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Ed Naylor, Editor

Benefit Corporations In Colorado

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On Tuesday, Jan. 15, 2013, Rep. Pete Lee (D. Colorado Springs) and Sen. John Kefalas (D. Larimer County) introduced H.B. 13-1138 entitled "Authorize Benefit Corporations" (Colorado Bill). As those following the subject matter know, benefit corporations have been the subject of legislation introduced in the Colorado General Assembly in 2011, 2012, and in the 2012 special session. Those bills, discussed in prior Newsletters (February and June 2011) and elsewhere, followed the strict mandate of the legislation proposed by B Lab Company of Berwyn, Pennsylvania, to support B Lab's certification process. In 2011 and 2012, with the support of the CBA, a number of attorneys opposed the strict mandates and the B Lab marketing aspects of the proposed legislation. With the support of the CBA, Rep. Clare Levy (D. Boulder) introduced a more flexible bill in the 2012 special session, but, like most legislation in that special session, it failed.

The new Colorado Bill is based on the work of a committee of business lawyers who worked from June through November of 2012 to draft a bill that accomplished the primary purpose of benefit corporations while avoiding the inflexible mandates and structure of the prior bills supported by B Lab. On Jan. 18, 2013, the CBA's Legislative Policy Committee voted to support and sponsor the Colorado Bill.

Reasons for Benefit Corporations

In decision-making, directors of corporations formed under the Colorado Business Corporation Act (CBCA) and the business corporation laws of other states must meet the business judgment rule, which requires (in part) that, when making decisions on behalf of the corporation, directors do so in the best interests of the corporation and its shareholders. Generally, this means profit maximization. Directors

may take into account other factors, such as the interests of employees, society or the environment, but those other factors must be considered in the profit-making context.

The benefit corporation concept follows from the corporate social responsibility (CSR) movement. CSR is a process that embraces responsibility for a company's actions and encourages companies to have positive impact on the environment, consumers, employees, communities, and all other members of the public who may also be considered as "stakeholders" of the company. CSR may be consistent with the short-term or the long-term goals of a company, but it also depends on the decision-makers to implement. Some entrepreneurs may desire to institutionalize their corporate social responsibility and the resulting socially or environmentally beneficial conduct. More importantly, the entrepreneur may desire to protect the corporation from a purely economic decision should there be a takeover attempt by a company that may not have the same social or environmental objectives. While it is possible that these social and environmental attributes can be documented in articles of incorporation or shareholder agreements, the benefit corporation specifically authorizes the directors, when making these decisions, to consider constituencies other than the shareholders and the profit maximization motive.

A Flexible Approach

Unlike benefit corporation bills adopted in a number of other states, the Colorado Bill provides a flexible approach for benefit corporations, allowing the shareholders to define the goals and benefit purposes. The Colorado Bill:

- Allows the shareholders to determine the nature of the other-than-profit maximizing purposes they wanted their corporation to pursue, which may be a specific or general public benefit;
- Adopts the existing standard of care under the CBCA for directors, but adds another layer of considerations—the shareholder-determined beneficial purpose—for the directors to take into account in their decision-making; and
- Allows the shareholders to determine whether they want to incur the expense of an independent benefit director, a third party assessment or certification, or an annual benefit report, and to define their governance should they desire to do so.

Other Issues—Solicitation of Funds, Tax Deductions

The Colorado Bill does not address a number of issues that may be important to benefit corporations. For example, if a benefit corporation solicits funds for its benefit purpose (as compared to its for-profit purpose), the directors will have to consider the potential applicability of the Colorado Charitable Solicitations Act (§ 6-16-101 et seq.) "to protect the public's interest in making informed choices as to which charitable causes should be supported" and "to help the secretary of state investigate allegations of wrongdoing in charities, without having a chilling effect on donors who wish to give anonymously or requiring public disclosure of confidential information about charities." If a benefit corporation solicits funds for investment purposes, it will need to consider the applicability of federal and state laws

regulating the offer and sale of securities.

