

## CONTREPRENEURSHIP? EXAMINING SOCIAL ENTERPRISE LEGISLATION'S FEEL-GOOD GOVERNANCE GIVEAWAYS

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I have never known much good done by those who affected to trade for the public good.<sup>1</sup>

—Adam Smith

This Article builds on my existing research regarding theoretical corporate agents—management—who wield greater power over the enterprise than the enterprise's owners. For over a century, the U.S. has witnessed a separation of shareholders' ability to control their agents and extract economic interests from the businesses they purportedly own.

Economist Milton Friedman proposed in 1970 that businesses are amoral persons with a sole responsibility to maximize profits, presuming that shareholders agree. Since then, however, theories of Corporate Social Responsibility ("CSR"), social enterprise, and other stakeholder-driven corporate policies have gained traction.

As Friedman's questionable economic views took hold in business school texts in the early 1980s by advancing a mistaken notion that all corporations aimed to maximize shareholder profit, other theorists pushed to enact "constituency statutes." These laws permitted management to consider non-owners in corporate decision making, regardless of shareholders' wishes.

Although many constituency statutes passed, many economic

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1. Adam Smith, *Of Systems of Political Economy*, in 1 AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 395, 421 (Edwin Cannan ed., 5th ed. 1904) (1776).

progressives remained dissatisfied. These advocates helped launch new—albeit opaque and divergent—ideas of social enterprise legislation (“SEL”). Since 2008, several states have passed SEL that authorizes or requires that a social benefit inure to non-owner stakeholders.

But some companies merely function like those authorized by SEL, as corporate owners often authorize management to take socially-beneficial action in charters and bylaws. This Article thus suggests that SEL is a “con” led by entrepreneurs called “contrepreneurs.” As I use the term, “contrepreneurs” are those who possess and advance interests opposed to equity holders, and disregard longstanding entrepreneurial and corporate governance tenets.

While SEL has a potentially charitable aim, I argue that contrepreneurs have advanced a deceptive maze of needless SEL using ethically-questionable marketing. In addition to this deception, contrepreneurs have attempted to silence political and legal counter narratives, and have created self-reinforcing laws to support a cottage industry that serves their own interests, not society’s. That cottage industry and SEL may allow managers to engage in value-destructive and morally hazardous behaviors that would otherwise lead to liability claims under traditional corporate law.

I.	TRADITIONAL LIABILITY-SHIELDED ENTITIES’ HISTORIES, PURPOSES, GOVERNANCE, TAXATION, SCALABILITY, AND PUBLIC DISCLOSURES.....	240
A.	The Moral Hazard Created by Liability Shielded Businesses.....	241
B.	Corporations .....	242
1.	General History of Corporations.....	242
2.	S-corps and C-corps Following the Creation of the Income Tax .....	244
a.	C-corps.....	244
i.	History .....	244
ii.	Governance.....	244
iii.	Taxation.....	245
b.	S-Corps .....	245
i.	History .....	245
ii.	Governance.....	246
iii.	Taxation.....	246
c.	LLCs .....	247
i.	History .....	247
ii.	Governance.....	247
iii.	Taxation.....	248
II.	L3Cs, FPCs, BENEFIT CORPORATIONS, B CORP.	

CERTIFICATIONS, AND INTERNATIONAL FOILS.....	248
A. L3Cs .....	251
1. Governance.....	251
2. Purpose .....	252
3. Taxation .....	253
4. Public Disclosure of Material Non-Financial Information .....	254
5. L3Cs and Protectionism.....	254
6. Opposition from Generally Well-Regarded Groups .....	256
B. FPCs .....	257
1. History .....	257
2. Governance .....	257
3. Purpose .....	258
4. Taxation .....	259
5. Public Disclosure of Material Non-Financial Information .....	259
C. Benefit Corporations.....	259
1. History .....	259
2. Governance .....	261
3. Purpose .....	262
4. Treatment by Municipalities .....	263
5. Scalability .....	263
6. Public Disclosure of Material Non-Financial Information .....	263
D. B Lab Certified B Corps.....	264
1. History .....	264
2. Governance .....	264
3. Purpose .....	265
4. Taxation .....	266
5. Public Disclosure of Material Non-Financial Information .....	266
6. The Non-Scalability Myth .....	267
7. The “Certified B Corporations” and GIIRS Ratings Myths .....	268
8. B Lab Certification as “Inside-the-Box” Nontrepreneurial Thinking .....	271
9. Contextualizing Contrepreneurs’ Tactics and Attempts to Silence Counter Narratives .....	275
E. Synthesis.....	276
III.GLOBAL CASE STUDIES .....	277
A. Asia—Bangladesh—PRAN.....	277
1. Background.....	277
2. Case Study .....	278

B. Africa—South Africa—Pick ‘N Pay .....279

IV. WHAT CONSTITUTES A SOCIAL BENEFIT AND WHOSE STANDARD APPLIES? .....283

A. Promoting the Advancement of Knowledge.....284

B. If “Any Other Societal Benefit” is Acceptable, then Whose Societal Norms Apply, and Are Those Norms Consistent? ....286

C. Concerns of State and Federal Conflicts .....287

1. Federalism.....287

2. State Law Concerns .....288

V. COMPARATIVE ANALYSIS: HISTORY, PURPOSE, GOVERNANCE, TAXATION, AND SCALABILITY .....289

CONCLUSION.....292

INTRODUCTION

In 2008, Vermont became the first state to pass Social Enterprise Legislation (“SEL”), which creates new business associations.<sup>2</sup> Since then, four brand-managed business types, all traceable to SEL, came into existence: (1) low-profit limited liability companies (“L3Cs”); (2) benefit corporations; (3) flexible purpose corporations (“FPCs”); and (4) B Lab-certified “B Corps”.<sup>3</sup> In any of its forms, however, SEL not only represents unnecessary and confused solutions to corporate evils that never existed, but also creates myriad future troubles for entrepreneurs and investors.

Law review articles typically attempt to accomplish two broad goals: (1) identify a specific socio-legal problem and (2) articulate novel descriptive or prescriptive claims to support solutions to the identified problems.<sup>4</sup> However, this Article employs a backwards design in articulating, advancing, and defending its thesis that SEL is an unneeded and aggravating purported solution to a nonexistent corporate problem, that corporations allegedly are hindered from pursuing social purposes.<sup>5</sup> This Article describes concerns with SEL and demonstrates how SEL

2. 2007 Vt. ALS 106.

3. See *infra* Part II (discussing each entity type in detail).

4. EUGENE VOLOKH, *ACADEMIC LEGAL WRITING: LAW REVIEW ARTICLES, STUDENT NOTES, SEMINAR PAPERS, AND GETTING ON LAW REVIEW* 9, 15-18 (Foundation Press 3d ed. 2007).

5. Backwards design is an educational tool employed by many teachers. See, e.g., GRANT WIGGINS & JAY MCTIGHE, *UNDERSTANDING BY DESIGN* 7-19 (1998). Assuming that a problem existed at all, then it was confined to a situation in which a public corporation underwent an auction to the highest bidder following a hostile takeover attempt. See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) (describing the narrow context in which directors’ fiduciary duties are exclusively to maximize shareholder value); see also Stephen M. Bainbridge, *The Geography of Revlon-land*, 81 *FORDHAM L. REV.* 3277, 3311-13 (forthcoming 2013) (discussing scenarios where Delaware courts have recognized a duty to maximize shareholder value).

structurally exacerbates quasi-agency relationships, the most important of which is a business owner's ability to control management and extract economic interest from the enterprise. Because no need for SEL-related business organizations exists, this Article posits that SEL is a con in the name of otherwise altruistic and consciously capitalistic entrepreneurial enterprises and investors.

This Article thus employs the term “contrepeneur” to describe SEL proponents. “The term ‘social entrepreneur’ [itself] was coined or at least popularized in the 1980s by [founder and CEO of Ashoka, a network of social entrepreneurs] Bill Drayton [who] . . . noted, ‘[t]hink back 25 years ago, there was no phrase [‘social entrepreneur’]—*we made it up*.’”<sup>6</sup>

“Social entrepreneur” is not the only SEL term of questionable provenance. “Corporate Social Responsibility,” “Corporate Stakeholders,” “Corporate Governance,” and “fiduciary duty” also have nebulous origins. First, CSR “has no clear, readily accepted definition.”<sup>7</sup> “Stakeholder” is also an unclear term in need of a definition. Professor Stephen Bainbridge asserts that “[t]he name [corporate] ‘stakeholders’ reportedly originated . . . as a descriptive term for ‘those groups without whose support the organization would cease to exist.’”<sup>8</sup> As for the term “corporate governance,” Professor Jonathan R. Macey indicates that it “is surely the most overused and poorly defined in the lexicon of business.”<sup>9</sup> Finally, fiduciary duty has conflicting definitions. The Third Restatement of Agency defines “fiduciary,” but it states that corporate directors represent only metaphorical—not legal—agents, who owe duties of care and loyalty

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6. 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, 3 n.7 (2011) (emphasis added) (internal citation omitted). Ashoka aims “[t]o support social entrepreneurs who are leading and collaborating with changemakers, in a team of teams model that addresses the fluidity of a rapidly evolving society.” *Vision and Mission*, ASHOKA (Nov. 24, 2013), <https://www.ashoka.org/visionmission>.

7. Antony Page & Robert A. Katz, *Is Social Enterprise the New Corporate Social Responsibility?*, 34 SEATTLE U. L. REV. 1351, 1351 (2011); see also C.A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century*, 51 U. KAN. L. REV. 77 (2002) (providing a detailed history of CSR).

8. Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 973 n.11 (1992) (quoting R. Edward Freeman & David L. Reed, *Stockholders and Stakeholders: A New Perspective on Corporate Governance*, 25 CAL. MGMT. REV. 88, 89 (1983)); see also Stephen M. Bainbridge, *The Bishops and the Corporate Stakeholder Debate*, 4 VILL. J.L. & INV. MGMT. 3, 3 (2002) (defining “stakeholders” as “nonshareholder corporate constituents, such as employees, customers, suppliers, and local communities in which the corporation does business,” again citing Freeman & Reed, at 88, 89).

9. JONATHAN R. MACEY, *CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN* 279 n.1 (Princeton Univ. Press 2008).

to the corporation, but not necessarily the owners.<sup>10</sup> I will use the terms “stockholders,” “shareholders,” “equityholders,” and “owners” interchangeably in this Article.

Despite the marketing and brand managing of SEL to investors and legislators, the new corporate entities traceable to SEL currently have legal, financial, and social costs that materially outweigh these entities’ purported benefits. Corporate governance perhaps represents the most meaningful way in which SEL may constitute a cost rather than a benefit to the broader U.S. and global economy. In particular, SEL legitimizes a further weakening of shareholders’ ability to enforce control over management and the shareholders’ capacity to extract economic value from the corporation that they theoretically own.

Milton Friedman famously wrote in 1970 that corporations faced no requirement to solely maximize shareholder value, so long as the owners of the corporation agreed with alternative corporate purposes and the business did not engage in fraud or deception.<sup>11</sup> The “key point,” Friedman argued, was that a corporate “manager<sup>12</sup> is the agent<sup>13</sup> of the individuals who own the corporation or establish the eleemosynary institution, and [the

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10. See RESTATEMENT (THIRD) OF AGENCY, § 8.01 (2006); see also David Groshoff, *Would “Junkholder Primacy” Reduce Junk Corporate Governance?*, 13 J. BUS. & SEC. L. 59, 74 n.61 (2012) (quoting Antonin Scalia, who stated that “to say that a man is a fiduciary only begins [the] analysis; it gives direction to further inquiry . . . [including] [w]hat obligations . . . he owe[s] as a fiduciary”).

11. Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, at 33.

12. The Delaware Corporate Code provides that directors as well as managers may manage a corporation. DEL. CODE ANN. tit. 8, § 141(a) (2012) (stating that “[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.”).

13. Whether an actor is an agent, particularly in the context of a director acting on behalf of shareholders, is not always clear and the contours of agency have been hotly debated through the years. See note 18 and accompanying text; see also RESTATEMENT (THIRD) OF AGENCY, §§ 1.01, 8.01 (stating that “[a]gency is the fiduciary relationship that arises when one person (a ‘principal’) manifests assent to another person (an ‘agent’) that the agent shall act on the principal’s behalf and subject to the principal’s control, and the agent manifests assent or otherwise consents so to act” and “[a]n agent has a fiduciary duty to act loyally for the principal’s benefit in all matters connected with the agency relationship.”); RESTATEMENT (SECOND) OF AGENCY ch. 1, topic 1, § 1, and ch. 13, topic 1, tit C, § 387 (1958) (“(1) Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act. (2) The one for whom action is to be take is the principal. (3) The one who is to act is the agent[,] and “[u]nless otherwise agreed, an agent is subject to a duty to his principal to act solely for the benefit of the principal in all matters connected with his agency.”). The Second Restatement of Agency existed when Friedman wrote *The Social Responsibility of Business*.

manager's] primary responsibility" runs to the business owners.<sup>14</sup>

Friedman explains that if a corporate manager uses corporate assets to fulfill a social responsibility to non-owner stakeholders, and the corporate owners believe that social responsibility does not serve a legitimate corporate purpose, then "the corporate executive would be spending someone else's money for a general social interest."<sup>15</sup> Friedman asserted that because a corporation is a constructive, rather than natural, person, corporate management bears a responsibility to attempt to effectuate the business owners' objectives. Friedman concluded that while corporate owners may have individual social goals, they represent amoral entities, and it would be inapposite for corporations to expend corporate money on owners' individual aims.<sup>16</sup>

Part of the entrepreneurs' marketing campaign in enacting SEL is based on a misunderstanding of Friedman's philosophy. They believe that boards of directors, as agents to corporate owners, possess a single overriding fiduciary duty to maximize profit or shareholder value at the expense of all other potential stakeholder interests.<sup>17</sup> But as Lynn Stout recently emphasized, "[c]hasing shareholder value is a managerial choice, not a legal requirement," and "[i]t's time to free ourselves from the myth of shareholder value."<sup>18</sup>

Despite growing scholarly critique of SEL in the U.S.,<sup>19</sup> SEL advocates won a meaningful victory in California in 2012, when the state enacted legislation providing for the creation of FPCs and benefit corporations.<sup>20</sup> California serves as an example throughout this Article

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14. Friedman, *supra* note 11, at 33.

15. *Id.*

16. *Id.*

17. See e.g., Micelle Cote, *Furthering Social Enterprise*, BOEHRINGER INGELHEIM, <http://blog.us.boehringer-ingelheim.com/home/detail/9059> ("Under current corporate law, corporate directors can only consider business practices that will maximize shareholder wealth. Benefit corporations are structured so that they not only allow social entrepreneurs to mix profits and purpose, they require it.").

18. LYNN STOUT, *THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INDIVIDUAL INVESTORS, CORPORATIONS, AND THE PUBLIC* 4, 11 (2012).

19. See, e.g., Robert A. Katz & Antony Page, *The Role of Social Enterprise*, 35 VT. L. REV. 59, 102–03 (2010) (opining that for-profit corporations can often add more social value than nonprofits); Daniel S. Kleinberger, *A Myth Deconstructed: The "Emperor's New Clothes" on the Low-Profit Limited Liability Company*, 35 DEL. J. CORP. L. 879, 881 (2010) (characterizing one form of SEL as "unnecessary and unwise"); Felicia R. Resor, *Benefit Corporation Legislation*, 12 WYO. L. REV. 91, 98–100 (2012) (claiming that constituency statutes, which give directors the freedom to consider interests besides those of the shareholder in decision-making, add minimal value).

20. CAL. CORP. CODE §§ 2500–2517 (West 2012) (governing the creation and management of the flexible purpose corporation); CAL. CORP. CODE §§ 14600–14604 (West 2012) (governing the creation and management of the benefit corporation).

because of its large global economy.<sup>21</sup> In 2013, legislatures have considered SEL in Nevada and corporate-friendly Delaware, where most public Fortune 500 companies are incorporated.<sup>22</sup> SEL is a still-developing concept, and courts have only begun to address harms caused by entities created under SEL. This Article seeks to employ historical entity comparisons and anecdotal case studies to demonstrate the improvidence of SEL-created business organizations. Because California is the most recent state to enact two new SEL-related enterprises, and because it has one of the largest global economies, much of this Article examines California's recently enacted SEL and compares California's SEL to other jurisdictions.

This Article concerns the ethical dilemma of enacting SEL to enable purportedly social and stakeholder-focused enterprises to tug on unwitting equity investors' heartstrings in order to loosen their purse strings. Part I briefly introduces the history, purposes, governance, and taxation relative to the dominant pre-2008 existing liability-shielded business organizations, corporations, and limited liability companies. Part II describes the new enterprises traceable to SEL: (1) L3Cs, (2) FPCs, (3) benefit corporations, and (4) B Lab-certified "B Corps." It will compare these SEL-related entities with pre-existing companies and concludes that no socially beneficial need exists for these new enterprises. Part III includes case studies that illustrate the harmonious coexistence of social goals and shareholder wealth maximization in other countries, despite the existence of SEL. Part IV asks what is socially beneficial and why SEL should designate what corporate activity is socially beneficial. Part V shows why new SEL is unnecessary. The Article concludes that SEL is a troubling non-solution to a problem that does not exist, and that SEL benefits the social enterprise cottage industry more than society or investors.

