Inc. in California, Greyston Bakery, Inc. in New York, and Farm Community Consultants in Virginia. *See* http://www.benefitcorp.net/find-a-benefit-corp.

42. *Sustainable Capitalism*, Feb. 15, 2012, Generation Investment Management LLP, p. 24.

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What Role Should the Government Play in Embracing the New Corporate Form?

- Preston DuFauchard, former California Corporations Commissioner

Introduction

Much discussion and excitement currently exist in the legal and business communities about a new style of corporate social involvement, one in which the company's very existence pivots on a social purpose in addition to maximizing shareholder return. In this article, I suggest that such new corporate objectives should also engage government action, sometimes of legal necessity. To that end, I discuss three possible roles state government might play in interacting with such an entity. Two substantive roles include: (1) careful evaluation and passage enabling statutes for legislative sponsors who provide a cogent legal approach; and (2) making sure existing regulations or laws do not unintentionally undercut the objectives of the legislation. A final government role, one of process, will permit the government to assess outcomes resulting from the enacted corporate legislation. The process involves data collection, review, and assessment regarding those companies that use the enabling legislation.

The Business Case For a New Corporate Form:

Perhaps no one makes a stronger case for passing enabling legislation for a new corporate form than Michael Porter, from the Harvard Business School. He refers to the objectives of the new corporate form as creating "shared value." See M. Porter and M. Kramer, "The Big Idea: Creating Shared Value," Harvard Bus. Review (Jan.-Feb. 2011). By way of example, he discusses the "fair trade" movement in the coffee bean market. At its optimum use, the "fair trade" model extends well beyond paying coffee bean farmers more of a living wage for the crops produced. In addition to the increased wages, the "fair trade" movement provides the farmers with knowledge about improving crop yields, sizes, and sustainability. In this manner, "fair trade" can be seen not as a way to redistribute revenues along an existing value chain, but instead as a way to grow the size and value of the pie in a way for all to share a larger piece. The value is shared by all participants in the economic stream, farmers, merchants, consumers, and the public (especially, improving the lives in villages where the coffee beans are farmed).

Corollary benefits for companies that employ a “shared value” model are many. They include a more enthusiastic customer base. Many consumers will purchase from a merchant that maintains a social objective as part of its business plan. Tom’s Shoes presents another example, a company founded on the principle of distributing used shoes and profits to those who need them in developing countries. In addition, the social purpose will attract a highly educated and dedicated workforce. All of these, in turn, establish a positive feedback loop; a devoted workforce and an enthusiastic customer base will lead to increased revenues and shareholder return.

Porter distinguishes his “shared value” concept from the well-tread efforts of Corporate Social Responsibility (CSR). Most companies spend some of their profits on philanthropy, at an appropriate scale to the company. That can range from, say a car dealership providing school uniforms to a local high school athletic team, to funding a corporation’s foundation that makes grants of various sizes to the communities in its footprint. “Shared value” exists within and as part of the corporate profit stream, not at the end of it, which is where CSR exists. And, “shared value” does not exist on the same ledge of CSR, where too much CSR may conflict with shareholder return, creating a potential shareholder claim for waste.

Others have advocated concepts similar to Porter’s. See, for example, J. Emerson, “The Blended Value Map: Tracking the Intersects and Opportunities of Economic, Social and Environmental Value Creation,” at www.hewlett.org/upload/files/BlendedValueMapFinal.pdf (2003), and generally Double Bottom Line Venture Capital at www.dblinvestors.com. No precise nomenclature exists for these entities, but they all share the same theoretical footing, whether called “shared value,” “blended value,” “double bottom line,” “benefit corporation,” or “flexible purpose corporation.” In this article, the terms “dual purpose” and “new form” describes all of these entities.

To be sure, skepticism exists about whether any dual purposed organization can survive successfully. One such critique is that any diversion by management away from the sole interests of shareholder return reduces accountability of management, and the effectiveness of all-around performance. In Michael Kinsley’s book Creative Capitalism, Larry Summers points to Fannie Mae and Freddie Mac as poster children for dual purpose entities whose failure was preordained. “When there were social failures, the companies always blamed their need to perform for the shareholders. When there were business failures, it was always the result of their social obligations.” M. Kinsley, Creative Capitalism : A Conversation With Bill Gates, Warren Buffet, and Other Economic Leaders, p. 196 (2008). When management responsibility becomes diluted, company executives can use the dual nature of the corporate objective to deflect management shortcomings in meeting its obligations to either objective.

Fannie Mae and Freddie Mac are compelling examples of potential shortcomings of a dual purpose entity, but they are not altogether on point in today's discussion. First, the history of these organizations, starting as government entities and later spun out to become semi-private companies, present a very different picture of what is at stake in today's environment. The dual purpose entities under discussion today start out in the private sector, and the government does not dictate the social values to be pursued by such companies. Indeed, the social purposes established by these entities are varied, ranging from fair trade, environmental sustainability, education, to other forms of community involvement.

The nature of the dual purpose of the companies, in any regard, should be embraced by governments as a form of public-private partnerships. In other words, many of the non-profit objectives of the companies will have a tendency to bolster government efforts on a variety of fronts, whether those social objectives relate to the environment, education, financial literacy, or other social well being. While there may be no explicit or direct engagement between the government and such entities, their existence will have a tendency to provide added resources where government resources are scarce or otherwise limited. Non-profit and philanthropic institutions do much of the same thing, but exist at a different edge of the corporate spectrum from dual purpose entities, which maintain a profit motive.

Careful Assessment and Enactment of Sponsored Legislation

The dual purpose of these new companies logically suggests the need for new laws to legitimize this new form of entity. And because corporations are creatures of state statutes, the responsibility for giving form to these enterprises falls to state legislatures. The challenge for legislatures, which do not focus on private sector corporate governance structures, is to be critical of sponsored legislation, which may have undesired consequences that extend beyond the design of the proposed laws.

