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Taking a Fresh Look at Delaware Public Benefit Corporations – Recent Legal and Market Developments

Over the last few years, corporate purpose has been under a spotlight. This scrutiny, which has intensified in 2020 and shows no signs of abating, is coming from institutional investors that are integrating the consideration of environmental, social and governance factors into investment and voting decisions, as well as other stakeholders, in particular consumers, employees and regulators.

Attorneys
[Michael R. Littenberg](#)
[Emily J. Oldshue](#)
[Brittany N. Pifer](#)
[Anne-Marie L. Beliveau](#)
[Nellie V. Binder](#)

Public benefit corporation statutes provide an alternative for-profit corporate form that expressly takes corporate responsibility into account. The Delaware General Corporation Law was amended in 2013 to add a public benefit corporation alternative. However, until the most recent DGCL amendments in July, a PBC was in a large number of cases an impractical or unavailable alternative. In this Alert, we discuss recent changes to the DGCL that in some cases may make PBCs a more attractive alternative, as well as related market trends.

The Delaware Public Benefit Corporation Provisions

Public benefit corporation legislation was enacted in Delaware in 2013. As defined under the statute, a “public benefit corporation” is a for-profit corporation that is intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner. The public benefit to be promoted by the corporation must be specified in its certificate of incorporation. Under the DGCL, a “public benefit” is a positive effect (or reduction of negative effects) on one or more categories of persons, entities, communities or interests (other than stockholders in that capacity), including but not limited to effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature.

Section 365 of the DGCL addresses the duties of the directors of a PBC. Under Section 365(a), the board of a PBC is required to manage or direct the business and affairs of the PBC in a manner that balances the stockholders’ pecuniary interests, the best interests of those materially affected by the corporation’s conduct and the public benefit identified in its certificate of incorporation. However, under Section 365(b), a director of a PBC does not, by virtue of the foregoing requirement, have a duty to any person on account of any interest of that person in the public benefit identified in the PBC’s certificate of incorporation or on account of any interest materially affected by the corporation’s conduct, and, in connection with a decision implicating the balancing requirement of Section 365(a), the director will be deemed to satisfy his or her fiduciary duties to stockholders and the corporation if the director’s decision is informed and disinterested and not such that no person of ordinary, sound judgment would approve.

Reporting

Under Section 366 of the DGCL, a PBC is required to provide its stockholders with a statement as to the PBC’s promotion of its public benefit and of the best interests of those materially affected by its conduct. The statement must be provided at least every other year. The statement is specifically required to include the following information:

- The objectives the board has established to promote the public benefit and interests;
- The standards the board has adopted to measure the corporation’s progress in promoting the public benefit and interests;
- Objective factual information based on the standards the board has chosen regarding the corporation’s success in meeting those objectives; and

- An assessment of the corporation's success in meeting the objectives and in promoting the public benefit and interests.

The report is not required to take a specific form. In addition, the PBC is not required to make the report available publicly, unless mandated by its certificate of incorporation.

Unless required by its certificate of incorporation, the PBC is not required to use a third-party standard in connection with the promotion of the public benefit and/or best interests of those materially affected by the corporation's conduct. The PBC also is not required to obtain third-party certification unless required by its certificate of incorporation.

The 2020 Amendments

Delaware has amended the PBC statute twice since inception to address concerns that limited its utility.

Most recently, in July, Delaware amended the PBC statute to, among other things, (1) reduce the stockholder approval threshold necessary for becoming a PBC, and for exiting the PBC regime; (2) eliminate statutory appraisal rights in connection with the conversion of a conventional corporation to a PBC; and (3) strengthen the protections for directors. Each of these amendments is discussed in more detail below.

Voting Thresholds for Opting In and Opting Out Lowered. Section 363(a) of the DGCL originally provided that an existing conventional corporation could not become a PBC without the approval of 90% of the outstanding stock on the amendment of its certificate of incorporation or the merger or consolidation with or into a PBC. Conversely, under Section 363(c), a PBC had to satisfy the 90% voting threshold to become a conventional corporation. In 2015, this threshold was amended down to a two-thirds majority. The 2020 PBC amendments eliminated Section 363(a) and (c). The result is that the voting thresholds for conversions, mergers and consolidations involving PBCs are now governed by Sections 242(b) and 251 of the DGCL, which provide for majority voting unless the certificate of incorporation provides otherwise.

