

Benefit corporations: A sophisticated and worthy reform

By Sam Morrissy, Lawyer and member of the B Lab Australia Policy Working Group

- Benefit corporations place both profit-making and the public good at the forefront of the purpose of the corporation.
- Benefit corporation legislation has been enacted in 31 states in the US.
- In 2015 a working party was established with the aim of introducing the benefit corporation in Australia.

In the United States in 2008, a new type of for-profit company limited by shares was conceived, known as the 'benefit corporation'. The benefit corporation has been introduced via legislative amendment in more than half of all US states over the past five years. Taking inspiration from this process, a group of Australian academics, lawyers, business leaders and governance experts are working towards the introduction of the benefit corporation in Australia.

A benefit corporation has two core purposes: to make a profit and to create a public benefit. Recognising the limits of voluntary action by companies, the benefit corporation enshrines the triple bottom-line principles of 'profit, people and planet'¹ in statute and in a company's governing documents, representing a significant shift in corporate law and governance practice. The benefit corporation modifies directors' duties and imposes auditing and reporting requirements beyond those of a traditional limited liability company.

The benefit corporation is not to be confused with the voluntary 'B Corp' certification awarded by not-for-profit organisation, B Lab, to companies that

meet particular standards of verified social and environmental performance, public transparency and legal accountability.² While there are a great many certified B Corps which are also benefit corporations, it is equally possible in many US jurisdictions to be legally incorporated as a benefit corporation without being a certified B Corp. Further, there are many certified B Corps in jurisdictions outside the US (including Australia) where the benefit corporation does not exist as a legal form.

Despite this distinction, B Lab has been at the forefront of promoting and agitating for legislative reform to introduce the benefit corporation around the world. B Lab Australia & New Zealand was incorporated in 2013, and in early 2015 oversaw the establishment of a policy working group to advocate for legislative reform in Australia.

What is the benefit corporation?

The benefit corporation is a for-profit company limited by shares. It is subject to the usual solvent trading obligations imposed on for-profit companies, and is distinct from legal forms commonly associated with charities.

While the benefit corporation legislation varies as between states in the US, in a majority of jurisdictions and under the model legislation first developed in 2008, there are four key ways in which the benefit corporation differs from a traditional for-profit company:

1. The benefit corporation is required to have as a core objective the creation of a 'general public

benefit', along with the creation of one or more specific public benefits unique to that entity. These specific benefits may include the protection of a particular environment, supporting a local community or may be more general (contributing to the advancement of science, for example).³

2. A modified auditing and reporting requirement, which mandates that the company produce a yearly benefit report and requires third party certification that the company has complied with its general public benefit and specific benefit mandate.
3. Directors have a procedural duty to consider non-shareholder interests in the course of their decision-making. These interests are specified in the legislation, and include shareholders, employees, suppliers, customers, communities, societal considerations, the local and global environment, the short-term and long-term interests of the corporation and the ability of the corporation to accomplish its general and specific public benefit purposes.
4. An enforcement procedure that gives standing to shareholders to require compliance with the general public benefit obligations in the company's constitution.

A 'general public benefit' is defined under the model legislation as a 'material positive impact on society and the environment, taken as a whole, as assessed against a third-party standard, from the business and operations of a benefit corporation'.⁴

Rationale for the benefit corporation

For close to a century, academics have debated whether a corporation is solely responsible to ownership interests, or whether it also possesses obligations to benefit the welfare of other stakeholders.⁵ Fundamental to this question is the role of the shareholder. A shareholder is the only person that 'owns' a corporation in any sense.⁶ The shareholder contributes equity in return for this ownership stake. Those who take a 'shareholder primacy' view argue that in return for this investment, all the

benefits of the corporation's activities should flow to the shareholder.⁷ The alternative 'stakeholder primacy' view contends that corporations owe duties to both shareholders and the community, that incorporation is a privilege bestowed solely by the state which carries significant advantages (limited liability and perpetual succession) and in turn society is justified in expecting the corporation to act in the general public interest.⁸

The benefit corporation revives stakeholder primacy in the context of the modern contract theory of corporate law, which defines the corporation as a 'nexus of contracts' between constituencies including shareholders, employees, suppliers and even the community.⁹ Under this model, even where the business judgment rule may legally protect directors from making decisions that don't always maximise shareholder profits, if there is no connection between a business decision and shareholder value, then that decision will itself open to shareholder criticism. Practically, the shareholder wealth maximisation principle remains the 'light on the hill' in modern corporate decision-making.¹⁰