The history of legislation in California proves this point. What started as a facially simple piece of proposed legislation, Assembly Bill 2944 of 2008, would have changed the existing business judgment rule statute, California Corporations Code section 309. Essentially, the draft bill would have shielded corporate officers and directors from shareholder liability if in exercising their judgment, the managers considered the interests of shareholders, employees, suppliers, customers, community, societal considerations, and the environment. Effectively, the business judgment rule would have been weakened, and management became responsible, in theory, to any variety of constituents. Governor Schwarzenegger vetoed the bill due to “unknown ramifications” the bill presented. Other states have passed so-called constituency statues, but not many companies appear to be organized under them.

In California, more careful and precise legislative proposals followed. One company, B-Labs, has prescribed a uniform set of laws for a dual purpose corporate structure, in what it refers to as "benefit corporations." Various states, including California, have adopted the B-Labs legislation. Such states include Virginia, Maryland, Vermont, New Jersey, and others. In addition, a working group of well-regarded California corporate lawyers, drafted a new statutory framework for a dual purpose entity. Referred to as the Corporate Flexibility Act of 2011, the legislation became effective in January 2012. It fits ,appropriately, in the California Corporations Code between the chapters of General Corporation Law and Non-Profit Corporation Law. Cal. Corp. Code sections 2500, et seq. The dual purpose entity, according to this statute, is the "flexible purpose" corporation.

Unforeseen consequences present the starkest dilemma for these new form corporations. The lives of the new form companies will be tested in litigation, most likely in the context of a merger or acquisition. Of particular concern is the potential use of the new corporate form as a type of anti-takeover law. For example, under the new corporate form, can management of a takeover target successfully exercise its right to reject a proposed takeover because the surviving firm will no longer maintain the social purpose of the target firm? If management cannot reject such a takeover attempt on that basis, the enabling legislation for new form companies holds limited value. And, if it is legitimate for management to reject such a takeover offer, can management avoid a hostile takeover by simply changing from a general corporation to a dual purpose company shortly before the hostile bid?

California's legislature decided not to enact anti-takeover laws after the Supreme Court ruled that crafting these statutes in a certain manner would pass constitutional muster. CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987). Post-CTS, other states enacted anti-takeover legislation. California elected not to do so, in some part due to the influence of its two large state pension funds, on for state teachers and the other for public employees - CalSTRS and CalPERS. Having chosen not to enact anti-takeover in the past, it would be unfortunate if the legislature, by giving birth to new corporate forms, found itself having enacted what could turn out to be a form of anti-takeover legislation. The earlier bill discussed, AB 2944, presented a stronger risk of that effect. Time will tell how real a risk that may be under existing laws.

Do No Harm

Having passed enabling legislation for the dual purpose entities, the government should be careful to examine what regulations or rules may hinder growth of these new corporate forms. One example comes to mind, although it is not a state regulation. It is from ERISA.

One avenue for young companies to seek capital for scaling their operations is through fund managers, who manage investments on behalf of qualified clients, or sophisticated investors, many of which are plan funds. ERISA provides guidelines for mangers of ERISA-based plan funds. ERISA regulations prevent an adviser from considering the socially responsible aspect of the investment in a particular entity. See 29 CFR §§2509.404a-1 and 2509.94-1. Although the adviser can make the investment if the economic performance of the company is equal to or greater than its peers, no consideration can be given to its dual purpose. To the extent these ERISA-based rules establish a standard of care for fiduciary responsibilities for an investment adviser, the government regulations may chill the ability of dual purpose entities to raise capital from fund advisers.

In other areas, government regulations may conflict with the implementation of social objectives these new form entities maintain. For this reason, it will become important for governments to be engage with these new form entities when the social objectives are congruent with government interests, but regulations may frustrate the implementation of these objectives.

Monitor Outcomes of Legislation

For states that pass enabling laws for these dual purpose companies, one measure of the effectiveness of the legislation will be to determine the number of companies that establish themselves under the new laws. Another suggested metric concerns the number of existing firms that change from an existing general corporate structure into the new corporate form. Finally, keeping track of judicial decisions regarding the use of the new corporate forms will be important for any later assessment about any potential need for amendments to the laws.

These metrics provide, by far, a more substantive approach to evaluate the new corporate form legislation than the approach advocated by some. One measure of the success of the new form legislation, used by some, has been to look at the number of states that have passed similar enabling acts. This measure does not point to any substantive legislative success, however, if no corporations are formed under the enabling laws, regardless of how many states have passed similar acts. If no one uses the new-form statutes, the discussion about “shared value” or dual purpose companies becomes purely academic and theoretical. And the public-private partnership nature of such companies is lost.

With the more substantive metrics described above, data collection will be important. And, who collects the data has a tendency to generate questions about data authenticity. Ideally, the government should collect the data, as a neutral party and as part of its oversight responsibilities for the laws it enacts. Given limited resources in state budgets, however, the prospect seems remote that any state government would create a new office with a mandate to collect such data. Collection of the information by private parties risks arguments about whether the data collection is skewed by the parties gathering the data for purposes of future advocacy.

One solution is for a state academic institution to become the repository of data received from the state. Academic institutions are used to data management, and do not present an obvious risk concerning lack of objectivity in data collection for future advocacy. In California, the Berkeley Law School, at the University of California, Berkeley, has begun to collect precisely such data from the state.

On the subject of metrics and data, I should mention that there exists real, and as yet unresolved, questions about internal measures of success within dual purpose firms. How can managers assess the performance of non-economic objectives, both over time and among firms with similar or even different social objectives? Researchers are trying to find ways to standardize these metrics, but have not yet agreed upon any uniform set of measures. There remains much to discuss about this point, but that is a subject beyond the purview of this article.

