

# WASHINGTON BUSINESS ENTITIES: Law and Forms Second Edition

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## VOLUME 1

*Stewart M. Landefeld*

*Eric A. DeJong*

*Filed Through:*

RELEASE NO. 9, OCTOBER 2013

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Washington Business Entities: Law and Forms, Second Edition  
Library of Congress Control Number: 2005930307  
ISBN: 978-0-327-16398-5 (looseleaf)  
ISBN: 978-0-352-71683-5 (eBook)

Cite this publication as:

STEWART M. LANDEFELD & ERIC A. DEJONG, WASHINGTON BUSINESS ENTITIES, [Vol, Ch., Sec.]  
(Matthew Bender & Co, 2013)

Example:

STEWART M. LANDEFELD & ERIC A. DEJONG, WASHINGTON BUSINESS ENTITIES, Vol 1, §21.02[a]  
(Matthew Bender & Co, 2013)

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MATTHEW  BENDER

# *DEDICATION*

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*This book is dedicated to Margaret Breen and Kimberlee DeJong.*



## *About the Authors*

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Stewart M. Landefeld is a partner practicing corporate finance law at Perkins Coie LLP in Seattle. He served as interim Chief Legal Officer, interim Chief Compliance Officer, and during its Chapter 11 filing, as Executive Vice President and General Counsel of Washington Mutual, Inc. His practice focuses on corporate governance, advice to boards of directors, private equity, mergers and acquisitions, public offerings and other aspects of securities and corporate finance law. Mr. Landefeld, a member of the Washington State Bar Association's Corporation, Business and Banking Law Section, is counsel to both public and privately held corporations doing business in the Pacific Northwest. He is a lecturer and author of papers and articles on corporate governance and securities law topics. He received his J.D. from the University of Chicago.

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# Acknowledgments

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Volume 1 of *Washington Business Entities: Law and Forms, Second Edition* reflects over two decades of efforts by many colleagues and friends in drafting both this publication and its predecessor, *Washington Corporate Law: Corporations and LLCs*, originally published in 1992. We wish to thank all who assisted in the preparation of this volume and the predecessor treatise, including those who were involved in the annual updating of the predecessor treatise over those years.

First, thanks for the substantive contributions and valuable insights of our colleagues, former colleagues and friends—Scott Edwards, Mike Young, Bob Mahon, Al Smith, Rich Peterson, Ellen Torvik, Dori Brewer, Frank Feeman of Pricewaterhouse Coopers, Dave Taylor, Angie Martinez, Jennifer Bell, Bruce Cross, Laura Solis, Ben Eisman, John Kaplan, Mel Wheaton and Neal Hudders. The predecessor treatise could not have been possible without the prior named co-authors of that treatise, including Steve Graham, Barry Kaplan and Steve Yentzer, as well as the contributions of Andrew Bor, Sue Morgan, Evelyn Sroufe, Ron Berenstein, Joe Bringman, Scott Gelband, Catherine K. Gelband, Karen K. Narasaki, Alexandra Brookshire, Mark Munson, Susan Barley, Michael E. Stansbury, Gregory Gorder, Kurt Becker, Mark Schneider and Laura Macpherson.

This volume and the predecessor treatise reflect years of updating projects in an effort to stay abreast of case law, statutory and regulatory developments. Those updating projects progressed only with huge assists from numerous associates and colleagues. We would like to thank Katherine VanYe for the 2013 update. Over the prior two decades, we have also received invaluable assistance from Katherine VanYe, Andrew Goodrich, Martha Sandoval, Christopher Warner, Willie White, Gaurab Bansal, Martin Le, Kris Yoshizawa, Steve Glasgow, Susan Naficy, Andrew Greene, Alvaro Alvarez, Sarah Massey, Yung Tan, Ryan Arai, Angela Cheung, Michael Marron, Sarah Dods, Linda Colwell, Michael Hatch, Bryce Jensen, Yoko Miyashita, Marc Porter, Sam Rosenthal, Tina Santos, Rick Hansen, Chris DeMayo, Tom Loser, Tom Newell, Maki Arakawa, Alan Smith, Rudy Gadre, Douglas Choi and Isamu Watson. We cannot thank them enough for their helpful scholarship and many contributions.

The authors also wish to express their gratitude to others who contributed in a variety of other ways, including Martha Vallely and her colleagues among the Perkins Coie Editors, Carolyn Crosley, Naomi Skudler and Susan Dean for assistance on forms in the predecessor treatise, and to Gavin Cullen, who oversaw the compilation of the 2003 update to the predecessor treatise.

We also would like to pay homage to Professor Richard O. Kummert, who passed away in 2012. Professor Kummert taught for many years at the University of Washington School of Law and was an active member of the Corporate Act Revision Committee. He was well-recognized for his expertise in Washington corporate law. We were fortunate to have the opportunity over the years to draw upon his expertise and are honored by his generous assistance.





