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Theorizing Forms for Social Enterprise

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THEORIZING FORMS FOR SOCIAL ENTERPRISE

Dana Brakman Reiser[*]

Jurisdictions across the country and around the globe are enacting legislation enabling founders of social enterprises to adopt specialized forms to house their entities. These forms blend elements traditionally found in nonprofit organizational forms, such as commitment to a social mission, with elements from for-profit business structures, such as the ability to attract investors. These legal forms appear to offer founders and investors the ability to "do well by doing good" and give consumers and employees access to "companies with a soul." These aspirations, however, have not yet been fully realized by any of the specialized forms currently available. In other work, I have described and critiqued the specifics of the various new forms, both here and abroad. This Article takes a step back, and examines the broader theoretical question of what specialized forms would have to provide in order for them to help social enterprise to realize its claimed potential.

INTRODUCTION

Social enterprise is a hotly contested term. For present purposes, though, a general idea will suffice. By social enterprise, I mean an organization formed to achieve social goals using business methods. Think companies that use one-for-one models[1] like TOMS shoes[2] and Warby Parker,[3] or employ "hard-to-

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[1] Companies with a one-for-one model typically produce consumer goods and "for every unit of a product sold, the company donates one similar or related item to people in need." Alisen Downey, *A One-for-One Revolution*, E MAG., Nov./Dec. 2011, at 40, 40 (describing various companies using the model).

[2] TOMS, http://www.toms.com/ (last visited May 10, 2013) ("With every pair you purchase, TOMS will give a pair of new shoes to a child in need.").

[3] *Do Good*, WARBY PARKER, http://www.warbyparker.com/do-good/#home (last visited May 10, 2013) ("For every pair of glasses we sell, we provide a pair to someone in need.").

employ," low-income, or foreign-born individuals like Greyston Bakery[4] and Hot Bread Kitchen.[5] Think of your favorite green or locally sourced business or of one serving customers at the bottom of the pyramid.[6] Founders, proponents, and evangelists of social enterprise, sometimes called social entrepreneurs, have big aspirations for it.

Enthusiasts argue social enterprises will have a more positive and sustainable impact on people and planet than ordinary for-profit businesses.[7] They claim social enterprises can do more good for more people than traditional nonprofits because their financing and business methods make them more efficient, effective, and scalable.[8] These advocates see social enterprises

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4 *The Greyston Bakery's Guiding Principles*, GREYSTON BAKERY, http://www.greystonbakery.com/wp-content/uploads/pdf/greyston-bakery-guiding-principles.pdf (last visited May 10, 2013) (stating its dual commitments to "consistently achieve an operating profit" and to "continue its open-hiring policy, and the associated apprenticeship program, in order to provide opportunity to [inner-city] Yonkers'[s] hard-to-employ population").

5 *Our Mission*, HOT BREAD KITCHEN, http://hotbreadkitchen.org/about-us/our-mission (last visited May 10, 2013) (describing its mission to "increase[] economic security for foreign-born and low-income women and men by opening access to the billion dollar specialty food industry . . . [through its] culinary workforce and business incubation programs" and its sale of "delicious multi-ethnic breads").

6 *See* C.K. PRAHALAD, THE FORTUNE AT THE BOTTOM OF THE PYRAMID: ERADICATING POVERTY THROUGH PROFITS 4 (2005) (describing the "bottom of the pyramid" as the more than four billion individuals with the lowest purchasing power parity worldwide); *see also, e.g.*, Nicole Wallace, *Opportunity International Spins Off Insurance Company*, CHRON. PHILANTHROPY (Jan. 17, 2013, 9:17 AM), http://philanthropy.com/blogs/innovation/opportunity-international-spins-off-insurance-company/1653 (featuring MicroEnsure, a nonprofit transitioning to for-profit status in order to scale its venture in selling low-cost insurance to "people in the developing world [who] are one failed crop, one illness, or one emergency away from financial ruin").

7 J. Gregory Dees & Beth Battle Anderson, *For-Profit Social Ventures*, *in* SOCIAL ENTREPRENEURSHIP 1, 5–6 (Marilyn L. Kourilsky & William B. Walstad eds., 2003).

8 *See, e.g.*, Charles R. Bronfman & Jeffrey R. Solomon, *Should Philanthropies Operate like Businesses? Yes: Good Intentions Aren't Enough*, WALL ST. J., Nov. 28, 2011, at R1 ("[T]o have a sustained and strategic impact, philanthropy must be conducted like business—with discipline, strategy and a strong focus on outcomes."); Dan Pallotta, *Why Can't We Sell Charity like We Sell Perfume?*, WALL ST. J., Sept. 15, 2012, at C1 ("If we free the nonprofit sector to hire the best talent in the world, take fundraising risks, use marketing to build demand and *invest capital for new revenue-generating efforts*, we could bring private ingenuity to bear on [the world's] problems and would not need to look to government to fill the gaps." (emphasis added)).

Of course, there are also critics of the social enterprise trend. *See, e.g.*, Phil Buchanan, *Charities Should Resist Drinking the "Kool-Aid" of Business Superiority*, CHRON. PHILANTHROPY, Sept. 20, 2012, at 56 ("[T]he rush to embrace the idea that for-profits can more easily combat our toughest social problems denies the reality that many crucial objectives simply cannot be accomplished while generating a financial return."); Michael Edwards, *Should Philanthropies Operate like Businesses? No, the Poorest Will Suffer*, WALL ST. J., Nov. 28, 2011, at R1 ("[T]he colonization of philanthropy by business could turn it into a much more conservative force and limit its potential to get at the really difficult problems.").

as a different and exciting new way forward, but they lambast one very improbable obstacle: legal form.[9]

Under this view, traditional for-profit and nonprofit legal forms frustrate social entrepreneurs' bold new vision for achieving social change.[10] The backward, old law forces a founder to choose between two equally inadequate categories. If she forms a for-profit, particularly a for-profit corporation, shareholder primacy will force her to single-mindedly focus on profit, with no way to protect the social mission of the entity or its founders. If she forms a nonprofit, this social vision can be protected, but business strategies, especially equity capital, are foreclosed. These mutually exclusive legal categories, the story goes, prevent social enterprises from pursuing mutually reinforcing commitments to profit and social good—and shortchange us all in the process.

Across the country and around the globe, jurisdictions have begun to respond to these claims by offering a variety of specialized legal forms intended to house social enterprises. Thus far, these include the low-profit limited liability company, the benefit corporation, the benefit LLC, the flexible purpose corporation, and the social-purpose corporation.[11] More will likely proliferate. Much legal scholarship in this fledgling area, including my own, has focused on understanding and critiquing the specifics of these enactments and proposals.[12] This Article does something new. It begins to theorize whether and how any legal form can do the work desired by social enterprise founders.

This work falls along three principal dimensions: permitting, achieving, and branding the difference of social enterprises. Social entrepreneurs begin with their desire to blend their profit-making and social missions in a single

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9 *See, e.g.*, Julie Battilana et al., *In Search of the Hybrid Ideal*, STAN. SOC. INNOVATION REV., Summer 2012, at 51, 52 (describing the "confusing dilemma" facing social entrepreneurs confronted with only pure for-profit and nonprofit organizational forms); William H. Clark, Jr. & Elizabeth K. Babson, *How Benefit Corporations Are Redefining the Purpose of Business Corporations*, 38 WM. MITCHELL L. REV. 817, 851 (2012) ("The sustainable business movement, impact investing, and social enterprise sectors are developing rapidly, but are constrained by an outdated legal framework that is not equipped to accommodate for-profit entities whose social benefit purpose is central to their existence."); Thomas Kelley, *Law and Choice of Entity on the Social Enterprise Frontier*, 84 TUL. L. REV. 337, 363–64 (2009); Heerad Sabeti, *The For-Benefit Enterprise*, HARV. BUS. REV., Nov. 2011, at 99, 99 (lamenting that "socially minded entrepreneurs end up shoehorning their vision into one structure or the other and accepting burdensome trade-offs in the process").

10 Battilana et al., *supra* note 9, at 52.

11 *See* Stephanie Strom, *A Quest for Hybrid Companies That Profit, but Can Tap Charity*, N.Y. TIMES, Oct. 13, 2011, at B1. As this Article goes to press, Delaware is moving toward adoption of its own specialized form, the "public benefit corporation."

12 *See, e.g.*, *infra* notes 35, 39, 43 (L3Cs, benefit corporations, and FPCs, respectively).

entity. They believe in the unique ability of social enterprise to solve social problems and return profits to owners. Rather than hiding these dual aspirations behind a veneer of "business as usual" or under a halo of selflessness, these founders want to claim their social enterprises' blended missions explicitly. For a specialized legal form to succeed, it must permit social entrepreneurs to embrace this different ideal.

Blended value, however, could easily remain purely aspirational. After all, pursuing profit and social good will not always lead in the same direction. Sometimes, perhaps often, they can be mutually reinforcing, especially if one takes the long view. For example, imagine that a social enterprise furniture manufacturer locates its factory in an economically depressed area, employing the formerly jobless and investing in the community. Its dedication draws skilled craftsmen to the area and their creations become darlings of the design world. The business endures and the reinvigorated town thrives.

But not every story will have an easy route to such a happy ending. Perhaps the skilled craftsmen need to be wooed to the town with high salaries, while frustrated local workers toil for a subsistence wage. Even if the stars align at the outset, eventually there will have to be decisions where profit and social good come into conflict and must be traded off. Perhaps this social enterprise will design the new "it" chair and make millions. Still, its managers will need to decide what portion of each dollar of earnings to donate to the community, or to invest in modernizing the plant, or to return to investors, without whom none of this would have happened. They will need to set prices, choose suppliers, hire, and fire. Social entrepreneurs say they will make these decisions in a way different than traditional for-profit or nonprofit entities. But, for adoption of a specialized legal form to indicate that an entity actually is different, it must impose a new and unambiguous baseline standard and provide for its reliable enforcement.

Only by doing so can a specialized legal form reach the ultimate goal of social entrepreneurs who seek them: to become a brand. Social entrepreneurs want to convey to investors that their entities will provide a different and better overall return—doing more for investors' pocketbooks than a charitable donation and more for their souls than an ordinary stock or bond. Furthermore, social entrepreneurs also want to reach consumers, employees, partners, and the public with positive messages about their different and better companies. A specialized legal form that serves as an effective brand will help social entrepreneurs to communicate these points.

The rest of this Article proceeds in four parts. Part I demonstrates that there are many ways a specialized form can permit social entrepreneurs to pursue both social good and profit. Part II, however, explains that for a specialized form to succeed it must challenge the idyllic version of the social enterprise, demanding realism and specificity about an entity's goals and the priority among them. This Part urges lawmakers to adopt a clear standard requiring entities adopting specialized forms to prioritize social good. It then explores various legal avenues for doing so. Part III canvasses the mechanisms that might be used to enforce such a standard. It might be policed from within or outside the entity, publicly or privately, and each enforcement mechanism comes with its own unique challenges. Finally, Part IV addresses the capacity of specialized legal forms to serve as brands. If a specialized form imposes a clear standard and creates viable enforcement mechanisms, it can communicate that its adopters are meaningfully different from for-profit or nonprofit competitors. This achievement would deliver considerable branding value to social enterprise, but it would still not convey all of the positive messages social entrepreneurs wish to transmit.

I. PERMITTING DIFFERENCE

One of the most basic things social entrepreneurs seek in a specialized legal form is safe space to declare that their entities are committed to a new and different goal—pursuing both profit and social good. The simple expression of this commitment is transgressive in traditional nonprofit legal entities. It is at best fraught, and at worst unlawful, in traditional for-profit ones. This Part explains why. It also introduces three types of specialized forms for social enterprise now available in the United States and explains how each creates an entity based on express permission to pursue blended missions.

A. Traditional Forms' Problems

Nonprofits can be formed as nonprofit corporations or charitable trusts, and both impose a strong "nondistribution constraint"[13] utterly incompatible with a hybrid mission. With very limited exceptions, a nonprofit corporation simply "shall not make any distributions."[14] A distribution is defined as a "payment of

[13] *See* Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 838 (1980) ("A nonprofit organization is, in essence, an organization that is barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees.").

[14] REVISED MODEL NONPROFIT CORP. ACT § 13.01 (1987). Similar prohibitions on distributions are likewise imposed by federal tax law upon nonprofits exempt from income taxation and eligible to receive tax-

a dividend or any part of the income or profit of a corporation to its members, directors or officers."[15] For charitable trusts, a similarly stark rule obtains: "A trust is not a charitable trust if the property or the income therefrom is to be devoted to a private use."[16] A charitable trust does not lose this designation "merely because its operation results in a profit," but if its profits are "applied to private purposes . . . the trust ceases to be charitable."[17] Although nonprofit organizations can pay their employees reasonable compensation, it is absolutely off-limits for them to provide a share of net profits to founders as a return on their investment.[18] Nonprofits are similarly barred from soliciting equity capital from others.[19] Thus, a social enterprise taking a nonprofit legal form cannot expressly commit to pursuing both social good and profits for owners.

Nor do social entrepreneurs perceive traditional for-profit forms as particularly hospitable. This perception stems in part from a debate about corporate law. Many legal scholars argue that owner wealth maximization need not be the sole or exclusive goal of a for-profit corporation.[20] Indeed, the American Law Institute suggests a dual-mission, for-profit corporation would

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deductible contributions. *See* I.R.C. §§ 501(c)(3), 170(c) (2006) (stating eligibility criteria for such organizations, including that "no part of the net earnings of which inures to the benefit of any private shareholder or individual").

15 REVISED MODEL NONPROFIT CORP. ACT § 1.40 (1987).

16 RESTATEMENT (SECOND) OF TRUSTS § 376 (1959); *accord* RESTATEMENT (THIRD) OF TRUSTS § 28 cmt. a (2003) (commenting in the reporter's notes that this language in the prior Restatement "is worth recalling").

17 RESTATEMENT (SECOND) OF TRUSTS § 376 cmt. d (1959); *accord* RESTATEMENT (THIRD) OF TRUSTS § 28 cmt. a(1) (2003) (explaining that a charitable trust may provide services on a fee-paid basis without risking its charitable status, so long as it "does not seek to make a profit to benefit its shareholders or otherwise to serve a noncharitable purpose").

18 *See, e.g.*, REVISED MODEL NONPROFIT CORP. ACT §§ 1.40, 13.01 (1987).

19 *See* Clara Miller, *The Equity Capital Gap*, STAN. SOC. INNOVATION REV., Summer 2008, at 41, 42–43 (noting that nonprofits suffer due to an inability to raise equity capital).

20 *See, e.g.*, LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC 25–31 (2012); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 738–47 (2005); Judd F. Sneirson, *Green Is Good: Sustainability, Profitability, and a New Paradigm for Corporate Governance*, 94 IOWA L. REV. 987, 996–1007 (2009); *see also* Lyman Johnson, *Pluralism in Corporate Form: Corporate Law and Benefit Corporations*, 25 REGENT U. L. REV. (forthcoming 2013) (manuscript at 40), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2177049 (critiquing "the unresolved muddle in corporate law doctrine and theory concerning the inter-relationship among corporate purpose, a corporation's best interests, and fiduciary duties" and arguing that benefit corporation statutes partly, but not fully, illuminate it); Mark A. Underberg, *Benefit Corporations vs. "Regular" Corporations: A Harmful Dichotomy*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 13, 2012, 8:31 AM), http://blogs.law.harvard.edu/corpgov/2012/05/13/benefit-corporations-vs-regular-corporations-a-harmful-dichotomy/ (advocating a similar view and warning of the dangerous implications of specialized forms for the ability of traditional for-profits to pursue nonshareholder interests).

be unproblematic, so long as its owners agreed.[21] Others are less sanguine about the place of goals other than enhancing shareholder value within for-profit corporations, accepting a strong shareholder wealth maximization norm.[22] Even among this norm's most strident proponents, however, there is wide recognition that outside of the takeover context, the business judgment rule will shelter corporate directors from liability for virtually all operational decisions.[23] In states with constituency statutes, such decisions will be protected even in response to a takeover threat.[24] Thus, directors appear to

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[21] *See* 1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01, at 73 n.6 (1994) ("[T]here is little doubt that [restrictions on the general profit-making objective] would normally be permissible if agreed to by all the shareholders. Such an agreement might be embodied in the certificate of incorporation, or not.").

[22] *See, e.g.*, Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1424–25 (1993) (noting that "[a]t least in Delaware, the shareholder wealth maximization norm thus remains a more accurate description of the state of the law than any of its competitors" and embracing that norm) [hereinafter Bainbridge, *In Defense*]; Henry Hansmann & Reinier Kraakman, Essay, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 441 (2001) (asserting that "there is today a broad normative consensus that shareholders alone are the parties to whom corporate managers should be accountable"); Leo E. Strine, Jr., Essay, *Our Continuing Struggle with the Idea That For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 155 (2012) (opining that "corporate law requires directors, as a matter of their duty of loyalty, to pursue a good faith strategy to maximize profits for the stockholders"); *see also* KENT GREENFIELD, THE FAILURE OF CORPORATE LAW 41–42 (2006) (describing shareholder primacy as a "foundational principle" that "informs every aspect of corporate and securities law" in a work arguing corporate law should embrace a broader sense of proper corporate purposes). Although Professor Bainbridge remains committed to the shareholder wealth maximization norm, he has recently argued the debate about corporate purpose is futile. *See* Stephen Bainbridge, *The Vacuity of Corporate Purpose*, PROFESSORBAINBRIDGE.COM (May 05, 2012, 10:47 AM), http://www.professorbainbridge.com/professorbainbridgecom/2012/05/the-vacuity-of-corporate-purpose.html [hereinafter Bainbridge, *Vacuity*].

[23] *See* Bainbridge, *In Defense*, *supra* note 22, at 1439 (opining that "the business judgment rule will insulate directors from liability without regard to the shareholder wealth consequences of the board's decision in the vast majority of cases"). Other scholars who challenge a strong shareholder wealth maximization norm have made similar observations. *See* Miriam A. Cherry & Judd F. Sneirson, *Beyond Profit: Rethinking Corporate Social Responsibility and Greenwashing After the BP Oil Disaster*, 85 TUL. L. REV. 983, 1022 (2011) ("[E]ven if one accepts the view that corporate law requires fiduciaries to focus on shareholder wealth, the business judgment rule affords corporate decision makers so much latitude as to render any such duty unenforceable and meaningless."); Antony Page & Robert A. Katz, *Freezing Out Ben & Jerry: Corporate Law and the Sale of a Social Enterprise Icon*, 35 VT. L. REV. 211, 232 (2010) ("Under the business judgment rule, courts will almost invariably defer to the directors' judgment. As long as a course of action may lead to some potential benefit to shareholders, even in the far distant future, the directors' decisions will survive judicial review." (footnote omitted)).

