

STROOCK

SPECIAL BULLETIN

New York State Authorizes Benefit Corporations

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On December 12, 2011, Governor Andrew Cuomo signed a bill making New York the seventh state to authorize the incorporation of benefit corporations (sometimes referred to as “B-Corps”).¹ The new law, codified primarily in new Article 17 of the New York Business Corporation Law (the “BCL”), will go into effect in February 2012.² A benefit corporation is a for-profit entity obligated to further certain public benefits, as defined in the law and explained in this **Stroock Special Bulletin**.

Formation and Benefit Purposes of a Benefit Corporation

A corporation formed under the BCL may be formed as a benefit corporation by providing in its certificate of incorporation that it was formed for the purpose of creating “general public benefit,” which is defined as “a material positive impact on society and the environment, taken as a whole, assessed against a third-party standard, from the business and operations of a benefit corporation.”³ An existing for-profit New York corporation may also become a benefit corporation by amending its certificate of

incorporation so that it contains a statement that the corporation is a benefit corporation.⁴ To make such an election, an existing for-profit corporation must obtain a supermajority approval of its shareholders.⁵

In addition to its obligation to create a general public benefit, a benefit corporation may also identify in its certificate of incorporation one or more specific public benefits as part of its purpose, which may include any of the following:

- (1) providing low-income or underserved individuals or communities with beneficial products or services;
- (2) promoting economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business;
- (3) preserving the environment;
- (4) improving human health;
- (5) promoting the arts, sciences or advancement of knowledge;

(6) increasing the flow of capital to entities with a public benefit purpose; and

(7) the accomplishment of any other particular benefit for society or the environment.⁶

The new law provides that a benefit corporation must have the success of its activities assessed against an independent and transparent third-party standard.⁷ This means that the standard must be developed by a person who is independent from the benefit corporation and the factors considered in evaluating the benefit corporation's performance, the relative weights of the factors, and the identity of the persons responsible for the standard must all be publicly available.⁸

Although the statute does not identify groups that issue such third-party standards, there are several organizations that currently serve as independent third parties for this purpose,⁹ including the not-for-profit group B Lab,¹⁰ Global Reporting Initiative,¹¹ GreenSeal,¹² Underwriters Laboratories,¹³ the International Organization for Standardization,¹⁴ and Green America. B Lab, for example, assesses benefit corporations by assigning scores in various areas, which may include the corporation's treatment of employees, its effect on the environment, its corporate governance and transparency, the provision of products or services to underserved customers, and the degree of local ownership and participation in the corporation's community through activities such as charitable giving.¹⁵ Depending on the corporation's size and its industry, different factors may be assigned different weights.¹⁶ B Lab then certifies corporations that meet a certain minimum overall score.¹⁷ The new law does not make clear what repercussions a benefit corporation may face for failing to meet the

benchmarks of the independent third-party assessing its activities. Additionally, a benefit corporation presumably could change the organization that assesses its activities, although the process for doing so is not discussed in the new law.

The "Benefit Report"

A benefit corporation must deliver an annual "benefit report" to its shareholders. The report must be posted to the corporation's website, if one exists, and filed with the New York Department of State. The report must contain a narrative description of

- (1) the process and rationale for selecting the third-party standard used to prepare the benefit report;
- (2) the ways in which the benefit corporation pursued the general public benefit during the year and the extent to which general public benefit was created;
- (3) the ways in which the benefit corporation pursued any specific public benefit included in its certificate of incorporation and the extent to which that specific public benefit was created; and
- (4) any circumstances that hindered the creation of its general or specific public benefit.

The report also must contain an assessment of the benefit corporation's performance "relative to its general public benefit purpose assessed against a third-party standard" and, if applicable, its performance "relative to its specific public benefit purpose or purposes." Finally, the report must include information about director compensation and the names of beneficial owners of 5% or more of the

corporation's shares.¹⁸

Conduct of Directors and Officers

Directors and officers of benefit corporations will have some duties that are meaningfully different from those of directors and officers of traditional for-profit corporations. In general, directors and officers of traditional New York for-profit corporations are required to act in the interests of the corporation and its shareholders.¹⁹ In 1989, however, New York enacted a so-called "constituency law" that amended the BCL to allow, but not require, the directors of a for-profit corporation to take into consideration various factors, interests and beneficiaries other than the short-term interests of shareholders, including (1) prospects for potential growth of the corporation, (2) employees of the corporation, (3) beneficiaries under the corporation's pension or similar benefit plans, (4) customers and creditors of the corporation, and (5) "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."²⁰

