

### Disclaimer

This document is for information only. It does not constitute legal or other advice. Each prospective B Corp should consider taking independent legal advice on the meaning and adoption of the Legal Test in the context of their particular circumstances.

## The 'Legal Test' for a B Corp in the UK – An Explanation

### 1. Introduction

1.1 The B Corp legal test in the UK (the "**UK Legal Test**") has been developed by the Policy Council of B Lab (UK) for B Corps in the UK.

1.2 As at 28 July 2015, the Policy Council is chaired by Luke Fletcher (Partner, Bates Wells Braithwaite) and includes Nicola Evans (Partner, Hogan Lovells), William H. Clark, Jr (Partner, Drinker Biddle & Reath LLP), Lucy Fergusson (Partner, Linklaters), Tom Fox (Policy Lead, UnLtd), Simon Rowell (Strategy and Market Development Director, Big Society Capital), Nick Temple (Chief Executive, Social Enterprise UK) and Louise Harman as secretary (Senior Associate, Bates Wells Braithwaite).

1.3 The UK Legal Test is a fundamental part of becoming a B Corp as all B Corps will need to go through the process of amending their constitutional documents to include a commitment to a "*triple bottom line*" approach to business, in an agreed form.

1.4 The UK Legal Test is deliberately a minimalist test and does not aim to be overly prescriptive, so that it has wide applicability and can be used by all prospective B Corps. The UK Legal Test language set out in paragraph 2 below is currently in agreed form by the Policy Council, but is subject to feedback from the consultation process (outlined below).

1.5 In order to ensure that the UK Legal Test language has been reviewed and tested by a wide range of stakeholders, the Policy Council has consulted with the following stakeholder groups:

1.5.1 the legal community;

1.5.2 prospective B Corps; and

1.5.3 the investor community.

1.6 The UK Legal Test has been developed by the Policy Council of B Lab (UK) after reviewing and taking into account:

1.6.1 the B Corp legal test in the US (the "**US Legal Test**");

1.6.2 the statutory framework for directors' duties under s172 of the Companies Act 2006 in the UK (the "**Companies Act s172 Framework**"); and

1.6.3 the articles of association of existing UK-incorporated B Corps.

### 2. Proposed language for the UK Legal Test

(1) *The purposes of the Company are to promote the success of the Company for the benefit of its members as a whole and, through its business and operations, to have a material positive impact on society and the environment, taken as a whole.*

(2) *A Director shall have regard (amongst other matters) to:*

- a. the likely consequences of any decision in the long term,*
- b. the interests of the Company's employees,*
- c. the need to foster the Company's business relationships with suppliers, customers and others,*
- d. the impact of the Company's operations on the community and the environment,*
- e. the desirability of the Company maintaining a reputation for high standards of business conduct, and*
- f. the need to act fairly as between members of the Company,*

*(together, the matters referred to above shall be defined for the purposes of this Article as the "**Stakeholder Interests**").*

(3) *For the purposes of a Director's duty to act in the way he or she considers, in good faith, most likely to promote the success of the Company, a Director shall not be required to regard the benefit of any particular Stakeholder Interest or group of Stakeholder Interests as more important than any other.*

(4) *Nothing in this Article express or implied, is intended to or shall create or grant any right or any cause of action to, by or for any person (other than the Company).*

(5) *The Directors of the Company shall for each financial year of the Company prepare a strategic report as if sections 414A(1) and 414C of the Companies Act 2006 (as in force at the date of adoption of these Articles) applies to the Company whether or not they would be required to do so otherwise than by this Article.*

### **3. Rationale for Proposed Language for the UK Legal Test**

#### *Background*

- 3.1 The language for the UK Legal Test has been developed so that it is a meaningful test by which B Corps will be differentiated from other companies, whilst still operating within the Companies Act s172 Framework and allowing directors scope for interpretation and discretion. In particular, it is recognised that directors will need to exercise a degree of judgment in deciding how to weigh and reconcile the factors set out in paragraph (2), depending on the circumstances and context of the company. In developing the language for the UK Legal Test, the requirement for the language to create clear differentiation has

been balanced with the concern that the test should not be set at a level which makes it too difficult for companies in the UK to obtain the shareholder consent necessary to amend their constitutional documents in the way contemplated.