#### I. TRADITIONAL LIABILITY-SHIELDED ENTITIES' HISTORIES, PURPOSES, GOVERNANCE, TAXATION, SCALABILITY, AND PUBLIC DISCLOSURES

This Part discusses the background of the material pre-2008 major

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21. See 2011 *California Economic Ratings*, NUMBERS IN THE NEWS (Ctr. for Continuing Study of the Cal. Econ.), Sept. 2012, at 1, available at <http://www.ccsce.com/PDF/Numbers-Sept-2012-CA-Economy-Rankings-2011.pdf> (noting that California has consistently ranked as one of the ten largest global economies)

22. A.B. 89, 77th Leg. Sess. (Nev. 2013) (enacted) (authorizing the formation of benefit corporations in Nevada); S.B. 47, 147th Gen. Assemb., Reg. Sess. (Del. 2013) (enacted) (authorizing creation of benefit corporations in Delaware); see also LEWIS S. BLACK, JR., DEL. DEP'T OF STATE DIV. OF CORPS., WHY CORPORATIONS CHOOSE DELAWARE 1 (2007), available at [http://corp.delaware.gov/whycorporations\\_web.pdf](http://corp.delaware.gov/whycorporations_web.pdf) (noting that "[o]f the corporations that make up the Fortune 500, more than one-half are incorporated in Delaware.").

forms of businesses that limit individual personal liability and separate ownership from control. It will first discuss the economic moral hazard of limiting personal liability through corporate forms. It then reviews the development of modern corporate forms: (1) Corporations, including (a) C corporations (“C-corps”) and (b) S corporations (“S-corps”); and (2) limited liability companies (“LLCs”), which developed at the end of the twentieth century.

*A. The Moral Hazard Created by Liability Shielded Businesses*

When governments enact statutes that create personal liability limitations for corporate actors and investors, they manipulate the economy and create tension with market-based capitalism and invite morally hazardous behavior.<sup>23</sup> Until the mid-to-late nineteenth century, most corporations were formed via an act of a state legislature, as opposed to the modern system of filing with the secretary of state’s office.<sup>24</sup> Legislatures typically shielded equity investors and agents involved in such corporations, especially those engaging in large-scale public works projects.<sup>25</sup> But today, anyone can obtain personal liability shields for their activities within the business enterprise, via LLCs, limited liability partnerships (“LLPs”), S-corps, and C-corps. These liability shields protect individuals acting within these corporate structures should they engage in socially irresponsible corporate behavior.

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23. See Timothy P. Glynn, *Beyond “Unlimiting” Shareholder Liability: Vicarious Tort Liability for Corporate Officers*, 57 VAND. L. REV. 329, 330-31 (2004) (stating that “[l]imited shareholder liability produces benefits, but it also inflicts costs, including encouraging excessively risky corporate activity.”); Rebecca Huss, *Revamping Veil Piercing for all Limited Liability Entities: Forcing the Common Law Doctrine into the Statutory Age*, 70 U. CIN. L. REV. 95, 107 (2001) (stating that “[s]ome commentators have proposed reducing or even eliminating limited liability coverage. Supporting these proposals is the theory that limited liability creates a moral hazard because interest holders are able to receive all the benefits of risky activities without all the costs”); Nina A. Mendelson, *A Control-Based Approach to Shareholder Liability for Corporate Torts*, 102 COLUM. L. REV. 1203, 1203 (2002) (stating that “[s]ome commentators defend limited shareholder liability for torts and statutory violations as efficient, even though it encourages corporations to overinvest in and to externalize the costs of risky activity.”).

24. See Robert Brauneis, *The First Constitutional Tort: The Remedial Revolution in Nineteenth-Century State Just Compensation Law*, 52 VAND. L. REV. 57, 84 (1999) (noting that “[t]hrough the mid-nineteenth century, American state legislatures created virtually all corporations by special charter or franchise.”).

25. Brauneis, *supra* note 24, at 84; see also Elizabeth Arens, *The Elevated Railroad Cases: Private Property and Mass Transit in Gilded Age New York*, 61 N.Y.U. Ann. Surv. Am. L. 629, 642-45 (2006) (discussing New York’s immunization of corporations conducting public works projects).

## B. Corporations

### 1. General History of Corporations

Conceptually, corporations have existed since ancient Rome or the sixth-century monasteries.<sup>26</sup> More modern corporations have existed since the days of the joint stock companies of the British East India Company in the 1400s<sup>27</sup> and the Dutch East India Company in the early 1600s.<sup>28</sup> To form these national joint stock corporations, a nation's government<sup>29</sup> had to pass a distinct law to charter each new corporate enterprise.<sup>30</sup> Some scholars believe that this requirement resulted in little interest in obtaining corporate charters for local, rather than national, business activities until the late eighteenth century.<sup>31</sup>

The earliest joint stock corporations formed to execute a “public purpose,”<sup>32</sup> i.e., a purpose perceived as beneficial to a nation's broader society.<sup>33</sup> SEL also purports to serve socially beneficial corporate purposes. For example, the corporate and socially beneficial purposes of each East India company were to extract natural and human resources from “undeveloped” regions.<sup>34</sup> These companies then employed the stolen

26. See JOHN DAVIS, *CORPORATIONS VOLUME II: AN INTRODUCTORY STUDY OF CORPORATIONS* 222–23 (Abram Chayes ed., Capricorn Books 1961) (1904); see also Greg MacLeod, *The Mondragon Experiment*, HARV. INT'L REV. (Apr. 4, 2009, 10:28 PM), <http://hir.harvard.edu/the-mondragon-experiment> (“The concept of the corporation reaches back to Roman times.”).

27. THE REGISTER OF LETTERS & C. OF THE GOVERNOUR AND COMPANY OF MERCHANTS OF LONDON TRADING INTO THE EAST INDIES, 1600–1619 3 (Sir George Birdwood ed., Piccadilly London 1893).

28. See, e.g., CHARLES MACKAY, *EXTRAORDINARY POPULAR DELUSIONS AND THE MADNESS OF CROWDS* (L.C. Paige & Co., 11th ed. 1960) (1841) (describing also the Dutch East India Company's role in Holland's famed tulip bulb bubble).

29. According to the blog maintained by the proxy advisory firm Institutional Shareholder Services (ISS), British monarchs had the sole power to charter a corporation until the South Sea Bubble Act of 1720 transferred the chartering power to parliament. Peter Kinder, *Corporations' Public Purpose: The Myth and the History*, INSTITUTIONAL SHAREHOLDER SERVICE GOVERNANCE BLOG (Sept. 28, 2007, 12:50 PM), <http://blog.issgovernance.com/esg/2007/09/corporations-public-purpose-the-myth-the-history.html>.

30. See Samuel Williston, *History of the Law of Business Corporations Before 1800*, 2 HARV. L. REV. 105, 113 (1888).

31. Charlie Cray & Lee Drutman, *Corporations and the Public Purpose: Restoring the Balance*, 4 SEATTLE J. FOR SOC. JUST. 305, 309 (2005).

32. See Kinder, *supra* note 29 (discussing the myth and history of corporations' public purpose).

33. See, e.g., Cray & Drutman, *supra* note 31, at 309 (asserting that the Boston Tea Party served as a colonial rebellion “against a British corporation and British crown whose interests were intertwined”).

34. *Id.*

human and natural resources to further the companies' respective economic expansion and imperialism.<sup>35</sup> As a result, these companies fulfilled the chartered joint stock corporation's "socially beneficial" public purpose, and protected equity holders from personal liability.<sup>36</sup>

By the United States' founding, several state legislatures individually chartered corporations. This practice led to questionable practices regarding who received a corporate charter, for what purpose, and what subsidies (typically protection against competition) were attached to that corporation.<sup>37</sup> In exchange for erecting a barrier to entry for competitors, legislators often limited the purposes of charters to causes that expanded economic development, such as constructing roads, bridges, or operating banks.<sup>38</sup> Beginning in the 1890s, however, New Jersey broke the stranglehold on legislative chartering and set forth a series of laws to simplify the incorporation process.<sup>39</sup> Delaware soon followed suit and ultimately achieved dominance over New Jersey during Woodrow Wilson's time as New Jersey's Governor.<sup>40</sup>

By the twentieth century, the U.S. had entered an era of general incorporation<sup>41</sup> in which human persons<sup>42</sup> could form corporate persons by submitting a filing to a state government office. Since the early twentieth century, the law has prevented equity investors from attempting to control or extract economic value from corporate purpose.<sup>43</sup> A board of directors, elected by the corporation's shareholders, manages corporations on behalf

35. *See id.*; *See also* J. Thomas Linblad, *Economic Aspects of the Dutch Expansion in Indonesia, 1870-1914*, 23 MODERN ASIAN STUD. 1 (1989) (arguing that the Dutch imperial rule of the Outer Islands helped with the colony's economic expansion).

36. Cray & Drutman, *supra* note 31, at 316 (discussing how states fostered increased corporate irresponsibility through the adoption of limited liability for investors).

37. *See, e.g.*, Kinder, *supra* note 29 (explaining the corruption and political favoritism were inherent in chartering).

38. HERBERT HOVENKAMP, *ENTERPRISE AND AMERICAN LAW: 1836-1937*, 12, 59, (Harvard Univ. Press 1991).

39. *See, e.g.*, RALPH NADER, ET. AL, *TAMING THE GIANT CORPORATION* 42-52 (1976).

40. *Id.*

41. Cray & Drutman, *supra* note 31, at 316-17 (explaining that "the system of general incorporation gradually replaced individual chartering").

42. By this time, the Supreme Court had already ruled that corporations constituted persons entitled to legal rights. *See Santa Clara Cnty. v. S. Pac. R.R.*, 118 U.S. 394, 396 (1886) ("The court does not wish to hear argument on the question whether the provision in the Fourteenth Amendment to the Constitution, which forbids a State to deny to any person within its jurisdiction the equal protection of the laws, applies to these corporations. We are all of opinion that it does."). The Court recently reexamined this controversial issue in its *Citizens United* decision. *Citizens United v. FEC*, 558 U.S. 310, 343 (rejecting the argument that corporations or other associations should be treated differently under the First Amendment "simply because such associations are not 'natural persons.'").

43. *See* Groshoff, *Junkholder Primacy*, *supra* note 6, at 63 n.13 (mentioning separation of ownership and control, as generally discussed by Adolf Berle and Gardiner Means in the 1930s).

of the shareholders.<sup>44</sup> The board of directors typically retains additional managers to run the company's day-to-day operations.<sup>45</sup> While no requirement exists for shareholders to serve as directors or officers, they may serve in both capacities.<sup>46</sup> A company's charter and bylaws governs the board of directors.<sup>47</sup>

## 2. S-corps and C-corps Following the Creation of the Income Tax

### a. C-corps

#### i. History

While corporate taxation has existed since 1913,<sup>48</sup> the law governing it is complex.<sup>49</sup> Organizing a Subchapter C corporation is not materially different than organizing any limited liability entity.<sup>50</sup> Corporations taxed under Subchapter C of the Internal Revenue Code are colloquially known as "C-corps."<sup>51</sup>

#### ii. Governance

A detailed discussion of C-corps' governance issues reaches beyond the scope of this Article, but equity holders generally possess little control or governance rights in a C-corp.<sup>52</sup> C-corps are appealing for entities seeking venture capital investment, because they may offer varied classes of shares and may undergo public offerings without significant reorganization.<sup>53</sup>

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44. Michael F. Schaff & Robert J. Chalfin, *Basic Factors to Consider when Advising Clients in Choosing an LLC or a Corporation*, N.J. LAW. MAG., Apr. 2006, at 46.

45. *Id.*

46. *Id.*

47. *Id.* at 48.

48. U.S. CONST. amend. XVI; *see also* Tariff Act of 1913, ch. 16, 38 Stat. 114, 166 (1913) (re-imposing federal income tax after the ratification of the 16th Amendment).

49. Robert Charles Clark, *The Morphogenesis of Subchapter C: An Essay in Statutory Evolution and Reform*, 87 YALE L.J. 90, 90 (1977) (internal citations omitted).

50. Matthew F. Kadish & Brian J. O'Connor, *S vs. C—Tax Considerations in Corporate Choice of Entity*, 2 BUS. ENTITIES 32, 34 (2000).

51. *See, e.g.*, Victor Fleischer, *The Rational Exuberance of Structuring Venture Capital Startups*, 57 TAX L. REV. 137, 144 (2003) (referring to a corporation taxed under Subchapter C of the Internal Revenue Code as a "C Corp").

52. *See* Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. Pa. L. Rev. 1209, 1215 (2006) (explaining that creditors "do not have their hands on the levers of power").

53. *See* Nellie Akalp, *What Corporate Structure is Best for Startups Considering VC Funding?*, MASHABLE (Dec. 1, 2013 2:36 PM), <http://mashable.com/2011/08/22/startups-structure-funding/> (discussing C-Corps and venture capital funding).

### iii. Taxation

The IRS subjects C-corps to a two-tiered system of taxation, commonly known as “double taxation.”<sup>54</sup> C-corps must pay on taxable income, subject to the corporate tax rate, which generally provides a net effective rate of forty percent.<sup>55</sup> In the event the corporation distributes any after-tax income to shareholders via dividends, the shareholders are taxed on the dividend received.<sup>56</sup> The tax rate on dividends currently ranges from fifteen percent to twenty percent, depending on a filer’s income and status.<sup>57</sup> This so-called double taxation may deter the formation of C-corps.<sup>58</sup>

#### b. S-Corps

##### i. History

S corporations (“S-corps”) have existed since 1958, following years of legislative attempts to address the double taxation issue.<sup>59</sup> Instead of a two-tiered tax system in which the IRS taxes both corporate earnings and the earnings distributed to equity holders in the form of dividends, S-corps permit pass-through taxation<sup>60</sup> so that the equity holder is the only person

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54. Fleischer, *supra* note 51, at 144. Commentators have disagreed on the accuracy of the term “double taxation.” Compare Greg Mankiew, *On Dividend Taxes, It’s a Post-Partisan Race*, N.Y. TIMES, Sept. 6, 2008, at BU-7 (claiming that double taxation exists) with Dean Baker, *The Double Taxation of Corporate Profits and Other Fairy Tales*, BUS. INSIDER (Nov. 27, 2011, 10:17 AM), <http://www.businessinsider.com/the-double-taxation-of-corporate-profits-and-other-fairy-tales-2011-12> (arguing that the corporation and individual shareholders are “distinct persons,” and thus taxation on a C-corp’s profits and dividends does not amount to double taxation).

55. See, e.g., *Corporate Tax Rates Table*, KPMG (Nov. 24, 2013), <http://www.kpmg.com/global/en/services/tax/tax-tools-and-resources/pages/corporate-tax-rates-table.aspx> (showing global corporate tax rates from 2006 -2013).

56. Kadish & O’Connor, *supra* note 50, at 34.

57. *Id.*

58. Kadish & O’Connor, *supra* note 50, at 34.

59. See I.R.C. § 1361 (2006) (laying out current taxation rules for S corporations and their shareholders); Technical Amendments Act of 1958, Pub. L. No. 85-866, § 64, 72 Stat. 1606, 1650-57 (1958) (adopting, for the first time, a statute providing for S corporations within the Small Business Tax Revision Act of 1958); see also Mirit Eyal-Cohen, *When American Small Business Hit the Jackpot: Taxes, Politics, and the History of Organizational Choice in the 1950s*, 6 PITT. TAX REV. 1, 2 (2008) (stating that “[a]t very rare moments Congress has been inclined to, at least partially, eliminate the double tax burden. One of these occasions was in 1958, when Congress added Subchapter S to the Internal Revenue Code of 1954.”).

60. James S. Eustice & Thomas Brantley, *Fed. Income Tax’n of Corp. & Shareholders* ¶ 6.06[1] (2013) (“From its enactment in 1958, subchapter S has exempted electing corporations from the corporate income tax because the corporate income, whether or not

subject to taxation.<sup>61</sup>

## ii. Governance

S-corps maintain rigid ownership requirements.<sup>62</sup> Shareholders have voting rights on many matters, and the shareholders often include the S-corp's directors and officers. S-corps may not have more than one hundred shareholders, and those shareholders cannot be corporations, non-resident aliens, pension funds, charities, partnerships, or certain types of trusts.<sup>63</sup> These ownership restrictions can make it difficult to attract large or venture fund investors to provide capital.<sup>64</sup> Beyond these ownership requirements, S-corps function in the same manner as C-corps, with a board of directors, officers, bylaws, and shareholder meetings.<sup>65</sup>

## iii. Taxation

The IRS does not tax an S-corp's income at the corporate level.<sup>66</sup> So long as the S-corp maintains certain conditions, an S-corp's income passes through to shareholders.<sup>67</sup> On equity holders' individual tax returns, the equity holders owe taxes on their pro-rata share of the corporation's income at their individual income tax rates.<sup>68</sup>

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distributed, is taxed to the shareholders under a conduit or pass-through regime based largely on the partnership model. Income, losses, deductions, and credits retain their corporate-level character and are allocated to the S corporation's shareholders on a per-share, per-day basis (by virtue of [26 U.S.C.] §§ 1366 and 1377(a)(1), respectively), and are treated by the shareholders as if attributable directly to the source from which they were generated.") (footnote omitted).

61. Eustice & Brantley, *supra* note 61, at ¶ 6.06[1]; Michael Doran, *Managers, Shareholders, and the Corporate Double Tax*, 95 VA. L. REV. 517, 519 (2009).

62. See I.R.C. § 1361(b)(1) (2006) (requiring no more than 100 shareholders, each of whom should be an individual except in some narrowly defined circumstances, and none of whom may be a nonresident alien).

63. *Id.*

64. See Richard M. Horwood & Jeffrey A. Hechtman, *The ABC's of LLCs*, 40 PRAC. LAW. 65, 79-81 (1994) (explaining the difference between LLCs and S-corps and noting that LLCs provide more flexibility for investors, including venture capital organizations, and real estate ventures).

65. Schaff & Chalfin, *supra* note 44, at 48.

66. See Kadish & O'Connor, *supra* note 50, at 36 (explaining that, although taxes in an S-corp "pass through" to shareholders, it may be more economically harmful to shareholders where the corporation retains its earnings).

