Date of Hearing: June 20, 2011

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Mike Eng, Chair
SB 201 (DeSaulnier) – As Amended: March 14, 2011

SENATE VOTE: 37-1

SUBJECT: Flexible purpose corporations: corporate mergers.

SUMMARY: Establishes the Corporate Flexibility Act of 2011. Specifically, this bill:

1) Creates a new corporate form called a flexible purpose corporation (FPC).

2) Provides that one or more natural persons, partnerships, associations, FPCs, or corporations, domestic or foreign, may form a FPC under the California Corporations Code, by executing and filing articles of incorporation with the Secretary of State (SOS).

3) Enacts conforming changes to the Corporations Code to recognize FPCs.

4) Requires in the articles of incorporation that each FPC list its flexible purposes, which could be any of the following:

   a) One or more charitable or public purpose activities that a nonprofit public benefit corporation is authorized to carry out; or,

   b) Promoting positive short-term or long-term effects of, or minimizing adverse short-term or long-term effects of the FPCs activities on the FPCs employee, suppliers, customers, and creditors, the community and society and/or the environment.

5) Provides that each FPCs articles of incorporation can include the following:

   a) A provision limiting the duration of the FPCs existence to a specified date;

   b) A provision limiting or restricting the business in which the FPC may engage or the powers that the FPC may exercise, or both, provided these restrictions are consistent with the purpose of the FPC; or,

   c) A provision requiring a shareholder approval for any corporate action.

6) Requires that each existing company wishing to become an FPC through conversion or reorganization to take an affirmative vote of at least two-thirds of each of its classes of shareholders, or a higher vote threshold, if required in the articles of incorporation.

7) States that the only type of action involving the formation or dissolution of an FPC that would not require a two-thirds vote would be a merger of one FPC into another FPC with a similar special purpose.

8) Establishes that shareholders of an existing corporation that decided to convert to an FPC would be entitled to dissenter's rights, which are spelled out in existing law.

9) Requires each FPC to prepare an annual report, which must be sent to its shareholders no later than 120 days after the close of the FPCs fiscal year, and at least 15 days prior to the shareholders annual meeting (35 days prior if sent via bulk mail). In addition to a balance sheet, income statement, and a statement of cash flows for that fiscal year, the annual report must also include a management discussion and analysis (MD&A) regarding the FPCs stated purpose or purposes, as set forth in its articles of incorporation, and, to the extent consistent with reasonable confidentiality requirements, must post the MD&A on its web site. Each FPCs MD&A is required to include the following information, at a minimum:

   a) An identification and discussion of the short-and long-term objectives of the FPC that relate to its special purpose(s), and an identification and explanation of any changes made to these special purpose objectives during the fiscal year;

   b) An identification and discussion of material actions taken by the FPC during the fiscal year to achieve its special purpose objectives, the impact of those actions, including the causal relationships between the actions and the reported outcomes, and the extent to which those actions achieved the special purpose objectives for the fiscal year;

   c) An identification of material actions, together with the intended impact of those actions, which the FPC expects to take in the short- and long-term to achieve its special purpose objectives;

   d) A description of the process for selecting, and an identification and description of the financial, operating, and other measures used by the FPC during the fiscal year for evaluating its performance in achieving its special purpose objectives, including an explanation of why the FPC selected those measures and an identification and discussion of the nature and rationale for any material changes in those measures made during the fiscal year; and,

   e) An identification and discussion of any material operating and capital expenditures incurred by the FPC during the fiscal year in furtherance of achieving its special purpose objectives, a good faith estimate of any additional material operating or capital expenditures the FPC expects to incur over the next three fiscal years in order to achieve its special purpose objectives, and other material expenditures of resources incurred by the FPC during the fiscal year, including employee time, in furtherance of achieving its special purpose objectives, including a discussion of the extent to which that capital or use of other resources served purposes other than, and in addition to, furthering the achievement of the special purpose objectives.

10) In addition to the annual report described above, each FPC would have to prepare and distribute a special purpose current report to its shareholders within 45 days of an expenditure, which was made in furtherance of its special purpose objectives, and which had or is believed likely to have a material adverse impact on the FPCs results of operations or financial condition for a quarterly or annual fiscal period. This special purpose current report would have to identify the expenditure or group of related or planned expenditures, which had or was likely to have a material adverse impact on the FPCs financial condition.

