THE HISTORY AND HOPE OF SOCIAL ENTERPRISE FORMS

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I. INTRODUCTION

This Article sketches the history of social enterprise legal forms in the United States and provides suggestions regarding their continued evolution. Social enterprises—companies that blend profit and social purpose—have a long history in the United States, but not until 2008 did a state pass a social enterprise specific statute. In that year, Vermont passed a statute allowing for formation of L3Cs, low-profit limited liability companies.¹ The L3C was aimed primarily at funding issues for social enterprises and attempted to unlock program related investments (PRIs) for that purpose. Following the L3C form were a number of variations on a corporation-based social enterprise: social purpose corporations, benefit corporations, and public benefit corporations. These forms evolved over the past decade to address the issues of corporate purpose and social accountability. Lastly, a small handful of states passed benefit limited liability company (BLLC) statutes for companies that desired a form similar to the benefit corporation but built on an LLC framework.

Since 2008, a few thousand companies have been formed under these social enterprise statutes, and a few of these companies have recently raised significant capital or gone public.² Yet, even at a time when the Business Roundtable has declared an increased focus on social purpose, these forms have not gained significant mainstream adoption. In addition,

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¹ VT. STAT. ANN. tit. 21, § 3001(27) (2009).

many commentators doubt the ability of the statutes to ensure production of social good. After relaying a brief history of social enterprise forms, this Article suggests that it is the possibility of shifting norms, not law, that is the true hope of social enterprise forms. For these norms to have staying power, however, additional accountability measures need to be added. More specifically, the Article suggests increasing stakeholder rights, realigning director incentives, and strengthening social reporting.

II. UNINCORPORATED FORMS OF SOCIAL ENTERPRISE

A. Low-Profit Limited Liability Companies (L3C)

The first social enterprise form in the United States was the L3C. Original advocates for the L3C form—Bob Lang and those associated with his Americans for Community Development organization—envisioned the L3C as a way to attract funding through PRIs and other social-focused investments. PRIs are one way that foundations can satisfy their 5% annual distribution requirement. Generally, jeopardy investments have not counted toward foundations’ distribution requirements, but PRIs are an exception to this general rule if: (1) the primary purpose is charitable; (2) “[n]o significant purpose of the investment is the production of income or the appreciation of property”; and (3) the purpose is not to influence legislation or elections. Foundations, however, have not taken full use of PRIs because of the cost in making sure their investment is properly used and the significant tax

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7 I.R.C. § 4942(g).

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consequences for noncompliance. The L3C proponents hoped that by transliterating the PRI regulation language into the L3C statutes they could create a safe harbor for PRIs for foundations.

Relatively soon after the passage of the first L3C statute, various legal commentators started writing in opposition to the L3C form. These critics primarily focused on the fact that the L3C had not been granted special status for PRI investments, and that L3Cs should not be granted special status because the enforcement mechanisms for ensuring charitable purpose were lacking. Other authors discussed ways to improve the L3C statutes, but nearly no academic commentators wrote in unreserved support of the statutes as passed.

The Internal Revenue Service has not granted a blanket safe harbor for L3Cs, bringing the movement to a near standstill in recent years. The last L3C state statute was passed in 2012 in Rhode Island, and North Carolina repealed its L3C statute in 2014. In total, eight states, three

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9 I.R.C. § 4942(a).
10 AMS. FOR CMTY. DEV., supra note 6.
12 Bishop, supra note 11, at 250; Callison & Vestal, supra note 5, at 274–75; Kleinberger, supra note 11, at 879; Chernoff, supra note 11, at 4–5.
Native American tribes, and Puerto Rico have active L3C statutes.\textsuperscript{16} As of June 2020, there are reportedly over 1,700 L3Cs.\textsuperscript{17}

**B. Benefit Limited Liability Companies (BLLC) and Benefit Limited Partnerships**

BLLC laws have been passed in five states—Maryland, Oregon, Pennsylvania, Delaware, and Utah.\textsuperscript{18} Delaware has also passed a benefit limited partnership statute.\textsuperscript{19} The proponents of the benefit corporation form, discussed below, do not seem to be advocating loudly for the BLLC or benefit limited partnership statutes at this time, acknowledging that the LLC and LP forms are flexible enough to accommodate social entrepreneurs.\textsuperscript{20} Nevertheless, some smaller businesses that should probably use an LLC or LP framework instead of a corporate one seem to want the social signal of benefit entities.\textsuperscript{21} Some scholars have argued that the benefit LLC form is not only useless, but that it improperly implies that conventional forms of business are “detriment” entities.\textsuperscript{22} Others admit that the BLLC is legally unnecessary, but focus on the norm-shifting potential of the entity and the desire for an LLC-based benefit statute to go alongside the already prevalent benefit corporation statutes.\textsuperscript{23}

