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Considering A Hybrid? Pennsylvania Adopts New Model Of Business Entity – The "Benefit Corporation"

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Earlier this year, Pennsylvania joined a growing number of states in adopting a new form of business entity – the "benefit corporation."[1] Benefit corporations are for-profit corporations that seek to advance a socially conscious or environmentally concerned objective while at the same time endeavoring to achieve the traditional goal of a for-profit corporation – a profit for its shareholders. Profit maximization, however, becomes just one piece of a benefit corporation's purpose and must be weighed with its more socially beneficial objectives. Directors of a benefit corporation will not be liable to the shareholders for considering other factors, such as the environment, employees and other stakeholders, when making decisions on behalf of the corporation. However, despite having similar objectives, the benefit corporation is not considered a nonprofit corporation, nor does it enjoy the same tax-exempt benefits.

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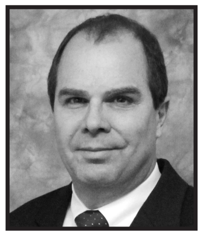

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In recent years, states have been moving away from a shareholder-centric corporate model to a more expansive scope of societal and environmental concerns. A dozen states now recognize benefit corporations as a distinct choice of entity. Well-known socially and environmentally focused companies, such as California-based clothing manufacturer Patagonia, have taken advantage of the availability of this new structure.[2] These companies see the benefit corporation as one way to avoid taking short-term actions in order to maximize shareholder profitability without focusing on the long-term effects on the corporation or society.[3] Other proponents feel that benefit corporations are a way to instill trust in corporations by an increasingly socially conscious public. Still others believe that government agencies and traditional nonprofits will see the benefit corporation as a more compatible and perhaps more attractive entity with which to do business. Critics of this relatively new form, however, warn of the relaxed accountability for directors[4] and the dangers of benefit corporations misleading the public if those corporations are confused with nonprofit corporations.[5]

Electing To Be A Benefit Corporation

The process to become a benefit corporation in Pennsylvania is entirely elective – a corporation must affirmatively state in its articles that it is a benefit corporation. An existing corporation (or other entity) can amend its governing document to elect to be a benefit corporation, but the amendment must be adopted by at least the "minimum status vote." This minimum status vote entitles all shareholders as a class, regardless of voting power, to vote, and requires a two-thirds vote of the shareholders. Interestingly, if a benefit corporation is the surviving or new entity as a result of a merger, consolidation or other fundamental transaction involving an entity that is not a benefit corporation, the fundamental transaction must have been approved by at least a minimum status vote even for the entity that is not the benefit corporation.

The General Public Benefit Purpose

A benefit corporation must have a "general public benefit" purpose – a material positive impact on society and the environment, taken as a whole and assessed against a "third-party standard" from the business and operation. This third-party standard is developed by another organization. The statute does not specify a particular organization to develop this third-party standard – the

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only main requirement is that it be independent of the benefit corporation. A benefit corporation may also have optional specific public benefit purposes in addition to (but not in place of) the general public benefit – which includes improving human health; promoting the arts, sciences or advancement of knowledge; or providing low-income or underserved individuals or communities with beneficial products or services. Professional corporations may also elect to become benefit corporations without violating the restriction against operating in a way other than their stated purpose.

Additional Disclosure Filing Requirements

One of the goals of the benefit corporation is to increase transparency of the corporation through the Annual Benefit Report. The Annual Benefit Report is required to be delivered to each shareholder and contain detailed information regarding the corporation's efforts to pursue and the extent to which it obtained the general and specific public benefit. The Annual Benefit Report must also contain certain other disclosures, such as the compensation paid to the directors; names of persons or entities that own 5 percent or more of the benefit corporation, either of record or beneficially; and a statement of the independence of the benefit corporation from the third-party standard provider. The nonfinancial and nonproprietary information included in the Annual Benefit Report must be posted on the benefit corporation's website and filed with the Pennsylvania Department of State.

Limitation Of Liability To Focus On The Public Benefit

One of the defining characteristics of this new type of entity is that directors of a benefit corporation are able to expand the scope of considerations when making decisions for the best interests of the corporation. This includes not only shareholders, but also a benefit corporation's employees and workforce; the interests of customers, community; societal considerations; and the local and global environment. While the traditional factors under the BCL are still present, directors are not mandated to prioritize one factor over another. A director is also protected from personal liability if the benefit corporation fails to create a general public benefit or specific public benefit. A director cannot be liable to a beneficiary of the general or specific public benefit simply because the person is a beneficiary.

Another unique aspect of the benefit corporation is the inclusion of a "benefit director" – an independent director who has the additional duty of filing the Annual Benefit Report and reporting whether the corporation and directors operated and acted in accordance with the general and specific public benefit. The benefit corporation may also have a benefit officer who manages the general and specific public benefit purpose and prepares the Annual Benefit Report.

The benefit corporation's exposure to liability based on its failure to pursue or create a general public benefit or specific public benefit is also limited. This includes a bar on monetary damages and a narrowing of potential plaintiffs – only the corporation itself, shareholders, directors, record owners of 5 percent or more equity interests in the corporation's parent entity, and any persons specified in the corporation's organizational documents have standing to bring action for such failure.

Choosing A Form

There have always been many factors to consider when choosing the legal entity to form in order to conduct business, and it has always been necessary to thoroughly consider all of the benefits and risks of each type of entity in determining which structure best fits the goals of the organizers. Entrepreneurs in Pennsylvania can now consider one more factor: whether they want their organization to stretch beyond the traditional corporate objectives and endeavor to achieve a societal benefit in addition to making a profit.

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1 35 FEB PA LAW 2 (January/February 2013).

2 Angus Loten, "When Profits Can Take a Back Seat," *Wall Street Journal* (Jan. 19, 2012).

3 *Id.*

4 *Id.*

5 Pennsylvania Accepts First Benefit Corporations, *Environmental Leader,* Jan. 2, 2013, http://www.environmentalleader.com.