MORRIS NICHOLS ARSHT & TUNNELL

Delaware Corporate Law Counseling Group
DELAWARE UPDATE

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DELAWARE GENERAL CORPORATION LAW AMENDED TO AUTHORIZE PUBLIC BENEFIT CORPORATIONS

Beginning on August 1, 2013, the Delaware General Corporation Law will authorize the formation of public benefit corporations. The new provisions will allow entrepreneurs and investors to create for-profit Delaware corporations that are charged with promoting public benefits. These provisions modify the fiduciary duties of directors of PBCs by requiring them to balance such benefits with the economic interests of stockholders. In addition, the new provisions will require public benefit corporations to report to their stockholders with respect to the advancement of such non-stockholder interests.

Below are a few of the more salient elements of Delaware's public benefit corporation legislation:

Specific Benefit

The certificate of incorporation of a PBC must identify one or more specific public benefits to be promoted. "Public benefits" are broadly defined to include positive effects (or reduction of negative effects) on persons, entities, communities or interests of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature.

Balancing Requirement

The board of directors of a PBC will be required to manage the business and affairs of the corporation in a manner that balances (1) the stockholders' economic interests, (2) the specific public benefits listed in the company's certificate of incorporation and (3) the best interests of those materially affected by the corporation's conduct.

Reporting Obligations

The new statute will require a PBC to provide a biennial report to its stockholders discussing the corporation's promotion of its specific public benefits and the best interests of those materially affected by its conduct. The corporation may, in its certificate of incorporation, undertake additional reporting obligations, such as reporting more often, making the report publicly available, or adding a third party standard of compliance.

Lawsuits and Balancing Decisions

Notwithstanding the balancing requirement, directors of PBCs will not owe duties to any non-stockholder. Moreover, directors will receive the benefit of the business judgment standard of review if stockholders challenge a disinterested balancing decision. Only stockholders owning a material stake in the corporation's outstanding shares will be authorized to maintain derivative suits on behalf of the corporation to enforce this balancing requirement. In addition, the certificate of incorporation may extend the reach of its exculpation provisions and of the corporation's indemnification obligations to all disinterested balancing decisions.

Identification of PBC Status

Because the new PBC provisions will be a significant change from the traditional law of Delaware corporations, the new statute ensures that PBC status is clear to stockholders and prospective investors. To that end, the corporate name must include the words "Public Benefit Corporation" or the identifier "P.B.C" or "PBC," stock certificates must include a legend noting that the company is a PBC and notices of stockholder meetings must do the same.

High Votes to Opt In or Opt Out

Existing corporations that are not public benefit corporations can opt into PBC status by merger or charter amendment, but approval of 90% of the outstanding shares of each class of stock of the corporation is required. Stockholders who do not vote in favor of the change will be entitled to appraisal rights. A PBC will not be able to eliminate or change the public benefit corporation provision in its certificate of incorporation without approval of two-thirds of the outstanding shares of each class of stock of the corporation.

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This legislation creates a significantly different structure for profit-making enterprises. While the current corporate law paradigm certainly allows directors of for-profit corporations to promote non-stockholder interests, the paradigm also requires that such promotion have as its ultimate goal the creation of stockholder value. Moreover, under the current governance model, the consideration of such non-stockholder interests is purely discretionary. The public benefit corporation is quite distinct: directors must consider non-stockholder interests, and may advance them even when such advancement compromises some economic value for stockholders. Beyond the fiduciary changes, the statute imposes reporting requirements that create a new level of transparency with respect to non-stockholder interests.

Many observers view the public benefit model with skepticism, believing that the changes will not make a practical difference in governance, and that PBCs will be unable to attract investors. On the other hand, there is a significant community of entrepreneurs and investors who believe the new provisions both reflect and enable a critical change in business practices, and who further believe that the utilization of PBCs will help to create an important new asset class that can attract significant capital.

For further information, please contact a member of Morris Nichols' Delaware Corporate Law Counseling Group.

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