67. *Id.*

68. See *id.* (explaining that individual shareholders in an S-corp may use the corporation's losses on their individual returns to offset income to the extent they have stock or debt basis in the corporation and to the extent they have passive income).

c. *LLCs*

i. History

Although some might argue that LLCs are not “traditional” corporations, a discussion of their development is pertinent to an analysis of SEL entities. Because LLCs are created by state statute, questions have arisen regarding federal taxation of LLCs. Wyoming passed the first LLC statute in 1977,<sup>69</sup> prompting discussion of federal income taxation of LLCs throughout the 1980s and early 1990s.<sup>70</sup>

The IRS indicated in a 1988 Private Letter Ruling that LLCs’ equity holders could treat LLCs as partnerships rather than corporations for the purpose of federal income taxation.<sup>71</sup> Although the IRS had traditionally assessed an entity’s tax status using a six-factor test,<sup>72</sup> in late 1996 it approved “check-the-box” election for LLC owners to choose pass-through or double taxation.<sup>73</sup>

ii. Governance

LLCs give entrepreneurs an enormous amount of flexibility. Statutes authorizing LLCs often contain default rules that serve as gap-fillers for items that the parties neglect to contract for in the LLC’s governing documents.<sup>74</sup> Operating agreements typically govern an LLC’s internal affairs in a similar manner to how bylaws govern a corporation.<sup>75</sup> LLC equity holders may manage the LLC, or they may delegate managerial authority to a third-party manager.<sup>76</sup>

Because LLCs are liability-shielded entities, members and managers of an LLC are not personally liable for its debts and obligations.<sup>77</sup> The liability of a member is generally limited to the amount of one’s capital

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69. Dale W. Cottam et al., *The 2010 Wyoming Limited Liability Company Act: A Uniform Recipe with Wyoming “Home Cooking”*, 11 WYO. L. REV. 49, 51 (2011).

70. Horwood & Hechtman, *supra* note 64, at 66 (noting that, “[a]lthough LLCs existed in certain states for more than 10 years, LLCs were not generally considered viable entities until 1988 when the Internal Revenue Service [ ] ruled that LLCs may be taxed as partnerships rather than as corporations”).

71. *Id.*

72. See *United States v. Kintner*, 216 F.2d 418 (9th Cir. 1954) (adopting the six factors initially introduced in *Morrissey v. Commissioner*, 296 U.S. 344 (1935), used to determine an entity’s tax classification status).

73. Treas. Reg. § 301.7701-1(b) (as amended by 61 Fed. Reg. 66, 584 (1996)).

74. Horwood & Hechtman, *supra* note 64, at 68.

75. *Id.*

76. *Id.* at 69.

77. *Id.* at 71.

contribution, plus any agreed-upon but unpaid contribution.<sup>78 79</sup>

### iii. Taxation

As detailed above, one of the primary attractions of an LLC is its hybrid nature that offers pass-through federal taxation along with a personal liability shield. Unless an LLC elects to be taxed as a corporation, the IRS will designate the LLC as a partnership for federal income tax purposes, allowing pass-through taxation to each member.<sup>80</sup>

## II. L3CS, FPCS, BENEFIT CORPORATIONS, B CORP. CERTIFICATIONS, AND INTERNATIONAL FOILS

The television show *Boston Legal* humorously demonstrated the confusion among attorneys at the fictitious law firm Crane, Poole, and Schmidt regarding the purpose and benefits of a particular socially focused enterprise:

Denny Crane: What the hell kind of charity is “Children’s Group?”

Shirley Schmidt: We’re teaching children to read.

Denise Bauer: No, we’re buying them food.

Alan Shore: I thought we were providing them with old people to play with.

Paul Lewiston: I believe it’s a children’s theatre group.

Denny Crane: Now how can kids with muscular dystrophy do theatre?

Brad Chase: They don’t have muscular dystrophy.

Denny Crane: Then what in the hell are we doing here?<sup>81</sup>

No humor exists, however, when attempting to address the meaningful concerns embedded in SEL. Social enterprise participants do, however, demonstrate a nearly comedic inability to articulate even the most basic cohesive definition of “social enterprise.”

Unlike the more traditional corporate entities discussed in Part I, socially focused enterprises lack a clear legal structure and definition.<sup>82</sup>

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78. *Id.*

79. See, e.g., Mohsen Manesh, *Contractual Freedom Under Delaware Alternative Entity Law: Evidence from Publicly Traded LPs and LLCs*, 37 J. CORP. L. 555, 557, n.17 (2012) (stating that publicly traded LLCs are master limited partnerships (“MLPs”) and “[a]lthough publicly traded LLCs are, of course, not limited partnerships, such firms are typically discussed in the same context as MLPs.”) (internal citations omitted).

80. Byron F. Egan, *Choice of Entity Decision Tree After Margin Tax and Texas Business Organizations Code*, 42 TEX. J. BUS. L. 71, 157 (2007) (internal citation omitted).

81. *Boston Legal: The Cancer Man Can* (ABC television broadcast Jan. 10, 2006).

82. See, e.g., Keren G. Raz, *Toward an Improved Legal Form for Social Enterprise*, 36

For example, Ashoka, a meaningful player in the social enterprise movement, indicates in its training materials that a “social enterprise” is “[a]n organization applying business strategies to achieving philanthropic goals” and “[a]n organization that makes money and does good.”<sup>83</sup> Ashoka materials also state, however, that “social entrepreneurs” do not necessarily engage in the work of, or constitute members in, “social enterprise.”<sup>84</sup> Similarly, Professor Thomas Kelley indicates that “[t]he nomenclature of this new area is variable and contested.”<sup>85</sup> And Professors Robert Katz and Anthony Page claim that “[s]ocial enterprise is a loose term for businesses that aim to generate profits while advancing social goals.”<sup>86</sup>

Similarly to Kelley, Katz, and Page, Karen Raz agrees that “[t]he definitions of social enterprise and social entrepreneurship are controversial. The field lacks consensus, resulting in the plethora of existing definitions.”<sup>87</sup> Given Raz’s highly specialized background as a former NYU Law and Social Enterprise Fellow and co-founder of NYU’s Law and Social Entrepreneurship Association,<sup>88</sup> her definition of the term “social enterprise,” is presumably respected within the field. While Raz defines social enterprise as “an organization or venture that advances a social mission through entrepreneurial, earned-income strategies,”<sup>89</sup> she also states that her definition reflects the definitions advanced by the Social Enterprise Alliance (“SEA”) and Social Enterprise UK (“SEUK”).<sup>90</sup>

The SEA’s and SEUK’s respective definitions, however, are inconsistent with Raz’s. The SEA defines “social enterprises” as “businesses whose primary purpose is the common good,” and whose goals are accomplished by: (1) “directly address[ing] an intractable social need and serv[ing] the common good”; (2) having its commercial activity serve as “a strong revenue driver”; and (3) having the “common good [as] its

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N.Y.U. REV. L. & SOC. CHANGE 283, 285 n.3 (2012) (stating that “[t]he definitions of social enterprise and social entrepreneurship are controversial. The field lacks consensus, resulting in the plethora of existing definitions.”).

83. MORRISON FOERESTER, JONES DAY & ADLER & COLVIN, TRAINING FOR ASHOKA FELLOWS: HYBRID STRUCTURES: NONPROFITS, FOR-PROFITS, AND NEW CORPORATE FORMS 6-7 (Jan. 29, 2013) [hereinafter TRAINING FOR ASHOKA FELLOWS] (on file with the University of Pennsylvania Journal of Business Law).

84. See Noga Leviner, Leslie R. Crutchfield & Diana Wells, *Understanding the Impact of Social Entrepreneurs: Ashoka’s Answer to the Challenge of Measuring Effectiveness*, in RESEARCH ON SOCIAL ENTREPRENEURSHIP: UNDERSTANDING AND CONTRIBUTING TO AN EMERGING FIELD 93 (Rachel Mosher-Williams ed., 2007).

85. Thomas Kelley, *Law and Choice of Entity on the Social Enterprise Frontier*, 84 TUL. L. REV. 337, 340 n.7 (2009).

86. Katz & Page, *supra* note 6, at 1353.

87. Raz, *supra* note 82, at 285 n.3.

88. *Id.* at 283.

89. *Id.* at 285.

90. *Id.* at 285 n.3.

*primary* purpose, literally ‘baked into’ the organization’s DNA, and trumping all other[ ] [purposes].”<sup>91</sup> Conversely, Social Enterprise UK offers many contextual examples of what may constitute “social enterprise,” but in terms of a definition, the organization states only that “[s]ocial enterprises are businesses trading for social and environmental purposes.”<sup>92</sup> Although the SEA’s definition of a “social enterprise” seems fairly loose, it has protected the term from private companies. For example, when Salesforce.com attempted to trademark the term “social enterprise,”<sup>93</sup> in 2012, the SEA opposed the action, claiming that “[s]ocial enterprise’ is a phrase that for more than two decades has been commonly used to describe business models, both nonprofit and for-profit, whose primary purpose is the common good.”<sup>94</sup>

Despite the demonstrated lexical mess, this Article will not confuse the strained meanings of social enterprise and social entrepreneurship further by creating yet another definition. Instead, this Article presumes that the reader will conceptualize social enterprise and social entrepreneurship as the terms currently stand, with various definitions. This Article assumes that the challenges in defining social enterprise and social entrepreneurship make analyzing SEL particularly difficult. This Part will, however, describe the new business formations traceable to SEL: (1) L3Cs (2) FPCs, (3) Benefit Corporations, and (4) B Lab’s (B Lab’s) “Certified B Corporations.” This Part will then compare the entities that one can form under SEL with the entities described in Part I. This Part will conclude that vehicles created under SEL and the entrepreneurs’ lobbying for the enabling SEL appear to be “crusade[s] without a cause,”<sup>95</sup> and represent

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91. *Why*, SOC. ENTER. ALLIANCE, <https://www.se-alliance.org/why> (last visited Oct. 27, 2013) (emphasis in original). Furthermore, while this is a pedantic point, diction matters when it serves as a basis for laws, and it is something that even experts in the social enterprise field struggle with, as demonstrated by the use of the word “literally.” See THE CHICAGO MANUAL OF STYLE § 5.202 (Univ. of Chi. Press 13th ed. 2003) (1982) “Commonly Misused Words” (stating “[l]iterally’ means ‘actually; without exaggeration.’ It should not be used oxymoronically in figurative senses, as in *they were literally glued in to their seats* (unless glue had in fact been applied).”) (emphasis in original).

92. SOC. ENTER. U.K. & UNITY TRUST BANK, SOCIAL ENTERPRISE EXPLAINED, 3 (2011), available at [http://www.socialenterprise.org.uk/uploads/editor/files/Publications/Social\\_Enterprise\\_Explained.pdf](http://www.socialenterprise.org.uk/uploads/editor/files/Publications/Social_Enterprise_Explained.pdf).

93. By trademarking, the company may have perhaps created a single definition for the term, a move that SEA resisted.

94. *Social Enterprise Alliance Opposes Salesforce.com’s Attempt to Trademark the Term “Social Enterprise” and Encourages Salesforce.com’s Engagement to Build the Field*, PRWEB (Aug. 31, 2012), <http://www.prweb.com/releases/social-enterprise/trademark-opposition/prweb9845675.htm>; but see *supra* notes 87-90 and accompanying text.

95. Jeffrey L. Kwall, *Subchapter G of the Internal Revenue Code: A Crusade Without a Cause?*, 5 VA. TAX REV. 223, 223 (1985).

more forms of the “[m]yth” of “[t]he [e]mperor’s [n]ew [c]lothes.”<sup>96</sup>

#### A. L3Cs

This subpart (1) reviews the history of L3Cs via the nation’s first L3C statute, enacted in Vermont; (2) describes North Carolina’s push for L3C legislation and applies longstanding economic theory coupled with a practical example to demonstrate North Carolina’s flawed legislative purpose in passing its L3C legislation; and (3) describes several high-profile nonprofits and other organizations that vehemently oppose L3C legislation.

Vermont passed the first legislation enabling L3Cs in April 2008.<sup>97</sup> To organize as a Vermont L3C, an enterprise must meet certain basic requirements. First, the business must further the accomplishment of one or more charitable or educational purposes within § 170(c)(2)(B) of the Internal Revenue Code of 1986 (“I.R.C.”), and the company’s formation must not have occurred but for the accomplishment of the charitable or educational purpose.<sup>98</sup> Second, the significant purpose of the business cannot be the production of income or appreciation of property.<sup>99</sup> Third, the business’s purpose cannot be to achieve a political or legislative purpose within the meaning of I.R.C. § 170(c)(2)(D).<sup>100</sup> L3Cs attempt to obtain program-related investments (“PRIs”) from foundations.<sup>101</sup>

#### 1. Governance

At its essence, an L3C is an LLC structured to seek below-market returns in hopes of obtaining some of its capitalization from private foundation funding. As a result, many laws relating to L3C governance resemble the laws affecting LLC governance, including the standards of

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96. See Kleinberger, *supra* note 19, at 879 (“debunk[ing] each major tenet of the L3C ‘movement’ and reveal[ing] the legal and practical realities under ‘The Emperor’s New Clothes.’”).

97. Doug Batey, LLC LAW MONITOR (Aug. 21, 2009), <http://www.llclawmonitor.com/2009/08/articles/lowprofit-llcs/lowprofit-llcs-the-newest-limited-liability-company-structure/>; see also *An Act Relating to Low-Profit Limited Liability Companies*, H.775, 2007-08 Leg. Sess. (Vt. 2008), available at <http://www.leg.state.vt.us/docs/legdoc.cfm?URL=/docs/2008/acts/ACT106.HTM>.

98. VT. STAT. ANN. tit. 11, § 3001(27)(A) (2012).

99. *Id.* at § 3001(27)(B).

100. *Id.* at § 3001(27)(C).

101. TRAINING FOR ASHOKA FELLOWS, *supra* note 83, at 26.

conduct for both members and managers.<sup>102</sup>

In a member-managed LLC, the member owes to the company and other equity holders fiduciary duties of loyalty and care.<sup>103</sup> Those default duties include: the duty to account to the company and hold as trustee any property, profit, or benefit; the duty to abstain from having an adverse interest to the company during the company's operation or winding up; and the duty to abstain from competing with the company before the dissolution of the company.<sup>104</sup> Finally, during the winding up of the company's affairs, a member must act as a reasonable person would in similar circumstances while taking into account the best interests of the company.<sup>105</sup>

In a manager-managed LLC, these fiduciary duties apply to the managers but not to the members.<sup>106</sup> Additionally, a member of the LLC does not owe a fiduciary duty to the company or other members by virtue of being a member of the LLC.<sup>107</sup>

Just as LLCs attempt to provide maximum freedom of contract in creating the enterprise, founders of L3Cs may also alter almost any governance matters by negotiation, provided that those matters are discussed in the company's operating agreement.<sup>108</sup>

## 2. Purpose

As discussed above, only entities with certain educational or charitable purposes may organize as L3Cs in Vermont. The charitable or education purpose requirement of an L3C is essential to helping the company attract investments from private foundations and nonprofits, known as PRIs.<sup>109</sup> PRIs must comply with the requirements of I.R.C. § 170(c)(2)(B).<sup>110</sup>

Should the company organize as an L3C and later fail to satisfy any of the above requirements, the L3C will lose its L3C status and transition to

102. *Id.* For an outline of the general standards governing members' and managers' conduct, see REVISED UNIF. LTD. LIAB. CO. ACT § 409 (2006).

103. REVISED UNIF. LTD. LIAB. CO. ACT § 409(a) (2006).

104. *Id.* at § 409(b)(1)-(3).

105. *Id.* at § 409(c).

106. *Id.* at § 409(g)(1).

107. *Id.* at § 409(g)(5).

108. *Id.* at §§ 110, 111.

109. See Dana Reiser, *Governing and Financing Blended Enterprise*, 85 CHI.-KENT L. REV. 619, 622 (2010) [hereinafter Reiser, *Governing and Financing*] (stating that "[t]he [L3C] model was intended to fit easily onto various states' LLC bases and provide sufficient limitations so that properly formed L3Cs would qualify to receive 'program related investments' (PRIs) under existing Internal Revenue Service (IRS) rules.").

110. I.R.C. § 4944(c) (2006) (defining program-related investments and providing that such contributions do not jeopardize a tax-exempt organization's charitable status).

an LLC.<sup>111</sup> All other relevant law governing an L3C comes from the state's law applying to LLCs.<sup>112</sup> But, as described *earlier*, the federal taxation of L3Cs and LLCs remains quite different. That an L3C may lose its L3C status suggests that organizations could work for traditional L3C educational and charitable purposes under a different and existing structure, the LLC. Therefore, each of these purposes could have been achieved via an LLC, without the existence of the L3C as a form of SEL.

### 3. Taxation

This subpart addresses the requirement of the L3C maintaining a charitable purpose under I.R.C. § 170(c)(2)(B). One challenge raised by L3Cs—at least under Vermont's L3C legislation—is of regulation and enforcement, especially surrounding the company's social mission. While the IRS could act as a shadow regulator, the IRS has questionable ability to oversee L3Cs.<sup>113</sup> Although L3Cs ostensibly pursue a charitable or educational mission in addition to profit, if the profits should ever exceed the charitable or educational purpose, then the L3C transforms into an LLC.

The drafters of L3C legislation wanted to structure L3Cs to comply with the Internal Revenue Code in order to attract investment from private foundations.<sup>114</sup> A state, however, cannot create any entity exempt from federal taxation. To contextualize in the L3C case, despite initial enabling legislation in the late 1970s in some states, LLCs did not surge in popularity and become legitimate business forms in all fifty states until after the IRS opined on the taxation of the LLC.<sup>115</sup> And relating to taxation, members of the L3C are taxed as if the business organizations

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111. VT. STAT. ANN. tit. 11, § 3001(27)(D) (2012).