- 3.2 It is important that the language for the UK Legal Test references or links to the Companies Act s172 Framework as this framework is relatively well understood by lawyers in the UK and should also be intelligible to the lay person.
- 3.3 Under the Companies Act s172 Framework, directors in the United Kingdom are legally bound to “*have regard to*” certain other stakeholders while promoting the success of the company for the benefit of its members. This does not mean they necessarily have to be swayed by other stakeholders’ interests – this is a matter for their good faith business judgment – but the directors’ duty to exercise reasonable care, skill and diligence will apply to their consideration of the factors listed in s172.
- 3.4 To quote from the official explanatory notes to the Companies Act 2006, “*it will not be sufficient [for the directors] to pay lip service to the factors*”. The directors will fulfil their duties if they act with reasonable care, skill and diligence and take their decisions in good faith. We think it is helpful to put some emphasis on the extent to which the “*enlightened shareholder value*” principle is enshrined in existing UK company law, (a) so that it is clear that companies that do not adopt the UK Legal Framework still have considerable ability to make social and environmental responsibility core to their strategies and (b) so that the extent of the difference made by the UK Legal Framework is not brought into doubt.
- 3.5 In practice, under the Companies Act s172 Framework, particularly for companies which trade on having a socially responsible brand and reputation, creating social and environmental benefits will be in the interests of members, so that the question of which interests prevail will often be academic. However this will not always be so. The Companies Act s172 Framework makes the interests of the members a paramount consideration, which may ultimately subordinate other stakeholder interests. In order to distinguish a “*B Corp*” from other organisations, it is necessary and helpful to include a legal test in its constitution to strengthen the extent to which these other factors can be taken into account.

*Paragraph (1) of the UK Legal Test*

- 3.6 The obligation of the directors to promote the success of the company for the benefit of the members as a whole, as set out in s172(1) of the Companies Act 2006, can be modified by the company's constitution in accordance with s172(2) of the Companies Act 2006. The effect of this is that if the purposes of the company consist of, or include, purposes other than the benefit of the members, the duties of the directors will, to that extent, be modified. This means that the constitution can effectively define what is meant by “*success*” of the company. This is integral to the concept of a “*B Corp*” because it redefines what success of the company means and therefore provides a mandate to directors when weighing stakeholder interests in making decisions.
- 3.7 Paragraph (1) of the UK Legal Test has been included so that the “*social and environmental purposes*” of the company are expressed up-front in the legal test in a clear manner. The effect of this under s172(2) of the Companies Act 2006 is that the obligation of the directors to promote the success of the company includes achieving those purposes. The inclusion of paragraph (1) will also emphasise the fact that at the heart of a B Corp's constitution is the “*triple bottom line*”.

- 3.8 Our approach to the word “*material*” is intended to indicate that the “*positive impact*” which the company is seeking to achieve is meaningful and more than tokenistic or trivial. A company which simply dabbles in a bit of corporate social responsibility is unlikely to be considered to be aiming to have a material positive overall impact on society and the environment and certainly not “*through its business and operations*”, which is about how the company carries out its core business. The word “*material*” is intended to take into account the relative size and scale of operations of the relevant company and so more impact would be expected of a larger company by virtue of the larger scale of the business and operations of the company.
- 3.9 The word “*positive*” is intended to be read with the words “*taken as a whole*” so that the aim is to achieve overall positive impact among all relevant stakeholder groups. This means that a company should not pursue strategies that create positive impact for one stakeholder group at the significant expense of another stakeholder group.
- 3.10 The word “*impact*” is understood in social science to mean “*positive change that would not otherwise have occurred*”. The intention of paragraph 1 of the Legal Test is to set out the “*purpose*” and aims of the company, as opposed to setting a benchmark for the results of the company and therefore B Corps are not required to take steps, such as randomised control trials, to evidence such impact on all key stakeholders in order to categorically demonstrate impact.
- 3.11 The words “*taken as a whole*” are intended to refer to taking a rounded view of the impact the Company has on society and the environment as well as to promoting the success of the Company for the benefit of the members as a whole.
- 3.12 If the Company fails to achieve a positive material impact taken as a whole in any given financial year, this does not mean to say that the directors will necessarily be in breach of their duties to the Company any more than if the Company failed to make a profit in the relevant financial year. What is important is that the directors act in good faith and in accordance with their other duties (including the duty of skill and care) so that the strategy and activities of the Company are directed towards the aim of achieving a positive material impact and that there is a reasonable prospect this will be achieved in time. The directors are accountable to members and the report required by paragraph (5) of the UK Legal Test should help members to assess how the directors have performed their duty.

