

## Update | Delaware Corporate Law / Environmental, Social & Governance (ESG)

February 2023

### Public Benefit Corporations: Intersection of Delaware Corporate Law, ESG, and Related Considerations

The public benefit corporation (PBC) is a statutory corporate form that allows a corporation to align its corporate purpose with a particular public benefit. The creation and promotion of PBCs over the past decade has dovetailed with important public conversations regarding the purpose of the corporation, environmental, social, and governance (ESG) issues, and related third-party certifications and regulations. Although there are meaningful differences among those conversations, the PBC overlaps with each channel and can serve an important strategic function for companies and investors thinking through how those issues should be handled.

This GT Update attempts to outline key elements of a PBC, largely from the Delaware corporate law perspective, while identifying its overlap with those important conversations and related perspectives. The article first addresses the placement of public benefits relative to corporate purpose, moves to a summary of technical and drafting issues involved in the PBC corporate documents, including those required by the Delaware General Corporation Law (DGCL), then touches on the modifications of fiduciary duties in a PBC according to the public benefit and

affected communities, and finishes with the ancillary disclosure framework and considerations for community engagement.

Although the understanding and use of PBCs are still in nascent stages, the PBC can feature prominently in strategic approaches to ESG and corporate purpose.

#### Public Benefit

At the heart of every PBC is a public benefit that focuses on either the creation of a positive effect or the decrease of negative effects. The public benefit is the mission statement for the PBC which connects the PBC to a specific interest and group and modifies the corporate purpose and power of the PBC. From both of those perspectives, it is worth considering the function of corporate purpose in a corporation and a PBC, as well as the wide-ranging conversations about the appropriate scope of corporate purpose and the relationship to ESG.

*Public Benefit Statement.* The DGCL requires each PBC to select a public benefit, which is defined as “a positive effect (or reduction of negative effects) on 1 or more categories of persons, entities, communities or interests (other than stockholders in their

capacities as stockholders) including, but not limited to, effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature.”<sup>1</sup> The public benefit must be set forth in the corporate charter to guide the purpose and management of the PBC, which is also intended to “operate in a responsible and sustainable manner.”<sup>2</sup>

Although the DGCL provides great latitude for public benefit statements, they should be tailored to embody the understanding held by investors, corporate fiduciaries, other stakeholders, and the affected communities as to the PBC’s objectives and core principles. The public benefit statements of SEC-registered PBCs often strike a balance between specificity and generality with respect to the public benefit and corresponding lines of business. For instance, public benefits may focus on both the intended business and the output or product to be developed, which is then connected to an intended effect or target community.<sup>3</sup> In that sense, public benefit statements have tended to fix both aspirational direction and achievable metrics, while seeking to avoid unworkably narrow restrictions and impossible ambition.

*Relationship to Corporate Purpose.* The selection of a public benefit fits into the broader conversation about corporate purpose, which encountered a flashpoint in 2019 when the Business Roundtable issued its statement of corporate purpose.<sup>4</sup> That statement superseded previous pronouncements that the primary purpose of the corporation is to maximize stockholder value. The Business Roundtable recommitted instead to deliver value to

customers, invest in employees, deal fairly and ethically with suppliers, support adjacent communities, and generate long-term value for shareholders. By that statement, the Business Roundtable also drove further reconsideration of the shareholder primacy view of corporate purpose. Although each PBC need not engage in a full-blown exploration of academic theories, there are aspects of that broader conversation that are applicable to the PBC.

In particular, boards and stockholders of traditional corporations, as well as Delaware courts, are thinking critically about how non-stockholder concerns can affect stockholder value.<sup>5</sup> Without electing to become a PBC, those corporations may effectively be identifying interests and communities that share objectives and could drive value in a symbiotic way. In that regard, identification of a public benefit and election to become a PBC may be viewed as outgrowths of the conversation around appropriate corporate purpose.

*Relationship to ESG.* Although there are differences between the broad categories of public benefits and the narrower topic of ESG, their purposes and driving forces have significant overlap. The public benefit statements of some SEC-registered PBCs relate to social issues, such as the welfare of employees and adjacent communities, while several also relate to environmental issues, such as climate.

