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CALIFORNIA AUTHORIZES TWO NEW TYPES OF CORPORATIONS

On October 9, 2011, Governor Brown signed into law California Senate Bill 201 and California Assembly Bill 361, creating two new classes of corporations. Prior to the effective date of these new laws, there are only two broad categories of California corporations: for-profit corporations and nonprofit corporations. Directors of for-profit corporations are tasked with maximizing monetary gains for shareholders. Directors risk personal liability if they cause a for-profit corporation to engage in activities for the benefit of the environment or society to the detriment of the corporation’s profitability. Nonprofit corporations may protect the environment and promote social welfare but are not permitted to devote a substantial part of their activities to producing a profit. The creation of the flexible purpose corporation and the benefit corporation combines the goals of for-profits and nonprofits and allows businesspersons to pursue both purposes simultaneously.

California SB 201 - The Flexible Purpose Corporation

Effective January 1, 2012, a flexible purpose corporation is organized in a manner similar to that of a for-profit corporation, but its articles of incorporation must identify it as a flexible purpose corporation and identify a special purpose listed in SB 201.

A special purpose includes: (1) one or more charitable or public purpose activities that a nonprofit public benefit corporation is authorized to carry out; or (2) the purpose of promoting positive short-term or long-term effects of, or minimizing adverse effects of, the flexible purpose corporation’s activities upon any of the following: (a) the corporation’s customers, creditors, employees and suppliers; (b) the community and society; or (c) the environment.

A flexible purpose corporation is required to set specific objectives for measuring the impact of its efforts and to analyze its success in annual reports. It must prepare a current report on expenditures made in pursuit of the specific purpose if the expenditures will have a material adverse effect on the corporation. An existing corporation or other business entity may convert to a flexible purpose corporation by a vote of the holders of at least two-thirds of the outstanding shares, subject to dissenters’ rights.

A flexible purpose corporation may define its special purpose liberally and is subject to relaxed corporate governance requirements. For example, unlike a benefit corporation, a flexible purpose corporation does not have to incur the cost of complying with third party standards.

California AB 361 - The Benefit Corporation

Effective January 1, 2012, a benefit corporation is also organized in a manner similar to that of a for-profit corporation, but its articles of incorporation must identify it as a benefit corporation and it must be organized to pursue a general public benefit or one or more of the specific public benefits listed in AB 361

A general public benefit is an activity that creates a material positive impact on society and the environment. A specific public benefit includes: (1) providing beneficial products or services to low-income or underserved individuals or communities; (2) promoting economic opportunity for individuals or communities beyond the creation of jobs; (3) preserving the environment; (4) improving human health; (5) promoting the arts, sciences, or advancement of knowledge; (6) increasing the flow of capital to entities with a public benefit purpose; or (7) accomplishing any other particular benefit for society or the environment.

In carrying out their fiduciary duties, directors of a benefit corporation must consider the impact of their decisions on the corporation's shareholders, customers, employees, and community and on the environment and society. A benefit corporation is held to an independent third-party's standard in assessing its overall social and environmental impact and must share the third party's assessment of its performance publically via its website. The B Lab, Global Reporting Initiative, and the Underwriters Laboratories are a few of the recognized organizations that meet the statutory criteria for a third party standard.

Subject to a two-thirds shareholders' vote and dissenting shareholders' rights, an existing for-profit corporation can amend its articles to become a benefit corporation. A benefit corporation offers the advantage of familiarity as it has been enacted in five states already.

Taxation

Both the flexible purpose corporation and benefit corporation will be taxed in the same manner as for-profit corporations.

Conclusion

Either of these entity types may be well-suited for entrepreneurs and investors in search of balancing profitability with social responsibility.

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For advice regarding this topic or any other corporate or non-profit related matter, please contact one of these members of our Corporate Group.

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