Mapping the State of Social Enterprise and the Law

2018–2019

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The Grunin Center

The Grunin Center for Law and Social Entrepreneurship was founded to create new ways for law and lawyers to support positive change in the world. Our mission is to enhance the community of lawyers and legal institutions engaged in social entrepreneurship and impact investing and to accelerate their effective participation in these fields.

To this end, the Grunin Center will publish The State of Social Enterprise and the Law annually. The second in the series, this report seeks to capture the encouraging progress that has been made at the state level to recognize specialized social enterprise legal forms and to provide incentives for social entrepreneurship through specialized tax treatment and other public policy measures. The report will also examine alternative ownership structures that have been recently adopted by companies, including social enterprises, across the United States to ensure long-term mission preservation and independence.

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About the Authors

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Introduction

The field of social enterprise law is steadily evolving in the United States. A decade into the emergence of social enterprise legal forms, more states than ever before have enacted at least one social enterprise enabling statute, with legislators at times even altering the traditional elements of the forms to address perceived needs and challenges. Across the country, a budding legal ecosystem is also developing to advance social entrepreneurship and provide incentives for the adoption of social enterprise legal forms.

For example, social enterprises can now receive procurement preferences or tax credits in several municipalities. Furthermore, the emergence of alternative ownership structures that enable companies to protect their mission and long-term independence is redefining governance and ownership for mission-driven companies.

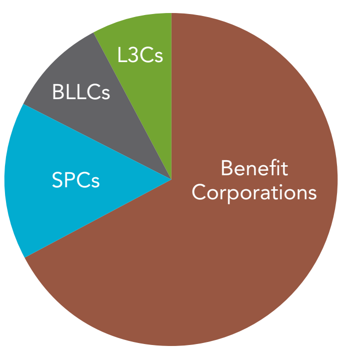
Notwithstanding the interesting developments taking place in social enterprise legislation and policy, the fields of social entrepreneurship and impact investing remain largely in flux. Policymakers, scholars, attorneys, and entrepreneurs continue to grapple with important questions about the value of social enterprise legal forms, and the feasibility of specialized tax treatment for social enterprises.

This report intends to evaluate the state of social enterprise and the law in the United States and help social entrepreneurs, impact investors, and their counsel navigate this rapidly evolving field. The report provides a comprehensive mapping of legislative developments in the United States with respect to forms of legal entities available to social entrepreneurs, describes recent developments in tax law and public policy to advance social entrepreneurship, and explores novel ownership structures being adopted by social enterprises to enshrine purpose into their companies.

Mapping State Legislation

With the adoption of the low-profit limited liability company (L3C) statute in Vermont in 2008, state legislatures across the United States began authorizing new forms of legal entities to house social entrepreneurial activities. These corporate forms were designed for for-profit businesses that seek to create positive social and environmental impacts in addition to financial returns. The most common of these forms of entities include the benefit corporation, the social purpose corporation (SPC), the low-profit limited liability company (L3C), and the benefit limited liability company (BLLC).

A decade later, social enterprise legislation continues to grow throughout the United States. As of December 31, 2018, 38 state jurisdictions across the country have enacted at least one social enterprise statute. Benefit corporations are the most popular, recognized by 35 states and the District of Columbia. The L3C is offered in eight states, the BLLC in five states, and the SPC in four states.



Enacted legislation

As of December 31, 2018

Beyond the absolute number of social enterprise laws adopted across the United States, the Social Enterprise Law Tracker reveals a number of interesting trends in the social enterprise landscape. The benefit corporation continues to be the most popular type of legal form, although in 2018, it experienced more failed legislative attempts at enacting authorizing statutes (six states) than any of the other entity types. While certainly not as widely adopted, BLLCs appear to be slowly gaining traction, with three bills under consideration in 2018, two of which have since been enacted. SPCs have not seen much activity in recent years, and legislative attempts at enacting L3C statutes failed in three states in 2018.

The Social Enterprise Law Tracker's findings also indicate that in recent years more states have considered adopting multiple forms of social enterprise legislation. In 2018 alone, seven states considered enacting a second or third form of social enterprise statute. Additionally, current legislative developments in Delaware may signal the upcoming adoption of a new social enterprise form. In particular, Delaware has developed a draft amendment to its existing Limited Partnership Act to permit the formation of a "statutory public benefit limited partnership." Below we explore each of these trends in turn.

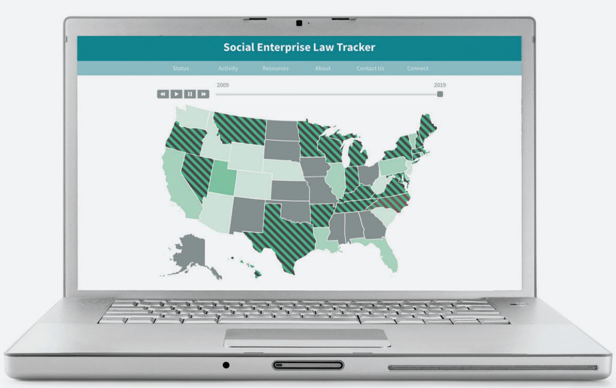
1 H.0775 "Low-Profit Limited Liability Companies" Vermont Legis. Session 2007-2008, http://www.leg.state.vt.us/database/status/summary.cfm?Bill=H.0775&Session=2008

The Social Enterprise Law Tracker

This mapping of state legislation is based on findings drawn from the Social Enterprise Law Tracker. Designed as a comprehensive online resource for legal practitioners and researchers, the Social Enterprise Law Tracker compiles relevant legislative actions across the 50 US states and the District of Columbia.[2]

Using an interactive map, the Social Enterprise Law Tracker aims to make it easy for users to see at a glance which states allow for the various social enterprise legal structures, as well as how social enterprise legislation has spread across the country from 2009 to the present day. The Social Enterprise Law Tracker is the first such tool to provide comprehensive mapping of social enterprise legislation in the United States.

The Social Enterprise Law Tracker was first developed in 2013 by Shawn Pelsinger and Robert Esposito, both Jacobson Fellows in Law and Social Enterprise at New York University School of Law. The Social Enterprise Law Tracker is now managed and updated by the Grunin Center for Law and Social Entrepreneurship at New York University School of Law.



2 The Social Enterprise Law Tracker *available at* https://www.socentlawtracker.org/#/map

Categorizations

The Social Enterprise Law Tracker maps the following social enterprise legal forms: the benefit corporation, the social purpose corporation (SPC), the low-profit limited liability company (L3C), and the benefit limited liability company (BLLC).

It is important to note what these categorizations represent. Benefit corporations are a type of corporate entity authorized by state law. They must be distinguished from "B Corporations," which are companies that have been certified by the independent nonprofit organization, B Lab. Furthermore, while benefit corporation statutes are often based on the Model Benefit Corporation Legislation, particular features vary across jurisdictions.

Similarly, SPC and BLLC statutes are not uniform. While California, Washington, and Florida recognize SPCs as a distinct corporate form, Texas simply allows all for-profit corporations to adopt a "social purpose." BLLCs have been enacted in five states, and each state has done so somewhat differently. Oregon has one statute for "benefit companies," allowing both corporations and LLCs to adopt the form. Pennsylvania and Utah use the term "benefit company" but only in reference to BLLCs, and both states have separate statutes for benefit corporations. Maryland has a standalone BLLC statute and does not use the term "benefit company." Most recently, Delaware amended its LLC statute to allow for the formation of a statutory "public benefit limited liability company," which closely corresponds to many of the material provisions of Delaware's corporate law statute that relate to public benefit corporations, such as its entity purpose requirement and its balancing of interests provision.

The benefit corporation continues to be the most popular social enterprise form, although no new states enacted legislation authorizing benefit corporations in 2018

Six benefit corporation bills were considered in 2018 in Alaska, Michigan, Mississippi, Missouri, Oklahoma, and Ohio. However, all six bills failed to make it to their respective floors for a vote and died in committee. Additionally, New Jersey and Florida introduced amendments related to existing benefit corporation legislation. New Jersey introduced a bill (S 2260) to clarify the purpose of benefit corporations and the standard of duty for the board of directors,[3] and Florida amended its business entity statute (H.B. 1285) to allow state banks and trust companies regulated by the Florida Office of Financial Regulation to modify their articles of incorporation to include provisions required of a benefit corporation (or an SPC).[4]

Benefit corporation bills were introduced in 2018 in Mississippi (H.B. 544),[5] Missouri (H.B. 2669 and S.B. 754),[6] and Michigan (a series of four benefit corporation bills: H.B. 5868, which generally defines a benefit corporation; H.B. 5867, which authorizes and establishes duties of officers and directors for benefit corporations; H.B. 5872, which requires annual benefit reports; and H.B. 5869, which establishes annual report filing requirements),[7] all of which subsequently died in the same year.

Benefit corporation bills in Oklahoma (H.B. 1809 and S.B. 343),[8] Alaska (H.B. 124),[9] and Ohio (S.B. 205)[10] were all introduced in 2017 and carried over to the 2018 Regular Session but did not emerge for a vote in their respective floors and died in 2018.

Interestingly, all of these states were considering benefit corporation legislation in 2018 after having previously failed with different versions of their respective bills. Despite this notable failure rate, benefit corporation bills were pre-filed in Missouri and New Mexico in December of 2018 in anticipation of the next legislative session,[11] and several bills were reintroduced across other states in the first few months of 2019, foreshadowing a resurgence in benefit corporation legislation.[12]

Recent developments in benefit corporation legislation also suggest an ongoing examination of key questions that benefit corporations are grappling with, namely: considering expanded fiduciary duties of directors and evaluating the need for benefit directors.

- **Expanded fiduciary duties of directors.** The ABA Corporate Law Committee is in the process of updating a

3 New Jersey Benefit Corporation Amendments, S. 2260, (2018-2019 Regular Session), Open States, *available at* https://openstates.org/nj/bills/218/S2260/

4 Florida Business Entities Amendment, H.B. 1285 (2018 Regular Session), *available at* http://flsenate.gov/Session/Bill/2018/01285/ByCategory/?Tab=BillHistory

5 Mississippi Benefit Corporation Act, H.B. 544, 2018 Reg. Sess. (Miss. 2018), *available at* http://billstatus.ls.state.ms.us/2018/pdf//history/HB/HB0544.xml

6 Missouri Benefit Corporation Act, H.B. 2669, 99th Gen. Ass. (Mo. 2018), *available at* https://house.mo.gov/billtracking/bills181/hlrbillspdf/6676H.01I.pdf; Missouri Benefit Corporation Act, S.B. 754, 99th Gen. Ass. (Mo. 2018), *available at* https://house.mo.gov/billtracking/bills181/hlrbillspdf/6676H.01I.pdf

7 Michigan Benefit Corporation Bills, Open States (2017-2018 Regular Session), *available at* https://openstates.org/mi/bills/?query=benefit+corporation&session=&classification=&sponsor=

8 Oklahoma Benefit Corporation Act, H.B. 1809 (2017-2018 Regular Session), *available at* http://www.oklegislature.gov/BillInfo.aspx?Bill=HB1809&session=1800; Oklahoma Benefit Corporation Act, S.B. 343 (2017-2018 Regular Session), *available at* http://www.oklegislature.gov/BillInfo.aspx?Bill=SB343&session=1800

9 Alaska Benefit Corporation Act, H.B. 124 (2017-2018 Regular Session), *available at* http://www.akleg.gov/basis/Bill/Detail/30?Root=HB0124#tab6_4

10 Ohio Benefit Corporation Bills, S.B. 205 (2017-2018 Regular Session), *available at* https://www.legislature.ohio.gov/legislation/legislation-status?id=GA132-SB-205

11 Missouri Benefit Corporation Act, S.B. 105, (2018 Regular Session), *available at* https://www.senate.mo.gov/19info/pdf-bill/intro/SB105.pdf; New Mexico Benefit Corporation Act, H.B. 467, (2018 Regular Session), available at https://www.nmlegis.gov/Legislation/Legislation?chamber=H&legtype=B&legno=467&year=17