ESG proponents can use the PBC form to demonstrate both commitment to the ESG-related public benefit and grounding the PBC’s management in that public benefit. By laying such a foundation, the directors and officers of the PBC must keep the public benefit and related ESG issue in mind when

exercising discretion and making corporate decisions. In that sense, PBCs and ESG proponents may be oriented and drive corporate conduct in similar directions.<sup>6</sup> Although gender and ethnic diversity laws (e.g., California) have encountered constitutional limits, the PBC offers a similar path for PBCs, instead of the state, to prescribe ESG-focused corporate action.<sup>7</sup>

### Corporate Structure

The key technical elements of a PBC consist of prescribed charter provisions and related changes to certain corporate documents. Although PBCs are governed by all provisions of the DGCL, there are specific provisions that apply only to PBCs in Subchapter XV of the DGCL. Those statutory provisions require the PBC's foundation to be set forth in its constitutional and corporate documents. Additional corporate law steps may be required if the PBC is changing from a non-PBC or seeking certification related to its public benefit or other ESG objectives.

*Governance Documents.* The PBC's certificate of incorporation must include a statement in its heading that it is a PBC. Although there was previously a requirement under the DGCL that a PBC also identify its status as a PBC in its name, that requirement has been eliminated. The certificate of incorporation must also identify the PBC's public benefit. The DGCL expressly provides that, in the absence of a conflict of interest or an express provision in the certificate of incorporation providing otherwise, no failure to satisfy the balancing requirement applicable to the fiduciary duties of PBC directors constitutes an act or omission not in good faith or a breach of the duty of loyalty for purposes of exculpation or indemnification. Bylaws and agreements

providing for indemnification of directors and officers may also be amended to reflect the fiduciary balancing requirement and any failure to satisfy it.

Another common component of a corporation's suite of governance documents are charters of board committees, including standing committees tasked with key audit, governance, and compensation functions. For a PBC, it may be appropriate to modify the charters for the audit committee and the nominating and governance committee (or committee fulfilling similar functions) to account for the PBC's public benefit. Oversight of the PBC's satisfaction of its public benefit and service to affected communities may be delegated to such a committee or to a new committee focused on that public benefit and potentially related ESG matters. Corporate performance, compensation metrics, and director qualifications may also be monitored and benchmarked against the public benefit and any affected communities, in addition to the operational and financial standards that typically would be appropriate for a board committee to oversee at a non-PBC.

Finally, the DGCL requires that PBC stockholder meeting notices state, and stock certificates and notices of uncertificated shares note conspicuously, that the corporation is a PBC formed pursuant to Subchapter XV of the DGCL. PBCs that are not publicly traded and do not have a reference to PBC status in the corporate name must provide notice to any person to whom the PBC issues its stock that it is a PBC.

*Election to Become a PBC.* There are several avenues for an entity to elect to become a PBC. A new Delaware corporation may

incorporate as a PBC. An existing Delaware corporation may adopt the PBC charter provisions by charter amendment, merger, or series of conversions (e.g., to another entity and then to a PBC). Finally, an existing entity other than a Delaware corporation may become a Delaware corporation and elect to become a PBC by including the PBC provisions in its charter adopted in a merger, conversion, or domestication.

The most typical and direct path for an existing Delaware non-PBC corporation to become a PBC is for the board to approve a charter amendment and submit it to stockholders for approval. Following stockholder approval, the corporation must file a certificate of amendment or amended and restated charter with the Delaware Secretary of State.

The board's decision to approve and recommend a corporation's election to become a PBC is an exercise of discretion, implicating its fiduciary duties. At the time of that decision, the non-PBC board typically owes fiduciary duties solely to the company and its stockholders. Thus, the election to become a PBC must be in the company's best interests and promote stockholder value. Boards should be thoughtful about this decision and take into account the company's history, business, and principles, as well as the interests of its stockholders. If directors are sued on the basis of an allegation that they had breached their fiduciary duties, the decision to become a PBC should receive business judgment deference if it is made carefully and in good faith by a majority of disinterested and independent directors (and the case for such deference may be

further bolstered by the use of board committees or independent advisors).