[24] John Tyler, *Negating the Legal Problem of Having "Two Masters": A Framework for L3C Fiduciary Duties and Accountability*, 35 VT. L. REV. 117, 132 (2010) (explaining that "constituency statutes formally allow corporate directors to consider the interests of some combination of non-shareholder[]" constituencies in the takeover context, and sometimes more broadly); *see also* Lisa M. Fairfax, *Doing Well While Doing Good: Reassessing the Scope of Directors' Fiduciary Obligations in For-Profit Corporations with Non-Shareholder Beneficiaries*, 59 WASH. & LEE L. REV. 409, 460–61 (2002) (offering a similar description); Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 27–29 (1992) (same).

have little to fear from decisions that will not strictly, and in the short term, pursue maximum value for shareholders.

One could take this narrow gap between scholars on either side of the question as close enough to consensus that a for-profit corporation could effectively house a social enterprise. Yet, various practical impediments remain. For example, anecdotal reports explain that one reason for initiating specialized-form legislation has been the unwillingness of a secretary of state's office to accept articles of incorporation from for-profit corporations that evinced a blended mission.[25] Corporate directors themselves also may embrace and comply with a strong shareholder primacy norm regardless of the positions of corporate law scholars.[26] They may do so not entirely out of misplaced fears of legal repercussions; vulnerability to takeover attempts or fears that investors will lose confidence can make it risky for for-profit entities to articulate a dual mission.

Of course, the risk of liability to shareholders all but disappears in small, closely held corporations. If directors and shareholders are the same individuals, there is little threat of suit. Shareholders in such corporations can also contract around many of these issues in a carefully drafted shareholders' agreement. Moreover, incorporation is hardly the only option for those seeking a for-profit form. Partnership and LLC forms are known for their flexibility, and their governance can be largely and idiosyncratically structured by partnership or operating agreements. These contracts can provide social entrepreneurs with a venue to express their entities' commitment to profit and

[25] *See* Dana Brakman Reiser, *Benefit Corporations—A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591, 592, 608 (2011).

[26] Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2073 (2001) (noting that "[n]orms in American business circles, starting with business school education, emphasize the value, appropriateness, and indeed the justice of maximizing shareholder wealth"); Stephen Bainbridge, *The Shareholder Wealth Maximization Norm*, PROFESSORBAINBRIDGE.COM (May 5, 2012, 12:51 PM), http://www.professorbainbridge.com/professorbainbridgecom/2012/05/the-shareholder-wealth-maximization-norm.html (citing surveys of directors reporting their prioritization of shareholder interests). *But see* D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 290–91 (1998); Sneirson, *supra* note 20, at 1011–12 (arguing businesspersons have more complex views on corporate objectives). A detailed empirical study of directors' views on this question can be found in JAY W. LORSCH WITH ELIZABETH MACIVER, PAWNS OR POTENTATES: THE REALITY OF AMERICA'S CORPORATE BOARDS 37–54 (1989), which found that corporate directors "believe the shareholders are their most important constituents when reaching decisions," but they view their role to more appropriately include a broader focus. These findings are also discussed in Lawrence E. Mitchell, *A Critical Look at Corporate Governance*, 45 VAND. L. REV. 1263, 1292–94 (1992).

social good.[27] Fiduciaries in partnerships and LLCs that do so should have little to fear from owners who opt into them despite clear notice of these dual commitments.

Still, social entrepreneurs might not see closely held corporations, LLCs, or partnerships as sufficient solutions.[28] The most ambitious worry about scale;[29] incorporation has long been seen as a stop along the path to largeness, if not to greatness. For founders with lofty (some might say unrealistic) goals for their enterprises' success, these forms will soon become overly constraining. At the other extreme are concerns about access. For those without counsel, let alone ambitions of publicly traded shares, highly adjustable forms may be difficult to manage. Small and legally unsophisticated founders will have neither expertise nor counsel to engage in complex contract drafting. Instead, they will want an off-the-rack legal form for dual-mission entities.[30]

B. *Specialized Forms' Solutions*

The low-profit limited liability company (L3C), benefit corporation, and flexible purpose corporation (FPC) are designed to fill this need. These specialized forms, now available in one-third of U.S. jurisdictions,[31] provide a

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27 *See* Daniel S. Kleinberger, *A Myth Deconstructed: The "Emperor's New Clothes" on the Low-Profit Limited Liability Company*, 35 DEL. J. CORP. L. 879, 896–97 (2010) (arguing that ordinary LLCs are quite capable of housing businesses committed to social good); *see also* J. William Callison & Allan W. Vestal, *The L3C Illusion: Why Low-Profit Limited Liability Companies Will Not Stimulate Socially Optimal Private Foundation Investment in Entrepreneurial Ventures*, 35 VT. L. REV. 273, 286–88 (2010) (explaining the difficulty of drafting an LLC operating agreement to resolve the tensions between profit and social-good goals, but arguing they would be the same for an LLC or L3C).

28 General partnership, of course, raises the additional concern of personal liability for owners. *See, e.g.*, REVISED UNIFORM PARTNERSHIP ACT § 306(a) (1997).

29 JOHN ELKINGTON & PAMELA HARTIGAN, THE POWER OF UNREASONABLE PEOPLE 179–96 (2008) (discussing the challenges of "scaling" up); Michael Chertok et al., *The Funding Gap*, STAN. SOC. INNOVATION REV., Spring 2008, at 44, 46 ("One of the reasons social enterprises have trouble raising money is that they do not fit neatly into either the traditional nonprofit or for-profit model."); J. Gregory Dees et al., *Scaling Social Impact: Strategies for Spreading Social Innovations*, STAN. SOC. INNOVATION REV., Spring 2004, at 24 (advising social entrepreneurs on the ways to overcome their challenges in increasing their scale).

30 *See* Sabeti, *supra* note 9, at 99 (arguing more social enterprises would exist if they could adopt "a legally recognized organizational structure"); Kyle Westaway, *New Legal Structures for "Social Entrepreneurs,"* WALL ST. J. (Dec. 12, 2011, 12:42 PM), http://online.wsj.com/article/SB10001424052970203413304577088604063391944.html (touting the benefits of affordable new specialized legal forms available to social entrepreneurs).

31 *See Laws*, AM. FOR COMMUNITY DEV., http://americansforcommunitydevelopment.org/laws.html (last visited May 10, 2013) (listing nine states and two Native American tribes with L3C statutes); *State by State Legislative Status*, BENEFIT CORP. INFO. CENTER, http://www.benefitcorp.net/state-by-state-legislative-status (last visited May 10, 2013) (listing fifteen states with benefit corporation statutes, two of which also have L3C

forum for social entrepreneurs to safely proclaim their blended missions proudly. Each does so by starting with an established for-profit legal form and adding a social mission component to it.

The L3C adds charitable or educational purpose requirements to an otherwise standard LLC framework. Rather than developing its own definition of *charitable* or *educational*, L3C statutes import definitions developed under the Internal Revenue Code.[32] In addition, "[n]o significant purpose" of an L3C can be "the production of income or the appreciation of property,"[33] although producing significant income or capital appreciation will not alone render an entity ineligible for L3C status.[34] An entity can retain this status as long as its purposes remain in line. Importantly, if an L3C ceases to comply, it simply and immediately transforms into an ordinary LLC.[35]

Benefit corporations are incorporated entities that, along with profits, must pursue a "general public benefit."[36] The level of detail benefit corporation statutes use in defining *general public benefit* varies across jurisdictions. Uniformly, though, they describe general public benefit as "a material positive impact on society and the environment" and "as measured by a third-party standard."[37] These third-party standards lie at the heart of the benefit

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legislation, and three of which also allow L3Cs). As of this writing, California and Washington are the only states to have passed FPC and social-purpose corporation legislation, respectively.

32 *See, e.g.*, ME. REV. STAT. ANN. tit. 31, § 1611(1) (2012); VT. STAT. ANN. tit. 11, § 3001(27)(A) (West Supp. 2012).

33 *See, e.g.*, LA. REV. STAT. ANN. § 12:1302(C)(1)(b) (2013); VT. STAT. ANN. tit. 11, § 3001(27)(B).

34 *See, e.g.*, N.C. GEN. STAT. ANN. § 57C-2-01(d)(2) (West 2011); WYO. STAT. ANN. § 17-29-102(a)(ix)(B) (West Supp. 2012). In addition, L3Cs may not be formed to "accomplish one or more political or legislative purposes," again as defined by the tax code. N.C. GEN. STAT. ANN. § 57C-2-01(d)(2); VT. STAT. ANN. tit. 11, § 3001(27)(C).

35 *See, e.g.*, ME. REV. STAT. ANN. tit. 31, § 1611(3); R.I. GEN. LAWS ANN. § 7-16-76(c) (West Supp. 2012). Several detailed analyses of the L3C form are available. *See* Carter G. Bishop, *The Low-Profit LLC (L3C): Program Related Investment by Proxy or Perversion?*, 63 ARK. L. REV. 243 (2010); Dana Brakman Reiser, *Governing and Financing Blended Enterprise*, 85 CHI.-KENT L. REV. 619, 620–30 (2010); Kleinberger, *supra* note 27, at 896–97; J. Haskell Murray & Edward I. Hwang, *Purpose with Profit: Governance, Enforcement, Capital-Raising and Capital-Locking in Low-Profit Limited Liability Companies*, 66 U. MIAMI L. REV. 1, 22–23 (2011).

36 *See, e.g.*, CAL. CORP. CODE § 14610(a) (West 2013); *see also* MD. CODE ANN., CORPS. & ASS'NS § 5-6C-01(c) (West Supp. 2012). An intriguing model for benefit corporation legislation, drafted by proponents, is available online. *Model Benefit Corporation Legislation*, BENEFIT CORP. INFO. CENTER (Jan. 26, 2012), http://benefitcorp.org/storage/Model_Legislation.pdf. This Article, however, will instead cite legislation as actually adopted by various jurisdictions as examples.

37 *See, e.g.*, HAW. REV. STAT. § 420D-2 (2012); VA. CODE ANN. § 13.1-782 (West Supp. 2012).

corporation concept.[38] Enabling legislation requires benefit corporations to frame their public benefit aspirations with respect to a standard developed by a transparent, independent entity.[39] Benefit corporations also must disclose their public benefit achievements to shareholders and the public with reference to such a standard.[40]

Flexible purpose corporations tweak the for-profit corporate model without recourse to third-party standards. Instead, an FPC is "organized . . . for the benefit of the long-term and the short-term interests of the flexible purpose corporation and its shareholders and in furtherance of [one or more] enumerated purposes" its founders select.[41] Special purposes may be either ones typically pursued by a charity or "promoting positive short-term or long-term effects of, or minimizing adverse short-term or long-term effects of, the flexible purpose corporation's activities upon any of the following: (i) [t]he flexible purpose corporation's employees, suppliers, customers, and creditors[;] (ii) [t]he community and society[;] (iii) [t]he environment."[42] Each adopting entity must declare its intention to pursue one or more of these special purposes in its articles of incorporation.[43]

The first thing social entrepreneurs want from a specialized form is permission to expose their enterprises' dual missions. Traditional nonprofit and for-profit forms of organization miss the mark, while all of the various specialized forms meet it effectively. Whatever the other problems or

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38 *See* Brakman Reiser, *supra* note 25, at 592, 600–03; J. William Callison, *Putting New Sheets on a Procrustean Bed*: *How Benefit Corporations Address Fiduciary Duties, the Dangers Created, and Suggestions for Change*, 2 AM. U. BUS. L. REV. 85, 90–92, 94 (2012); J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*, 2 AM. U. BUS. L. REV. 1, 21 (2012).

39 *See, e.g.*, N.J. STAT. ANN. § 14A:18-1 (West Supp. 2012); VT. STAT. ANN. tit. 11A, § 21.03(a)(5), (8). Importantly, benefit corporations need not submit to assessment by such a third party. Benefit corporations can self-assess, but they must use a third party's metric. For general discussion and critique of the benefit corporation form, see Brakman Reiser, *supra* note 25; Callison, *supra* note 38; and Murray, *supra* note 38.

40 *See, e.g.*, LA. REV. STAT. ANN. § 12:1831 (2013); N.Y. BUS. CORP. LAW § 1708 (McKinney Supp. 2012). Benefit LLCs likewise rely upon third-party standards, but tweak the LLC, rather than a corporate, form. *See* MD. CODE ANN., CORPS. & ASS'NS § 4A-1101(c).

41 *See* CAL. CORP. CODE § 2602(b)(1)(A).

42 *See id.* § 2602(b)(2).

43 *See id.* § 2602(b). Comprehensive discussion of the FPC form can be found in Dana Brakman Reiser, *The Next Big Thing: Flexible Purpose Corporations*, 2 AM. U. BUS. L. REV. 55 (2012), and Robert T. Esposito, *The Social Enterprise Revolution in Corporate Law: A Primer on Hybrid Corporate Entities in Europe and the United States and the Case for the Benefit Corporation*, 4 WM. & MARY BUS. L. REV. (forthcoming 2013) (manuscript at 52–58), *available at* http://ssrn.com/abstract=2134022. Washington's social-purpose corporation statute also looks to founders to declare their social mission, without tax law or third-party signposts. *See* WASH. REV. CODE ANN. § 23B.25.020–.40 (West Supp. 2013); *see also* Esposito, *supra*, at 57–61 (analyzing the social-purpose corporation form).

shortcomings of an L3C, benefit corporation, or FPC, each begins with a for-profit template and requires its adopters to express their commitment to social good as well.

II. ACHIEVING DIFFERENCE

Making space to articulate a dual mission is the easy part of designing an organizational form for social enterprise. Designing a for-profit form that will achieve social good is much harder. To succeed, governments must do two things: (1) set a standard for what counts as a true dual-mission entity, and (2) fashion or enable mechanisms to enforce that standard. This Part and the next explain how legislative attempts to date have fallen short on these tasks and suggest how future efforts might do better.

A. A Different Standard: Prioritize Social Good

A government creating a specialized form for social enterprises must set some baseline standard for accessing it. If a specialized form is to constitute a separate, third category of organization, it needs some core quality that differentiates it from traditional for-profit and nonprofit forms. As will be discussed in more detail below, current specialized forms allow adopting entities to pursue both profit and social good, but rarely require them to prioritize one or the other. This generic command to "do both" insufficiently distinguishes specialized forms from ordinary for-profit entities.

No matter where one falls in the debate over the strength of the shareholder wealth maximization norm, for-profit corporations can certainly produce social good when it will coincide with producing profits. Legislation in every state permits for-profit corporations to make charitable contributions.[44] These donations, along with far more extensive corporate social responsibility programs, have become ubiquitous and go on unchallenged.[45] Unincorporated for-profit entities offer their founders and managers even greater flexibility to pursue social objectives along with business ones. There is plenty of space for entities that "do both," but prioritize profit, under the traditional for-profit umbrella.[46] If specialized forms are to create a meaningful, separate category

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[44] *See* R. Franklin Balotti & James J. Hanks, Jr., *Giving at the Office: A Reappraisal of Charitable Contributions by Corporations*, 54 BUS. LAW. 965, 970 (1999).

[45] *See* Dana Brakman Reiser, Essay, *For-Profit Philanthropy*, 77 FORDHAM L. REV. 2437, 2447–49 (2009) (describing pervasiveness of corporate charitable giving and corporate social responsibility programs).

[46] *Id.*

of social enterprise, adopting entities must meet a baseline standard that demands something different.

Governments creating specialized forms should require entities adopting them to prioritize social good in their affairs overall.[47] Not every decision that adopting entities make or every penny they spend must demonstrably prioritize social good over profit. Unlike a purely for-profit entity, though, a social enterprise organized using a specialized, government-sponsored form should be able to show it prioritizes social good as a general matter and over time.[48]

Some may argue this standard pushes the social enterprise category too close to the nonprofit pole, as charities are also charged with pursuing their missions rather than profits for owners. There is a key difference, however. For nonprofits, social good is not just the priority, it is the sole use to which profits may be put. By law, nonprofits cannot distribute profits to owners.[49] The basic premise of specialized forms reverses this nondistribution constraint. The baseline standard I advocate does not disturb permission for entities adopting specialized forms to pursue profits or to distribute them to owners. It simply demands that they prioritize social good over profit-focused goals as a general matter.

True, some founders who view themselves as social entrepreneurs may not wish to prioritize social good as much as this standard would require. Some investors may not want to risk their capital with an entity committed to prioritizing social good over profit.[50] Some employees may distrust the longevity of a company with this commitment; some consumers may doubt the efficiency of its operations. For them, the universe of for-profit entities "doing both" remains available and sufficient. To access a specialized social enterprise form, governments should set prioritization of social good as the required baseline.

Notice also that my standard leaves *social good* undefined. I understand that this term is vague and contested. I leave it open intentionally and

[47] In his critique of the benefit corporation, Professor Murray also argued in favor of requiring prioritization. *See* Murray, *supra* note 38, at 27–31. His desire for clear guidance for directors, however, would likely not be satisfied by my admittedly still-general standard. *See id.* at 29–31.

[48] Importantly, not every entity that currently claims the social enterprise mantle—including, perhaps some mentioned at the outset of this Article—would meet this more rigorous standard.

[49] *See supra* Part I.A.

[50] This limitation on investment could be quite serious. *See* Chertok et al., *supra* note 29, at 46 (quoting Heerad Sabeti, who lamented that social enterprises that are able to attract funding to grow "often do so by compromising their mission and values in order to satisfy investor demands").

inevitably. Allowing individuals the freedom to pursue their own visions of the social good, rather than one prescribed by fiat, is necessary to produce a vibrant and pluralistic civil society. Outside minimal requirements of lawfulness and compliance with public policy, even legal definitions of charity are extremely capacious.[51] Current statutory formulations for social enterprises follow suit. They treat social good as encompassing traditionally charitable activity, as well as pursuing the interests of stakeholders as proximate as employees and as distant as the global environment and society at large.[52] Here, early legislation reflects good choices. Founders adopting specialized forms should have wide discretion to choose the social good they choose to pursue, but then should be required to differentiate themselves by prioritizing that social good over profit.

B. Imposing the Standard

Specialized form legislation should impose a clear social-good prioritization standard on organizations themselves and on the actions of their leaders. To impose this standard on organizations, statutes should state unambiguously that the social purposes of adopting entities must trump their business purposes. To impose it on leaders and managers, legislation should structure fiduciaries' duties to require prioritization of social good. Unfortunately, current legislative efforts rarely do either.

1. Legislating Standards for Adopting Entities

As noted earlier, L3C statutes require an adopting entity to "significantly further the accomplishment of one or more charitable or educational purposes" as defined under the tax code.[53] This language requires an L3C to pursue social good, but not to prioritize it. The legislation also demands that L3Cs "would

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51 *See* I.R.C. § 501(c)(3) (2006) (describing the category of exempt organizations as those pursuing "religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals"); RESTATEMENT (THIRD) OF TRUSTS §§ 28 & cmt. f, 29 (2003) (stating that "[c]haritable trust purposes include: (a) the relief of poverty; (b) the advancement of knowledge or education; (c) the advancement of religion; (d) the promotion of health; (e) governmental or municipal purposes; and (f) other purposes that are beneficial to the community" and that charitable trusts are subject to the rule of section 29 that trust purposes and provisions must not be unlawful or contrary to public policy); MARION R. FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION 127 (2004) (describing the long lists of charitable purposes for which many state nonprofit corporate statutes allow formation and that many also repeat the provisions of I.R.C. § 501(c)(3)).

