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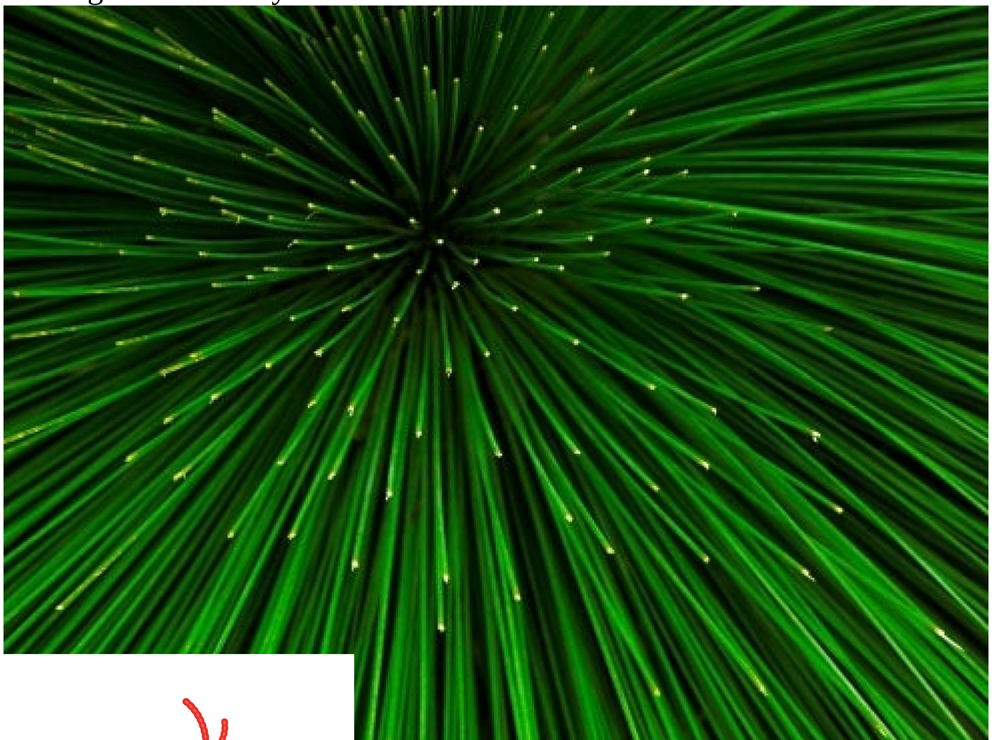
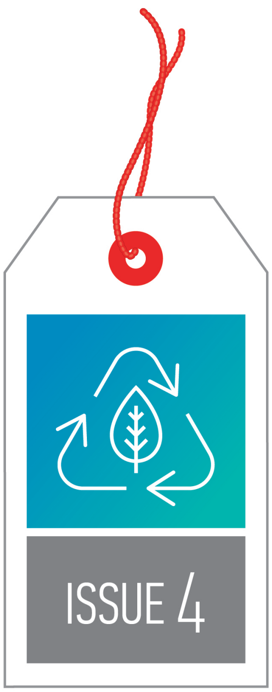
Making Sustainability a Stakeholder





Consumers increasingly are aware of, and make value assessments and purchase decisions based on, the environmental and social impact of brands. Brands, in turn, are evaluating and embarking on sustainability programs. Before doing so, they must evaluate the effect those programs have on their corporate governance. At least one company views the stakeholder governance model—a model that requires companies to consider its other stakeholders, including its customers and suppliers, service providers, investors, and the environment—as a critical element of sustainability. This issue in our Summer Sustainability Series reviews the fiduciary duties owed by directors and discusses an alternative corporate governance model and corporate form that is gaining traction among branded companies.

Governance Models and Fiduciary Duties

The traditional model of corporate governance is centered on the premise that the corporation exists primarily to generate long-term stockholder wealth. As a result, courts have focused on the maximization of stockholder wealth as the main consideration in determining whether directors complied with their fiduciary duties. A byproduct of the pressure to produce stockholder value is that companies favor short-term financial performance over long-term sustainability.

An alternative governance model is centered on stakeholder interests. Public benefit corporations (PBCs), also called social purpose corporations in some jurisdictions, are a type of for-profit corporation designed by statute to provide a public benefit and "operate in a responsible and sustainable manner," as described in the Delaware General Corporation Law. In furtherance of a PBC's purpose, boards of directors are required to consider public benefit interests alongside stockholder value in decision-making.