12 For example: North Dakota benefit corporation bill, H.B. 1466 (2019 Regular Session) *available at* https://www.legis.nd.gov/assembly/66-2019/documents/19-0151-02000.pdf; Oklahoma benefit corporation bill, H.B. 2423 (2019 Regular Session), *available at* http://webserver1.lsb.state.ok.us/cf_pdf/2019-20 COMMITTEE AMENDMENTS/House/HB2423 FULLPCS1 BEN LORING-JBH.PDF; Ohio benefit corporation bill, S.B. 21 (2019-2020 Regular Session), *available at* https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA133-SB-21; Missouri benefit corporation bill in the House, H.B. 1154 (2019 Regular Session), *available at* https://house.mo.gov/billtracking/bills191/hlrbillspdf/2329H.01I.pdf; Missouri benefit corporation bill in the Senate S.B.105 (2019 Regular Session), *available at* https://www.senate.mo.gov/19info/pdf-bill/intro/SB105.pdf; Georgia benefit corporation bill H.B. 230 (2019-2020 Regular Session), *available at* http://www.legis.ga.gov/Legislation/20192020/180933.pdf; Iowa benefit corporation bills H.F. 229, H.F. 312, and H.F. 645 (2019-2020 Regular Session), *available at* https://www.legis.iowa.gov/docs/publications/LGI/88/attachments/HF229.html, https://www.legis.iowa.gov/docs/publications/LGI/88/attachments/HF312.html, and https://www.legis.iowa.gov/docs/publications/LGI/88/attachments/HF645.html

white paper and sample statute to make the directors responsible for the impact that corporate activities have on stakeholders, not just shareholders.[13] The updated sample statute would differ from its prior version by adding express duties of directors to act in a responsible and sustainable manner and to consider, in addition to the interests of shareholders, separate interests of stakeholders known to be affected by the business of the corporation, such as the employees and workforces of the corporation; customers; and the local and global environment, to name a few.[14]

It appears that states have also begun to actively consider a shift in how they define fiduciary duties for directors of benefit corporations. For example, New Jersey introduced a bill (S 2260) in March 2018 that would amend New Jersey's existing benefit corporation legislation to clarify the purpose of benefit corporations and the standard of duty for the board of directors.[15] Specifically, the new statutory scheme includes a specialized standard of directors' conduct that instructs directors to consider a list of particular constituencies.[16] This bill was referred to a Senate committee, and no other legislative action has taken place.[17]

- **Reconsidering benefit directors.** Along with the examination of fiduciary duties of directors generally, another evolving trend with respect to benefit corporation legislation is the apparent decrease in popularity of benefit director provisions. Benefit director provisions are statutory provisions that allow or require the benefit corporation to designate an individual as a benefit director.[18] The benefit director must be independent from the benefit corporation and is tasked with preparing the annual compliance statement portion of the annual benefit report and providing their perspective on whether the corporation has been successful in pursuing its public benefit purpose.[19] While earlier versions of the Model Benefit Corporation Legislation required that each benefit corporation have a benefit director, the 2014 version of the Model Legislation limited the benefit director requirement to publicly traded benefit corporations,[20] and the current version of the Model Legislation, established on April 17, 2017, eliminated the requirement altogether.[21]

This evolving trend is also reflected in the most recent benefit corporation bills that were under consideration. In 2018, two out of the six benefit corporation bills under consideration—Michigan (H.B. 5868, H.B. 5867, H.B. 5872, H.B. 5869),[22] and Ohio (S.B. 205)[23]—did not include any reference to benefit directors. Another three out of the six bills—Missouri (H.B. 2669),[24] Mississippi (H.B. 544 and S.B. 754),[25] and Alaska (H.B. 124)[26]—merely allowed for the creation of benefit directors but did not make it a requirement. Only Oklahoma's bill in the House (H.B. 1809) explicitly required a benefit director for publicly traded corporations.[27] However, unlike its bill in the House, Oklahoma's bill in the Senate (S.B. 343) authorizes but does not require the creation of a benefit director

13 The Corporate Law Committee. *Changes in the Model Business Corporation Act—Proposed New Chapter 17 on Benefit Corporations.* ABA Business Law Section (April 10, 2019).

14 Email exchange with Rick Alexander, Head of Legal Policy at B Lab, on Wednesday, May 1, 2019.

15 New Jersey Benefit Corporation Amendments, S. 2260, (2018-2019 Regular Session), Open States, *available at* https://openstates.org/nj/bills/218/S2260/

16 *Id.*

17 *Id.*

18 Montgomery, John. Mastering the Benefit Corporation. American Bar Association (Sep. 19, 2018), *available at* https://www.americanbar.org/groups/business_law/publications/blt/2016/07/02_montgomery/

19 *Id.*

20 The Model Benefit Corporation Legislation (June 24, 2014), *available at* https://benefitcorp.net/sites/default/files/documents/Model_Benefit_Corp_Legislation.pdf

21 The Model Benefit Corporation Legislation (April 17, 2017), *available at* https://benefitcorp.net/sites/default/files/Model%20benefit%20corp%20legislation%20_4_17_17.pdf

22 Michigan Benefit Corporation Bills, Open States (2017-2018 Regular Session), *available at* https://openstates.org/mi/bills/?query=benefit+corporation&session=&classification=&sponsor=

23 Ohio Benefit Corporation Bills, S.B. 205 (2017-2018 Regular Session), *available at* https://www.legislature.ohio.gov/legislation/legislation-status?id=GA132-SB-205

24 Missouri Benefit Corporation Act, H.B. 2669, 99th Gen. Ass. (Mo. 2018), *available at* https://house.mo.gov/billtracking/bills181/hlrbillspdf/6676H.01I.pdf; Missouri Benefit Corporation Act, S.B. 754, 99th Gen. Ass. (Mo. 2018), *available at* https://house.mo.gov/billtracking/bills181/hlrbillspdf/6676H.01I.pdf

25 Mississippi Benefit Corporation Act, H.B. 544, 2018 Reg. Sess. (Miss. 2018), *available at* http://billstatus.ls.state.ms.us/2018/pdf//history/HB/HB0544.xml

26 Alaska Benefit Corporation Act, H.B. 124 (2017-2018 Regular Session), *available at* http://www.akleg.gov/basis/Bill/Detail/30?Root=HB0124#tab6_4

27 Oklahoma Benefit Corporation Act, H.B. 1809 (2017-2018 Regular Session), *available at* http://www.oklegislature.gov/BillInfo.aspx?Bill=HB1809&session=1800

for any benefit corporation.[28] These legislative developments suggest that benefit director provisions are falling out of favor. It is believed that this trend is motivated by a newfound understanding that benefit corporations are about re-orienting the corporation, not about establishing a niche.[29]

Finally, benefit corporations continue to be subject to ongoing criticism over lax reporting practices and accountability. While every state's benefit corporation statute requires benefit reporting, not all states require that the benefit report be filed with the state.[30] Additionally, there is no effective policing in place and benefit corporations go largely unregulated. Thus, there is a valid concern that many benefit corporations are not complying with the benefit reporting requirement.[31] In fact, data collected from early benefit corporations show a benefit report compliance rate of below 10 percent.[32] This raises important questions as to who should shoulder the responsibility of ensuring compliance by benefit corporations, the state or the private sector, and how thorough should that screening process be. Some are of the opinion that shareholders should be responsible for enforcing the disclosure obligation, just as it is up to shareholders to enforce the corporation's obligation to consider the interests of relevant stakeholders, because ultimately the theory of the benefit corporation is that shareholders should want the company to operate on stakeholder values.[33]

28 Oklahoma Benefit Corporation Act, S.B. 343 (2017-2018 Regular Session), *available at* http://www.oklegislature.gov/BillInfo.aspx?Bill=SB343&session=1800

29 Yale Environmental Law Association, Patagonia, Inc., Vermont Law School. A Legislative Guide to Benefit Corporations (2018), *available at* http://benefitcompanybar.org/wp-content/uploads/2018/07/Legislative-Guide-B-Corps_Final.pdf; email exchange with Rick Alexander, Head of Legal Policy at B Lab, on Sunday, March 10, 2019 [hereinafter *Rick Alexander March Interview*].

30 Yale Environmental Law Association, Patagonia, Inc., Vermont Law School. A Legislative Guide to Benefit Corporations (2018), *available at* http://benefitcompanybar.org/wp-content/uploads/2018/07/Legislative-Guide-B-Corps_Final.pdf

31 Diehl, Caleb. Benefit Company Label Marred by Confusion and Lax Reporting Practices. Oregon Business (Sept. 20 2018), *available at* https://www.oregonbusiness.com/article/energy-environment/item/18511-benefit-company-label-marred-by-confusion-and-lax-reporting-practices

32 Murray, J. Haskell, An Early Report on Benefit Reports (October 28, 2015). West Virginia Law Review, Vol. 118, No. 25, 2015, *available at* https://ssrn.com/abstract=2682709

33 Rick Alexander March Interview, *supra* note 29.

In conclusion, a number of interesting trends have developed around benefit corporation statutes as they continue to evolve to meet the practical needs of the community. Although no benefit corporation bills were passed this year, all six bills considered were in states where prior versions of the bill had failed, and this highlights states' committed interest in passing benefit corporation legislation and attracting this new market to their local economy. Additionally, these bills differed significantly from the benefit corporation statutes contemplated a decade ago. Structural changes, such as the reconceptualization of directors' fiduciary duties and the decreasing popularity of benefit director provisions, suggest that the field is still wrestling with how best to address the interests and needs of social entrepreneurs.

Growing interest in the BLLC

As of December 31, 2018, the BLLC has been enacted in five states and has seen slightly more growth over the past year than any other social enterprise form. In March of 2018, Utah became the fourth state to enact a BLLC statute (H.B. 186),[34] which amended Utah's Limited Liability Company Act,[35] and, in July of 2018, Delaware amended its Limited Liability Company Act (S.B. 183) to allow the formation of statutory public benefit limited liability companies (PBLLCs).[36] Lastly, Connecticut's BLLC statute (H.B. 5251) was introduced on February 26, 2018, but it did not emerge in the House for a vote and died in committee.[37]

Utah's Benefit Limited Liability Company Act requires that the entity have a stated purpose of creating a general or specific public benefit.[38] Similar to Utah's Benefit Corporation legislation, the new statute lists specific public benefits of a BLLC, which include providing low-income

34 Utah Limited Liability Company Amendments, H.B. 186, (2018 General Session), *available at* https://le.utah.gov/~2018/bills/static/HB0186.html

35 *Id.*

36 Delaware Limited Liability Company Amendments, S.B. 183, (2017-2018 General Session), *available at* https://legis.delaware.gov/BillDetail?LegislationId=26554

37 Connecticut Act Establishing Benefit Limited Liability Companies, H.B. 2521, (2018 General Session), *available at* https://www.cga.ct.gov/asp/cgabillstatus/cgabillstatus.asp?selBillType=Bill&bill_num=HB5251&which_year=2018

38 Utah Limited Liability Company Amendments, H.B. 186, (2018 General Session), *available at* https://le.utah.gov/~2018/bills/static/HB0186.html

or underserved individuals or communities with beneficial products, protecting or restoring the environment, and improving human health, to name a few.[39] While many states have enacted BLLC legislation as a result of their limited LLC statutes, Utah did not share in this rationale. Interestingly, Utah's LLC statute actually provides the flexibility to allow for a company to operate in a way that benefits the community.[40] Therefore, Utah chose to enact a BLLC statute so that companies could organize as a BLLC and use this legal classification strategically to show the public their commitment to creating a public benefit.[41]