Although directors and officers of traditional New York for-profits must act in the interests of the corporation and its shareholders and are *permitted* to consider numerous other considerations and constituencies, directors and officers of benefit corporations are *required* to consider a much more extensive list of factors and interests in discharging their duties for the benefit corporation. A benefit corporation *must* address the various public benefit purposes in its certificate of incorporation, so its directors and officers must seek to achieve those benefit purposes in furthering the interests of the corporation.²¹

Furthermore, under Article 17 of the BCL, both directors and officers of a benefit corporation must consider the effects of any action upon (1) the ability

of the corporation to accomplish its general and any specific benefit purpose, (2) the corporation's shareholders, (3) the employees and workforce of the benefit corporation and its subsidiaries and suppliers, (4) its customers as beneficiaries of its general or specific benefit purpose, (5) community and societal considerations, including those of any community in which offices or facilities of the benefit corporation or its subsidiaries or suppliers are located, (6) the local and global environment, and (7) the short-term and long-term interests of the benefit corporation, including benefits that may accrue to the benefit corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the benefit corporation.²² From the mandatory language of the statute, it appears that all of these factors must be considered by the directors and officers of any benefit corporation, even if the focus of the corporation is not directly related to all of those factors.

As with traditional for-profit corporations, the interests of the shareholders must factor into management's decision-making,²³ but the shareholders make up only one of the numerous groups or interests identified in the statute. Moreover, the new law provides that directors and officers are not required to give priority to the interests of any one person or group whose interests are required to be considered, unless the benefit corporation has stated its intention to give such interests priority related to a specific public benefit purpose set forth in its certificate of incorporation.²⁴ The result is that the interests of shareholders may be downplayed with respect to benefit corporations.

Enforcing the Corporation's Benefit Purposes

The law authorizing the creation of benefit corporations also amends Section 720(a)(1) of the

BCL, which allows a corporation and certain related parties to bring proceedings against corporate directors or officers for misconduct.²⁵ The new Section 720(a)(1)(C) states that an action may be brought against a director or officer of a benefit corporation for failure to pursue the corporation's benefit purposes, the failure to deliver a benefit report, or the general violation of the standards of conduct under Article 17.²⁶

The likelihood of liability (or claims of liability) for directors and officers of a benefit corporation under this provision is unclear at this time, but those risks conceivably could be greater for directors and officers of benefit corporations than for directors and officers of traditional for-profit corporations. Previously, New York State courts have held that Section 720 should be interpreted broadly,²⁷ and the new Section 720(a)(1)(C)(iii) provides for general liability for violations of duties or the standard of conduct assigned to directors and officers of benefit corporations. This provision could pose a particular risk for the officers and directors of benefit corporations because of the extensive list of factors they must consider in fulfilling their fiduciary duties to the corporation – especially because the benefits to the various constituencies that the benefit corporation must consider when acting may be vague or possibly contradictory.

Except where the new law states otherwise, directors and officers of a benefit corporation are still subject to the duties and obligations of the BCL and common law as they apply to directors and officers of traditional for-profit corporations. Article 17 identifies specific sections of the BCL that cannot be violated by carrying out the duties prescribed in Article 17, but it remains uncertain as to how much

of a shield from liability that limitation will provide.²⁸

Choosing to Become a Benefit Corporation

The certificate of incorporation of a benefit corporation likely will restrict its activities more than would the certificate of incorporation of a traditional for-profit corporation. Additionally, by becoming a benefit corporation, the corporation is opting to disclose certain information about its business, practices and significant equity owners that a traditional for-profit corporation would not be required to disclose. Also, at this time, there are no federal, New York State or New York local tax provisions giving special treatment to benefit corporations. The City of Philadelphia, however, does accord benefit corporations certain tax benefits.²⁹

An advantage that a benefit corporation may enjoy over a not-for-profit corporation is that the benefit corporation can be a vehicle for achieving one or more public benefits while still providing a financial return to its shareholders. Although a benefit corporation cannot be tax exempt, it will have shareholders who own the equity of the corporation (and therefore could reap the rewards of economic success by the corporation), rather than non-equity members in a not-for-profit corporation who are precluded from reaping any economic benefit from their membership. This may attract entrepreneurs who want their company to act in the public good, but still wish to reap the benefits of their labor or investment. Furthermore, most not-for-profit corporations in New York have certain federal and state law disclosure requirements and are required to file annual financial reports with the Internal Revenue Service and the Charities Bureau of the

New York Department of Law.³⁰ Consequently, persons forming a corporation for which tax exemption is not critical and who are prepared to deal with the reporting burden of a benefit corporation may conclude that a benefit corporation is a more attractive option than forming as a not-for-profit. Moreover, it should be noted that for-profit corporations are only subject to significant taxes if they make a profit. If the organization does not envision making sufficient profits that would give rise to significant taxes, being a for-profit corporation may not be a significant impediment. Furthermore, in some cases, a for-profit corporation may view paying taxes as an appropriate public benefit.

