ROPES & GRAY

ALERT

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Insights from Experience – Acquiring Public Benefit Corporations

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Corporate purpose has been gaining attention in recent years, with increased focus from investors as well as other constituencies, including consumers and employees. One way in which a for-profit company can formalize its commitment to a societal mission is by organizing under (or validly converting pursuant to) a state's regime governing alternate-form benefit corporations, which are available, in varying forms, in a majority of states. These provisions generally require the corporation to specify a particular public benefit in its organizational documents, impose benefit-related reporting and other governance requirements, and require the corporation's board of directors to take into account external stakeholders and public impacts beyond traditional shareholder-centric considerations.

Under the Delaware General Corporation Law ("DGCL"), a for-profit corporation may organize as a public benefit corporation ("PBC") that is intended to produce one or more public benefits that are specified in its certificate of incorporation and to operate in a responsible and sustainable manner.[1]

The number of publicly traded PBCs has increased significantly in recent years. Following the first IPO of a PBC (Laureate Education, Inc.) in 2017, we have identified at least 18 publicly traded PBCs at present—with a particular uptick since 2020. Among those corporations that went public as PBCs in recent years is Zymergen Inc., which was acquired by Ginkgo Bioworks Holdings, Inc. Ropes & Gray advised Ginkgo Bioworks in the transaction, which was consummated in October 2022.

As a result of the uptick in PBCs going public in recent years, we anticipate that acquisitions of publicly traded PBCs will similarly be on the rise. Because Delaware law treats PBCs and traditional corporations differently in certain respects, these transactions can raise unique issues throughout the deal life cycle. We highlight several special considerations for PBCs in the M&A context below.

Duties of PBC Directors in the M&A Context

Under the DGCL, directors of a PBC are tasked with managing the corporation's business and affairs 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. While each of these factors must be considered, it is up to the board to determine the relative weight to ascribe to each factor. When carrying out a decision implicating this balancing requirement, a director will be deemed under the DGCL to satisfy his or her fiduciary duties if the director's decision is informed and disinterested and not such that no person of ordinary, sound judgment would approve—a deference commonly known as the "business judgment rule."

The balancing requirement described above applies in both day-to-day operations and in the context of M&A transactions (including a sale of control), which marks a key distinction from the duties of directors of traditional corporations, which require directors to maximize short-term value in transactions involving a sale of control (i.e., "Revlon" duties).

Accordingly, directors evaluating a sale of a PBC must account for the interests of the other relevant stakeholders as well as the corporation's public benefit purpose. The secretary of each board meeting should take care to reflect the directors' application of the balancing test to the specific factual considerations underlying their evaluation of the transaction in the

[1] Ropes & Gray previously highlighted the Delaware PBC statutory framework, including 2020 DGCL amendments that effectively lowered certain hurdles associated with adoption of the PBC form.

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minutes of the meetings held throughout the process. These deliberations will also be described in detail in the "Background of the Merger" section of the securities filings made in connection with the transaction.

Given that the statute expressly requires the directors to engage in the balancing exercise described above, directors of a PBC cannot be held liable simply for considering the interests of stakeholders other than the current stockholders of the corporation. A PBC's directors do not, however, have a duty to any third party by virtue of the corporation's stated public benefit purpose or the additional stakeholders whose interests may be taken into account in the balancing test.

To date, there are no judicial decisions indicating how the Delaware courts would view a board's application of the balancing requirement in a change-of-control transaction. However, the Delaware courts would likely respect the statute and its deference to directors seeking to balance interests as required by the statute but would not countenance attempts by PBC directors to justify self-enriching or otherwise disloyal conduct by invoking the PBC statute or its balancing requirement.

Merger Agreement Terms

Whether the balancing requirement under the DGCL may also require modifications to customary "fiduciary out" provisions will likely be the subject of debate among transaction counterparties. For example, target company boards are likely to take the position that a "superior proposal" cannot be solely "superior to stockholders" but instead must be determined by the directors to be more favorable after taking into account the statutory balancing requirement. However, the question of whether the balancing requirement will continue to apply after the target enters into a merger agreement has not been decided by Delaware courts, and, accordingly, acquirers are likely to be hesitant to accept that a target company may terminate the merger agreement to enter into a "superior proposal" based on a definition that accounts for the statutory balancing requirement.

It may also be up for debate how customary formulations of "intervening event" concepts should be modified in light of the statutory balancing requirement. Typically, an "intervening event" would be material to the target company and its subsidiaries, taken as a whole. However, the degree to which the balancing test should shape the "intervening event" standard is ripe for debate among practitioners. Specifically, the debate would center around whether an event must be (solely) material to the target company or instead must impact the board's application of the balancing requirement (and the external considerations inherent in such an approach).

Due Diligence Considerations

Advisers to both acquirers and targets will likely face unique due diligence workstreams in connection with transactions involving a PBC. Among the characteristics that the acquirer of a PBC should assess include any statements the PBC has provided to its stockholders regarding the promotion of its public benefit; the DGCL requires that such a statement be provided every two years (which must include the objectives established to promote the corporation's public benefit, standards adopted to measure its progress, and an assessment of the PBC's success in meeting its public benefit objectives). The acquirer of a PBC should carefully evaluate the target's designated public benefit and any of these periodic reports, with a view toward ensuring compliance with DGCL requirements and assessing the alignment of corporate objectives between the two companies.

In a transaction in which some or all of the consideration consists of an acquirer's stock, a PBC target's reverse due diligence exercise will include evaluating the acquirer's corporate purpose, culture and strategy, as well as other aspects of the acquirer, that would enable the PBC target's board to complete its analysis of the transaction under the DGCL's balancing requirement. For instance, a PBC target might consider (among other factors) the degree to which a transaction will expand the reach of its public benefit purpose, the cultural alignment between the two entities, and whether the acquirer will serve as an appropriate steward for advancing the public benefit in the future.

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Key Takeaways

The DGCL's statutory framework for PBCs presents novel issues and process considerations for those considering an M&A transaction. The potentially competing interests that a PBC's board must balance when managing the business and affairs of the corporation represent a statutory divergence from traditional notions of corporate decision-making, both in operational matters as well as in sale processes. The application of the statutory balancing requirement can be expected to impact merger agreement negotiations in transactions involving a PBC target, and the benefit-oriented nature of PBCs will likely present additional due diligence considerations for both an acquiring corporation and a PBC target. As additional businesses adopt this alternative form, we expect PBC-related transactions (along with the process considerations driven by the DGCL's statutory framework for the entities) to continue to gain attention in the public markets.

About Our M&A Practice

Ropes & Gray's M&A attorneys navigate clients through some of the largest, most complex and demanding transactions around the world. Recognized as leaders in the field, Ropes & Gray's M&A attorneys possess both extensive transactional experience and deep industry knowledge. In 2022, the firm advised on M&A transactions with an aggregate value of more than $185 billion across technology, life sciences, healthcare and consumer brands sectors. The firm holds a strong track record of advising strategic investors on a wide variety of corporate transactions, creating and implementing innovative deal structures driven by industry trends and evolving market terms. The transaction teams include attorneys with various specialties, including tax, intellectual property, finance, antitrust, employee benefits, environmental, litigation and government enforcement, which allows the firm to present an integrated service offering to resolve matters that span the full spectrum of transaction-related issues. Our public company M&A lawyers have routinely blazed new trails over the years, having fashioned the first deal to use a "reverse break-up fee" in the context of financed deals, negotiated and executed the first successful acquisition of a U.S. public company by a Chinese acquirer, and structuring the first use of "stub equity" to secure shareholder approval of a contested public company M&A transaction.

For further information on the practice, click here.

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