

Delaware Legislature Responds to Growing Business Interest in Sustainability Measures

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Sustainability Goes Mainstream

Over the last decade, corporate responsibility and sustainability has moved to the forefront. Large businesses have Chief Sustainability Officers and produce sustainability reports—indeed, more than 80% of the S&P 500 do so. Investors seek consistent sustainability information and propose resolutions on matters from gender equality to human rights to climate change, and these are beginning to find support from the largest of institutional investors. Academics are producing papers showing links among corporate ESG (environmental, social and governance) performance and financial return.

Delaware, along with a number of other jurisdictions, responded to this development by offering a new option to corporations, allowing them to become “benefit corporations,” with an explicit purpose to serve all stakeholders, and not just stockholders. This memo provides an update on the benefit corporation movement, as well as two potential new statutes in Delaware that provide additional opportunities for businesses looking to make explicit commitments regarding environmental and social goals.

These developments evidence a growing need for businesses to understand and communicate the impact they have on all of their stakeholders, and not only stockholders. Larry Fink, Chairman of BlackRock, the world’s largest asset manager, addressed the importance of stakeholders and purpose in his most recent annual letter to CEOs:

The public expectations of your company have never been greater. Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate.

Despite this increased focus, there is growing concern that many businesses are more interested in good marketing than they are in making real changes in their social and environmental impact. Delaware, the world’s leader in business entity law, is continuing to respond to those developments and concerns by providing options that allow businesses to change their structure to be more stakeholder oriented or to simply communicate their sustainability programs on a universal platform.

Public Benefit Corporations Take Off

In 2013, the Delaware General Assembly adopted legislation that created the public benefit corporation (“PBC”) as an option for entrepreneurs and investors who wanted to focus on “responsible and sustainable business.” The PBC form allowed Delaware corporations to make economic, social and environmental commitments to stakeholders such as employees, customers and communities, and ensure that such commitments were as strong as the corporation’s commitment to its stockholders.

The heart of the PBC statute is the expansion of corporate and director accountability. Conventional corporate law is focused on director accountability to stockholders, while other stakeholders must rely on contracts, laws, good faith and the corporation’s need to protect its reputation. PBC law allows a corporation to strengthen the stakeholder bond by having directors’ highest duty—that of fiduciaries—extend to all stakeholders. The statute also requires a PBC to be transparent about how that protection is implemented.

While many questioned the idea, it has gathered strength over the ensuing five years, quieting many doubters. Similar legislation has been adopted in 35 states in the US (often called “benefit corporations,” dropping the word “public”), as well as in Italy and Colombia. Legislation has also been introduced in the legislatures of three additional countries and in British Columbia, and is being considered in a number of other jurisdictions. There are more than 5,000 benefit corporations, including more than 1,000 in Delaware.

The idea has spurred interest not only among impact investors and social entrepreneurs, but with mainstream venture, private equity and institutional investors, and with businesses in the mainstream of commerce. Benefit corporations have raised close to \$2 billion from hundreds of investors, including an IPO by Laureate Education, which raised \$490 million in the sale of common stock to the public, and several companies that have raised more than \$100 million in venture capital financings.

Public companies are exploring the form in other ways as well. Danone North America, a subsidiary comprising all of the North American assets of the multinational Danone, is now the world’s largest benefit corporation, with annual sales of over \$6 billion. The Gap recently announced that Athleta, a subsidiary, had been converted to a benefit corporation. United Therapeutics, Campbell Soup and Proctor & Gamble are other examples of public companies with benefit corporation subsidiaries.

The growing benefit corporation economy illustrates that more businesses are looking for a way to communicate an authentic commitment to a purpose beyond profit. Delaware is on the cusp of passing two statutes that will further accommodate businesses looking for a means to do so.

Statutory Public Benefit Limited Liability Companies

Following the growing popularity of the PBC form, a number of business owners questioned why a similar form was not available to businesses formed as limited liability companies. For many small businesses (and some quite large enterprises as well), the LLC provides a better structure than a corporation for tax or other reasons. Interestingly, because LLC law is almost entirely contractual, all of the provisions that make a PBC different from a conventional corporation could be imported into an LLC operating agreement, without a change to the statute.

Using this contractual flexibility is not really an adequate solution, however. Many LLCs are formed by small businesses, and the cost of hiring counsel to draft specific provisions could be limiting. More importantly, a simple contract change does not create a widely recognized form that tells employees and customers, and any other interested third party, that the company in question has broad accountability built into its corporate structure.

In order to address this gap, the legislature is considering the creation of a statutory public benefit limited liability company (an “SPBLLC”). The new statute will offer businesses formed as LLCs a turnkey solution and easily recognizable form, providing for easy entrée into the benefit corporation economy.

In order to be a SPBLLC, an LLC must state that it is such in the heading of its certificate of formation, and must also include a specific purpose in the certificate. Once those provisions are in place, the managers are required to balance the members’ pecuniary interests, the best interests of those materially affected by the SPBLLC’s conduct, and the public benefit or public benefits set forth in its certificate of formation. That specific purpose can only be changed (and the SPBLLC can only revert to conventional status) with a two-thirds vote of the members.