Once the board submits the charter amendment to stockholders for approval by consent or at a meeting, the applicable voting standard under the DGCL is a simple majority, which has been twice reduced by amendments to the DGCL; first in 2015 from 90% to 66%, and then in 2020 from 66% to a majority.<sup>8</sup> As a result of the 2020 DGCL amendments, stockholders also no longer have statutory appraisal rights in connection with such an amendment electing to become a PBC. The stockholder approval of the charter amendment will also be subject to any other applicable consent or approval provisions in the company's governance documents, such as charter-based protective provisions as well as other material agreements such as debt documents.

Following stockholder approval, the company must file with the state of Delaware the relevant certificate, which must include the contents the DGCL requires for an election to become a PBC.

#### *Public Benefit Alternative Entities.*

Although this article focuses on public benefit corporations, Delaware law also authorizes other entities to elect to adopt a public benefit statement and the other hallmarks of a PBC. The technical requirements for an election to become, and to operate as, a public benefit limited liability company or other public benefit entity, are set forth in those respective entity statutes.<sup>9</sup> The Delaware LLC Act provides that, unless the LLC agreement provides otherwise, there will be no liability for failure to meet the balancing requirements analogous to those under the DGCL.

*Alternative to Nonprofit Nonstock Corporation.* The Delaware PBC may also be viewed as an alternative to a Delaware nonprofit nonstock corporation formed under the DGCL. Nonstock corporations, which are not authorized to issue stock, may be operated for profit but are more frequently established to operate as nonprofits. Under the DGCL, a nonprofit nonstock corporation cannot merge with a PBC.

Directors of a nonprofit nonstock corporation owe fiduciary duties to protect and advance the corporation's charitable purpose, and the attorney general has the power and responsibility to enforce those duties.<sup>10</sup> This differs from a PBC, where directors owe fiduciary duties to balance stockholders' pecuniary interests, the PBC's public benefit, and those materially affected by the PBC. However, only PBC stockholders can sue to enforce those duties.

A common reason for operating as a charitable nonprofit nonstock corporation is to obtain benefits under Section 501 of the federal Internal Revenue Code. Unlike a tax-exempt charitable organization, however, a PBC has stockholders, can pay dividends, is taxed as a regular corporation, and is not eligible to receive tax-deductible contributions.

*ESG-Related Certifications.* Further overlap in terminology related to categories of entities operating in the PBC and ESG space arises in certifications offered by public and private institutions based on standards of ESG objectives and public benefits. These certifications tend to reflect and promote similar corporate objectives as those contemplated by PBCs and their public benefit statements. A key difference is that the certifications do not affect the

company's legal form but instead demonstrate performance measured against accountability, transparency, and social metrics.

One organization offering certification of ESG-related businesses is B-Labs, which requires companies to engage in a relatively extensive process for evaluation of its ESG foundation and performance. Successful participants receive a "B-Corp" certification, reflecting the company's satisfaction of standardized metrics and incorporating the company in the B-Corp community. Companies with a B-Corp certification may be PBCs, traditional corporations, or other entity types.

The State of Delaware has adopted legislation separate from the PBC statutes, promoting the use of individualized transparency and sustainability standards.<sup>11</sup> The Delaware Certification of Adoption of Transparency and Sustainability Standards Act does not prescribe best practices related to sustainability but instead authorizes corporations to voluntarily adopt their own standards according to its business and particular circumstances. The corporation may then file with the Delaware Secretary of State a statement of adoption of transparency and sustainability standards. This legislation does not create liability or enforcement mechanisms.

Other governments and organizations, such as the European Union, the United Kingdom, and the International Sustainability Standards Board, have promulgated standards for reporting and measuring ESG matters.<sup>12</sup> These standards take into account a broad range of financial and non-financial metrics, while seeking to balance them in different ways.<sup>13</sup> The divergence and rapid development of

standards require PBCs (as well as non-PBCs) and their advisors to remain up to date.

### **Fiduciary Duties**

The most fundamental difference between a PBC and a traditional Delaware corporation is in the nature of fiduciary duties and corresponding beneficiaries of those duties. Although the alignment between fiduciary duties at traditional corporations, on the one hand, and ESG and non-stockholder pecuniary interests, on the other hand, is not always intuitive, that alignment at a PBC is typically mandated by the PBC charter. In that respect, a corporation with a business that factors ESG heavily into its decision making may wish to consider becoming a PBC as part of a comprehensive strategy to align its legal structure with its corporate objectives.