Delaware's PBLLC statute (Subchapter XII of Chapter 18, Title 6 of the Delaware Code) closely tracks the Delaware public benefit corporation statute.[42] The PBLLC statute permits a for-profit LLC to balance the members' pecuniary interests with the public benefit to be promoted by the PBLLC, as well as the best interests of those materially affected by the PBLLC's conduct.[43] Although the managers of the PBLLC are required to balance the members' pecuniary interests with the stated public benefit, the managers are not subject to personal liability for monetary damages for failure to balance such interests.[44] These amendments also impose a two-third member voting requirement for PBLLCs seeking to amend their certificate of formation in order to revise the statement of public benefit, merge into an entity that is not a PBLLC, or otherwise cease to be a PBLLC.[45]

39 *Id.*

40 Baldwin, Bruce. The Pennsylvania Limited Liability Company Law of 2017 (2016), Business Advisor, *available at* https://422business.com/groups/legal-perspectives/pennsylvania-limited-liability-company-law-2017; Batey, Doug. Oregon becomes the second state to authorize benefit LLCs (Jun. 7 2013), Lexology, *available at* https://www.lexology.com/library/detail.aspx?g=e5bde836-e2a1-430e-8f70-5f4c5fc5ef63

41 Nydegger, Workman. *Considering the Benefits of a Benefit Limited Liability Company* (Jun. 11 2018), Lexology, *available at* https://www.lexology.com/library/detail.aspx?g=de5002cd-ab76-414e-831f-f2588121fb2d

42 Susan Mac Cormac, Alfredo Silva, and Jesse Finfrock. Delaware Considers New Statutory Public Benefit Limited Liability Company. MoFo Impact (June 4, 2018), *available at* https://impact.mofo.com/corporate-form/delaware-considers-new-statutory-public-benefit-limited-liability-company/

43 Allison L. Land. Delaware Enacts Amendments to LLC Act and Delaware General Corporation Law. Skadden, Arps, Slate, Meagher & Flom (August 2, 2018), *available at* https://www.skadden.com/insights/publications/2018/08/delaware-enacts-amendments

44 *Id.*

45 Id

Notably, the BLLC bill (H.B. 5251) introduced by Connecticut in February 26, 2018, was unlike other states' BLLC legislation. It recognized BLLCs as a distinct entity separate from benefit corporations.[46] Supporters of the bill believed that it offered greater financial, management, and tax flexibility, which if enacted, could have attracted thousands of businesses into the state.[47] However, the bill did not come to the floor for a vote and died in committee,[48] marking the second time that Connecticut's BLLC bill has died. Despite this, the state has not given up on its efforts to pass BLLC legislation, and a bill (H.B. 5600) was introduced on January 18, 2019, that proposed an act concerning a study of the tax implications of allowing BLLCs under state law.[49] This legislative activity indicates that Connecticut's BLLC legislation is still under contemplation.

Although the BLLC is still only the third most popular social enterprise form, the trends from this year suggest that this entity form is enjoying growing support. Moreover, the rise of BLLC legislation highlights states' interest in identifying and providing new tools for their local social enterprise communities to expand. However, given that the enacted BLLC statutes are not uniform and no other jurisdictions are considering BLLC legislation as of December 2018, it is unclear which model, if any, will be followed for future BLLCs.

L3C Legislation Continues to Fail

While L3C legislation has seen a higher overall adoption rate than either SPCs or BLLCs over the past decade, introduced L3C legislation has consistently failed throughout the country—between 2008 and 2017, approximately

46 Connecticut Act Establishing Benefit Limited Liability Companies, H.B. 2521, (2018 General Session), *available at* https://www.cga.ct.gov/asp/cgabillstatus/cgabillstatus.asp?selBillType=Bill&bill_num=HB5251&which_year=2018

47 Connecticut Act Establishing Benefit Limited Liability Companies—Judiciary Committee Joint Favorable Report, H.B. 2521, (2018 General Session), *available at* https://www.cga.ct.gov/2018/JFR/h/pdf/2018HB-05251-R00JUD-JFR.pdf

48 Session Schedules. State Scape Legislative & Regulatory Tracking, *available at* http://www.statescape.com/resources/legislative/session-schedules.aspx

49 Connecticut Act Concerning a Study of Tax Implications of Allowing Benefit Limited Liability Companies Under States Law, H.B. 5600, (2019 General Session), Open States, *available at* https://openstates.org/ct/bills/2019/HB5600/

40 L3C bills failed to make it out of legislative committees.[50] L3Cs are also the only form of legal entity to see its legislation repealed.[51]

In 2018, L3C statutes were considered but failed to be enacted in New York (A 10060),[52] Massachusetts (S. 184),[53] and Hawaii (H.B. 19).[54] Notably, New York and Massachusetts had previously introduced versions of the L3C bills that had also failed.

It appears that states that are still interested in introducing L3C legislation attribute this in part to the success found by other states. For example, in New York, L3C bill supporters noted that "judging from the examples of other states that have enacted L3C legislation, such entities are particularly favorable to equity investment because the foundations can take the highest risk at little or no return. Such trenched investing has been described as turning the venture capital model on its head, giving many social enterprises a low enough cost of capital that they are able to be self-sustainable."[55] However, there has also been a significant amount of resistance to the adoption of these entity forms, which may explain in part the high failure rate. In Hawaii, for example, the Department of Taxation of the House Committee on Economic Development and Business shared three main concerns: 1) the L3C bill fails to provide any enforceable standard to guide the enterprise's pursuit of social benefits or for the department to determine the same; 2) being an L3C will not provide advantages over any other legal form of business organization, because a regular LLC can already do the same things; and 3) while a nonprofit entity has certain reporting requirements, which the public may access through the attorney general's website, the L3C statute contains no such reporting, monitoring, and oversight requirements.[56]

No states have adopted SPC statutes in 2018, but one state amended legislation to make the SPC form available to state banks and trust companies

To date, only four states continue to offer SPC statutes—California, Florida, Texas, and Washington. The only legislative activity that occurred in 2018 with respect to SPCs took place in Florida, which amended its business entity statute (H.B. 1285)[57] to allow state banks and trust companies regulated by the Florida Office of Financial Regulation to modify their articles of incorporation to include provisions required for an SPC (or a benefit corporation).[58] The amendment also expressly allows SPCs or benefit corporations to omit confidential information from their annual benefit reports.[59]

Given that the enacted SPC statutes are not uniform and no other jurisdiction has considered SPC legislation, it is unclear whether SPCs will see broader adoption, or which SPC model will be followed, if any, for future SPCs.

More states are adopting multiple forms of social enterprise legislation

As of December 31, 2018, 11 states have enacted more than one form of social enterprise legislation. Notably, all 11 states have adopted benefit corporations legislation, while only five have enacted BLLC statutes; five have L3C statutes; and three have SPC statutes. Utah, however, offers both BLLCs and L3Cs in addition to benefit

50 The Social Enterprise Law Tracker is *available at* https://www.socentlawtracker.org/#/map

51 Grunin Center for Law and Social Entrepreneurship at NYU School of Law, Mapping of the State of Social Enterprise and the Law for 2017-2018, at 7 (*where we explain that North Carolina repealed its L3C Statute Effective January 2014*), *available at* https://www.law.nyu.edu/sites/default/files/upload_documents/Tepper%20Report%20-%20State%20of%20Social%20Enterprise%20and%20the%20Law%20-%202017-2018.pdf

52 New York Low-Profit Limited Liability Companies Act, A. 10060, (2018 General Session), *available at* https://nyassembly.gov/leg/?default_fld=&leg_video=&bn=A10060&term=2017&Summary=Y&Actions=Y

53 Massachusetts Low-Profit Limited Liability Companies Act, S. 184, (2017-2018 General Session), Open States, *available at* https://openstates.org/ma/bills/190th/S184/

54 Hawaii Low-Profit Limited Liability Companies Act, H.B. 19 , (2017-2018 General Session), Open States, *available at* https://openstates.org/hi/bills/

55 New York Low-Profit Limited Liability Companies Act—Memo, A. 10060, (2018 General Session), *available at* https://nyassembly.gov/leg/?default_fld=&leg_video=&bn=A10060&term=2017&Memo=Y

56 Hawaii Low-Profit Limited Liability Companies Act—Testimony to the House Committee on Economic Development & Business, H.B. 19, (2017-2018 General Session), *available at* https://www.capitol.hawaii.gov/session2018/testimony/HB19_TESTIMONY_EDB_02-15-17_.PDF

57 Florida Business Entities Amendment, H.B. 1285 (2018 Regular Session), *available at* http://flsenate.gov/Session/Bill/2018/01285/ByCategory/?Tab=BillHistory

58 *Id.*

59 *Id.*

corporations, making Utah the only state to offer three social enterprise legal forms.

In 2018 alone, seven states considered enacting more than one form of social enterprise legislation, with a predominance of states seeking to adopt BLLCs or L3Cs after having enacted benefit corporations legislation. Specifically, Connecticut, Delaware and Utah—with existing benefit corporation legislation (and also L3C legislation in Utah) —considered adopting BLLC statutes, while Massachusetts, New York, and Hawaii—with existing benefit corporation legislation—considered adopting L3C statutes. Michigan—with existing L3C legislation—is the only state to consider enacting a benefit corporation statute as its second social enterprise form. Only Delaware and Utah passed their relevant BLLC legislation, while the rest of the bills died in their respective committees. See chart below for further details.

US State	Benefit Corporation	BLLC	L3C	SPC
California	Cal. Corp. Code § 14600–14631 (2012)			Cal. Corp. Code § 2500-3503 (2011)
Connecticut*	S.B. 23, 2014 Sess. (Ct. 2014) (2014)	H.B. 5251 (Introduced and Died in 2018)		
Delaware	Del. Code Ann. tit. 8 § 361-368 (2013)	Del. Code. Ann. tit. 6 § 18.1202–18.1208 (2018)		
Florida	Fla. Stat. Ann. § 607.601–607.613 (2014)			Fla. Stat. Ann. § 607.501–607.513 (2014)
Hawaii*	Haw. Rev. Stat. § 420D-1–420D-13 (2011)		H.B. 19 (Introduced in 2017 and Died in 2018)	
Illinois	805 Ill. Comp. Stat. Ann. 40/1–40/5.01 (2013)		805 Ill. Comp. Stat. 180/1-5, 1-10(a)(1), 1-26, 15-5 (2009)	
Louisiana	La. Rev. Stat. Ann. § 12:1801–12:1832 (2012)		La. Rev. Stat. Ann. § 12:1301(A)(11.1), 1302(c), 1305(B)(3), 1306(A)(1), 1309(A) (2010)	

** States that introduced bills to adopt a second social enterprise form, which ultimately failed.*

Mapping State Legislation

US State	Benefit Corporation	BLLC	L3C	SPC
Massachusetts*	Mass. Gen. Laws Ch. 156E § 1-16 (2012)		S. 184 (Introduced in 2017 and Died in 2018)	
Maryland	Md. Code Ann., Corps. & Ass'ns § 5-6C-01–5-6C-08 (2010)	Md. Code Ann., Corps. & Ass'ns § 11-4A-1201–11-4A-1208, 11-1-502, 5-6C-03 (2011)		
Michigan *	H.B.5868; H.B.5867; H.B.5872; H.B.5869 (Introduced and Died in 2018)		Mich. Comp. Laws § 450.4102, 4204(2), 4803(1) (2009)	
New York *	N.Y. Bus. Corp. Law § 1701-1709 (2011)		A 10060 (Introduced and Died in 2018)	
Oregon	Ore. Rev. Stat. § 60.750–60.770 (2013)	Ore. Rev. Stat. § 60.750–60.770 (2013)		
Pennsylvania	15 Penn. Cons. Stat. § 3301-3305 (2012)	15. Penn. Cons. Stat.§ 8891-8898 (2016)		
Texas	Tex. Bus. Org. Code § 21.951–21.959 (2017)			Tx. Bus. Org Code § 23.0001–23.110 (2013)
Utah	Utah Code § 16-10b-101–16-10b-402 (2014)	S.B. 148 (2018)	Utah Code Ann. § 48-2c-102, -403, -405, -412, -1411 (2009)	
Vermont	Vt. Stat. Ann. tit. 11A §§ 21.01 to -.14 (2009)		Vt. Stat. Ann. tit. 11, §§ 3001(27), 3005(a), 3023(a) (2009)	

** States that introduced bills to adopt a second social enterprise form, which ultimately failed.*

Delaware proposes a new social enterprise form

Delaware is currently considering amending its existing Limited Partnership Act to permit the formation of a "statutory public benefit limited partnership."[60] The proposed amendment tracks Delaware's public benefit corporation statute's language closely. It defines "statutory public benefit limited partnership" as "a for-profit limited partnership…that is intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner. To that end, a statutory public benefit limited partnership shall be managed in a manner that balances the partners' pecuniary interests, the best interests of those materially affected by the limited partnership's conduct, and the public benefit or public benefits set forth in its certificate of limited partnership."[61] While these proposed amendments still need to be passed by the General Assembly and, if passed, would not take effect until August 1, 2019,[62] this legislative development is worth following over the course of the next year.