Adjust As Needed

The long-term collection of data will prove to be useful in the future assessment of the new corporate form statutes. Legislatures will have an evidence-based measure of whether these statutes have been used as designed, and if there exist any unintended negative consequences created by use of the statutes. In this fashion, state legislatures can adjust the laws accordingly. If unforeseen consequences exist, but the statutes prove popular and provide substantial benefits, the data will show this. Legislatures will not be faced with an all or nothing approach in deciding whether to eliminate the statutes or live with the undesired effects. Measured solutions will emerge from practitioners and scholars, based on data interpretation.

Conclusion

Michael Porter refers to the movement towards “shared value” companies as a form of capitalism 2.0. It turns on its head the traditional trajectory of a successful capitalist who builds a firm, and later uses his amassed fortune for purposes of philanthropy. Instead the new corporate form practices a form of philanthropy while at the same time building the riches of its capitalist founders. The government has a role in helping these firms, and should embrace them, as the new firms can become a boon to local economies as well as communities. How governments respond to the new corporate forms will determine whether this capitalism 2.0 can exist, or will thrive. And, in the long term, government action may be necessary to rein in any undesired consequences posed by the new form statutes.

Corporate Form and Social Entrepreneurship: A Status Report from California and Beyond

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> *There is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.*
>
> *Milton Friedman*
> *Capitalism and Freedom (1962).*

> *The purpose of the corporation must be redefined as creating shared value, not just profit per se. This will drive the next wave of innovation and productivity growth in the global economy. It will also reshape capitalism and its relationship to society. Perhaps most important of all, learning how to create shared value is our best chance to legitimize business again.*
>
> *Michael Porter & Mark Kramer*
> *Harv. Bus. Rev. (2011).*

Few propositions of modern corporate law have proven as persistent (or as debatable) as *shareholder primacy:* the maxim that corporate entities (and managers who control them) should focus telescopically on the goal of maximizing the wealth of shareholders (a.k.a., the corporation's "residual claimants"). This core tenet (as well as variations and violations of it) occupies a prominent position in myriad modern debates concerning (*inter alia*) corporate governance, fiduciary duties, takeover defenses, mergers and acquisitions, proxy contests, securities regulation, and even criminal law.

Skeptics of shareholder primacy – particularly those concerned with the broader role of sustainable business practices – have openly questioned the wisdom of the judicial commitment to the proposition, arguing that it unjustifiably subordinates considerations both of (extra-corporate) societal actors and of (intra-corporate) stakeholder actors to those of shareholders, whose capital stake represents a narrow tranche of the economic interests that incorporated entities produce. Moreover, they argue, in modern corporate capital structures – rife with options, convertible debt, derivatives, leverage, and thin equity cushions – shareholders can hardly claim distinction as the corporation's sole "residual claimants" (and thus focal beneficiaries) of a its activities. Finally, skeptics assert, even if (for argument's sake) one assumed that maximizing shareholder *welfare* should take precedence over other intra- and extra-corporate goals, that objective does not necessarily equate to maximizing shareholder *wealth,* particularly for shareholders who have preferences broader than wealth maximization (e.g., they care about for public goods, environmental sustainability, wealth distribution, and so forth). Our continued obsession with shareholder primacy, critics conclude, makes little economic, political, or philosophical sense.

Defenders have rejoined that the shareholder primacy norm *does* (or at least can) make policy sense, at least for the vast majority of corporations where shareholders still bear the lion's share of economic risk. Moreover, they assert, even if shareholder primacy does not entirely square with the way risks are actually distributed within (and outside of) the firm, shareholder welfare provides a useful criterion for holding managers accountable – a task that would become hopelessly elusive were managers given wide discretion to pick and choose which constituency (or combination thereof) their actions or inactions are meant to serve. Finally, defenders argue, if broader social purposes were important to shareholders (or other corporate constituencies), a profit maximizing firm would have a natural profit incentive to commit contractually to pursuing such purposes as a way to make the corporation more attractive as a supplier, trading partner or target for capital investment.

By all indications, this now-century-old debate will continue to rage on for some time, and I do not aspire to resolve it here. A fair reading of the current state of play, however, suggests that while the shareholder primacy norm continues to be a valuable organizing theme for some (or even most) corporate entities, it is not categorically so: Numerous businesses – particularly those in environmental sustainability industries – would plausibly benefit (in a variety of ways) from choosing an entity form that commits them to broader social purposes alongside profit generation. Accordingly, perhaps, reform-minded lawyers have endeavored over time to conjure up mechanisms by which firms might plausibly embrace such goals in a credible and durable fashion. These reforms include initiatives to encourage corporate social responsibility, innovations to judicial doctrine (such as a highly protective business judgment rule), and – in a number of states – corporate "constituency statutes" (which provide legal protection for corporate directors who wish to weigh stakeholder considerations alongside shareholder return).

Recently, however, a different, more tailored governance innovation has taken hold in a handful of states: the creation of alternative corporate forms that require the incorporated entity to articulate a broader social goal (or goals) against which – alongside profitability – corporate performance is to be gauged. These alternative forms are designed to provide a concrete means by which a corporation can bind itself to a broader set of purposes, without also having to go "all in" with non-profit (or low-profit) status. To date, twelve states have implemented legislation creating these new corporate forms,[1] and many others are in various stages of promulgation. A national experiment is decidedly underway.

What we still lack, however, is reliable information about the experiment's results. This paper attempts to make a modest contribution to that enterprise, offering a status report on statutory innovations across states, and drilling down to focus on the data currently available from California's own social enterprise experiment, eight months after its effective date.