*Balancing Requirement.* Directors and officers of a Delaware corporation generally owe fiduciary duties to manage, operate, and oversee the corporation in the best interests of the corporation and its stockholders. In a PBC, however, the DGCL directs corporate fiduciaries to balance stockholder pecuniary interests, the interests of those materially affected by the corporation's conduct, and the corporation's public benefit. The DGCL specifically provides that directors are deemed to have satisfied their balancing obligation if their decision is disinterested and informed and "not such that no person of ordinary, sound judgement would approve."

This balancing requirement should be brought to bear on board decisions regarding the strategic direction of the PBC, as well as management's implementation of the PBC's daily operations. The process for

orienting operations to the PBC's public benefit, while maintaining the statutory balance, will require thoughtfulness on the part of directors and officers. To ensure that the views and interests of relevant constituencies are appropriately incorporated, PBC fiduciaries may need to spend additional time considering and engaging with those constituencies, such as employees, suppliers, customers, and affected communities.

Until the Delaware courts have an opportunity to address the PBC and its balancing requirements, PBC fiduciaries must live with less case law guidance than corporate fiduciaries of traditional Delaware corporations. Counsel can extrapolate key principles from the traditional corporate context, such as application of business judgment deference to disinterested and informed board decisions, though PBC-specific jurisprudence under the DGCL or other states' PBC statutes may develop more specific guidance in the future.

Another aspect of the DGCL that PBC fiduciaries should keep in mind is that only stockholders—and not affected communities or other stakeholders—have standing to bring fiduciary duty claims based on the PBC balancing requirement.<sup>14</sup> To maintain standing under the DGCL in such a suit, however, plaintiff-stockholders must own individually or collectively, as of the time the litigation is instituted, at least 2% of the outstanding shares or, in the case of a nationally listed PBC, the lesser of that percentage and shares representing a market value of at least \$2 million.

*Potential Applications of Balancing Requirement.* How traditional corporate standards of conduct and litigation standards of review would apply to claims

for alleged breaches of fiduciary duty and the balancing requirement by PBC fiduciaries is uncertain. Until courts weigh in on these issues, there will be uncertainty. There are some important operational and transactional contexts, however, that have received particular attention in Delaware case law that PBC boards and their counsel should consider.

The obligation of directors and officers to oversee the corporation, which has been litigated in the Delaware *Caremark* line of cases, requires the implementation of a system for reporting red flags and appropriate reaction to red flags. Corporate fiduciaries are also expected to manage the corporation to ensure compliance with applicable laws, particularly “mission critical” operations subject to heavy regulation.

The oversight role of a PBC’s directors and officers may expand to include an obligation to monitor operations related to the PBC’s public benefit, as well as compliance with applicable ESG laws which could potentially constitute mission critical operations of a PBC.<sup>15</sup> Indeed, non-PBC corporations are receiving increased regulatory scrutiny and investor pressure regarding ESG matters such as compliance with greenhouse gas emission standards and disclosure of environmental sustainability and climate mitigation.<sup>16</sup> In addition, NASDAQ-listed companies now must comply with diversity standards for their boards.<sup>17</sup>

In the context of mergers and acquisitions, directors’ fiduciary duties traditionally require them to pursue the best reasonably available stockholder value. In litigation alleging breaches of those fiduciary duties, Delaware courts apply an enhanced scrutiny standard of review under the *Revlon* line of

cases. The application of this duty in the PBC context will require thoughtfulness on the part of PBC directors who must balance stockholder pecuniary interests, the PBC’s public benefit, and the interests of those materially affected by the PBC. For mergers and conversions in which stockholders are entitled to an appraisal by the Delaware Court of Chancery of the “fair value” of their shares, there are also questions about how a court will determine fair value. For instance, while the fair value of a non-PBC corporation’s shares is appraised solely with respect to the stockholder’s pecuniary interest exclusive of value arising from the transaction, a court might determine whether, and to what extent, the public benefit and interests of affected constituencies factor into the fair value of PBC shares.<sup>18</sup>

The alignment of corporate fiduciaries’ compensation and incentives with interests of their corresponding beneficiaries may also warrant consideration. Equity compensation often is viewed as aligning directors’ and officers’ interests with stockholders’ interests. Advisors’ compensation may also be structured to align with the interests of the corporation and its stockholders. At a PBC, however, compensation might be pegged to key performance indicators in measurable ways that are tied to ESG, the PBC’s public benefit, and interests of affected constituencies.

