Benefit Corporations & Employee Ownership—A Legal and Ownership Structure for the Future

By Michael McGinley

During the past few years, it has become almost impossible to read anything about corporate America or public investing without hearing about a company or investment fund's Environmental, Social and Corporate Governance ("ESG") factors. ESG factors are those that allow investors and consumers to better understand how a company "behaves." At its core, this new focus on company behavior prioritizes long-term growth that is both sustainable and socially and environmentally responsible. These factors are gaining in importance in the boardroom and on Wall Street as well as with employees and Main Street consumers. According to Morningstar, over half of the new money invested in mutual funds in Europe during 2021 went to "sustainable" focused funds. The United States appears to be experiencing similar trends, which means that any company that wants to be relevant going forward should be evaluating its ESG factors.

Notably, there is a way that a company can maximize its sustainability, profitability and socially conscious structure simultaneously: adopt the legal status of a Benefit Corporation and become employee-owned, either in whole or in part. A Benefit Corporation that is employee-owned offers one of the most powerful corporate governance and ownership structures available to businesses in America today. Indeed, this corporate governance and ownership structure might be the best available method to allow a company to optimize its ESG goals; harmonize the relationship between companies and their employees, customers and stakeholders; and meet the rising demand from consumers and market participants for good corporate "behavior" in today's marketplace.

Benefit Corporation vs. B Corps

Many people confuse the terms Benefit Corporation and B Corp, and while the two concepts are related, they do have some differences. A Benefit Corporation is a legal status of incorporation—much like an LLC or C Corporation—available only in states that have passed Benefit Corporation legislation. In a Benefit Corporation, the Board of Directors has legal protection to pursue objectives other than solely maximizing profits. These goals could include having a positive impact on the environment as well as benefiting the company's employees and customers and the community at large. One of the major drawbacks of an ordinary corporation is that, under current law, Board members can be found personally liable to shareholders for failing to maximize shareholder value, which has increasingly led most Boards to focus on short-term profits and stock price growth over long-term sustainability, environmental impact or social good. In contrast, a Benefit Corporation provides legal protection to Board members who balance profit and purpose, which is no small shift in focus compared to corporate law governing the actions of non-Benefit Corporation Board members.

According to legal networking platform UpCounsel, more than 40 states have proposed or passed legislation regarding Benefit Corporations. If a company would like to incorporate as a Benefit Corporation, they must pay a state filing fee, which ranges between $70 and $200. In addition, each year, a Benefit Corporation must prepare a formal report which accounts for the impacts the business is making on the environment and social issues. Companies may incorporate as Benefit Corporations whether they are newly formed or existing. If an existing company would like to become a Benefit Corporation, they must amend their governing documents; the amendment typically requires a two-thirds supermajority vote of all shareholders.

The Benefit Corporation concept has been gaining in popularity in recent years. For instance, according to Professor Christopher Marquis of the Cornell University SC Johnson College of Business, the period from July 2020 to June 2021 could be referred to as the "year of the Benefit Corporation in the public markets," since many companies such as Coursera, Lemonade and Veeva Systems either converted or incorporated to become Benefit Corporations during the period. (In addition to the aforementioned firms, publicly-traded companies that are also Benefit Corporations include Amalgamated Financial Co., AppHarvest, Broadway Financial Co., Laureate, Sustainable Development Acquisition I, Vital Farms and Zymergen Inc.).

In comparison to Benefit Corporations, companies that are designated as B Corps have been certified as such through B Lab, a non-profit organization. B Lab administers the B Impact Assessment ("BIA"), which is the only certification that measures a company's impact on its workers, customers, community and environment. The BIA is free of charge, conducted entirely online and takes approximately one to three hours to complete, depending on the size of the company. In order to earn the certification, companies must score a minimum of 80.0 (out of a possible 200.0) on the BIA. B Lab notes, "Any score higher than 0 points is a good score, as a positive score indicates that the company is doing something positive for society and the environment." The majority of companies receive between 40.0 and 100.0 points out of the maximum 200.0 points. B Lab notes that the BIA has been utilized by more than 50,000 businesses since its inception.

According to B Lab, the certification process is "currently experiencing overwhelming interest." The review process for B Corp certification takes B Lab between six and 10 months to complete. Notably, only one in three companies that submit for certification qualify.

B Lab notes that, once certified, a B Corp is required to post their B Impact Report on bcorporation.net and must "amend their legal governing documents to require their board of directors to balance profit and purpose." In addition, the company's status must be recertified every three years. B Lab certification fees are based on revenue and can range between $1,000 and $50,000 per year, though companies with more than $1.0 billion in revenue are subject to a different fee schedule.

Currently, there are more than 4,000 Certified B Corps in over 70 countries and more than 150 different industries. Unlike Benefit Corporations, which are subject to state laws, a B Corp can be any company in the world, as long as they achieve the minimum score of 80.0 on the BIA. Companies seeking certification should be for-profit and have been in operation for at least one year. Further, while Benefit Corporations may be certified as B Corps, they are not required to do so.