Why California? After all, its statutory reforms are relatively new, coming almost two years after Maryland became (in early 2010) the first state to embrace for-profit social purpose entities. California's experience is still relatively developmental compared to other states with a longer track record. That said, the scope of California's reform is notable and worthy of our considered attention for at least two reasons. First, California is big, geographically and economically, comfortably ranking first in the country in number of registered firms (incorporated or not), employees, and payroll.[2] Adding in the home-state incorporation bias of non-public companies (one that is particularly salient in California[3]), the Golden State's reform decisions simply matter more. And second, California's reforms are tantalizingly unique, in that they provide (unlike other states) a <u>menu</u> of social enterprise forms, allowing the choice among two new alternative business forms for social-purpose oriented corporations. California corporations now have an option between incorporating as a "benefit corporation" (BC) a "flexible purpose corporation" (FPC), [4] or any of the preexisting forms. The intervening months have provided an intriguing window for assessing not only the extent of demand for such new business forms *writ large*, but revealed preferences among them.

<u>The Backstory</u>

Before delving into these statutes and their effects, however, one must first understand why proponents of reform thought them necessary in the first instance. Prior to the enactment of

California's recent legislation, if a for-profit business located in California wished to pursue a social benefit mission other than maximizing shareholder returns, it faced limited options. Although many states' statutes permit corporate entities great freedom to tailor their corporate purpose (as articulated in the charter), including social benefit goals,[5] an odd quirk in California corporate law does not permit that type of drafting flexibility.[6] Nor, for that matter, has California heretofore embraced the notion of "constituency" statues that have the effect of permitting / requiring directors to weigh costs and benefits of their decisions across a large number of constituencies (including shareholders, corporate stakeholders and society).[7] While incorporating in another state (e.g., one allowing tailored corporate purposes or offering a constituency statute) may be an option, it is not always an attractive one for California-based firms, who remain beholden to many of the California's corporate provisions anyway, by "virtue" (using that term advisedly) of its infamous long-arm statute.[8] Similarly, embracing other socially-oriented business forms, such as non-profit status, or L3Cs, posed myriad issues related to – inter alia – the subordination (or nonexistence) of profit motive, tax consideration, and the difficulty of attracting capital investments.

Consequently, prior to the new statutory innovations, many (if not most) socially-minded California businesses tended to incorporate as "plain vanilla" C-corporations, falling back (perhaps optimistically) on their managerial discretion and the (so-called) business judgment rule ("BJR") – a legal presumption that grants great deference to fiduciaries in weighing the costs and benefits of business decisions, without fear of judicial second guessing. While the deference embodied in the BJR is comforting, it is also limited in a major respect: While the rule grants fiduciaries discretion about *how* to serve their shareholder interests, it does not give discretion about *whether* to do so. Consequently, for decisions that obviously sacrifice shareholder welfare for the benefit of other considerations (including social purposes), the BJR provides no protection. Such clear tradeoffs are often manifest at "watershed" junctures in the life of a corporation, such as when a corporate entity enters *"Revlon"* mode, putting itself up for sale or reorganization in a fashion that will cause (usually public) shareholders to surrender their ability to extract a control premium for their shares.[9] Here, the dictates of corporate law tend to give corporate fiduciaries little choice but to take appropriate steps to maximize shareholders' short term value and accept the highest offer reasonably available. Many other concerns (including social benefit goals) tend to fade quickly when scrutinized against this simple judicial calculus.

Finally, even assuming away all the above constraints, many reform proponents perceived existing corporate structures as inadequate means for making credible, long-term commitments to a social purpose that remains immune to "mission creep." In other words, if market conditions became too tempting or the demands of short-termism to pressing, they argued, the corporation could too easily re-define its mission through charter / bylaw amendments, restructurings, dissolutions, asset sales or acquisitions, abandoning any purpose that did not contribute directly to attractive quarterly P&Ls.

Legal reform advocates therefore

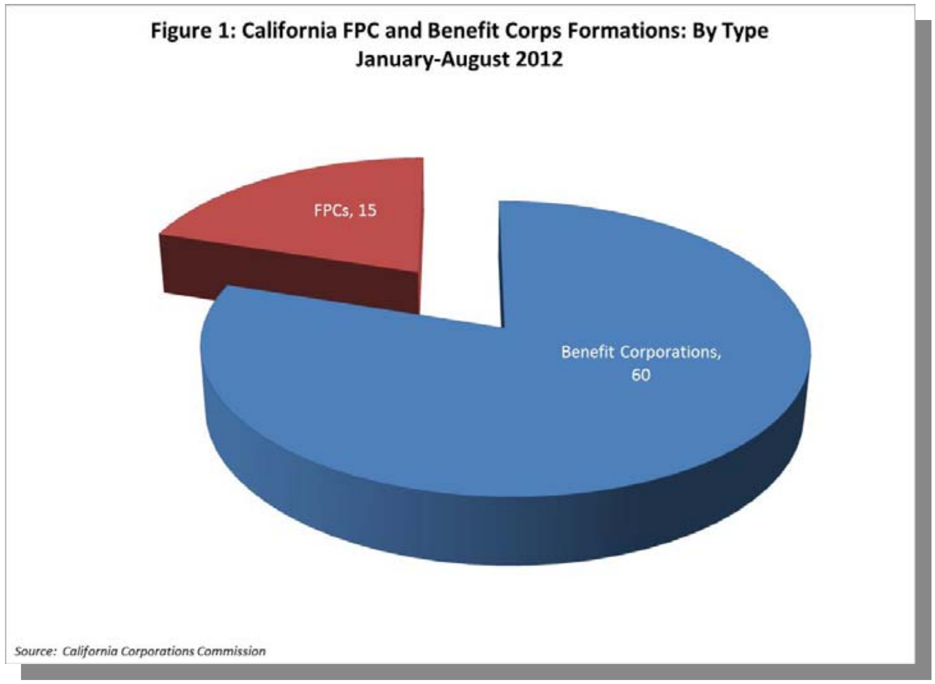
perceived this *status quo ante* to be inadequate for the needs of at least some socially-motivated entrepreneurs, their employees, and their prospective investors, who wished to pursue profitable ventures *without* having to sacrifice their company's defining commitment to a broader social goals, such as environmental sustainability, public health, and poverty elimination. Drawing momentum from the preexisting efforts at reform in other states, the California BC and FPC statutes were soon to follow.

