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Washington State Passes Legislation Authorizing Social Purpose Corporations: Bill to Permit Corporations to Seek Social, Environmental-Oriented Goals

By C. Kent Carlson, G. Scott Greenburg, and Patrick J. Loney

Washington Governor Christine Gregoire signed into law SHB 2239, a bill amending the Washington Business Corporation Act (“WBCA”) to authorize the use of social purpose corporations, effective June 7, 2012. Washington follows a growing list of states adopting legislation giving for-profit corporations the legal tools to formally incorporate social and environmental goals into their mission statement and charter documents. The new legislation allows for the creation of what could be considered “hybrid corporations” between traditional for-profit corporations and non-profit corporations. The new subchapter is an enabling act much like the overall structure of WBCA and the Model Business Corporation Act and allows corporations to tailor their specific approach.

Background

Although some for-profit corporations currently devote time and resources to social purposes, the primary aim of a corporation is long-term value growth for its shareholders. Because of this, social and charitable purposes should not significantly deter from the corporate directors’ mandate of seeking financial returns, and directors owe shareholders legal duties—called fiduciary duties—which require that they make decisions in a manner that prioritizes shareholder value. On the other hand, non-profit corporations may seek out charitable and social purposes, but are legally prohibited from distributing profits for shareholders. The new social purpose format allows the shareholders of for-profit corporations to remove or modify the legal restrictions traditionally imposed on directors of for-profit corporations (e.g. the risk of shareholder “failure to maximize value” lawsuits) so that they may pursue both social and financial goals in the for-profit context.

Fiduciary Duties for For-Profit Directors. Directors and officers of for-profit corporations owe to shareholders certain fiduciary duties requiring that they make decisions in good faith, in a manner reasonably believed to be in the best interests of the corporation, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. These are typically referred to as the duty of due care and the duty of loyalty. Traditionally, there has been confusion as to the extent that these fiduciary duties require directors and officers to seek solely to maximize shareholder value in the form of financial returns on investment, particularly in the context of a sale of the company. In this context, directors and officers of for-profit corporations have arguably lacked the legal cover to pursue social and environmental purposes on behalf of the corporation without exposing themselves to the threat of liability for breach of fiduciary duties. Corporations adopting social purposes have therefore most typically operated in the non-profit context.

Summary of New Legislation. The legislation signed by the Governor and effective on June 7 adds a new subchapter to the WBCA. The legislation permits for-profit corporations to pursue one or more social and/or environmental purposes while also creating economic value for shareholders, and it

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protects directors and officers from shareholder lawsuits in the event that social purposes take priority in the decision-making process. To effectuate this result, the law allows social purpose corporations to establish modified fiduciary duties for directors and officers, and it requires a series of rules governing corporate governance. Except for those provisions in the new subchapter, all other provisions of the WBCA apply to social purpose corporations. Other than with respect to the specific provisions in the new subchapter, the other provisions of the WBCA apply to these corporations.

Basic Compliance Requirements

A corporation may be formed as a social purpose corporation or may be converted from a traditional for-profit corporation into a social purpose corporation, so long as the requirements of the statute are satisfied. Specifically, the articles of incorporation for the social purpose corporation must:

- Include in its name “social purpose corporation” or “SPC”;
- Explicitly designate itself as a social purpose corporation governed by the new subchapter;
- Explicitly state the social purpose or purposes for which it was organized, which can be general or specific¹; and
- Include the statement: “The mission of this social purpose corporation is not necessarily compatible with and may be contrary to maximizing profits and earnings for shareholders, or maximizing shareholder value in any sale, merger, acquisition, or other similar actions of the corporation.”

Additionally, the bill permits—but does not require—the corporation to include in its articles of incorporation provisions:

- Requiring directors and officers to consider the impacts of corporate decisions on its social purposes;
- Requiring the corporation to provide third-party performance assessments to shareholders with respect to the social purposes; or
- Limiting corporate existence to a particular date.

Fiduciary Duties

As mentioned, the bill modifies the fiduciary duties of directors and officers of social purpose corporations without altering the basic standard of conduct (i.e. duties of care and loyalty, and actions in good faith). The bill permits directors and officers, in discharging their duties, to “consider and give weight to one or more of the social purposes of the corporation as the director deems relevant.” Additionally, any action taken by a director or officer which he/she believes promotes a social purpose “shall be deemed to be in the best interests of the corporation.” If the director or officer complies with these requirements, he/she “is not liable for any action taken.”