### *Paragraph (2) of the UK Legal Test*

- 3.13 Paragraph (2) of the UK Legal Test tracks the format and language of s172 of the Companies Act 2006. Because of this it is arguably unnecessary but in the context of B Corps we think it is helpful for directors to have explicitly set out the factors they should take into account in fulfilling their duty to promote the success of the Company.

### *Paragraph (3) of the UK Legal Test*

- 3.14 The Companies Act s172 Framework makes the interests of the members a paramount consideration, which may ultimately subordinate other stakeholder interests.
- 3.15 The effect of paragraph 1 of the UK Legal Test should be that directors do not need to place members’ interests ahead of other interests because (as stated above), by virtue of s172(2), the statement that the company has other purposes redefines “*success*” and displaces the

members as the paramount interest group. However, it seems helpful to require the incorporation of paragraph (3) the UK Legal Test since this works to explain the effect of paragraph (1) of the UK Legal Test.

#### *Paragraph (4) of the UK Legal Test*

- 3.16 The UK legal test retains the concept (at paragraph (4) of the UK Legal Test) that stakeholders are not granted rights of recourse against directors in respect of the carrying out of their responsibilities in accordance with the UK Legal Test. This is an important component which is intended to deal with the concern that because directors have a duty to consider interests beyond those of the members, in theory their liabilities could also extend to those stakeholders who could potentially have standing to bring a claim. If this paragraph is not included, directors in the UK may potentially have concerns about adopting the B Corp form in case it exposes directors to claims from a very broad range of stakeholders, even though the UK Legal Test does not affect the fundamental principle (codified in s170 of the Companies Act 2006) that the duties of directors are owed to the company (and generally not to anyone else) and so the only person with a right of recourse is the company itself or in limited circumstances a member on behalf of the company.

#### *Paragraph 5 of the legal test*

- 3.17 Paragraph 5 of the UK Legal Test refers to s414A (1) and s414C of the Companies Act, which requires companies to produce a strategic report to accompany the annual accounts. The purpose of the strategic report is to help members of the company assess how the directors have performed their duty under section 172 to promote the success of the company, which in the case of a UK B Corp is as defined in paragraph (1) of the UK Legal Test.
- 3.18 In summary, the strategic report must contain a fair review of the Company's business and a description of the principal risks and uncertainties facing the Company. The review required is a balanced and comprehensive analysis of the development and performance of the company's business during the financial year and the position of the company's business at the end of that year, consistent with the size and complexity of the business.
- 3.19 Producing a strategic report will assist members in assessing whether the Company has an overall positive impact over time, taking all matters into account. The provision is included to ensure that even when a company would otherwise be exempt under the Companies Act from the requirement to produce a strategic report, it will still have to do so. The provision is also drafted so as to apply the requirement even if the Companies Act were to change subsequently and remove the requirement for companies to publish this report.

#### *Takeover Considerations*

- 3.20 The implications of paragraphs 1 to 4 of the UK Legal Test is that any Director who acts in the way he or she considers, in good faith, most likely to promote the success of the Company and in doing so takes into account the interests of Stakeholders other than members, shall not, absent another breach, be construed as being in breach of that Director's duty to the Company. This may conceivably result in the Company receiving a lower price on a disposal of any business or asset than might otherwise be the case or, in the context of a transaction leading to an offer or arrangement for an acquisition of shares in

the Company, in members receiving a lower price per share than might otherwise be the case.