\textsuperscript{19} DEL. CODE ANN. tit. 6, § 17-1202 (2019).
\textsuperscript{21} Lloyd Hitoshi Mayer & Joseph R. Ganahl, Taxing Social Enterprise, 66 STAN. L. REV. 387, 402 n.62 (2014) (noting the passage of benefit LLC law and citing to articles showing companies using the statute).
\textsuperscript{22} Mohsen Manesh, Introducing the Totally Unnecessary Benefit LLC, 97 N.C. L. REV. 603, 649–50, 670 (2019) (“The problem is that existing benefit entity statutes offer no accountability—no means for the public to ensure that a benefit entity will pursue or produce public benefit any more or differently than a business organized as a conventional corporation or LLC.”).
\textsuperscript{23} ALEXANDER, supra note 20 (admitting the benefit LLC is not technically necessary, but noting the potential “branding” benefit of the form); J. Haskell Murray, Beneficial Benefit LLC? 85 U. CIN. L. REV. 437, 437 (2017) (“the benefit LLC entity type is largely unnecessary, but also not particularly harmful”).
III. CORPORATION-BASED FORMS OF SOCIAL ENTERPRISE:
CERTIFIED B CORPORATIONS V. BENEFIT CORPORATIONS

Before discussing benefit corporations, they should be distinguished from Certified B Corporations, as both are sometimes confusingly referred to as “B Corps.” Further, some of the highest profile social enterprises, like Patagonia, are both Certified B Corporations and benefit corporations.

Certified B Corporations are curated by the nonprofit organization B Lab and are a certification in the vein of Fair Trade or Leadership in Energy and Environmental Design (LEED). To obtain the B Corp certification, the entity must score at least an eighty on a 200-point B Impact Assessment (BIA), publicly post their BIA, meet certain legal requirements to clearly allow stakeholder consideration, and pay B Lab a fee. B Lab audits 10% of the recertifying Certified B Corporations each year. B Lab will certify a variety of business forms, including partnerships and LLCs, making the “B Corporation” moniker somewhat misleading.


28 Id.

29 Presumably, B Lab will even certify an S-Corp., giving you a B.S. Corporation. Criticism or praise for that joke should be sent to Professor Cass Brewer at Georgia State University. See US—LLC/LLP/L3C—Yes, B Lab, https://bcorporation.net/us-llclpl3c-yes (last visited Mar. 8, 2021) (listing qualifications for LLC, LLP, and L3Cs to become certified as B Corps).
As of February 2021, there were over 3,800 Certified B Corps. The fees for certification range from $1,000 to over $50,000 per year, depending on the revenue of the business. The benefits of certification revolve around branding, networking, product discounts, attracting talent, and a few small local tax credits.

The benefit corporation form is a legal entity type allowed by state statute. B Lab, which certifies B Corporations, as discussed above, has been spearheading the passage of benefit corporation legislation. Neither certification nor a social audit are required to use the benefit corporation form. No extra fee, beyond the typical state fee for formation, is required. According to the vast majority of the benefit corporation statutes, a third-

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31 Certification, B LAB, https://bcorporation.net/certification (last visited Mar. 8, 2021) (listing an annual certification fee of $50,000 for companies with revenue of $750,000,000 to $999,900,000 per year; companies with one billion or more in annual revenue require a separately negotiated fee, presumably higher than $50,000, depending on the complexity and size of the business).
32 Alicia E. Plerhoples, Nonprofit Displacement and the Pursuit of Charity Through Public Benefit Corporations, 21 LEWIS & CLARK L. REV. 525, 548 (2017) (“Scholars of social enterprise have previously noted that the main benefit of new hybrid corporate forms such as the public benefit corporation has been branding.”); Dana Brakman Reiser, Benefit Corporations—A Sustainable Form of Organization?, 46 WAKE FOREST L. REV. 591, 622 (2011) (“The third reason founders and operators of social enterprises may find a hybrid form attractive is to help them to create a distinctive brand.”).
33 Joseph W. Yockey, The Compliance Case for Social Enterprise, 4 MICH. BUS. & ENTREPRENEURIAL L. REV. 1, 45 (2014) (“Another says that organizing as a benefit corporation ‘opened me up to a whole network of, not only like-minded people, but also people who had achieved so much and that could inspire me to do the same.’”).
36 Sustainable Business Tax Credit, CITY OF PHILA., https://www.phila.gov/services/payments-assistance-taxes/tax-credits/sustainable-business-tax-credit/ (last visited Mar. 10, 2021) (providing up to $4,000 tax credit; to be eligible, the company must be certified by B Lab).
37 Lydia Segal, Benefit Corporations: A Step Towards Reversing Capitalism’s Crisis of Legitimacy?, 24 VA. J. SOC. POLY & L. 97, 119–210 (2017) (“Although benefit corporations must make public an annual benefit report, the report is not audited or certified by a third party.”).
party standard must be used to measure social impact and an annual benefit report is generally required. However, B Lab only charges for the certification and provides the standard free for public use. Further, there is currently no state auditing of the contents of the benefit reports. Purported benefits of the benefit corporation include the ability to fully deduct charitable contributions as a business expense, protection from profit-focused shareholder lawsuits, and access to certain socially-minded providers of capital. While there have been some benefit corporations to raise significant capital, it is not clear whether the entity type is more of a help or more of a hindrance in raising capital.