112. See Reiser, *Governing and Financing*, *supra* note 109, at 623 (stating that “[t]he L3C legislation includes virtually no additional content beyond the four core requirements, relying instead on existing LLC law to address any matters not covered by these spare enactments. LLC law is quite voluminous, covering myriad topics ranging from filing requirements to investor liability to derivative actions.”) (internal citations omitted).

113. Marya N. Cotten & Gail A. Lasprogata, *Corporate Citizenship & Creative Collaboration: Best Practices for Cross-Sector Partnerships*, 18 J.L. BUS. & ETH. 9, 37 (2012) (“[C]urrently an L3C is not automatically determined to be a PRI without an individual determination by the U.S. Internal Revenue Service (‘IRS’). This will remain the case without either a blanket ruling by the IRS with such a qualification, the creation of an IRS approval process and roster of approved entities or an act of the U.S. Congress (which has not occurred as of the writing of this article.)” (footnotes omitted)).

114. *Program-Related Investing in L3Cs: A Question-and-Answer Guide*, 118 JTAX 41, 43 (2013) (“As an otherwise standard LLC for federal tax purposes, the L3C is by default either disregarded altogether (if it has a sole member) or is treated as a partnership (if there are two or more members).”).

115. See *supra* Part I.B.2.c.

were an LLC.<sup>116</sup> For federal tax purposes, LLCs have been treated as partnerships under federal income tax law since 1997.<sup>117</sup> Because LLCs allow for “pass-through” taxation, businesses themselves are not subject to federal taxation on their income; rather, the profits and losses are assigned to each member for taxation at that member’s tax status.<sup>118</sup>

#### 4. Public Disclosure of Material Non-Financial Information

No obligation exists for L3Cs to provide additional non-financial disclosures to investors that relate to the low-profit mission of the enterprise.<sup>119</sup>

#### 5. L3Cs and Protectionism

Vermont’s enacted the first L3C legislation in 2008, and North Carolina followed suit in 2010.<sup>120</sup> Examining the L3C movement in North Carolina provides context for analyzing some SEL. Bob Lang, who drafted Vermont’s model L3C legislation, also lobbied North Carolina’s politicians in hopes of enacting L3C legislation in the name of “rescu[ing] [the state’s] flailing furniture industry” from offshoring domestic jobs to China.<sup>121</sup>

While enacting laws in the name of protectionism may enable politicians to score re-election votes in their respective districts,<sup>122</sup> government’s protectionist interference can materially harm both the domestic and global economies’ long-run production possibilities frontiers.<sup>123</sup> Although both Presidents George W. Bush and Barack Obama

116. See Reiser, *Governing and Financing*, *supra* note 109, at 623 (stating that “the L3C relies heavily on the tax treatment of LLCs to produce its desired effects.”).

117. *Id.*

118. *Id.* at 623-24 (describing the taxation procedure for LLCs and L3Cs).

119. VT. STAT. ANN. tit. 11, § 3001(27) (2012).

120. See David L. Kyger & Dianne Chipps Bailey, *The L3C: North Carolina’s Newest Type of Entity*, N.C. BAR ASSOC. (Nov. 4, 2010), <http://businesslaw.ncbar.org/newsletters/nbinov2010/lc3inncc>; see also N.C. GEN. STAT. § 57C-2-01(d) (2010) (codifying legislation providing for the new form of business entity).

121. *An Overview of Low-profit Limited Liability Companies*, ISSUE BRIEF 2011-210 (The Fla. Senate Comm. on Commerce), 2010, at 8, available at <http://www.flsenate.gov/Committees/InterimReports/2011/2011-210cm.pdf>.

122. Daniel J. Gifford, *The Robert E. Hudec Article on Global Trade and Tensions*, 15 MINN. J. INT’L L. 297, 298-99 (2006) (stating that “[b]ecause business firms in adversely-affected industries are more likely to be organized than consumers, they are more likely to be able to exert political pressures on government decision makers.”); Gerald Willmann, *Why Legislators are Protectionists: the Role of Majoritarian Voting in Setting Tariffs* (2005), available at <http://willmann.com/~gerald/pe-trade.pdf>. (discussing the election of protectionist legislators).

123. See, e.g., John Cirace, *When Judges Balance Interests Through Trade-offs, They*

employed protectionism to advance a government-sponsored bailout of two U.S. automakers in 2008-09,<sup>124</sup> by 2012, President Obama ostensibly had distanced himself from protectionist policies.<sup>125</sup>

Further, the orthodox Ricardian, Neo-Ricardian, and Sraffian economic theories demonstrate how protectionism is generally socio-economically harmful.<sup>126</sup> These theories posit that when a given economy focuses resources where it has a comparative productivity advantage over another economy or economies, long-term socially beneficial economic activity results.<sup>127</sup> Empirical studies support the theory that comparative advantage economies tend to perform better than those adopting

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*Implicitly Use Economic Theory to Order Cases*, 74 U. DET. MERCY L. REV. 27 app. at 55-57 (detailing the trade-offs faced by an economy through the elaboration of the production possibility frontier); Christopher R. Leslie, *Achieving Efficiency Through Collusion: A Market Failure Defense to Horizontal Price Fixing*, 81 CALIF. L. REV. 243, 268 n.169 and accompanying text (1993) (describing production possibilities frontiers and Pareto-efficient solutions).

124. Emergency Economic Stabilization Act of 2008, H.R. 1424, 110th Cong. § 101(a) (2008); see also David Groshoff, *The New Meaning of Public Company: Challenges to the Government's Post-Bailout Exit as a Corporate Stakeholder*, 34 OKLA. CITY U. L. REV. 179, 179 (2009) [hereinafter Groshoff, *New Meaning of Public Company*] (arguing that material government interventions benefitted the flow of capital to one company, instead of other companies and industries in greater need of that capital, such as the automotive industry that ultimately received a government bailout). For full disclosure regarding this Author's relationship with JPMorgan, see Groshoff, *Junkholder Primacy*, *supra* note 6, at 94 n.182.

125. Specifically, during a presidential debate, President Obama told former Massachusetts Governor Mitt Romney,

You mentioned [not wanting to make cuts to] the Navy . . . and that we have fewer ships than we did in 1916. Well, Governor, we also have fewer horses and bayonets, because the nature of our military's changed . . . . We have these things called aircraft carriers, where planes land on them. We have these ships that go underwater, nuclear submarines.

*Third Presidential Debate: Full Transcript*, ABC NEWS (Oct. 23, 2012)

<http://abcnews.go.com/Politics/OTUS/presidential-debate-full-transcript/story?id=17538888&singlePage=true>; see also *Debate Quote: Obama on the*

*Changing Nature of the Military* – “We have Fewer Horses and Bayonets” than we did in 1916, FOX NEWS INSIDER (Oct. 22, 2012, 10:21 PM),

<http://foxnewsinsider.com/2012/10/22/debate-quote-obama-on-the-changing-nature-of-the-military-we-have-fewer-horses-and-bayonets-than-we-did-in-1916/>.

126. See Ndiva Kofele-Kale, *The Principle of Preferential Treatment in the Law of Gatt: Toward Achieving the Objective of an Equitable World Trading System*, 18 CAL. W. INT'L L.J. 291, 316 & n.131 (1988) (describing Ricardo's doctrine of comparative advantage); DAVID RICARDO, *ON THE PRINCIPLES OF POLITICAL ECONOMY, AND TAXATION* (Dover Publications 2004) (1817) (describing the Ricardian and Neo-Ricardian economic theories); PIERO SRAFFA, *PRODUCTION OF COMMODITIES BY MEANS OF COMMODITIES: PRELUDE TO A CRITIQUE OF ECONOMIC THEORY* (Cambridge Univ. Press 1975) (describing the Sraffian economic theory).

127. D. Russell Roberts, *When does a decrease in distortion increase welfare?*, 39 ECONOMICS LETTERS 37, 37-42 (1992).

protectionist measures;<sup>128</sup> that open, multilateral trade stimulates global economic development; and that “trade barriers . . . and other trade-distorting measures” are of particular concern to developing countries.<sup>129</sup>

Protectionism—the underpinning of some SEL—thus helps prolong an economy’s comparative disadvantage by constricting the expansion of domestic and international production possibilities frontiers.<sup>130</sup>

## 6. Opposition from Generally Well-Regarded Groups

Advocates of L3C statutes have faced high-profile opposition. For example, in May 2012, the New York Council of non-profits wrote to the New York legislature, arguing that “L3C’s are an alternative path to charities or profiteers who seek to avoid public scrutiny and appropriate regulatory, oversight including executive compensation.”<sup>131</sup> Other non-profits also have opposed the L3C structure. The managing attorney of The Law Firm for Nonprofits, PC, recently wrote that “it is unclear what function an L3C serves other than that ‘it creates the illusion of value.’”<sup>132</sup>

The ABA’s Business Law Section reflects a similar skepticism towards L3Cs.<sup>133</sup> It states that the tranching<sup>134</sup> related to PRIs

128. See, e.g., WORLD DEVELOPMENT REPORT, WORLD BANK, (1987) (reviewing the periods 1963-73 and 1973-85 of developing economies such as Ghana); Nancy Birdsall et. al, *How to Help Poor Countries*, 84 FOREIGN AFF. 136, 147 (2005) (“Wealthy nations can also take positive steps to directly benefit developing countries—specifically, by . . . enhancing global labor mobility.”).

129. U.N. Gen. Assembly, Preparatory Comm. for the Int’l Conference on Fin. for Dev., Fourth Session, Agenda item 3, Finalization of the Outcome of the Int’l Conference on Fin. for Dev., Paragraphs 26, 28, at 6-7, U.N. Doc. A/AC.257/L13 (Jan. 30, 2002).

<sup>130</sup> A production possibility frontier is “the set of Pareto optimal points at which there can be no more of A without having less of B.” William W. Bratton & Michael L. Wachter, *Shareholders and Social Welfare*, 36 SEATTLE U. L. REV. 489, 499 (2013).

131. Memorandum of Opposition from Doug Sauer, CEO of N.Y. Council of Nonprofits, Inc. (NYCON) to Members of the N.Y. State Legislature (May 15, 2012), available at <http://www.nycon.org/news/newsDetails.asp?newsid=401>. Cf. *infra* Part II.D (detailing B Lab’s social entrepreneurship activities).

132. Arthur Rieman et al., *California’s New Hybrid Corporation Statute*, L.A. LAWYER 19 (Sept. 2012) (quoting Matthew Doeringer, *Reevaluating the L3C: Mistaken Assumptions and Potential Solutions*, in PHILANTHROPY, VOLUNTARISM, AND NOT-FOR-PROFIT MGMT. 15 (Duke Univ., 2010), available at <http://ssrn.com/abstract=1696267>).

133. See Letter and Attachments from Linda Rusch, Chair ABA Bus. Law Section, to Steve Simon, H. Minority Leader, Minn. H. of Rep. (Apr. 19, 2012), available at <http://open.wmitchell.edu/cgi/viewcontent.cgi?article=1228&context=facsch> (stating the ABA Business Law Section’s views on a bill relating to limited liability companies and low-profit limited liability companies). The date of this letter is the same date that a proposed tax regulation relative to L3C’s appeared in the Federal Register. *Examples of Program Related Investments*, 77 Fed. Reg. 2012-9468 (Apr. 19, 2012), available at <http://www.gpo.gov/fdsys/pkg/FR-2012-04-19/html/2012-9468.htm>.

134. L3C’s tranching is highly quantitative, and is beyond this Article’s scope.

under the I.R.C. yet “promoted by L3C advocates portend[] serious risk” of benefitting for-profit investors’ private interests, which can “imperil a [charitable] foundation’s tax-exempt status.”<sup>135</sup> The ABA’s Business Law Section concludes that, relative to PRIs and charitable foundations, “[t]he L3C is no better than any other business form . . . [and] L3C legislation implies otherwise and we believe is therefore misleading.”<sup>136</sup>

## B. FPCs

### 1. History

California became the first state to enact FPC legislation.<sup>137</sup> So far, it is the only state to do so.<sup>138</sup>

### 2. Governance

FPC directors may consider the best interests of the corporation, its equity holders, and any special purpose interest set forth in the corporate charter.<sup>139</sup> This language does not materially differ from the language used in *Dodge v. Ford Motor Co.*,<sup>140</sup> where a Michigan court indicated that directors of a corporation must primarily focus on shareholder interests; nor does the language materially differ from California’s statutory regime for traditional corporations, which similarly states that management must focus primarily on shareholder interests.<sup>141</sup> Constituency statutes enacted in a majority of states permit—but do not mandate—directors to consider non-shareholder interests.<sup>142</sup>

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It is the subject of a work-in-progress.

135. Daniel S. Kleinberger, *ABA Business Law Section, on Behalf of Its Committees on LLCs And Nonprofit Organizations, Opposes Legislation for Low Profit Limited Liability Companies (L3Cs)*, (Wm. Mitchell Coll. of Law Faculty Scholarship, paper 228, 2012), available at <http://open.wmitchell.edu/facsch/228>.

136. *Id.* (emphasis added).

137. CAL. CORP. CODE § 2700(a) (West 2012); Rieman et al., *supra* note 132, at 19.

138. Rieman et al., *supra* note 132, at 19.

139. CAL CORP. CODE § 2700(a) (West 2012).

140. 170 N.W. 668, 684 (Mich. 1919); See Jonathan Romiti, Note, *Playing Politics with Shareholder Value: The Case for Applying Fiduciary Law to Corporate Political Donations Post-Citizens United*, 53 B.C. L. REV. 737, 738-39 (2012) (“Over ninety years after Dodge, [its] rationale still resonates in American corporate law today. Although modern corporate law rules are extremely deferential to the discretion of corporate management, most courts still require that board decisions be made with the best interests of shareholders in mind.”).

141. CAL. CORP. CODE § 309(a) (West 2012).

142. Discussing the various nuances of constituency statutes are beyond this Article’s scope. For a brief explanation of constituency statutes, see Anthony Bisconti, Note and Comment, *The Double Bottom Line: Can Constituency Statutes Protect Socially*

Assuming, however, that the FPC language does permit management to focus on other stakeholder interests, then the language used in California's statute further reduces fiduciary obligations owed to business owners. I posit that this reduction in obligation will drive capital to the higher-yielding corners of the corporate debt markets, where investors can contract for the rights and governance restrictions they want, or that investors will move their corporate-invested capital to international equities subject to stronger fiduciary-like duties than those that exist in the U.S.<sup>143</sup>

### 3. Purpose

In California, an FPC's charter must identify a public benefit purpose.<sup>144</sup> That purpose may include charitable or public purpose activities, or it may consist of promoting or minimizing bad effects of the FPC's operations on the employees, suppliers, customers, creditors, community, society, or environment.<sup>145</sup> Most directors of entities owe their stakeholders, at a bare minimum, a duty of loyalty; FPC directors, however, owe no such duties.<sup>146</sup> Controlling and extracting equity can be quite challenging for FPC investors.

Confusion exists as to which business organizations in California indeed are FPCs. A quick comparison of FPCs listed on the California Secretary of State's website,<sup>147</sup> for example, demonstrates how differently organizations construe the public benefit requirement. Ontario, California's "Charity Thrift FPC" incorporated as an FPC on October 26, 2012,<sup>148</sup> "Generosity Holdings" incorporated as an FPC on November 29, 2012,<sup>149</sup> "Giga Solar" incorporated as an FPC on April 6, 2012,<sup>150</sup> "Real Asset Investment Services, FPC" on October 29, 2012,<sup>151</sup> and perhaps the most

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*Responsible Corporations Stuck in Revlon-Land?*, 42 LOY. L.A. L. REV. 765, 780 (2009) ("Constituency statutes essentially permit directors to consider, to varying degrees, nonshareholder interests when making corporate decisions. At least on their face, constituency statutes provide a legislative alternative to the developing case law originating in the ever-influential Delaware courts.").

143. See, e.g., Groshoff, *Junkholder Primacy*, *supra* note 6, *passim* (discussing the competing theories of corporate governance and fiduciary duties).

144. CAL. CORP. CODE § 2602(b)(2) (West 2012).

145. *Id.*

146. *Id.* at §§ 2603(10) (permitting a flexible purpose corporation's articles of incorporation to contain provisions limiting or eliminating personal liability of a director in a breach of fiduciary duty action).

147. *Business Search*, CAL. SECRETARY OF ST. DEBRA BOWEN, <http://kepler.sos.ca.gov/cbs.aspx> (select "Entity Number"; type in the specific Entity Number; then select "Search") (last visited Nov. 24, 2013).

148. *Id.* (Entity Number "C3517785").

149. *Id.* (Entity Number "C3520963").

150. *Id.* (Entity Number "C3469924").

151. *Id.* (Entity Number "C3517755").

confusing of all, is “Vicarious FPC, Inc.,” incorporated on July 31, 2012.<sup>152</sup> That these entities “incorporated” as FPCs begs the question of what, exactly, they are, and if corporation or FPC law governs them.

#### 4. Taxation

Unlike L3Cs, FPCs cannot make a tax-treatment election, whether as a partnership, C-corp, S-corp, or otherwise.<sup>153</sup>

#### 5. Public Disclosure of Material Non-Financial Information

FPCs must disclose non-financial information in an annual report or “special purpose current report.” This report includes a specific Management Discussion and Analysis (“MD&A”) section addressing the objectives of and changes to the special purpose<sup>154</sup> and what the FPC did during the reporting period to materially achieve the special purpose.<sup>155</sup> California’s FPC statute requires several additional disclosures.<sup>156</sup> Any assessments of the FPC’s governance that might be disclosed in an annual report or “special purpose current report” may be conducted in-house and not by a third-party.<sup>157</sup>

### C. Benefit Corporations

#### 1. History

Using California as the example of how benefit corporations originated, Assembly Bill 361, which created benefit corporations, met vehement opposition from the Corporations Committee of the Business Law Section of the State Bar of California.<sup>158</sup> In a letter to Jared Huffman,

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152. *Id.* (Entity Number “C3492551”).