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- § 23.01      **Background**
  - [a]    **Social Entrepreneurship and the Need for a “Hybrid” Corporate Model**

State corporate statutes have historically divided the corporate world into two basic forms—the traditional business corporation, organized to generate profits and create shareholder wealth, and the non-profit corporation, organized to carry out charitable, educational, environmental, civic, or other not-for-profit activities. There is a long history of for-profit corporations devoting monetary and other resources to the promotion of charitable, environmental and other “social” purposes, as well as

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incorporating into their strategies and decision-making processes consideration of the impact their activities may have on their employees, their communities, the environment or other constituencies. However, uncertainty exists about how far the traditional for-profit corporate form can be stretched to incorporate social, environmental, or similar goals and activities.

It is often said that directors of for-profit corporations have a “duty to maximize shareholder wealth.” These specific words are nowhere to be found in state corporate statutes and, in general, represent an oversimplification of how courts have articulated the fiduciary duties of directors of for-profit corporations.<sup>1</sup> Statutory standards of conduct (such as Section 23B.08.300 of the Business Corporation Act) and court decisions that require directors to act in the “best interests of the corporation” do not mean that directors are compelled to make every decision with a view to the immediate maximization of corporate profits and shareholder wealth. Outside the context of a sale of control, where Delaware courts have indeed charged directors with a duty to obtain the best price reasonably available to shareholders<sup>2</sup> (and, it is assumed, courts in other jurisdictions would follow suit), it is quite clear that directors have considerable latitude in deciding what is in the best interests of the corporation (and by implication, its shareholders), provided their decisions are made in a well-informed and deliberative manner and are not tainted by conflicts of interest.

Nonetheless, some socially-conscious entrepreneurs, directors and their legal advisors have fretted over the extent to which they can promote social, environmental, charitable, or similar causes or give priority to the interests of constituencies other than shareholders in setting strategy, carrying out business activities and making decisions that affect the business and its owners.<sup>3</sup> In an archetypal example that has taken on legendary status in the minds of socially-conscious entrepreneurs everywhere, the board of directors of Ben & Jerry’s Homemade, Inc. purportedly approved the 2000 sale of the Vermont ice cream maker to Unilever out of concern that their hands were tied by the law that applies to for-profit corporations. Their *Revlon* duties, so it was said, compelled them to accept Unilever’s offer even though the founders and many observers were distraught that Unilever’s ownership would ultimately result in the abandonment of the socially-conscious ethos that drove the company.<sup>4</sup> This example has reinforced in the minds of many socially-conscious entrepreneurs that the traditional for-profit corporation is a less than desirable vehicle for carrying out both

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<sup>1</sup> Cf. *Dodge v. Ford Motor Co.*, 204 Mich. 459, 170 N.W. 668 (1919), in which the Michigan Supreme Court stated that “a business corporation is organized and carried on primarily for the profit of the stockholders.”

<sup>2</sup> See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1985).

<sup>3</sup> Some states have addressed this concern by adopting constituency statutes that explicitly permit directors to consider the interests of non-shareholders (such as employees) in making decisions. Although over 30 states have adopted constituency statutes of one form or another, Washington has not.

<sup>4</sup> The Ben & Jerry’s saga is often cited as Exhibit 1 for the argument in favor of the hybrid corporate model. For a somewhat different perspective, see Anthony Page & Robert A. Katz, *The Truth About Ben & Jerry’s*, STAN. SOC. INNOVATION REV., Fall 2012, available at [http://www.ssireview.org/articles/entry/the\\_truth\\_about\\_ben\\_and\\_jerrys](http://www.ssireview.org/articles/entry/the_truth_about_ben_and_jerrys).

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profit-making activities and a social or environmental mission.

On the other hand, the non-profit corporation is not a workable model for blending profit-making motives with social, charitable, educational, environmental, or similar objectives. Federal tax law, and to some extent state non-profit corporation laws, restrict the ability of non-profit (or not-for-profit) corporations organized for charitable, religious, eleemosynary, benevolent, educational, or similar purposes to distribute income or assets to their members (the analog to shareholders in the non-profit world) or engage in profit-making activities.

For these reasons, in recent years a growing segment of the entrepreneurial community—referred to in some quarters as “social entrepreneurs”—and organizations that support them have called for a new “hybrid” model, one that allows them to pursue profit-making activities and the creation of shareholder wealth while incorporating a social or environmental mission into the “corporate DNA” of their businesses.