A. The B Lab Model

The Model Benefit Corporation Legislation was drafted by Bill Clark, senior counsel at Faegre Drinker Biddle & Reath LLP, and promoted by nonprofit B Lab (“The B Lab Model”). The B Lab Model, on which most


39 Id.


of the benefit corporation statutes are based, has been revised a number of times, and contains the following four main components: (1) purpose, (2) director/officer conduct, (3) benefit enforcement proceedings, (4) benefit reporting. First, the B Lab Model purpose is to create “[a] material positive impact on society and the environment, taken as a whole, from the business and operations of a benefit corporation assessed taking into account the impacts of the benefit corporation as reported against a third-party standard.” Second, directors and officers are to consider the effects on corporate stakeholders, though directors and officers are exonerated from monetary liability for disinterested actions or “for failure of the benefit corporation to pursue or create general public benefit or specific public benefit.” Third, shareholders may bring a benefit enforcement proceeding for failure of duties under the statute, but monetary damages may not be recovered, making the proceeding fairly weak. Fourth, the B Lab Model requires annual benefit reports that are publicly posted and measured against a third-party standard, but the reporting requirements are mostly just narrative rather than any quantified metrics.

B. The Delaware Model

Delaware’s public benefit corporation (PBC) statute departed significantly from the B Lab Model. Colorado had actually pushed for a similar statute before Delaware, but reportedly received some resistance from B Lab. After Delaware passed its statute, Colorado was able to pass a statute largely based on the Delaware Model. Delaware’s statute states

45 Id. § 102. Some statutes also have a benefit director or benefit officer, placed in charge of spearheading the socially-focused efforts of the benefit corporation. See, e.g., id. § 302.
46 Id. § 301(c).
47 Id. § 305.
48 Id. §§ 401, 402.
49 See generally, J. Haskell Murray, Social Enterprise Innovation: Delaware’s Public Benefit Corporation Law, 4 HARV. BUS. L. REV. 345 (2014) (The Delaware statute has been amended since publication of this article).
that PBCs are “intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner.” Directors are instructed to manage PBCs “in a manner that balances the stockholders’ pecuniary interests, the best interests of those materially affected by the corporation’s conduct, and the public benefit or public benefits identified in its certificate of incorporation purpose statement.” Delaware only requires benefit reports once every two years and does not require that they be publicly posted. Delaware allows, but does not require, the use of a third-party standard. Colorado’s benefit corporation law largely follows the Delaware Model, but Colorado does require a third-party standard and annual reporting. The Delaware Model is more of an enabling act when contrasted against the prescriptions of the B Lab Model.

C. The Washington Model

Washington state passed the first “social purpose corporation” statute in the United States, and California later renamed its similar “flexible purpose corporation” statute to match. California also has a B Lab Model benefit corporation statute. The Washington Model is defined by allowing a specific social purpose and not engaging in the broad social language seen in the B Lab Model, or (to a lesser extent) in the Delaware Model. Annual, publicly accessible social reporting is required, though use of a third-party standard is not. Minnesota allows its entrepreneurs a choice between a B Lab Model entity it calls a “general benefit corporation” and a Washington Model entity it calls a “specific benefit corporation.”