Elimination of Statutory Appraisal Rights in Connection with PBC Conversions. Section 363(b) of the DGCL previously provided appraisal rights for stockholders of a conventional corporation that amended its certificate of incorporation to become a PBC or engaged in a merger or consolidation that resulted in the surviving corporation being a PBC, to the extent the stockholder did not vote for the amendment, merger or consolidation. In 2015, this section of the DGCL was amended to add a "market out" exception, which provided that appraisal rights generally would not be available to holders of shares listed on a national securities exchange or held of record by more than 2,000 holders. The market out exception of course did not apply in the private company context.

The 2020 PBC amendments eliminated Section 363(b). As a result, there no longer is a specific statutory appraisal right if a conventional corporation converts to a PBC. Appraisal rights in connection with PBC mergers and consolidations are now governed by Section 262 of the DGCL, which addresses appraisal rights in connection with mergers and consolidations more generally.

Director Protections Strengthened. As discussed above, under Section 365(a) of the DGCL, directors of a PBC must balance the pecuniary interest of stockholders, the interests of other stakeholders and the specific public benefit identified in the certificate of incorporation. Section 365(c) has been amended to clarify that a director's ownership of stock or other interests in the PBC does not inherently create a conflict of interest, unless the ownership of the interests would create a conflict of interest in a conventional corporation.

In addition, the 2020 PBC amendments revised Section 365(c) to provide that any failure on a director's part to satisfy Section 365(a)'s balancing requirement does not constitute an act or omission not in good faith or a breach of the duty of loyalty for purposes of Section 102(b)(7) (exculpation of directors) or Section 145 (indemnification) of the DGCL, unless the certificate of incorporation provides otherwise. Previously, this was framed as an opt-in in Section 365(c), rather than as an opt-out.

Ability to Bring Derivative Suit Brought into Alignment with Conventional Corporations. Section 367 of the DGCL sets forth the ownership requirements for PBC stockholders to be able to bring a derivative suit to enforce the statutory

requirement to balance the stockholders' pecuniary interests, the best interests of those materially affected by the PBC's conduct and the public benefit identified in the certificate of incorporation. The 2020 PBC amendments provide that a derivative action to enforce the balancing requirement can only be brought by one or more plaintiffs owning individually or collectively (1) at least 2% of the corporation's outstanding shares or (2) in the case of a corporation listed on a national securities exchange, the lesser of 2% of the corporation's shares and shares with a value of at least \$2,000,000.

The amendments to Section 367 align the thresholds for PBC derivative actions with those applicable to conventional corporations.

Interest in Public Benefit Corporation Conversions by Larger and More Established Companies Is Increasing

Most PBCs are smaller entities. However, in the short time since the adoption of the 2020 PBC amendments, we already are starting to see more interest in PBCs from larger and more established entities. This interest is being driven by two principal factors: (1) the increasing popularity of ESG- and impact-themed investment products, in both the public and private markets; and (2) the increasing focus on corporate purpose by other stakeholders, in particular consumers. Although we expect over time to see more PBCs that are larger entities, we nevertheless believe that PBCs will (appropriately) remain a niche corporate form.

Public Companies. It is likely that more IPO candidates will consider whether to convert to a PBC pre-IPO. To the extent an IPO issuer already has a strong social purpose, formalizing that purpose in its charter may help it stand out from the crowd and attract interest from institutional and retail investors for which that is a focus.

Currently, there are three publicly traded Delaware PBCs: Laureate Education, Inc., Lemonade, Inc. and Vital Farms, Inc. Laureate went public in 2017. Lemonade and Vital Farms went public last month.

Laureate's specified public benefit is to "produce a positive effect (or a reduction of negative effects) for society and persons by offering diverse education programs delivered online and on premises operated in the communities that [it] serve[s]." Lemonade's specified public benefit is to "harness novel business models, technologies, and private-nonprofit partnerships to deliver insurance products where charitable giving is a core feature, for the benefit of communities and their common causes." Vital Farms's public benefits are "(i) bringing ethically produced food to the table; (ii) bringing joy to our customers through products and services; (iii) allowing crew members to thrive in an empowering, fun environment; (iv) fostering lasting partnerships with our farmers and suppliers; (v) forging an enduring profitable business; and (vi) being stewards of our animals, land, air and water, and being supportive of our community."