Finally, corporate fiduciaries operating in a complex web of entities or a holding company structure comprising both PBCs and non-PBCs will also need to ensure that discretionary actions at each level align with the applicable fiduciary duties at such level.

*Board Assessments.* Board assessments have become common tools for measuring board performance and evaluating current and candidate directors. These assessments may be structured in a variety of ways, including the methods and extent of assessment. For a PBC, it may be appropriate to tailor a board assessment to a review of board composition, culture, practices, and succession related to the PBC's public benefit. Identifying an advisor with credentials to assist in crafting that assessment may be an important first step in creating an effective PBC-specific board assessment. This may also overlap with any consulting with ESG licensing bodies.

## Disclosure

Disclosure related to the corporate purpose is an important ancillary component of the PBC regime.

*Delaware Reporting and Disclosure.* The DGCL imposes a specific reporting requirement on PBCs. Under that statute, a PBC must provide its stockholders with a statement at least every other year as to the PBC's promotion of its public benefit and the best interests of those materially affected by the PBC's conduct. The biennial report must include (1) the objectives established by the board to promote the public benefit, (2) the standards adopted by the board to measure the PBC's progress in promoting the public benefit, (3) objective, factual information based on those standards regarding the PBC's success in meeting its objectives, and (4) an assessment of the PBC's success in meeting those objectives. In addition, the PBC's charter or bylaws may require more frequent or publicly available reporting and

use of a third-party standard or certification addressing the public benefit.

In traditional disclosure documents and notices, such as proxy statements, PBC directors have disclosure obligations arising from their fiduciary duties, and that may require disclosure of directors' views on PBC-specific issues. For instance, it would be important to consider whether the impact of a proposed transaction on the PBC's public benefit and those materially affected by the PBC constitutes material information that a reasonable stockholder would need to know when deciding how to act.

## *Regulatory and Stock Exchange*

*Requirements.* PBCs with publicly listed stock must also comply with ESG-related requirements imposed by the SEC and the relevant stock exchange.<sup>19</sup> Those requirements may apply to disclosures, board composition, and business operations. On the other hand, PBCs should also be aware of the emerging anti-ESG regulations and consider how business with such states and governments accords with the PBC's public benefit and obligations to those materially affected by the PBC.

## *Investor and Community Feedback.*

Publicly listed PBCs and their counsel should understand the views of proxy advisory firms and may benefit from engagement with like-minded ESG-focused organizations such as the Shareholder Commons. In addition to typical corporate outreach efforts to the investment community, a PBC may require similar outreach to other communities such as those implicated by its stated public benefit.



## Takeaways

The election to become a PBC represents an important step for a company to align its corporate foundation with a specific public benefit. Because of the significant (but not perfect) overlap between such public benefit and ESG objectives, that election may be a

logical step for certain corporations to potentially synchronize operations, objectives, and purpose. Ultimately, however, the board and the stockholders must determine what is most appropriate, taking into account many factors, such as those mentioned in this article.

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## Endnotes

<sup>1</sup> 8 Del. C. § 362(b).

<sup>2</sup> 8 Del. C. § 362(a).

<sup>3</sup> See, e.g., [Amended and Restated Certificate of Incorporation of Lemonade, Inc., a public benefit corporation](#) (“This corporation’s public benefit purpose is to harness novel business models, technologies and private-nonprofit partnerships to deliver insurance products where charitable giving is a core feature, for the benefit of communities and their common causes.”); [Amended and Restated Certificate of Incorporation of Veeva Systems Inc. \(a public benefit corporation\)](#) (“The specific public benefits to be promoted by the Corporation are to provide products and services that are intended to help make the

industries we serve more productive, and to create high-quality employment opportunities in the communities in which we operate.”).