60 Delaware State Bar Association. DE LP Act—2019 Amendments. Available at http://www.legis.delaware.gov/BillDetail/47447.

61 *Id.*

62 *Id.*

Evolving Tax Treatment of For-Profit Social Enterprises

An area that continues to generate heated debate within the fields of social entrepreneurship and impact investing concerns the taxation of for-profit social enterprises. Policymakers, scholars, and practitioners have questioned how for-profit social enterprise should be treated for tax purposes. Should there be tax laws designed specifically for for-profit social enterprises? Should for-profit social enterprises receive tax subsidies?

Some social enterprises are organized as nonprofits, which allows them to apply to be recognized as state and federal tax exempt entities and receive tax-deductible donations.[63] However, the nonprofit structure generally limits the permissible business activities of the enterprise[64] and, thus, many social enterprises set up as for-profit entities.

The most common for-profit social enterprise legal forms available in the United States—namely, benefit corporations, L3Cs, BLLCs, and SPCs—are not currently subject to new tax categories or treatments. These social enterprises are subject to the rules of for-profit entities and activities and are not eligible for exemption from federal income tax under any of the currently available categories. In this sense, federal tax law requires that these new social enterprise forms be classified for federal tax purposes as C corporations, S corporations, partnerships, or sole proprietorships, depending on how they are organized at the state level and how they have chosen to be classified. The benefit corporation and the SPC are treated the same as typical state law corporations, while the L3C and BLLC are treated the same as a state law entity that can be classified as a partnership or a sole proprietorship for federal tax purposes (and have the ability to choose a corporate tax treatment, if preferred). As a result, to date the adoption of new social enterprise legal forms has not translated into new federal or state law tax treatments.[65]

While currently taxed as for-profit entities, the new social enterprise legal forms are typically a type of hybrid entity that aims to combine elements of for-profits and nonprofits.[66] For example, benefit corporations can have private shareholders and distribute dividends like traditional corporations, but they are also bound to make decisions in line with the purpose of the corporation, similar in some ways to how a nonprofit corporation must be both organized and operated to further the purpose for which tax-exemption is granted. Naturally then, a question arises as to what tax treatment such entities should be afforded.

In accordance with the subsidy theory of taxation—whereby tax-exemption for nonprofits functions as a government subsidy to encourage the provision of services that are beneficial to society, such as poverty relief, health care and education,[67] proponents have argued that for-profit social enterprises should be awarded a tax subsidy because they often provide services that benefit the public at large. This, in theory, would encourage increased adoption of and stimulate investment in social enterprise forms.[68]

In accordance with the tax base theory—whereby nonprofit entities are not organized for private profit and thus their income should not come into the tax base at all, because the purpose of the income tax is to "reduce private consumption and accumulation in order to free resources for public use"[69] —some commentators support a form of taxation for for-profit social enterprises that would provide incentives for the company to commit, and stay committed, to a public purpose. This would theoretically reduce the possibility of "greenwashing" or

63 Notice 844 (Rev. 6-2010), *available at* https://www.irs.gov/pub/irs-pdf/n844.pdf

64 Gene Takagi, *Non-profit Social Enterprises: Introduction*, Non-profit Law Blog (2013), *available at* http://www.nonprofitlawblog.com/nonprofit-social-enterprises-unrelated-business-income-tax/

65 Lloyd Hitoshi Mayer and Joseph R. Ganahl, *Taxing Social Enterprise*, 66 Stan. L. Rev. 397, 416-18 (2014).

66 Ofer Eldar, *The Role of Social Enterprise and Hybrid Organizations*, 1 Colum. Bus. L. Rev. 92 (2017).

67 Mayer and Ganahl, *supra* note 65 at 428. *See also* Rob Atkinson, *Theories of the Federal Income Tax Exemption For Charities: Thesis, Antithesis, and Synthesis*, 17 Stetson. L. Rev. 396, 402-408.

68 Mayer and Ganahl, *supra* note 65 at 428.

69 William D. Andrews, Personal Deductions in an Ideal Income Tax, 86 Harv. L. Rev. 309, 310 (1972) ("[T]he charitable contribution deduction has been described as a kind of government matching gift program for the support of taxpayers' charities[, and]… the distribution of matching grants is effectively skewed to favor the charities of the wealthy because of their higher marginal tax rates….")

"attracting investors and customers based on a stated commitment to social benefit goals while not actually furthering such goals in any meaningful way."[70]

Proponents of tax benefits for for-profit social enterprises, however, have been met with resistance due to the challenges the government would face in certifying social enterprises and ensuring that they are achieving the intended public benefit, particularly where there is no single definition of social enterprise in the United States but rather a complicated legal landscape of multiple social enterprise legal forms across states.

Beyond this theoretical debate, some cities and states have recently begun to explore different tax treatments for social enterprises. Philadelphia, the first US jurisdiction to enact a social enterprise-related tax law, passed in 2009 the Philadelphia Sustainable Business Tax Credit (SBTC), which enables up to 25 eligible businesses in Philadelphia to receive a tax credit of up to $4,000 a year if they are B-Lab certified or are a "sustainable business."[71] To be considered a "sustainable business" under the ordinance, applicants must submit evidence that they give substantial consideration to employee, community, and environmental interests in their practices, products, and services.

70 Lloyd Hitoshi Mayer, *Creating a Tax Space for Social Enterprise*, in *The Cambridge Handbook of Social Enterprise Law* 157, 168 (2019).

71 Philadelphia, PA, Business Income and Receipts Tax Regulations §505 (Feb. 7, 2013), *available at* https://www.phila.gov/media/20160928122807/Section505-2016-BIRT-regulations.pdf

The supporters of the bill framed it as providing an incentive for the private sector to begin tackling the city's social problems.[72] Interestingly, however, the ordinance has not been amended to include benefit corporations or BLLCs, despite these social enterprise forms being available in Pennsylvania since 2012 and 2016, respectively. This may signal a reluctance on behalf of the city to assume that companies set up as benefit corporations or BLLCs are per se sustainable businesses. Or, it may indicate that policymakers do not believe legal form is dispositive, and that observable actions of the businesses are more important than form.

Despite its potential to advance social entrepreneurship, the Philadelphia Sustainable Business Tax Credit has been criticized for failing to achieve full participation since its inception. While 25 tax credits are available, the full $4,000 credit is available only if annual sales amount to nearly $3 million, which is well beyond the reach of most eligible businesses.[73] Also, businesses appear to decide whether to seek B-certification without consideration of the tax credit, indicating that "the SBTC is not significantly furthering its apparent goal of increasing the number of social enterprises in Philadelphia."[74]

Following in Philadelphia's footsteps, in June 2018 Spokane City Council adopted an ordinance (Ord. No. C35638) to halve annual business registration fees for companies that are B-Lab certified or registered as SPCs in the State of Washington. The ordinance also eliminates the "head tax" for companies that are B-Lab certified—-the "head tax" is an additional fee that is paid annually by businesses for each personnel.[75]

72 Matt Devine, *Aligning Profits with Purpose: An Analysis of the Philadelphia Sustainable Business Tax Credit*, 25 Temp. Pol. & Civ. Rts. L. Rev. 75 (2016).

73 Mayer, *supra* note 70, at 160.

74 *Id.*

75 For the text of the ordinance see Mayor and City Council, 108 Official Gazette, Spokane City 786 at 804 (2018); *See also* Ben Stuckart, *Business Registration & Personnel Fees for Social Purpose Corporations and Certified B Corporations Briefing Paper* (2018), *available at* https://static.spokanecity.org/documents/citycouncil/interest-items/2018/06/social-purpose-corporation-briefing-paper.pdf

Evolving Tax Treatment of For-Profit Social Enterprises

Interestingly, the ordinance expressly references the City of Spokane's intent to promote SPCs and B-Lab certified corporations. Moreover, the president of the Spokane City Council and primary sponsor of the ordinance, Ben Stuckart, stated that "the current lack of these types of businesses allows the City to craft and implement a clean slate incentive for new, established, and relocating businesses that believe in sustainable business practices" and that the ordinance was intended to help Spokane "become the hub for socially and environmentally responsible businesses in the Northwest and across America."[76]

At the state level, Hawaii and New Jersey have also attempted to pair tax rate reductions with specific social enterprise legal forms. In Hawaii, the legislature enacted an income tax exemption provision to accompany the state's initial benefit corporation legislation in 2006 (H.B. 3118),[77] only for the governor to veto the legislation, in part, because of the included tax benefit.[78] Governor Linda Lingle, in her statement of objections to the House Bill, stated that "giving tax breaks to encourage the creation of alternative corporate forms is bad public policy," and that she was "not willing to force taxpayers to subsidize an experiment of this sort."[79] Hawaii has since enacted benefit corporation legislation (Haw. Rev. Stat. § 420D-1–420D-13) absent differing tax law treatment.[80]

In 2018, New Jersey Senator Troy Singleton, inspired by the corporate tax cut in the 2018 federal tax bill, introduced legislation to reduce the tax rate for benefit corporations by 20 percent per privilege period, defined as the calendar or fiscal accounting period for which a tax is payable (S 2093).[81] Further, the bill also creates a procedure to ensure that benefit corporations have pursued a general public benefit during the year by requiring that benefit corporations submit a report to the Division of Taxation—either the annual benefit report that all benefit corporations are required to deliver to their shareholders according to the benefit corporation statute, or a report that contains that information. The director of the Division of Taxation is required to review the submissions and, within 60 days, make a determination as to whether to certify that the applicant is, or continues to be, in compliance with New Jersey's benefit corporation law.[82]

Interestingly, this is not the first time that New Jersey has attempted to pair tax benefits with a specific corporate form. In January 2018, a bill (A. 395) was introduced to create a new type of corporation called a "garden state corporation" following previous attempts in 2016 (A. 1189), 2014 (A. 579), and 2012 (A. 3582).[83] The unique aspect of garden state corporations is that the certificate of incorporation or by-laws of a garden state corporation must provide that half of the members of the board of directors of the corporation are elected by the employees of the corporation who work in New Jersey manufacturing facilities. To provide incentives to adopt this form, the bill would qualify such corporations for credits against the corporation business tax of 35 percent during the first five tax years in which it is continuously a garden state corporation; 25 percent during the sixth and seventh tax years; and 15 percent during the eighth and ninth tax years.