The Colorado Bill does not, and cannot, address issues that may arise under the Internal Revenue Code for a benefit corporation pursuing its benefit purpose. For example, § 162(a) of the Internal Revenue Code authorizes taxpayers to deduct from income their “ordinary and necessary business expenses.” Marketing expenses generally fall within this section, such as the expenses incurred in advertising “organically grown ingredients, sustainably grown coffee, or contributions to local schools or charities.” Will expenditures for a benefit purpose that do not fit within the marketing rubric or which may be excessive when compared to normal marketing budgets be deductible? That is a question to be answered.

Will a benefit corporation be able to attract investment from foundations and others who are interested in the benefit purpose contained in the benefit corporation’s articles of incorporation? Probably so, but any investment or contribution for the benefit purpose will likely have to be vetted in the same manner prudent investors perform due diligence with respect to any investment opportunity or charitable contribution. Merely relying on the statements by the benefit corporation or its principals leaves room for misunderstanding or fraud.

It is unlikely that the benefit corporation legislation, if adopted by the General Assembly and signed by the Governor, will provide a panacea for the socially responsible business movement. It will, however, put another arrow in its quiver.

The following is a fact sheet prepared for the Colorado legislators to assist them in understanding the goals and the reasons behind the Colorado Bill authorizing benefit corporations in Colorado.

Fact Sheet:

HB 13-1138, Colorado Benefit Corporations

Sponsors: Rep. Pete Lee 303-866-2932, Sen. John Kefalas 303-866-4841

This bill creates a new class of Colorado companies called Benefit Corporations, which pursue a general or specific public benefit to have a positive impact on society and the environment in addition to seeking profits. Historically, there have been two types of Colorado corporations: business corporations, which pursue profit maximization for the benefit of its shareholders, and nonprofit corporations, which pursue charitable, religious and other social and public goals. In a business corporation, a director who puts social or public benefit ahead of profit maximization may be violating his or her duty to the shareholders. This legislation provides flexibility to business corporations to pursue general or specific public benefits, even at the cost of reducing profits, by becoming “benefit corporations.”

- A business corporation can become a “benefit corporation” either upon formation or with the consent of 2/3 of its shareholders. Shareholders who do not consent to the designation will have dissenters’ rights.
- The bill includes detailed notification requirements to ensure that those who become

shareholders of a benefit corporation are aware of the nature of the corporation—i.e., that it will also pursue social or public benefits rather than pure profit maximization. As a result, shareholders and investors will be able to make an informed decision about whether they wish to invest in such a corporation.

- When a benefit corporation is formed the shareholders decide the nature of the benefit to be sought after, whether it be a “general public benefit” and/or a “specific public benefit.” “General public benefit” means a “material positive impact on society and the environment, taken as a whole, as assessed against a third party standard.” “Specific public benefit” means a material positive impact on specific things. For example, supporting the sustainability of the Arkansas River Basin, the economic development of a depressed neighborhood, a religious mission, the advancement of arts and sciences, or a local school district would all be specific public benefits.
- Corporate directors are required to take the specified general or specific public benefit into account in decision-making. They may also consider the interests of shareholders, employees, customers, suppliers, and their operating communities as well as the local and global environment. They are protected from breach of fiduciary duty claims when they do so.
- Shareholders may bring an action against a benefit corporation or its directors for failing to pursue the general or specific public benefit, but members of the public may not do so unless granted the authority to do so in the benefit corporation’s articles of incorporation.
- Benefit corporations may designate a benefit director, prepare and publish annual benefit reports discussing their public benefit activities, and have third party assessments done to evaluate their performance, all to the extent required by their articles of incorporation or by resolution of its shareholders/directors.

A goal of this bill is to attract social entrepreneurs and socially responsible “impact” investors to Colorado. It offers a flexible approach empowering shareholders to decide what type of general or specific benefits to pursue, in lieu of profit maximization, and how they want to govern their entity.