Certain persons in the not-for-profit community have expressed general opposition to benefit corporations (and other similar ventures that seek both profits and at least one broader social or environmental goal). One concern is that the IRS might become less receptive to granting tax-exempt status to certain not-for-profits if benefit corporations start to do the work of such not-for-profits. Another concern is that potential donors would take money they would otherwise give to charity and invest it in for-profit corporations pursuing social goals.³¹ Although the investor would lose out on a charitable contribution tax deduction, the potential for an economic return may be sufficient motivation. B Lab, however, is encouraging not-for-profit corporations to look to benefit corporations as vendors and partners, due to the benefit corporations' level of social responsibility, which often corresponds to the missions of the not-for-profits, and willingness to make contributions to not-for-profits.³²

One of the collateral legal advantages of forming a benefit corporation is that the new law contains provisions that could make a change in corporate control more difficult—an issue that may be of concern to entrepreneurs who are afraid that less

civically-minded firms may take control of their corporation. First, the new law prescribes the same supermajority vote required for an existing for-profit corporation to elect to become a benefit corporation in order for a benefit corporation to approve a merger in which the surviving corporation is not a benefit corporation.³³ Second, the law requires directors to consider the possibility that the short-term and long-term interests of the benefit corporation may be best served by continued independence of the benefit corporation,³⁴ and it permits them to consider “the resources, intent and conduct” of a potential acquirer.³⁵

It remains to be seen whether the authorization of benefit corporations will have the intended effect of allowing socially-conscious entrepreneurs to tap into the pool of capital held by socially-conscious investors. However, for socially-conscious investors, this development seems like a good start towards allowing such investors to more efficiently identify and align investment opportunities with their social agenda.

To ensure compliance with requirements imposed by the United States Treasury Department in Circular 230, we inform you that any tax advice contained in this Bulletin is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

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- California, Hawaii, Virginia, Maryland, Vermont and New Jersey have passed similar legislation. For a summary of the status of benefit corporation legislation in the various states, including passed legislation, see <http://www.bcorporation.net/publicpolicy>.
- S. 79A-2011 (N.Y.), A. 4692A-2011 (N.Y.) (enacted). This *Stroock Special Bulletin* cites to the provisions of the newly-enacted bill as they are expected to be codified in the Consolidated Laws of the State of New York. Some amendments to the new law were passed by the New York State Assembly in early January 2012 but have not yet been enacted. S. 6088-2011 (N.Y. 2012) (referred to Sen. Judiciary Comm., Jan. 18), A. 8907-2011 (N.Y. 2012) (passed). Except where otherwise noted, this *Stroock Special Bulletin* addresses the provisions as they were signed into law in December 2011.
- N.Y. Bus. Corp. Law §§ 1702(b), 1706(a).
- Id.* § 1704(a).
- Id.* §§ 1702(d)(2), 1704(a). The same supermajority vote is required if a corporation wishes to terminate its benefit corporation status. *Id.* § 1705(a). As originally enacted, the law provides that the supermajority must be three quarters of the votes that all shareholders of each class are entitled to cast (*i.e.*, a supermajority of each class of outstanding shares entitled to vote, not three quarters of a quorum). *Id.* § 1702(d)(2). However, the proposed amendment to the law would change the supermajority to two thirds or a higher level specified in the certificate of incorporation. S. 6088 § 2.
- N.Y. Bus. Corp. Law §§ 1702(e), 1706(b).
- Id.* § 1702(g) (defining “third-party standard”); *id.* § 1708(a) (requiring delivery to each shareholder of an annual benefit report).
- Id.* § 1702(g)(2)(A)–(C). The new law does not state how this information will be made publicly available.
- For a list of some providers, see “B Lab, Benefit Corporation – Legal Provisions and FAQs 3,” <http://www.bcorporation.net/resources/bcorp/documents/Benefit%20Corporation%20-%20Legal%20Provisions%20and%20FAQ.pdf>.
- <http://www.bcorporation.net>.
- <http://www.globalreporting.org>.
- <http://www.green seal.org>.
- <http://www.ul.com>.
- <http://www.iso.org>.
- Examples of B Lab’s assessments of benefit corporations can be found at <http://www.bcorporation.net/community>.
- B Impact Assessment, <http://www.bcorporation.net/become/BRS>.
- B Corp Certification Overview, <http://www.bcorporation.net/Certification-Overview>.
- N.Y. Bus. Corp. Law § 1708.
- 14A N.Y. Jur. 2d *Business Relationships* § 695 (2009). These duties arise at common law. The statute does not say in whose interests directors and officers of traditional for-profit corporations are required to act. Rather, the statute merely says that in so acting, directors and officers must perform their duties in good faith and with that degree of care which an ordinarily prudent person in a like position would use under similar circumstances. N.Y. Bus. Corp. Law § 715(h) (officers); *id.* § 717(a) (directors).
- N.Y. Bus. Corp. Law § 717(b)(2)(ii)–(iv). Directors are in effect the corporation’s executive representatives – they elect and supervise officers, set policies and approve non-routine actions, whereas officers manage the day-to-day affairs of the corporation. 14A N.Y. Jur. 2d *Business Relationships* §§ 532, 581. Accordingly, Article 7 of the BCL only provides this list of conceptual considerations with respect to directors’ actions.
- The creation of the corporation’s general and any specific public benefit is deemed to be in the corporation’s best interests as a matter of law. N.Y. Bus. Corp. Law § 1706(c).

