

Tax Law

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The Birth of a New Class of Corporation in California "Benefit Corporations"

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When Governor Jerry Brown signed Assembly Bill 361 into law on October 9, 2011, California became the sixth state to recognize a new category of corporation known as "benefit corporations" or "B corporations." (Maryland enacted the first B corporations statute in 2010.) The new California law is codified as Corporations Code section 14600 et seq.

Benefit corporations are for-profit corporations organized under California law. However, under the new law, for-profit corporations may adopt (in addition to one or more business purposes) purposes that have been historically pursued by nonprofit corporations. In other words, benefit corporations are business corporations that differ from traditional corporations in that they may set a goal to create public benefit while, at the same time, delivering economic returns to their investors. The new law provides legal protection to directors of this new class of corporations in pursuing what social entrepreneurs have termed a double bottom line-creating a beneficial social and environmental impact as well as financial returns to shareholders.

AB 361 defines B corporation as a corporation that has been organized under the General Corporation Law and has elected to become subject to the provisions of the new law. B corporations may be created in various ways, including incorporation as a new entity or through a merger, reorganization, or conversion. Generally, a supermajority shareholders' vote (not less than two-thirds) is required to create a B corporation via mergers, reorganizations or conversions.

A B corporation must state in its articles of incorporation that one of its purposes is to create a "general public benefit"-defined as a material positive impact on society and the environment-that is intended to result from the corporation's business and operations.

Additionally, a B corporation may identify one or more specific public benefit(s), examples of which include:

- Promoting economic opportunities beyond the creation of jobs in the ordinary course of business.
- Providing beneficial products or services to low-income or underserved individuals or communities.
- Preserving the environment.
- Improving human health.
- Promoting the arts, sciences, or advancement of knowledge.
- Increasing the flow of capital to entities with a public benefit purpose.

B corporations must provide their shareholders with an annual benefit

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report containing, among other elements, an assessment of the corporation's overall social and environmental performance as measured against independent and transparent third-party standards. Where the board of directors is of the opinion that the corporation failed to pursue its general (and any specific) public benefit purposes, the annual report must contain a statement to that effect together with a description of the ways in which the corporation so failed.

Directors of B corporations are subject to the same duties as are traditionally imposed upon directors of for-profit corporations, including the duties of care, inquiry, and loyalty. However, unlike their traditional counterparts, who answer almost exclusively to shareholders when weighing corporation actions, B corporation directors are required, when considering an action or proposed action, to take into account the impacts of any such action upon the following:

- The employees and workforce of the corporation and its subsidiaries and suppliers.
- The interests of customers of the corporation as beneficiaries of the public benefit purposes of the corporation.
- Community and societal considerations, including communities where the corporation or its subsidiaries or suppliers have offices.
- The local and global environment.
- The corporation's ability to accomplish its general and any specific public purposes.
- The corporation's short- and long-term interests, including the possibility that such interests may be best served by retaining – rather than selling-the corporation.

By recognizing as a legitimate corporate purpose the pursuit of positive societal and environmental benefit, the new law is designed to protect directors (and officers) of B corporations from liability for monetary damages that may be sought by disgruntled shareholders whose sole goal is maximum economic returns. The trade-off, of course, is the obligation of B corporations to meet higher standards of accountability and transparency.

B corporations are something of a hybrid between a for-profit and a nonprofit (similar to the low-profit limited liability companies or L3C's). As such, some may view B corporations as a competitor for charitable donations. But because "contributions" to B corporations are not deductible under tax laws, any perceived siphoning of philanthropic dollars away from the nonprofit sector may be insignificant.

AB 361 has been touted as a tool to help grow the California economy and create more jobs that also provide social and environmental benefit. It remains to be seen whether and how quickly the new law will accomplish that goal. But in enacting AB 361, California has joined what appears to be a growing national trend to provide social entrepreneurs with a new entity choice to serve a broader spectrum of constituencies.

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