52 *E.g.*, VT. STAT. ANN. tit. 11, § 3001(27)(A) (West Supp. 2012).

53 *E.g.*, ME. REV. STAT. ANN. tit. 31, § 1611(1) (2012).

not have been formed but for the company's relationship to the accomplishment of charitable or educational purposes."[54] This seems to address the founder's motivation for forming the entity, but again lacks a clear command to prioritize pursuit of social good. Finally, the statutes warn:

> No significant purpose of the entity is the production of income or the appreciation of property provided, however, that the fact that an entity produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property.[55]

A fair reading of this admittedly confusing language would prohibit an L3C from prioritizing profit overall. Unfortunately, the somewhat contradictory provisions in the language undermine even this conclusion. Further, a prohibition on prioritizing profit still does not affirmatively require an L3C to prioritize social good.

The other forms fall even shorter, generally adopting an explicit "do both" approach to corporate purposes. FPCs are formed "to engage in any lawful act or activity . . . for the benefit of the long-term and the short-term interests of the flexible purpose corporation and its shareholders *and* in furtherance of . . . [one or more] enumerated [social-good] purposes."[56] The statute does not require prioritization of one type of purpose or the other in any way. Benefit corporations must be formed to pursue a general public benefit but also can pursue any lawful business purpose. While a benefit corporation may choose to set its public benefit up as a limit on its business purposes, under all but one statute this path is optional.[57] New York's statute, which became effective in 2012 and perhaps signals future legislative improvements in standard setting, is an important outlier. For New York benefit corporations, "[t]he purpose to create general public benefit shall be a limitation on the other purposes of the benefit corporation, and shall control over any inconsistent purpose of the benefit corporation."[58] This clear command for adopting entities

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54 *E.g.*, VT. STAT. ANN. tit. 11, § 3001(27)(A)(ii).

55 *E.g.*, WYO. STAT. ANN. § 17-29-102(a)(ix)(B) (West Supp. 2012).

56 CAL. CORP. CODE § 2602(b) (West 2013) (emphasis added).

57 *See, e.g.*, *id.* § 14610(a); MD. CODE ANN., CORPS. & ASS'NS § 5-6C-06(a)(2) (West Supp. 2012); N.J. STAT. ANN. § 14A:18-5(a) (West Supp. 2012).

58 N.Y. BUS. CORP. LAW § 1706(a) (McKinney Supp. 2012). *Compare* N.J. STAT. ANN. § 14A:18-5(a) ("This purpose is in addition to, and *may be a limitation on*, its purpose under its certificate of incorporation and any specific purpose set forth in its certificate of incorporation." (emphasis added)), *with* N.Y. BUS. CORP. LAW § 1706(a).

to prioritize social good is commendable and should be emulated in future legislation.

2. *Legislating Standards for Fiduciaries*

Legislation creating specialized forms should also impose a patent mandate that their fiduciaries must prioritize social good. After all, these entities are legal fictions and can only act through the leaders and managers who operate them. John Tyler forcefully argued that L3C statutes have done so. In his view:

> [They] clearly impose an unambiguous ordering of fiduciary priorities:
>
> - the primary purpose of the L3C operations must prioritize pursuing charitable, exempt purposes, thereby exalting charitable purpose above all other purposes; and
> - realizing profit and enhancing value can be purposes of the enterprise as long as they are not significant purposes, thereby subordinating profit motive and placing it not just secondary on the continuum of permissible purposes, but near the extreme end of such continuum.[59]

J. Haskell Murray and Edward Hwang similarly concluded that the L3C's purpose language "convey[s] a mandate for an L3C manager to prioritize the organization's charitable purpose above all other things and to consider such priority as a framework for fiduciary duties of loyalty and care."[60] This careful parsing of the statutory language is surely a reasonable purposive interpretation by sophisticated experts. But, a standard that social enterprises, their fiduciaries, and counsel might find in reading between statutory lines is insufficient. For limitations on fiduciary conduct to differentiate a new category of specialized forms, they must clearly and explicitly instruct these leaders to prioritize social good. The brief and muddled mandate L3C statutes contain does not go nearly this far.[61]

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59 Tyler, *supra* note 24, at 141 (footnotes omitted).

60 Murray & Hwang, *supra* note 35, at 27–28.

61 Callison and Vestal likewise challenged Tyler's view of the LC3's requirements for fiduciaries. *See* Callison & Vestal, *supra* note 27, at 286–88. The strange statutory formulation is actually borrowed from federal tax legislation describing a program-related investment (PRI). A PRI is an investment made by a private foundation to further its exempt purpose. *See* I.R.C. § 4944(c) (2006); *see also Examples of Program-Related Investments by Private Foundations—Proposed Regulations*, IRS, http://www.irs.gov/Charities-&-Non-Profits/Examples-of-Program-Related-Investments-by-Private-Foundations-%E2%80%93-Proposed-Regulations (last updated Nov. 19, 2012). If such an investment meets the tax law requirements now incorporated into L3C statutes, it will qualify as a PRI, will count toward the foundation's required annual

Although benefit corporation and FPC statutes discuss the role of directors in great detail, they do not impose a clear standard requiring fiduciaries to prioritize social good.[62] Benefit corporation language typically includes a specialized standard for directors' conduct. In it, directors are instructed to consider a laundry list of constituencies. For example, under Vermont law:

> [Directors] *shall*, in determining what the director reasonably believes to be in the best interests of the benefit corporation, consider the effects of any action or inaction upon:
> (A) the shareholders of the benefit corporation;
> (B) the employees and workforce of the benefit corporation and its subsidiaries and suppliers;
> (C) the interests of customers to the extent they are beneficiaries of the general or specific public benefit purposes of the benefit corporation;
> (D) community and societal considerations, including those of any community in which offices or facilities of the benefit corporation or its subsidiaries or suppliers are located;
> (E) the local and global environment; and
> (F) the long-term and short-term interests of the benefit corporation, including the possibility that those interests may be best served by the continued independence of the benefit corporation.[63]

This language clearly neutralizes any real or perceived shareholder wealth maximization norm, drawing heavily on constituency statutes. Unlike most constituency statutes, which only free directors to consider the interests of various stakeholders, benefit corporation statutes mandate their consideration. The language does not, however, require directors to prioritize social good. In fact, benefit corporation statutes frequently reject the idea of prioritization expressly.[64]

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distributions, and will not trigger penalties as a jeopardizing investment. *See id.* The L3C was initially formulated as a vehicle to receive PRIs. *See* Cassady V. ("Cass") Brewer, *A Novel Approach to Using LLCs for Quasi-Charitable Endeavors (A/K/A "Social Enterprise")*, 38 WM. MITCHELL L. REV. 678, 680 n.4, 682 (2012); Elizabeth Schmidt, *Vermont's Social Hybrid Pioneers: Early Observations and Questions to Ponder*, 35 VT. L. REV. 163, 165 (2010). Nothing in the statute, however, limits it to this use and an early study suggests it is not the major reason for most L3C adoptions. *See id.* at 177–78.

62 *See* Brakman Reiser, *supra* note 25, at 598–600; Callison, *supra* note 38, at 24–25; Murray, *supra* note 38, at 27–31.

63 VT. STAT. ANN. tit. 11A, § 21.09(a)(1) (West Supp. 2012) (emphasis added). Many benefit corporations bestow even greater discretion on benefit corporation directors, who may also consider "any other pertinent factors or the interests of any other group that the director determines are appropriate to consider." *Id.* § 21.09(a)(2); *see also* HAW. REV. STAT. § 420D-6(a)(2)(H) (2012) (using essentially identical language).

64 *See, e.g.*, LA. REV. STAT. ANN. § 12:1821(A)(3) (2013) (stating that directors "[s]hall not be required to give priority to the interests of a particular person or group . . . over the interests of any other person or

Perversely, while this standard seeks to make stakeholder interests more potent in the boardroom, it may simply give fiduciaries license to do whatever they want. The familiar concern that constituency statutes in fact act as director protection is well taken here.[65] With such a lengthy list of permissible considerations and no instruction on prioritization, one can question whether any standard of conduct for benefit corporation directors evaporates.[66]

The standard of conduct imposed on FPC directors is quite different, but still does not require them to treat social good as their priority. The California legislation expands directors' discretion to:

> consider those factors, and give weight to those factors, as the director deems relevant, including the short-term and long-term prospects of the flexible purpose corporation, the best interests of the flexible purpose corporation and its shareholders, and the purposes of the flexible purpose corporation as set forth in its articles.[67]

Thus, directors may consider only the particular special purpose or purposes identified for their FPC and expressed in its articles of incorporation.[68] Notably, consideration of these purposes is permissive, not mandatory.[69] While this FPC language might be characterized as "do both" and compared favorably to benefit corporation statutes' instruction to "do everything," it does not demand that FPC leaders prioritize social good.

In future iterations, specialized form legislation should provide fiduciaries with not only discretion, but real guidance. It should state plainly that fiduciaries of adopting entities are duty-bound to prioritize social good.

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group unless" the organization's articles express a contrary intention); VT. STAT. ANN. tit. 11A, § 21.09(a)(3) (rejecting a similar prioritization requirement).

65 *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 38 (1991) ("[A] manager told to serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither."); Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1493 (1992) ("[T]he primary effect of these constituency statutes is simply to enhance managers' discretion in responding to hostile takeover bids.").

66 Brakman Reiser, *supra* note 25, at 599–600.

67 CAL. CORP. CODE § 2700(c) (West 2013).

68 *See id.*

69 *See id.*

3. *Imposing Standards by Judicial Interpretation*

To date, specialized form legislation has seldom included clear mandates and future legislative efforts may fail to incorporate them.[70] Thus, it is important to consider whether courts will interpret existing concepts of fiduciary obligation to require social-good prioritization. After all, the fiduciary duty idea is known and vaunted for its malleability; its meaning and requirements change with the context in which it is applied.[71] If judicial interpretation can effectively embed social-good prioritization within fiduciary duty concepts, legislative clarity may not be indispensable.

For-profit organizational forms all impose fiduciary duties of loyalty on their leaders and vest investors with authority to enforce them.[72] For corporate directors, this duty demands that fiduciaries act with good faith and loyalty, not putting their personal interests before those of the enterprises they serve.[73] Of course, avoiding self-dealing or unfair competition is likewise necessary for dutiful service to a social enterprise. But it is not sufficient to train fiduciaries' attention on prioritizing social good.

Imagine a social enterprise founded to pursue "a cooler, greener planet and profits for owners by producing clean energy technology." It needs to choose a new supplier for the primary input in its sole product. The decision is one of great magnitude, since the cost of procuring this input represents 75% of the company's production expenses. One potential supplier offers the input for a very low price; the other supplier prices the input considerably higher but produces it with a smaller carbon footprint. A narrow reading of loyalty prohibits a fiduciary from sourcing the input from a supplier she controls, at least if the price agreed upon is above market. Yet it gives her no guidance on how to balance the competing aims of profit and social good. Traditional

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70 *See supra* Part II.2.

71 *See* TAMAR FRANKEL, FIDUCIARY LAW 1–6 (2011) (noting fiduciary duty's application and differing elements in varying contexts, in a work attempting to define a common core of fiduciary concept); Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 879 ("Although one can identify common core principles of fiduciary obligation, these principles apply with greater or lesser force in different contexts involving different types of parties and relationships.").

72 In this Part, I draw on for-profit and nonprofit corporate fiduciary law to anticipate how courts might delineate the duties of fiduciaries of social enterprises taking specialized forms. Still further instruction might be drawn from LLC law's concept of good faith and fair dealing or fiduciary concepts applicable in other forms of organization. I decline to consider additional alternatives here out of concern doing so would make an already lengthy discussion unwieldy.

73 *See* JAMES D. COX & THOMAS LEE HAZEN, BUSINESS ORGANIZATIONS LAW § 10.9, at 221 (3d ed. 2011).

loyalty concepts will also provide plaintiffs and courts no signposts for determining when fiduciaries have struck an inappropriate balance. In the absence of clear legislative mandates, judges will need to expand the idea of the duty of loyalty beyond these typically narrow quarters for it to spur our fiduciary to prioritize social good.

Perhaps instead, the duty of care would provide the necessary direction. It requires fiduciaries to act prudently.[74] As they make decisions they must inform themselves suitably, may rely upon experts as needed, and can delegate to committees when appropriate.[75] Yet these process-oriented indicia of care will not require fiduciaries to prioritize social good. To do so, the duty of care would need to include a substantive component beyond mere rationality.[76] Judges would need to opine that careful action equates with erring on the side of social good.

The process-heavy nature of typical care obligations is exacerbated by application of the business judgment rule. Under this rule, courts defer to corporate fiduciaries' nonconflicted, good faith decisions taken with adequate information. It is drawn from for-profit corporate law, but has been applied to nonprofit fiduciaries as well.[77] Like in the for-profit realm, application of this rule to nonprofits is based on courts' professed nonexpertise in their affairs[78] and a desire not to discourage fiduciaries from responsible risk taking.[79] Unless legislatively overridden, the business judgment rule will likely be applied to social enterprises adopting specialized forms for these same reasons.[80] Courts

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74 *See id.* § 10.2, at 201.

75 *See id.* § 10.4, at 208–12.

76 *See id.* § 10.5, at 212.

77 *See* REVISED MODEL NONPROFIT CORP. ACT § 8.30 cmt. 3 (1987) ("While the application of the business judgment rule to directors of nonprofit corporations is not firmly established by the case law, its use is consistent with [the statute]."); FREMONT-SMITH, *supra* note 51, at 209–11, 226–27 (noting codifications and judicial support for applying the business judgment rule in the nonprofit context); *see also* 1 LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 9:2 (2008) (addressing the role of the business judgment rule in LLC managers' duties of care); Larry E. Ribstein, *An Analysis of the Revised Uniform Limited Liability Company Act*, 3 VA. L. & BUS. REV. 35, 65 (2008) (criticizing application of the rule to LLCs in part because it "introduces a corporate concept that is an inappropriate default rule for partnership-type and closely held firms").

78 *Cf.* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 119 (2004) ("Judges likely have less general business expertise than [for-profit] directors.").

79 *See* FREMONT-SMITH, *supra* note 51, at 210; Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631, 644 (1998).

80 Murray advocated the application of such a rule, the "purpose judgment rule," to benefit corporations. *See* Murray, *supra* note 38, at 41. Under it, "only if a director of a benefit corporation consciously failed to carry out her duties in good faith, knowingly violated the law or prioritized her own self-interest, would the real possibility of liability exist." *Id.*

will have no desire to shackle fiduciaries to crabbed and conservative strategies alone—the whole idea of specialized forms is to encourage a new and bold way of thinking about doing business and creating social good.

Recall our fiduciary's decision whether to source her company's major input from the cheaper or greener supplier. She would seem to comply with her duty of care obligations to inform herself and attend to her duties with prudence by putting the contract out for bid and selecting the lowest priced bid from among those the company received. The business judgment rule would shield her from liability with even less effort. It would defer to the fiduciary's choice unless it represented a conflict of interest, lacked good faith, or was badly uninformed. The traditional duty of care will encourage directors to use deliberate and conscientious methods when making decisions that pit social good and profit against each other, which they absolutely should. It will not, however, tell them to prioritize social good.

Courts might reach beyond narrow understandings of loyalty or care to impose a social-good prioritization standard. For example, courts could interpret good faith differently for specialized form fiduciaries. The meaning of good faith has been much discussed in recent commentary on Delaware corporate caselaw.[81] Until *Stone ex rel. AmSouth Bancorporation v. Ritter*, some commentators even argued it constituted an independent, third category of directors' fiduciary obligation.[82] *Stone* rejected that position and sited good faith firmly within the ambit of the duty of loyalty.[83] Directors must act in good faith to meet their loyalty obligations, but a showing of lack of good faith alone will not ground liability.[84] Given the flexibility of fiduciary duty law generally, and the lack of Delaware dominance in social enterprise law, there is

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81 *See, e.g.*, Tara L. Dunn, *The Developing Theory of Good Faith in Director Conduct: Are Delaware Courts Ready to Force Corporate Directors to Go Out-of-Pocket After* Disney IV*?*, 83 DENV. U. L. REV. 531 (2005); Sean J. Griffith, *Good Faith Business Judgment: A Theory of Rhetoric in Corporate Law Jurisprudence*, 55 DUKE L.J. 1 (2005); Charles W. Murdock, *Fairness and Good Faith as a Precept in the Law of Corporations and Other Business Organizations*, 35 LOY. U. CHI. L.J. 551 (2005); John L. Reed & Matt Neiderman, *"Good Faith" and the Ability of Directors to Assert Section 102(b)(7) of the Delaware General Corporation Law as a Defense to Claims Alleging Abdication, Lack of Oversight, and Similar Breaches of Fiduciary Duty*, 29 DEL. J. CORP. L. 111 (2004); David Rosenberg, *Making Sense of Good Faith in Delaware Corporate Fiduciary Law: A Contractarian Approach*, 29 DEL. J. CORP. L. 491 (2004).

82 *See, e.g.*, Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1, 3 (2006); Hillary A. Sale, *Delaware's Good Faith*, 89 CORNELL L. REV. 456, 494 (2004); *see also* Leo E. Strine, Jr. et al., *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L.J. 629 (2010) (detailing, and critiquing, this debate).

83 *See* 911 A.2d 362, 369–70 (Del. 2006) (en banc).

84 *See id.*

no need for courts addressing specialized forms to follow this narrow path. If legislation does not impose a fiduciary duty to prioritize social good explicitly, courts can interpret good faith in this context to require it.

The duty of obedience offers courts another pathway by which they can impose a mandate to prioritize social good. Although the duty of obedience in modern for-profit corporate law is typically understood primarily to require regulatory compliance,[85] many commentators argue a more expansive duty of obedience constrains the work of nonprofit fiduciaries.[86] In their view, "the duty of obedience requires that a director act with fidelity, within the bounds of the law generally, to the organization's 'mission,' as expressed in its charter and by-laws."[87] Commentators debate whether obedience is a separate and independent duty of nonprofit directors, but even those who dispute its existence as a separate duty agree nonprofit fiduciaries must adhere to purposes of the entities they serve.[88] If legislatures fail to directly impose a

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85 *See* Alan R. Palmiter, *Duty of Obedience: The Forgotten Duty*, 55 N.Y.L. SCH. L. REV. 457, 460–61 (2010–2011). Fiduciary duties requiring obedience can also be found in agency law and trust law. *See* RESTATEMENT (THIRD) OF TRUSTS § 76(1) (2007) (recognizing a trustee's "duty to administer the trust . . . in accordance with [its terms] and applicable law"); RESTATEMENT (THIRD) OF AGENCY § 8.09 (2006) (noting agent's "duty to take action only within the scope of the agent's actual authority" and to "comply with all lawful instructions received from the principal"); *id.* § 1.01 & cmt. f; *see also* FREMONT-SMITH, *supra* note 51, at 225–26 (discussing obedience in the context of private and charitable trusts); Megan Wischmeier Shaner, *Restoring the Balance of Power in Corporate Management: Enforcing an Officer's Duty of Obedience*, 66 BUS. LAW. 27, 44–46 (2010) (discussing the duty of obedience in agency law in an article arguing for its application to corporate officers).