153. Steven R. Chiodoni & David A. Levitt, *Program-Related Investing in L3Cs: A Question-And-Answer Guide*, 1 J. TAX’N 42 (2013).

154. CAL. CORP. CODE §§ 3500, 3501 (West 2012).

155. CAL. CORP. CODE § 3501 (West 2012).

156. *Id.*

157. CAL. CORP. CODE §§ 3500, 3501 (West 2012) (requiring disclosure of certain governance aspects but neglecting to mention a requirement of preparation by an independent third party).

158. In the interest of full disclosure, while I attended some meetings of this Section as an Associate Member of the California State Bar Business Law Section, I possessed no voting rights, as my bar memberships are in New York, Ohio, and Massachusetts. In California I am a tentative Registered In-House Counsel.

member of the California State Assembly in 2011, the Committee expressed its disapproval of the bill. The bill was flawed, the Committee wrote, because “AB 361 *marginalize[d] shareholders, relie[d] on a third-party standard largely beneficial to one organization* [B Lab], [wa]s not well integrated into the existing Code, and fail[ed] to make benefit corporations easily recognizable to the public.”<sup>159</sup> Furthermore, as the California Bar indicated, it was “*unclear if directors of benefit corporations have duties to shareholders.*”<sup>160</sup>

Worse, the letter indicated that “[i]f directors only have a duty to the corporation and not to the shareholders and shareholders are just a factor that can be moved to the bottom of the list of priorities, it is unclear what effect this would have on shareholder rights to bring claims against directors.”<sup>161</sup> California’s benefit corporation SEL created statutory confusions in the Corporations Code ranging from defining unused terms to failing to define utilized terms (such as “equity”)<sup>162</sup> to referring to corporate entities that exist nowhere else in the California Corporations Code.<sup>163</sup> Certain definitions, however, merit sufficient importance to reproduce in this Article, particularly the definitions of a “general public benefit”<sup>164</sup> and a “specific public benefit.”<sup>165</sup>

A “[g]eneral public benefit” means a material positive impact on society and the environment, taken as a whole, as *assessed against a third-party standard*, from the business and operations of a benefit corporation.”<sup>166</sup> B Lab or its wholly owned subsidiary GIIRS, discussed *infra*, is the market leader in providing (and inventor of) the third-party standard.<sup>167</sup> This situation is unsurprising, given that B Lab, along with its acolytes, has pushed for SEL that drives revenues to B Lab for certifications.<sup>168</sup> The California statute, however, requires that a standard be developed by an entity with “no material financial relationship with the benefit corporation or any of its subsidiaries.”<sup>169</sup> Here the standard that certifiers must meet is the mere absence of a “material” relationship with

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159. Letter from Corp. Comm. of the Bus. Law Section of the State Bar of Cal. to the Hon. Jared Huffman, Member of the Assembly of the State of Cal. 2 (Apr. 26, 2011) (emphasis added) (on file with the University of Pennsylvania Journal of Business Law).

160. *Id.* at 2-3 (emphasis added).

161. *Id.* at Ex. A p. 8.

162. *Id.* at Ex. B, at 7 -8.

163. *Id.* at 1.

164. CAL. CORP. CODE § 14601(c) (West 2012).

165. CAL. CORP. CODE § 14601(e) (West 2012).

166. CAL. CORP. CODE § 14601(c) (West 2012) (emphasis added).

167. *See infra* Part II.D.

168. *See GIIRS Terms and Conditions*, GIIRS, <http://www.giirs.org/component/content/article/117> (last visited Oct. 26, 2013).

169. CAL. CORP. CODE § 14601(g) (West 2012).

the benefit corporation.<sup>170</sup>

California's benefit corporation legislation defines a "specific public benefit" as:

Providing low-income or underserved individuals or communities with beneficial products or services.

Promoting economic opportunity for individuals or communities beyond the creation of jobs in the ordinary course of business.

Preserving the environment.

Improving human health.

Promoting the arts, sciences, or advancement of knowledge.

Increasing the flow of capital to entities with a public benefit purpose.

The accomplishment of any other particular benefit for society or the environment.<sup>171</sup>

These definitions of "specific public benefit" are extremely vague, and challengers may seek to clarify them through otherwise needless litigation.

## 2. Governance

Professor Daniel Kleinberger argues that "if the board at [a benefit corporation] falls down on its job, it might be able to point to ill-defined 'social benefits' to escape liability for its actions."<sup>172</sup> Kleinberger notes that "[o]ne of the best ways to rip people off is to tell them that you're working for the good of God or the good of the environment or the good of whatever . . . ."<sup>173</sup>

Benefit corporation owners may bring a benefit enforcement proceeding against the benefit corporation.<sup>174</sup> The directors of benefit corporations must consider the probable effects of an enforcement proceeding on third-party stakeholders, but those stakeholders do not have legal standing to instate such proceedings themselves. A benefit enforcement proceeding may either be brought directly by the benefit corporation itself, or derivatively by a shareholder.<sup>175</sup> Such proceedings may also be maintained by a director, a person or group of persons who own more than five percent of the equity interests in an entity of which the

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170. CAL. CORP. CODE § 14601(g)(2) (West 2012).

171. CAL. CORP. CODE § 14601(e) (West 2012).

172. Matt Sledge, *Benefit Corporations Aim to Help Capitalism Save Itself*, HUFFINGTON POST (Feb. 22, 2013, 6:28 PM), [http://www.huffingtonpost.com/2012/06/27/benefit-corporations-patagonia-greyston-bakery\\_n\\_1632318.html](http://www.huffingtonpost.com/2012/06/27/benefit-corporations-patagonia-greyston-bakery_n_1632318.html). For full disclosure, I currently serve as a regular columnist for *The Huffington Post*.

173. *Id.* (quoting Professor Kleinberger).

174. CAL. CORP. CODE § 14623 (West 2012).

175. CAL. CORP. CODE § 14623(b) (West 2012).

benefit corporation is a subsidiary, or other persons specified in the benefit corporation's charter or bylaws.<sup>176</sup>

Even if an enforcement proceeding occurs against a benefit corporation, the benefit corporation likely will not receive more than a proverbial slap on the wrist.<sup>177</sup> If non-shareholder stakeholders are harmed to the benefit of shareholders, then shareholders likely would forego any enforcement of the public benefit and instead seek increased returns by having the company emphasize profits over any social benefit.<sup>178</sup>

The fiduciary duties imposed on a benefit corporation's board of directors differ from the duties imposed by the shareholder primacy doctrine. In the event of the auction sale of a business following a hostile takeover attempt, however, "[t]he duty of the board [will] thus change[] from the preservation of . . . [the] corporate entity to the maximization of the company's value at a sale for the stockholders' benefit."<sup>179</sup> The duties language advanced by entrepreneurs opposes *Revlon*, insisting that consideration of non-shareholder interests

shall not, absent another breach, be construed as a breach of a Director's fiduciary duty of care, even in the context of a Change in Control Transaction where, as a result of weighing other Stakeholders' interests, a Director determines to accept an offer, between two competing offers, with a lower price per share.<sup>180</sup>

### 3. Purpose

California Corporations Code § 14602 requires that a benefit corporation's charter state that "the corporation is a benefit corporation" and that it "identify any specific public benefit adopted pursuant to Section 14610."<sup>181</sup> However, the charter also must include a purpose statement per § 202(b), which requires a purpose consistent with the California Corporate

176. CAL. CORP. CODE § 14623(b)(West 2012).

177. See CAL. CORP. CODE § 14623(c) (West 2012) (stating that "[a] benefit corporation shall not be liable for monetary damages under this part for any failure of the benefit corporation to create a general or specific public benefit.").

178. See Reiser, *Governing and Financing*, *supra* note 109, at 613 (explaining that, if a benefit corporation neglects to fulfill its social mission, shareholders stand to benefit. Therefore, shareholders are unlikely to enforce the social mission).

179. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).

180. See Steven J. Haymore, *Public(ly Oriented) Companies: B Corporations and the Delaware Stakeholder Provision Dilemma*, 64 VAND. L. REV. 1311, 1322 (2011) (quoting *Corporation Legal Roadmap*, CERTIFIED B CORP., <http://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/legal-roadmap/corporation-legal-roadmap> (last visited Nov. 24, 2013) (explaining how the language of Certified B Corporations' charters vitiates the ruling in *Revlon*)).

181. CAL. CORP. CODE § 14602 (West 2012).

Code.<sup>182</sup> As a result, there is unnecessary and meaningful statutory tension between these two sections.<sup>183</sup>

#### 4. Treatment by Municipalities

San Francisco's City Council amended the San Francisco Administrative Code to provide an incentive for California benefit corporations that bid on city contracts.<sup>184</sup> The bid preferences give benefit corporations "additional points in a graded system the city uses for bidding contracts."<sup>185</sup> Benefit corporations also receive a four percent discount on their bids from San Francisco, such that benefit corporations must receive public contracts when the difference in bid price between a benefit corporation and another business organization is less than four hundred basis points.<sup>186</sup> Philadelphia has considered similar legislation to provide discounts and incentives to benefit corporations bidding on public contracts within the city.<sup>187</sup>

#### 5. Scalability

The scalability of benefit corporations is likely the entrepreneurs' end-game and explains why the entrepreneurs targeted an economy as large as California, followed by the benefit corporation SEL in Delaware. Once Delaware began offering public benefit corporations on August 1, 2013, the door to managers of scaled and publicly traded entities swung wide open. The resulting lack of shareholder control rights in theory will usher in the age of "empty shareholders."

#### 6. Public Disclosure of Material Non-Financial Information

California benefit corporations must provide certain non-financial information to remain a benefit corporation.<sup>188</sup> Yet nothing currently

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182. CAL. CORP. CODE § 202(b) (West 2012).

183. Keith P. Bishop, *Forming a Benefit or Flexible Purpose Corporation? Some Pitfalls to Avoid*, CAL. CORP. & SEC. L. BLOG (Feb. 13, 2012), <http://calcorporatelaw.com/2012/02/forming-a-benefit-or-flexible-purpose-corporation-some-pitfalls-to-avoid/>.

184. S.F., CAL., ADMINISTRATIVE CODE ch. 14C (2012).

185. Mark Hrywna, *Benefit Corporation in California Meets Chill in San Francisco*, THE NONPROFIT TIMES (March 23, 2012), <http://www.thenonprofitimes.com/news-articles/benefit-corporation-in-california-meets-chill-in-san-francisco/>.

186. S.F., CAL., ADMINISTRATIVE CODE § 14C.3 (2012).

187. See *Blending Profit and Purpose: The Future of Hybrid Organizations*, NONPROFIT LAW BLOG, <http://www.nonprofitlawblog.com/home/2013/10/blending-profit-and-purpose-the-future-of-hybrid-organizations.html> (last visited Nov. 24, 2013).

188. CAL. CORP. CODE § 14630(a)(2) (West 2012).

prevents corporations from already providing this additional information, and several corporations already provide this information.<sup>189</sup>

#### D. B Lab Certified B Corps

This subpart (1) suggests that the entrepreneurs behind SEL and that Certified B Corporations may not have been honest in their dealings with investors, legislators, and other stakeholders, and (2) deconstructs and refutes numerous of the entrepreneurs' spurious claims. This subpart concludes that while social enterprise may possess legitimate goals, SEL is a result of entrepreneurial marketing and brand management that appeals to unsophisticated equity investors.

##### 1. History

SEL benefit corporations may be confused with unlegislated entities that claim to be "Certified B Corporations" and "Certified Benefit Corporations," by virtue of having obtained B Lab's certification. For example, Professor Linda O. Smiddy indicates that Vermont had passed legislation applicable to two types of social enterprise, (1) the L3C and (2) "what is called the benefit corporation (the 'B Corporation' or 'B Company')," and cites B Lab's website as the authority for Vermont having "enact[ed] B Corporation or B Company legislation."<sup>190</sup>

##### 2. Governance

The legal status governing a Certified B Corporation remains static, regardless of whether the corporation has a B Lab certification. Yet B Lab indicates that its governance and structure is the same as that of its potential clients.<sup>191</sup> B Lab's website appears to push the *Citizens United* envelope as

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189. David Monsma & Timothy Olson, *Muddling Through Counterfactual Materiality and Divergent Disclosure*, 26 STAN. ENVTL. L.J. 137, 161 (2007) ("[T]oday many of the world's largest companies produce social, environmental, or sustainability reports . . . in addition to their financial reports.") (internal quotations omitted).

190. Linda O. Smiddy, *Corporate Creativity: The Vermont L3C & Other Developments in Social Entrepreneurship*, 35 VT. L. REV. 3, 3 & n.2 (2010). *But see Legislation*, Certified B Corporation (last visited Dec. 8, 2013), <http://www.bcorporation.net/what-are-b-corps/legislation> (discussing the difference between Benefit Corporations and Certified B Corporations).

191. *See Term Sheet for B Corporations*, [http://www.bcorporation.net/sites/all/themes/adaptivetheme/bcorp/pdfs/term\\_sheet\\_constituency\\_states\\_llcs\\_llps\\_3.pdf](http://www.bcorporation.net/sites/all/themes/adaptivetheme/bcorp/pdfs/term_sheet_constituency_states_llcs_llps_3.pdf) (stating that "B Lab is governed by an independent Board of Directors").

far as one can take the proposition for which that case stands.<sup>192</sup> Indeed, the website often refers to a B Corporation's "DNA," stating, for example, that "[t]he value of meeting the legal requirement for B Corp certification is that it bakes sustainability into the DNA of your company as it grows, brings in outside capital, or plans succession, ensuring that your mission can better survive new management, new investors, or even new ownership."<sup>193</sup> Furthermore, B Lab is a 501(c)(3) non-profit,<sup>194</sup> a status applied to entities that typically cannot lobby.<sup>195</sup> B Lab's pride in lobbying and assisting to pass SEL, however, goes so far as to include posted photos and names of candidates helpful to B Lab's cause throughout its website.<sup>196</sup>

### 3. Purpose

B Lab's attempts to create legislation that will coerce entities to pay funds to B Lab for legally questionable certification tools. There is little doubt that B Lab is marketing an undefined notion of social enterprise. Indeed, the background of some of its highest ranking employees, such as Dermot Hikisch, includes marketing.<sup>197</sup> Similarly, B Lab markets social

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192. *Citizens United* is the well-known 2010 decision in which the Supreme Court stated that corporations are persons for purposes of free speech protection under the First Amendment to the U.S. Constitution and that, therefore, a federal statute prohibiting independent corporate expenditures for electioneering communications violated the Constitution. *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310, 365-67 (2010). Roger Colinvaux indicates the concerns of applying *Citizens United* to charitable organizations. Roger Colinvaux, *The Political Speech of Charities in the Face of Citizens United: A Defense of Prohibition*, 62 CASE W. RES. L. REV. 685, 686-87 (2012) (Stating that "[t]he rule that charitable organizations may not 'participate in, or intervene in . . . any political campaign' is hardly a secret. Since its introduction as part of the Internal Revenue Code in 1954, section 501(c)(3)'s 'Political Activities Prohibition,' as it is often called, has been the subject of considerable scholarly debate, practical concern, and occasional political wrangling. Although the contours of the rule may be imprecise, and enforcement by the IRS uneven—resulting in frustration for some—arguably the rule has stood the test of time. Like it or not, understand it or not, it is an embedded characteristic of the charitable sector that charity and political activity are by law incompatible.").

193. *Protect Your Mission*, Certified B Corp., <http://www.bcorporation.net/become-a-b-corp/why-become-a-b-corp/protect-your-mission> (last visited December 5, 2013).

194. *Powered by B Lab*, GIIRS, <http://giirs.org/powered-by-b-lab> (last visited Nov. 24, 2013).

195. I.R.C. § 501(c)(3) (2006); *but cf.* Rev. Rul. 07-41, 2007-1 C.B. 1421-26 (analyzing twenty-one factual situations and noting whether, in light of the facts, the organization is engaged in impermissible lobbying or other political campaign intervention).

196. *Passing Legislation*, CERTIFIED B CORP. <http://www.bcorporation.net/what-are-b-corps/legislation> (last visited Oct. 18, 2012) (web page since changed; original screen captures on file with author).

197. Dermot Hikisch is a former sustainability ambassador for Procter & Gamble. *Dermot Hikisch*, Sustainable Brands, <http://www.sustainablebrands.com/users/dermot-hikisch#>. Procter & Gamble has traditionally excelled in marketing. *See e.g.*, Jack Neff, *How P&G Reshaped the Industry From Brand Management to Digital and Beyond: World's*

enterprise.

B Lab's website states that "[b]enefit corporations operate the same as traditional corporations but with higher standards of corporate purpose, accountability, and transparency."<sup>198</sup> Not only has federal taxpayer money funded B Lab,<sup>199</sup> but B Lab has used that federal funding to support and certify as "B Corporations" some controversial entities. For example, Berkeley Patients Group is a medical marijuana dispensary in Berkeley and a Certified B Corporation. By selling medicinal marijuana, it violates federal criminal law.

#### 4. Taxation

Because B Lab is a 501(c)(3) nonprofit entity, B Lab receives federal tax benefits currently unavailable to any entity created under SEL.<sup>200</sup>

#### 5. Public Disclosure of Material Non-Financial Information

B Lab is structured as a traditional non-profit entity and not an entity created under SEL, even though it would qualify under California's benefit corporation statute.<sup>201</sup> As a result, the sole public disclosure that B Lab must make is its Form 990 with the IRS.<sup>202</sup>

*Largest Advertiser Led the Way With Firsts in Radio, TV, and Tech*, ADVERTISING AGE (Oct. 29, 2012), <http://adage.com/article/special-report-pg-at-175/p-g-reshaped-industry/237994/>; *American Business, 1920-2000: How It Worked - P&G: Changing the Face of Consumer Marketing* (2000), Working Knowledge, <http://hbswk.hbs.edu/archive/1476.html> (last visited December 5, 2013).

