

A New Corporation for a New Economy



A law influenced by B Corp being drafted in California could pave the way for a new form of corporation

By Amy Westervelt

Current corporate statutes rarely deny corporations the right to consider the social and environmental impacts of their business ... but that doesn't mean it's easy to do so. Nowhere is this fact more apparent than when a corporation is in "play" (i.e. up for sale with multiple offers), during which board members in many states, most notably California and Delaware, are required by law to consider only what will bring shareholders the highest financial return. And while Milton Friedman would argue that in a free market system this should be the sole social responsibility of business, one thing is clear: Such a system denies the freedom of those who wish to build or invest in businesses seeking to create benefits for society as well as shareholders.

That could all change in the next year, however. California is poised to become the first state in the country to consider legislation creating a new corporate form permitting broader standards for corporate purpose, coupled with higher standards of transparency. Following a financial crisis that has left the nation looking for more systemic solutions to systemic problems, this new corporate form may be just that.

B Lab supports a legal working group comprised of leading California attorneys (see "California Legal Working Group" below) that are working to draft a legislative proposal to create such a new corporate form in California. And B Lab is working to see similar models adopted throughout the country.

Great Idea, Wrong Implementation

With leadership from San Francisco-based law firm Hanson Bridgett and New Voice of Business, B Lab in 2008 worked for the passage of California assembly bill 2944 (AB 2944), which sought to create a non-shareholder constituency statute in California that included an allowance for consideration of environmental impacts—a first.

With some opposition from the Business Law Section of the California Bar and the California Chamber of Commerce, Gov. Arnold Schwarzenegger vetoed the bill along

California Legal Working Group on New Corporate Form:

W. Derrick Britt (Co-chair), Partner, Doty, Barlow, Britt, and Thomas

R. Todd Johnson (Co-chair), Partner, Jones Day

Susan H. MacCormac (Co-chair), Partner, Morrison Foerster

Keith Paul Bishop, Partner, Allen Matkins

Edward A. Deibert, Director, Howard Rice

William P. Fitzpatrick, Director, Legal Affairs, Omidyar Network

Steven K. Hazen, Former Head Business Law Section, CA State Bar

David M. Hernand, Partner, Gibson Dunn

Jay A. Mitchell, Director, Org and Transactions Clinic, Stanford Law School

Robert A. Wexler, Partner, Adler & Colvin

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with 92 other pieces of legislation during a standoff with the assembly over budgetary concerns. However, other business groups, including the Silicon Valley Leadership Group, the Bay Area Council and the San Francisco Chamber all supported the bill along with hundreds of other individual businesses—and the governor wasn't wholly opposed either. Out of 92 pieces of legislation, only AB 2944 caught his attention long enough to earn a note of encouragement. "While I have concerns with the approach taken with this bill, I am interested in many of the issues raised in support of this measure," he wrote. "California should be at the forefront of all states in

of the new code. "One of the great things that emerged from AB 2944 is this consensus from all sides that a new corporate form is the best alternative," Kassoy says.

A Brave New Corporation

While reform of corporate law may sound like an uphill battle, it's not unheard of. A precedent to what the Legal Working Group in California is trying to accomplish now is the establishment of the LLC, largely during the 1990s.

So what exactly would this new type of corporation look like?