<sup>4</sup> *Business Roundtable Statement on the Purpose of a Corporation* (Aug. 19, 2019).

<sup>5</sup> *See, e.g., McRitchie v. Zuckerberg*, C.A. No. 2022-0890-JTL (Del. Ch. Feb. 7, 2023) (AMENDED COMPLAINT); *see also* James McRitchie, *Moving Beyond Modern Portfolio Theory: Reflections, Corporate Governance* (Aug. 10, 2021).

<sup>6</sup> One could also imagine a public benefit statement for a corporation, which is engaged in a business that is arguably in tension with traditional ESG objectives, such as a weapons manufacturer or fossil fuel producer. The “public benefit” of such a PBC could potentially be benefits or protection from harm to particular communities related to that business. Although that use of the PBC could be viewed as a perversion of the legislative intent, it may alternatively view it as a way to channel the purpose and power of that corporation toward its beneficial effects and/or away from its negative effects while ensuring that its board of directors is mandated to account for that public benefit and the communities affected thereby. In light of the magnitude of such corporations, in terms of economics and global impact, even marginal alterations in their governance as a result of electing to be PBCs could have significant public benefit.

<sup>7</sup> *See, e.g., Nate Emeritz, Female Board Power and Delaware Law*, Harvard Law School Forum on Corporate Governance (Aug. 13, 2019).

<sup>8</sup> 80 Del. Laws 40, §§ 12-14 (2015); 82 Del. Laws 256, § 17 (2020).

<sup>9</sup> 6 Del. C. §§ 18-1201, et seq.

<sup>10</sup> *Oberly v. Kirby*, 592 A.2d 445, 468 n.17 (Del. 1991).

<sup>11</sup> 6 Del. C. §§ 5000E, et seq.

<sup>12</sup> *See also* David Larcker, Lukasz Pomorski, Brian Tayan, and Edward Watts, *ESG Ratings: A Compass without Direction*, Rock Center for Corporate Governance at Stanford University Working Paper Forthcoming (Aug. 2, 2022).

<sup>13</sup> *See also* Frederick Alexander, *One Small Step From Financial Materiality to Sesquimateriality: A Critical Conceptual Leap for the ISSB*, Harvard Law School Forum on Corporate Governance (May 4, 2022).

<sup>14</sup> One could imagine methods of providing standing or corporate enforcement mechanisms to particular organizations that are focused on the PBC’s public benefit or its affected communities, which may arguably bolster those elements when balanced with stockholder’s pecuniary interests. For instance, a class or series of stock could be authorized under the charter, provided with consent rights over specified corporate actions, and issued solely to the oversight organization.

<sup>15</sup> *See also* Frank Placenti, Barbara Jones, Nathan Emeritz, Justin Mann, et. al, *Delaware Court of Chancery Determines that Corporate Officers Owe Duty of Oversight: Practical Considerations*.

<sup>16</sup> *See, e.g., Commonwealth v. Exxon Mobil Corp.*, 187 N.E.3d 393, SJC-13211 (Mass. 2022) (alleging violations of the Commonwealth’s consumer protection statute arising from statements about climate change generally and the company’s climate mitigation performance); *SEC v. Vale S.A.*, C.A. No. 22-cv-2405 (E.D.N.Y.) (alleging false and misleading claims about the safety of its dams prior to the collapse of the company’s dam); *Milieudefensie et al. v. Royal Dutch Shell PLC*, ECLI:NL:RBDHA:2021:5339 (The Hague District Court May 26, 2021) (ordering the company to reduce greenhouse gas emissions by 45% by 2030).

<sup>17</sup> NASDAQ Nasdaq Rules 5605 & 5606.

<sup>18</sup> *See* Frederick Alexander, Lawrence Hamermesh, Frank Martin, and Norman Monhait, *M&A Under Delaware’s Public Benefit Corporation Statute: A Hypothetical Tour*, 4 Harvard Bus. L. Rev. 256.

<sup>19</sup> *See, e.g.,* Barbara Jones, Marc Rossell, and Joan Timmins, *SEC Proposes Comprehensive Package of Climate-Related Disclosure Rules*.