EXISTING LAW

1) Provides for the formation and regulation of corporations. (Corporation Code, Section 100 et seq.)

2) Provides for the formation and regulation of non-profit entities. (Corporation Code, Section 5000 et seq.)

3) Provides a standard of care that a director must use in discharging his or her duties. A director's duties must be performed in good faith, in a manner the director believes to be in the best interests of the corporation and the shareholders, and with the care, including reasonable inquiry that "an ordinary prudent person in a like position would use under similar circumstances." (Corporations Code, Sections. 309(a) and 5231.)

FISCAL EFFECT: Unknown

COMMENTS:

Should AB 201 become enacted, California would be the first state to establish "flexible purpose corporations." At least 4 other states have established "benefit corporations" and a number of other states are looking into creating benefit corporations. Maryland, Vermont, Virginia and New Jersey have adopted benefit corporations. Hawaii, Michigan, New York, North Carolina, Pennsylvania and Virginia have introduced legislation to create benefit corporations.

This measure stems from the California Working Group for New Corporate Forms (ten attorneys) that has been looking into creating a FPC since 2008. The goal of the working group was to design a new division in the Corporations Code to facilitate the organization of companies in California with greater flexibility for combining profitability with broader social or environmental purpose.

FPC

A FPC would encourage and expressly permit companies to be formed or converted from other forms to pursue one or more purposes in addition to creating economic value for shareholders.
FPCs would be required to set forth their special purpose in their articles of incorporation. That special purpose mission would be anchored, unless and until two thirds of each class of voting shares decided otherwise (or a greater threshold, if so specified in the articles of incorporation). The directors of a FPC would be protected from decision-making involving trade-offs between profitability and the special purpose(s). Any merger or reorganization materially altering or eliminating an existing FPCs special purpose, and any decision by any other business entity to become a FPC would require the same supermajority vote. Each FPC would be required to provide annual reports on its impact toward achieving its special purpose(s), and an estimate of future anticipated expenditures. Shareholders of a FPC who object to an action requiring a shareholder vote in connection with a conversion, reorganization, or merger would have dissenter's rights, which would allow them to cash out their shares in the FPC. Dissenters' rights would not be available for shareholders who object to a material change in a FPCs special purpose.

In contrast, a traditional corporation must be mindful of shareholder interests in the profits of the corporation. In a traditional corporation directors are required to utilize good faith in taking actions for the best interests of the corporation and the shareholders. A main goal is to maximize shareholder value. Directors are liable to shareholders in cases where shareholders disagree with not-for-profit activities. AB 201 has the intention to make it easier for corporations to adopt and implement meaningful strategies by allowing directors the flexibility to pursue social and environmental purposes in addition to profitability.

How does a FPC differ from a benefit corporation (B-Corp)? A B-Corp allows corporations to engage in activities that benefit non-profit interests. According to the Working Group the main differences include:

a) B-Corp lives under a legislative prescribed standard that requires a material positive impact on society and the environment, taken as a whole, as compared FPCs that must include one or more special purposes in their articles;

b) B-Corp requires that the benefit being achieved be measured in accordance with the third-party standard, whereas, FPCs are provided added protection in they apply "best practices";

c) In determining what is in the best interests of the corporation, the directors of a B-Corp must consider the impacts of any action or proposed action upon various constituents or stakeholders of the corporation, whereas, the directors of a FPC must consider the impacts of any action of any special purpose;

d) B-Corp legislation requires the appointment of a Benefit Director and Benefit Officer who must certify compliance with the public benefit, whereas the FPC legislation does not; and,

e) B-Corp legislation creates a new right of action for enforcement of benefit, whereas, the FPC legislation relies on the transparency of requirements and seeks to provide the fullest measure of protection to directors in order to permit innovation and an unfettered application of their business judgment in making any necessary trade-offs between special purpose and maximizing shareholder value without fear of litigation.