As a consequence, the legal structure of the company itself gives rise to a somewhat irreconcilable tension. Directors have a practical duty (arguably more perception than legal obligation in Australia) to maximise profit for their shareholders. It is an oft-cited failure of the free market system that maximisation of profit creates a great number of negative externalities, and provides insufficient public benefits, particularly when measured against key social and environmental metrics.¹¹ While directors continue to be saddled with a profit-maximisation duty (whether perceived or otherwise) directors can only consider public or non-shareholder interests to the extent that they do not materially impact on the corporation's bottom line (and therefore shareholder returns), or to the extent that some other long-term benefit accrues to shareholders.¹² This constrains the ability of directors in a traditional company structure to consider non-shareholder interests, and creates a

disharmony between profit-making activities and the active consideration of wider stakeholder interests.

Australian companies are free to adopt voluntary codes and corporate social responsibility measures to achieve sustainability targets or deliver social justice outcomes. However, these measures do not remove the legal uncertainty which directors are forced to confront when considering non-shareholder interests. The benefit corporation attempts to address this by placing both profit-making and the public good at the forefront of the purpose of the corporation.

Development of the benefit corporation in the US

As at 10 January 2015, a total of 31 US states had enacted benefit corporation legislation, including Delaware (although its own legislation differs in some respects to the model laws adopted nearly unanimously by the other states). The legislation in Delaware is significant given that Delaware is home to over one million companies, including half of all publicly listed companies in the US.

The rapid success of the benefit corporation in the US is reflected in many businesses of all sizes. A high profile example is Patagonia, a privately owned outdoor apparel and accessories retailer, which has revenues of over \$500 million and was one of the first entities to incorporate as a benefit corporation under the Californian legislation when it was introduced.¹³ Its founder Yvon Chouinard has stated that the attraction of the benefit corporation was that it institutionalised the values, culture, processes and high standards of his company, and allowed these to remain constant through capital raisings or a future change of ownership.¹⁴

Arguably the most effective aspect of the benefit corporation legislation is the positive protection that it offers directors who wish to allocate the company's resources to activities that do not maximise shareholder profits.¹⁵ William H Clark, a pioneer of the benefit corporation movement in the US, sums this up poignantly:



...material positive impact on society and the environment, taken as a whole, as assessed against a third-party standard, from the business and operations of a benefit corporation.

For-profit companies pursuing a social mission face increasing difficulty as they scale; as officers and directors of these entities consider investments, mergers or liquidity events, the default position tends to favour the traditional fiduciary responsibility to maximise returns to shareholders over the company's social mission ... whatever the letter of the law, these fears, combined with both prevailing business culture and advice of counsel about the risk of litigation if one fails to maximise shareholder value, have a chilling effect on corporate behaviour as it relates to pursuit of a social mission.¹⁶

Whatever the black letter law might say — and there is no doubt that in both the US and Australia, directors certainly do have scope to consider non-shareholder interests under the current law¹⁷ — directors are uncomfortable in straying too far from the profit-maximisation norm. Removing the liability risk for directors and obliging them to consider public benefits and devote corporate resources to this end, is a fundamental part of why the benefit corporation structure has potential to work successfully and effect change in corporate behaviour.

From an economic perspective, the benefit corporation may assist in reforming the underlying capital and labour structure of the economy, so as to shift some of the growing burden of externalities from the public sector into the private sphere. Despite criticisms about efficiency in resource allocation, this type of corporate structure has the potential to reduce pressure on tax revenues and the not for profit

sector, and let the private sector 'clean up after itself' to a far greater degree than is currently possible. Evidence in the US to date has shown that the benefit corporation structure offers discounted capital to investors, a home for the increasingly large pool of ethical investments funds and accompanying marketing and goodwill advantages for those choosing to support it.¹⁸ The research demonstrates that a higher level of corporate social performance leads to more sustainable profits over the long term.¹⁹

The benefit corporation has interesting implications in a takeover and M&A context. The frequently cited example is that of 'Ben & Jerry's', an American ice-cream company that was sold to Unilever (a multinational corporation) in 2000. The owners of Ben & Jerry's were forced to accept Unilever's offer as it was the highest bid and offered the best monetary value for shareholders.²⁰ There were significant concerns at the time about local manufacturing and environmental impacts (two key points of differentiation for their business) and that the directors, when considering takeover bids, could not take into account these factors. This position would have been different had the company been a benefit corporation (as it is now).

