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February 16, 2011

Hon. Sheldon Silver
Speaker
New York State Assembly
Legislative Office Building 932
Albany, NY

Hon. Daniel L. Squadron
Member of the New York State Senate Committee
on Corporations, Authorities and Commissions
Legislative Office Building 946
Albany, New York 12247

Re: A.4692 (Silver) / S.79 (Squadron) - Authorizing the Incorporation of Benefit Corporations[1]

Dear Speaker Silver and Senator Squadron:

The Corporation Law Committee of the Association of the Bar of the City of New York (the "Committee") supports in principle the concept of benefit corporations – i.e. a business corporation that elects in its certificate of incorporation to pursue one or more public purposes – such as those recently authorized by legislation in Maryland and Vermont and under consideration in New York and other states. Indeed, we believe that Section 717(b) of the New York Business Corporation Law already authorizes directors to consider various factors that contribute to the communities where the corporation does business, and thus, with minor modifications to address the director liability issues identified below, could be used to accomplish the goals of this legislation. However, if this approach is not chosen, the Committee believes that certain significant changes should be made to A.4692/S.79 (the "Bill") to ensure that the proposed statute creates a viable and attractive framework for creating benefit corporations in New York.

First, provisions of the Bill impose potentially conflicting duties on the directors of a benefit corporation, which may make it difficult to attract qualified individuals to serve in this

[1] This letter was originally sent by the Corporation Law Committee to Senator Squadron in October 2010 after a request from his office for comments on then-Senate bill 7855-B. It is being resent for consideration in the new legislative session.

capacity. Specifically, Section 1707(a) states that directors must consider the effects of any action on various constituencies, including shareholders, employees, customers, the community and the local and global environment, and makes clear that directors "shall not be required to give priority to the interests of any particular person or group . . . over the interests of any other person or group unless the benefit corporation has stated its intention to give priority to interests related to a specific public benefit purpose identified in its certificate of incorporation." The permission to consider other constituencies and interests is fundamental to the concept of a benefit corporation.

However, Section 1707(c) of the Bill creates a conundrum for directors, by establishing that "a director of a benefit corporation has the fiduciary duties of a director of a business corporation that is not a benefit corporation except to the extent those duties are inconsistent with the provisions of this article." Directors of a New York business corporation owe fiduciary duties to the corporation's shareholders, and shareholders may sue the directors to recover damages if directors have breached these fiduciary duties. The directors' fiduciary duties to shareholders are not inconsistent with the provisions of the Bill; indeed, Section 1707(a) allows directors to consider the interests of shareholders. Accordingly, Section 1707(c) of the Bill confirms that directors of a benefit corporation would continue to owe the same fiduciary duties (and be subject to liability) to shareholders of the benefit corporation as they would if it were not a benefit corporation. But the concept of a benefit corporation should be to allow directors, in appropriate circumstances, to determine that the interests of other constituencies and the public purposes of the benefit corporation are sufficiently important that an action should be taken by the benefit corporation, notwithstanding the fact that the directors might not support that action if they were considering only the interests of the corporation's shareholders.

The Bill thus imposes a challenge for directors of a benefit corporation who in good faith seek to achieve a balance between their fundamental duties to further the interests of shareholders and the pursuit of the corporation's public benefit goals, which may or may not align with what is solely in the shareholders' best interests.[2] The Committee believes that individuals who serve as directors of a benefit corporation should not be at greater risk of liability than directors of a business corporation that is not a benefit corporation. To accomplish this, the Bill should include an explicit provision exculpating directors from personal liability, consistent with the exculpation provision contained in Section 402(b) of the Business Corporation Law, and Section 1706(c) of the Bill should be modified to read: "The creation of ... public benefits ... is in the best interests of the benefit corporation *and its shareholders*." (Added language in italics). The Bill should also make clear that it does not create a cause of action for non-shareholder constituencies to pursue claims against directors.

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[2] *See, e.g.,* "The Case Against Corporate Social Responsibility" by Professor Aneel Karnani of the University of Michigan Ross School of Business in the August 23, 2010 issue of *The Wall Street Journal*.

An earlier version of the Bill in the 2010 session included an exculpation provision.[3] In addition, the statutes enacted by both the Vermont and Maryland legislatures to establish benefit corporations have included these types of provisions, ensuring that directors of a benefit corporation in those states do not owe duties to the beneficiaries of the corporation's public purposes (unless, in the case of Vermont, the benefit corporation specifies a beneficiary in its certificate of incorporation).[4] Moreover, the Maryland and Vermont statutes have made clear that a director of a benefit corporation will not have personal liability if the director performs his or her duties in good faith, in a manner the director reasonably believes to be in the best interests of the corporation and with the care that an ordinarily prudent person in a like position would use under similar circumstances.[5]

A second major concern of the Committee is the Bill's requirement that a benefit corporation's performance must be measured by a "third-party standard."[6] Although a "third-party standard" may be useful for certain benefit corporations, the Committee believes that it should not be the sole mandated standard because it may prove too restrictive in fostering the range of public benefits that could be addressed by benefit corporations. Accordingly, the Committee supports the broadest possible approach, which is to allow shareholders to determine which public benefits should be pursued by the benefit corporation (as expressed in its certificate of incorporation), notwithstanding the fact that those purposes may not fit neatly within the confines of an approved "third-party standard." The Committee is confident that shareholders of benefit corporations and the benefit community generally will be capable of analyzing both (i) the worthiness of the public benefits to be pursued by a particular benefit corporation and (ii) whether the benefit corporation is performing in accordance with its benefit purposes.[7] Each benefit corporation should be able to measure, and should disclose to its shareholders, its achievements relative to its stated goals.

