

SENATE BILL REPORT

SHB 2239

As Reported by Senate Committee On:
Judiciary, February 23, 2012

Title: An act relating to social purpose corporations.

Brief Description: Establishing social purpose corporations.

Sponsors: House Committee on Judiciary (originally sponsored by Representatives Pedersen, Goodman, Rodne and Hudgins; by request of Washington State Bar Association).

Brief History: Passed House: 2/13/12, 62-31.

Committee Activity: Judiciary: 2/21/12, 2/22/12, 2/23/12 [DP, DNP].

SENATE COMMITTEE ON JUDICIARY

Majority Report: Do pass.

Signed by Senators Kline, Chair; Harper, Vice Chair; Pflug, Ranking Minority Member; Hargrove, Kohl-Welles and Regala.

Minority Report: Do not pass.

Signed by Senators Carrell, Padden and Roach.

Staff: Juliana Roe (786-7438)

Background: The Washington Business Corporations Act (WBCA) provides requirements for the creation, organization, and operation of corporations and the relationship between the corporation's directors, officers, and shareholders. WBCA is based on the Model Business Corporation Act, prepared by the American Bar Association, which generally establishes default rules regarding the organization and operation of corporations.

Under WBCA, a corporation's directors and officers have a fiduciary duty to the corporation – an obligation to act in its best interests. This duty has been interpreted as a responsibility to maximize financial returns for shareholders. The risk of liability can arise for directors and officers if they make decisions on the basis of some mission at the expense of maximizing shareholder value. Such decisions could be interpreted as a breach of the duty to act solely in the corporation's best interests.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

There is an emerging corporate model designed to permit a company to pursue a social mission in addition to maximizing shareholder value. The benefit corporation model has three main elements:

- the corporation must establish a general public benefit aimed at yielding material positive societal impacts;
- corporate directors must consider the corporation's public benefit when making decisions; and
- each year, the corporation must report on its social and environmental performance, as assessed by a third party standard.

Several states, including New Jersey, Vermont, Maryland, Virginia, California, and Hawaii, have adopted benefit corporation legislation. A number of other states are pursuing similar legislation that allows companies to combine the goals of pursuing a social or environmental purpose as well as returns for shareholders.

Summary of Bill: A social purpose corporation is established under WBCA. A social purpose corporation, while subject to all provisions applicable to other corporations, must be organized to promote a general social purpose, that is, it must be organized in a manner intended to positively affect certain constituencies. These constituencies must include one or more of:

- the corporation's employees, suppliers, or customers;
- the local, state, national, or world community; or
- the environment.

In addition, a social purpose corporation may set forth specific social purposes for which the corporation is organized.

Any person or persons may form a social purpose corporation by delivering articles of incorporation that conform to existing requirements for all corporations and clearly identify the corporation's intent to become a social purpose corporation. The articles of incorporation must set forth the general social purpose for which the corporation is organized. If the social purpose corporation has designated specific social purposes, the articles of incorporation must include these as well. The articles of incorporation must also contain a provision that states that the mission of the corporation may be contrary to maximizing profits and earnings, or maximizing shareholder value in mergers or other significant transactions.

In addition to the required provisions, a social purpose corporation's articles of incorporation may set forth certain performance requirements for directors and officers. These include the requirements to:

- consider the impacts of any corporate action on the corporation's social purposes; and
- furnish shareholders with an assessment of the overall performance of the corporation with respect to its social purpose, prepared in accordance with a third-party standard.

Other provisions may be added to the articles of incorporation, including those relating to voting conditions, approval requirements, and limiting the duration of the corporation's existence to a specified time period.

An existing corporation may elect to become a social purpose corporation, subject to a two-thirds majority vote of eligible shareholders and any other voting conditions established by the board of directors. To elect to become a social purpose corporation, an electing corporation must amend its articles of incorporation according to the standard for forming a social purpose corporation. The election to become a social purpose corporation does not affect any obligations or liabilities incurred by the electing corporation.

A social purpose corporation may elect to cease being a social purpose corporation, subject to at least a two-thirds majority shareholder vote and any other voting conditions established by the board of directors. The corporation thereafter continues to exist as a traditional corporation. The election to cease to be a social purpose corporation does not affect any obligations or liabilities incurred by the social purpose corporation prior to its election to cease to become a social purpose corporation.

Directors and officers of social purpose corporations must discharge their duties in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and in a manner they believe to be in the best interests of the corporation.

In discharging their duties, directors and officers may consider the social purposes of the corporation. Any action or inaction carried out as a result of such consideration are deemed to be in the best interests of the corporation. No liability attaches to a director or officer who acted in the best interests of the corporation, and directors and officers are not responsible to any party other than the corporation and its shareholders.

Not later than four months after the close of the corporation's fiscal year, the board of directors of a social purpose corporation must produce a social purpose report, furnished to the corporation's shareholders and made publically available on the corporation's website, free of charge. The social purpose report includes a narrative description of the corporation's efforts to promote its social purposes. Failure to produce a report does not affect the validity of any corporate action. If a social purpose report has not been furnished to shareholders for at least two consecutive fiscal years, the superior court in which the social purpose corporation's registered office is located may order a social purpose report to be furnished to shareholders, after notice is given to the corporation.

Proposed amendments to a social purpose corporation's articles of incorporation that would materially change one or more of the corporation's social purposes must be approved by at least a two-thirds majority of eligible shareholders. Similarly, a plan of merger or share exchange whereby a social purpose corporation would not be the surviving corporation, or a sale of a social purpose corporation's assets, must be approved by at least a two-thirds majority. This requirement is mandatory unless the surviving corporation of the plan of merger or share exchange or the acquirer of the social corporation's property is a social purpose corporation whose social purposes are not materially different.

Provisions that establish requirements for notifying shareholders that the corporation is a social purpose corporation, that limit derivative proceedings, and that create dissenter's rights are also included. Language is added to the definitions section of WBCA that defines social purpose corporations and related elements.

Appropriation: None.

Fiscal Note: Not requested.

Committee/Commission/Task Force Created: No.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony: PRO: This bill allows directors to look at things other than the duty to maximize the company's value. It provides flexibility for companies.

The hurdle for a corporation to change to a social purpose corporation is high. The board would have to approve the change, and two-thirds of the shareholders would have to approve. Those who don't want to be involved in a social purpose corporation would have the right to dissent as well as have the fair value of their shares paid to them. This bill helps citizens of the state to engage in good behavior.

Persons Testifying: PRO: Representative Pederson, prime sponsor; Kent Carlson, Kathryn Leathers, WSBA; Drew Markham, Wilson Sonsini Law Firm.