198. *The Non-Profit behind B Corps*, CERTIFIED B CORP. (2013), <http://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps> (last visited Feb. 1, 2013) (web page since removed; original screen capture on file with author).

199. *See Our Funders*, CERTIFIED B CORP., <http://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps/1047> (last visited Nov. 24, 2013) (indicating that Certified B Corp. has received \$1 million in funding from the United States Agency for International Development, a federal government agency).

200. 26 U.S.C. § 501(c)(3) (2010); *see also* 26 U.S.C. § 501(a) (2010) (providing that an 501(c)(3) organization is exempt from income taxation).

201. *See The Non-Profit Behind B Corps*, CERTIFIED B CORP., <http://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps> (last visited December 5, 2013); *Practicing What We Preach*, CERTIFIED B CORP., <http://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps/practicing-what-we-preach> (last visited December 5, 2013).

202. B Lab Co., 2010 Return of Organization Exempt from Income Tax (Form 990) (June 7, 2011); B Lab Co., 2011 Return of Organization Exempt from Income Tax (Form 990) (June 13, 2012).

## 6. The Non-Scalability Myth

Contrepreneurs have claimed that social entrepreneurs cannot scale their businesses and look forward to the day when, under SEL, social enterprises can be scaled.<sup>203</sup> Multiple examples, however, challenge the conception that social entrepreneurs cannot scale their businesses under existing models. While the San Francisco Bay Area and Silicon Valley represent the West Coast's hub of innovation and entrepreneurship,<sup>204</sup> Boston and the Massachusetts Institute of Technology ("MIT") represent the East Coast's hub for innovation and entrepreneurship.<sup>205</sup> One part of MIT is its well-regarded D-Lab,<sup>206</sup> founded by Amy Smith<sup>207</sup> over a decade ago.<sup>208</sup> D-Lab helps foster impactful, community-related technologies<sup>209</sup> that attempt to explore and create "economically viable solutions through

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203. DVD: Incorporating Change Symposium (Hastings Business Law Journal 2012) 29:22–29:45 (on file with author).

204. See, e.g., *THE SILICON VALLEY EDGE: A HABITAT FOR INNOVATION AND ENTREPRENEURSHIP 2* (Chong-Moon Lee et al., eds. 2000) (claiming "the Silicon Valley edge stems from an entire environment, or habitat, honed for innovation and entrepreneurship.") (internal citation omitted).

205. See, e.g., Phil Budden, *Greater Boston: a world-class hub of entrepreneurship*, BOSTON.COM (Dec. 14, 2012, 11:00 AM), [http://www.boston.com/business/blogs/global-business-hub/2012/12/greater\\_boston.html](http://www.boston.com/business/blogs/global-business-hub/2012/12/greater_boston.html) (stating that "Greater Boston is extremely fortunate both to be home to institutions that train future entrepreneurs, attracting talent from around the world, and to have a wide range of entrepreneurs within the city region. MIT . . . and now Harvard (among many others) are systematically developing entrepreneurs, teaching them the skills to build new enterprises.").

206. *MIT Courses*, D-LAB (Jan. 19, 2013), <http://d-lab.mit.edu/>. I almost cringe at the likeness between the name D-Lab and B Lab, especially given that B Lab was not incorporated until December 4, 2006, after D-Lab's incorporation date. *Business Entity Filing History - B Lab Company*, PA. DEPT. OF ST., <https://www.corporations.state.pa.us/corp/soskb/corp.asp?2507035> (last visited Oct. 15, 2013).

207. See Sandy Pentland, *Amy Smith*, TIME (Apr. 29, 2010), [http://www.time.com/time/specials/packages/article/0,28804,1984685\\_1984745\\_1984806,0,0.html](http://www.time.com/time/specials/packages/article/0,28804,1984685_1984745_1984806,0,0.html) (describing Smith as one of TIME magazine's Top 100 people who affect the world); Pagan Kennedy, *Necessity is the Mother of Invention*, N.Y. TIMES MAG. (Nov. 30, 2003), <http://www.umsl.edu/~sauterv/analysis/creativity/30MIT.html> (describing Smith and her work).

208. D-Lab celebrated its 10<sup>th</sup> anniversary in 2011-12. *D-Lab's D-ecitennial (It's Our 10th Anniversary!)*, D-Lab (Nov. 23, 2011), <http://d-lab.mit.edu/news/general/d-labs-d-ecitennial-its-our-10th-anniversary> (last visited December 5, 2013).; see also David L. Chandler, *Bringing the World to Innovation: With up to \$25 million in new USAID funding, MIT's D-Lab will gain greater ability to help people in the developing world find their own solutions*, MIT NEWS (Nov. 8, 2012), <http://web.mit.edu/newsoffice/2012/going-inside-d-lab-at-mit-1108.html>.

209. See *About D-Lab*, D-LAB, <http://www.victorgrau.net/about> (last visited Nov. 24, 2013) (These technologies include "community water testing and treatment, clean-burning cooking fuels, post-harvest processing, pedal and human power production, medical devices for global health, mobility aids and physical rehabilitation.").

developmental entrepreneurship . . . and continually explores new models for scaling-up innovation and facilitating technology access.”<sup>210</sup>

The MIT and D-Lab February 2013 conference for growing social ventures included a panel and keynote address on the successful scaling of social enterprise.<sup>211</sup> The panel on scaling social enterprise featured “short presentations by [four established social entrepreneurs] about how they successfully scaled from a small enterprise to a medium enterprise to a large enterprise and what was different about those transition phases as well as what tools they used to make the process easier.”<sup>212</sup> The social enterprises that spoke at D-Lab regarding their scalability successes were d.light, Kopernik, SELCO, and Assure.<sup>213</sup> Given the reputations of MIT, D-Lab, and Ms. Smith, along with the opaque definitions of social enterprise and scalability, I assume that these entities are successfully scaled social enterprises, based on the advertising of the conference by MIT and D-Lab.<sup>214</sup> Of the five scaled entities presented at the 2013 Conference for Growing Social Investors by Amy Smith’s D-Lab at MIT, not one of these scaled social entrepreneurial enterprises needed SEL to achieve its success, and only one of those entities—and only within the past year—has been certified by B Lab.<sup>215</sup>

#### 7. The “Certified B Corporations” and GIIRS Ratings Myths

B Lab cannot give its “Certified B Corporations” legal status. Rather, B Lab merely serves as an external private certifier.<sup>216</sup> B Lab’s mission is to ensure that B Corps “meet rigorous standards of social and environmental performance, accountability, and transparency.”<sup>217</sup> B Lab has also analogized its function as being “what LEED certification is to

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210. *Id.*

211. *MIT Ideas Global Challenge: Scaling Development Ventures-2013 Schedule*, MIT, <http://globalchallenge.mit.edu/about/scalingdevventures/schedule> (last visited Nov. 8, 2013).

212. *Id.*

213. *Id.*

214. *Id.*

215. d.light was certified by B Lab in August 2012. *d.light design*, Certified B Corp., <http://www.bcorporation.net/community/dlight-design> (last visited December 5, 2013).

216. See Dana Brakman Reiser, *Benefit Corporations—A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591, 594 (2011) (“B Lab, of course, cannot confer a legal form on an organization. By varying governance structures and conveying information about conforming entities, however, B Corp status appeals to social enterprises . . .”).

217. *The Non-Profit Behind B Corps*, CERTIFIED B CORP., <http://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps> (last visited Oct. 26, 2013).

green building or Fair Trade certification is to coffee.”<sup>218</sup> While B Lab offers what it contends is an independent certification, in reality, companies are simply paying to license B Lab’s mark of certification.

Fee assessments become even more questionable when they relate to corporate law and finance. Contrepreneurs and legislators seem to have failed to learn from some of the major credit ratings agencies and their ratings of collateralized debt obligations (“CDOs”) immediately preceding the Great Recession.<sup>219</sup> Those credit rating agencies not only failed to serve their intended purpose but also subjected themselves to manipulation.<sup>220</sup> In addition, should an entity get on a rating agency’s bad side—even if that entity is the United States of America—the rating agency may spitefully downgrade it.<sup>221</sup>

Apparently, even the Better Business Bureau provides high ratings in return for cash and, conversely, low ratings to companies who would not pay.<sup>222</sup> For example, the Better Business Bureau rated the Walt Disney Company an “F,” but Hamas, an organization that the U.S. government has designated as a foreign terrorist organization from at least 2006 until July

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218. *Id.*

219. See, e.g., Arthur E. Wilmarth, Jr., *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis*, 41 CONN. L. REV. 963, 1026 (2009) (noting that, although investors in residential mortgage-backed securities relied on the credit ratings supplied by ratings agencies, these ratings were flawed because they were solicited by the underwriters creating the securities); see also Steven McNamara, *Informational Failures in Structured Finance and Dodd-Frank’s “Improvements to the Regulation of Credit Rating Agencies”*, 17 FORDHAM J. CORP. & FIN. L. 665, 694-97 (2012) (acknowledging the fact that conflicts of interest between ratings agencies and underwriters greatly exacerbated the scope and length of the financial crisis but arguing that flawed ratings models were perhaps the primary “germ of the ratings disaster”).

220. See, e.g., John W. Uhlein, *Breakdown in the Mortgage Securitization Market: Multiple Causes and Suggestions for Reform*, 60 SYRACUSE L. REV. 503, 515–518 (2010) (describing the conflict of interest arising from the influence of borrowers and issuers, who both paid the ratings agencies and received ratings of their products).

221. See, e.g., Bob Sullivan, *Was S&P downgrade an act of revenge?*, NBC NEWS (Aug. 9, 2011, 3:22 PM), [http://redtape.nbcnews.com/\\_news/2011/08/09/7321296-was-sp-downgrade-an-act-of-revenge?lite](http://redtape.nbcnews.com/_news/2011/08/09/7321296-was-sp-downgrade-an-act-of-revenge?lite) (examining whether the downgrade of U.S. Treasury debt by the credit rating agency S&P—despite no similar downgrade by the other two major rating agencies Moody’s and Fitch—was a vengeful act by S&P).

222. See Joseph Rhee, *Terror Group Gets ‘A’ Rating from Better Business Bureau?*, ABC NEWS (Nov. 12, 2010), <http://abcnews.go.com/Blotter/business-bureau-best-ratings-money-buy/story?id=12123843> (reporting on an accusation that the Better Business Bureau was engaged in a “pay for play” scheme in which A plus ratings [were] awarded to those who pa[id] membership fees, and F ratings used to punish those who d[idn’t]”); see also Letter from Richard Blumenthal, Attorney Gen. for the State of Conn., to Alan Cohen, Vice President and Gen. Counsel for the Council of Better Bus. Bureaus, (Nov. 10, 2010), available at <http://ctwatchdog.com/business/ct-attorney-general-threatens-legal-action-against-better-business-bureau> (expressing concern over Better Business Bureau’s rating practices).

2012,<sup>223</sup> secured an “A-” rating.<sup>224</sup> No reason exists to believe that B Lab would engage in more ethical behavior.

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223. *See, e.g.*, U.S. DEP’T OF STATE OFFICE OF THE COORDINATOR FOR COUNTERTERRORISM, COUNTRY REPORTS ON TERRORISM 2011 (2012) (designating an entity as a foreign terrorist organization only if it: (a) engages in terrorist activity as defined in (i) 8 U.S.C. § 1182(a)(3)(B), (ii) 22 U.S.C. § 2656f(d)(2), or (iii) retains the capability of, and intends to engage in, terrorism that threatens U.S. national security); U.S. DEP’T OF STATE OFFICE OF THE COORDINATOR FOR COUNTERTERRORISM, PUB. NO. 11324, COUNTRY REPORTS ON TERRORISM 2005 *passim* (2006) (mentioning Hamas as a terrorist organization).

224. *See* Rhee, *supra* note 2221 (questioning the authenticity of Better Business Bureau’s rating system); *see also* Letter from Richard Blumenthal, *supra* note 2221 (addressing concerns over Business Bureau’s rating practices).

## 8. B Lab Certification as “Inside-the-Box” Nontrepreneurial Thinking<sup>225</sup>

Former management consultant-turned-stand-up comedian Colm O’Regan employed the phrase “box-ticking exercise” to define post-Sarbanes-Oxley business actors who undertake “the motions of compliance . . . to get regulators off their back” that are otherwise meaningless. O’Regan likened this process to the computer-based training (“CBT”) courses that many businesses employ. Specifically, O’Regan stated:

[a]s anyone who has ever done a CBT will testify, the way to complete it is to not really ready anything. You just keep clicking ‘Next,’ and when it gets to the quiz bit, keep on re-taking the quiz until you get the questions right . . . And I suppose you might call that ‘thinking inside the box.’<sup>226</sup>

Similarly, B Lab’s computer-generated questionnaire, required of companies wishing to receive a B Corporation certification, represents a form of check-the-box behavior, which has led to recent material concerns regarding the vulnerability of corporate stakeholders relying on those certifications.<sup>227</sup>

To receive certification from B Lab, a benefit corporation must meet the performance requirement as set forth in the B Impact Assessment.<sup>228</sup> The B Impact Assessment addresses corporate accountability, transparency, compensation and wages for employees, corporate giving, and

225. Colm O’Regan, *Banking Black Hole* (BBC World radio broadcast Dec. 22, 2012), available at <http://www.bbc.co.uk/programmes/p0121841>.

226. *Id.*

227. *Compare B-Lab Self-Assessment*, CERTIFIED B CORP., [http://bcorp.nonprofitsoapbox.com/storage/documents/b\\_lab\\_self\\_assessment.pdf](http://bcorp.nonprofitsoapbox.com/storage/documents/b_lab_self_assessment.pdf) (last visited Oct. 26, 2013) (listing the factors for assessing a company under B Lab standards) with PICK N PAY, SUSTAINABLE LIVING REPORT 2010/2011 (2012), available at [http://www.picknpay-ir.co.za/downloads/2012/pick\\_n\\_pay\\_report.pdf](http://www.picknpay-ir.co.za/downloads/2012/pick_n_pay_report.pdf) (reporting the values of an African retailer company). See also Stephanie Clifford & Steven Greenhouse, *Fast and Flawed Inspections of Factories Abroad*, N.Y. TIMES, Sept. 1, 2013, at 1 (describing the many recent high grades that presaged global failures in “perfunctory ‘check-the-box’ audit[ing]” of ethics, labor and environmental conditions, and other stakeholder concerns relevant to social enterprise; yet describing how companies that monitor other enterprises have become a “booming business” in the past two decades, with several such companies’ share prices rising more than fifty percent in the past two years, thereby emphasizing a likely end-game for B Lab, and further quoting a Harvard researcher regarding third-party company audits: “It starts as a dream, then it becomes an organization, and it finally ends up as a racket”; and also quoting an executive at a nonprofit monitoring group: “[i]f it’s a check-the-box inspection, you better have the right boxes to look at . . .”).

228. *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 Oct. 26, 2013).

environmental impact.<sup>229</sup> The number of questions and weighting of responses depends upon the size and industry of the company and the assessment is estimated to take only sixty to ninety minutes to complete online.<sup>230</sup> The subject enterprise need only score eighty points out of two hundred to achieve B Lab's certification.<sup>231</sup> Short of the sport of baseball—where, for example, Boston Red Sox Hall of Fame left fielder Ted Williams maintained a career batting average of .344 and who remains the most recent player to achieve an over .400 average<sup>232</sup>—a forty percent success rate is rarely considered laudable, let alone worthy of certification.

Even after passing the B Impact Assessment and being granted a B Corp mark from B Lab, the Certified B Corp must pay to license the mark. B Lab uses a sliding scale based on the benefit corporation's annual sales, but certified B Corps may be forced to pay up to \$25,000 per year to use the B Corp certification.<sup>233</sup> B Lab's annual certification fees are as follows<sup>234</sup>:

BENEFIT CORPORATION'S ANNUAL SALES	ANNUAL LICENSE FEE
\$0 - \$1,999,999	\$500
\$2,000,000 - \$4,999,999	\$1,000
\$5,000,000 - \$9,999,999	\$2,500
\$10,000,000 - \$19,999,999	\$5,000
\$20,000,000 - \$49,999,999	\$10,000
\$50,000,000 - \$99,999,999	\$15,000
\$100,000,000+	\$25,000

229. *B-Lab Self-Assessment*, *supra* note 227.

230. *The B Impact Ratings System*, FOUND. CENTER, <http://trasi.foundationcenter.org/record.php?SN=29> (last visited Oct. 26, 2013).

231. See *How to Become a B Corp*, *supra* note 228 (describing how to earn the B Corp certification).

232. *Ted Williams Player Page*, BASEBALL-REFERENCE.COM, <http://www.baseball-reference.com/players/w/willite01.shtml> (last visited Oct. 26, 2013). A batting average of .344 means that the player averaged a hit 34.4 percent of the times he was at bat. The average baseball batting averages are between .250 and .270. *League by League Totals for Batting Average*, BASEBALL ALMANAC, <http://www.baseball-almanac.com/hitting/hibavg4.shtml> (last visited Jan. 20, 2013); see also Steve Goodman, *The Dying Cubs Fan's Last Request*, on AFFORDABLE ART (RED PAJAMAS RECORDS, 1979) (stating that "the law of averages says that anything will happen that can, but the last time [something happened in baseball occurred around] the year we dropped the bomb on Japan.").

233. *Make it Official*, CERTIFIED B CORP., <http://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/120> (last visited Oct. 26, 2013).

