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REPORT BY THE COMMITTEE ON CORPORATION LAW

A.4692-A **Speaker Silver**
S.79-A **Sen. Squadron**

AN ACT to amend the general construction law and the business corporation law, in relation to authorizing the incorporation of benefit corporations, providing for the public benefit to be created by benefit corporations, for the election and termination of the status of a benefit corporation, for the standards of conduct for directors of a benefit corporation, and for the preparation and distribution of an annual benefit report by a benefit corporation.

THIS BILL IS APPROVED WITH MODIFICATIONS

The Corporation Law Committee of the New York City Bar Association (the "Committee") has previously commented on A.4692/S.79 by letter dated February 2011 (and on an earlier version of this bill)[1], and we appreciate that efforts have been made to address many of those comments. As we indicated in our prior letter, 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, New Jersey, Vermont and Virginia 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, could be used to accomplish the goals of this legislation. However, if this approach is not chosen, the Committee believes that certain changes should be made to A.4692-A/S.79-A (the "Bill") to ensure that the proposed statute creates a viable and attractive framework for creating benefit corporations in New York.

First, the Committee continues to be concerned with the Bill's requirement that a benefit corporation's performance must be "assessed against" a "third-party standard."[2] In part, we believe this standard may prove too restrictive in fostering the range of public benefits that could be addressed by benefit corporations. For example, if a corporation desires to achieve public benefits that are not included by a third party in what is then considered a "recognized standard", it could not become a benefit corporation. Accordingly, the Committee supports the broadest possible approach, which would be to allow shareholders to determine which public benefits should be pursued by the benefit

[1] http://www.nycbar.org/pdf/report/uploads/20072008-LetteronA.14498BS.7855BAuthorizingtheIncorporationofBenefitCorporations.pdf

[2] §§1702(b) & 1702(g).

corporation (as expressed in its certificate of incorporation), notwithstanding the fact that those purposes may not fit neatly within the confines of a "recognized" "third-party standard." The Committee is confident that shareholders of benefit corporations and the benefit community generally will be capable of analyzing both (1) the worthiness of the public benefits to be pursued by a particular benefit corporation and (2) whether the benefit corporation is performing in accordance with its benefit purposes.[3] Each benefit corporation should be required to measure, and disclose to its shareholders, its achievements relative to its stated public benefit goals.

A second area of concern is the Bill's definition of "minimum status vote" in Section 1702(d), which would require, in addition to any other approval or vote required by the statute, the certificate of incorporation or bylaws, that both (1) the holders of every class or series of voting shares must be entitled to vote *as a class* and (2) the applicable corporate action must be approved by the holders of at least 75% of *each class or series* of the benefit corporation's shares that are entitled to vote on the corporate action. These clauses appear to be conflicting or, at least, unclear. The conflict arises because clause (1) indicates that all of these holders would vote as a class, whereas clause (2) provides that a separate vote of each class or series is required. We are concerned in particular that the Bill may require class voting on such matters, even if separate class voting is not provided in the certificate of incorporation or bylaws. It is not uncommon for corporations to create multiple classes or series of voting shares (with differing economic rights) that provide that all holders of voting shares vote together as a single class. Allowing each class or series of shares that would ordinarily vote together as a single class to have a separate class vote would give those stockholders leverage to extract "hold-up" value. This result could disadvantage benefit corporations when competing with non-benefit corporations for capital. The Committee notes that the Maryland, Vermont and Virginia statutes do not create separate class votes on such matters.[4]

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). In addition, Section 1705(b) of the Bill could be read to impose the same requirement on a benefit parent corporation that creates a subsidiary to effect an acquisition of a non-benefit corporation by means of a triangular merger. These requirements would be dramatically different from what is required in the context of a merger involving solely benefit corporations or solely non-benefit corporations, and there appears to be no policy basis for requiring the approval of stockholders of a parent corporation to permit

[3] The Committee also notes that certain providers of "third-party standards" may require benefit corporations to pay licensing fees, respond to questionnaires and take other actions that impose unnecessary costs on benefit corporations without serving any public benefit.

[4] Maryland Corporations and Associations §§ 2-604(e), 5-6C-03(B), 5-6C-04(B) and 5-6C-06(C) (requiring approval by "two thirds of all the votes entitled to be cast on the matter."); Vermont Business Corporations 11A V.S.A. §§ 21.05(2), 21.06(a)(2) and 21.06(b)(2) (effective July 1, 2011) (requiring approval by the higher of "(A) the vote required by the articles of incorporation; or (B) two-thirds of the votes entitled to be cast by the outstanding shares of the corporation, provided that if any class of shares is entitled to vote as a group, approval shall also require the affirmative vote of the holders of at least two-thirds of the votes entitled to be cast by the outstanding shares of each voting group."); Va. Code § 13.1-785 (effective July 1, 2011) and § 13.1-707 (requiring approval by "each voting group entitled to vote . . . by more than two-thirds of all the votes entitled to be cast by that voting group . . . ."); *but see* New Jersey Statutes 14A:18-1 (requiring approval by the holders of at least two-thirds of "each class or series" of the corporation's shares.).

a merger of a subsidiary with another corporation if the status of the parent corporation will not change as a result of the merger. 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. . . ." Similarly, Section 1705(b) of the Bill should be revised as follows to address this matter and to clarify to which entity the minimum status vote applies: "*Any benefit corporation that* is a party to a merger or consolidation in which *such corporation will not be a benefit corporation as a result of the transaction must approve the plan of merger or consolidation by* at least the minimum status vote in addition to. . . ."