86 *See* DANIEL L. KURTZ, BOARD LIABILITY: GUIDE FOR NONPROFIT DIRECTORS 84–86 (1988) (articulating the duty of obedience as such and explaining its demands on nonprofit fiduciaries); Rob Atkinson, *Obedience as the Foundation of Fiduciary Duty*, 34 J. CORP. L. 43 (2008) (offering an expansive review of the duty of obedience across corporate and trust contexts); Palmiter, *supra* note 85, at 466–69 (summarizing the duty's requirements); *see also* Melanie DiPietro, *Duty of Obedience: A Medieval Explanation for Modern Nonprofit Governance Accountability*, 46 DUQ. L. REV. 99, 102 (2007) (arguing that a separate duty of obedience for nonprofit fiduciaries is needed); Linda Sugin, *Resisting the Corporatization of Nonprofit Governance: Transforming Obedience into Fidelity*, 76 FORDHAM L. REV. 893, 904–05, 919–27 (2007) (advocating reinvigoration of a requirement of nonprofit fiduciaries' obedience to mission as a duty of fidelity).

87 KURTZ, *supra* note 86, at 21; *see also* Manhattan Eye, Ear & Throat Hosp. v. Spitzer, 715 N.Y.S.2d 575, 593 (Sup. Ct. 1999) ("It is axiomatic that the Board of Directors is charged with the duty to ensure that the mission of the charitable corporation is carried out. This duty has been referred to as the 'duty of obedience.'").

88 *See, e.g.*, PRINCIPLES OF THE LAW OF NONPROFIT ORGANIZATIONS §§ 300 cmt. g, 320 cmt. e (Tentative Draft No. 1, 2007) (articulating such an obligation without approving a separate duty of obedience); FREMONT-SMITH, *supra* note 51, at 225–26 (arguing obedience to mission is appropriately seen as a component of the duty of loyalty); Goldschmid, *supra* note 79, at 641 (arguing obedience to mission is appropriately seen as a component of the duty of care).

duty to prioritize social good on specialized form fiduciaries, courts can hold such prioritization is an inherent requirement of their duty of obedience.

This might be easiest in an FPC, whose articles will dedicate the entity to at least one special purpose. For other types of entities, formative documents may speak in very general terms, offering little guidance to fiduciaries, litigants, and courts. Analogous obstacles arise and have been overcome, however, in charitable entities; organizational documents can say little about mission and modern charters often permit the organization to pursue "any lawful purpose."[89] Of course, even if purpose language is very specific, obedience to it should not be slavish. Like charities, to be effective, social enterprises often will need to evolve over time to meet society's changing needs.[90]

Consider again our supply-chain decision. Our fiduciary will have an easier time choosing a supplier if specialized forms contain a social-good prioritization mandate—a sort of tiebreaker for close cases. She can safely select the greener supplier, erring on the side of furthering the entity's environmental mission. Of course, this does not mean these fiduciaries will face no hard choices. Real decisions may not be this stark, such as if the entity was also founded to serve the local community and the greener vendor operated out of state.

Nor does a mandate to prioritize social good rob fiduciaries of all their discretion. It bears repeating that not every decision fiduciaries make must demonstrably further social good. The requirement is to make social good the organization's priority as a general matter. In decisions of smaller impact for the entity, profit-seeking outcomes can be favored. Furthermore, fiduciaries can pursue subtler solutions as long as they fit within an overall prioritization of social good. Even on this major vendor decision, fiduciaries might appropriately decide to source some of their supply from the cheaper vendor. Or, perhaps, awarding the contract to the cheaper, emitting vendor is justified here because of recent major decisions pursuing environmental gains. A command to prioritize social good hardly turns fiduciaries into do-gooding robots, reflexively taking every decision in furtherance of social mission,

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[89] *See* Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 510 (1981).

[90] PRINCIPLES OF THE LAW OF NONPROFIT ORGANIZATIONS §§ 300 cmt. g, 320 cmt. e (Tentative Draft No. 1, 2007); FREMONT-SMITH, *supra* note 51, at 225–26; Dana Brakman Reiser, *Charity Law's Essentials*, 86 NOTRE DAME L. REV. 1, 12–13 (2011); Dana Brakman Reiser, *Filling the Gaps in Nonprofit Accountability: Applying the Club Perspective in the U.S. Legal System*, *in* VOLUNTARY REGULATION OF NGOS AND NONPROFITS: AN ACCOUNTABILITY CLUB FRAMEWORK 41, 48–49 (Mary Kay Gugerty & Aseem Prakash eds., 2010).

damning the consequences for investors. It does, however, provide a baseline of content to help fiduciaries resolve otherwise paralyzing dilemmas.

There is no caselaw on these questions to date, but when cases arise courts should use these or other interpretive vehicles to impose a clear social-good prioritization standard. As discussed above,[91] I disagree with Tyler's view that "the L3C statutes clearly impose an unambiguous ordering of fiduciary priorities."[92] I agree, however, that social-good prioritization would be a fair gloss for courts to apply to L3C statutes. It could also be easily read into the fiduciary duties of New York benefit corporations, whose social-good purposes control over any other inconsistent objectives. For other explicitly "do both" statutes, courts would need to be somewhat more aggressive, but would be acting within a long tradition of common law fiduciary duty interpretation.

C. Conclusion

Taking New York's lead, specialized form legislation should clearly state that only social enterprises that prioritize social good may adopt the specialized forms they enable. It should also definitively bind their fiduciaries to prioritize social good. If legislation fails to do so, courts should take up the cause as they interpret the fiduciary obligations of social enterprise leaders over time.

This social-good prioritization standard will not ensure that every adopting entity will meet everyone's standards for a good, socially conscious, responsible, or green company. Individual entities are free to promise they will do more.[93] And, investors, employees, and customers are free to demand more from those companies with whom they associate. But, requiring adopting entities to prioritize social good will identify them as meaningfully distinct from ordinary for-profits. Their ability to distribute profits to owners will mark them as importantly different from nonprofits.[94] Imposing this standard will

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91 *Supra* Part II.B.2.

92 Tyler, *supra* note 24, at 141.

93 Ordinary antifraud provisions may be used to police these claims. *Cf.* Tyler, *supra* note 24, at 156 (describing the potential use of fraud claims to police failures by L3C fiduciaries to prioritize charitable goals).

94 Note this definition is widely found in the business literature on social enterprise. *See, e.g.*, FRANK MARTIN & MARCUS THOMPSON, SOCIAL ENTERPRISE: DEVELOPING SUSTAINABLE BUSINESSES 5–6 (2010) (noting "[t]he most common definition that appears in texts written about social enterprise" in the United Kingdom is "a business with primarily social objectives whose surpluses are reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners"); JANE WEI-SKILLERN ET AL., ENTREPRENEURSHIP IN THE SOCIAL SECTOR 4 (2007) (stating in a business school text that for social enterprises "[t]he creation of social value takes precedence over the creation

differentiate those entities adopting specialized forms as part of a new and significant category, assuming it can be enforced. The next Part examines this pivotal assumption.

III. ENFORCING THE STANDARD

A social-good prioritization standard will have only expressive value unless specialized form legislation also establishes mechanisms for enforcing it. Recent enactments offer many insights on how to shape enforcement. This Part goes beyond those extant examples, however, to develop a typology of enforcement mechanisms upon which specialized forms might rely. These include mechanisms that look within adopting entities for enforcement resources, as well as mechanisms that pursue enforcement externally, through public or even private regulators.

In situations where enforcement is suboptimal, self-regulation regimes often develop if enforcement is of value to the relevant industry. Social entrepreneurs' own interest in achieving their social missions and branding their entities as truly different may motivate them to find their own methods of enforcement. They could define goals and limitations on their enterprises' activities in partnership, operating, or shareholder agreements.[95] They could maintain a controlling ownership position for themselves or a trusted few.[96] They could adopt a financing structure that locks themselves and investors into a pact to prioritize social good.[97] These options may eventually create limitations on scale, but can be effective for many if not most social enterprises even for the long term. Still, they are individual responses, not ones compelled or even driven by organizational form.

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of personal shareholder or stakeholder wealth"); Sabeti, *supra* note 9, at 99 (explaining in the *Harvard Business Review* that social enterprises "generate earned income but give top priority to an explicit social mission"). For a more detailed discussion of the business literature's use of the terms *social enterprise* and *social entrepreneurship*, see J. GREGORY DEES, THE MEANING OF "SOCIAL ENTREPRENEURSHIP" (2001), *available at* http://www.caseatduke.org/documents/dees_sedef.pdf. In this influential white paper, Dees noted that for social entrepreneurs, "[m]ission-related impact becomes the central criterion, not wealth creation." *Id.* at 2.

95 *See* Callison & Vestal, *supra* note 27, at 286–88 (describing this strategy in the LLC context); *see also, e.g.*, MODEL BUS. CORP. ACT § 7.32 (2010) (granting shareholders broad discretion in crafting shareholder agreements to fit their needs, even in many situations otherwise "inconsistent" with the Act's provisions).

96 *See* Dees & Anderson, *supra* note 7, at 17–19 (describing retaining control with owners sympathetic to a social enterprise's social missions as a strategy for maintaining it).

97 *See* Dana Brakman Reiser & Steven A. Dean, *Hunting Stag with FLY Paper: A Hybrid Financial Instrument for Social Enterprise*, 54 B.C. L. REV. (forthcoming 2013).

For a specialized form for social enterprise to lead social entrepreneurs to achieve social mission, the form itself must provide a ready answer to the enforcement question. None of the current forms have yet accomplished this. There are clear legislative or judicial paths for establishing a social-good prioritization standard. Establishing effective enforcement mechanisms is more difficult, yet legislators and social entrepreneurs must meet this challenge for specialized forms to succeed.

A. Enforcement from Within

Legislation creating specialized forms could empower one or more groups within adopting entities to engage in enforcement activity. The first line of defense is self-discipline by organizational leaders. Many fiduciaries will strive to meet the obligations the law imposes, even without a serious threat of enforcement, provided they understand the law's limits.[98] The concern about understanding what the law requires is especially serious in the benefit corporation, where the sheer number of mandatory considerations for fiduciaries may be overwhelming. But L3C and FPC directors also lack guidelines on how to handle the inevitable moments when profit and social good conflict. The structure of L3C legislation might provide attentive fiduciaries some clues. The FPC statute's limitation on the universe of potential social goods FPC directors can consider also offers directors some moorings.[99] Still, the essential "do both" approach adopted by all of these forms offers fiduciaries little guidance. A clear standard prioritizing social good would improve fiduciaries' ability to self-police.

1. Investor Enforcement

Specialized forms need not rely, however, solely on fiduciaries' good intentions. They may also inform, empower, and incentivize investors and other stakeholders to enforce social-good prioritization. Current forms prominently feature private enforcement by investors, arming them with an array of informational, voting, and litigation rights. This subsection canvasses

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[98] *See* Julian Velasco, *The Role of Aspiration in Corporate Fiduciary Duties*, 54 WM. & MARY L. REV. 519, 524 (2012) (arguing that the unenforced duty "is a meaningful concept because people obey the law for many different reasons, and not simply out of fear of punishment").

[99] *See* CAL. CORP. CODE § 2700(c) (West 2013) (permitting directors to look to "those factors, and give weight to those factors, as the director deems relevant, including the short-term and long-term prospects of the flexible purpose corporation, the best interests of the flexible purpose corporation and its shareholders, and the purposes of the flexible purpose corporation as set forth in its articles").

these investor rights—and other rights future legislation might consider—and evaluates their potential to enforce a standard of social-good prioritization.

a. Informational Rights

Information is a precondition for effective investor enforcement. Without knowledge of how fiduciaries are undertaking their roles, and in particular how they are handling the inevitable conflicts between profit and social good, even empowered and motivated investors will have little enforcement impact. Traditional for-profit forms recognize investors' need for information and entitle them to information about the conduct of a business.[100] These basic informational rights can, and frequently have, been carried over to specialized forms.

In profit-focused entities, the information investors receive naturally emphasizes business outcomes and profit forecasts, explaining their expected impact on investor earnings. This content must be adjusted to empower investors in social enterprises. These investors still need information about profit, but they also need information about how an enterprise is pursuing social good and balancing these goals. Moreover, they need not only information on outcomes, but also some visibility into entities' decision-making processes, especially when profit and social good come into conflict. The benefit corporation and FPC statutorily expand disclosure to investors in this fashion.

All benefit corporation statutes require adopting entities to distribute to their shareholders an annual "benefit report" and post it on their public website, if one exists.[101] This report must describe "[t]he ways in which the

[100] Basic financial reports must be disclosed upon investor request and, for a proper purpose, investors must be given access to the company's books and records. Information will also be provided at shareholder, member, or partnership meetings in preparation for director elections or other shareholder votes. *See, e.g.*, DEL. CODE ANN. tit. 8, § 220 (West Supp. 2012). The Model Business Corporation Act also requires those regulated by it to distribute annual financial statements to shareholders. MODEL BUS. CORP. ACT § 16.20 (2010). *But see* COX & HAZEN, *supra* note 73, § 13.6, at 354 (explaining that "the response of state legislatures was not favorable" to this Model Act feature but that the federal securities laws served the same purpose for public companies). For disclosure duties in LLCs, see generally 1 RIBSTEIN & KEATINGE, *supra* note 77, § 9:5, which notes that "[a]n LLC manager probably has no ongoing affirmative duty to disclose developments concerning the LLC to the members in the absence of some transaction or event, including a demand for information, which would lead the member to expect disclosure." Where they apply, investors may also obtain information about the companies in which they invest from disclosures mandated by federal and state securities laws. COX & HAZEN, *supra* note 73, § 13.6, at 354.

[101] *See, e.g.*, CAL. CORP. CODE § 14630(a)–(c); N.Y. BUS. CORP. LAW § 1708(a)–(c) (McKinney Supp. 2012).

benefit corporation pursued a general public benefit during the year and the extent to which the general public benefit was created," along with "[a]ny circumstances that have hindered the creation by the benefit corporation of the public benefit."[102] In addition, the report must assess the entity's performance with respect to its chosen third-party standard.[103] Some benefit corporation enabling acts also mandate that adopting entities seat a "benefit director" to "prepare . . . a statement whether, in the opinion of the benefit director, the benefit corporation acted in accordance with its general, and any specific, public benefit purpose in all material respects during the period covered by the report" for inclusion in the annual report.[104] Also, "[i]f in the opinion of the benefit director the benefit corporation . . . failed to act in accordance with its public benefit purpose, then the statement of the benefit director shall include a description of the ways in which the benefit corporation or its directors or officers failed to act."[105] The basic benefit report disclosures are primarily outcome based. Required reporting on obstacles to achieving social good and the opinion of benefit directors, though, can give investors insight on the profit–social-good tradeoffs their benefit corporations have made in a given year and over time.

California's FPC statute goes even further, requiring boards to send shareholders two-part annual disclosures and post them publicly when confidentiality is not a barrier.[106] The two parts track the dual mission of an FPC. The first part addresses financial performance, including a current balance sheet, income statement, and statement of cashflows, along with an independent accountant's report or officer's validating certificate.[107] The contents of the second part are highly scripted and require comprehensive reporting on an FPC's achievement of its chosen special purpose or purposes. This part of the annual report must include:

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[102] MD. CODE ANN., CORPS. & ASS'NS § 5-6C-08(a)(1)(i), (iii) (West Supp. 2012); *see, e.g.*, N.J. STAT. ANN. § 14A:18-11(a)(1)(a), (c) (West Supp. 2012) (similar); S.C. CODE ANN. § 33-38-500 (Supp. 2012) (similar).

[103] *See, e.g.*, HAW. REV. STAT. § 420D-11(a)(2) (2012); VA. CODE ANN. § 13.1-791(A)(2)(a) (West Supp. 2012).

[104] N.J. STAT. ANN. § 14A:18-7(c); *see, e.g.*, HAW. REV. STAT. § 420D-7(c); S.C. CODE ANN. § 33-38-410(c)(1).

[105] N.J. STAT. ANN. § 14A:18-7(c); *see, e.g.*, MASS. GEN. LAWS ANN. ch. 156E, § 11(c)(3) (West Supp. 2012); VT. STAT. ANN. tit. 11A, § 21.10 (West Supp. 2012). These same enactments permit the benefit corporation to appoint a "benefit officer" to prepare the annual benefit report. *See* 805 ILL. COMP. STAT. ANN. 40/4.15(b)(2) (West Supp. 2012); LA. REV. STAT. ANN. § 12:1824(B)(2) (2013); N.J. STAT. ANN. § 14A:18-9.

[106] *See* CAL. CORP. CODE § 3500(b).

[107] *Id.* § 3500(a). Benefit corporations with fewer than 100 shareholders need not comply with generally accepted accounting principles in their financial statements. *Id.* § 3502(g).

(1) Identification and discussion of the short-term and long-term objectives of the flexible purpose corporation relating to its special purpose or purposes, and an identification and explanation of any changes made in those special purpose objectives during the fiscal year.

(2) Identification and discussion of the material actions taken by the flexible purpose corporation during the fiscal year to achieve its special purpose objectives, the impact of those actions, including the causal relationships between the actions and the reported outcomes, and the extent to which those actions achieved the special purpose objectives for the fiscal year.

(3) Identification and discussion of material actions, including the intended impact of those actions, that the flexible purpose corporation expects to take in the short term and long term with respect to achievement of its special purpose objectives.

(4) A description of the process for selecting, and an identification and description of, the financial, operating, and other measures used by the flexible purpose corporation during the fiscal year for evaluating its performance in achieving its special purpose objectives, including an explanation of why the flexible purpose corporation selected those measures and identification and discussion of the nature and rationale for any material changes in those measures made during the fiscal year.