Although some reform in California seemed inevitable, the state's ultimate decision to embrace of two distinct social enterprise corporate forms was somewhat more surprising. Although a working group focused on stimulating social entrepreneurship in California originally began drafting unified legislation, the group eventually split into two camps. This divide persisted, ultimately leading to two bills that – while substantially similar in many respects – differed in some important ways.

The California Reforms

As noted above, both the BC and FPC statutes in California require the corporation to articulate in its charter a public purpose (or purposes), and to issue annual reports on the corporation's fealty to that articulated purpose. Moreover, both statutes require a super-majority vote of shareholders (set by default at 2/3) to alter, repeal, reorganize out of, or otherwise jettison the special purpose provision. Nevertheless, the two forms differ in a few important respects. First, FPCs give somewhat of a greater freedom to tailor and articulate special purposes in the charter, while the BC purpose is somewhat more structured around a broad social purpose, defined as "a material positive impact on society and the environment, taken as a whole…"[10] In addition, the statutes differ in the process by which fidelity to the broader social purpose is measured and assessed. While both require annual reports, assessment within a BC must be in accordance with an established, documented and measurable third-party standard; the FPC form, in contrast, permits greater latitude in analyzing performance. Third, embedded in the BC statute is also a form of traditional constituency statue, requiring the directors to consider the impacts of any action or proposed action upon various stakeholders of the corporation, such as customers and employees.[11] The FPC statute does not contain a like provision. Furthermore, the BC statute creates a new type of "Benefit Enforcement Proceeding" (filed by a director, shareholder, or significant equity holder) while the FPC statute relies on traditional enforcement rights (and in particular the derivative action). Moreover, many of the core attributes typifying the California BC structure also carry over to other states' benefit corporation statutes (albeit with some exceptions[12]) – a similarity generated by the national scope of reform-minded companies like B-Lab.

By most accounts, the FPC entails a somewhat greater degree of (for want of a better term) flexibility on organizational / governance dimensions than does the BC form, and it therefore represents the more modest departure from the traditional corporate form. Such flexibility likely brings about both benefits and costs. As to the former, FPCs are more likely to have a 'look and feel' similar to other for-profit start-ups, an affinity that may (in some circumstances) attract more financing interest from sources who value legal predictability and familiarity with existing corporate legal standards.[13] On the other hand, by committing to independent third-party accountability standards and creating a new enforcement action, the BC form makes an arguably more concrete commitment that may (in some circumstances) be less susceptible to "mission creep." A disadvantage that both forms face is their novelty, and the lack of a well settled jurisprudence clarifying the interpretation and application of the legislative reforms, as well as the development of best practices in the operation and management of both firms. In this respect, it seems plausible that the BC form – by virtue of its relatively more established presence other states – is likely to generate a more robust quantity of judicial opinions in the short to medium term.[14] Only time will tell, of course, which of these relative costs and benefits will win the day (and for what type of firm).



Current State of Affairs

Interesting as all the above speculations might be, they will remain speculations until we have meaningful data on how prospective new businesses have responded to legal reforms. We are now only at the cusp of being able to collect, organize and analyze this information. That said, data provided by the State of California permit some preliminary windows into the current state of play.[15] What follows is a short overview of that data.

Figure 1 provides a count of BC and FPC incorporations filed in California between January and August 2012. As illustrated by the figure, a total of 75 corporate entities were organized under one of the two new statutes. Although large enough a group to be analyzed statistically, this is still an extremely small number in the greater scheme of things, massively dwarfed by the roughly 60,000 new incorporations filing paperwork over the same period of time in California.

As Figure 1 further shows, entities that chose to file under one of the two new statutory forms preferred the BC form on a three-to-one basis over the FPC. The reasons behind this preference are as yet unclear, as is the question of whether this preference will persist over time. Figure 2 perhaps provides a small window into this question, tracking incorporations on a monthly basis. The figure suggests that the strong preference for the BC over the FPC