**[b] Enter the Social Purpose Corporation**

Washington joined several other states that have authorized a hybrid corporate form designed to address the needs of social entrepreneurs when, in 2012, the Washington Legislature approved Substitute House Bill 2239 (“SHB 2239”). SHB 2239, which added a new chapter to the Business Corporation Act (codified at Chapter 23B.25), authorized a new form of business corporation—the “social purpose corporation.” According to the commentary of the Corporate Act Revision Committee of the Washington State Bar Association that accompanied the bill, the social purpose corporation is a new type of corporation that is “designed to facilitate the organization of companies in Washington with greater flexibility for combining profitability with a broader social or environmental purpose.” Each social purpose corporation must be organized to carry out a general social purpose—to promote positive effects on, or minimize adverse effects of the corporation’s activities on, the corporation’s employees, suppliers, or customers, the community or the environment.<sup>5</sup> Aside from this general prescription, however, Chapter 25 provides organizers of social purpose corporations and their directors considerable flexibility, in contrast to the hybrid corporation statutes adopted in some other states. For example, directors of social purpose corporations may consider and give such weight to the corporation’s general and specific social purposes as he or she deems relevant, unless the corporation’s articles of incorporation require otherwise.<sup>6</sup> In addition, while social purpose corporations are required to provide shareholders an annual report on the corporation’s social purpose and its performance during the course of the year, its evaluation is not required to be done by reference to any third party standard. As with other parts of the Business Corporation Act, Chapter 23B.25 takes a permissive, rather than prescriptive, approach.

Chapter 23B.25 of the Business Corporation Act permits corporations to be formed to pursue one or more social purposes in addition to the pursuit of profits and

<sup>5</sup> Wash. Rev. Code § 23B.25.020.

<sup>6</sup> Wash. Rev. Code § 23B.25.060.

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shareholder wealth. A social purpose corporation may carry on any lawful business or activity for which a traditional business corporation may be organized and, except as otherwise expressly provided in Chapter 23B.25, has all the powers, rights and obligations as any traditional business corporation organized under the Business Corporation Act.<sup>7</sup>

**[c] Other Models for “Hybrid” Business Entities**

Several states have recently enacted statutes that authorize new hybrid business models, including the “benefit corporation,” the “flexible benefit corporation,” and the “low profit limited liability company.” The benefit corporation model, which has been adopted by a number of states including California, Hawaii, Maryland, New Jersey, and New York, is based on a model statute developed by a group of corporate lawyers.<sup>8</sup> A benefit corporation is organized to pursue profit-making activities, but must have a corporate purpose to create a material positive impact on society or the environment.<sup>9</sup> Directors of benefit corporations have a duty to consider the effects of corporate action or inaction on not only shareholders, but also employees of the corporation and its suppliers, customers, and the community or society.<sup>10</sup> In addition, a benefit corporation is required to deliver to its shareholders and post on its website an annual benefit report, a report on its overall social and environmental performance “as assessed against a comprehensive, credible, independent and transparent third-party standard.”<sup>11</sup>

The benefit corporation model is championed by B Labs, a nonprofit organization that, for a fee, will certify socially or environmentally conscious business organizations as “B Corporations,” a sort of “seal of approval” that is only granted to businesses that pass muster under B Labs’ certification standards. Although B Corporation certification is theoretically available to businesses organized under various hybrid corporate statutes, B Labs has shown a distinct preference for the benefit corporation model. B Labs’ standards may be used by a benefit corporation to perform the mandatory annual assessment of its social and environmental performance, although benefit corporations may use other third party standards so long as they meet the requirements of the benefit corporation statute.<sup>12</sup>

Although California has adopted a benefit corporation statute, it also authorized “flexible benefit corporations” with the passage of the Corporate Flexibility Act of

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<sup>7</sup> Wash. Rev. Code § 23B.25.010.

<sup>8</sup> See William H. Clark, Jr. and Larry Vranka (Principal Authors), “The Need and Rationale for the Benefit Corporation—Why It is the Legal Form that Best Addresses the Needs of Social Entrepreneurs, Investors and, Ultimately, the Public” (“Benefit Corporation White Paper”), available at <http://benefitcorp.net/for-attorneys/benefit-corp-white-paper>, at 15. The Benefit Corporation White Paper includes the Model Benefit Corporation Legislation.

<sup>9</sup> Benefit Corporation White Paper, at 15.

<sup>10</sup> Benefit Corporation White Paper, at 15.

<sup>11</sup> Benefit Corporation White Paper, at 15.

<sup>12</sup> Benefit Corporation White Paper, at 24.

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2011. Washington’s social purpose corporation model is similar to the California flexible purpose corporation model. A flexible purpose corporation, or FPC, must be formed to carry out one or more charitable or public purposes or to promote the positive effects of, or minimize the adverse effects of, the corporation’s activities on employees, suppliers, customers, creditors, the community, society, or the environment.<sup>13</sup> Directors of an FPC may consider these purposes, along with the short-term and long-term prospects of the FPC and the best interests of its shareholders, in discharging their duties, and will be protected from liability for breach of fiduciary duty if they do so.<sup>14</sup> Similar to a benefit corporation, an FPC must provide an annual report that includes “special purpose management’s discussion and analysis,” a discussion of the corporation’s purposes and its activities and expenditures in furtherance of those purposes.<sup>15</sup> However, an FPC is not obligated to assess its performance against a third party standard.

A third hybrid model is the “low profit limited liability company,” or L3C, which has been enacted in a number of states including Illinois, Louisiana, Maine, Michigan, and Vermont. The L3C is a type of limited liability company, or LLC. Like the traditional LLC model, the L3C provides owners and managers liability protection and significant flexibility in structuring the governance of the organization. Unlike LLCs and even the other hybrid models described above, the L3C model requires that the social mission of the organization take precedence over its profit-making objectives.