The Committee also suggests that Section 1705(d) of the Bill, which requires a minimum status vote prior to a "sale, lease, conveyance, exchange, transfer, or other disposition of all or substantially all of the assets of a benefit corporation, unless the transaction is in the usual and regular course of business of the benefit corporation" should not contain an exception for transactions "in the usual and regular course of business." A corporation may dispose of all or substantially all of its assets only once, so no such transaction could be "in the usual and regular course of business." Allowing this exception creates uncertainty as to whether a sale of "substantially all assets" should be interpreted differently in the context of a benefit corporation than it is for a non-benefit corporation, and in particular may include a "usual and regular course of business" transaction. We note that Section 909 of the Business Corporation Law currently requires approval of a majority of the votes of all outstanding shares entitled to vote thereon prior to a sale by a New York corporation of substantially all of its assets.

A third area of concern is Section 1707(a)(1) of the Bill, which includes a list of constituencies upon whom benefit corporation directors *must* consider the effects of an action. Section 717(b) of the Business Corporation Law already includes a similar list of constituencies, including shareholders, employees, customers and the community. To avoid ambiguities in the interpretation of existing Section 717(b) with Section 1707(a) of the Bill and because these additional constituencies may not be included in a corporation's public benefit purposes, the Committee believes that Sections 1707(a)(1)(C), (D), (E) and (F) of the Bill should be moved to Section 1707(a)(2) (i.e., those constituencies upon whom benefit corporation directors *may* consider the effects of an action). If the relevant constituencies are included in a benefit corporation's public benefit purposes, they would be covered by (a)(1)(A) and (G) of the Bill.

A related concern is the interplay between Section 1706(a) and Section 1707(a)(3) of the Bill. The former provision indicates that the purpose to create general public benefit may limit other purposes of the benefit corporation, while Section 1707(a)(3) explains that officers and directors are not required to give priority to the interests of any particular 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. These provisions appear to some extent to be inconsistent, and the Committee questions why Section 1707(a)(3) does not allow a corporation to give priority to interests related to its general or specific public benefit purposes. Accordingly, the Committee recommends that Section 1707(a)(3) be revised to read as follows: "shall not be required to give priority to the interests of any particular person or group referred to in subparagraphs one and two of this paragraph over the interests of any other person or group *except to the extent the benefit corporation has stated its intention to give priority to interests related to its general public benefit purpose or any specific public benefit purpose and such priority is* identified in its certificate of incorporation."

In addition to the foregoing comments, the Committee notes that "benefit corporation" is not defined consistently in the Bill. Because a benefit corporation, like any other New York corporation, is formed under Article 4 of the Business Corporation Law, the Committee suggests that the following revisions be made to the Bill:

- Section 2 should be revised in part to read, *"4-a. A 'benefit corporation' means a business corporation incorporated under article four of the business corporation law that was formed as a benefit corporation or has elected to become a benefit corporation as provided in article seventeen of the business corporation law until such time as it has ceased to be a benefit corporation as provided in article seventeen of the business corporation law."*;

- Section 1702(a) should be revised to read, *"'Benefit corporation' means a business corporation incorporated under article four of this chapter that was formed as a benefit corporation or has elected to become a benefit corporation as provided in article seventeen of this chapter until such time as it has ceased to be a benefit corporation as provided in article seventeen of this chapter."*; and

- Section 1703 be revised to read, *"A benefit corporation shall be incorporated under article four of this chapter except that its certificate of incorporation shall also state that it is a benefit corporation."*

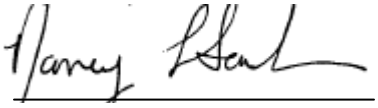
The Committee also believes that Section 1706(c) of the Bill should be modified to read: "The creation of . . . public benefits . . . is in the best interests of the benefit corporation *and its shareholders*."

Finally, the Committee questions the intended meaning of Section 1701(c) of the Bill. The Committee believes that the statement that the "specific provisions" of this article control over the "general provisions" of this chapter raises questions as to which provisions are "specific" and which are "general" and how this mandate should be interpreted. We recommend deleting this sentence.

The Committee appreciates the consideration of these comments.

Respectfully submitted,

Corporation Law Committee of the New York City Bar Association

By: 

Nancy Sanborn, Chair

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