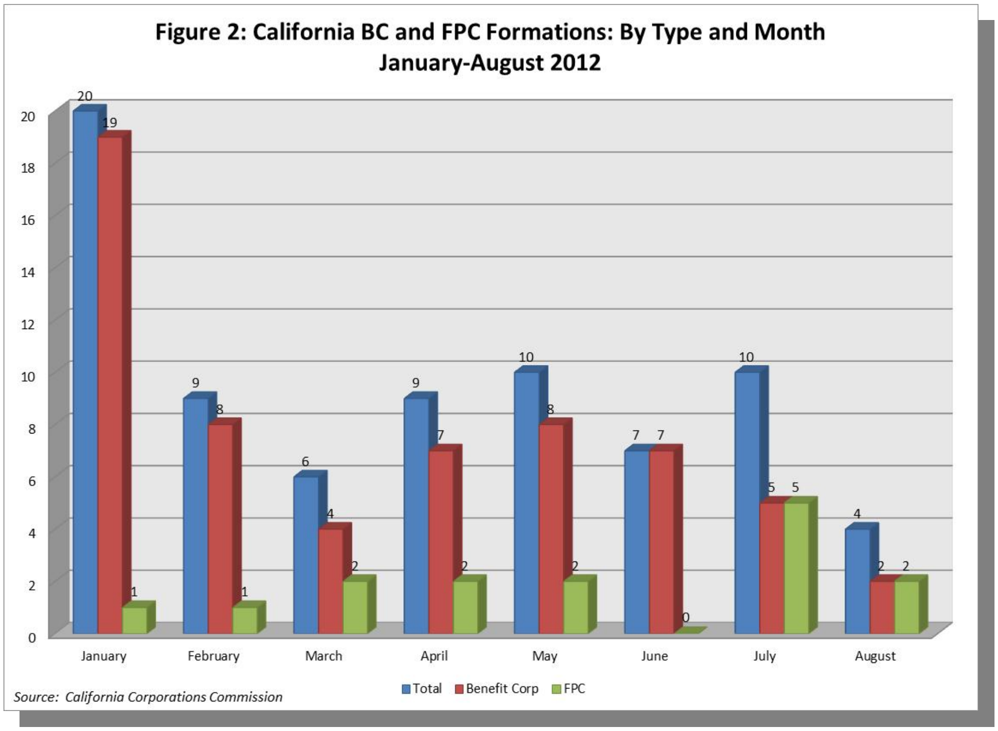


Figure 2: California BC and FPC Formations: By Type and Month January-August 2012

Source: California Corporations Commission

was particularly marked during the first few months in which the statutes were effective, possibly suggesting an "inventorying" phenomenon, in which prospective BCs were already organized and lined up for incorporation before the statute's effective date.[16] In later months, while the BC still appears to be keeping a narrow advantage, the FPC has largely increased in popularity while the BC has remained somewhat stable.

Geographic dispersion within (and outside of) California is also provides an interesting insight into demand for alternative forms. Figure 3 separates the new business entities by the geographic location of their headquarters. As the figure demonstrates, the vast majority of incorporations (95 percent) involve companies whose business is headquartered in California. Of those, Northern California companies outnumber Southern California by almost a two-to-one ratio. This greater popularity in Northern California may be due to the large concentration of renewable / alternative energy and clean-tech companies located in the Bay Area.

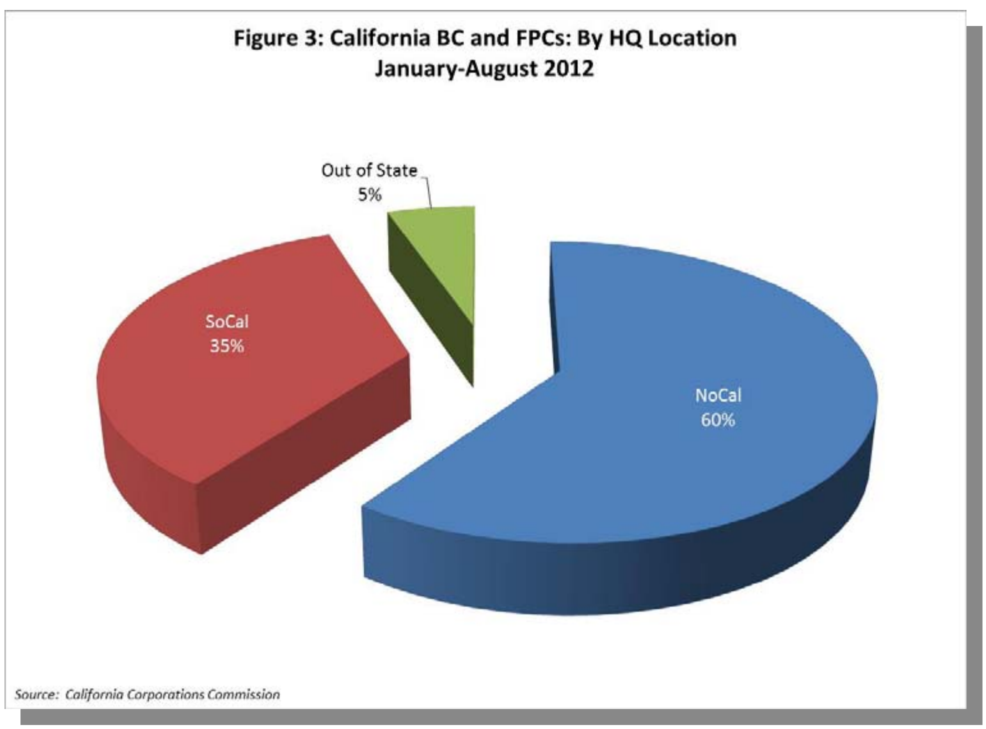
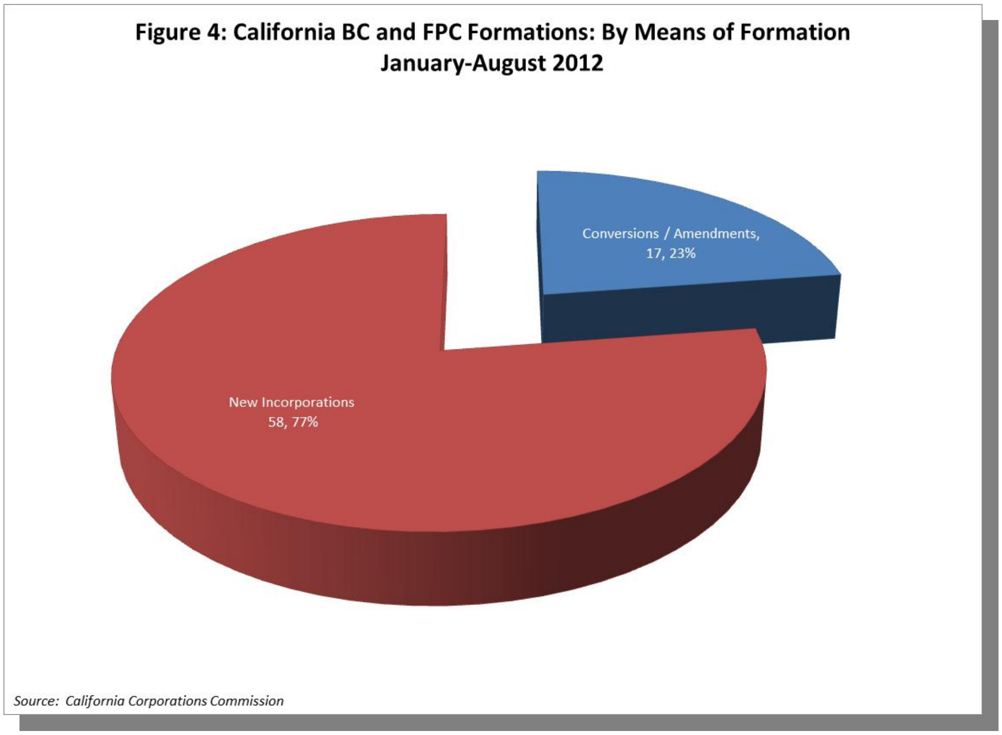