By explicitly permitting directors and officers to consider social purposes, the legislation insulates these groups from common law liability based on making decisions that provide social benefit at the expense of shareholder value.

¹ This can include language stating that the corporation intends to promote positive short-term or long-term effects of, or minimize adverse short-term or long-term effects of, the corporation’s activities upon any or all of (1) the corporation’s employees, suppliers, or customers; (2) the local, state, national, or world community; or (3) the environment.

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Share Certificate Legends

In order to ensure that shareholders are given notice, the social purpose corporation must provide shareholders with copies of its articles of incorporation prior to issuing shares, and each shareholder must provide copies of the articles to transferees of shares prior to transfer. Additionally, each share certificate issued to shareholders of a social purpose corporation must conspicuously state:

THIS ENTITY IS A SOCIAL PURPOSE CORPORATION ORGANIZED UNDER TITLE 23B OF THE WASHINGTON BUSINESS CORPORATION ACT. THE ARTICLES OF INCORPORATION OF THIS CORPORATION STATE ONE OR MORE SOCIAL PURPOSES OF THIS CORPORATION. THE CORPORATION WILL FURNISH THE SHAREHOLDER THIS INFORMATION WITHOUT CHARGE ON REQUEST IN WRITING.

Shareholder Voting Rights and Dissent

The legislation includes a number of provisions designed to protect the expectations and interests of shareholders in the event that the social purposes pursued by the corporation do not align with the intentions of the shareholder.

Shareholders may dissent from certain decisions of the corporation and receive fair value for their shares in the corporation for the following actions:

- An election by a traditional for-profit corporation to become a social purpose corporation;
- An election by a social purpose corporation to become a traditional for-profit corporation; or
- An amendment of the social purpose corporation's articles of incorporation materially changing the corporation's purposes.

Additionally, at least two-thirds shareholder approval is required for various actions performed by social purpose corporations, including:

- Amending the articles of incorporation in a manner which would materially change one or more of the social purposes²; or
- Effecting a merger, share exchange, or asset purchase in which the social purpose corporation would not survive, unless the survivor is a social purpose corporation with purposes that do not materially differ from the non-surviving firm.

Conversion Into and From the Social Purpose Corporation

The bill contains detailed steps which must be followed in order for a traditional for-profit corporation to convert into a social purpose corporation, and vice versa. The process includes recommendation by the board, consent by at least two-thirds of the shareholders entitled to vote, and amendment and filing of the articles of incorporation.

² This provision was intended to solidify the mission of the social purpose corporation by requiring a voting threshold greater than mere majority approval.

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Reports

The legislation requires all social purpose corporations to provide on their own websites an annual report detailing the corporation's efforts to promote the social purposes, including short-term and long-term objectives, discussion of material actions taken in furtherance of the objectives, and expected future actions to be taken in furtherance of the social objectives.

Flexibility and Third-Party Assessments

The structure of the social purpose corporation conflicts in some ways with that of the benefit corporation—or “B corporation”—model adopted by other states. Whereas directors and officers may be required to consider social benefits in each decision under the B corporation structure, the Washington legislature merely permits directors and officers to consider social purposes as a statutory default, and permits shareholders by provisions in the articles of incorporation to require directors and officers to consider social purposes if they so desire.

Additionally, the Washington legislature decided not to include provisions in the bill which would require shareholders of the social purpose corporation to adopt third-party standards against which to judge the corporation's commitment to its social purposes. Instead, the bill seeks to impose accountability measures while maintaining a level of flexibility to serve the needs of each corporation. It does this by requiring social purpose corporations to post annual progress reports on their websites, and by giving shareholders the legal authority—but not the obligation—to define compliance with social objectives themselves or through a third party.

Authors:

C. Kent Carlson

kent.carlson@klgates.com
+1.206.370.6679

G. Scott Greenburg

scott.greenburg@klgates.com
+1.206.370.6797

Patrick J. Loney

patrick.loney@klgates.com
+1.206.370.7668

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