234. *Id.*

B Corp certification lasts for two years, and enterprises may recertify.<sup>235</sup>

Several factors raise legitimate questions as to whether B Lab should possess 501(c)(3) status. First, according to several sources, B Lab has been lobbying to pass legislation.<sup>236</sup> Yet a 501(c)(3) nonprofit generally cannot be used to achieve a political or legislative purpose.<sup>237</sup> How closely B Lab's activities comport with the permitted legislative lobbying permitted in the I.R.C. thus remains questionable.

Second, as indicated earlier, B Lab certified an entity that has openly violated federal drug laws for years.<sup>238</sup> Also, B Lab's position that certification and rating agencies provide social value raises a material question as to why B Lab itself, as a 501(c)(3) nonprofit, has failed to obtain the seal of approval from Guidestar.<sup>239</sup> As a result, B Lab appears hypocritical in believing that it itself does not need to obtain certifications when B Lab is actively pushing for legislation that mandates others to obtain such certifications.

Similar challenges exist in seeing the ratings benefit—or the nonprofit justification—relative to B Lab's wholly owned subsidiary GIIRS, which provides social benefit ratings. B Lab includes a link to GIIRS on its “Attract Investors” webpage.<sup>240</sup> B Lab describes GIIRS as a “[d]isregarded [e]ntity” in Schedule R to B Lab's 2012 Form 990 IRS filing, a public

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235. *Id.*

236. See Steven Munch, *Improving the Benefit Corporation: How Traditional Governance Mechanisms can Enhance the Innovative New Business Form*, 7 NW. J. L. & SOC. POL'Y 170, 185 (2012) (mentioning B Lab's continuous efforts to lobby for legislation); *Maryland First State in Union to Pass Benefit Corporation Legislation*, CRS WIRE (Apr. 14, 2010, 10:57 AM), [http://www.csrwire.com/press\\_releases/29332-Maryland-First-State-in-Union-to-Pass-Benefit-Corporation-Legislation#](http://www.csrwire.com/press_releases/29332-Maryland-First-State-in-Union-to-Pass-Benefit-Corporation-Legislation#); Sledge, *supra* note 172.

237. I.R.C. § 501(c)(3) (2006).

238. See *Berkeley Patients Group B Impact Report*, (Sept. 9, 2009), <http://old.bcorporation.net/index.cfm/fuseaction/company.report/ID/6d7aa0c6-866d-4677-810d-e10bf89fe84c> (giving the 2009 rating for Berkeley Patients Group, a company that produces medical cannabis, a schedule 1 drug under 21 U.S.C. § 812(b)(1)(C) (2006) for which “[t]here is a lack of accepted safety for use of the drug or other substance under medical supervision”). Potential First Amendment issues aside, any questions concerning whether 501(c)(3) entities should carry a charitable federal tax status while generating revenues from funds derived from the sale of federally illegal drugs is beyond this Article's scope. For more on the conflict between federal and state law relative to this issue, see Jared Willis, *The Hazy Cloud Engulfing Cultivation, Possession, and Transportation of Aggregate Amounts of Collectively Cultivated Medical Marijuana Pursuant to California Health and Safety Code Section 11362.775*, 40 WASH. ST. U. L. REV. 135 (2013).

239. GuideStar rates 501(c)(3)s. *B-Lab Company*, GUIDESTAR, <http://www.guidestar.org/organizations/20-5958773/b-lab-company.aspx> (last visited Oct. 26, 2013).

240. *Attract Investors*, CERTIFIED B CORP., <http://www.bcorporation.net/become-a-b-corp/why-become-a-b-corp/attract-investors> (last visited Oct. 26, 2013) (providing that B Corps receive free GIIRS ratings).

document required of all 501(c)(3) entities.<sup>241</sup> And GIIRS—directly controlled by B Lab—states in section 1.13 of the massive disclaimers and warnings on its website entry page:

[R]atings . . . are statements of opinion . . . and not statements of fact or recommendations to . . . make any investment decisions. The GIIRS Parties assume no obligation to update the Content following publication in any form or format. *The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients*<sup>242</sup> when making investment and other business decisions. *The Content is for informational purposes* and . . . GIIRS's opinions and analyses do not address the suitability of any security . . . . GIIRS does not act as a fiduciary . . . . *GIIRS does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.*<sup>243</sup>

Also of interest is the fact that only four law firms included by B Lab as impliedly an approved B Corp is Hanson Bridgett, LLP. Attorney Jonathan Storper's of Hanson Bridgett helped pass California's Benefit Corporation statute.<sup>244</sup> Material hosted on B Lab's website at one time regarding Hanson Bridgett stated,

we are not only fulfilling our responsibility as lawyers; we are doing our part to create a more sustainable world. [Our B Lab certified clients] are diligently engaged to make improvements in the following areas: Clean Technologies; Socially Responsible Investing . . . . Hanson Bridgett LLP is offering a 10% discount off our rates to help our fellow B Corporations with their legal issues.<sup>245</sup>

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241. B Lab 2011 Return of Organization Exempt From Income Tax (Sched. R to Form 990) (June 13, 2012), *available at* [http://990s.foundationcenter.org/990\\_pdf\\_archive/205/205958773/205958773\\_201112\\_990.pdf](http://990s.foundationcenter.org/990_pdf_archive/205/205958773/205958773_201112_990.pdf). A “disregarded entity” means that the parent organization—in this case, B Lab—is the sole member in an LLC. Thus, the LLC is a wholly owned subsidiary. *Single Member Limited Liability Companies*, IRS, <http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Single-Member-Limited-Liability-Companies> (last visited Oct. 26, 2013).

242. These entities seem to be stakeholders, not stockholders.

243. *GIIRS Terms and Conditions*, *supra* note 168 (emphasis added).

244. *Interview: Jonathan Storper, Partner at Hanson Bridgett LLP and Involved in Passage of CA Benefit Corporation Legislation*, INNOV8SOCIAL (March 13, 2013), <http://www.innov8social.com/2013/03/interview-jonathan-storper-partner-at.html>.

245. *10% Discount for B Corporations*, CERTIFIED B CORP., [http://bcorp.nonprofitsoapbox.com/storage/documents/ServicePartners/HansonBridgett\\_B\\_Corp\\_offer.pdf](http://bcorp.nonprofitsoapbox.com/storage/documents/ServicePartners/HansonBridgett_B_Corp_offer.pdf) (cached version last visited Oct. 16, 2013) (accessed by searching for “Hanson 10% Discount for B Corporations” in Google and viewing cached version); *Hanson Bridgett LLP*, CERTIFIED B CORP., <http://www.bcorporation.net/community/hanson-bridgett-llp> (last visited Oct. 16, 2013).

Interestingly, Hanson Bridgett also claims to be “*uniquely qualified* to serve clients of all sizes to . . . [c]ounsel[] and advis[e] investors (angel, venture capital and others)” to part with their money.<sup>246</sup> The contact information listed at the bottom of the page leads to Mr. Storper.

But Hanson Bridgett is not alone. A firm called Rimon also offers “to help advance the missions of . . . fellow B Corporations” by offering a 25 percent discount off its usual rates.<sup>247</sup> Vox Legal claims to provide “[i]nnovative legal counsel for world-changing companies” by “deliver[ing] [a] great return on your legal investment by doing *exactly what you need and nothing more*.”<sup>248</sup> These claims involve questionable advertising practices under professional responsibility rules. They may also amount to impermissible referral fees.

### 9. Contextualizing Contrepreneurs’ Tactics and Attempts to Silence Counter Narratives

A demonstration of how two of the major proponents of SEL attempt to silence the counter narrative helps contextualize why California’s legislature ultimately passed two forms of SEL. A symposium held by the University of Hastings College of the Law featured Hanson Bridgett’s Jonathan Storper,<sup>249</sup> as the moderator of its approximately sixty-minute “SEL and politics” panel.<sup>250</sup> Storper, who conducted a forty-five minute

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246. *Id.* (emphasis added).

247. *25% Discount for B Corporations*, RIMON LAW, [http://bcorp.nonprofitsoapbox.com/storage/documents/ServicePartners/Rimon\\_B\\_Corp\\_Affiliate\\_Offer1.pdf](http://bcorp.nonprofitsoapbox.com/storage/documents/ServicePartners/Rimon_B_Corp_Affiliate_Offer1.pdf). (cached version last visited Oct. 16, 2013) (accessed by searching for “Rimon offers a 25% discount off” in Google and viewing cached version). Law firms are not necessarily prohibited from choosing a corporate entity form so long as they are not publicly traded. *See* MODEL RULES OF PROF’L CONDUCT R. 5.4(b) (2011) (prohibiting a lawyer from engaging in a law firm partnership with a non-lawyer). However, choosing to become a Certified B Corporation seems to tow the ethical line because it requires the firm to amend its operating documents to refrain from putting any particular constituent’s interests higher than the next. This conflicts with the Model Rules of Professional Conduct. *Compare* MODEL RULES OF PROF’L CONDUCT PREAMBLE [2] (2011) (requiring a lawyer, “[a]s advocate, [to] zealously assert[] the client’s position under the rules of the adversary system”) *with* *Corporation Legal Roadmap*, CERTIFIED B CORP., <http://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/legal-roadmap/corporation-legal-roadmap> (last visited Oct. 16, 2013) (requiring a Director, in discharging his or her duties, to determine “the best interests of the corporation” without regard to one particular interest group).

248. VOXLEGAL, <http://www.voxlegal.com/> (last visited Jan. 20, 2013) (emphasis in original).

249. *Our Attorneys*, Jonathan Storper, HANSONBRIDGETT, <http://www.hansonbridgett.com/Our-Attorneys/jonathan-s-storper.aspx> (last visited Jan. 15, 2013).

250. DVD: Incorporating Change Symposium, *supra* note 2032.

pro-SEL presentation earlier in the symposium, spoke for an additional twelve and a half minutes as the “moderator.” Storper then permitted an additional twenty-nine minutes of pro-SEL advocacy from panelist—and Storper’s former co-author—William H. (Bill) Clark, the self-professed “person that wrote the model [SEL] and [who] has been involved in writing the statutes in every state that it’s passed.”<sup>251</sup> By contrast, Storper permitted the sole panelist articulating the counter narrative against SEL to speak for less than than ninety seconds before interrupting him.<sup>252</sup> Combined, Storper and Clark reinforced the dominant narrative by speaking for approximately seventy percent of the time allocated to four discussants and one moderator. SEL advocates also engage in this type of political advocacy in legislatures, such as Nevada, where not one opposing viewpoint testified, despite requests to do so.<sup>253</sup>

### *E. Synthesis*

The exacerbation of separation of ownership and control that SEL inherently creates, whether at a scaled or non-scaled level, may raise concerns for economists who subscribe to Friedman’s<sup>254</sup> or Keynes’<sup>255</sup> theories. The material purpose and tax aims of these organizations can be

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251. *Id.* See also WILLIAM H. CLARK, JR. ET AL., THE NEED AND RATIONALE FOR THE BENEFIT CORPORATION: WHY IT IS THE LEGAL FORM THAT BEST ADDRESSES THE NEEDS OF SOCIAL ENTREPRENEURS, INVESTORS, AND ULTIMATELY, THE PUBLIC (Nov. 16, 2011), available at <http://benefitcorp.net/for-attorneys/benefit-corp-white-paper>.

252. DVD: Incorporating Change Symposium, *supra* note 2032.

253. Minutes of the Meeting of the Assembly Committee on Judiciary, Seventy-Seventh Session, February 25, 2013, Nevada Legislature, <http://www.leg.state.nv.us/Session/77th2013/Minutes/Assembly/JUD/Final/316.pdf> (last visited December 5, 2013).

254. See *supra* note 11 and accompanying text (stating that one of Friedman’s most enduring quotes is that a business has only one social responsibility: “to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game”).

255. See Joseph E. Stiglitz, Economics Nobel Laureate, Keynote Address at World Bank Annual Bank Conference on Development Economics: Whither Reform? Ten Years of the Transition (Apr. 28 1999) (paper prepared for the Annual Bank Conference on Development Economics, Apr. 28-30, 1999) (stating that “[a] point arrives . . . at which the owners of the capital, i.e., the shareholders, are almost entirely dissociated from the management, with the result that the direct personal interest of the latter in the making of the great profit becomes quite secondary”) (quoting JOHN MAYNARD KEYNES, ESSAYS IN PERSUASION 314 (Harcourt, Brace and Co. 1932)). Stiglitz also stated, “the shorter the agency chain, the easier it is to resolve the corporate governance problem.” *Id.* at 13. However, Stiglitz assumed that a potential solution to this problem would be privatization to stakeholders who have long-term relationships with the enterprise, which could allow stakeholders a way to “exercise ‘corporate governance,’” *id.* at 16; however, as discussed in this Article, the position of the stakeholder in SEL exacerbates, rather than tightens, the agency chain.

achieved by existing business law structures, particularly because entities created by state law cannot alter the federal taxation schemes relative to invested equity capital and distributions to owners. Despite the ostensible social good inherent in the names ascribed to SEL-related enterprises, these organizations structurally exacerbate equity investors' ability to control corporate agents effectively, thereby leading to less disclosure of agent activity and reduced ownership control capabilities. SEL creates statutory inconsistencies regarding otherwise settled corporate law. Finally, while corporate law has developed over hundreds of years, LLC law, for example, has unfolded only since the mid-1990s and remains an often unsettled hodgepodge of corporate and partnership law.<sup>256</sup> As a result, no further need exists to create additional confused, unsettled, internally inconsistent, and unnecessary business laws via SEL.

### III. GLOBAL CASE STUDIES

This Part analyzes two global case studies of non- or quasi-Western developing economies. These studies are admittedly anecdotal, but they nonetheless (1) help to demonstrate that outside of the U.S., a consistent corporate code provides material opportunities for publicly traded enterprises to maximize stakeholder value and profits, and (2) illustrate that, as in other countries, the justifications for new corporate forms in the U.S. are unnecessary and baseless.

#### A. Asia—Bangladesh—PRAN

##### 1. Background

Bangladesh maintains traditional fiduciary duties as Western law may view them, with some additions. For example, Bangladesh employs phrases such as “liability of directors,” “breach of trust,” or “deprive the shareholders [ ] of a reasonable return on their investment” in addition to duties of loyalty and conflicts of interest.<sup>257</sup>

Sections 108, 118, 124, and 130 of the Bangladesh Companies Act of 1994 provide historical context regarding the purpose of the Act and managerial duties.<sup>258</sup> If the government has reason to believe that the managing agent of a public company has violated laws applicable to management, then the government may conduct investigations and issue

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256. CORPORATE COUNSEL GUIDE TO DOMESTIC JOINT VENTURES § 7:11 (2013 ed.).

257. Companies Act of 1994 §§ 102, 118 (Bangl.), available at [www.pdf-archive.com/2012/11/06/companies-act/companies-act.pdf](http://www.pdf-archive.com/2012/11/06/companies-act/companies-act.pdf).

258. *Id.*

259. Corporations must submit reports to the government if asked by a government investigator and change management's agreements and duties relative to the corporation.<sup>260</sup>

## 2. Case Study

The Programme for Rural Advancement Nationally ("PRAN") represents Bangladesh's largest grower of fruits and vegetables<sup>261</sup> in a permissible stakeholder-centric enterprise. PRAN's corporate aim is to "generate employment and earn dignity and self-respect for [its] compatriots through profitable enterprises" with a vision of "improving livelihood."<sup>262</sup> PRAN's corporate values, however, include nods to consumers, suppliers, employees, and others in the trade.<sup>263</sup> Its corporate mission embodies "corporate social responsibilities with the additional compulsion to make profits . . . to thrive and grow . . . to fulfill its corporate social responsibilities in greater measure as time passes. PRAN has a bifocal objective of making profits through the fulfillment of corporate social responsibilities."<sup>264</sup> PRAN's concept is to "fight poverty & hunger in Bangladesh in the shortest possible time through employment generation."<sup>265</sup> PRAN's equity continues to pay dividends and trades on the e-NRB Platform.<sup>266</sup>

Finally, in the same webpage where PRAN discusses social responsibilities that correspond with generating profits, PRAN specifically articulates that these purposes all stemmed from the region's "*comparative advantage*."<sup>267</sup> This attitude illustrates the difference between approaches to social businesses in Bangladesh and in the United States; it is the antithetical economic concept<sup>268</sup> against which North Carolina, for example, passed its L3C statute.<sup>269</sup> Simply put, as a case study of corporate

259. *Id.* at §§ 118, 130.

260. *Id.* at §§ 108, 118.

261. *Our Inception*, PRAN, [http://www.pranfoods.net/our\\_inception.php](http://www.pranfoods.net/our_inception.php) (last visited Jan. 21, 2013).

262. *Our Mission & Vision*, PRAN, [http://www.pranfoods.net/mission\\_vision.php](http://www.pranfoods.net/mission_vision.php) (last visited Jan. 21, 2013).

263. *Our Corporate Values*, PRAN, [http://www.pranfoods.net/corporate\\_values.php](http://www.pranfoods.net/corporate_values.php) (last visited Jan. 21, 2013).

264. *Corporate Social Responsibility*, PRAN, <http://www.pranfoods.net/csr.php> (last visited Oct. 21, 2013).

265. *Id.*

266. *About Us*, E-NRB, [http://www.e-nrb.com/pages/about\\_us](http://www.e-nrb.com/pages/about_us) (last visited Jan. 21, 2013).

267. *Our Inception*, *supra* note 261.

268. See *supra* notes 138-41 and accompanying text (asserting that protectionist legislation underpins some SEL and prolongs comparative disadvantages).

269. See *supra* notes 122-29 and accompanying text (discussing the benefits of the Ricardian economic theory of comparative advantage, particularly for developing

governance, law, and development economics, PRAN provides strong evidence that Ricardian or Neo-Ricardian comparative advantage theory can not only coexist with—but, more importantly, serve as the basis for—global social enterprise development.