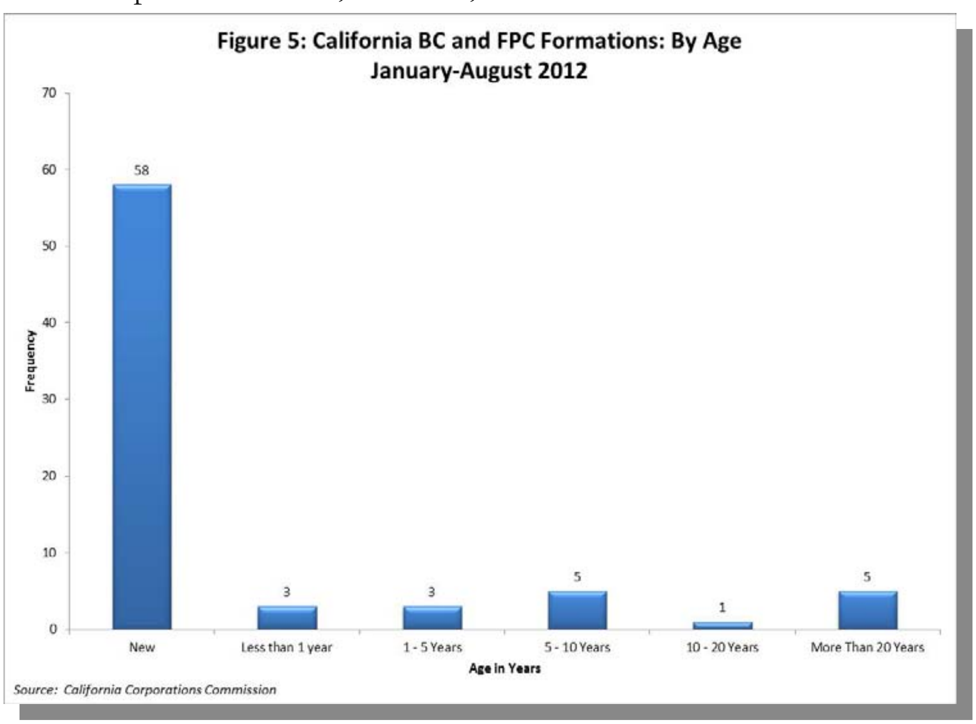
Figure 3: California BC and FPCs: By HQ Location January-August 2012

Source: California Corporations Commission

Given the nature of social enterprise oriented businesses, and their concentration in emerging industries, one would expect that FPC and BC incorporations would be heavily represented by new companies rather than existing ones. Consistent with this prediction, Figure 4 shows that over three-quarters of the BC/FPC incorporations in California during 2012 represent what appear to be new corporations rather than corporations that either amended their charter in accordance with the statute, or when through the formal conversion process.