- 3.21 In the public company context, the UK Takeover Code (the “**Code**”) expressly requires the board of a target company to set out for members its views on a proposed offer. In doing so it must include its views on the effects of the offer on all the company’s interests, including specifically on employment. The Code also specifically states that the board is not required by the Code to consider the offer price as the determining factor in giving its view and may take into account other factors it considers relevant.
- 3.22 In addition, a recent debate was held in parliament in relation to a probing amendment on whether directors of a target should set out in a takeover document how they have considered the factors set out in section 172 of the Companies Act. The government’s response was essentially that the amendment was not needed given the directors’ duty under section 172 applies at all times, including during a takeover.
- 3.23 The Policy Council have taken the view that equivalent wording in the US Legal Test regarding directors duties in the context of a change of control transaction is not required on the basis that it is already covered by the law and the preceding paragraphs of the UK Legal Test.

### *Insolvency Considerations*

- 3.24 The UK Legal Test tracks wording from most of the Companies Act s172 Framework, however it does not include the language at s172(3) of the Companies Act 2006. Section 172(3) of the Companies Act 2006 makes it clear, that, in an insolvency scenario, directors should consider and act in the interests of the creditors of the company. Since the incorporation of other purposes as contemplated by s172(2) in the UK Legal Test does not affect the duty to creditors under s172(3) it could be confusing or superfluous to refer to it in the UK Legal Test.

## **4. Other Options for B Corps**

- 4.1 Whilst the UK Legal Test is necessary to articulate the factors that a director should consider, there is no guidance in the test as to how these factors should be weighed. The directors of a prospective B Corp may find it helpful to include a set of guiding principles which set out the aims and principles by which the Company will conduct its business and enables the B Corp to articulate in more elaborate ways the aspects of its social responsibility.
- 4.2 Certain B Corps may wish to go a step further and articulate their social purpose more clearly in the objects of the company and lock-in this purpose by way of mission lock. Guidance could accompany the UK Legal Test to explain how this might be done. Ultimately, it is for the directors of the prospective B Corp to determine which constitutional provisions, if any, in addition to the mandatory UK Legal Test, are needed to articulate and protect the social identity and principles of the company.

## **5. Different Legal Forms**

- 5.1 The key consideration when deciding whether or not an organisation with a certain legal form or business model ought to be eligible to be a B Corp is whether a reasonable person would regard the organisation as a ‘business’ in the conventional sense and whether the

organisation is by its nature one which would fit well into the community of B Corps which B Lab in the US and B Lab (UK) wish to create.

- 5.2 A business will usually fit well into the community of B Corps if it generates the majority of its revenue from trading, competes in a competitive marketplace, is not a charity and is not a public body or otherwise majority owned by the state.

### *The Approach in the US*

- 5.3 In the US, only "*for profit*" entities which have an ability to distribute profits or assets to private parties are able to certify as B Corps. The rationale for this is that the founders of B Lab were committed to the notion of doing business in a new way and viewed non-profits and charities as falling into a separate category because non-profits and charities do not tend in the US to issue equity, trade or distribute profits and therefore the tension between members and other stakeholders does not exist.
- 5.4 However, the UK has a very different legal environment to the US and there is a pre-existing and established social enterprise movement, as well as diverse legal forms.

### *Companies Limited by Guarantee*

- 5.5 In the UK, some large businesses, such as BUPA and Welsh Water, are not "*for profit*" in the usual sense but instead use the company limited by guarantee legal form. A company limited by guarantee does not have share capital or shareholders, but instead has members who act as guarantors. The guarantors do not advance equity to the company but instead give an undertaking to contribute a nominal amount (typically £1.00) in the event of the winding up of the company.

A company limited by guarantee will usually have constitutional provisions which prohibit the distribution of profits or assets to members. However, an ordinary company limited by guarantee does not have an 'asset lock' and may – if it has the constitutional power to do so – make distributions of profits to members or transfer its assets at an undervalue to members or to other parties. We anticipate that a number of businesses which are companies limited by guarantee will wish to certify as B Corps and, provided the business generates the majority of its income by trading in a competitive marketplace, we see no reason why an ordinary company limited by guarantee should not be capable of certifying as a B Corp.