Like a PBC, the SPBLLC will be required, at least once every two years, to send a report to its members that uses standards to assess the SPBLLC’s performance as to its benefit purposes, both general and specific. Also like the PBC statute, the SPBLLC statute provides that the business judgment rule, which gives managers broad discretion as to business decisions, will apply to balancing decisions. In addition, the statute states that unless the operating agreement provides for a different rule, managers cannot be liable for making a balancing decision, even if it determined that the decision violated their fiduciary duties. (In the PBC statute, the presumption is reversed—a corporate charter can eliminate such liability, but exculpation is not the default rule.) In any event, actions challenging such balancing decisions can only be brought by members with 2% profit interest or, in the case of publicly traded membership interests, having a value of at least \$2,000,000.

The statute authorizing SPBLLCs (which is still being considered by the legislature) is expected to become effective August 1, 2018.

Delaware's New Transparency and Sustainability Act

In addition to adopting the SPBLLC law in this session, the Delaware General Assembly is considering a first in the nation law that will give every Delaware entity an entirely voluntary platform for reporting on its sustainability standards.

In order to take advantage of the statute, the governing body of a Delaware formed entity must adopt a set of standards, which may take the form of principles, guidelines or standards that allow the enterprise to assess and report the impacts of its activities on society and the environment. The governing body must look outside the organization in developing those standards—they must be based on or derived from “third party criteria.” A third party is a person (not controlled by the enterprise) that provides tools or services for assessing social and environmental impact.

Once an entity adopts such standards and commits to publish an annual report based on them, it may file a statement attesting that it has done so. At this point, it becomes a Reporting Entity under the statute, and is required to publish its report annually on its website. The report must include assessments as well as changes to the standards and assessment measures, and any plans to improve performance under the standards.

In order to maintain its status, the entity must file an annual report with the Delaware Secretary of State in the fourth quarter of the calendar year, attesting that it is current on its reporting. Any Reporting Entity may obtain a certification of its status from the Secretary of State. If a company falls out of compliance, it will have to publish its reports and file a reinstatement document, for which the filing fee may be as high as \$5,000, in comparison to the \$200 fee otherwise payable annually.

The statute is very clear that Delaware is not analyzing the standards that companies adopt or the quality of the reports. The statute also provides that the failure to follow a standard or report correctly does not create a claim for liability.

The purpose of the statute is not to regulate, but to create a platform for companies who want to adopt and report against social and environmental standards that have been adopted at the highest level of the organization. Given the creation of such standards by organizations like GRI, B Lab (where I serve as Head of Legal Policy) and SASB, and the growing trend among large corporations to provide sustainability reports, Delaware's new statute may provide a platform for many companies to establish, and for interested stockholders and stakeholders to compare, sustainability programs.

Final Thoughts

Public benefit governance and sustainability reporting are two very different sides of one coin, and should not be thought about as alternatives, but rather as complementary. The latter is a vehicle to let relevant stakeholders know the extent to which a business is behaving responsibly with respect to the systems in which it operates. In today's world, such communication is rapidly becoming a necessity—Delaware is fulfilling a market need for a platform for comparable information already being provided by the early majority.

The creation of the SPBLLC can be thought of as representing the leading edge of a more fundamental change. The new statutory form is a response to demand by early adopters for a business form that allows them to go beyond acting responsibly while pursuing profit and to actually create businesses where the commitment to responsibility is as core to their function as is the commitment to profit.

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Rick has been recognized as one of the 10 most highly regarded corporate governance lawyers worldwide by *The International Who's Who of Corporate Governance Lawyers* and selected by *The Best Lawyers in America* as Delaware Corporate Law Lawyer of the Year and Delaware Mergers & Acquisitions Lawyer of the Year. He has been named one of the 500 leading lawyers in the United States by the *Lawdragon* guide, selected for inclusion in *Delaware Super Lawyers*, and is listed in the Delaware Corporate/M&A category *Chambers USA: America's Leading Lawyers for Business*.

He is the author of three books: *Benefit Corporation Law and Governance: Pursuing Profit with Purpose* (2017), *The Public Benefit Corporation Guidebook* (2016) and *The Delaware Corporation; Legal Aspects of Organization and Operation 1-5th C.P.S.* (BNA, 2014) and has written numerous articles, including *M&A Under Delaware's Public Benefit Statute: A Hypothetical Tour*, Harvard Business Law Review (forthcoming); *Forum Selection Bylaws: Where We Are and Where We Go From Here* (Insights 2013); *The Multi-Jurisdictional Stockholder Litigation Problem and the Forum Selection Solution* (Corporate Counsel Weekly, 2011); *Responding to Unsolicited Takeover Offers* (Conference Board, 2009); *Power to the Franchise or the Fiduciaries?: An Analysis of the Limits on Stockholder Activist Bylaws* (Delaware Journal of Corporate Law, 2008); and *An Optimal Mix of Clarity and Flexibility* (Delaware Lawyer, Spring 2008).

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