51 DEL. CODE ANN. tit. 8, § 362(a) (2020).
52 Id. §§ 362(a), 365.
53 Id. § 366.
54 Id.
55 COLO. REV. STAT. ANN. § 7-101-507 (West 2021) (The Colorado statute also has appraisal rights for shareholders who vote against conversion to a PBC. Delaware originally had a similar provision but deleted it to make it easier to convert. COLO. REV. STAT. ANN. § 7-101-504 (West 2021)).
56 Lowenstein, supra note 50, at 393–94.
57 Joan MacLeod Heminway, To Be or Not to Be (A Security): Funding For-Profit Social Enterprises, 25 REGENT U. L. REV. 299, 304 (2013).
59 Id. § 23B.25.150; CAL. CORP. CODE § 3501 (West 2021).
60 MINN. STAT. ANN. § 304A.104 (West 2021).
Unlike the Washington Model, the Minnesota statute does require use of a third-party standard for its specific benefit corporations.61

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61 Id. § 304A.301.
IV. THE HOPE OF SOCIAL ENTERPRISE

A. Norms and Law

Critics of social enterprise law often focus on the fact that traditional corporate law already allows for significant attention to social purpose. Critics also note the strength of the business judgment rule protection and the paucity of corporate law mandating shareholder primacy. The strong shareholder wealth centric statements of former Delaware Supreme Court Chief Justice Leo Strine are largely dismissed as extra-judicial musing.

62 Mark A. Underberg, Benefit Corporations vs. “Regular” Corporations: A Harmful Dichotomy, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 13, 2012), https://corpgov.law.harvard.edu/2012/05/13/benefit-corporations-vs-regular-corporations-a-harmful-dichotomy/ (“In fact, for the vast majority of corporate decisions, there is no legal restriction on directors’ ability to consider the interests of other stakeholders, including the groups listed in the B Corp statutes.”); see, e.g., Kent Greenfield, Corporate Citizenship: Goal or Fear?, 10 U. ST. THOMAS L.J. 960, 967 (2013) (“[T]hose [businesses] that do opt in could have behaved positively without the legal protection of the benefit corporation status. Under the ‘business judgment rule’ courts will only set aside the decisions of management—of any company—if they are tainted with self-interest or, more rarely, if management is grossly misinformed before acting. So, under current law, if a board wants to support charitable causes, pay employees more, or voluntarily reduce pollutive emissions, there is no doubt that they can do so without fearing legal recourse.”).

63 Greenfield, supra note 62, at 962; see also Mohsen Manesh, Introducing the Totally Unnecessary Benefit LLC, 97 N.C. L. REV. 603, 622–25 (2019) (“But corporation statutes do not expressly contemplate the pursuit of profits or profit maximization as a corporation’s sole or even ultimate purpose. The commonly cited cases—Dodge, Revlon, and eBay—do not compel a different conclusion. Dodge is an archaic decision that today has dubious precedential value. Moreover, the decision’s language regarding shareholder primacy is arguably dicta, and not part of the court’s holding. Further, Dodge and eBay are more appropriately understood as disputes between controlling and minority shareholders, and, therefore, the judicial assertions in both decisions as to the ultimate purpose of a corporation must be understood in that specific context and not as a broader judicial mandate that corporations must always maximize shareholder wealth . . . . In most cases, the board’s exercise of this statutory power is protected from judicial or shareholder second-guessing by the judge-made doctrine of the business judgment rule. Under the business judgment rule, in the absence of bad faith or a conflict of interest, courts will not entertain a shareholder lawsuit challenging a board decision that ‘can be attributed to any rational business purpose.””).

64 Manesh, supra note 63, at 624 (“Finally, regarding the academic writing of Chief Justice Strine, those extrajudicial musings have no legal force, even if the chief justice’s personal beliefs are provocative and influential. Indeed, it is not a coincidence that the chief justice has left it to academic articles, rather than written judicial opinions, to espouse his views on shareholder primacy.”).
to Milton Friedman’s highly cited article entitled *The Social Responsibility of Business Is to Increase Its Profits*, it is noted that the article is more nuanced than the title suggests.\(^{65}\)

There is admittedly limited enforcement of shareholder primacy in corporate law. The few cases that do exist, however, contribute to the norm of shareholder wealth maximization within traditional corporations.\(^{66}\) Claims by well-known figures like former Chief Justice Strine and Milton Friedman further bolster the norm.\(^{67}\) As has been noted, Friedman’s article is more nuanced than the title or the famous quotes, but it is easy for busy directors to disregard nuance.\(^{68}\) Even if the law and norms are rarely enforced, directors will often do what is expected of them, especially when, as explained in the next section, the structure of corporate governance and the incentives are placed to encourage focus on shareholders.\(^{69}\)

Social enterprise forms seek to disrupt the norm. Just names like “benefit corporations” and “social purpose corporations” suggest that these forms are not shareholder-focused, but rather focused on the broader society. Granted, while the name may signal a social focus to many,
it may also attract those wishing to profit off of the good name. While there will always be some fraud and misuse with any form, if the structure of corporate governance and the incentives are not reconsidered, positive change is likely to be limited.