**§ 23.02 Creating a Social Purpose Corporation**

Chapter 23B.25 of the Business Corporation Act contemplates two ways to create a social purpose corporation—incorporating a new business corporation governed by Chapter 23B.25 or converting an existing corporation that is not a social purpose corporation to a social purpose corporation.

**[a] Newly Incorporated Social Purpose Corporations**

Any person (or group of persons) may incorporate a new social purpose corporation by filing with the Washington Secretary of State articles of incorporation that conform to the requirements of Chapter 23B.25 of the Business Corporation Act.<sup>16</sup>

**[b] Converting an Existing Corporation to a Social Purpose Corporation**

Any existing corporation (an “electing corporation”) may elect to become a social purpose corporation by following the requirements set forth in Section 23B.25.130 of the Business Corporation Act.<sup>17</sup> An election does not affect any obligations or liabilities of the electing corporation incurred prior to the election or the personal

<sup>13</sup> Cal. Corp. Code § 2602.

<sup>14</sup> Cal. Corp. Code § 2700.

<sup>15</sup> Cal. Corp. Code § 3500.

<sup>16</sup> Wash. Rev. Code § 23B.25.005(1)(a). See Subchapter 23.04, *infra*.

<sup>17</sup> Wash. Rev. Code § 23B.25.005(1)(b).

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liability of any person incurred before the election.<sup>18</sup> An election is effected by amending the electing corporation's articles of incorporation to include the matters required to be set forth in a social purpose corporation's articles of incorporation.<sup>19</sup> The election to become a social purpose corporation is subject to the following conditions:

- each share of the same class or series of capital stock of the electing corporation must be treated equally with respect to any securities, cash or other property to be received by, or any obligations or restrictions to be imposed on, the holder of that share;
- the electing corporation's board of directors must recommend the election to the shareholders, unless due to conflict of interest or other special circumstances the board determines that it should make no recommendation and communicates that to shareholders; and
- the election must be approved by two-thirds of all shares entitled to vote on the election, voting together, two-thirds of the shares of each class or series voting separately, and two-thirds of each other voting group entitled under the electing corporation's articles of incorporation to vote separately on the election.<sup>20</sup>

In addition, the board of directors of an electing corporation may condition its submission of the proposed election on any basis, including a higher vote than that otherwise required or a vote held by a different voting group than is otherwise entitled to separate voting rights.<sup>21</sup> The board of directors may abandon a planned election after shareholder approval (subject to any contractual rights), without further shareholder approval.<sup>22</sup>

An election to become a social purpose corporation is effective when the required amendment to the articles of incorporation is filed with the Washington Secretary of State, or a later effective date or time set forth in the articles of amendment.<sup>23</sup> The electing corporation becomes a social purpose corporation once the election is effective but its existence is deemed to have commenced when the electing corporation was originally incorporated.<sup>24</sup>

**§ 23.03 Social Purposes—General and Specific**

Every social purpose corporation governed by Chapter 23B.25 of the Business Corporation Act must be organized to carry out a general social purpose and may have

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<sup>18</sup> Wash. Rev. Code § 23B.25.130(7).

<sup>19</sup> Wash. Rev. Code § 23B.25.130(3). *See* Subchapter 23.04, *infra*.

<sup>20</sup> Wash. Rev. Code § 23B.25.130(1).

<sup>21</sup> Wash. Rev. Code § 23B.25.130(2).

<sup>22</sup> Wash. Rev. Code § 23B.25.130(4).

<sup>23</sup> Wash. Rev. Code § 23B.25.130(5).

<sup>24</sup> Wash. Rev. Code § 23B.25.130(6).



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one or more specific social purposes.<sup>25</sup> A general social purpose, which must be set forth in the social purpose corporation's articles of incorporation,<sup>26</sup> means promoting the positive short-term or long-term effects of the corporation's activities, or minimizing such effects, on any or all of the following:

- the corporation's employees, suppliers, or customers;
- the local, state, national, or world community; or
- the environment.<sup>27</sup>

According to the Corporate Act Revision Committee commentary accompanying SHB 2239, the general social purpose is meant to "create a directional performance requirement . . . without creating unnecessarily prescriptive requirements" and is not on its own intended to limit in any way the general purposes or activities that corporations organized under the Business Corporation Act are entitled to engage in under Section 23B.03.010(1).

