

# HOUSE BILL REPORT

## SHB 2239

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### As Passed Legislature

**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:**

##### **Committee Activity:**

Judiciary: 1/11/12, 1/19/12 [DPS].

##### **Floor Activity:**

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

Passed Senate: 3/2/12, 34-14.

Passed Legislature.

#### **Brief Summary of Substitute Bill**

- Authorizes a new type of corporation in Washington, the social purpose corporation.
- Establishes the procedures for forming and dissolving a social purpose corporation, and for issuing and transferring shares.
- Sets standards of conduct for directors and officers of a social purpose corporation.

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### HOUSE COMMITTEE ON JUDICIARY

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 9 members: Representatives Pedersen, Chair; Goodman, Vice Chair; Eddy, Hansen, Kirby, Nealey, Orwall, Rivers and Roberts.

**Minority Report:** Do not pass. Signed by 2 members: Representatives Shea, Assistant Ranking Minority Member; Klippert.

**Staff:** Oliver Stiefel (786-5793) and Edie Adams (786-7180).

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*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.*

**Background:**

The Washington Business Corporations Act (WBCA) provides requirements for the creation, organization, and operation of corporations and the relationship between the corporation directors, officers, and shareholders. The 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 the 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.

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: (1) the corporation must establish a general public benefit, aimed at yielding material positive societal impacts; (2) corporate directors must consider the corporation's public benefit when making decisions; and (3) 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 and returns for shareholders.

**Summary of Substitute Bill:**

A new type of corporate business model is established under the WBCA, the "social purpose corporation." 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 affect positively certain constituencies. These constituencies must include one or more of: (1) the corporation's employees, suppliers, or customers; (2) the local, state, national, or world community; or (3) the environment. In addition, a social purpose corporation may set forth specific social purposes for which the corporation is organized.

*Formation/Dissolution.*

Any person or persons may form a social purpose corporation by delivering articles of incorporation that not only conform to existing requirements for all corporations, but also identify clearly the corporation's intent to become a social purpose corporation. This is achieved by including the words "social purpose corporation" or the abbreviation "SPC" in the corporation's name and providing a statement that the corporation is organized as a social purpose corporation. The articles of incorporation must also 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.

In addition, the articles of incorporation must 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.

As to the required provisions, a social purpose corporation's articles of incorporation may also set forth certain performance requirements for directors and officers. These include the requirement to consider the impacts of any corporate action on the corporation's social purposes and the requirement to furnish shareholders 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 relating to voting conditions, approval requirements, and limiting the duration of the corporation's existence to a specified date may also be added to the articles of incorporation.

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 to be 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 will thereafter continue 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.

#### *Responsibilities/Standards of Conduct.*

Directors and officers of social purpose corporations must discharge their duties in good faith, with the care 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 will be deemed to be in the best interests of the corporation. No liability will attach 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.

#### *Reporting Requirements.*

Not later than four months after the close of the corporation's fiscal year, the board of directors of a social purpose corporation shall produce a social purpose report, to be furnished to the corporation's shareholders and made publically available on the corporation's

website, free of charge. The social purpose report shall include a narrative description of the efforts of the corporation intended to promote the social purposes of the corporation. The narrative discussion may also include additional information concerning the corporation's social purpose objectives and specific actions taken or to be taken in regard to achievement of the corporation's 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.

*Materially Altering/Eliminating Designated Social Purposes.*

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.

*Additional Elements.*

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

**Appropriation:** None.

**Fiscal Note:** Not requested.

**Effective Date:** The bill takes effect 90 days after adjournment of the session in which the bill is passed.

**Staff Summary of Public Testimony:**

(In support) This bill permits entrepreneurs in Washington to establish social purpose corporations, entities that facilitate the pursuit of profits and social/environmental purposes. Case law has established that the paramount duty of a corporation is to maximize shareholder profits. The bill does not modify the balance of power established under traditional corporate law, but permits shareholders to tell directors that they may or must take into consideration

social or environmental goals when making decisions. Through the market, the public will determine how well a social purpose corporation has accomplished its mission.

This bill represents a balanced approach that is the culmination of a two-year process undertaken by the Corporate Act Revision Committee (CARC) of the Washington State Bar Association. In preparing this bill, the CARC received support from public and privately-held corporations.

This type of statute is in high demand, with seven states having passed similar legislation, and several others who are considering it. One example of a new form of corporation that permits a business to pursue both social mission and profit is the benefit corporation. The benefit corporation model, however, changes well-settled law regarding the duties corporate directors owe to shareholders. In contrast, social purpose corporations do not change the corporate structure.

There are four main objectives of the bill: (1) to address the needs and demands of the sustainable business community; (2) to be consistent with the enabling nature of the WBCA; (3) to not affect the existing corporate community dedicated to charitable giving and community involvement; and (4) to ensure that stakeholders understand the nature of the business in which they are investing.

(Opposed) None.

**Persons Testifying:** John Reed and Michael Hutchins, Washington State Bar Association.

**Persons Signed In To Testify But Not Testifying:** None.