### *Community Interest Companies*

- 5.6 A Community Interest Company ("**CIC**") is a special type of limited company which exists to benefit the community. CICs have social objectives and profits generated by a CIC must be used wholly for community benefit.
- 5.7 One of the main features of a CIC is that it has a regulated "*asset lock*", which ensures that the company's assets are used for its social objectives and which sets limits to the profits it can pay to shareholders. A CIC cannot be a charity. CIC's can be incorporated as either companies limited by shares or companies limited by guarantee. In light of the fact that CIC's limited by shares can distribute some profits (subject to the dividend cap which requires 65% of CIC's aggregate distributable profits in each year to be reinvested back into the company), CIC's limited by shares should be capable of becoming B Corps.

- 5.8 It is notable that approximately 75% of CICs are limited by guarantee. To avoid confusion and the risk of a perception of conflict between the CIC community and the B Corp community, the Policy Council recommends that CICs limited by guarantee should also be eligible for B Corp status.

### *Charities*

- 5.9 As the B Corp model exists to demonstrate that business can be a force for good, it is important that, in the public mind, the B Corp brand is associated with business.
- 5.10 Some charities trade in competitive markets and receive the majority of their income from trading activities. However, the majority of charities are primarily funded through grants, donations and voluntary income. All charities receive significant tax breaks from the state, including relief from corporation tax, and have the usual brand associations which go with charitable status. In the public mind, charity and business are two very different things. As a result, the Policy Council recommends that charities are excluded from eligibility for B Corp status, as charities already have a strong 'socially responsible' brand in any event and because there is a risk that allowing charities to become B Corps confuses and dilutes the B Corp brand. However, the Policy Council anticipates that a typical trading subsidiary of a charity would be eligible for B Corp status, provided that it meets the criteria set out in paragraph 5.14.

### *Public Bodies*

- 5.11 Similarly, entities which receive the majority of their income from grant or other subsidies from the state or are public bodies according to the Office of National Statistics classification criteria – and which are therefore considered to be part of the state and on its balance sheet – should not generally be eligible for B Corp status, as such entities will not generally be operating in competitive markets.
- 5.12 Where a business is majority owned by the state it is unlikely to be eligible to become a B Corp. It is possible that there may be some exceptions to this principle where a business is nevertheless competing in the market on a level playing field with other businesses but this is likely only to be in a small minority of cases.
- 5.13 A business which competes in public service markets and so receives the majority of its income through contracts with the state will usually be eligible for B Corp status.

### *Conclusion*

- 5.14 In summary, in the UK, every organisation which has the following characteristics is likely to be regarded by a reasonable person as a 'business', to fit well into the B Corp community and therefore be eligible for certification;
- 5.14.1 it competes in the marketplace with respect to its core business activities;
- 5.14.2 it receives the majority of its income from its business activities;
- 5.14.3 it is not a "*public body*" in accordance with Office of National Statistics classification criteria, as amended from time to time (unless it can clearly demonstrate that it is operating in a competitive marketplace); and

- 5.14.4 it is not registered as a “*charity*” with the Charity Commission, Office of the Scottish Charities Regulator, the Charity Commission for Northern Ireland or Her Majesty’s Revenue and Customs and is not otherwise an exempt or excepted charity,
- 5.15 Such businesses may be in the form of (amongst others) companies limited by shares (including typical trading subsidiaries of charities), companies limited by guarantee (other than charities), community interest companies (whether limited by guarantee or shares), co-operatives, community benefit societies (other than charities), partnerships and limited liability partnerships.
- 5.16 Where there are difficult or borderline cases, the Policy Council will recommend to B Lab (UK) whether the particular business in question is eligible for B Corp status. A right of appeal from decisions of the Policy Council will rest to the board of B Lab (UK).
- 5.17 The Policy Council and B Lab (UK) reserve the right to develop and update the UK Legal Test over time and in light of market and other developments.

## **6. Other Legal Forms - The UK Legal Test**

- 6.1 The UK Legal Test asset out above is suited to a company limited by shares. Adaptations of the Legal Test for other legal forms are set out in the appendix.

