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OLR BACKGROUNDER: SOCIAL ENTERPRISE AND THE BENEFIT CORPORATION

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This report describes benefit corporations (b-corps), for-profit corporations structured to make profits and produce social benefits.

This report proceeds in five sections, discussing (1) social enterprise, (2) the challenges that social enterprise faces, (3) the b-corp's history, (4) model b-corp legislation and how the b-corp's legal features address the noted challenges, and (5) additional sources of information on the b-corp.

SOCIAL ENTERPRISE

The term "social enterprise" encompasses a range of business operations and strategies that aim to promote a social goal through profit-making business, an approach characterized by the phrase "doing good by doing well." Pursuing social goals, though, could reduce a business' profit margin. For example, a business might spend more to make a product if it chooses to use more expensive recycled materials.

The tension between the social goal and profit-making goal of social enterprise has been called the dual mission dilemma, prompting some observers to recall the biblical adage "no man can be the servant of two masters" (Matthew 6:24). Generally, business forms structured to promote social enterprise utilize some governance mechanism—a corporate charter, an oversight committee, or extended shareholder powers—to mediate between the organization's dual goals.

A related term, “social entrepreneurs”, refers to proponents of social enterprise and business leaders engaged in social enterprise.

CHALLENGES SOCIAL ENTERPRISE FACES

Scholars and observers have identified three key challenges that social enterprise organizations face as a result of their dual purpose. These challenges are cumulative and interdependent, meaning any attempt to meet one challenge requires meeting the other two as well.

Protecting Directors so they can Pursue Social Goals and Shareholders so they Receive Value for their Investment

For social enterprise to be successful in pursuing its dual mission, the law under which these organizations operate must respect and protect both social entrepreneurs’ efforts to promote social goals and investors’ need to receive a return on their investment.

In a traditional business corporation, the law protects owners and investors from actions against their interest done by the investor’s own agents. In affording this protection, business law generally prioritizes owners’ pecuniary interests above other interests.

Social enterprises’ dual mission complicates this legal structure, because these organizations do not prioritize profit-making over their social goals. Social entrepreneurs have tried a variety of strategies to simultaneously provide business agents—corporate directors, executive officers, and managers—with the legal flexibility they need to pursue social goals and shareholders with assurances that their interests are adequately protected.

Creating a Trusted Brand

While a reputation for trustworthiness is important to any business, a strong and trusted brand is particularly important for social enterprise because part of the value that these businesses provide to customers is the knowledge that their business is doing good and the positive feelings that such knowledge engenders. The goodwill that customers develop toward a business that they feel is doing good is called the “halo effect.”

Consumers and employees have shown a robust preference toward socially responsible and beneficial businesses, in part due to the halo effect. Moreover, customers have shown a distinct distaste for businesses that support social goals in only a superficial way, a practice

disparagingly called “greenwashing.” In the face of this win or lose dynamic, social entrepreneurs seek out strategies to differentiate themselves from greenwashers and signal to consumers their trustworthiness and commitment to social goals.

Accessing Capital

Pursuing social goals while also pursuing profits could put social enterprise at a disadvantage when accessing traditional sources of capital. As a profit seeking venture, social enterprise is generally ineligible for charitable grants to promote social goals, and as a social organization, it does not appeal to market investors or lenders. However, social enterprise has the promise of providing a countercyclical investment opportunity closely tied to the growth potential of a particular community or market. Social entrepreneurs require a business form that gives foundations, capital investors, and lenders a modicum of security and familiarity.

OVERVIEW OF THE BENEFIT CORPORATION’S HISTORY

The campaign to establish the b-corp began in 2006 by the founders of the AND1 basketball footwear and apparel company. These entrepreneurs saw the interdependence of business success and social prosperity, and presented their “Declaration of Interdependence” (<http://www.bcorporation.net/what-are-b-corps/the-b-corp-declaration>) on July 5, 2006. The b-corp campaign is supported by a non-profit organization, the B Lab, which (1) coordinates state-level lobbying efforts, (2) works with businesses and entrepreneurs to create b-corps, and (3) runs a ratings agency to evaluate b-corps and assess their commitment to social goals.

Sixteen states have enacted b-corp legislation, and another 16 states are considering b-corp legislation, including Connecticut. Maryland, the first state to enact legislation, did so in April, 2010. Massachusetts, New York, New Jersey, Pennsylvania, and Vermont have all enacted b-corp legislation. Delaware, the most recent state to enact b-corp legislation, did so on April 18, 2013.

