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Connecticut Adopts Benefit Corporation Act; Businesses May Operate for Public Benefit

Connecticut has joined the ranks of 25 other states and the District of Columbia by adopting an act that permits formation of benefit corporations, or B Corps. The Connecticut Benefit Corporation Act (the Act) constitutes sections 140-154 of the state budget act (PA 14-217) that Governor Dannell Malloy signed on June 13. The provisions take effect on October 1. B Corps are required to have a purpose of creating a "general public benefit" among their corporate purposes. They may also identify specific public benefits among their purposes, such as helping low-income communities or protecting the environment. These purposes are different from those of traditional business corporations, whose sole purpose is to maximize the value to shareholders. Under traditional business corporation doctrines, directors and officers have a fiduciary duty to maximize shareholder value, typically through increasing earnings, dividends and share prices. A traditional corporation may pursue social and community goals in certain circumstances, but these goals must be secondary to maximizing shareholder value. The Act permits the formation of a for-profit corporation that must pursue public benefit and maximize value for its shareholders. Socially minded entrepreneurs have had other alternatives that would allow for the consideration of factors other than maximizing shareholder wealth. For example, a limited liability company may be operated for any purposes set forth in its operating agreement. But these other options have been simply permissive. The Act creates a new class of corporation - the benefit corporation, or B Corp?- that *requires* a public benefit in the organization's operations. These benefit corporations are generally subject to the Connecticut Business Corporation Act (CBCA), but they must also comply with the Act. If there is a conflict, the provisions of the Act supersede any contradictory provisions in the CBCA. **Public Benefit** The Act requires that all benefit corporations have as a purpose the creation of a "general public benefit." This is defined as "a material positive impact on both society and the environment, taken as a whole, as assessed against a third-party standard." In addition, the Act permits a benefit corporation to incorporate as an additional "specific public benefit" one of the following:

1. providing underserved or low-income individuals and communities with needed products or services;
2. promoting economic opportunity for individuals or communities (other than simply creating jobs in the normal course of its business);
3. protecting or restoring the environment;
4. improving human health;
5. promoting the sciences, arts or advancement of knowledge;
6. increasing the flow of capital to other benefit corporations or other entities that have as a purpose the benefit to society or the environment; and
7. conferring any other particular benefit on society or the environment.

A benefit corporation's general public benefit (and any additional specific public benefit) must be set forth in its certificate of incorporation. The certificate of incorporation may be amended to add or delete a specific public benefit through a "minimum status vote," discussed further below. When making board or committee decisions, the Act requires the directors and officers to consider the impact on:

1. the shareholders;
2. the employees of the benefit corporation and its subsidiaries and suppliers;

3. community and societal factors (which may be different in each community in which offices or facilities of the benefit corporation are located);
4. the local and global environments;
5. the short- and long-term interests of the benefit corporation; and
6. the benefit corporation's ability to accomplish its general public benefit and any specific public benefit.