In both models of governance, directors are protected from liability when decisions are informed and serve a rational purpose, although a director of a PBC must balance public benefit interests with stockholder value. PBC statutes provide directors of a PBC with greater latitude to consider sustainability in board decision-making than traditional corporate directors.

An Alternative Corporate Form: Benefit Corporations

A majority of states and the District of Columbia have adopted statutes creating PBCs, the requirements of which vary from state to state. PBCs are similar to traditional corporations but have additional statutory requirements, including the following requirements found in Delaware's statute:

- **Public Benefit Purpose:** The Certificate of Incorporation must identify at least one specific "public benefit"—"a positive effect (or reduction of negative effects) on persons, entities, communities or interests"—that it must promote. *The public benefit purpose should be specific and tied to the company's business objectives.*
- **Reporting:** The PBC must provide stockholders a report on the company's performance in promoting its public benefit purpose and an assessment of its success in doing so every two years. *The company should be prepared to track its reporting obligations and should prioritize compliance to promote transparency and accountability.*
- **Balancing:** Directors must balance the pecuniary interests of stockholders, the best interests of those materially affected by the corporation's conduct, and the public benefit(s) in decision-making. *Director actions should be supported by documentation evidencing the factors considered in weighing these interests.*

PBCs have a short history in Delaware and have not been subject to fiduciary duty claims similar to their traditional for-profit counterpart. However, in Delaware and elsewhere, directors should be aware there is little practical guidance on how they can effectively balance the public interests with the profit motive. As such, a director may experience uncertainty as to how they should balance these interests in accordance with their fiduciary duties. This uncertainty, combined with the relatively new existence of PBCs, has in the past created some friction with institutional and traditional venture capital investors.

More recently, however, investor sentiment, and the sentiment of the broader business community, has shifted toward favoring a stakeholder-centric governance model as demonstrated by the purpose statement published in 2019 by the Business Roundtable. Various capital markets have also embraced PBCs. In fact, two PBCs—Lemonade, Inc. and Vital Farms, Inc.—recently filed for IPOs.

Conversion to a Public Benefit Corporation

Converting from a traditional corporation to a PBC in Delaware is relatively simple due to recent amendments to the Delaware benefits statutes that were adopted on July 16, 2020. The amendments adopted in Delaware House Bill 341 include a reduction to the vote required to effect a conversion of a traditional corporation to a PBC from two-thirds to a majority of a company's outstanding shares.

Prior to converting to a PBC, directors should evaluate to what extent becoming a PBC will meaningfully affect the company's governance structure given its stockholder base.

What About "B Corporations"?

PBCs and certified "B Corporations" are frequently conflated and confused. The term "B Corporation" (or "B Corp") refers to a certification by B Labs, a nonprofit organization that certifies companies for meeting certain standards of social and environmental performance, accountability, and transparency.

B Corp certification is not required by law, and a company can be a PBC without being a certified B Corp. A B Corp can be structured as a limited liability company or professional limited liability company, among other legal forms, instead of as a corporation. B Corp certification has become a widely recognized designation by consumers and is a powerful branding tool for many companies.

As Patagonia, Ben & Jerry's, and Toms, among others, have demonstrated, B Corp certification can help a company build trust and credibility in the eyes of consumers, attract young talent, and draw impact investors.

There are multiple steps required to certify as a B Corp, but the primary steps are the following:

1. **Meet the Performance Requirement:** Must complete the B Impact Assessment (primarily assessing a company's impact in social and environmental areas) and earn a minimum score (which is publicly available in the B Corp Directory)

2. **Meet the Legal Requirement:** Dependent on the type of entity and the corresponding state statue, but typically requires revising governing documents to include a "public benefit purpose" (PBCs automatically meet this requirement)
3. **Pay a Fee:** Ranging from $500 to $50,000, based on a company's annual revenue

Choosing Between a PBC or Traditional Corporation

Whether a company should form or convert to a PBC and/or become a certified B Corp will depend on the following:

1. Its social consciousness and emphasis on sustainability
2. The alignment between the company's stockholders and its board regarding the shift in governance models

PBCs will not be suitable for every organization, and companies should consult with counsel prior to forming or converting to a PBC.

Authors

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