In addition to a general social purpose that meets the requirements of Section 23B.25.020, a social purpose corporation may (but is not required to) have one or more specific social purposes.<sup>28</sup> As with the general social purpose, any specific social purpose must be set forth in the social purpose corporation's articles of incorporation.<sup>29</sup> A social purpose corporation has significant flexibility in defining its specific social purposes, although any specific social purpose should be consistent with the corporation's general social purpose. For example, a social purpose corporation with the general social purpose of promoting the positive short-term or long-term effects of its activities on the environment may include a specific social purpose in its articles that the corporation will seek to source a majority of its supplies and raw materials from companies that have received ISO 14001 certification. According to the Corporate Act Revision Committee commentary accompanying SHB 2239, the role of specific social purposes is to guide directors and officers in "determining what is in the best interest of the social purpose corporation with respect to decisions about operations, policies and transactions." As with a general social purpose, a specific social purpose should generally not be viewed as a limitation on the activities that a social purpose corporation is organized to pursue, although social purpose corporations have the flexibility of drafting their specific social purposes that way.

**§ 23.04 Article of Incorporation of a Social Purpose Corporation****[a] Required Provisions**

Generally speaking, the articles of incorporation of a social purpose corporation must contain the minimum provisions that are required under Section 23B.02.020(1)

<sup>25</sup> Wash. Rev. Code §§ 23B.25.020, .030.

<sup>26</sup> Wash. Rev. Code § 23B.25.040(1)(c).

<sup>27</sup> Wash. Rev. Code § 23B.25.020.

<sup>28</sup> Wash. Rev. Code § 23B.25.030.

<sup>29</sup> Wash. Rev. Code § 23B.25.040(1)(d).

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and (2) for any other corporation organized under the Business Corporation Act.<sup>30</sup> In addition, a social purpose corporation's articles of incorporation must contain the following:

- a corporate name that contains the words “social purpose corporation” or “SPC” as an abbreviation;<sup>31</sup>
- a statement that the corporation is organized as a social purpose corporation governed by Chapter 25 of the Business Corporation Act;<sup>32</sup>
- a statement setting forth the corporation's general social purpose;<sup>33</sup>
- any specific social purposes that the corporation may have designated pursuant to Section 23B.25.030;<sup>34</sup> and
- a provision that states “The mission of this social purpose corporation is not necessarily compatible with and may be contrary to maximizing profits and earnings for shareholders, or maximizing shareholder value in any sale, merger, acquisition, or other similar actions of the corporation.”<sup>35</sup>

The latter provision is one of the ways Chapter 23B.25 attempts to protect investors in social purpose corporations, by putting them on notice that they are investing in businesses that may place the pursuit of social purposes ahead of the maximization of profits or shareholder wealth.

**[b] Optional Provisions**

In addition to the matters that are required to be set forth in a social purpose corporation's articles of incorporation, and any optional provisions that may be included under Section 23B.02.020(5) and (6),<sup>36</sup> the articles may include the following:

- a provision *requiring* the directors or officers to consider the impacts of any corporate action on the social purposes of the corporation;<sup>37</sup>
- a provision requiring the corporation to furnish shareholders with an assessment of the corporation's performance with respect to its social purposes that is prepared in accordance with a third-party standard;<sup>38</sup>
- a provision increasing the shareholder vote, or the quorum or vote required for director action, required to approve any or all corporate actions beyond the

<sup>30</sup> Wash. Rev. Code § 23B.25.040(1). *See also* Subchapter 1.05[b] and [c], *supra*.

<sup>31</sup> Wash. Rev. Code § 23B.25.040(1)(a).

<sup>32</sup> Wash. Rev. Code § 23B.25.040(1)(b).

<sup>33</sup> Wash. Rev. Code § 23B.25.040(1)(c).

<sup>34</sup> Wash. Rev. Code § 23B.25.040(1)(d).

<sup>35</sup> Wash. Rev. Code § 23B.25.040(1)(e).

<sup>36</sup> *See* Subchapter 1.05[f], *supra*.

<sup>37</sup> Wash. Rev. Code § 23B.25.040(2)(a).

<sup>38</sup> Wash. Rev. Code § 23B.25.040(2)(b).

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vote or quorum required under the Business Corporation Act generally or Chapter 23B.25 in particular;<sup>39</sup>

- a provision requiring shareholder approval for any corporate action, even though not required under the Business Corporation Act;<sup>40</sup> or
- a provision limiting the duration of the corporation's existence.<sup>41</sup>

**[c] Obligation to Furnish Shareholders a Copy of Articles**

A social purpose corporation is required to provide prospective shareholders a copy of its articles of incorporation.<sup>42</sup> In addition, prior to any transfer of shares of a social purpose corporation, the transferor is required to give notice of the transfer to the corporation and the corporation, within a reasonable time after receiving such notice, must provide the prospective transferee with a copy of the articles.<sup>43</sup> These requirements are unique to social purpose corporations. Although regular business corporations have an obligation to allow shareholders to inspect and copy the articles of incorporation pursuant to an inspection request under Section 23B.16.020(1) of the Business Corporation Act, they do not have an affirmative obligation to send shareholders a copy of the articles in connection with the issue or transfer of shares.