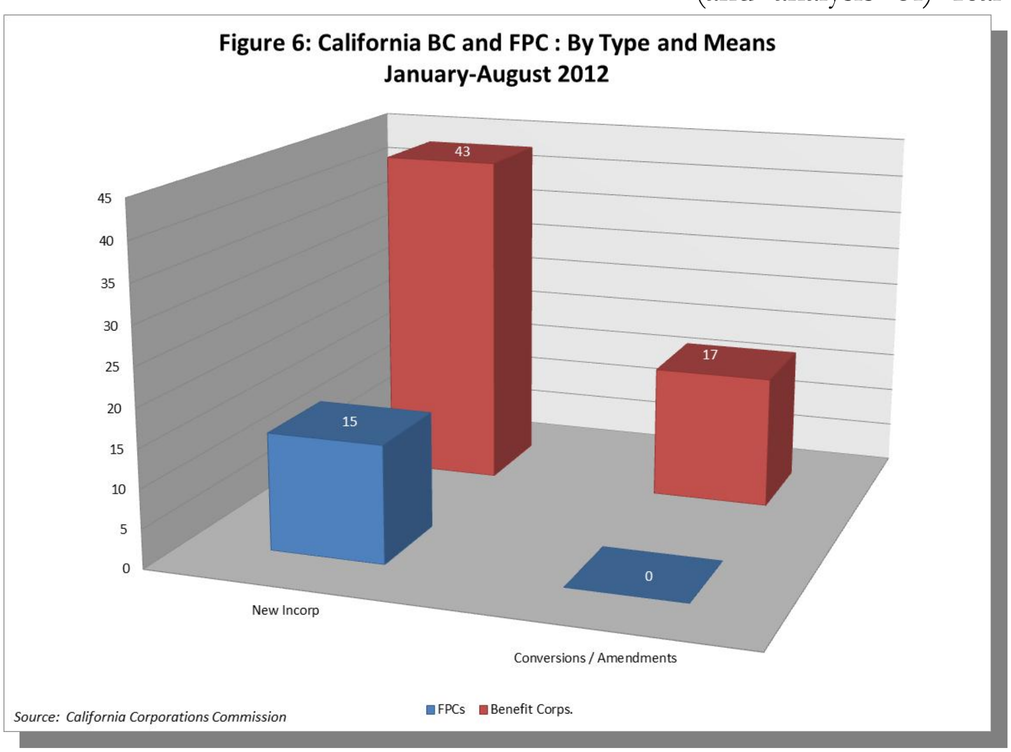


It is important to note, however, that the new incorporations number may be biased upwards, as it plausibly captures existing firms that – while newly created – actually succeeded to the business of preexisting firms through the asset sale or acquisition process. That said, as Figure 5 demonstrates, the amending and/or converting firms tended to vary considerably in age, ranging from 2 months to 37 years, with a relatively uniform distribution in between. Although the numbers are admittedly small, it is interesting to note that at least some well established firms find it worthwhile to adopt the BC/FPC status.



An interesting

and unanticipated oddity about the firms who adopted FPC/BC status by converting or amending their charters is their evidently strong preference for the BC form over the FPC form, as illustrated by Figure 6. As the figure shows, *none* of the converting / amending firms appears to have opted for a FPC approach. This is a bit surprising, given the impression that the FPC is widely perceived to be a relatively modest departure from a traditional corporate form than is the BC. Although this evident regularity may be due to the possibility that new firms are more likely than established ones to want to attract investments from outsiders, or greater marketing visibility of BC proponents,[17] at this stage the drivers behind this trend are unclear, and – as with all these data – the trend itself may well change or even reverse over time.



What Now?

Thus far, California's and other states' legislative experiments in social entrepreneurship business forms remain decidedly a work in progress. While there is obviously interest in these new corporate forms, judging by California's experience, uptake rates have been thus far been modest. In many respects, this observation should not be too surprising, given the novelty of the area, the absence of developed case law, the lack of developed best practices in administering these sorts of business entities, and the understandable aversion that many have to being the first canary to fly into a new statutory cave. Fully appreciating the implications of this new "wave" in corporate organization, as well as course adjustments that may be necessary, will obviously require more time to let the experiment percolate.

But as the experiment continues, it will also demand more systematic access to (and analysis of) real world data, across states, over time, and along numerous dimensions. Thus far, there is little concentrated effort to collect, organize, and warehouse such data across (or even within) states. Because such information itself has significant public benefits, moreover, it would seem imprudent to leave its collection and analysis to private entities (with private motives) or partisan advocates (with ideological commitments). Respected academic institutions or non-partisan research centers are far more likely to be reliable and credible source for data, best practices, and policy relevant research on corporate form, social purpose, and entrepreneurship. The task of installing that infrastructure is something that we can (and should) work to accomplish today.

Endnotes

[1] These include California, Hawaii, Illinois, Louisiana, Maryland, New Jersey, New York, North Carolina, South Carolina, Vermont, Virginia and Washington.
[2] See 2000 Census Bureau, County Business Patterns survey.
[3] As explained below, California's unique long arm statute makes it particularly attractive for private corporations to incorporate in California, enhancing this home state bias.
[4] AB 361, codified in California Corp. Code §§ 14600-14631 (Benefit Corporations) and SB 201, codified in Cal. Corp. Code §§ 2500-3508. The competing bills were introduced and passed on parallel tracks, and both were signed into law by California Governor Brown in October 2011, with simultaneous effective dates of January 1, 2012.
[5] See, e.g., Del. Gen. Corp. Law §§ 101-102.
[6] Cal. Corp. Code § 202, which prescribes specific language for a general corporate purpose, and specifically prohibits expansions of that purpose.
[7] Although thirty states currently have such statutes, they are absent from both the California and Delaware corporate codes. For a state-by-state accounting, see Jonathan Springer, Corporate Constituency Statutes: Hollow Hopes and False Fears, 1999 Ann. Surv. Am. Law 85 (1999).
[8] Cal. Corp. Code § 2115. The Delaware Supreme Court declared Section 2115 to be unconstitutional on commerce clause grounds in VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108 (Del. 2005). Since the VantagePont holding, no California court has recognized it as binding on California courts, though some recent decisions have acknowledged it in passing. E.g., Lidow v. Superior Court, 141 Cal. Rptr. 3d 729 (Cal. Ct. App. 2012).
[9] See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). Although California courts are sometimes said to have "rejected" the *Revlon* doctrine, the evidence for this claim is questionable. Indeed, there appears to be no published opinion by a California state court at any level that rejects the doctrine, and the handful that cite *Revlon* appear to do so approvingly.
[10] Compare Cal. Corp. Code § 2602(b) to § 14610(b). BCs may also adopt specific social purposes in addition to a broad one. *Id.*
[11] Cal. Corp. Code § 14620(b).
[12] For example, many other states (but not California) include requirements for director seats or officer titles dedicated to the pursuit of the public benefit.
[13] See, e.g., Susan Mac Cormac and Heather Haney, New Corporate Forms: One Viable Solution to Advancing Environmental Sustainability, 24 *J. App. Corp. Fin.* 49-58 (2012).
[14] It bears noting, however, that FPC-like statutes have also recently been proposed in a number of states.
[15] Many thanks to the California Corporations Commissioner's office for assistance in collecting this data.
[16] Many of the 19 BCs incorporated in January, for example, appear to have been executed by a small number of attorneys, which may be a byproduct of concerted marketing efforts by BC proponents. (This is but one of many possibilities, however, and the data does not currently permit testing of it).
[17] See note 15, *supra.*