76 Api Podder, *Spokane City Council Votes to Remove Head Tax and Reduce Business Registration Fees for Certified B Corporations*, MySocialGoodNews.com (2018)

77 H.B. 3118, 23rd Leg. (Haw. 2006).

78 Mayer, *supra* note 70, at 162.

79 Governor Linda Lingle's Statement of Objections to the House Bill. H.B. 3118, 23d Leg. Sess. § 10 (Haw. 2006).

80 Haw. Rev. Stat. Ch. 420D (2011).

81 New Jersey Benefit Corporation Amendments, S. 2093, (2018-2019 Regular Session), Open States, *available at* https://openstates.org/nj/bills/218/S2093/; Troy Singleton, *Why Can't Stakeholders and Shareholder Both Profit?*, Troy Singleton ForSenate (July 2018). https://www.troysingleton.com/why_cant_stakeholders_and_shareholders_both_profit

82 S.B. 2093, 218th Leg. (N.J., 2018). Bill text *available at* https://www.njleg.state.nj.us/2018/Bills/S2500/2093_I1.HTM

83 Garden State Manufacturing Jobs Act., A.B. 395, 218th Leg. (N.J. 2018).

Notably, if the corporation was both a garden state corporation and a benefit corporation, the bill allowed the corporation credits against its liability for the corporation business tax of: 60 percent during the first five tax years in which it is continuously both a garden state corporation and a benefit corporation; 45 percent during the sixth and seventh tax years; and 30 percent during the eighth and ninth tax years. While the bill represents a novel attempt to provide incentives for a combination of employee ownership and benefit corporation status, both the Assembly and the Senate versions of the bill are still being deliberated in committee.[84]

These are only a few of the many potential ways in which tax law could be structured to encourage the adoption of and investment in social enterprise forms and to encourage the commitment to public benefit goals. Given the early stages of experimentation with these measures, it is unclear whether a distinct tax treatment for for-profit social enterprises will emerge in other states or at the federal level and, if so, what model might prevail. Obvious challenges lie ahead, such as overcoming the lack of a clear and uniform definition for qualifying social enterprises, the need to garner sufficient political will to drive such reform, and the management of complexities and inadvertent consequences that are likely to arise. However, as commentators have noted, special tax treatment for for-profit social enterprises may be desirable, for which more experimentation is needed at the state and local levels to design appropriate tax measures and test them against the desired goals.[85]

84 A.B. 395, 218th Leg. (N.J. 2018); S.B. 1582, 218th Leg. (N.J. 2018)

85 Mayer, *supra* note 70, at 160.

Public Policy Tools to Provide Incentives for Social Entrepreneurship

In addition to tax reform, there are a number of non-tax regulatory methods available to encourage companies to undertake social entrepreneurship. One such method is to prioritize social enterprises' access to markets under public procurement laws. As market actors with massive purchasing power, state and local governments have considerable potential to encourage and drive market innovation, as well as achieve social goals through their procurement practices.

Procurement that aims to create markets for green technology, products, and services and promote more efficient use of public resources, commonly known as sustainable procurement, is perhaps the most well-known form of procurement that aims to achieve a social goal. A 2012 survey found that 21 US states have enacted a statutory sustainable procurement policy.[86]

Procurement policies that give a preference to social enterprise forms are a more recent development, and they are part of a larger international movement, widely known as *social procurement*. In 2014, for example, the European Union published a new set of directives regarding public procurement, directive 2014/24/EU,[87] which according to legal scholars "provides the green light for social creativity in procurement and a strong indication that the EU...will in fact be supportive of targeted social initiatives."[88] The United Kingdom, which is considered by many to be at the forefront of social procurement in Europe, enacted the Social Value Act in 2013,[89] that requires all public bodies to consider the social value created in contracts.

In the United States, San Francisco and Los Angeles Counties in California and Cook County in Illinois have enacted ordinances that give qualifying social enterprises a discount when bidding on government contracts. Provided that a business fits the definition of a social enterprise in the statute, it can receive the bidding preference regardless of which social purpose it is pursuing, and what service or good it is providing. In this sense, local governments are relinquishing some control over the specific social goals that are to be achieved by the policy.

- **San Francisco, California**. In 2012, the City of San Francisco became the first to enact an ordinance that provided a "benefit corporation discount" equal to 4 percent for eligible California benefit corporations that applied for procurement contracts estimated to cost less than $10,000,000 (Ord. No. 76-12).[90] To qualify for the discount, the business: (1) must have been incorporated for at least 6 months as a benefit corporation in California, and (2) cannot have been a subsidiary of a non-benefit corporation. Notably, even if a benefit corporation qualified, it wouldn't get the discount if it displaced other preferential bidders, such as designated local business entities, nonprofits, or San Francisco and regional businesses.[91] Interestingly, this ordinance expired in 2015 as it failed to be extended by the Board of Supervisors, the legislative body of the County of San Francisco.

86 Danielle M. Conway, *Sustainable Procurement Policies and Practices at the State and Local Government Level in Greening Local Government*, 43 (2012).

87 Council Directive 2014/24/EU, para. 2, (2014), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0024&from=en

88 Amy Ludlow, Social Procurement: Policy and Practice, 7 EUR. L. J. 479, 482 (2016).

89 Public Services (Social Value) Act (2012). http://www.legislation.gov.uk/ukpga/2012/3/pdfs/ukpga_20120003_en.pdf

90 San Fran. Admin. Code. ch. 14(c), https://sfgov.org/cmd/sites/default/files/FileCenter/Documents/12124-Chapter%2014C%20-%20California%20Benefit%20Corporation%20Discount.pdf

91 Michelle Baker, Socially Responsible Businesses Get a Boost From Local Governments, NON-PROFIT LAW BLOG (May, 2013), http://www.nonprofitlawblog.com/socially-responsible-businesses-get-a-boost-from-local-governments/

- **Los Angeles County**. On January 12, 2016, following the recommendations of a commissioned four-year utilization plan,[92] the Los Angeles County Board of Supervisors adopted a motion revising the Local Small Business and Disabled Veteran Business preference programs to include social enterprises among the Price Preference Entities (PPEs)—the other two consisting of small businesses and disabled veteran-owned businesses. As PPEs, social enterprises get a considerable price preference when competing for LA County contracts against non-certified businesses. In particular, PPEs receive a price reduction of 15 percent in bidding processes, but still get paid their initial bid amount.

  The price reduction is intended to encourage the "establishment of new businesses, the growth of existing small businesses, the creation of new local and disadvantaged worker employment opportunities, and the achievement of social and environmental goals through innovation and private sector partnerships."[93]

  The Board of Supervisors was particularly interested in the ability of social enterprises to provide both services and jobs to homeless people in the city. This partly explains why the previous procurement preference given to nonprofits that provide transitional employment services since 2007[94] was replaced by the procurement preference to social enterprises (Ord. No. 2016-0036), a broader category that includes these nonprofits as well as other entities.

  Social enterprises automatically qualify for the certification and procurement preference if they are incorporated as a benefit corporation or an SPC in California; if they are certified as a B Corp by B-Lab or as Green by a city government located in Los Angeles County; or if they can prove that their primary purpose is the common good, as demonstrated through a published mission statement.

  This program (L.A. County Code Ch. 2.205) also includes the nation's first social enterprise certification. In order to obtain the benefits of a PPE, social enterprises must be certified as such with the county. The certification is intended to provide multiple benefits in the contracting process beyond the bid preference: department purchasers are provided with incentives to seek out certified organizations when soliciting bids for contracts under $10,000, and certified organizations are earmarked in county contracting systems so that purchasers can easily discern that they are a social enterprise when searching for goods and service providers.[95]

- **Cook County, Illinois**. In 2017, Cook County, Illinois, the second most populous county in the United States, also passed a procurement ordinance to encourage social entrepreneurship. The Cook County Ordinance, which awards city contracts to the lowest bidder that is a social enterprise with a majority of their workforce located within the county (as long as the bid is not more than 5% higher than the lowest bid from another type of entity), is agnostic as to corporate structure or legal form.[96] This means any nonprofit or for-profit entity—or even any business unit that maintains its own books and records—can qualify for the procurement preference as long as it relies on earned-revenue strategies and directly addresses social needs through its goods or services,

92 *Certifying as a Social Enterprise in LA County*, REDFWORKSHOP (Apr. 10, 2019, 6:17pm), https://redfworkshop.org/la/social-enterprise-certification

93 County of Los Angeles, *Local Small Business Enterprise, Disabled Veteran Business Enterprise, and Social Enterprise Preference Programs Implementation Guidelines* (2016), http://dcba.lacounty.gov/wp-content/uploads/2018/01/Preference_Programs_Implementation_Guidelines.pdf

94 County of Los Angeles, *Implementation Instructions for the Transitional Job Opportunities Preference Program* (2012), http://doingbusiness.lacounty.gov/cpy0023.PDF

95 County of Los Angeles, LOCAL SMALL BUSINESS ENTERPRISE, DISABLED VETERAN BUSINESS ENTERPRISE, AND SOCIAL ENTERPRISE PREFERENCE PROGRAMS IMPLEMENTATION GUIDELINES (Nov. 2016). http://dcba.lacounty.gov/wp-content/uploads/2018/01/Preference_Programs_Implementation_Guidelines.pdf

96 COOK COUNTY, CODE OF ORDINANCES, Ch. 34, Art. IV, Div. 6, §34-241. https://library.municode.com/il/cook_county/codes/code_of_ordinances?nodeId=PTIGEOR_CH34FI_ARTIVPRCO_DIV6BIINPR_S34-241SOENPRALCO

or through its employment of "disadvantaged people."[97] Importantly, social enterprises and other entities can earn credits to lower their bid price based on the number of labor hours performed by former offenders, eligible veterans, apprentices and youth.

While these procurement preferences for social enterprises have existed at the city level in the United States since 2012, no such procurement preference has yet to be established at the state level. In fact, an attempt to create the first statewide government procurement preference for social enterprises in California was vetoed. Introduced in 2016, (SB-1219) Small Business Procurement and Contract Act: Employment Social Enterprises attempted to create procurement preferences for a subset of social enterprises, so-called "employment social enterprises" (ESEs).[98] ESEs were defined as California-based SPCs, benefit corporations, or nonprofit corporations that (i) earn greater than 51 percent of their revenue from the sale of goods or services and (ii) include in their organizational documents a mission to hire and assist people who face multiple barriers to employment. Under this bill, ESEs would be granted a preference of up to five percent of the lowest bidder for awards to be made to the lowest bidder, and a preference of up to five percent of the highest bidder for awards to be made to the highest bidder.

Despite being passed by the California legislature with overwhelming support, S.B. 1219 was ultimately vetoed by the governor of California in September 2016. The governor stated that the implementation of the bill would require "an expensive modification to FI$Cal at a time when the state must focus its resources on the project's successful deployment."[99]

These developments in social enterprise procurement programs, while currently limited and at times unsuccessful, may signal a new direction in social enterprise policy in the United States and may serve as models for other cities and states across the country to foster local social entrepreneurship through public procurement policies.

97 Office of the Chief Procurement Officer, Cook County Buying Plan (2018), https://www.cookcountyil.gov/sites/default/files/service/cook-buyingplan-2018.pdf

98 S.B. 1219 (Cal., 2016), https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201520160SB1219

99 The Financial Information System for California (FI$Cal) is California's statewide accounting, budget, cash management, and procurement IT system. Governor Jerry Brown Veto Message (Oct. 2016), https://leginfo.legislature.ca.gov/faces/billStatusClient.xhtml?bill_id=201520160SB1219

Alternative Ownership Structures

The 2018 Deloitte Global Human Capital Trends report identified the rise of the social enterprise as a "profound shift facing business leaders worldwide" which "reflects the growing importance of social capital in shaping an organization's purpose, guiding its relationships with stakeholders, and influencing its ultimate success or failure."[100] As part of this seismic shift, the models of corporate ownership and governance that have prevailed over the past 30 years—where shareholder profit maximization reigns supreme—are undergoing scrutiny. Deloitte Global's Inclusive Growth Survey Report found that 65 percent of CEOs rated "inclusive growth" as a top-three strategic concern, more than three times greater than the proportion citing "shareholder value."[101]

Moreover, some social entrepreneurs who place a high value on the interests of stakeholders beyond shareholders have been dissatisfied with the limitations imposed by the standard ownership models adopted under both traditional and new legal forms. As a result, there is a small, but growing, community of companies in the United States that have begun to implement alternative ownership structures to "permanently anchor their values and independence into their legal DNA."[102]

One alternative ownership approach that is garnering attention is called "steward-ownership"—a form of ownership that enables mission-driven entities to permanently secure a company's purpose and independence. Steward-ownership is based on the notion that owners of a corporation are its stewards and is guided by two key principles: "self-governance and profit serving purpose."[103] Steward-ownership models ensure that control of a business is passed down from one generation of trusted stewards to the next, and that the company's mission is protected over the long term. Steward-ownership structures also separate economic and voting rights to remove the financial incentive to sell for profit maximization. As such, these innovative structures are redefining governance and ownership for mission-driven companies.