A third area of concern is the Bill's definition of "Minimum Status Vote", which would be required prior to (i) a corporation's electing benefit corporation status, (ii) a corporation's terminating its status as a benefit corporation (including by merger), (iii) an amendment to a benefit corporation's certificate of incorporation to change its specific public benefit purposes or (iv) the adoption of a plan of merger or consolidation if the surviving or consolidated corporation

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[3] S. 7855 §1707(c) (N.Y. 2010).

[4] Maryland Corporations and Associations § 5-6C-07(b); Vermont Business Corporations 11A V.S.A. §§ 21.09(e) and 21.13(b)(4) (effective July 1, 2011).

[5] Maryland Corporations and Associations §§ 2-405.1(a) and 5-6C-07(c) and Maryland Courts and Judicial Proceedings § 5-417; Vermont Business Corporations 11A V.S.A. § 21.09(d) (effective July 1, 2011) and 11A V.S.A.§ 8.30(a).

[6] §1702(g).

[7] The Committee also notes that certain providers of "third-party standards" may require benefit corporations to pay licensing fees, imposing an unnecessary cost on benefit corporations.

will be a benefit corporation and any corporation that is not a benefit corporation "is a party to" such merger or consolidation.

As defined in Section 1702(d) of the Bill, the "Minimum Status Vote" requires, in addition to any other limitations set forth in the statute, the certificate of incorporation or bylaws, the approval of the holders of at least 75% of all of the benefit corporation's shares, whether or not any class or series generally has voting rights or is otherwise subject to restrictions on voting. Providing non-voting stock with the right to vote on such matters effectively allows the holders of such stock to extract "hold-up" value. As a result, for example, benefit corporations may be less inclined to reward management with non-voting stock, which in turn could disadvantage benefit corporations when competing with non-benefit corporations for skilled managers. The Committee notes that the Maryland and Vermont statutes do not provide non-voting shares with voting rights on such matters.[8]

In addition, the "Minimum Status Vote" required in the merger context by Section 1704(b) of the Bill could be read to require that a non-benefit parent corporation that creates a subsidiary to effect an acquisition of a benefit corporation by means of a triangular merger would need to obtain a "Minimum Status Vote" prior to the merger, because it could be viewed as a "party to the merger", although the parent itself would not merge with a benefit corporation (and this result may not have been intended). This requirement would be dramatically different from what is required in the context of a merger involving non-benefit corporations, and there appears to be no policy basis for requiring the approval of stockholders of a non-benefit corporation to permit a merger of its benefit corporation subsidiary with another benefit corporation. Accordingly, the Committee believes that Section 1704(b) of the Bill should be revised to read: "Any corporation that is not a benefit corporation that is a party to a merger or consolidation *in which such corporation will become a benefit corporation* must approve the plan of merger or consolidation by at least the Minimum Status Vote. . . ." In addition, the Committee recommends the addition of the following provision to Section 1704 of the Bill:

> (c) Any corporation that is not a benefit corporation that is party to a merger or consolidation in which shares of stock of such corporation will be converted into a right to receive shares of stock of a benefit corporation must approve the plan of merger or consolidation by at least the Minimum Status Vote in addition to any other vote required by this chapter, the certificate of incorporation or the bylaws.

Furthermore, the Committee recommends the addition of the following provision to Section 1705 of the Bill:

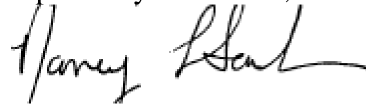
> (c) Any benefit corporation that is party to a merger or consolidation in which shares of stock of such benefit corporation will be converted into a right to receive shares of

[8] Maryland Corporations and Associations §§ 2-604(e), 5-6C-03(B), 5-6C-04(B) and 5-6C-06(C); Vermont Business Corporations 11A V.S.A. §§ 21.05(2), 21.06(a)(2) and 21.06(b)(2) (effective July 1, 2011).

stock of a corporation that is not a benefit corporation must approve the plan of merger or consolidation by at least the Minimum Status Vote in addition to any other vote required by this chapter, the certificate of incorporation or the bylaws.

In addition to the foregoing comments, the Committee is concerned that Section 1706(a) of the Bill may create uncertainty for directors in their management of the affairs of the corporation because it provides that "The purpose to create general public benefit **may** be a limitation on the purposes of the benefit corporation, and **shall** control over any inconsistent purpose of the benefit corporation [emphasis added]." The Committee suggests that "**shall**" be used in both places. We also note that the Bill appears to have retained vestiges of prior iterations – principally in the definition of "independent," which refers to the terms "benefit director" and "benefit officer" although they no longer appear, or are defined, in the Bill. These references should be deleted. Finally, the Committee questions whether there is a need for distinctions between "general benefit purposes" and "specific benefit purposes" and suggests that consideration be given to consolidating these concepts.

Respectfully submitted,



Nancy L. Sanborn
Chair
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Cc: Laura J. Wood, Esq., Office of the Hon. Daniel L. Squadron
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