The first b-corps were established in 2007, without b-corp legislation. There are currently 759 b-corps in 27 countries, working in about 60 industries.

Many well-known companies are b-corps, including Cabots Creamery Cooperative, King Arthur Flour, Seventh Generation Household & Personal Care Products, Patagonia Clothing, and Freelancers Insurance

Company. B-corps are found in many industries, including investment services, business consulting, marketing, public relations, green technology, and organic food production.

MODEL BENEFIT CORPORATION LEGISLATION

This report uses the Connecticut General Assembly's 2013 House Bill 6356, as amended by House "A", (HB 6356) as a model for b-corp legislation. This bill can be found online at <http://www.cga.ct.gov/2013/FC/2013HB-06356-R000839-FC.htm>, and an analysis of the bill can be found at <http://www.cga.ct.gov/2013/BA/2013HB-06356-R010839-BA.htm>. The bill passed the House of Representatives and was not brought out to the Senate.

The following section discusses key features of b-corp legislation and how these features work to address the challenges that social enterprise faces. For each legal feature the corresponding sections from HB 6356 are noted.

B-corp's Legal Framework within the Corporate Code – §§ 2 & 16

A b-corp is a for-profit corporation that seeks to make profits and achieve social goals. Consequently, it is governed simultaneously by its state's b-corp law and corporate code, with the specific b-corp law controlling over the general corporate code. The corporate code is unchanged by the enactment of b-corp law, except for appraisal rights, which are generally extended to all affected shareholders when a b-corp engages in a corporate transaction (appraisal rights entitle shareholders who disapprove of a corporate transaction, like a merger or consolidation, to be bought out by the corporation at a fair price).

By extending appraisal rights to shareholders involved in transactions with b-corps, the state acts to assure that shareholders receive fair value for the investments.

B-corps are subject to their state's legal precedent regarding corporate law because they are built on the existing corporate code. This consistency gives investors a sense of familiarity and security, helping b-corps access capital. On the other hand, certain legal precedent can constrain the b-corp's ability to prioritize its social goals over its shareholders' pecuniary interests.

B-corp's Purpose – §§ 3 & 8

B-corps must certify their purpose to have a material positive impact on society and the environment in their certificate of incorporation, filed with the state. This is called the b-corp's general public benefit purpose. A b-corp may also certify any legal specific public benefit purpose it chooses, including:

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. protecting or restoring the environment;
4. improving human health;
5. promoting the arts, sciences, or advancement of knowledge; or
6. increasing the flow of capital to other benefit corporations or similar entities whose purpose is to benefit society or the environment.

These certifications help to build trust between the b-corp and its customers, employees, and the communities in which it operates. Moreover, they provide the legal foundation on which the directors stand whenever they put the b-corp's social goals ahead of the b-corp's pecuniary goals.

Minimum Status Vote (“MSV”) – § 3

Generally, major corporate actions affecting a b-corp require a minimum status vote (“MSV”), which is usually two thirds of all shareholders of all classes or series. No shareholder or equity holder can be denied a vote by bylaw or otherwise.

The MSV requirements give shareholders confidence that their vote will be counted concerning the b-corp's major transactions. Also, the MSV requirement promotes a perception of b-corps' trustworthiness, because major decisions are made in a transparent and broadly democratic way.

Creating, Amending, Merging, or Consolidating B-corps – §§ 3, 4, 5, & 8

B-corps are created by filing a certificate of incorporation that designates the organization as a b-corp. Existing corporations become b-corps by amending their certificates to designate themselves as a b-corp. Such an amendment, or an amendment that changes an existing b-corp's specific public benefit purpose, requires shareholder approval by a MSV. Mergers, share exchanges, and other corporate transactions that result in a b-corp surviving the transaction require shareholder approval by a MSV from all involved corporate parties.

Preserving, Dissolving, Terminating, or Transforming B-corps – §§ 6 & 7

A b-corp can lock its capital into serving a charitable purpose by enacting a legacy preservation provision ("LPP") in its certificate of incorporation. Doing so requires unanimous shareholder approval, with no shareholder being denied a vote. B-corps with an LPP can merge or consolidate only with another b-corp with an LPP, and at the b-corp's dissolution any assets that do not go to settle accounts must go either to a charitable organization or to another b-corp with an LPP.

Like the certifications described above, an LPP can serve to build a b-corp's reputation for trustworthiness by more closely aligning it with the non-profit, charitable sector. On the other hand, an LPP can limit the b-corp's ability to access capital by restricting it to a charitable purpose.