**[d] Amendments to a Social Purpose Corporation's Articles**

Amendments to a social purpose corporation's articles are generally subject to the requirements of Chapter 10 of the Business Corporation Act.<sup>44</sup> However, any proposed amendment that would materially change one or more of the corporation's social purposes is subject to special approval requirements. Such amendments must be approved by two-thirds of all shares entitled to vote on the amendment, voting together, two-thirds of the shares of each class or series voting separately, and two-thirds of each other voting group entitled under the social purpose corporation's articles of incorporation to vote separately on the amendment.<sup>45</sup> The articles of incorporation of a social purpose corporation may require a greater (though not lesser) vote than that described in the preceding sentence.<sup>46</sup>

**§ 23.05 Required Information with Respect to Shares**

As with traditional business corporations organized under the Business Corporation Act, social purpose corporations may choose to issue shares in certificated or uncertificated form.<sup>47</sup> If a social purpose corporation chooses to issue shares

<sup>39</sup> Wash. Rev. Code § 23B.25.040(2)(c).

<sup>40</sup> Wash. Rev. Code § 23B.25.040(2)(d).

<sup>41</sup> Wash. Rev. Code § 23B.25.040(2)(e).

<sup>42</sup> Wash. Rev. Code § 23B.25.040(3).

<sup>43</sup> Wash. Rev. Code § 23B.25.040(4).

<sup>44</sup> See Chapter 3, *supra*.

<sup>45</sup> Wash. Rev. Code § 23B.25.090.

<sup>46</sup> *Id.*

<sup>47</sup> Wash. Rev. Code § 23B.25.070(1). See also, Subchapter 11.14, *supra*.

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represented by certificates, the share certificates must contain a statement indicating that the corporation is a social purpose corporation, that its articles contain one or more social purposes, and that the corporation will furnish this information to the shareholder without charge upon request in writing.<sup>48</sup> If a social purpose corporation chooses not to certificate its shares, then within a reasonable time after the issue or transfer of shares, it must send the shareholder a record containing the information required by Section 23B.06.260(2) of the Business Corporation Act<sup>49</sup> and the language referred to above.<sup>50</sup>

**§ 23.06 Standards of Conduct for Directors and Officers of Social Purpose Corporations**

Chapter 23B.25 of the Business Corporation Act takes a different approach to director and officer standards of conduct (sometimes short-handed to “fiduciary duties”) than the benefit corporation statutes described above in Subchapter 23.01[c]. Benefit corporation statutes impose on directors, as well as on officers with discretion to act on a particular matter, an affirmative duty when making decisions to consider not only the effects of action or inaction on shareholders of the corporation, but also employees of the corporation and its suppliers, customers as beneficiaries of the general or specific public benefit purposes of the corporation, community and societal factors, the environment and other matters.<sup>51</sup> The benefit corporation directly, and directors and significant shareholders derivatively, may bring action for a violation of this requirement.<sup>52</sup>

Chapter 23B.25, on the other hand, imposes on a social purpose corporation’s directors and officers (with discretionary authority) the same duties that directors and officers of traditional business corporations incorporated under the Business Corporation Act have under Section 23B.08.300 and 23B.08.420, respectively.<sup>53</sup> Generally, in discharging his or her duties as a director or officer of a social purpose corporation, the director or officer “may consider and give such weight to one or more of the social purposes of the corporation as the director [or officer] deems relevant.”<sup>54</sup> As the Corporate Act Revision Committee commentary relating to SHB 2239 indicates, the provisions are designed to provide directors and officers of social purpose corporations “considerable flexibility in their decisions and actions, both within and outside of the ordinary course of business,” and do not require directors and officers to “favor any one purpose over any other (including creating economic value for shareholders)” or indeed to even “consider any of the social purposes . . . in discharging their duties.” On the other hand, Chapter 23B.25 provides that any action taken by a director or

<sup>48</sup> Wash. Rev. Code § 23B.25.070(2).

<sup>49</sup> See Subchapter 11.14, *supra*.

<sup>50</sup> Wash. Rev. Code § 23B.25.070(3).

<sup>51</sup> See, e.g., Cal. Corp. Code §§ 14620(b) and 14622.

<sup>52</sup> See, e.g., Cal. Corp. Code § 14623.

<sup>53</sup> Wash. Rev. Code §§ 23B.25.050(1), .060(1). See Subchapters 15.04 and 15.08, *supra*.

<sup>54</sup> Wash. Rev. Code §§ 23B.25.050(2), .060(2).

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officer of a social purpose corporation that he or she reasonably believes is intended to promote one or more of the corporation's social purposes shall be deemed to be "in the best interests of the corporation."<sup>55</sup> Consistent with the flexible nature of the Business Corporation Act generally, Chapter 23B.25 allows social purpose corporations to impose an affirmative duty on their directors and officers to consider the impact of any corporate action on the social purposes of the corporation by including a provision to that effect in the articles of incorporation.<sup>56</sup> In this way, Chapter 23B.25 allows social purpose corporations to structure standards of conduct for their directors and officers to be consistent with benefit corporation model.