22. *Id.* § 1707(a)(1).
23. *Id.* § 1707(a)(1)(B).
24. *Id.* § 1707(a)(3).
25. These related parties include a corporation's receiver, trustee in bankruptcy, officer, director or judgment creditor thereof, or by a shareholder through a derivative suit. *Id.* § 720(b). Note, however, that the various constituents whose interests must be considered by a benefit corporation do not have a right to sue the benefit corporation for failing to pursue its benefit purposes. *See id.* § 1707(c) (stating that a director of a benefit corporation does not have a fiduciary duty to such constituents).
26. *Id.* § 720(a)(1)(C).
27. *In re Princeton Industries, Inc.*, 39 B.R. 140, 142 (Bankr. S.D.N.Y. 1984) (stating that “[i]t has been held that section 720 is to be broadly construed and is to cover every form of waste of assets and violation of corporate duty”).
28. Specifically, the new law provides that Sections 715 and 717 of the BCL, which govern the duties and conduct of directors and officers will not be violated. N.Y. Bus. Corp. Law § 1707(b)(1).
29. In December 2009 the City of Philadelphia reduced business privilege taxes for certified B Corporations, but this affects a limited number of corporations. *B Corporations Gain Tax Advantage in Philly*, Environmental Leader, Dec. 4, 2009, <http://www.environmentalleader.com/2009/12/04/b-corporations-gain-tax-advantage-in-philly>.
30. N.Y. Exec. Law § 172-b.
31. *See* Ben Gose, *Defining Social Good: Nonprofits Worry About Calif. Bill*, Chronicle of Philanthropy, April 21, 2011, available at <http://philanthropy.com/blogs/state-watch/defining-social-good-nonprofits-worry-about-calif-bill/534>.
32. *See generally* B Corps for Non Profits, www.bcorpsformonprofits.com (last visited Jan. 30, 2012).
33. N.Y. Bus. Corp. Law § 1705(b). The supermajority vote is also required when the stock of a benefit corporation will be converted into a right to receive shares of another type of corporation. *Id.* § 1705(c). The same supermajority vote applies to the reverse – when a corporation that is not a benefit corporation is party to a merger or consolidation and the resulting entity is a benefit corporation, or when the stock of a corporation that is not a benefit corporation is converted to that of a benefit corporation. *Id.* § 1704(b)–(c). The bill that would amend the new law would change the wording of the provisions regarding mergers so that a supermajority vote would be required to approve of any transaction in which a non-benefit corporation “will become” a benefit corporation or in which a benefit corporation “will no longer be a benefit corporation as a result of the transaction.” S. 6088 § 5.
34. N.Y. Bus. Corp. Law § 1707(a)(1)(G).
35. *Id.* § 1707(a)(2)(A).

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