(5) Identification and discussion of any material operating and capital expenditures incurred by the flexible purpose corporation during the fiscal year in furtherance of achieving the special purpose objectives, a good faith estimate of any additional material operating or capital expenditures the flexible purpose corporation expects to incur over the next three fiscal years in order to achieve its special purpose objectives, and other material expenditures of resources incurred by the flexible purpose corporation during the fiscal year, including employee time, in furtherance of achieving the special purpose objectives, including a discussion of the extent to which that capital or use of other resources serves purposes other than and in addition to furthering the achievement of the special purpose objectives.[108]

[108] *Id.* § 3500(b). In addition to these wide-ranging required annual reports, an FPC's board must make an interim report to shareholders if it decides to change or abandon one of its special purposes or if it changes its planned expenditures toward its special purposes from those stated in the most recent annual report. *Id.* § 3501. This obligation applies whether the change is to make a new expenditure or decline to make one previously planned, though it does not include changes in director or officer compensation alone. *Id.*

FPC disclosures will thus provide investors information not only on profit and social-good outcomes, but also significant information on the process of reaching them. This window into decision making can arm investors with important data to use in enforcing social-good prioritization.

Compliance with these disclosure requirements may also be prohibitively expensive. The statute's drafters anticipated this concern, and included a statutory explanation that directors need not provide every detail of their actions and decisions, but only "use their discretion" and "provid[e] . . . the reasonable detail that a reasonable investor would consider important in understanding the corporation's objectives, actions, impacts, measures, rationale, and results of operations as they relate to the nature and achievement of the special purpose objectives."[109] Further, when and if best practices emerge for such reports, compliance with them will raise a rebuttable presumption that all required information was provided.[110] If this leeway is insufficient, the legislation gives many FPCs an easy way out of the special-purpose reporting obligation altogether. All required reports on special purpose can be waived by a two-thirds vote of the FPC's shareholders if an FPC has fewer than 100 of them.[111] Although the FPC statute's disclosure requirements are quite comprehensive, it remains to be seen how widely used they will be.

Finally, informational rights and any additional enforcement mechanisms predicated on the disclosures they provide raise concerns about the utility of the performance measures they utilize. When success cannot be measured by a pure financial bottom line, assessing and reporting performance will be difficult and contested.[112] In an organization with dual purposes to pursue profit and social good, it will be easier to focus on and report financial

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109 *Id.* § 3502(a).

110 *Id.* § 3502(b).

111 *Id.* § 3502(h).

112 *See* Evelyn Brody, *Sunshine and Shadows on Charity Governance: Public Disclosure as a Regulatory Tool*, 12 FLA. TAX REV. 183, 191 (2012) (lamenting that for nonprofits "performance measurement is an unsolved metric"); Garry W. Jenkins, *Who's Afraid of Philanthrocapitalism?*, 61 CASE W. RES. L. REV. 753, 787–92 (2011) (elaborating on the many reasons why "measurement in the social sector is immensely complicated"). These problems have long been understood as a challenge for the nonprofit sector. *See, e.g.*, Patrice Flynn & Virginia A. Hodgkinson, *Measuring the Contributions of the Nonprofit Sector*, *in* MEASURING THE IMPACT OF THE NONPROFIT SECTOR 3, 15 (Patrice Flynn & Virginia A. Hodgkinson eds., 2001); Rosabeth Moss Kanter & David V. Summers, *Doing Well While Doing Good: Dilemmas of Performance Measurement in Nonprofit Organizations and the Need for a Multiple-Constituency Approach*, *in* THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 154, 154–59 (Walter W. Powell ed., 1987).

outcomes.[113] Many organizations are currently working to develop better social performance measures for use by nonprofits as well as social enterprises, but these are far from perfect.[114] The problems of creating and using these metrics will complicate any enforcement mechanism for social enterprise, and in large part this complication cannot be avoided.

b. Management Rights

Assuming investors obtain information that alerts them to failures to prioritize social good, the next important question in evaluating their enforcement capacity is: what actions can they take? Investors might engage directly in management and decision making, participate through voting for representatives or on business decisions, or be given standing to sue managers for failures to appropriately prioritize social good. The extent to which each of these paths is open to investors under current social enterprise forms depends on the incorporated or unincorporated nature of the entity and, in unincorporated entities, on the governance arrangement adopted by the parties.

The benefit corporation and FPC forms adopt the fundamental precept of for-profit corporation law that management is centralized and separated from investors.[115] Together with officers and employees, benefit corporation and FPC directors make everyday decisions and initiate extraordinary transactions. Shareholders' participation is limited to electing directors and approving major organic changes like mergers, sales of all or substantially all assets, or dissolutions. Centralized management can have great advantages. Specialist managers offer expertise and efficiency and free investors from the demands full participation would make on their time and energy.[116] Yet, unless

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[113] *See* Brakman Reiser, *supra* note 45, at 2464–65 (discussing the special challenges of applying social performance measures in a blended-mission environment).

[114] *See* Murray, *supra* note 38, at 31–32 (discussing these efforts); *see also* Esposito, *supra* note 43, at 69–70 (describing metrics available to assess social and environmental impact).

[115] *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (West 2006) ("The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors . . . ."). Scholars across the ideological spectrum accept the point that directions like this place everyday management of corporate affairs outside the hands of shareholders. *See, e.g.*, Bebchuk, *supra* note 65 (recognizing this facet of current law in the context of a reform proposal to permit shareholders to initiate at least some corporate actions); Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance* (Univ. of Cal., L.A. Sch. of Law Research Paper Series, Research Paper No. 02-06, 2002), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=299743 (arguing for the value of this and even broader director autonomy).

[116] *See* Stephen M. Bainbridge, Response, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1744–46 (2006); Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1656 (2001).

specialized corporate forms expand shareholders' role, investors will lack statutory authority to weigh in on the everyday tradeoffs between profit and social good at the point of decision. Shareholders, as such, simply will not be consulted.

That said, when an incorporated social enterprise is closely held, reality may contradict statutory form because shareholders and directors will likely overlap. Some of the value of centralized management is lost, but greater investor control is gained and can be used as an enforcement tool. Through their participation in management, these investors will have significant access to the decision-making process. They can monitor and compel compliance with a mandate to prioritize social mission. At first blush, this seems like good news for investor enforcement through management, as most social enterprises will be—or at least will start—small.[117] Thus far, though, drafters of incorporated forms for social enterprises have not envisioned this kind of role for investors in closely held entities. Benefit corporation statutes are generally silent on the issue.[118] When the FPC statute singles out adopting entities with few shareholders, it is to limit the disclosure obligations due to them.[119] The statute neither requires nor exhorts closely held FPC shareholders to enforce social-good prioritization through their participation in management.

Specialized form legislation might also carve out a more meaningful decision-making role for investors by modeling unincorporated forms, which lack the commitment to centralized management. As a default, "[e]ach partner has equal rights in the management and conduct of the partnership business"[120] and limited liability companies are managed by their members.[121] Unincorporated social enterprise forms could engage investors in enforcement

117 *See* Jim Schorr, *Social Enterprise 2.0: Moving Toward a Sustainable Model*, STAN. SOC. INNOVATION REV., Summer 2006, at 12, 12 ("[T]he vast majority of these [social enterprise] businesses are inherently small . . . .").

118 Only a few jurisdictions contemplate closely held benefit corporations in their legislative text. *See* 805 ILL. COMP. STAT. ANN. 40/4.05(e) (West Supp. 2012) (providing that closely held benefit corporations must designate a party with the "powers, duties, rights, and immunities of a benefit director" among those who act as a board); VT. STAT. ANN. tit. 11A, § 21.10(e) (West Supp. 2012) (similar); *see also* S.C. CODE ANN. § 33-38-120(C) (Supp. 2012) (noting that benefit corporations may be subject to the state's law governing close corporations).

119 *See* CAL. CORP. CODE § 3502(h) (West 2013) (allowing FPCs with fewer than 100 shareholders to avoid the statute's disclosure requirements if two-thirds of the shares vote to waive this obligation).

120 REVISED UNIFORM PARTNERSHIP ACT § 401(f) (1997); *see also* UNIFORM PARTNERSHIP ACT § 18(e) (1914) (providing only slightly different language that "[a]ll partners have equal rights in the management and conduct of the partnership business").

121 COX & HAZEN, *supra* note 73, § 1.11[4], at 31.

as conflicts between profit and social good arise in daily decisions. Imagine again our clean energy social enterprise's vendor selection. If incorporated, shareholders would not be involved in making this type of decision, except in the case when shareholders are also directors. In contrast, partners or LLC members engaged in management could weigh in on this choice.

Importantly, though, investor management in unincorporated business entities is a default, not a demand. Where incorporated forms prize centralized management, unincorporated ones prize flexibility.[122] The L3C and benefit LLC follow suit. Investor management remains a waivable default; flexibility is their hallmark.[123] Without a major deviation from this path, specialized unincorporated forms will hold out the possibility of investor enforcement through management, but no certainty.

c. Voting Rights

Specialized form legislation could also enfranchise investors to enforce a mandate to prioritize social good. For example, motivated investors might use social-good prioritization as a crucible to determine their favored candidate in director elections. Benefit corporation and FPC shareholders elect directors in precisely the manner found in for-profit corporations.[124] For voting to be an effective enforcement tool, however, investors need to vote and they need candidate choices. "[T]raditional shareholders wield their voting power infrequently at best."[125] Even assuming specialized form investors would vote more, only in the rare contested election could votes potentially be used to penalize failures to prioritize social good.[126] Similar dynamics will occur in a social enterprise structured like a manager-managed LLC.

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122 *See* Brewer, *supra* note 61, at 680 (noting the attractive "inherent contract-like flexibility" of LLCs); David S. Walker, *A Consideration of an LLC for a 501(c)(3) Nonprofit Organization*, 38 WM. MITCHELL L. REV. 627, 652 (2012) ("[A]s is widely known, the limited liability company frees those managing it and conducting its business and affairs from the detailed prescriptions and required [corporate] formalities . . . .").

123 *See* ROBERT LANG, AMS. FOR CMTY. DEV., THE L^{3}C & ECONOMIC DEVELOPMENT (2010), *available at* http://americansforcommunitydevelopment.org/downloads/The%20L3C%20&%20Economic%20Development.pdf ("The L^{3}C was built on the LLC structure in order to provide the flexibility of membership and organization needed to cover a wide variety of social enterprise situations."); Kelley, *supra* note 9, at 370–75.

124 *See* COX & HAZEN, *supra* note 73, § 9.1, at 152 (explaining that shareholders traditionally elect directors); *id.* § 13.17, at 371 ("The prevailing default rule for the election of directors is that directors are elected under a plurality voting system . . . .").

125 Lisa M. Fairfax, *Achieving the Double Bottom Line: A Framework for Corporations Seeking to Deliver Profits and Public Services*, 9 STAN. J.L. BUS. & FIN. 199, 226 (2004).

126 Where shareholders and directors overlap significantly, voting will have little more enforcement impact than the participation of investors themselves in decision making.

Investors could also use voting on fundamental transactions to enforce social-good prioritization. Even though management initiates and negotiates major events in the life of an enterprise, legislation often requires investors to approve them.[127] One can easily imagine fundamental transactions structured to abandon pursuit of social good, or rebalance it with profit in a way that undermines the social-good prioritization standard. If investors must approve these transactions, voting can be used to enforce the priority of social purposes. Investors can use their approval rights for legacy protection by refusing to approve a dissolution that would snuff out the entity's social mission or a transaction that would diminish or eradicate its commission to social good.[128] That said, voting rights on fundamental transactions will not afford investors opportunities to challenge the many interim decisions that trade off profit and social good.

Benefit corporation and FPC statutes subject various fundamental transactions to shareholder approval, often by a two-thirds majority.[129] Article amendments that reprioritize mission, transactions that sell all assets to a for-profit entity, or deals that merge with one, must all pass muster with investors.[130] Investors in these forms can, at least in theory, enforce against actions that threaten the ultimate existence of their enterprises, and thus their commitments to social good. The practical utility of shareholder voting, however, may undermine the power of this enforcement tool, and it will apply only in endgame situations.

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127 *See* COX & HAZEN, *supra* note 73, § 13.1, at 350 (noting one aspect of shareholders' right to vote "as to the making of amendments to the charter and other fundamental changes in the corporate existence").

128 *See* Robert A. Katz & Antony Page, *The Role of Social Enterprise*, 35 VT. L. REV. 59, 95–97 (2010) (describing the legacy problem as "[t]he risk that the for-profit social enterprise may subordinate social mission to profits . . . following a change in ownership" and citing Susan Mac Cormac).

129 *See, e.g.*, CAL. CORP. CODE §§ 3000(b), 3100(a), 3201, 3301(a)(2) (West 2013); N.J. STAT. ANN. § 14A:18-3(a) (West Supp. 2012). L3C statutes leave LLC default member-approval rights unchanged.

130 *See, e.g.*, CAL. CORP. CODE § 3201; MD. CODE ANN., CORPS. AND ASS'NS §§ 2-604(e), 5-6C-04(b) (West Supp. 2012) (noting that "[t]he proposed amendment shall be approved by the stockholders of the corporation by the affirmative vote of two thirds of all the votes entitled to be cast on the matter," which must be complied with under section 5-6C-04(b)). This same level of shareholder approval is required for an ordinary for-profit to transform into a benefit corporation by charter amendment. *See* MD. CODE ANN., CORPS. AND ASS'NS § 5-6C-03(b).

The California benefit corporation and FPC statutes also provide shareholders with dissenters' rights. *See* CAL. CORP. CODE § 1300(a); *see also id.* § 3305 (providing dissenters' rights under section 1300 in transactions converting an FPC into another type of business entity); *id.* § 14604(d) (granting dissenters' rights on sale or other disposition of all or substantially all of a benefit corporation's assets). For a discussion challenging the utility of dissenters' rights in this context, see Brakman Reiser, *supra* note 43.

d. Litigation Rights

Legislation can grant investors standing to litigate nonexistential threats to social mission, and it has frequently done so. Of course, the value of litigation rights in enforcing social-good prioritization will depend largely on resolving the serious fiduciary duty issues addressed above and on courts' institutional competence to judge compliance with a social-good prioritization standard.[131] Assuming these challenges can be met, however, investors will likely have standing to enforce them.

For-profit corporation statutes authorize shareholders to sue fiduciaries derivatively on behalf of their corporations by alleging breach of duty.[132] Most LLC statutes confer similar rights.[133] L3C and FPC legislation leaves these existing rights essentially undisturbed.[134]

Many benefit corporation statutes, however, create a specialized "benefit enforcement proceeding."[135] Such proceedings may be brought by the corporation or derivatively by a shareholder, director, a percentage of beneficial owners, or others the articles identify.[136] The statutes often describe this new proceeding as an exclusive remedy for challenging benefit directors' unique duties.[137] Yet, beyond limiting plaintiffs, benefit legislation contains few details on how it will operate.

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131 *See supra* Part II.B.2–3.

132 COX & HAZEN, *supra* note 73, § 15.2, at 443 ("As a rule, the shareholder's judicial remedy for mismanagement or other wrongful acts of directors, officers, or third parties is by a derivative or representative suit on behalf of the corporation.").

133 1 RIBSTEIN & KEATINGE, *supra* note 77, § 10:3 ("The derivative remedy is explicitly made available by most LLC statutes. Most of these statutes provide for rules similar to those applied to corporate derivative suits. Even where the right is not available by statute, courts have recognized the remedy . . . ." (footnotes omitted)); *see also id.* app. 10-2, at 231 (providing state-by-state analysis).

134 LLC and Benefit L3C statutes do not address derivative litigation specifically. The FPC does so, but applies typical requirements like contemporaneous ownership, demand on the board, and security for expenses. *See* CAL. CORP. CODE § 2900.

135 *See, e.g.*, LA. REV. STAT. ANN. § 12:1825 (2013); MASS. GEN. LAWS ANN. ch. 156E, § 14 (West Supp. 2012).

136 *See, e.g.*, N.J. STAT. ANN. § 14A:18-10 (West Supp. 2012); VA. CODE ANN. § 13.1-790(B) (West Supp. 2012).

137 *See, e.g.*, CAL. CORP. CODE § 14623(a) ("No person may bring an action or assert a claim against a benefit corporation or its directors or officers under this chapter except in a benefit enforcement proceeding."); VA. CODE ANN. § 13.1-790(A) ("The duties of directors and officers under this article, the obligation of a benefit corporation to prepare and make available the annual benefit report . . . and the general and any special public benefit purpose of a benefit corporation may be enforced only in a benefit enforcement proceeding.").

For additional discussion of the benefit enforcement proceeding, see Brakman Reiser, *supra* note 25, at 605–06; Callison, *supra* note 38, at 12–13, 28; and Murray, *supra* note 38, at 34–35.

If these claims will operate on a footing similar to for-profit shareholder derivative suits, obstacles to investor enforcement are numerous and well-known.[138] Derivative plaintiffs must often survive challenging demand conditions, pleading standards, and bond requirements.[139] Moreover, they must overcome the collective action problem inherent in derivative litigation. When each shareholder stands to gain only a few dollars or pennies, while her shares will increase in value after a successful suit, her incentive to litigate is low. Plaintiffs' attorneys can help overcome this collective action problem when their fees can be paid out of an aggregated recovery. Yet it is doubtful that lawyers will solve benefit corporation investors' coordination difficulties because the redress available through such suits is quite limited. Either in their sections on director obligations or the provisions on benefit enforcement proceedings, benefit corporation statutes severely limit directors' monetary liability for failures to "*create* a general or specific public benefit."[140] Perhaps directors may still be held liable for failure to *pursue* such benefits, but it is difficult to imagine how such damages would be calculated and the statutes are silent on this question. Without money damages to fund contingency fee litigation (and possibly even with it) or provisions for attorneys' fees, it is unlikely an aggressive plaintiffs bar will develop in this area.

e. Incentives

Finally, even assuming the content of fiduciary duty could be sufficiently settled to operate as a real constraint and that the information, management, voting, and litigation rights investors possess are sufficient, they may lack adequate incentives to police social-good prioritization effectively. Investors' preferences will not always track social-good priority precisely. We can assume that when an investor chooses to put her resources into an entity adopting a specialized form with a clear social-good prioritization standard, she shares this preference.[141] But investors' preferences are not static.

[138] *See* Fairfax, *supra* note 125, at 221–25 (describing how "procedural and substantive rules blunt the force of [shareholder litigation]").

[139] *Id.*

[140] *See, e.g.*, CAL. CORP. CODE § 14623(c) (emphasis added); VA. CODE ANN. § 13.1-788(C)(2) (similar); *see also* Murray, *supra* note 38, at 34–35.

[141] *See* Alicia E. Plerhoples, *Can an Old Dog Learn New Tricks? Applying Traditional Corporate Law Principles to New Social Enterprise Legislation*, 13 TRANSACTIONS: TENN. J. BUS. L. 221, 252–54 (2012).

Economic fortunes may turn and investors who once were pleased to give up some financial returns for psychic ones may no longer be willing to do so.[142]

Additionally, unless transfer is restricted by organizational form or contractual choice, investors may be persuaded to sell to others with differing views—at least as long as buyers believe they can change the entity's course.[143] Different statutory formulations allow such buyers more or less challenging exit routes. Under benefit corporation and FPC statutes, buyers will have to vote in friendly directors and persuade two-thirds of the shares to abandon social-good prioritization.[144] For L3Cs, the course is far smoother. All its managers (or owners instructing managers) must do is abandon their charitable or educational purposes, and the entity instantaneously transforms into an ordinary LLC.[145] Neither disillusioned investors, nor those with a windfall in their sights, are good candidates to police deviations from social-good prioritization.