Directors and officers of social purpose corporations that comply with Section 23B.25.050 and Section 23B.25.060, respectively, may not be held liable for any action or failure to take action in such capacity.<sup>57</sup> Moreover, they do not take on any special responsibilities to any parties—such as the beneficiaries of the corporation's social purposes—other than the corporation and its shareholders.<sup>58</sup>

**§ 23.07 Annual Reports of Social Purpose Corporations**

A social purpose corporation is required to annually furnish its shareholders a "social purpose report" that meets the requirements of Section 23B.25.150. The annual social purpose report is required to be made publicly accessible, free of charge, on the social purpose corporation's web site not later than four months after the close of the corporation's fiscal year, and to remain available through the end of the corporation's fiscal year.<sup>59</sup> The social purpose report is required to include a narrative discussion about the corporation's social purpose or purposes and its efforts to promote those purposes.<sup>60</sup> A social purpose corporation has flexibility in crafting this discussion, but the social purpose report may:

- identify and discuss the short-term and long-term objectives of the corporation relating to its social purposes;
- identify and discuss the material actions taken during the course of the year to achieve its social purposes;

<sup>55</sup> Wash. Rev. Code §§ 23B.25.050(3), .060(3). However, nothing in Chapter 23B.25 is intended to alter the general standards for directors and officers of any corporation that is not a social purpose corporation. Wash. Rev. Code §§ 23B.25.050(6), .060(6). This point was included to rebut any possible inference that someone might be tempted to draw from the enactment of Chapter 23B.25 that directors and officers of traditional business corporations cannot, in the proper discharge of their duties, act in a manner that promotes social, charitable, or similar purposes.

<sup>56</sup> Wash. Rev. Code §§ 23B.25.040(2)(a), .050(2), .060(2).

<sup>57</sup> Wash. Rev. Code §§ 23B.25.050(4), .060(4).

<sup>58</sup> Wash. Rev. Code §§ 23B.25.050(5), .060(5).

<sup>59</sup> Wash. Rev. Code § 23B.25.150(1). Alternatively, a social purpose corporation with a class of securities registered under Section 12 of the Securities Exchange Act of 1934 can comply with this requirement by furnishing shareholders with an annual report that meets the requirements under the federal proxy rules and includes the narrative discussion required under Subsection (2) of Section 23B.25.150. Wash. Rev. Code § 23B.25.150(3).

<sup>60</sup> Wash. Rev. Code § 23B.25.150(2).

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- identify and discuss the material actions that the corporation plans to take in the future to achieve its social purposes; and
- describe the financial, operating or other measures used by the corporation during the fiscal year to evaluate its performance in achieving its social purposes.<sup>61</sup>

In contrast to the benefit corporation statutes adopted by other states, Chapter 23B.25 does not require that the annual report of a social purpose corporation include an annual assessment of its social and environmental performance under an independent third-party standard. However, a social purpose corporation formed under Chapter 23B.25 can impose such a requirement on itself by including a provision in its articles of incorporation requiring that it furnish to its shareholders an annual assessment of the corporation's performance with respect to its social purposes that is prepared in accordance with a third-party standard.<sup>62</sup>

The failure of a social purpose corporation to furnish a social purpose report to its shareholders does not affect the validity of any corporate action.<sup>63</sup> If a social purpose corporation fails to furnish a social purpose report for at least two consecutive fiscal years, any shareholder may bring an action in the superior court for the county in which the social purpose corporation's registered agent is located, and the court may, after notice to the corporation, summarily order the corporation to furnish a social purpose report.<sup>64</sup>

**§ 23.08 Mergers, Share Exchanges and Asset Sales**

A social purpose corporation is generally subject to the same requirements with respect to mergers, share exchanges and the sale or other transfer of all or substantially all of the corporation's assets as traditional business corporations organized under the Business Corporation Act.<sup>65</sup> In addition, these transactions are subject to special shareholder approval requirements. A merger or share exchange in which the social purpose corporation is not going to be the surviving corporation must be approved by two-thirds of all shares entitled to vote on the transaction, voting together, two-thirds of the shares of each class or series voting separately, and two-thirds of each other voting group entitled under the social purpose corporation's articles of incorporation to vote separately on the transaction.<sup>66</sup> However, this requirement does not apply if the surviving corporation of the merger or share exchange is also a social purpose corporation governed by Chapter 23B.25 and includes one or more specific social purpose or purposes that are not materially different than those of the disappearing

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<sup>61</sup> *Id.*

<sup>62</sup> Wash. Rev. Code § 23B.25.040(2)(b).

<sup>63</sup> Wash. Rev. Code § 23B.25.150(3).

<sup>64</sup> Wash. Rev. Code § 23B.25.150(4).

<sup>65</sup> Wash. Rev. Code §§ 23B.25.100(1), .110(1). *See* Chapters 5 and 6, *supra*.

<sup>66</sup> Wash. Rev. Code § 23B.25.100(1).