Evolution of a capitalist businessman

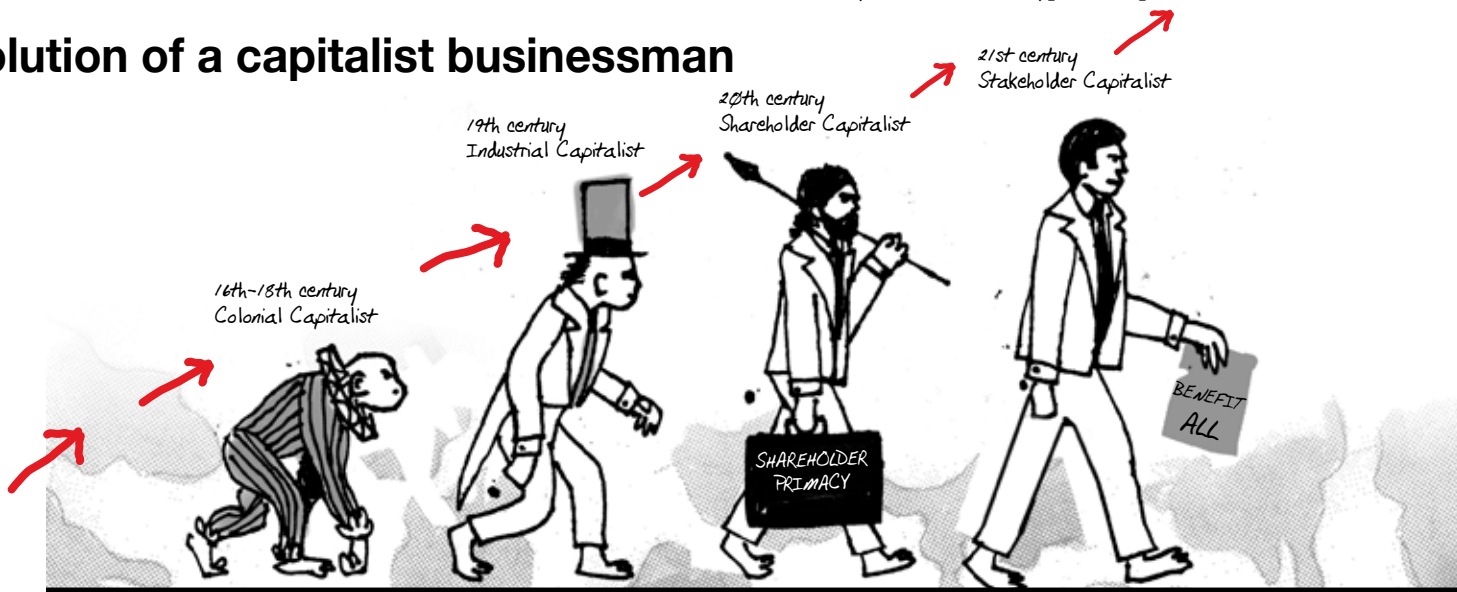


Illustration by: Tim Gough

considering alternative models of corporate governance for the new millennium."

Many read this to mean, "Great idea, wrong implementation—bring me the right implementation and I'll sign it."

"The problem with AB 2944 was that it was playing around the edges of an existing corporate form and thus inherently had grey areas and conflicts with that form, particularly around questions of the duties of directors in the case of a sale of business," says B Lab co-founder Andrew Kassoy.

The new legislation should allay the concerns of opponents of AB 2944 that it could lead to legislation or regulation requiring all corporations to take more than financial interests into account.

"This new approach is enabling rather than prescriptive; it won't tell people how to do business, but it will allow them to have a little more freedom to describe their broader intentions right in their charter," explains Jeff Mendelsohn, CEO of New Leaf Paper, a Certified B Corp and co-leader of the Business Working Group vetting drafts

The California Legal Working Group is reluctant to share its ideas until they have been shared with business and legal advisory panels and legislators who have expressed interest in co-sponsoring legislation. But as this article was going to print, the Working Group was preparing to circulate a draft to solicit input from businesses and others throughout the fall, with a goal of sending something to the state legislature by early 2010. Even without specifics, however, there are a few key friction points between current corporate law and the objectives of social entrepreneurs and social investors that the group hopes to address with the statute: purpose, exit options and transparency.

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—Jeff Mendelsohn, New Leaf Paper

Purpose: Most fundamentally, these new corporations (they haven't come up with an official name yet) are required to name at least one social or environmental purpose for which the company exists and to which it is willing to be held accountable through greater transparency. B Corps, in contrast, are required to consider the impact of their decisions on all stakeholders, including employees, suppliers, customers, community, and the environment. In the California proposal, the one non-financial purpose could be as broad as B Corp-type language 'to consider the impact of its decisions on all stakeholders' or as narrow as being carbon neutral or keeping the river in back of the factory clean.

Exit: The exit issue has always been particularly sticky for mission-driven companies. Exit or liquidity options are constrained by directors' fiduciary duty which, based on current case law in states such as California and Delaware, reduces directors' discretion to consider only maximizing shareholder value. The sale of Ben & Jerry's is the example most oft-cited. The proposed new corporate structure in California will support mission-driven businesses by giving directors the legal protection (called Safe Harbor) to consider non-financial interests when considering liquidity options.

"Under current California law, in a sale or liquidity scenario, a business incorporated in California is not permitted to consider the non-financial impact of its decisions." Kassoy says. "Given that California has probably the highest concentration of mission-driven businesses in the country, this is crucial for its business community, which wants to maintain mission as it brings in outside capital or explores sale or IPO options."

Transparency: In terms of transparency, the new code is being written to include requirements to report on the corporations' stated social or environmental purpose. "Both financially driven and socially driven investors are interested in this type of transparency," says Todd

Johnson of Jones Day, a co-chair of the California Legal Working Group.

Beyond California

As the draft legislation works its way towards California law, other states are beginning to consider similar actions. In fact, a legal working group is already forming in Colorado. There is interest from other states as well, including Delaware, Pennsylvania, Maine, North Carolina, New York, Oregon and Vermont.

B Lab is working with Bill Clark, a partner at Drinker Biddle in Philadelphia, and a group of attorneys from across the country to learn from California's experience and draft model legislation that pushes the envelope a bit further, according to Kassoy. This model legislation and a National Legal Advisory Council will be available this fall to help other interested states move forward more quickly with versions appropriate to their local context.

So, just how likely is it that this proposed California legislation will make it into law? Johnson says he thinks it's got a fair shot because it learns from the mistakes of AB 2944 and leaves any sort of regulatory language out. "If you're a Republican legislator, you're thinking 'Hey, I'm a free market guy, and this is a great way to harness the free market for good.' It's a very Republican message, actually."

"This also helps Democrats by letting them push companies to do good outside of a regulatory framework, while also positioning themselves as more free market than usual," Johnson says.

And then you've got the fact that Governor Schwarzenegger actually wants this bill to be something he can sign. After all, you can't create a new economy without a new kind of corporation. ®