While steward-ownership is fairly new to the United States, it has a European history that dates as far back as the mid-1800s when the German optics manufacturing company ZEISS established the first modern example of steward-ownership. Since then, a few other major companies have adopted similar structures, particularly in Europe. The most well-known of these companies include the German electronics company Bosch, Danish pharmaceutical company Novo Nordisk, British department store chain John Lewis, and the US internet company Mozilla.

Under existing laws, there are a number of ways to structure steward-ownership, depending on the needs, capacity, and maturity of a business. The structures vary across jurisdictions, as well as in their structural complexity and governance approaches. Some structures, such as the Perpetual Purpose Trust, are uniquely designed to include a broad range of stakeholders in their governance and profit-sharing structures. Other models, such as the Golden Share, can be adapted to accommodate the cultural and governance needs of both small and large organizations.[104]

The **Perpetual Purpose Trust** ("PPT") is becoming a promising model for steward-ownership in the United States. The PPT is a non-charitable trust that is established for the benefit of a purpose rather than a person and, unlike most non-charitable trusts, it may operate indefinitely. Designed to protect the company's purpose, the PPT owns a majority of common (voting) shares and appoints the board of directors of the company. The PPT structure decouples ownership and control (which sits with the trust) from the financial outcomes of the equity investment (which sit with

100 Deloitte, The Rise of the Social Enterprise: 2018 Deloitte Global Human Capital Trends 2 (2018), https://www2.deloitte.com/content/dam/insights/us/articles/HCTrends2018/2018-HCtrends_Rise-of-the-social-enterprise.pdf

101 Deloitte, The Business Case for Inclusive Growth: Deloitte Global Inclusive Growth Survey 4 (Jan. 2018), https://www2.deloitte.com/content/dam/Deloitte/global/Documents/About-Deloitte/gx-abt-wef-business-case-inclusive-growth-global%20report.pdf

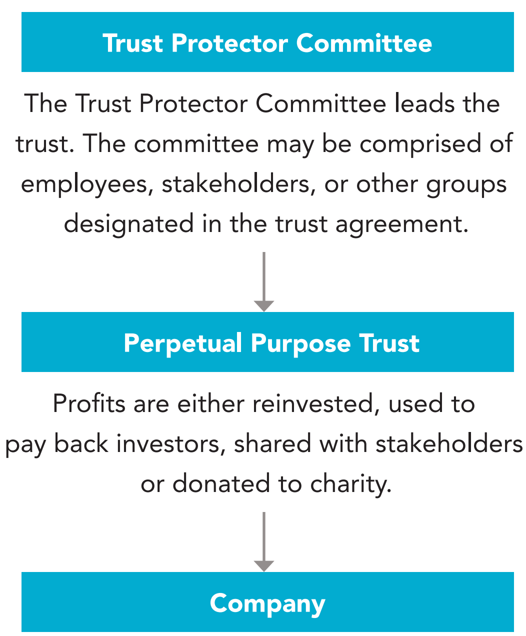
102 Purpose Foundation, Steward-Ownership: Rethinking Ownership in the 21st Century 7 (2019), https://purpose-economy.org/wp-content/uploads/2019/02/Purpose_Booklet_EN_150119_Digital_B.pdf [hereinafter *Purpose Foundation 2019 Report*].

103 *Id.* at 2.

104 *Id.* at 16.

the operating company). As the sole owner of the company, the PPT prioritizes profitability in service to the company's mission and its stakeholders.[105]

A hallmark of the PPT is that it grants a great deal of flexibility with respect to the structure of the trust agreement, the purpose of the trust, and the relationship between the operating bodies. As a result, the PPT makes it possible to include multiple stakeholder groups in the trust agreement (such as employees, investors, customers, suppliers, and the community). These stakeholders or other groups designated in the trust agreement comprise the "Trust Protector Committee," which leads and oversees the PPT.



Source: Purpose Foundation, Steward-Ownership, Rethinking ownership in the 21st Century[106]

As highlighted in one of our case studies below, a complex multi-stakeholder PPT was recently adopted by Organically Grown Company, a 40-year-old leader in sustainable and organic agriculture, which has helped answer for some the question of how a mission-based company can scale and transition its founders and early employees without selling or going public. The PPT has also been adopted by smaller businesses, such as Equity Atlas, a 100 percent worker-owned home mortgage company, which set up an employee owned trust, a form of PPT that, as the name suggests, ensures that the business will remain worker-owned and controlled into the future.[107]

At present, nearly half of all US states offer non-charitable trusts. However, early adopters of the PPT should consider certain limitations and challenges facing PPTs in the United States. First, several states have laws that limit a trust's existence in perpetuity. It is estimated that only a dozen states offer a modified rule permitting trusts to exist for an extended period of time or outright perpetuity, which would enable the PPT to operate in the very long term.[108] Second, some states also require that trusts have a trust beneficiary, and beneficiaries may dissolve a trust by unanimous consent, thus also threatening the perpetuity of the PPT. According to the Purpose Foundation—an organization that helps entrepreneurs, founders, and investors navigate the path of becoming steward-owned or investing in a steward-owned company—four states in the United States have trust

105 Purpose Foundation, RSF Social Finance, Organic Valley & Organically Grown Company, *Steward-ownership, Ownership and finance solutions for mission-driven businesses* 8 (2019), https://purpose-economy.org/wp-content/uploads/2019/03/ExpoWest_Purpose_Digital_010319_Final.pdf

106 *Purpose Foundation 2019 Report, supra note 102,* at 24.

107 *See NCEO Conference 2017 Presentation Materials*, Equity Atlas Website (May 10, 2019, 10:45am) for a sample version of the document under which Equity Atlas is structured, https://www.equityatlas.com/resources/nceo/ *See also* Christopher Michael, *The British are Coming—ESOPs and Perpetual Trusts*, Medium (2018), *available at* https://medium.com/fifty-by-fifty/the-british-are-coming-esops-and-perpetual-trusts-c1d4cf45ba61

108 For example, as of October 2018, the states of South Dakota, Rhode Island, Illinois, Missouri, and New Hampshire have outright perpetuity for trusts. Alaska and Ohio allow for outright perpetuity or 1,000 years if power of appointment is exercised. Delaware allows outright perpetuity for personal property and 110 years for real estate. Wyoming allows for 1,000 years, Nevada for 365 years, and Tennessee and Florida for 360 years. *See* S.D. Codified Laws § 43-5-8 (2016); 34 R.I. Gen. Laws § 34-11-38 (2016); 765 Ill. Comp. Stat. 305 / 3 (2016); Mo. Rev. Stat. § 456.025 (2016); N.H. Rev. Stat. Ann. § 564:24 (2016); Alaska Stat. § 34.27.051 (2016); Ohio Rev. Code Ann. § 2131.09 (Lexisnexis 2016); Del. Code Ann. Tit. 25, § 503 (2016); Wyo. Stat. Ann. § 34-1-139 (2016); Nev. Rev. Stat. § 111.1031 (2015); Tenn. Code Ann. § 66-1-202 (2016); *and* FLA. STAT. § 689.225 (2016).

laws that meet all the criteria for a PPT: Delaware, New Hampshire, Wyoming, and Maine.[109] Nevada and South Dakota also permit the concept, but with constraints.[110]

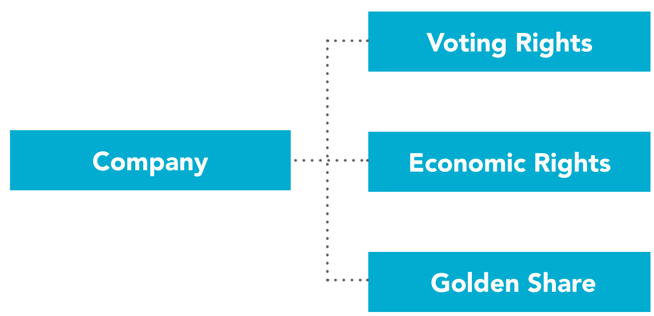
Another potential impediment to a wider adoption of the PPT structure is that many trust management companies are not familiar with these alternative structures. PPTs are a fairly new concept in the United States and therefore remain untested. As is the case with all novel structures, this can create uncertainty and can act as a disincentive for businesses considering such alternative structures. Moreover, despite its notable flexibility and benefits, the PPT may not be the right structure for every business. In particular, the PPT may not be a realistic option for early-stage companies due to its potential cost and complexity.

Emerging as an alternative to the PPT, the **Golden Share model** is another form of steward-ownership that offers a similar level of protection for the stakeholders of the company, while being less costly and arguably more flexible than the PPT. The Golden Share model separates economic rights from voting rights through the use of different shareholder classes to protect the company from ever being used to maximize profit over the pursuit of its mission. The mechanics of the different share classes vary across jurisdictions and companies, but the basic concepts remain:

- **Steward shares**. Stewards hold shares with 99 percent of the voting rights without any economic rights. Companies can limit the groups eligible to receive these steward shares.

- **Non-voting preferred shares**. A share class may be created with dividend rights but no voting rights. These shares are often held by investors, charitable entities, employees, and/or founders.

- **Golden share**. The structure is protected by a "golden share," the holder of which has the authority to veto any attempts to sell the company or change its structure in a way that would undermine the company's commitment to purpose. This golden share is held by a "veto-share service provider," which ensures that the veto is secure and not under the control of those with economic interests.



Source: Purpose Foundation, Steward-Ownership, Rethinking ownership in the 21st Century[111]

In essence, through this ownership structure, the Golden Share model "ensures that a company's assets are committed to a purpose and cannot be privatized, and that their governance is in the hands of people who are interested in the company's mission, rather than merely in profits."[112]

109 Purpose Foundation 2019 Report, *supra* note 102 at 24.

110 *Id.* It should be stressed that this analysis is valid as of late 2017. The following factors were considered when conducting this analysis: existence of a non-charitable purpose trust statute; absence of need for defined beneficiaries; constraints on time period or, in other words, the applicable rule against perpetuities; scope of permitted purposes for trusts under statute; scope of any limitations on assets in trust; and statutory trust requirements. Currently, some organizations and law firms are working to propose changes in various states' trust statutes.

111 Purpose Foundation 2019 Report, *supra* note 102 at 17.

112 *Id.*

The biggest advantage of the Golden Share model over most other forms of steward-ownership is that the stewards of Golden Share companies are direct owners of the company, not through a trust. Additionally, the Golden Share model is generally simple to set up and does not require any costly processes—the existing legal form is transformed only by changes in the company's statute.

While a great alternative, the Golden Share model is not necessarily the right solution for all entrepreneurs, because an external actor holding a golden share is also co-owner. Indeed, compared to other models, such as the Perpetual Purpose Trust, the Golden Share model always requires an external "veto service provider." The Ziel case study discussed in the next section of this report provides an illustrative example of what the Golden Share model can look like, as well as the opportunities and challenges faced by founders who adopt this alternative ownership structure.

Overall, the Perpetual Purpose Trust, the Golden Share model, and other forms of steward-owned alternative structures can offer a host of benefits. The customizable nature of these structures provides an important degree of flexibility and autonomy to founders as they determine how to enshrine the goals and mission of their companies. This is important because companies that consider these structures often do so in response to the unique makeup and needs of their stakeholders. Additionally, it has been argued that steward-owned companies "[o]utperform traditional for-profit companies in long-term profit margins" and are "[m]ore resilient to financial and political crises, and offer significantly less volatile returns."[113] As these companies are owned by their stakeholders, it should be no surprise that they also "[p]ay employees higher wages with better benefits, attract and retain talent more effectively, and are less likely to reduce staff during financial downturns."[114]

113 *Id.* at 9.