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corporation's social purposes.<sup>67</sup> Similar voting requirements apply to a sale or other disposition of a social purpose corporation's assets other than in the usual and regular course of business unless the acquirer is also a social purpose corporation governed by Chapter 23B.25 and includes one or more specific social purpose or purposes that are not materially different than those of the disappearing corporation's social purposes.<sup>68</sup>

**§ 23.09 Ceasing to Be a Social Purpose Corporation**

A social purpose corporation may elect to cease being a social purpose corporation (an "electing social purpose corporation") by amending its articles of incorporation to remove the matters required to be set forth in its articles of incorporation under Section 23B.25.040(1)(a) and (b).<sup>69</sup> Such an election does not affect any obligations or liabilities of the electing social purpose corporation incurred prior to the election or the personal liability of any person incurred before the election.<sup>70</sup> An election to be a social purpose corporation is subject to requirements that are similar to those described above in Subchapter 23.02[b] for an election by an existing corporation to become a social purpose corporation. Namely, an election to cease to be a social purpose corporation is subject to the following conditions:

- each share of the same class or series of capital stock of the electing social purpose corporation must be treated equally with respect to any securities, cash or other property to be received by, or any obligations or restrictions to be imposed on, the holder of that share;
- the electing social purpose corporation's board of directors must recommend the election to the shareholders, unless due to conflict of interest or other special circumstances the board determines that it should make no recommendation and communicates that to shareholders; and
- the election must be approved by two-thirds of all shares entitled to vote on the election, voting together, two-thirds of the shares of each class or series voting separately, and two-thirds of each other voting group entitled under the electing social purpose corporation's articles of incorporation to vote separately on the election.<sup>71</sup>

In addition, the board of directors of the electing social purpose corporation may condition its submission of the proposed election on any basis, including a higher vote than that otherwise required or a vote held by a different voting group than is otherwise entitled to separate voting rights.<sup>72</sup> The board of directors may abandon a planned election to cease to be a social purpose corporation after shareholder approval (subject

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<sup>67</sup> Wash. Rev. Code § 23B.25.100(2).

<sup>68</sup> Wash. Rev. Code § 23B.25.110.

<sup>69</sup> Wash. Rev. Code § 23B.25.140(3). See Subchapter 23.02[b], *supra*.

<sup>70</sup> Wash. Rev. Code § 23B.25.140(7).

<sup>71</sup> Wash. Rev. Code § 23B.25.140(1).

<sup>72</sup> Wash. Rev. Code § 23B.25.140(2).

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to any contractual rights), without further shareholder approval.<sup>73</sup>

An election to cease to be a social purpose corporation is effective when the required amendment to the articles of incorporation is filed with the Washington Secretary of State, or a later effective date or time set forth in the articles of amendment.<sup>74</sup> The electing social purpose corporation ceases to be a social purpose corporation once the election is effective, at which time it becomes subject to all the provisions of the Business Corporation Act applicable to corporations generally.<sup>75</sup> Its existence is deemed to have commenced when the electing social purpose corporation was originally incorporated.<sup>76</sup>

**§ 23.10 Dissenters' Rights**

Chapter 23B.25 of the Business Corporation Act establishes dissenters' rights for a number of corporate actions relating to social purpose corporations. A shareholder is entitled to the same dissenters' rights as are available under Chapter 13 of the Business Corporation Act<sup>77</sup> for the following:

- an election by an existing corporation to become a social purpose corporation;
- an election by a social purpose corporation to cease to be a social purpose corporation; and
- an amendment to a social purpose corporation's articles of incorporation that would materially change one or more of the corporation's social purposes.<sup>78</sup>

Mergers, share exchanges and asset sales involving social purpose corporations are subject to the same dissenters' rights provisions as apply to the same transactions involving traditional business corporations incorporated under the Business Corporation Act.

**§ 23.11 Derivative Actions**

Even though social purpose corporations may be organized to promote positive impacts or minimize negative impacts on various constituencies such as employees, customers, suppliers, or other groups, these persons have no right to bring a derivative action in the right of the corporation. No person other than a shareholder of a social purpose corporation may institute or maintain a proceeding in the right of the corporation.<sup>79</sup> A person may commence a proceeding in the right of a social purpose corporation only if he or she was a shareholder at the time the transaction that is the subject of the complaint occurred, or acquired shares through operation of law from a

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<sup>73</sup> Wash. Rev. Code § 23B.25.140(4).

<sup>74</sup> Wash. Rev. Code § 23B.25.140(5).

<sup>75</sup> Wash. Rev. Code § 23B.25.140(6).

<sup>76</sup> *Id.*

<sup>77</sup> See Chapter 7, *supra*.

<sup>78</sup> Wash. Rev. Code § 23B.25.120.

<sup>79</sup> Wash. Rev. Code § 23B.25.080(1).



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person who was a shareholder at that time.<sup>80</sup> Any derivative action brought in the right of a social purpose corporation must generally comply with the procedure set forth in Section 23B.07.400.<sup>81</sup>

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<sup>80</sup> Wash. Rev. Code § 23B.25.080(2).

<sup>81</sup> Wash. Rev. Code § 23B.25.080(3). *See* Subchapters 17.03–17.11, *supra*.