The benefit corporation in Australia

Since early 2015, a group of academics, lawyers, business leaders and governance experts have been working towards the introduction of

the benefit corporation in Australia, alongside B Lab Australia & New Zealand. This group is currently co-ordinating the development of a set of draft amendments to the *Corporations Act 2001* which will be used as the basis for advocating for legislative reform in 2016.

Simultaneously, thanks to the efforts of B Lab, there are now more than 90 certified B Corps in Australia and New Zealand, and more than 1000 companies currently working through the assessment process.

Despite this rapid progress and the enthusiasm shown by the Australian business community for B Corps, the uptake of 'B Corp' certification does not overcome the legal and practical impediments for companies looking to place profit making on an equal footing with social responsibility and the public good.

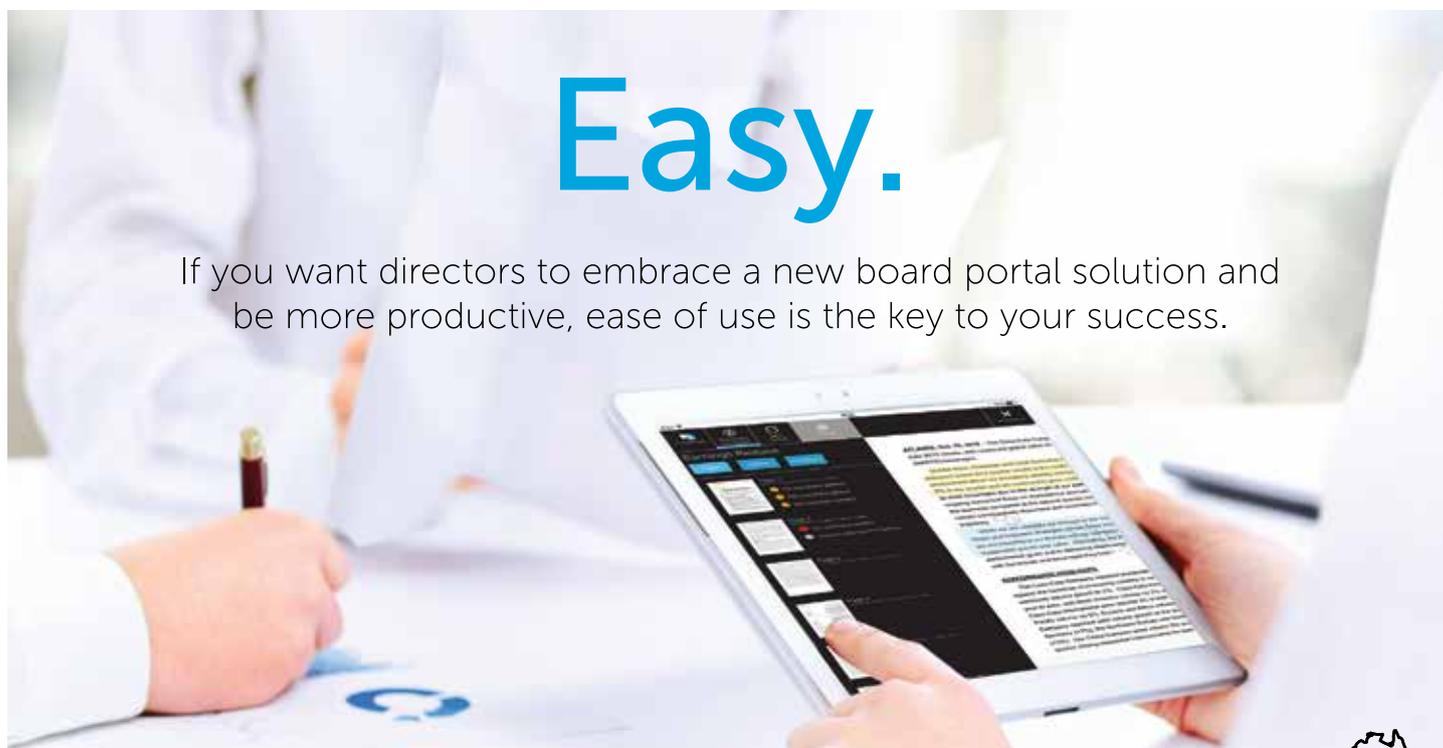
The benefit corporation is the most widely adopted dual-purpose corporate structure that has been developed in the US. It is a sophisticated and worthy reform and would accelerate sustainable business, social enterprise and ethical investment in Australia. ■