The Act specifically provides that the directors and officers will not be violating any duties under the CBCA when considering the factors set forth above. It further provides that the directors and officers will not be liable for a benefit corporation's failure to produce a general public benefit or any specific public benefit. Finally, the Act provides that the directors and officers have no duty to a person whose only connection with the benefit corporation is that he or she benefits from the general or specific public benefit. **Benefit Director** The Act requires that each publicly traded benefit corporation designate a benefit director who is responsible for preparing the annual report (described below) and any other specifically assigned duties. All other benefit corporations may, but need not, appoint a benefit director. A benefit director must not have a "material relationship" with the benefit corporation. Generally speaking, someone who was recently an employee of the benefit corporation, who has an ownership interest or controlling position at the benefit corporation, or who is related to the executive officer of the benefit corporation will be deemed to have a material relationship. The Act protects a benefit director from liability to a greater extent than it does the other directors?- a benefit director is liable only for self-dealing, willful misconduct or a knowing violation of the law. **Legacy Preservation Provision (LPP)** The Act permits a benefit corporation to adopt a legacy preservation provision (LPP) that will ensure that its assets continue to serve a public purpose if the benefit corporation dissolves or otherwise ceases operations. Once a benefit corporation has been in existence for at least two years, it may add an LPP to its certificate of incorporation that requires upon dissolution assets to be distributed to one or more entities that are tax exempt under federal law or to one or more benefit corporations that have a certificate of incorporation that includes an LPP. The adoption of an LPP must be unanimously approved by all of the shareholders of the benefit corporation, in all classes or series, regardless of any restrictions on the shareholders' voting rights or consent powers that are contained in the certificate of incorporation or bylaws. This approval is in addition to any other requirements for amendment of the certificate of incorporation as set forth under the CBCA. Once a benefit corporation has adopted an LPP, it cannot amend its certificate of incorporation to terminate its status as a benefit corporation. This provision is unique to the Act, and no other states have adopted this restriction. **Minimum Status Voting Requirement** The Act establishes a minimum status voting requirement?- a voting requirement that must be met prior to (i) converting a traditional corporation into a benefit corporation, (ii) amending the certificate of incorporation of an existing benefit corporation, or (iii) entering into mergers or share exchanges involving a benefit corporation. In the case of a business corporation, the minimum status voting requirement requires that the shareholders in each corporation's class, series or voting group be entitled to vote as a separate group (regardless of any restrictions on these shareholders' voting rights or consent powers that are set forth in the certificate of incorporation or the bylaws). The action must be approved by two-thirds vote. This approval is in addition to any other requirements under the corporation's certificate of incorporation, bylaws, board resolutions or the CBCA. In the case of any other entity, the minimum status voting requirement requires that all equity holders in any class or series that is entitled to a distribution from the entity, regardless of any restrictions on voting rights that are otherwise set forth, approve the action by a two-thirds vote. **Merger and Consolidation** A benefit corporation that has added an LPP to its certificate of incorporation may (i) merge with another corporate entity if the surviving entity is a benefit corporation with an LPP in its certificate of incorporation; (ii) convert its shares into the right to receive shares of another benefit corporation that is subject to an LPP; and (iii) exchange its shares for those of another benefit corporation that is subject to an LPP; provided, however, that each transaction is approved by a minimum status vote. A benefit corporation that is not subject to an LPP can undertake the same transactions, so long as the transactions do not involve another benefit corporation or result in a new benefit corporation and so long as the minimum status voting requirement is met. With respect to a merger or consolidation of a traditional corporation and a benefit corporation, where the benefit corporation is the surviving entity or the traditional corporation's shares are exchanged for that of the benefit corporation, the traditional corporation's shareholders must approve the transaction by a minimum status vote. A noncorporate entity may merge or consolidate with a benefit corporation, provided that the entity's equity holders will be entitled to appraisal rights under the same procedures as set forth under the CBCA. **Distribution of Assets and Termination** A benefit corporation that is subject to an LPP can sell, lease, exchange or otherwise dispose of its assets within the normal course of its business operations. Any such transaction that would fall outside of the normal course of its

business operations must be approved by a minimum status vote, and the assets must be distributed to a charitable organization or another benefit corporation subject to an LPP. A benefit corporation that is not subject to an LPP is required to have a minimum status vote only if such transaction would leave it without significant business activity. In addition, a benefit corporation without an LPP may terminate its benefit corporation status by amending its certificate of incorporation, as approved by a minimum status vote. **Benefit Enforcement Proceeding** Under the Act, a benefit corporation or its shareholders may bring an enforcement proceeding for failing to create the general or specific public benefit or for violating shareholder appraisal rights. Such a proceeding may be brought for an order to undertake an action (or to refrain from taking one) but not for money damages. In addition, the benefit corporation's certificate of incorporation may permit other groups to bring an enforcement proceeding. **Annual Benefit Report and Third-Party Standard** The Act requires that a benefit corporation prepare and publish an annual benefit report, which assesses the benefit corporation's performance against a recognized third-party standard for defining and assessing the benefit corporation's social and public performance. The standard must address the benefit corporation's impact on its employees and shareholders, customers, communities in which it operates, and the local and global environment. The annual benefit report must contain a narrative description of:

1. how the general public benefit purpose was pursued and to what extent a general public benefit was created;
2. how the specific public benefit (if any) was pursued and to what extent a specific public benefit was created;
3. any circumstances that hindered the creation of the general or any specific public benefit; and
4. the process and rationale for changing the third-party standard used to prepare the benefit report.

The report must also assess the benefit corporation's overall social performance against a third-party standard, which must be applied consistently with the organization's prior benefit reports. Any discrepancy in the application of the standard from year to year must be explained. The report must also provide the benefit director's opinion of whether the benefit corporation's actions were in accordance with its general purpose benefit (and any specific purpose benefit) during the reporting period, as well as whether the directors and the officers complied with their duties under the Act. Any connection between the organization that established the third-party standard and the benefit corporation must be described in the benefit report. The benefit report must also provide each director's annual compensation for serving as director, as well as the name and mailing address of the benefit director. In addition, if the benefit director resigned, was removed or refused to be re-elected, the report must include any written statement or correspondence from such benefit director regarding the circumstances of his or her departure. The report does not need to be audited or certified by the third-party standard provider. The report must be sent to each shareholder within 120 days of the end of the reporting period (or with any other annual report it provides to its shareholders, if that report is provided earlier). The report must also be posted and maintained on the organization's website, although it may redact compensation or other confidential information. **Risks and Rewards** There are significant risks and rewards in electing to structure a business as a benefit corporation. If you are considering forming a B Corp, it is important to discuss these risks and rewards with well-informed advisors.

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