114 *Id.*

Case Studies

The following case studies explore the stories of companies that have implemented alternative ownership structures to protect their mission. Although their legal structures, business models, and industries vary, these companies share a common commitment to the principles of steward-ownership. As such, they illustrate the various options available to companies for embedding purpose and independence into their legal DNA.

Organically Grown Company

Organically Grown Company ("OGC") is one of the largest distributors of organic produce in the United States, moving more than 100 million pounds of fresh fruit and vegetables across the Pacific Northwest region in 2017. For 40 years, it has been an industry leader, promoting health through organic agriculture and corporate responsibility through sustainable business practices.

As OGC grew, it was faced with a business challenge common to many social enterprises: How does a mission-driven business scale without "selling out"? OGC was looking for a long-term ownership solution that would allow it to remain purpose-driven and independent. Rather than pursue solely profit-maximization, OGC's goal is to support organic agriculture and help it thrive by doing business in a way that is "good, clean and fair"[115] and that takes into consideration its five stakeholder groups: customers, vendors, employees, the larger community, and investors.

In furtherance of this goal, OGC transitioned to a unique ownership structure that best served its evolving needs. In 2018, OGC set up as a C corporation organized under the laws of the State of Oregon, and transferred a majority ownership of OGC to a Perpetual Purpose Trust, titled the Sustainable Food and Agriculture Perpetual Purpose Trust ("SFAPPT") and organized under the laws of the State of Delaware. The SFAPPT, as the primary shareholder of OGC, exists to support and further the mission of the Oregon operating company. OGC thus became one of the first US businesses to use trust law to "structure its operational and funding model to support purpose-based entrepreneurship, ownership and succession," the company press release announced.[116]

To establish this new ownership structure, OGC used a combination of debt and equity to buy back all of its common shares from its legacy stockholders (producers and employees who had been working with OGC since its inception) and transferred those shares to the SFAPPT.[117] At 60 percent ownership, the SFAPPT is now the majority shareholder of OGC and has plans to purchase all outstanding voting common shares from the company's non-preferred stockholders in the next few years.[118]

The company, which got its start as an Oregon-based, organically grown, nonprofit in 1978, has gone through numerous structure changes to arrive where it is today. In 1983, with the goal of changing the role of the organization from an educational community platform to one with expanded distributive and marketing goals, OGC

115 Organically Grown Company, *About*, https://www.organicgrown.com/about/ (last visited March 4, 2019).

116 OGC Pioneers Groundbreaking Steward Ownership Structure to Maintain Independence, Organically Grown Company (July 9, 2018), https://www.organicgrown.com/organically-grown-company-pioneers-groundbreaking-steward-ownership-structure-to-maintain-independence-into-perpetuity/

117 The stock buyback was in the form of a leveraged buyout, a private commercial financing transaction with a small pool of shareholders, and communications were completed as required under US securities laws. OGC's board satisfied their fiduciary duties by conducting an independent third-party valuation, ensuring that all shareholders were informed by full disclosure, and receiving 100 percent shareholder ratification on the decision to restructure. Telephone Interview by Ava Haghighi with Ronald D. McFall, Partner, Stoel Rives (Nov. 14, 2018) [hereinafter *McFall Interview*].

118 Tax treatment of the Delaware PPT and the Oregon corporation are defined by each state's respective laws and the usage of both structures in this way does not create any novel tax treatments. *Id.*

became a growers marketing cooperative and operated under that structure for nearly two decades. Eventually, due to seasonal limitations and a desire to expand its reach, the co-op began partnering with farmers from other regions, which caused a need to move away from the cooperative structure which stipulated a majority of purchases had to be from the members. In addition, employees who were working for the co-op desired to purchase shares themselves in the spirit of the "co-ownership" culture. In response to this, OGC became an S corporation in 1999, though the structure limits share ownership to 100 shareholders.[119] By 2008, as OGC continued to grow in size and market reach, the limitation on the number of shareholders of the S corporation became an issue. To remedy this situation, an Employee Stock Ownership Plan (ESOP) was added to the existing S corporation structure.

With the ESOP, OGC was able to provide liquidity to its retiring farmer- and employee-owners for decades, by funding share repurchases and redistributing the ownership to current employees. By 2018, however, the limitations and challenges of an S corporation + ESOP structure had begun manifesting. As OGC saw it, the challenges it experienced were three-fold.[120] First, OGC has five stakeholder groups that it values equally.[121] However, an ESOP by definition exists only to reward employees via a stock retirement plan and, as a result, OGC began noticing a pull away from other stakeholder participation such as new farmer suppliers buying shares.[122] Second, OGC was worried about the future risk of acquisition or liquidation as the company was becoming more successful, because any such event would have resulted in the misalignment of OGC's structure with its mission. As the ESOP approached majority ownership of the company, it became possible that a competitor would approach the ESOP trustees directly and offer to buy their shares. The trustees would then be required to consider the offer in good faith. OGC did not want to be put in a situation where it had to focus solely on maximizing shareholder value in contravention of its purpose.[123] Third, while an S corporation + ESOP structure is a tax-efficient one, it does not allow for the issuance of multiple classes of stock. OGC wanted to be able to issue non-voting preferred shares for mission-aligned investors to free the company of being constrained to use its own cash flows to continually retire stock.[124]

In addition, the practical year-to-year operating difficulties of implementing the ESOP resulting from employee retirements, new hires, and exits were creating constant changes in share ownership, causing the company to spend capital every year that it instead could have used to further its mission.[125] As a result of these multiple factors and challenges, OGC decided to create and adopt the PPT ownership structure. Notably, OGC considered simply setting up as a benefit corporation under either Oregon or Delaware laws, but determined that neither structure would have effectively allowed OGC to focus on its mission in the long term.[126]

Steward-ownership through the SFAPPT is intended to ensure that OGC delivers positive economic, social, and environmental impacts, as well as maintains its independence into perpetuity. Because the SFAPPT aims to hold the company stock into perpetuity, it eliminates the ongoing need to find vehicles for liquidity exits for past owners. OGC's novel structure also allows it to raise

119 *See generally* Or. Rev. Stat. § 62.165 (2017); https://www.oregonlaws.org/ors/62.165;Choice of Entity, Co-op Law, http://www.co-oplaw.org/governance-operations/entity/ (last visited Mar. 4, 2019).

120 Telephone Interview by Ava Haghighi and Carolina Henriquez-Schmitz with Kimberlee Chambers, Supply Chain and Sustainability Program Manager (Aug. 2016–Nov. 2018), Organically Grown Company, and Natalie Reitman-White, VP of Organizational Vitality & Trade Advocacy, Organically Grown Company (Oct. 22, 2018) [hereinafter *OGC Interview*].

121 These five stakeholder groups are OGC's farmers and vendors, qualified employees, community representatives, charities, and purpose-aligned investors. Organically Grown Company, Presentation Slides to Stakeholders Titled Perpetual Purpose Trust Conversion Considerations: Motives, Structure, Governance, Financials, Process (Mar. 26, 2018).

122 OGC Interview, *supra* note 120.

123 *Id.*

124 *Id.*

125 *Id.*

126 McFall Interview, *supra* note 117.

capital through a private placement of non-voting preferred stock with accredited investors, while the SFAPPT protects the company's independence by putting stakeholders in control of the business.

Notwithstanding the solutions it offered, the OGC restructuring faced a unique challenge: How could OGC address investors' expectations of a reasonable rate of return on their investments and their concern over a lack of voting rights while prioritizing purpose over profits? To solve this problem, OGC created a governance and financial structure premised on shared governance and shared upside.

In developing the governance structure for the SFAPPT, OGC spent a lot of time developing a sophisticated system of checks and balances. This governance system is comprised of the following:[127] The *trust protector committee*, which serves as the protector of OGC's mission and elects the board of directors of the OGC. To ensure democratic control and active stakeholder involvement, the various stakeholder groups elect the members of the trust protector committee. Accordingly, the committee is comprised of a broad range of stakeholders, including OGC's farmers and vendors, qualified employees, community representatives, charities, and purpose-aligned investors. The *trustee* carries out the administrative functions of the SFAPPT. The *trust enforcers* are the final safety valve, similar to beneficiaries in traditional trust law, and are those who can stand in the shoes of the beneficiary to ensure that the SFAPPT is operating in accordance with its mission and step in to ensure enforcement, when necessary.[128]

Further, OGC created a cash flow waterfall that ensures the financial treatment of OGC's stakeholders and its mission are fairly aligned.[129] First, the waterfall allocates any monies to the operation of the business, the mechanics of which are determined by the board. Prioritizing reinvestment in the business reaffirms OGC's belief in and commitment to its mission. Second, any remaining monies are used to pay debts and debt servicing obligations. Third, OGC's non-voting preferred stockholders receive a 5 percent baseline dividend, ensuring that investor dividends are paid before any other stakeholder groups participate in profit distributions. Fourth, any remaining profits are shared with employees up to a ceiling of 20 percent of OGC's prior year net income. Fifth and last, the waterfall flows upward, and any remaining profits are shared with the stakeholder groups by various means, such as the expansion of grower services and community giving. OGC is also considering offering incentive programs such as discounts to those customers who serve low-income communities.

Ultimately, through this novel structure, OGC was able to remove the pressure to maximize short-term profits and exit-value for shareholders. Instead, it can maximize "purpose" and create long-term returns to mission-aligned investors while sharing the balance of profits with its stakeholders. OGC's example demonstrates how mission-centric for-profit companies can grow stronger over the years, both in size and profitability, while remaining true to their core values and faithful to their multitude of stakeholders.

127 Organically Grown Company, Presentation Slides to Stakeholders Titled Perpetual Purpose Trust Conversion Considerations: Motives, Structure, Governance, Financials, Process (Mar. 26, 2018); McFall Interview, *supra* note 117.

128 OGC Interview, *supra* note 120.

129 OGC's waterfall is the result of negotiations with one of its five stakeholder groups: its non-voting preferred shareholders including both family and larger investment funds. McFall Interview, *supra* note 117.

Equity Atlas

In 2016, Brad Hippert founded Equity Atlas, a worker-owned, home mortgage company. Hippert's experiences in founding Equity Atlas provide insight into how an entity's structure can be devised and adapted to promote a particular social mission, what legal challenges await founders who choose relatively nascent structures, and what legislative changes could aid in the proliferation of social enterprises.

Since the financial crisis in 2008, US consumers have grown increasingly distrustful of large US banks; 77 percent of Americans believe the big banks would harm consumers if they thought it was profitable to do so.[130] Furthermore, most Americans believe that government financial regulators are ineffective, selfish, and biased.[131] It is in this broader social context that Equity Atlas established a perpetual employee-owned trust ("EOT"), a form of PPT that maintains worker-owner democratic control and equal profit-sharing in perpetuity.