Without an LPP, a b-corp terminates by amending its certificate of incorporation to remove any indication that the organization is a b-corp. Such an amendment requires shareholder approval by a MSV.

Generally, b-corps without an LPP must have shareholder approval, by a MSV, to merge, exchange shares, or combine with another corporation or entity.

Directors' and Officers' Duties & Immunities – §§ 9 & 10

When making corporate decisions, b-corp directors must consider their shareholders, employees, customers, local communities, the environment, the short- and long-term interests of the b-corp, and the b-corp's ability to accomplish its social goals. Doing so is deemed to be in the best interests of the b-corp, and is thus protected under corporate law. When considering these interests, directors are not required to prioritize any one interest over any other.

Directors have the legal duty to consider disparate interests in their decision-making, so they are well protected to pursue the b-corp's social goals in furtherance of those interests. These protections help build the b-corp brand as a socially conscientious business.

B-corp directors are protected from personally liable for their corporate acts done in compliance with b-corp law and the corporate code.

B-corp officers must consider the same interests as directors, when considering a decision within the officer's bailiwick. Officers are similarly protected from personal liability when acting within their bailiwick and in compliance with relevant laws.

Benefit Director & Officer – §§ 11 & 12

Publically traded b-corps must, and private b-corps may, have a benefit director ("BD"), in charge of overseeing b-corp's social goals and annually reporting on its progress toward those goals.

The BD must be independent, generally meaning he or she cannot be a b-corp employee or former employee (other than being the benefit officer), be related to an executive officer, or own 5% or more of the b-corp's shares.

The BD has heightened legal immunity and is liable only for self-dealing, willful misconduct, or a knowing violation of the law.

The requirement to have a BD helps build the b-corp brand, because customers, employees, and local community members know that someone is personally accountable for the b-corp's socially-oriented actions.

A b-corp may also have a benefit officer. The benefit officer, who can be the BD, manages the b-corp's social goals on an operational level and prepares annual report on progress towards those goals, helping the BD.

Enforcing the B-corp's Social Goals – § 13

Only a limited set of parties can sue a b-corp for failure to pursue its social goals, in what is called a "benefit enforcement action." Generally, only the BD and owners of 5% or more of the b-corp can bring such an action, but the b-corp's certificate of incorporation can designate other potential plaintiffs. A benefit enforcement action can only seek equitable

relief (i.e., an injunction or specific order). Such an action cannot seek or result in money damages against the b-corp.

The limitations of the benefit enforcement action helps the b-corp address all three challenges faced by social enterprise (i.e., pursuing social goals and generating a return on investment, creating a trusted brand, and accessing capital). B-corp directors are motivated to pursue the b-corp's social goals by the fear of being publically sued. Investors are assured that the b-corp will not face money damages as a result of such a suit, and are more willing to provide capital. And, b-corps promote their trustworthiness by explicitly extending the right to bring suit to interested parties for the b-corp's failure to pursue its social goals.

Annual Benefit Report – §§ 3, 10, 14, & 15

The b-corp's annual benefit report assesses the extent to which the b-corp created general and specific social benefit over the past year. Each state's b-corp legislation defines the specific content of the report, but generally, the report includes the BD's opinion on the b-corp's progress toward its social goals and obstacles in the way of achieving those goals.

The report also evaluates the b-corp's operations against a third party standard, that is, generally, comprehensive, independent, and transparent. Each state can define these terms, but generally the standard must (1) guide the b-corp to fully consider all its social goals and progress toward those goals, (2) have been created by an organization that is not financially or otherwise influenced by the b-corp, and (3) be clear about how the standard was created and who created it.

Finally, b-corp's must distribute their annual report to their shareholders and make it publically available online.

The annual report requirement helps to build the b-corp brand. Moreover, it can help the b-corp access capital by providing potential investors with a heightened level of insight into the b-corp and its operations.

RESOURCES

B Labs' B Corporation website, <http://www.bcorporation.net/>, last visited June 27, 2013.

Benefit Corp Information Center website, <http://benefitcorp.net/>, last visited June 27, 2013. Features a state-by-state analysis of b-corp legislation, among other resources.

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, Benefit Corp Information Center (January 18, 2013), available online at

http://benefitcorp.net/storage/documents/Benefit_Corporation_White_Paper_1_18_2013.pdf, last visited June 27, 2013.

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