Overall, Benefit Corporations and Certified B Corps share a focus on accountability and transparency.

They both also balance mission and purpose with profit. Moreover, the boards of directors in both Benefit Corporations and B Corps must consider the company's impact on all stakeholders and are also required to publish an annual public report regarding the company's environmental and social performance. However, only Benefit Corporations provide legal protection to the Board since it changes the laws by which the company's duties to shareholders are governed. Meanwhile, B Corp certification does not provide any legal protection since it is a certification that is not governed by state business laws.

To that end, B Lab notes, "The best way for corporations to meet the legal requirement for B Corp Certification is to use the Benefit Corporation legal structure." Indeed, a number of companies have used the Benefit Corporation structure to meet their legal requirement for B Corp certification, including King Arthur Flour, Kickstarter, Greyston Bakery, Sun Light & Power, Farmigo and Klean Kanteen. Notably, in some states—such as Delaware—the Benefit Corporation structure is the only way to meet the B Corp certification's legal requirements.

Employee Stock Ownership Plans ("ESOPs")

An ESOP is an employee benefit plan that governs a trust which is established to own some or all of the stock of a corporation for the benefit of the sponsor company's employees. Workers who meet eligibility requirements (such as being 18 years old and working over 1,000 hours per year) can be eligible for beneficial ownership of the stock of the sponsor corporation. According to the National Center for Employee Ownership ("NCEO"), "[T]here are roughly 6,500 employee stock ownership plans (ESOPs) covering almost 14 million participants." Notably, a Washington State study found that "ESOP participants made 5% to 12% more in wages and had almost three times the retirement assets as did workers in comparable non-ESOP companies."

Benefit Corporations and ESOPs

Benefit Corporations and employee-owned companies have a variety of commonalities—including the fact that both share a demonstrable level of commitment to their employees, which drives social good. As a result, both types of companies attract and retain talent at a high rate. According to the Deloitte Global 2022 Gen Z & Millennial Survey, approximately 40.0% of respondents have refused a role or assignment that was not consistent with their personal values. In addition, the study found that respondents are more likely to remain employed at a company long-term if they are satisfied with the company's ESG impact. Companies that are Benefit Corporations, have ESOPs or both are more likely to succeed in an uncertain labor market due to their focus on purpose and mission as well as the boost they receive in performance and employee recruiting and retention.

Moreover, many ESOP companies are becoming Benefit Corporations and vice versa. Since 100.0% ESOP-owned S corporations are almost completely exempt from paying income taxes, companies that are both Benefit Corporations and 100.0% employee-owned S-corporations tend to have significantly enhanced free cash flow to commit to their environmental and social objectives while still generating significant after-tax profits relative to their peers.

The NCEO points out that Benefit Corporations—just like other types of companies—do not inherently have a built-in structure for ownership transition. Additionally, Benefit Corporations are in a unique position in that they typically want to protect their mission long-term. If Benefit Corporations are also employee-owned, the company can rest easy knowing that their mission lies in the hands of the employee-owners.

The NCEO indicates that several companies are Benefit Corporations and employee-owned through an ESOP, including Global Prairie PBC, Inc. ("Global Prairie"); Schuber Mitchell Homes PBC, Inc.; Southern Bancorp; Dansko; EA Engineering, Science and Technology; Eileen Fisher; Gardener's Supply Company; and King Arthur Flour. In an interview with *Forbes*, Anne St. Peter, founder of Global Prairie, notes, "Building a culture with purpose at our core is part of our strategy…having a broad base of stakeholders versus shareholders, people are seeking us out as pioneers in this space, and it's nice to see that trend."

Notably, Global Prairie is also a certified B Corp, and the firm recently scored 168.4 on their BIA re-certification, the fourth-highest score for B Corps globally. This is no surprise since, according to a recent report from Fifty by Fifty in conjunction with data from B Lab, "mission-led employee-owned" firms outperform B Corps that are not employee-owned. When comparing employee-owned B Corps to non-employee-owned B Corps as well as ordinary companies, the employee-owned B Corps outperformed the other two types of firms on the average BIA score, the average worker score and the average environment score. For the overall BIA score, employee-owned B Corps averaged 112.8, while non-employee-owned B Corps averaged 93.4 and ordinary businesses averaged 55.0. Moreover, the average worker score for employee-owned B Corps was significantly higher on a relative basis (43.3) when compared to those of non-employee-owned B Corps (21.9) and ordinary companies (18.0).

Conclusion

An ESOP-owned Benefit Corporation offers one of the most powerful corporate governance and ownership structures available to businesses in the U.S. today. Companies that balance profit and purpose and prioritize long-term growth that is more sustainable and socially and environmentally responsible benefit in myriad ways. Consumers tend to prefer companies with strong ESG initiatives. Similarly, these firms are able to recruit and retain employees with greater ease and, in my experience, tend to financially outperform their peer companies. Overall, the ESOP-owned Benefit Corporation legal and ownership structure is a sustainable model that enables firms to serve their communities well into the future.

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