There may be another publicly traded PBC soon. Earlier this month, CF Finance Acquisition Corp., a special purpose acquisition company (SPAC), filed a proxy statement for a business combination with GCM Grosvenor Inc. The transaction agreement for the business combination includes a provision that the post-combination company charter will provide the board of directors with the right to cause the company to convert into a PBC without further notice to or any vote of shareholders. If the board of directors elects to convert the company into a PBC, its public benefit will be "to have a positive effect on society by promoting a culture of diversity, equity and inclusion within its workforce and that of its vendors while reducing the environmental impact of its operations and to continue to offer, consistent with [the post-combination company's] fiduciary duties to its investment advisory clients, investment products and services that promote positive Environmental, Social and Governance objectives and Impact investment themes."

PBC Subsidiaries. A handful of large corporates already have PBC subsidiaries and, over time, we expect to see more. For example, Danone North America, a subsidiary of Danone S.A., converted to a PBC in 2017, following the combination of the Danone U.S. dairy business and Whitewave Foods. Danone North America's specified public benefit is to "(a) encourage dietary practices in line with Danone's longstanding mission to 'bring health through food to as many as possible' and (b) to promote a model of sustainable growth with a view to creating economic and social value in the interests of key stakeholders such as employees, customers and suppliers and improving the impact of its activities on the environment." According to the press release that Danone issued at its one-year anniversary of being a PBC, this conversion

was a part of Danone S.A.'s project to balance economic success and social progress. Danone North America also has several PBC subsidiaries. New Chapter, Inc., a subsidiary of Procter & Gamble, is a PBC. Its specified public benefit is "sustainably promoting public health by nourishing body and soul through its products, including, but not limited to, whole foods and herbal supplements, in an environmentally conscious and socially responsible way."

Growth Companies. Finally, we also are seeing more interest in PBC conversions from companies that plan to seek growth capital. Historically, many growth capital investors have pushed existing PBCs to convert back to conventional corporations before investing. Changes to the PBC statute will alleviate some of the concerns institutional private capital had with this form of entity.

A Couple of Related Topics

We briefly address below two additional topics that frequently come up in our conversations with companies concerning PBC conversions.

"B Corp" Certifications

A significant number of public benefit corporations also seek to become Certified B Corporations. B Corp certifications are administered by B Lab, a non-profit. Certifications are issued to applicants that meet specified social and environmental performance, accountability and transparency requirements. Applicants are required to complete a customized assessment questionnaire and undergo B Lab's review and verification process. B Lab fees are scaled based on the sales and ownership of the corporation. Corporations are required to go through recertification every three years.

Laureate Education, Lemonade and Vital Farms all are certified B Corps. Several subsidiaries of Danone and New Chapter also are certified B Corps.

Another Delaware Alternative: Certification of Adoption of Transparency and Sustainability Standards

In October 2018, Delaware adopted the Certification of Adoption of Transparency and Sustainability Standards Act. This Act established a voluntary disclosure regime to foster dialogue around sustainability and responsibility among participating Delaware entities and their various stakeholders. An entity that opts into the disclosure regime does not change its corporate form. A Delaware entity can become certified if (1) its governing body adopts principles, guidelines and standards designed to guide the entity's business activities in a sustainable and responsible manner, (2) the entity adopts metrics for assessing whether it has met its sustainability objectives and (3) the entity agrees to ongoing public reporting requirements. The governing body of the entity selects the standards for the entity, and can tailor them to the specific needs of the entity's industry or business. In designing these standards, the governing body may rely upon various sources, including third-party experts and advisors, as well as input from investors, clients and customers.

Thus far, the Certification has not gained traction, and we do not foresee it doing so. In our view, Delaware entities can demonstrate to stakeholders their commitment to sustainable and responsible business practices without the imprimatur of the Certification, and many already are doing so successfully.

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