Even for investors who remain committed to prioritizing social good, when faced with a social enterprise veering off the rails, active enforcement may be a very unattractive option. If the cost of enforcement activity is high, as will often be the case if litigation is required, investors might rather give up on the social mission of a given entity. If coordination problems keep them from working together to bear these high costs, individual investors might prefer to exit by liquidating their positions and looking for new socially responsible investments. Even if they do not exit by cashing out, investors will not necessarily opt to enforce. If the social enterprise has become more thoroughly profit seeking, they might opt to stay invested, enjoy the greater profits, and contribute these to other social-good-producing entities.

2. Non-Investor Stakeholder Enforcement

Of course, investors are not the only stakeholder group that specialized forms might recruit to enforce social-good prioritization. Employees,

[142] Tyler noted these potential problems undermine the ability of investors to enforce L3C obligations alone. *See* Tyler, *supra* note 24, at 155–56. He argued, however, that sufficient additional enforcement can be provided by civil or criminal suits by attorneys general alleging fraud or misrepresentation, reinvigorated ultra vires claims, or veil piercing, and opposesd public regulation or enforcement of social enterprises. *Id.* at 156–57. He also noted that "[s]uccess [d]oes [n]ot [n]eed to be [r]emedied." *Id.* at 158.

[143] Social enterprises might be particularly ripe takeover targets; so long as insurgents can re-chart the entities' dual mission course toward profit alone, they can quickly cut costs and reap large gains. *See* Plerhoples, *supra* note 141, at 233–36.

[144] *See* Brakman Reiser & Dean, *supra* note 97 (manuscript at 14).

[145] *See supra* note 35 and accompanying text.

consumers, beneficiaries, or even the public at large could also be deployed. For any private stakeholder to enforce social-good prioritization, either individually or as part of a coordinated group, she will need at least three things. First, she must have access to information about the social enterprise's outcomes and decision making to understand if enforcement is needed. Second, she requires tools such as management, voting, or litigation rights to raise challenges when she feels the entity has gone off track. Third, like all other potential enforcers, she needs appropriate incentives to engage actively in enforcement rather than sitting passively on the sidelines.

The current social enterprise forms provide relatively little instruction on how to empower and utilize non-investor stakeholders in enforcement, as none go beyond providing these groups with information. The benefit corporation and FPC forms' public disclosure requirements offer essentially the same data to all stakeholder groups.[146] The L3C contains no disclosure requirements, and so in its own way it also provides informational parity. No existing form equips non-investor stakeholders with management, voting, or litigation rights to enforce social-good prioritization. In fact, statutes creating these forms often expressly state their intention not to grant standing to groups beyond investors.[147] Thus, the task here is to envision creatively how an organizational form might use these other individuals and groups with a stake in the social enterprise as enforcement resources.

In terms of information, social enterprise employees will have the advantage of proximity, and often expertise, over all other stakeholder groups—at times even over investors. Employees can have unparalleled access to more detailed data, organizational leaders of whom they might ask

[146] *See, e.g.*, CAL. CORP. CODE § 14630 (West 2013); MASS. GEN. LAWS ANN. ch. 156E, §§ 15–16 (West Supp. 2012). Hawaii requires benefit corporations to make drafts of their benefit reports available for a sixty-day public comment period. *See* HAW. REV. STAT. § 420D-11(b) (2012).

[147] *See, e.g.*, 805 ILL. COMP. STAT. ANN. 40/4.01(d) (West Supp. 2012) ("A director does not have a duty to a person that is a beneficiary of the general public benefit purpose or a specific public benefit purpose of a benefit corporation arising from the status of the person as a beneficiary."); MASS. GEN. LAWS ANN. ch. 156E, § 10(e) ("A director shall not have a fiduciary duty to a person that is a beneficiary of the general or specific public benefit purposes of a benefit corporation arising from the status of the person as a beneficiary.").

Recent experimental findings suggest that empowering shareholders alone to engage in enforcement will undermine fiduciaries' willingness to respond to the concerns of other constituencies, even if legislation directs fiduciaries to consider them. *See, e.g.*, Sven Fischer et al., *Cui Bono, Benefit Corporation? An Experiment Inspired by Social Enterprise Legislation in Germany and the US* 26 (Max Planck Inst. for Research on Collective Goods, Working Paper No. Bonn 2013/4, 2013), *available at* ssrn.com/abstract=2226382 (suggesting enforcement by shareholders alone creates an insufficient "incentive structure [that] deserve[s] more careful attention by policy-makers").

questions, and their own knowledge about operations and industry norms. Consumers' and beneficiaries' positions as users of the social enterprise's product or service might give them special insights into its features and ultimate quality, but little information on how these outcomes are reached or the entity's internal operations. The public will be at a considerable informational deficit relative to other stakeholder groups, but might develop views of a social enterprise's performance from passing observations or media coverage. In a benefit corporation or FPC, employees can use their differential access and expertise to enhance the value of the significant disclosures available to all constituencies. The L3C's lack of disclosure requirements will accentuate the information gap between employees and other non-investor stakeholders. To narrow this gap, specialized forms might require additional disclosures to consumers, beneficiaries, or the public—or provide them with rights to inquire. Of course, additional reporting burdens will also impose greater costs on adopting entities, perhaps undermining social entrepreneurs' enthusiasm for specialized forms.

Assuming stakeholders are informed, they still cannot enforce social-good prioritization without management, voting, litigation, or other rights to act. Employees' positions can provide them with tools for enforcement regardless of whether additional ones are made available by their enterprise's organizational form. Depending on their level of authority, employees may participate in making precisely those midstream and endgame decisions that pit profit and social good against each other. In doing so, they may voice their opinions on the need to prioritize social mission and impact outcomes. A social enterprise form could impose additional participation rights for employees, consumers, beneficiaries, or the public. These stakeholders might be granted dedicated board seats or management authority, approval or veto rights over existential or even more mundane decisions, or standing to sue for redress. Again, such innovations would not come without costs. Empowered stakeholders could become unbearable nags or nuisance-suit plaintiffs.[148] Authorizing broad swaths of non-investor stakeholders to challenge the actions of entities adopting specialized forms could make these forms prohibitively unattractive to social enterprise founders. Thus far, specialized social enterprise forms have made the call that these costs and risks are not worth bearing. They impose only public disclosure obligations, if that. Additional enforcement tools for non-investor stakeholders have been squarely rejected.

[148] *See* Callison, *supra* note 38, at 28.

Even if future legislation were to provide these tools to stakeholders, these groups will often lack incentives to enforce social-good prioritization. Some may be highly motivated, even passionate, about their entity's social mission. But there are good reasons not to rely too heavily on their willingness to enforce social-good prioritization, especially if enforcement efforts will be costly. Employees and customers might have begun working for and buying from a social enterprise precisely because of its social mission. Yet, they may stand to gain financially by ignoring its failure to prioritize social good, as higher profits increase wages and reduce prices.[149] Beneficiaries and the public might be less conflicted in their motivations to enforce social-good prioritization, but are probably even less likely to take on its costs. And all of these groups will be challenged by coordination problems.

To activate non-investor stakeholder groups to enforce social-good prioritization, specialized form legislation would need to impose potentially onerous disclosure requirements to inform them. It would also have to empower them with strong enforcement tools to deploy, and may need to help them overcome serious incentive problems. This is a tall order. Furthermore, empowering a broad range of stakeholders to challenge the actions of social enterprises and their leaders may raise the specter of strike suits by troublemakers and make specialized forms less appealing to social enterprise founders in the first place.

B. Enforcement from Outside

Legislation might also look outside social enterprises for enforcement of a social-good prioritization standard. A public regulator could enforce this mandate, much as state attorneys general and state and federal tax authorities police the missions of nonprofits. Alternatively, legislation might incentivize private parties to create entities engaged in this regulatory project.

1. Public Enforcement

The major advantage to public enforcement lies in its public nature. A public regulator has a mandate to speak for the people writ large and for the good of society. Again, charity enforcement provides a nice analogy. There, state attorneys general "represent the public's interest in the proper use of the

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[149] *See* Dees & Anderson, *supra* note 7, at 9–12 (addressing the concern that customers and employees may ultimately push social enterprises away from their social missions); *see also* Battilana et al., *supra* note 9, at 54 (describing the challenge of maintaining organizational culture and developing talent in a hybrid entity).

funds raised and held by charitable organizations."[150] By the same token, a public regulator could vindicate a societal claim to require social enterprises to prioritize social good. The United Kingdom's dedicated regulator for its specialized social enterprise form, the community interest company (CIC), follows this model.[151] In a CIC, legislation specifically prioritizes the public benefit (or, in their words, community benefit) purposes of adopting social enterprises.[152] The CIC Regulator is a dedicated agency responsible for determining whether applying entities qualify as CICs, and if established ones remain so, through review of annual disclosures and investigation to ensure compliance with community benefit requirements, limits on dividends to shareholders, and the partial asset lock imposed by the CIC form.[153]

The public nature of government regulators could also raise potential obstacles to their use in social enterprise enforcement. A motivated and sufficiently resourced regulator should engage in significant enforcement when social enterprises fail to pursue their espoused public good. Yet, public regulators' public focus could also cause them to overemphasize the social mission of social enterprises, undermining social enterprises' pursuit of profits for shareholders. Again taking the CIC as an example, critics have argued that the Regulator set dividend caps too low, overemphasizing community benefit and making the shares insufficiently attractive to investors.[154] A focus on social good should not be an insurmountable obstacle to public regulation. Investor interests should be more than sufficient to train the focus of social enterprise leaders on profit goals. Further, specialized entities should be

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150 *See* NAT'L ASS'N OF ATTORNEYS GEN., STATE ATTORNEYS GENERAL: POWERS AND RESPONSIBILITIES 183–94 (Lynne M. Ross ed., 1990) (explaining the rationale for the role of public regulators in charity enforcement). State charity regulators echo this concern for vindicating the public interest in their own statements of purpose. *See, e.g.*, *Frequently Asked Questions*, CAL. OFF. ATT'Y GEN., http://oag.ca.gov/charities/faq#c5 (last visited May 10, 2013) ("The Attorney General represents the public beneficiaries of charities, who cannot sue in their own right."); *Reviewing Nonprofits and Charitable Trusts/Gifts*, TENN. OFF. ATT'Y GEN. & REP., http://www.tn.gov/attorneygeneral/nonprofit/nonprofit.html (last visited May 10, 2013) (describing its role in representing "the interest of charitable beneficiaries, potential charitable beneficiaries and the people of the State of Tennessee").

151 *See* DEP'T FOR BUS. INNOVATION & SKILLS, REGULATOR OF COMMUNITY INTEREST COMPANIES: STATUS, ROLE, FUNCTION AND LOCATION 5 (2010), *available at* http://www.bis.gov.uk/assets/cicregulator/docs/leaflets/10-1390-community-interest-companies-regulators-status-role-function-and-location-guide.pdf.

152 *See* DEP'T FOR BUS. INNOVATION & SKILLS, OFFICE OF THE REGULATOR OF COMMUNITY INTEREST COMPANIES: INFORMATION AND GUIDANCE NOTES 10 (2012), *available at* http://www.bis.gov.uk/assets/cicregulator/docs/guidance/12-1333-community-interest-companies-guidance-chapter-1-introduction.pdf (explaining that "CICs are intended to use their assets, income and profits for the benefit of the community they are formed to serve" and describing their asset-lock and dividend-cap features).

153 *See* DEP'T FOR BUS. INNOVATION & SKILLS, *supra* note 151.

154 *See* Brakman Reiser, *supra* note 35, at 635–36.

permitted to pursue profit, but not to prioritize it. Thus, the accountability lapses needing enforcement attention arise on the social-good side of the social enterprise equation, where public regulators' attention to social mission would be a good fit.[155]

The more serious challenge to public enforcement is a lack of resources. In these times of fiscal austerity, states are very unlikely to create and fund new regulatory agencies. Legislatures might add to attorneys general's portfolios, and particularly to their charities bureaus, the duty of ensuring that social enterprises prioritize social good. After all, these regulators have useful expertise in enforcing obligations to pursue public benefits in the related area of charity enforcement.[156] Unless such a delegation of authority is accompanied by appropriation of greater resources, however, it will lead to very little social enterprise enforcement activity or social enterprise enforcement only at the expense of charity enforcement. The understaffing and lack of resources in charities bureaus has been discussed by virtually every commentator in the field and is, by now, widely accepted as both problematic and unlikely to change.[157] Attorneys general simply lack the capacity to do more enforcement without greater resources.

In various campaigns to pass L3C and benefit corporation legislation, state charities bureaus made these very objections. Indeed, Hawaii's benefit corporation legislation includes an express disavowal of regulatory involvement, stating that "[e]nforcement of [adopting entities'] responsibilities [to operate in a socially and environmentally sustainable manner] comes not from governmental oversight, but rather from new provisions on transparency and accountability."[158] An interesting counterexample, however, can be seen in Illinois's experience with the L3C. The Illinois L3C statute designates L3Cs and their CEOs, directors, and managers as "trustees" under the state's Charitable Trust Act.[159] This designation triggers application of registration

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155 *But see* Tyler, *supra* note 24, at 151–54 (describing his opposition to such public regulation of L3Cs, primarily due to concerns it would inappropriately undercut their profit-making purposes and those of their investors).

156 *See supra* text accompanying note 150.

157 *See, e.g.*, FREMONT-SMITH, *supra* note 51, at 445–46.

158 HAW. REV. STAT. § 420D-1 (2012). The Hawaii statute also provides that a benefit corporation's annual report must include: "A statement that . . . the sustainable business corporation and its activities are subject to the oversight of the board of the sustainable business corporation and are not subject to the direct oversight, regulation, or endorsement of any governmental body." *Id.* § 420D-11(a)(8).

159 805 ILL. COMP. STAT. ANN. 180/1-26(d) (West Supp. 2012) ("Any company operating or holding itself out as a low-profit limited liability company in Illinois, any company formed as a low-profit limited liability

and reporting requirements under Illinois charity law and empowers the attorney general to take enforcement action against L3Cs formed there.[160] Although other state attorneys general might argue that social enterprises adopting specialized forms come within their purview due to their control of assets dedicated to charitable purposes, thus far Illinois's direct approach is exceptional.[161]

Some of the understaffing of charity enforcement at the state level is ameliorated by the overlapping jurisdiction of the Federal Internal Revenue Service.[162] The federal role there stems from charities' desire to obtain the favorable tax status federal law affords to nonprofits that meet its eligibility requirements.[163] At present, however, specialized forms for social enterprise are an exclusively state-level phenomenon with no targeted federal benefits.[164] Legislation has been introduced in Congress to bless or "fast track" entities organized as L3Cs as eligible recipients of tax-favored foundation PRIs.[165] So

company under this Act, and any chief operating officer, director, or manager of any such company is a 'trustee' as defined in Section 3 of the Charitable Trust Act.").

160 *See* MARC J. LANE, SOCIAL ENTERPRISE: EMPOWERING MISSION-DRIVEN ENTREPRENEURS 102–06 (2011) (describing Illinois charity law that will apply to "any entity with charitable purposes"); *see also* Tyler, *supra* note 24, at 151 n.144 (expressing serious concerns that the Illinois approach undermines the dual-purpose concept of an L3C).

161 Some benefit entity statutes require filing of annual reports with a state official, but this is purely ministerial. *See, e.g.*, MASS. GEN. LAWS ANN. ch. 156E, §§ 15–16 (West Supp. 2012); N.J. STAT. ANN. § 14A:18-11(d)(1) (West Supp. 2012); *see also* HAW. REV. STAT. § 420D-13 (specifically noting that the state's involvement with entity filings is "[m]inisterial").

162 *See* FREMONT-SMITH, *supra* note 51, at 377 ("[S]ince the 1950s the regulatory power of the federal government has been expanded so that it is effectively the primary source of [charity] regulation, extending to matters that had previously been the exclusive province of the states and, in many instances, preempting state regulation by conditioning tax exemption upon compliance with federal standards of behavior."); *see also* James J. Fishman, *Stealth Preemption: The IRS's Nonprofit Corporate Governance Initiative*, 29 VA. TAX REV. 545 (2010) (challenging the increased IRS role in regulating charity governance based on federalism concerns).

163 *See* Fishman, *supra* note 162, at 549–51 (describing the IRS's role in an article critiquing the Service for overstepping it).

164 For analysis of whether social enterprise should receive federal tax advantages, see Joseph M. Binder, Note, *A Tax Analysis of the Emerging Class of Hybrid Entities*, 78 BROOK. L. REV. (forthcoming 2013); Lloyd Hitoshi Mayer & Joseph Ganahl, Taxing Social Enterprise (Jan. 14, 2013) (unpublished manuscript) (on file with author).

165 *See* Philanthropic Facilitation Act, H.R. 3420, 112th Cong. § 2 (2011); Kelly Kleiman, *"L3C" Spells "Caveat Emptor,"* STAN. SOC. INNOVATION REV. (Mar. 18, 2011), http://www.ssireview.org/blog/entry/l3c_spells_caveat_emptor (noting that scholars and lawyers "point out that the IRS has not yet issued (and does not seem inclined to create) a rule awarding automatic program-related investment status to any investment in an L3C"); Daniel S. Kleinberger, *The Fatal Design Defects of L3Cs*, NONPROFIT Q. (June 21, 2010), http://www.nonprofitquarterly.org/management/5501-the-fatal-design-defects-of-l3cs.html ("Congress has not created a special category of PRI treatment for low-profit limited liability companies and appears unlikely to

far it has gained little traction, and its future success is unlikely. The IRS does not rely on an entity's state-created legal form to drive tax determinations.[166] And, in these times of budget deficits and fiscal crisis, Congress will not be dispensing broad new tax benefits to social enterprises anytime soon. Without such an improbable expansion of federal tax benefits, there is simply no relevant overlapping federal tax jurisdiction to engage in public regulation of social enterprise.

In sum, while public enforcement might desirably focus on the social mission of social enterprises, it is an unrealistic solution. State governments will not be keen to create and fund new agencies. Most attorneys general will have little appetite for adding responsibilities to their already overloaded and understaffed charities bureaus. And, using the Federal IRS for this purpose would require far-fetched, new authorizations and significant investment. To create a successful legal form for social enterprise, legislatures must look elsewhere to ensure social-good prioritization will be enforced.