B. Incentives and Structure

In traditional corporations, shareholders hold the stick of accountability. Shareholders elect directors, sue directors derivatively on behalf of the corporation, and can make books and records demands. While benefit corporations purport to have the purpose of making “[a] material positive impact on society and the environment,” the accountability structure is virtually identical to traditional corporations.

In benefit corporations and similar social enterprise forms, shareholders—not other stakeholders—hold the accountability tools.

Likewise, the carrots in traditional corporations generally favor shareholders. Directors are often paid in stock options and are publicly commended for rises in stock price. With benefit corporations, there has

70 Amy K. Lehr, Fiduciary Duties for A Globalized World: Stakeholder Theory Reconceived, 27 GEO. MASON L. REV. 81, 109 n.155 (2019) (“Some argue that the public benefit requirement combined with ambiguous duties to stakeholders heightens the risk of corporate whitewashing, which could in the long run undermine the reputations of benefit corporations.”).


72 The Model Legislation, supra note 43 (limiting standing to sue derivatively to shareholders, and shareholders are the only stakeholders with rights to demand the benefit report). But see Miriam A. Cherry, The Law and Economics of Corporate Social Responsibility and Greenwashing, 14 U.C. DAVIS BUS. L.J. 281, 294 (2014) (arguing that the reporting and third-party standard requirements may cut against whitewashing by benefit corporations).

73 Justin Blount & Kwabena Offei-Danso, The Benefit Corporation: A Questionable Solution to a Non-Existent Problem, 44 ST. MARY’S L.J. 617, 639–40 (2013) (“[E]ven though it expressly disavows shareholder primacy and articulates this new public benefit corporate purpose, the MBCL retains much of the existing corporate structure by leaving ultimate accountability in the hands of the shareholders in the form of voting rights and the benefit enforcement proceeding.”).

74 Sanjai Bhagat et al., Getting Incentives Right: Is Deferred Bank Executive Compensation Sufficient?, 31 YALE J. REG. 523, 544 (2014) (“Director compensation typically consists of a cash component (called the retainer), smaller cash amounts paid for attendance at board and committee meetings, and incentive compensation in the form of stock and stock option grants which vest over a period of time of a few years. . . . We think that it is
not been much publicized departure from this practice, though perhaps options with a much longer time horizon would better align incentives with stakeholder interests. For example, perhaps options with an exercise date far in the future (25 or 50 years) would focus directors on the stakeholders who are necessary to carry the corporation that far. Perhaps directors would not be sufficiently motivated to serve by compensation they could not access in their lifetime, but possibly it would attract directors motivated by the good of following generations. And reasonable cash compensation could be provided as well to hire the necessary director talent.

In addition to the incentives, the structure of governance in social enterprises could be amended. There are many different possibilities that have been proposed. More stakeholders could be given standing to sue. More stakeholders could be given the ability to elect directors to the board. In larger companies, stakeholder representatives could be elected, and then the stakeholder representatives could be vested with the powers of shareholders in a traditional corporation. Stakeholders could be involved in creating and monitoring a plan to benefit the public. Long-term shareholders could receive increased voting rights. Social reporting could be not only mandated, but also enforced and made less vague. Social

plausible to assume that incentives operate similarly in both employment positions. If, for example, directors can liquidate their vested stock and options, and a director feels the need to liquidate the position in the near future, then the director may focus on short-term performance that may be to the detriment of long-term shareholder value and the public fisc.

Cf. Kent Greenfield, The Impact of “Going Private” on Corporate Stakeholders, 3 BROOK. J. CORP. FIN. & COM. L. 75, 80 (2008) (“So if short-term management hurts stakeholders and long-term management benefits stakeholders, privatization may be a positive trend for stakeholders because it frees managers to manage with a longer time horizon and without the need for immediate accountability in the form of profits.”).


enterprise status could be limited to companies in certain industries or with certain hiring practices or compensation metrics. Executive compensation could be capped, and employee compensation could be mandated at a living wage or better. The options are numerous, but this Article contends that the state bestowing a social sounding moniker on a business type should come with governance requirements that elevate non-shareholder stakeholders’ rights.

V. CONCLUSION

After recounting a brief history of the social enterprise forms in the United States, this Article makes two primary arguments: (1) social enterprise forms are more needed to combat the shareholder wealth maximization norm than they are needed to combat a restriction of traditional corporate law and (2) to ensure the social enterprise forms have staying power and are not eventually discredited as white washing vehicles, the statutes need to be amended to support superior outcomes for non-shareholder stakeholders.