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Notes

- 1 Elkington J, 1999, *Cannibals With Forks: The Triple Bottom Line of 21st Century Business*, Capstone.
- 2 'About B Lab', B Lab, available at <www.bcorporation.net> as at 10 January 2015.
- 3 Clark W H Jr et al, 2013, 'The Need and Rationale for the Benefit Corporation: Why it is the Legal Form that Best Addresses the

- Needs of Social Entrepreneurs, Investors, and, Ultimately, the Public' (White Paper, Benefit Corp Information Centre.) 5 <http://benefitcorp.net/storage/documents/Benefit_Corporation_White_Paper_1_18_2013.pdf> 30.
- 4 *Model Benefit Corporation Legislation 2013* s 102, available at <http://benefitcorp.net/sites/default/files/documents/Model_Benefit_Corp_Legislation.pdf>.
 - 5 Early famous works are Berle A A, 1931, 'Corporate Powers as Powers in Trust', 44 *Harvard Law Review* 1049; Berle A A, 1932, 'For Whom Corporate Managers Are Trustees: A Note', 45 *Harvard Law Review* 1365; Dodd E M, 1932, 'For Whom Are Corporate Managers Trustees?', 45 *Harvard Law Review* 1145.
 - 6 Austin R P and Ramsay I M, 2012, *Ford's Principles of Corporations Law* (15 edn) at [1.180]-[1.190].
 - 7 Dodd, 'For Whom Are Corporate Managers Trustees?', above n 5, 1147-48.
 - 8 *Ibid*, 1162.
 - 9 Bainbridge S M, 2002, 'The Board of Directors as Nexus of Contracts', 88 *Iowa Law Review* 1, 4-6.
 - 10 Bainbridge S M, 2003, 'Director Primacy: The Means and Ends of Corporate Governance', 97 *Northwestern University Law Review* 547, 577-83.
 - 11 Cowan T and Crampton E, 2003, *Market Failure or Success: the New Debate*, Edward Elgar, pp 30-60.
 - 12 For discussion of the scope of this duty in Australia, see Austin R P, Ford H A J and Ramsay I M, 2005, *Company Directors: Principles of Law and Corporate Governance*, LexisNexis Butterworths at [7.2].
 - 13 See Patagonia, Inc., *Company Info*, 2015, <www.patagonia.com/us/patagonia.go?assetid=3351> at 10 January 2015.
 - 14 Tozzi J, 'Patagonia Road Tests New Sustainability Legal Status', 2012, Bloomberg <<http://www.bloomberg.com/news/2012-01-04/patagonia-road-tests-new-sustainability-legal-status.html>> at 30 September 2013.
 - 15 *Model Benefit Corporation Legislation 2013*, above n 4, s 301.
 - 16 Clark WH Jr et al, 'The Need and Rationale for the Benefit Corporation: Why it is the Legal Form that Best Addresses the Needs of Social Entrepreneurs, Investors, and, Ultimately, the Public' (above n 3).
 - 17 For a discussion of the extent to which directors can consider non-shareholder interests under the existing corporate law in most US jurisdictions, see Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance', above n 9, 547-570. In Australia, this is discussed in detail in Austin, Ford and Ramsay, *Ford's Principles of Corporations Law*, above n 6, [1.390], [8.120]-[8.130] and the cases referred to by those authors.
 - 18 Everett C R, 2013, 'Measuring the Social Responsibility Discount for the Cost of Equity Capital: Evidence from Benefit Corporations' 3(2) *The Journal of Behavioral Finance and Economics* 55, 55-62.
 - 19 *Ibid*. See also Barnett M and Salomon RM, 2012, 'Does it pay to be really good? Addressing the shape of the relationship between social and financial performance', *Strategic Management Journal*, Vol 33 (11), 1304, 1305-1308.
 - 20 Murray, J H, 2012, 'Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes', *American University Business Law Review* 2, no. 1, 22-25.



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