Although Hippert originally envisioned that the company might be set up as a benefit corporation, he ultimately decided that Equity Atlas would be structured as a traditional C corporation in Oregon and owned by an EOT. Without outside shareholders, and with the employee shareholders having strong decision-making control in the organization, setting up as a benefit corporation was not deemed necessary to ensure the company pursued its mission.[132] Some practitioners in the field, however, do recommend pairing the EOT with a benefit corporation.[133]

Equity Atlas was among the first US companies to adopt an EOT.[134] It achieved this by setting up a trust into which it placed the company's shares. These shares are now held on behalf of all tenured employees, making the employees of the company beneficial owners of the shares. While the employees have no personal interest, right, or claim on the shares of Equity Atlas or power to sell, assign, or transfer any interest, right, or claim on shares of Equity Atlas, the Board of Directors of Equity Atlas is guided in all decisions by a majority of the employee members. The EOT is also subject to a series of obligations outlined in the trust agreement. For example, the Equity Atlas trust agreement states that the trustees cannot sell the EOT shares, must act in such a way as to guarantee that wages and salaries are capped at 115 percent of the market rate, and must allocate and retain a minimum 70 percent of the company's net income in an indivisible reserve.[135]

Equity Atlas makes maintaining employee control a central tenet of the trustees' obligations. Trustees of the Equity Atlas EOT must preserve the company as a majority employee-controlled business entity in which permanent employees exercise control on a one-employee, one-vote basis. Such control includes election of the board of directors, open nominations for directors, a staggered board, a right to recall directors, and voting on all shareholder-related matters. As a result, by eliminating absentee shareholders that demand profit-maximization, and by enshrining ethical ideas like fair wages and employee control into the trust agreement, Equity Atlas is able to insert the value it generates back into the community it serves through lower mortgage interest rates and fees.[136]

130 Emily Ekins, *Wall Street vs. The Regulators: Public Attitudes on Banks, Financial Regulation, Consumer Finance, and the Federal Reserve: Results from the Cato Institute 2017 Financial Regulation Survey*, Cato Institute (Sep. 19, 2017), https://www.cato.org/survey-reports/wall-street-vs-regulators-public-attitudes-banks-financial-regulation-consumer

131 *Id.*

132 Telephone Interview by Dan Brown and Carolina Henriquez-Schmitz with Brad Hippert, founder and CEO of Equity Atlas (Oct. 18, 2018).

133 Telephone Interview by Dan Brown and Carolina Henriquez-Schmitz with Christopher Michael, attorney and advisor for Employee Ownership (Nov. 14, 2018).

134 Notably, the United Kingdom passed EOT legislation in 2014. *See* Jennifer Martin, *New Tax Exemptions for Companies Owned by Employee Ownership Trusts*, Fieldfisher (Sep. 22, 2015), https://www.fieldfisher.com/publications/2015/09/new-tax-exemptions-for-companies-owned-by-employee-ownership-trusts#sthash.dtm8G990.dpbs

135 Equity Atlas has made a sanitized version of the trust agreement available online at http://www.equityatlas.com/downloads/sanitized-eot-trust-doc-pacj-feb-17/

136 *Community*, Equity Atlas, https://www.equityatlas.com/community/equity-ownership/ (last visited March 4, 2019).

As Hippert considered available options for Equity Atlas, the question arose as to why, given the prominence of the ESOP, would he decide to adopt a new and largely unproven structure? Hippert believes there are four distinct benefits to establishing an EOT. First, unlike ESOPs, an EOT is not subject to the exclusive benefit rule, meaning the company does not have to prioritize profits to the detriment of other values like employee agency or loyalty. Second, the EOT is governed by the "naked in, naked out" principle. In an EOT, unlike an ESOP, the company does not repurchase stock when individual employees leave the company. This means that the employee-owned nature of the firm is not diluted over time. Third, the EOT is more flexible than the ESOP, because founders have the ability to lock into the structure of the company certain rights, such as fixed-based compensation. Finally, given the lack of a repurchase obligation and a corresponding need for annual valuations, recurring administrative costs for an EOT are minimal as compared to the ESOP.[137]

The novelty of the EOT has led to some challenges for its founder. For example, Hippert expected that Equity Atlas, merely because of its unique ownership structure, would be flagged by the authorities during the process of getting licensed as a mortgage company in the State of Oregon. To expedite the process, Hippert had to engage in an extensive educational effort and met with the head of the licensing division several times to explain the details and purpose of Equity Atlas' legal structure. The perpetual nature of the structure may also, one day, come into conflict with rules the vast majority of states have against perpetual trusts. To "solve" this issue, the Equity Atlas EOT trust agreement requires the trustee to move the company to a state without a rule against perpetuities when the time limit on its trust in Oregon has expired, in order to overcome the rule against perpetuities issue.[138]

Nevertheless, as the EOT becomes more widely known, it may be a practicable alternative for companies looking to preserve their mission, with a focus on employee ownership, without facing the considerable constraints of the ESOP. Whether the EOT increases in popularity may depend on whether US laws can be altered to extend the same advantages to EOTs as are currently afforded to ESOPs. At the federal level, advocates are looking to Congress to balance the tax treatment afforded EOTs and ESOPs. In particular, proponents argue that EOTs should be qualified as tax-exempt and eligible to hold stock in S corporations, a major benefit currently afforded only to ESOPs; and that business owners should receive the same federal capital gains tax benefits on sales to an EOT that they enjoy on sales to an ESOP.[139] At the state level, some advocates have developed legislation in Maryland, Wisconsin, and New York that, if adopted, would provide a 100 percent state capital gains tax exemption to business owners who sell a majority of their shares to an EOT or an ESOP.[140]

137 Christopher Michael, *The Employee Ownership Trust, An ESOP Alternative*, 31 Prob. & Prop. 42 (2017).

138 *See supra* note 135.

139 Christopher Michael, *The British are Coming—ESOPs and Perpetual Trusts*, Medium (2018), *available at* https://medium.com/fifty-by-fifty/the-british-are-coming-esops-and-perpetual-trusts-c1d4cf45ba61

140 *Id.*

Ziel

In 2015, Marleen Vogelaar, founded Ziel, an activewear apparel company, with a mission—to reduce waste in the fashion industry by using ecologically friendly textiles and to create local jobs for low-middle-class workers by manufacturing exclusively in the United States.[141] Vogelaar started Ziel because she wanted to make a positive impact on the environment as well as the economy.[142]

Ziel was founded as a Public Benefit Corporation in Delaware.[143] As an experienced entrepreneur, Vogelaar was all too familiar with the pressure many companies face between growing the business and maintaining control over the business' mission.[144] Vogelaar chose to incorporate Ziel as a Public Benefit Corporation to ensure that Ziel was legally required to protect the company's environmental and social mission.[145] It was important to her that Ziel's decision-makers were influenced by the company's mission and not just short-term growth.[146] Furthermore, she believed that this entity status could mitigate potential legal risk from suppliers, investors, customers, and employees.[147]

Vogelaar first discovered the Golden Share model in 2017, two years after Ziel was founded.[148] As she was contemplating what sustainable growth would look like for her company, the Golden Share model presented an attractive means with which to further ensure that the values of the company were embedded into its future development.[149]

Ziel's Golden Share structure enables the company to take on the necessary capital to grow, while ensuring its independence and mission are protected over the long term.[150] Ziel's Golden Share structure has four share classes—steward shares; founder shares; investor shares; and a veto share.[151] The steward shares represent 99 percent of the voting rights of the company and have no dividend rights. The founder shares have dividend rights but no voting rights; they are bought back by the company at a predetermined valuation and represent delayed compensation for the founding years. The investor shares hold dividends rights, but no voting rights. Lastly, the veto share represents 1 percent of the voting rights and does not include dividends rights. This veto share can block a sale of the company and a change to the charter that would undermine its mission. The veto share is held by the Purpose Foundation.[152]

When establishing this alternative ownership structure, Vogelaar recalls, it took a lot of time and energy to find investors who would be willing to fund a company with the Golden Share model.[153] Many investors were reluctant to agree to a deal structure in which they did not have any voting rights. Investors were also concerned about making a return on their investment.[154] In light of their concerns, Vogelaar created a deal structure similar to an equity loan where in five years Ziel would use 30 percent of its cash flows to pay back its investors.[155] This structure guaranteed higher returns for investors than the average portfolio performance; however, the guaranteed returns were also capped at 5x the original investment.[156]

141 Telephone Interview by Hanna Downing and Carolina Henriquez-Schmitz with Marleen Vogelaar, Founder and CEO of Ziel (March 6, 2019) [hereinafter *Marleen Vogelaar Interview*].

142 *Id.*

143 Telephone Interview by Hanna Downing and Carolina Henriquez-Schmitz with Perry Teicher, Impact Finance Attorney at Orrick (March 1, 2019) [hereinafter *Perry Teicher Interview*].

144 Marleen Vogelaar Interview, *supra* note 141.

145 *Id.*

146 *Id.*

147 *Id.*

148 *Id.*

149 *Id.*

150 *Id.*

151 Purpose Foundation 2019 Report, *supra* note 102 at 71.

152 *Id.*

153 Marleen Vogelaar Interview, *supra* note 141.

154 *Id.*

155 *Id.*

156 *Id.*

Despite these challenges, Vogelaar believes there are three distinct benefits to establishing a Golden Share structure. First, although it took longer for Ziel to get financed, Vogelaar says that the Golden Share model allowed her to attract the right kind of investors that understand, appreciate, and believe in the company's environmental and social mission.[157] Moreover, she notes that these investors not only value Ziel's mission, but they also understand how the company's mission will help Ziel achieve long-term profitability.[158] Second, in addition to finding early-stage investors that are mission-aligned, the Golden Share model created an attractive incentive structure for her employees, because the steward shares and voting rights allow for Ziel employees to have a stake in the progress of the company.[159] Third, the Golden Share model makes Ziel customers and vendors feel safe that their data will not be transferred as a result of a later merger or buyout.[160] In other words, the Golden Share structure allows for confidential consumer and corporate data to stay within the company, and that has been extremely reassuring for many stakeholders during this age of corporate data mining.[161]

Although Ziel's adoption of the Golden Share model was a long and arduous process, Vogelaar does not regret establishing this structure and she is grateful to have discovered this steward-ownership model as a tool to help protect the company's mission and future.[162] Thus, this Golden Share model has been a valuable feature for Vogelaar to make sure that as Ziel grows, its environmental and social values are embedded into the company's DNA.

157 Id; Perry Teicher Interview, *supra* note 143.

158 Marleen Vogelaar Interview, *supra* note 141.

159 *Id.*

160 *Id.*

161 *Id.*

162 *Id.*

Conclusion

Since the adoption of the first social enterprise legal form a decade ago, the social enterprise landscape in the United States has rapidly developed in a number of interesting ways. Social enterprise legislation being introduced this year looks markedly different from the legislation introduced in 2008. Practical questions are forcing states to decide whether the social enterprise forms they have enabled are appropriate for the needs of their social enterprise communities.

While benefit corporations are the most popular form of legislation, the form is in a state of flux, responding to the proliferating needs of the field. Shifts in the structure of the benefit corporation statutes suggest changing conceptions of the reach and goals of the form. For instance, the evolution of benefit director provisions and the examination of fiduciary duties within benefit corporations highlight the underlying, unresolved question of whether the new social enterprise forms actually accomplish their goals and add value to the field. Indeed, there is still not an established consensus on whether the new social enterprise forms are necessary to advance the field, whether one of these forms will ultimately prevail over others, and how these forms should be treated for tax and other purposes under state and federal laws.

Despite the field's continued struggle with these questions, there is a slowly growing ecosystem of incentives for social enterprises tied to their legal form. Social enterprises are eligible to qualify for certain public procurement programs and may receive potential tax benefits in a few states. Although these initiatives were established in recent years and it is unclear whether they will be more widely adopted, they should not go unnoticed and can serve as models for legislators who may decide to seize the opportunity to expand them to other states or to the federal level.

As this report further highlights, social entrepreneurs are also going beyond the adoption of the social enterprise forms and using alternative ownership structures as a new way in which to embed, protect, and preserve their mission in the legal structure of the company. While still being refined and tested, these innovative structures are redefining governance and ownership for mission-driven companies. Moreover, as alternative ownership structures can be used by both social enterprise forms and traditional forms, they are expanding the toolkit available to companies of different size and ilk to embed mission into their structures.

In sum, recent years have seen encouraging progress being made by policymakers, legal practitioners, and entrepreneurs to advance the fields of social enterprise and impact investment through legislation, public policy, and novel ownership structuring. Looking forward, we expect to see continued development in each of these areas as constituents demand more from their legislators, consumers from businesses, and entrepreneurs and investors from their lawyers.

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