In addition to the B-Corp, another alternative is the L3C or low profit limited liability company. This alternative exists in 5 other states: Illinois, Michigan, Utah, Vermont, and Wyoming. It is a statutory type of limited liability companies (LLC) that permits LLCs to be organized both for income and wealth accumulation and for socially beneficial purposes. This form would be utilized by a for-profit company with a charitable purpose wishing to attract program related investments by foundations. The charitable purpose of the company would be the primary purpose with making a profit the secondary purpose.

EXAMPLE

According to an article titled, "Protecting your Mission: Legal tools to keep your Company on the Righteous Path," Ben Cohen and Jerry Greenfield founded Ben and Jerry's Ice Cream in 1978. The mission of Ben and Jerry's was to create top quality ice cream and give back to the community. They donated 7.5% of pretax profits to charity and partnered with nonprofits to open shops in inner city neighborhoods to employ low-income residents. The company's feel good image attracted the interest of multinational corporations. In 2000, Unilever made a buyout offer to the company's shareholders. Even though Ben and Jerry did not want to sell out, they had little choice. The board could not risk accepting a lower competing offer without exposing itself to litigation from shareholders asserting their right to the highest possible return at the expense of other considerationsa right upheld by many courts. Since the takeover, the donations and inner-city shops have gone by the wayside.

ARUGMENTS IN SUPPORT

According to the California Legal Working Group for New Corporate Forms, AB 201 allows FPCs to integrate the for-profit orientation of the traditional corporation, with its statutory certainty and standardization, with a special purpose mission, by encouraging and expressly permitting companies formed or converted to pursue one or more purposes in addition to creating economic value for shareholders. AB 201 creates an important avenue for entrepreneurs, corporate boards and investors to meld profitably with a broader social or environmental purpose without the traditional obstacles.

According to the State Bar of California, Business Law Section, Corporations Committee, they perceive a demand among investors and companies for a more flexible corporate regime and broad political support in California for changing the Corporations Code to permit Corporations and their boards of directors to consider interests other than shareholder returns.

ARGUMENTS IN OPPOSITION

The California Association of Nonprofits believes the measure needs a more public vetting. SB 201 presents historic and difficult choices that will affect the type, scope and integrity of social, educational, cultural, and environmental services delivered to the people of California for decades to come. There is significant risk involved that needs to be more closely examined, including opportunity for abuse and detrimental impacts of qualify of life-saving resources, such as the bloody supply.

The California Society of Association Executives opposes the bill one two grounds: more time is needed to examine the potential impacts of the measure on the non-profit community, and the scope and impact of the bill is tremendous but unclear.

RELATED LEGISLATION

AB 361 (Huffman, 2011 Legislative Session) would authorize and regulate a new corporate entity called the Benefit Corporation, which would allow corporations to form in ways similar to this bill.

PRIOR LEGISLATION

SB 1463 (Desaulnier, 2010 Legislative Session) would have created FPCs in order to authorize corporations to participate in designated for-profit and not-for-profit activities. (Senate Judiciary Committee)

AB 2944 (Leno, 2008 Legislative Session) would have allowed a corporate director, when making business decisions on behalf of the corporations, to consider several factors, such as the long and short term interest of the corporation and shareholder, the corporation's employee, suppliers, customers, and creditors, community and societal consideration, and the environment. (Vetoed by Governor)

QUESTIONS TO CONSIDER

This measure is similar to AB 361 (Huffman). Both bills take two different approaches, would it benefit the state to determine, possibility through an oversight hearing, which approach would better serve California corporations and non-profits?

Could this measure not only encourage corporations to stay in California but also persuade new corporations to come to California?

REGISTERED SUPPORT / OPPOSITION:

Support

Benetech
Brightpath
California Legal Working Group for New Corporate Forms
Corporations Committee State Bar of California
GreenBiz
GreenOrder
iVeridis Corporation
Lawyers' Committee for Civil Rights of the San Francisco Bay
Leapfrog Network
Omidyar Network
OneSun
Pacific Community Ventures
Revolution Foods
Sierra Business Council
Social Profit Network
Source Trace Systems, Inc.
SPNCO, Inc.
The Troy and Alana Pack Foundation

Nonprofit & Unincorporated Organizations Committee State Bar of California **(support if amended)**

Opposition

Blood Centers of California
California Association of Nonprofits (CAN)
California Church IMPACT
California Society of Association Executives (CalSAE)

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