2. *Private Regulators*

A more plausible course would be for specialized legal forms to create a market for private, third-party entities to serve as regulators. Legislation enabling specialized forms can chart the contours of this enforcement role. Private regulators might be engaged solely to develop and disseminate information about social enterprises and their practices or to engage more directly in enforcement themselves. The benefit entity forms attempt to harness the energies of third-party regulators, albeit in a limited fashion. Other techniques remain untested.

a. *Information Forcing*

An information-forcing take on outsourced regulation tasks private regulators with distributing information about social enterprises adopting specialized legal forms. For example, private regulators might publicize disclosures organizations produce, offer comparative and evaluative analysis of this data, develop and circulate best practices, or some combination of these options. They could also work as midstream monitors, reviewing entities using the forms at intervals and publishing results. This role for third-party regulators

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do so."); *see also* Schmidt, *supra* note 61, at 170–71 (describing an earlier version of the bill prior to its introduction in Congress).

[166] *See* Kleinberger, *supra* note 27, at 905–07.

asks them only to arm other public or private actors with the information those parties need to engage in more direct enforcement.

The benefit corporation and benefit LLC forms rely on private third parties for enforcement in a limited information-forcing role. As noted earlier, to form as a benefit corporation or benefit LLC, a social enterprise must assert that it is formed for a general public benefit "as measured by a third-party standard."[167] At a minimum, benefit entity legislation secures the quality of the standards third parties produce by requiring them to be independent[168] and transparent.[169] Standing alone, these requirements are insufficient. Typical profit-seeking corporations other than truly heinous polluters likely create "a material positive impact on society and the environment"[170] by doing business as usual. A third party could promulgate and publicly disclose a qualifying standard requiring only that a company employ one or more members of the community, pay assessed taxes, and avoid fines or penalties for environmental harms for one year. Without oversight of standard setters, it is easy to imagine standard setters going further, offering standards requiring only a small donation to a conservation organization, or the standard setter itself. So long as a benefit entity is unrelated to such a lax standard setter, and the standard is publicly available, a company with a quite limited commitment to "social good" could adopt and self-assess against this low hurdle.

Jurisdictions with later-adopted benefit corporation statutes frequently and helpfully impose additional requirements for third-party standards.[171] About

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[167] VA. CODE ANN. § 13.1-782 (West Supp. 2012); *accord* LA. REV. STAT. ANN. §§ 12:1803(A)(6), :1811(A) (2013); N.Y. BUS. CORP. LAW §§ 1702(b), 1706(a) (McKinney Supp. 2012).

[168] A benefit corporation or LLC cannot utilize a standard created by an entity with a "material relationship with [the] benefit corporation or any of its subsidiaries . . . either directly or as a shareholder, partner, member or other owner or a director, officer or other manager of an entity that has a material relationship with the benefit corporation or any of its subsidiaries." N.J. STAT. ANN. § 14A:18-1 (West Supp. 2011); *see, e.g.*, MD. CODE ANN., CORPS. & ASS'NS § 5-6C-01(e)(1) (West Supp. 2012); VT. STAT. ANN. tit. 11A, § 21.03(a)(8)(A) (West Supp. 2012).

[169] For a standard to be acceptable, the following information about the standard must be publicly available: "(a) The factors considered when measuring the performance of a business; (b) The relative weightings of those factors; and (c) The identity of the persons that develop and control changes to the standard and the process by which those changes are made." VA. CODE ANN. § 13.1-782; *accord* HAW. REV. STAT. § 420D-12(3)(A)–(E) (2012); VT. STAT. ANN. tit. 11A, § 21.03(a)(8)(B)(i)–(iii).

[170] This language is used to describe the general public benefit that benefit corporations must pursue. *See, e.g.*, VA. CODE ANN. § 13.1-782.

[171] These standards appear to derive from the Model Benefit Corporation Statute. *See Model Benefit Corporation Legislation*, *supra* note 36, § 102(a). For clarity, please note that this model was promulgated by a group of benefit corporation advocates, rather than a bar association or general law reform group.

half of them demand that third-party standards be "comprehensive."[172] These comprehensiveness standards are variously expressed. Their common core demands that an acceptable standard considers the impact of entities reviewed under it on the range of considerations described in the statutes' standard of conduct for directors.[173] Thus, comprehensiveness injects some substantive dimension into the statutory floor, but it is also subject to the "too many masters" critique described above.[174] At least four jurisdictions with comprehensiveness requirements also require third-party standards to be "credible."[175] Credibility means standard setters "access[] necessary and appropriate expertise to assess overall corporate social and environmental performance" and "use[] a balanced multi-stakeholder approach, including a public comment period of at least 30 days to develop the standard."[176] Comprehensiveness and credibility are welcome additions to the bare-bones requirements of independence and transparency, and may well encourage third parties to set standards meaningfully requiring adopting entities to "do both" profit and social good. They do not, however, require standards to mandate social-good prioritization. Nor do any of the statutes provide for oversight or enforcement of the standards that third parties promulgate.

Moreover, it is worth noting again that third-party standard setters themselves need never review those entities that take their standards on board. Rather, benefit entity statutes incentivize third parties only to develop and publicize standards for public benefit and positive societal and environmental impact. These standards then serve as metrics for organizational self-assessment. Social enterprises seeking recognition as benefit corporations or

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172 *Compare* CAL. CORP. CODE § 14601(g)(1) (West 2013) (including a comprehensiveness requirement), HAW. REV. STAT. § 420D-12(1) (same), 805 ILL. COMP. STAT. ANN. 40/1.10 (West Supp. 2012) (same), LA. REV. STAT. ANN. § 12:1803(A)(12)(a) (including a comprehensiveness requirement, though not styled as such), MASS. GEN. LAWS ANN. ch. 156E, § 2 (West Supp. 2012) (same), *and* S.C. CODE ANN. § 33-38-130(A)(9)(a) (Supp. 2012) (including a comprehensiveness requirement), *with* MD. CODE ANN., CORPS. & ASS'NS § 5-6C-01(e) (requiring only transparency and independence), N.J. STAT. ANN. § 14A:18-1 (same), N.Y. BUS. CORP. LAW § 1702(g) (same), VA. CODE ANN. § 13.1-782 (same), *and* VT. STAT. ANN. tit. 11A, § 21.03(a)(8) (same).

173 *See, e.g.*, HAW. REV. STAT. § 420D-12(1) (requiring a third-party standard to be "[c]omprehensive in its assessment of the effect of the business and its operations upon the interests listed in section 420D-6(a) [describing the '[s]tandard of conduct for directors']"). Not every comprehensiveness requirement sweeps this broadly, however. *See* LA. REV. STAT. ANN. § 12:1803(A)(12)(a) (requiring a third-party standard to be "[c]omprehensive in that it assesses the effect of the corporation and its operations in producing general public benefit and any specific public benefit specified in the articles").

174 *See supra* notes 65–66 and accompanying text.

175 *See* MASS. GEN. LAWS ANN. ch. 156E, § 2; *see also* CAL. CORP. CODE § 14601(g)(3); 805 ILL. COMP. STAT. ANN. 40/1.10; S.C. CODE ANN. § 33-38-130(A)(9)(a).

176 *See, e.g.*, 805 ILL. COMP. STAT. ANN. 40/1.10; *see also, e.g.*, MASS. GEN. LAWS ANN. ch. 156E, § 23.

benefit LLCs will choose among the third-party standards available, but need not engage the third-party standard setters to apply them.

This limited information-forcing role for private regulators makes them merely one early link in a long enforcement chain. Under the benefit entity statutes, disclosures pegged to third-party standards give shareholders information to use in enforcement activity. Then, the benefit entity forms rely on the market to monitor adopting entities and the third-party standards they select. The legislation assumes there will be a set of highly engaged users for the information disclosed by adopting entities.

This assumption is dubious. It requires a set of users that is motivated to seek out and analyze information about the social enterprise with which they are considering some involvement. But, their appetite for information must extend still further. They must take the additional step of investigating the quality of the third-party standard their chosen social enterprise has elected to employ. And, they must digest and assess the self-evaluation their chosen social enterprise has undertaken and disclosed, using the third-party standards as a metric. This is a great deal to ask even of investors and employees, let alone consumers. Studies suggest donors will not necessarily use accountability information available regarding charities to which they are considering making a donation.[177] To the extent these data are analogous, the enforcement value of this particular information-forcing model is questionable. Third-party standard setters with no baseline mandate to demand social-good prioritization may simply shift the accountability problem to a different level.

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[177] *See, e.g.*, HOPE CONSULTING, MONEY FOR GOOD: THE US MARKET FOR IMPACT INVESTMENTS AND CHARITABLE GIFTS FROM INDIVIDUAL DONORS AND INVESTORS 8, 19–21 (2010), *available at* http://www.hopeconsulting.us/pdf/Money%20for%20Good_Final.pdf (reporting findings from a study of charitable donors that "[f]ew donors do research before they give, and those that do look to the nonprofit itself to provide simple information about efficiency and effectiveness"); Katie Cunningham & Marc Ricks, *Why Measure*, STAN. SOC. INNOVATION REV., Summer 2004, at 44, 46 (finding negligible interest in performance measures in a study of donors); William F. Meehan III et al., *Investing in Society*, STAN. SOC. INNOVATION REV., Spring 2004, at 35, 36 (describing studies and comments indicating donors do not investigate the governance and finances of organizations before donating to them); Margaret F. Sloan, *The Effects of Nonprofit Accountability Ratings on Donor Behavior*, 38 NONPROFIT & VOLUNTARY SECTOR Q. 220, 229 (2009) (reporting study finding that a positive accountability rating resulted in a statistically significant increase in donations to a nonprofit, but that negative ratings appeared not to impact donors' contributions); *Do Donors Care Whether Nonprofits Are Any Good?*, TACTICAL PHILANTHROPY (June 8, 2012, 8:30 AM), http://www.tacticalphilanthropy.com/2010/06/do-donors-care-whether-nonprofits-are-any-good/ (reporting on a U.K. poll showing "68% of people would switch their donations to another charity if they found the one they were supporting was performing badly," and yet "68% of people think that an independent [charity] rating system would not affect their giving decisions").

And all of this is a prerequisite to engaging in any kind of enforcement activity.

Even in the attenuated role they play in benefit entity legislation, the quality of the standards private regulators produce and circulate is important. Thus far, specialized form legislation stewards the quality of these standards by requiring independence and transparency, as well as sometimes comprehensiveness and credibility.[178] Future legislation would be improved by injecting social-good prioritization as a baseline. This additional content, though, may exacerbate the problem with declining to oversee the standard setters. And, lawmakers will likely be just as loathe to appropriate resources for monitoring private regulators as they are to fund public ones directly.

b. Direct Enforcement

Another approach would authorize private regulators to engage in direct enforcement. Third-party regulators could certify entities as initially qualified to adopt a specialized legal form, applying their own or statutorily determined standards. These gate-keeping entities could also monitor social enterprises over time. Should an entity initially qualify to use the specialized form but over time fail to live up to its initial promise, private regulators could be empowered to revoke access.

Legislation in many fields empowers private regulatory bodies to certify and monitor the bona fides of governmentally recognized or benefitted entities. State legislatures rely on certifying agencies like the Joint Commission on Accreditation of Healthcare Organizations (JCAHO) to qualify hospitals and other health care providers to offer various services and to participate in state-financing schemes.[179] The United States Department of Education recognizes many private accrediting agencies to certify institutions of higher education to participate in federal financial aid programs.[180] Both operate on a continuing basis and loss of accreditation will often bring with it a loss of recognition by government agencies and programs. Looking abroad, the Philippines has long delegated to the Philippine Council for NGO Certification responsibility for

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[178] *See supra* notes 170–77.

[179] *See State Recognition Details*, JOINT COMMISSION, http://www.jointcommission.org/state_recognition/state_recognition_details.aspx?ps=100 (last visited May 10, 2013) (providing a comprehensive list of programs for which JCAHO accreditation is required or permitted).

[180] *See Accreditation in the United States*, U.S. DEPARTMENT EDUC., http://www2.ed.gov/admins/finaid/accred/accreditation_pg9.html (last modified Feb. 12, 2013) (listing accrediting agencies qualifying postsecondary schools for Title IV participation).

qualifying its charities to receive government recognition and tax-favored status.[181]

None of the currently available legal forms for social enterprise go this far in empowering private regulators, but such a tack remains possible. In fact, authorizing private entities to qualify and police social enterprises that adopt specialized forms would do more to encourage the formation of private regulators than does the limited information-forcing role they play under benefit entity schemes. These efforts give only a slight nudge to this market, as they require adopting entities to utilize third-party standards, but do not require third parties to apply them. Once a would-be benefit corporation or benefit LLC acquires the third party's standards, the social enterprise must apply the standard to itself. Accessing such standards should not be difficult or expensive because they must be made public to meet the statutory requirement of transparency.[182]

Standards are generally nonrivalrous goods—consumption of them by one user does not leave any less for another.[183] Requiring publication of standards makes them nonexcludable as well: the very definition of a public good that competitive markets tend to under-produce.[184] Standard setters will be better able to earn a return on the investments required to generate a useful standard if hopeful adopters must come to them to obtain or retain certification. Carving out a more direct and forceful role for private regulators could, therefore, make the business of private regulation itself more attractive and sustainable.

Of course, the fact that purveyors of social enterprise standards already exist suggests that there may be successful models for private standard setters, even if they do not control access to specialized forms. B Lab is perhaps the

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181 *See The PCNC Public Accountability System*, PHILIPPINE COUNCIL FOR NGO CERTIFICATION, http://www.pcnc.com.ph/pas.php (last visited May 10, 2013); *see also* Mark Sidel, *The Promise and Limits of Collective Action for Nonprofit Self-Regulation: Evidence from Asia*, 39 NONPROFIT & VOLUNTARY SECTOR Q. 1039, 1047–49 (2010) (describing the PCNC's emergence in a piece placing it within a comparative context); Mark Sidel, *The Guardians Guarding Themselves: A Comparative Perspective on Nonprofit Self-Regulation*, 80 CHI.-KENT L. REV. 803, 823–25 (2005) (similar).

182 *See, e.g.*, HAW. REV. STAT. § 420D-12(3)(A)–(E) (2012); N.Y. BUS. CORP. LAW § 1702(g)(2)(A)–(C) (McKinney Supp. 2012).

183 *See, e.g.*, ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 42 (3d ed. 2000) (explaining "nonrivalrous consumption" as existing where consumption "by one person does not leave less for any other consumer"); *see also* RUSSELL HARDIN, COLLECTIVE ACTION 17 (1982) (terming this quality "jointness of supply"); Mary Kay Gugerty & Aseem Prakash, *Voluntary Regulation of NGOs and Nonprofits: An Introduction to the Club Framework*, *in* VOLUNTARY REGULATION OF NGOS AND NONPROFITS, *supra* note 90, at 3, 19 (describing the need for standard-setting clubs to create excludable benefits).

184 *See* COOTER & ULEN, *supra* note 183, at 42–43; HARDIN, *supra* note 183, at 17.

most important case to examine. B Lab is a nonprofit entity that has granted "B" certification to 610 entities meeting its standards for "us[ing] the power of business to solve social and environmental problems."[185] A company begins the B certification process by completing a self-assessment of its social and environmental impact using B Lab's "B Impact Assessment" tool.[186] It also must adopt changes to its organizational documents that permit fiduciaries to consider stakeholder interests in making decisions.[187] Once these changes are made, and the assessment and documentation have been reviewed by B Lab personnel, applicants with sufficiently high scores may license the trademarked "B" designation.[188] They also become part of the B Corp community with access to discounted services and a supportive group of like-minded companies.[189] B Lab also maintains an ongoing monitoring process, auditing ten percent of its certified entities each year.[190]

B Lab was intimately involved with efforts to draft and promote state benefit corporation legislation,[191] even though these statutes require neither certification by B Lab nor even the use of B Lab's specific standards. If B Lab, one of the major forces behind the benefit corporation and benefit LLC legislation, is not pushing for a more potent role in the social enterprise

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185 CERTIFIED B CORP., http://www.bcorporation.net/ (last visited May 10, 2013) (noting it has certified 744 B Corporations, representing $4.2 billion in revenues and 60 industries).

186 *See How to Become a B Corp*, CERTIFIED B CORP., http://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp (last visited May 10, 2013).

187 *See Protect Your Mission*, CERTIFIED B CORP., http://www.bcorporation.net/become/legal (last visited May 10, 2013).

188 *See How to Become a B Corp*, *supra* note 186.

189 *See Why Become a B Corp?*, CERTIFIED B CORP., http://www.bcorporation.net/become-a-b-corp/why-become-a-b-corp (last visited May 10, 2013). By becoming a B Corp., an entity can "[s]ave [m]oney and [a]ccess [s]ervices" through group discounts, *id.*, and help lead a movement to "redefine success in business." *Why B Corps Matter*, CERTIFIED B CORP., http://www.bcorporation.net/what-are-b-corps/why-b-corps-matter (last visited May 10, 2013).

190 *See On-Site Reviews*, CERTIFIED B CORP., http://bcorp.nonprofitsoapbox.com/become-a-b-corp/how-to-become-a-b-corp/119 (last visited May 10, 2013). The results of the 2010 reviews can be found on the B Corporation website. The summary there reports:

> Twenty companies passed their on-site reviews, and two company reviews, Busboys & Poets and U.S. Tile, are still under review. As a result of the on-site review process, on average each company had its survey score adjusted upwards by 1.6 points or 1.6% of their total scores. Utilikilts, Institute of Green Professionals and Kings Counsel were also selected for on-site review but decertified prior to review. Vetrazzo was also selected for an onsite review, but was purchased by another company prior to the review.

Id.

191 *See Passing Legislation*, CERTIFIED B CORP., http://www.bcorporation.net/what-are-b-corps/legislation (last visited May 10, 2013).

enforcement architecture, perhaps a limited information-forcing role is sufficient to promote others to enter the market. Only experience will provide the answer to this question.

It is important to recognize, however, that B Lab has found a market for its services outside of the legislative context. It offers B licensees access to group discounts and a potentially valuable mark for branding, even without being tied to a specialized form. B Lab also may be motivated by forces beyond its own financial success. After all, it is organized as a nonprofit, with a mission of "serv[ing] a global movement of entrepreneurs using the power of business to solve social and environmental problems."[192] B Lab explains its leadership on the legislative front as a service to its customers and this movement.[193] Unless we are content to rely on this single, even if presumably altruistic, private regulator, we must consider whether other private regulators will enter the market to create third-party standards with only a limited information-forcing role.

Of course, the goal is not merely to generate private regulators. Rather, these regulators must sufficiently produce or contribute to enforcement for specialized forms to succeed. Third parties in this role should admit only those social enterprises worthy of adopting a special form. If they are likewise empowered to adjudicate compliance over time, private regulators need to monitor and audit adopting entities and should revoke status when entities go astray. The most aggressive use of third-party regulators would also authorize them to impose penalties beyond revocation of status. Failure to exercise these gate-keeping functions responsibly raises the specter of greenwashing, or worse, corruption. Thus, this Article's recommendations regarding the need to strengthen content requirements for third-party standards apply with even greater force if private regulators' roles are expanded beyond information forcing. In addition, if a legislature delegates to private third parties the right to qualify entities for access to legal form or punish them for noncompliance, it also should provide for monitoring these delegees. Expecting investors and consumers to investigate and police their bona fides expects far too much.