## APPENDIX – LEGAL TEST FOR OTHER LEGAL FORMS

### CIC Legal Test – Limited by Shares or Guarantee

1. The objects of the Company are:
  - 1.1 to carry on activities which benefit the community and in particular (without limitation) to [ ]; and
  - 1.2 through its business and operations, to have a material positive impact on society and the environment, taken as a whole.
2. A Director shall have regard (amongst other matters) to:
  - 2.1 the likely consequences of any decision in the long term,
  - 2.2 the interests of the Company's employees,
  - 2.3 the need to foster the Company's business relationships with suppliers, customers and others,
  - 2.4 the impact of the Company's operations on the community and the environment,
  - 2.5 the desirability of the Company maintaining a reputation for high standards of business conduct, and
  - 2.6 the need to act fairly as between members of the Company,

(together, the matters referred to above shall be defined for the purposes of this Article as the "Stakeholder Interests").
3. Subject to the requirement to carry on activities which benefit the community under Article [ ] and the Regulations, for the purposes of a Director's duty to act in the way he or she considers, in good faith, most likely to promote the success of the Company a Director shall not be required to regard the benefit of any particular Stakeholder Interests or group of Stakeholder Interests as more important than any other.
4. Nothing in this Article express or implied, is intended to or shall create or grant any right or any cause of action to, by or for any person (other than the Company).
5. The Directors of the Company shall for each financial year of the Company explain in the strategic report accompanying the annual accounts of the Company (or where the Company benefits from the small companies exemption, a report in the form of a strategic report) how the Directors have sought to promote the success of the Company in accordance with this Article.

## Company Limited by Guarantee Legal Test

1. The objects of the Company are:
  - 1.1 to [ ]; and
  - 1.2 through its business and operations, to have a material positive impact on society and the environment, taken as a whole.
2. A Director shall have regard (amongst other matters) to:
  - 2.1 the likely consequences of any decision in the long term,
  - 2.2 the interests of the Company's employees,
  - 2.3 the need to foster the Company's business relationships with suppliers, customers and others,
  - 2.4 the impact of the Company's operations on the community and the environment,
  - 2.5 the desirability of the Company maintaining a reputation for high standards of business conduct, and
  - 2.6 the need to act fairly as between members of the Company,

(together, the matters referred to above shall be defined for the purposes of this Article as the "Stakeholder Interests").
3. For the purposes of a Director's duty to act in the way he or she considers, in good faith, most likely to promote the success of the Company, a Director shall not be required to regard the benefit of any particular Stakeholder Interests or group of Stakeholder Interests as more important than any other.
4. Nothing in this Article express or implied, is intended to or shall create or grant any right or any cause of action to, by or for any person (other than the Company).
5. The Directors of the Company shall for each financial year of the Company explain in the strategic report accompanying the annual accounts of the Company (or where the Company benefits from the small companies exemption, a report in the form of a strategic report) how the Directors have sought to promote the success of the Company in accordance with this Article.

## LLP Legal Test

1. The purposes of the LLP are to promote the success of the LLP for the benefit of the Members and, through the carrying out of the Business and the operations of the LLP, to have a material positive impact on society and the environment, taken as a whole.
2. Each of the Members and each member of the Management Board shall have regard, among others, to the following factors:
  - 2.1 the likely consequences of any decision in the long term;
  - 2.2 the interests of the LLP's employees;
  - 2.3 the need to foster the LLP's business relationships with suppliers, customers and others;
  - 2.4 the impact of the LLP's operations on the community and the environment;
  - 2.5 the desirability of the LLP maintaining a reputation for high standards of business conduct; and
  - 2.6 the need to act fairly as between Members of the LLP,

(together, the matters referred to above shall be defined for the purposes of this clause as the "Stakeholder Interests").
3. Each of the Members and each member of the Management Board shall be under a duty to act in the way he or she considers, in good faith, most likely to promote the success of the LLP and a Member shall not be required to regard the benefit of any particular Stakeholder Interests or group of Stakeholder Interests as more important than any other.
4. Nothing in this clause express or implied, is intended to or shall create or grant any right or any cause of action to, by or for any person (other than the LLP).
5. The Management Board shall for each financial year of the LLP explain in the form of a strategic report accompanying the annual accounts of the LLP how the Directors have sought to promote the success of the LLP in accordance with this Article.