Finally, it must be recognized that casting private regulators as gatekeepers sets for them an extremely difficult job. Third-party certification schemes are

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[192] *See The Nonprofit Behind B Corps*, CERTIFIED B CORP., http://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps (last visited May 10, 2013).

[193] *See Passing Legislation*, *supra* note 191 (describing B Lab's leadership on benefit corporation legislation).

exceedingly difficult to get right because they have two important ingredients that are often in tension. On the one hand, they require a level of penetration and acceptance to have an impact; certification is valuable only if it is common enough that consumers of this information recognize it.[194] Thus, gatekeepers cannot apply such onerous standards that few applicants make the cut, or nobody will know or care about certification anyway. On the other hand, they are only as good as the standards they enforce; certification is meaningless if it is so easily achieved that it is no mark of distinction.[195] Gatekeeping private regulators must not apply such a weak screen that they certify too many applicants, or their stamps of approval will be well-known but little-valued. Threading this needle will be a challenge for B Lab and any new entrants specialized form legislation encourages to join the private regulatory market.

Specialized forms can enlist third-party regulators as part of their enforcement architecture. Thus far, only the benefit entity forms have done so, and have endowed them with a limited information-forcing role. Future legislation can replicate this approach, or can cast private regulators in more fulsome information-forcing or direct-enforcement roles or both. In any case, private regulators' contribution to enforcement will be determined by the content of the standards they apply and the energy and care with which they apply them.

C. Conclusion

Legislatures can select from among an expansive range of options to enforce social-good prioritization from within or outside social enterprises. Extant specialized forms already grant investors an assortment of informational, voting, and litigation rights. Legislatures could expand these or grant investors greater rights in management. Additional stakeholder groups, including employees, consumers, beneficiaries, and even the public more broadly, might also be tapped to enforce social-good prioritization. If resources should become available, public regulators might be tasked with enforcement as well. Or, legislation could seed a market for private regulators to do the job. For enforcement by any of these parties to help specialized forms achieve social mission, the law must impose a clear standard for them to enforce. Even with such a standard, however, serious obstacles will bedevil legislatures'

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194 *See* Brakman Reiser, *supra* note 90, at 60; Gugerty & Prakash, *supra* note 183, at 20.
195 *See* Brakman Reiser, *supra* note 90, at 60; Gugerty & Prakash, *supra* note 183, at 20.

attempts to provide potential enforcers with information relevant to judge compliance, effective enforcement tools, and incentives to act.

IV. BRANDING DIFFERENCE

Ultimately, social entrepreneurs seeking specialized forms want these new forms to brand their enterprises as different. "Brands are sets of associations linked to a name or mark associated with a product or service," or here, an entity.[196] Social entrepreneurs want to create a brand for their individual enterprises, of course. But, in their search for specialized forms, they also desire this legal form to create a brand for any organization that inhabits it.[197] They want the specialized form, whether it be an L3C, benefit corporation, FPC, or some other new entrant, to identify adopting entities as "distinct."[198] Social entrepreneurs wish to use specialized forms to convince contributors of capital to invest in their brand, employees to trust it, and the broader public to value it. This Part evaluates what role specialized forms can play in these efforts.

Social entrepreneurs want specialized forms to identify their entities as meaningfully different from both traditional businesses and traditional charities, but still appeal to those who would contribute capital to both. Ideally, specialized forms would help them to attract equity capital from market investors as well as contributions from traditional charitable donors. Neither result, however, is likely. For market-rate investors purely interested in profits, an ownership interest in an entity adopting a specialized form that credibly commits it to pursue social good along with profit is simply no substitute for a share of a traditional for-profit.[199] Without the incentive of tax deductibility, a

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196 Tim Calkins, *The Challenge of Branding*, *in* KELLOGG ON BRANDING 1, 8 (Alice M. Tybout & Tim Calkins eds., 2005).

197 *See* LANG, *supra* note 123 ("Probably more importantly than anything else, the L3C is a brand . . . ."); Kelley, *supra* note 9, at 361–62 (discussing "[t]he [c]hallenge of '[b]randing' [s]ocial [e]nterprises").

198 *Dictionary*, AM. MARKETING ASS'N, http://www.marketingpower.com/_layouts/Dictionary.aspx?dLetter=B (last visited Sept. 25, 2012) (defining "brand").

199 L3C advocates have asserted this form will encourage tranched investing, including a tranche attractive to market-rate investors. *See* Robert Lang & Elizabeth Carrott Minnigh, *The L^3C, History, Basic Construct, and Legal Framework*, 35 VT. L. REV. 15, 17–18 (2010) (describing this technique and how it can provide "a market rate of return for market-rate investors"). In the words of the form's principal proponent:

> [The L3C] facilitates layered investing with [foundation investors] usually taking first risk position thereby taking much of the risk out of the venture for other investors in more secure positions. . . . The rest of the investment levels become more attractive to commercial investment by improving the credit rating and thereby lowering the cost of capital. It is particularly favorable to equity investment.

donation to an entity adopting a specialized form is likewise not a substitute for one to a recognized charity. Thus far, specialized forms come with no tax benefits for contributors,[200] and Congress is unlikely to extend such benefits in the near future.[201]

Two groups of capital contributors can more likely straddle the middle of this divide. First, there are the mysterious and vaunted "socially responsible" or "impact investors," who are willing to take a below-market return to achieve simultaneous social good with their invested funds.[202] Such investors might be socially motivated venture capital firms or angel investors, as well as individuals and institutions (including mutual funds) that target companies pursuing both social good and profit for owners. Efforts to size this impact, or socially responsible investment market, value it in the billions or even trillions

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AMS. FOR CMTY. DEV., WHAT IS THE L^{3}C? (2011), *available at* http://americansforcommunitydevelopment.org/downloads/What%20is%20the%20L3C%20080711-1.pdf; *accord* LANG, *supra* note 123. In my view, even without a clear and enforceable social-good prioritization mandate, market investors will be wary of the L3C's mixed motives, especially if governance arrangements are structured to give foundation investors control. *See* Brakman Reiser, *supra* note 35, at 647–48. Others have argued this structure may breach the prohibitions on inurement or private benefit for foundations that might invest in L3Cs, *see* Bishop, *supra* note 35, at 263–65, and that it may make L3Cs less attractive to "socially minded" mezzanine-tier investors. *See* Murray & Hwang, *supra* note 35, at 50–51; Usha Rodrigues, *Entity and Identity*, 60 EMORY L.J. 1257, 1317–19 (2011).

200 Philadelphia has introduced an extremely limited tax benefit for which some social enterprises adopting specialized forms will qualify. *See Credits, Grants & Other Incentives*, BUS. SERVICES, https://business.phila.gov/Pages/TaxCreditsOtherIncentives.aspx (last visited May 10, 2013) (providing $4000 tax credit to twenty-five sustainable businesses per year, and including certified B Corporations within eligible group); *see also* Anurag Gupta, Note, *L3Cs and B Corps: New Corporate Forms Fertilizing the Field Between Traditional For-Profit and Nonprofit Corporations*, 8 N.Y.U. J.L. & BUS. 203, 225 (2011) (reporting "rumor[s]" other municipalities will follow suit); Mark Hrywna, *Benefit Corporation in California Meets Chill in San Francisco*, NONPROFIT TIMES (Mar. 23, 2012), http://www.thenonprofittimes.com/article/detail/benefit-corporation-in-california-meets-chill-in-san-francisco-4497 (describing opposition to a San Francisco measure under consideration to grant city contracting preferences to benefit corporations).

201 *See supra* notes 165–66 and accompanying text.

202 *See* Kelley, *supra* note 9, at 358 ("Social entrepreneurs view Socially Responsible Investing, or SRI, as a potential source of growth capital for the emerging fourth sector."). Socially responsible investors "incorporate social criteria into their investment decisions." Michael S. Knoll, *Ethical Screening in Modern Financial Markets: The Conflicting Claims Underlying Socially Responsible Investment*, 57 BUS. LAW. 681, 681 (2002). Impact investors are typically defined as investing "to create positive impact alongside financial return," J.P. MORGAN, INSIGHT INTO THE IMPACT INVESTMENT MARKET 2 (2011), though some use the term to denote investors who "seek a social return first and foremost." Keren G. Raz, *Toward an Improved Legal Form for Social Enterprise*, 36 N.Y.U. REV. L. & SOC. CHANGE 283, 294 (2012); *accord* Paul Sullivan, *Philanthropists Weigh the Returns of Doing Good*, N.Y. TIMES, Sept. 29, 2012, at B5 (describing "impact investing" as "essentially investing money in an organization, either profit-making or nonprofit, with the expectation that it will generate a social benefit and perhaps a financial return").

of dollars.[203] Social enterprise is a complex and challenging concept, and the market for capital is brisk and competitive. If specialized forms can serve as an effective brand to reach this market, adopting such forms will be quite valuable indeed.[204]

The puzzle about these investors is why they would not prefer to invest for a market rate of return and then make a tax-deductible donation of some portion of their return to a nonprofit charity pursuing their preferred social mission. One explanation is that such investors believe they can get different, better, and even more social good from a social enterprise pursuing social mission and profit together than from a nonprofit pursuing social good alone. This belief might be founded on the idea that the partial profit motive of a social enterprise leads to more efficient social-good production.[205] Nonprofits are frequently charged with inefficiency and waste, in part due to their lack of investor principals who could hold fiduciary agents accountable.[206] Alternatively, or in combination, these investors might believe that social-good production by a social enterprise will be qualitatively different, perhaps being less influenced by elitism or cultural imperialism, which some charge has infected traditional philanthropy.[207] Investors who view social enterprise's

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203 *See* HOPE CONSULTING, *supra* note 177, at 61 (finding a $120 billion market opportunity to increase impact investing); J.P. MORGAN, *supra* note 202, at 5 (reporting "[t]he 52 investors that responded to our online survey have indicated that they plan to invest a total of USD [$3.8 billion] in the 12 months following the survey"); MONITOR INST., INVESTING FOR SOCIAL & ENVIRONMENTAL IMPACT: A DESIGN FOR CATALYZING AN EMERGING INDUSTRY 9 (2009), *available at* http://www.monitorinstitute.com/impactinvesting/documents/InvestingforSocialandEnvImpact_FullReport_004.pdf (valuing the potential size of the impact investing market at $500 billion); SOC. INV. FORUM FOUND., REPORT ON SOCIALLY RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES 8 (2010) ("At the start of 2010, professionally managed assets following SRI strategies stood at $3.07 trillion . . . ."); DAVID VOGEL, THE MARKET FOR VIRTUE: THE POTENTIAL AND LIMITS OF CORPORATE SOCIAL RESPONSIBILITY 60 (2005) (reporting that in 2003, $151 billion was under management with investment funds that screen companies for social impact).

It is difficult to size the market for social enterprise investments specifically. Some of the estimates above include mutual funds that merely screen out certain investments deemed socially irresponsible by their investors, like tobacco or weaponry producers. These funds appeal to some investors' desires not to fund production of products they abhor, but do not line up with social enterprise writ large and certainly not with entities adopting specialized forms.

204 It is also possible that investors will see specialized forms as a distinct disadvantage, merely because of their novelty.

205 *See* Dees & Anderson, *supra* note 7, at 5–6.

206 *See, e.g.*, Katz & Page, *supra* note 128, at 95.

207 *See, e.g.*, THE REVOLUTION WILL NOT BE FUNDED: BEYOND THE NON-PROFIT INDUSTRIAL COMPLEX (INCITE! Women of Color Against Violence ed., 2007); Garry W. Jenkins, *Nongovernmental Organizations and the Forces Against Them: Lessons of the Anti-NGO Movement*, 37 BROOK. J. INT'L L. 459, 479–92 (2012) (describing the anti-NGO movement's claims of NGO elitism and cultural imperialism, among other failings); Deborah M. Weissman, *Law as Largess: Shifting Paradigms of Law for the Poor*, 44 WM. & MARY L. REV. 737, 803–04 (2002) ("Philanthropies have engendered a sense of mistrust because of their concentration of

hybridity as part of its value will be looking for entities they can trust with their capital. Adopting a specialized form that indicates an enforceable commitment to prioritize social good might well draw in these investors and their funds.

The other group of capital contributors social enterprises should try to reach might be called "quasi-donors." Quasi-donors prefer to mix their donations toward a social good with product or service purchases. They make payments in which they expect to receive something less than full and fair consideration in return. They overpay in order to enable the recipient to dedicate some portion of its revenues to achieving their shared vision of social good. In a way, this is simply the other side of the coin of the impact investor, but the emphasis is on the donation, rather than the investment side. Sales revenue from pink products, yellow bracelets, and countless other cause-related marketing efforts provide ample evidence consumers are willing to part with their funds on this category of expenditure.[208]

A quasi-donation might be attractive for at least two reasons. A quasi-donation may be a lesser risk than a pure donation, as a quasi-donor will receive some valuable item or service in return for her funds.[209] In addition, like impact investors, quasi-donors may be convinced that the hybrid nature of social enterprise will produce more, better, or qualitatively different social good than will charities.[210] Thus, they may prefer to make quasi-donations over unlinked donations and product purchases. For quasi-donors too, then, branding is key. To reach their funds, a social enterprise must convince quasi-donors it offers this ideal, blended value. Specialized forms can also be part of this effort.

As currently constituted, however, specialized forms provide very little branding value. One cannot create a brand for social enterprises through legal

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power and wealth, added to their ability to control valuable assets that might otherwise go to public coffers."); Courtney Martin, *The Future of Philanthropy*, AM. PROSPECT (June 8, 2009), http://prospect.org/article/future-philanthropy (describing groups challenging the perceived elitism of the nonprofit sector).

[208] *See* Terri Lynn Helge, *The Taxation of Cause-Related Marketing*, 85 CHI.-KENT L. REV. 883, 885 (2010) (describing more than $1 billion in cause-related marketing revenues earned by charities in 2005).

[209] Of course, tax deductibility can reduce the real cost of a pure donation to a qualifying charity. *See* I.R.C. § 170(c) (2006). As discussed, social enterprises will not qualify to receive tax-deductible contributions, and thus the difference in cost for a donation and quasi-donation may be closer than it would originally appear.

[210] Quasi-donors may also desire to be seen as consumers of socially responsible or environmentally friendly goods. *See generally* FRAN HAWTHORNE, ETHICAL CHIC: THE INSIDE STORY OF THE COMPANIES WE THINK WE LOVE (2012) (describing this consumer preference and exploring whether the companies consumers presume to be ethical actually are).

forms without permitting them to express how different their enterprises are. But, this expressive function is essentially the only one current specialized forms serve. For a specialized form to credibly brand adopting entities as different, it must signal that these entities actually achieve both social good and profit objectives. Thus, for branding purposes too, specialized forms must impose a standard meaningfully distinguishing those adopting it from traditional nonprofits and for-profits. Social-good prioritization is that standard, but its adoption alone is still insufficient. To serve as an effective brand, a specialized form must also instill confidence that social-good prioritization will be enforced. Each of the potential enforcement mechanisms available faces serious obstacles. Future legislation must overcome these challenges, and both impose and enforce social-good prioritization for specialized forms to function effectively as brands.

Of course, even if lawmakers take up the social-good prioritization standard and find enforceable methods by which to enforce it, a specialized form will only convey a fairly general message. It will communicate that an adopting social enterprise, on balance, prioritizes social good. Obtaining this level of brand messaging from a legal form of organization is an ambitious goal and it would be a significant achievement. But, the branding goals social entrepreneurs have for their entities do not stop there. They want to convince consumers to buy and beneficiaries to trust their different and better products.[211] They want to attract and retain employees to their different and better jobs.[212] They want to convince other companies, communities, and the public that they will be different and better partners for creating long-term economic and social value. In a crowded market of for-profits, nonprofits, and social enterprises, each social enterprise must persuade these audiences that the value proposition it offers is especially attractive. Social entrepreneurs and their advocates will need to be the driving force in their own branding efforts. And, they will need to do more than adopt a specialized legal form—even the most fully realized one—to convey their unique appeal to the numerous audiences they need to persuade.

The fact that even powerful specialized forms are not alone sufficient to secure success does not detract from the value they can offer to social enterprise. Legal forms rarely serve as the single indicator of worth to all of the

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[211] *See* VOGEL, *supra* note 203, at 47–56 (analyzing whether consumers are moved by a producer's commitment to pursuing social good).

[212] *See id.* at 56–60 (evaluating whether and to what extent employees seek out employers based on their commitment to pursuing social good).

markets and stakeholders with whom an entity will interact. Social enterprises have many other available avenues to further distinguish themselves. They can use traditional marketing levers and novel advertising approaches to inform investors, consumers, and the public about what makes their social mission particularly compelling. To shore up these claims, they can invest in obtaining voluntary certifications of overall quality, like that offered by B Lab, or those available in their individual industry or geographic location.[213] The law can do good work here. It should strive to improve specialized form legislation so that it does provide a brand for a new and different type of entity—one that prioritizes social mission but still distributes profits to owners. Social enterprises adopting these forms will need to take it from there and do the hard work of making their ventures a success.

CONCLUSION

Founders and proponents of social enterprise frustrated with the polar categories of nonprofit and for-profit form appear to have found accommodating audiences in state legislatures. A third of U.S. jurisdictions have approved legislation sanctioning L3Cs, benefit corporations, or FPCs, and more will almost certainly follow.[214] Unfortunately, however, these enactments will only begin to address the goals social entrepreneurs have for specialized forms. These statutes permit social entrepreneurs to dedicate their entities to a very different model—one of doing both social good and profit. They fall short, however, of structuring organizations falling under them to ensure they actually will be different. This failing will prevent these specialized forms from functioning as effective brands.

For specialized forms to achieve more, legislation adopting them should provide a clear standard requiring adopting entities to prioritize social good and must develop meaningful enforcement mechanisms. The social-good prioritization standard will be challenging to apply and will not answer every quandary a social enterprise faces. It will, however, usefully distinguish adopting entities from their traditional for-profit counterparts and will offer organizational leaders needed guidance in many difficult situations. Meeting the enforcement challenge will be more difficult. Whether legislation activates enforcement resources within or outside social enterprises, there will be

[213] *See, e.g.*, *List of Standards*, BENEFIT CORP. INFO. CENTER, http://www.benefitcorp.net/selecting-a-third-party-standard/list-of-standards (last visited May 10, 2013) (listing a range of standards for assessing a company's "sustainability practices").

[214] *See supra* note 31.

incentive problems, resource gaps, and market factors to overcome. Without offering some reliable means to enforce the meaningful difference a social-good prioritization standard signifies, however, specialized forms will fail to steward social enterprises' dual goals and will not develop into effective brands.