*B. Africa—South Africa—Pick ‘N Pay*

Since the democratization of South Africa fewer than twenty years ago, the country’s law on corporations has also changed. Through new legislation, including the Companies Act of 2008 and the King Report on Corporate Governance, South Africa has broadened the interests directors must consider when making decisions.<sup>270</sup>

The Guidelines for Corporate Law Reform provide that “[n]ew company law should therefore be consistent not only with the Constitution of South Africa and the principles of equality and fairness that it enshrines, but also with other laws that have been enacted . . . .”<sup>271</sup>

One South African legal scholar has written that as South Africa has grown into a democracy, there has been a need to move past a system that favored shareholder primacy. As he noted:

With time it became obvious that the principles of traditional corporate governance were failing. With the growth and impact of companies on social and other issues, stricter and more-inclusive measures had to be adopted for better corporate governance which take account not only of the shareholders, but also the imbalances of the past which were created by segregation laws.<sup>272</sup>

That scholar further suggested that a modern corporation in South Africa must seek more than profit; rather, he wrote, “[t]he dismantling of apartheid brought with it the realization that companies were not operating in a vacuum. The shibboleths of the exclusive or ‘shareholder supremacy

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economies, and why protectionism represents a poor justification for SEL).

270. The Companies Act 71 of 2008 (S. Afr.); *King Report on Corp. Governance for S. Afr. 2002*, King Comm. on Corp. Governance, Code of Corp. Practices & Conduct, p. 21, ¶ 1.1 (Mar. 2002) available at [http://library.ufs.ac.za/dl/userfiles/documents/Information\\_Resources/KingII%20Final%20doc.pdf](http://library.ufs.ac.za/dl/userfiles/documents/Information_Resources/KingII%20Final%20doc.pdf).

271. DEP’T OF TRADE AND INDUS., GOV’T GAZETTE NO. 26493, SOUTH AFRICAN COMPANY LAW FOR THE 21ST CENTURY: GUIDELINES FOR CORPORATE LAW REFORM (2004) [hereinafter SOUTH AFRICAN COMPANY LAW FOR THE 21ST CENTURY] available at <http://www.info.gov.za/gazette/notices/2004/26493.pdf>. See also S. AFR. CONST., 1996, pmbl.

272. Tshepo Mongalo, *South Africanizing Company Law for a Modern Global Economy*, 121 SALJ 93, 114 (2004).

at all costs' approach were revealed.<sup>273</sup>

South Africa addressed corporate governance in the country through the King Committee on Corporate Governance in South Africa.<sup>274</sup> The committee's recommendations were published in the Code of Corporate Practices and Conduct.<sup>275</sup> Interestingly, no statutory underpinning for the Code of Corporate Practices and Conduct exists; rather, the code has adopted a scheme of self-regulation.<sup>276</sup> Under this scheme, affected companies<sup>277</sup> must either comply with every provision of the code, or identify areas of non-compliance and state the reasons for non-compliance in the company's annual report.<sup>278</sup>

Emphasizing the need for good corporate governance in South Africa, the Committee cited a McKinsey & Co. study, finding that more than eighty-four percent of global institutional investors would pay a premium for shares of a company with good corporate governance over a company with poor corporate governance and comparable financial information.<sup>279</sup>

The King Committee recommended that "[t]he board should ensure that the company complies with all relevant laws, regulations and codes of business practice, and that it communicates with its shareowners and relevant stakeholders (internal and external) openly and promptly and with substance over prevailing form."<sup>280</sup> The Committee's recommendation thus urged companies to maintain a good relationship with their stakeholders. The Code also makes it clear that the company is ultimately responsible to its shareholders, stating that "[t]he essential principle advanced by the Commonwealth Association for Corporate Governance that '*directors and boards owe their fiduciary duty to the company and thereby are accountable to shareholders, as owners of the corporation's capital*' remains paramount."<sup>281</sup>

South Africa's Companies Act of 2008 includes a partial codification of the directors' duties.<sup>282</sup> Should the company run into financial distress

273. *Id.*

274. *Id.* at 102.

275. *Id.*

276. *Id.*

277. *King Report on Corp. Governance for S. Afr. 2002*, King Comm. on Corp. Governance, Code of Corp. Practices & Conduct, p. 21, ¶. 1.1 (Mar. 2002) available at [http://library.ufs.ac.za/dl/userfiles/documents/Information\\_Resources/KingII%20Final%20d oc.pdf](http://library.ufs.ac.za/dl/userfiles/documents/Information_Resources/KingII%20Final%20d oc.pdf) [hereinafter *King Report 2002*] (stating that affected companies include all securities listed on the Johannesburg Stock Exchange, banks, financial services companies, insurance companies, and public sector agencies and enterprises covered by the Public Finance Management Act and the Local Government: Municipal Finance Act).

278. Mongalo, *supra* note 272, at 102.

279. *King Report 2002*, *supra* note 277, at 13.

280. *Id.* at 22.

281. *Id.* at 98 (emphasis in original).

282. See The Companies Act 71 of 2008 § 76(3) (S. Afr.).

and enter a business rescue regime to rehabilitate the business, then the company must consider “affected person[s]”, a category which extends beyond shareholders.<sup>283</sup> Included among the affected persons that the company must consider are: shareholders and creditors of the company, trade unions representing employees of the company, and employees of the company not represented by a trade union (or those employees’ representatives).<sup>284</sup> In the event that a company seeks to dispose of its assets, relevant law indicates that “[a]ny part of the undertaking or assets of a company to be disposed of, as contemplated in this section, must be given its fair market value as at the date of the proposal, in accordance with the financial reporting standards.”<sup>285</sup> Regarding takeovers, if the company receives an offer, the target company’s board cannot frustrate the offer.<sup>286</sup>

The government report also suggested that corporate disclosure extend beyond shareholders.<sup>287</sup> The report recommends that other constituencies, such as employees and creditors, be able to access such information.<sup>288</sup> Moreover, the report not only does not limit disclosure to financial information, but also suggests that reports also include “statements on compliance with public interest legislation, including the Black Economic Empowerment Act, environmental regulation and labour regulation [that are] generally described as Triple Bottom Line Accounting.”<sup>289</sup> In addition, the Johannesburg Stock Exchange also mandates all listed companies to issue integrated reports including their Environmental, Social, and Governance (“ESG”) factors.<sup>290</sup>

In terms of a case study, Pick ‘N Pay (“PNP”) has remained organized as a typical corporation under the prevailing laws of South Africa since its founding in 1968. PNP is a major retailer in South Africa.<sup>291</sup> Its core principles consist of the following:

[m]aintaining abiding values, in spite of business practices changing with time[;] [f]ostering respect for individuals, not as a strategic advantage, but because it is morally correct[;]

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283. *Id.* at § 128(1).

284. *Id.*

285. *Id.* at § 112(4).

286. *See id.* at § 126(1)(a)(ii) (“[T]he board [ ] must not take any action . . . that could effectively result in [ ] a *bona fide* offer being frustrated.”).

287. SOUTH AFRICAN COMPANY LAW FOR THE 21ST CENTURY, *supra* note 271, at 41.

288. *Id.*

289. *Id.*

290. Institute of Dirs. S. Afr., *The Code for Responsible Investing in South Africa* (CRISA) (July 19, 2011), available at <http://www.iodsa.co.za/?page=crisa>; see also *What is ESG?*, ESG MANAGERS PORTFOLIOS, [http://www.esgmanagers.com/sustainable\\_investing/what\\_is\\_esg](http://www.esgmanagers.com/sustainable_investing/what_is_esg) (last visited Oct. 23, 2013) (defining and describing ESG).

291. *About Us*, PICK N PAY, <http://www.picknpay.co.za/picknpay/content/en/about-us-introduction> (last visited Nov. 8, 2013).

[a]cknowledging the difference between timeless principles and daily business practices[;] [and] [s]ticking to values—even if this appears to put us at a competitive disadvantage.<sup>292</sup>

In post-Apartheid South Africa, PNP maintains its position that:

The more economic freedom that exists within South African society, the more scope there will be for growth in the retail market. It is no surprise that our view is the same as it was at our inception—big business must work together towards securing the economic security and social wellbeing of generations to come.<sup>293</sup>

PNP includes a corporate social initiative in which it funds what it believes to be socially beneficial enterprises such as developing parks or providing incubators to hospitals in need.<sup>294</sup> PNP is devoted to sustainable living causes, proactively publishing a detailed, yet unrequired, manual on its sustainable living activities and so-called green issues.<sup>295</sup> The South African government has certified PNP stores as contributors to Black Enterprise Empowerment (BEE).<sup>296</sup>

Despite engaging in numerous voluntary stakeholder-centric activities, PNP remains a publicly traded entity on the Johannesburg Stock Exchange (JSE),<sup>297</sup> pays a regular dividend to its shareholders,<sup>298</sup> and generates positive Earnings Before Interest, Tax, Depreciation and Amortization (“EBITDA”),<sup>299</sup> a metric generally associated with cash flow.<sup>300</sup> PNP’s stakeholder pledge includes employees, customers, the country and local communities, suppliers, and shareholders. Yet again, no law, rule, or regulation prevents a traditional publicly traded U.S. corporation from

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292. *Fundamental Principles*, PICK N PAY, <http://www.picknpay.co.za/picknpay/content/en/fundamental-principles> (last visited Oct. 23, 2013).

293. *Id.*

294. *CSI*, PICK N PAY, <http://www.picknpay.co.za/picknpay/content/en/CSI> (last visited Oct. 23, 2013).

295. PICK N PAY, *SUSTAINABLE LIVING REPORT 2010/2011* (2012), *supra* note 227.

296. *BEE Certification*, PICK N PAY, <http://www.picknpay.co.za/picknpay/content/en/bee-certification> (last visited Oct. 23, 2013).

297. *See Pick’n Pay Holdings, Ltd.*, BLOOMBERG, <http://www.bloomberg.com/quote/PWK:SJ> (last visited Oct. 23, 2013) (displaying stock chart and key statistics for PNP).

298. *Director’s Report*, PICK N PAY, [http://www.picknpay-ir.co.za/financials/annual\\_reports/2012/financials/stores-directors-report.php](http://www.picknpay-ir.co.za/financials/annual_reports/2012/financials/stores-directors-report.php) (last visited Oct. 23, 2013).

299. *Id.*

300. *How to Value Stocks: Cash Flow-Based Valuations*, The Motley Fool, <http://www.fool.com/investing/beginning/how-to-value-stocks-cash-flow-based-valuations.aspx> (last visited December 5, 2013).

engaging in these activities outside of an auction context,<sup>301</sup> and no law, rule, or regulation prohibits a publicly traded U.S. LLC from engaging in these activities in any situation.<sup>302</sup>

#### IV. WHAT CONSTITUTES A SOCIAL BENEFIT AND WHOSE STANDARD APPLIES?

Some legal scholars, politicians, and cabinet-level officials have argued that investment in renewable energy enterprises undertakings ostensibly has a “‘beneficial’ purpose.”<sup>303</sup> Entrepreneurial startups, whether in their early or late stages, are often geographically bounded and typically funded by local private investment.<sup>304</sup> Although “state VCs” exist,<sup>305</sup> the federal government’s funding of purported socially beneficial green energy companies such as Solyndra<sup>306</sup> demonstrates that, as former Harvard President and Obama Administration Chief Economic Advisor Lawrence Summers wrote in an email, “gov[ernment] is a crappy VC.”<sup>307</sup>

The abstract idea of socially beneficial business organizations may appeal to many liberal- or progressive-minded people who oppose traditional corporation excesses. In practice, however, SEL can whipsaw these people’s preconceptions because of legislative flaws that obscure what constitutes social beneficence. Positing what could occur under California’s general and specific public benefit SEL definitions is instructive. In examining what may constitute a public benefit, this Part explores the nexus of four of those categories’ pertinent parts: (1) promoting the advancement of knowledge; (2) increasing the flow of

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301. See STOUT, *supra* note 18, at 24-32.

302. *Id.*

303. Ann E. Conaway, *The Global Use of the Delaware Limited Liability Company for Socially-Driven Purposes*, 38 WM. MITCHELL L. REV. 772, 777 (2012).

304. See, e.g., Darian M. Ibrahim, *Financing the Next Silicon Valley*, 87 WASH. U. L. REV. 717, 731 (2010) (indicating that “Facebook . . . moved to Silicon Valley” despite its inception in both capital- and entrepreneur-friendly Boston).

305. *Id.* at 737.

306. Matthew Lynley, *Peter Thiel: Clean technology is a “disaster”*, VENTUREBEAT (Sept. 12, 2011, 12:50 PM), <http://venturebeat.com/2011/09/12/thiel-cleantech-disaster-disrupt> (expressing that Peter Thiel, co-founder of PayPal and early investor in Facebook, views clean technology as a fad-like “disaster” in which private investor capital held little remaining interest).

307. David Groshoff, *If Lawrence Summers believed that the “Gov is a crappy VC,” could the government have been a better Distressed Investor?*, THE CONGLOMERATE BLOG (Oct. 3, 2011), <http://www.theconglomerate.org/2011/10/if-lawrence-summers-believed-that-the-gov-is-a-crappy-vc-could-the-government-have-been-a-better-dis.html>; see also Roberta Rampton & Mark Hosenball, *In Solyndra note, Summers said Feds “crappy” investor*, REUTERS.COM (Oct. 3, 2011, 6:20 PM), <http://reuters.com/article/2011/10/03/us-solyndra-idUSTRE7925C520111003>.

capital to entities with a public benefit purpose<sup>308</sup>; (3) improving human health; and (4) accomplishing any other particular benefit for society.

*A. Promoting the Advancement of Knowledge*

Public charter schools present an example of entities that mix various profit models, including non-profit and quasi-for-profit.

A 2009 publication, *Investing in Charter Schools: A Guide for Donors*,<sup>309</sup> attempts to steer donor-investor capital to particular charter schools by asking donors to “provide funds to ‘brand-name’ charter management organizations (CMOs) so they [could] open new charter schools in the community.”<sup>310</sup> This quasi-prospectus or private placement memorandum employs many of the latest buzzwords such as emphasizing that “CMOs[] are the ‘brands’ of the charter sector, with quality control and cost efficiencies.”<sup>311</sup> The report distinguishes between (1) CMOs that are nonprofits and (2) EMOs, an acronym representing for-profit “Educational Management Organizations.”<sup>312</sup> The report is primarily concerned with CMOs, but also discusses KIPP,<sup>313</sup> a national chain of charter schools whose acronym stands for “Knowledge is Power Program.”<sup>314</sup>

Throughout this donor-investor guide, the authors sprinkle the

308. See *Studio B with Shepard Smith* (FoxNews television broadcast Aug. 5, 2012). BP, in its commercial, displayed serious commitment to environmental issues and took credit for social benefits that turned out to be a blatant lie when BP pleaded guilty to multiple charges filed by the Department of Justice in November 2012. Even the reporters on the Fox News Channel, a typically pro-corporate media outlet, indicated that BP “lied to our faces, and we knew it.” In January 2013, BP officially pleaded guilty to manslaughter for killing several people. It would seem that BP’s marketing pitch would be sufficient to obtain a B Corp. Certification or form as a Benefit Corporation. Yet what is one to do, put a stock certificate in a prison? Revoke a corporate charter?

309. Julie Kowal, Bryan C. Hassel & Sarah Crittenden, *Investing in Charter Schools: A Guide for Donors* (prepared for the Philanthropy Roundtable by Public Impact, 2d ed. 2009), available at [http://publicimpact.com/web/wp-content/uploads/2009/09/Investing\\_in\\_Charter\\_Schools\\_\\_A\\_Guide\\_for\\_Donors.pdf](http://publicimpact.com/web/wp-content/uploads/2009/09/Investing_in_Charter_Schools__A_Guide_for_Donors.pdf).

310. *Id.* at 23.

311. *Id.* at 29 (stating further, “[n]ot only do brands signal valuable information to consumers, but they also create powerful incentives for their owners to maintain quality to keep the brand-name strong. Perhaps most importantly, brands can achieve economies of scale that make them more efficient than stand-alone shops”).

312. Kowal, Hassel & Crittenden, *supra* note 3099, at 30.

313. See *id.* at 30 (“One national brand that has received support from many funders is the Knowledge is Power Program (KIPP).”).

314. *Id.* For more on KIPP and charter schools, see David Groshoff, *Unchartered Territory: Market Competition’s Constitutional Collision with Entrepreneurial Sex-Segregated Charter Schools*, 2010 BYU EDUC. & L.J. 307, 324, 327 [hereinafter *Unchartered Territory*]; see also Stephanie Y. Brown, *Law Teaching and Social Justice: Teaching Until the Change Comes*, 25 J. C.R. & ECON. DEV. 195, 203 n.50 (describing the process of “KIPPnotizing” students to adhere to KIPP’s methods).

business verbiage of “seed capital,”<sup>315</sup> “venture philanthropy,”<sup>316</sup> “value-added,”<sup>317</sup> “venture philanthropy fund,”<sup>318</sup> and “incubators.”<sup>319</sup> The authors additionally quote a major funder of charter schools as stating, “[I]ike venture capital funds . . . we take board seats [at the schools] and become active investors, working with the entrepreneurs we support to build sustainable world-class organizations.”<sup>320</sup> As described in *Entrepreneurial Charter Schools*, charter schools provide educational entrepreneurs with an ability to implement innovative techniques.<sup>321</sup> Another benefit of charter schools is that most states that authorize them allow them to create a competitive market for human and financial capital, after years of a failed government monopoly, particularly in urban areas.<sup>322</sup>

But of the seventeen “world-class organizations” supported by the educational venture capitalists NewSchools<sup>323</sup> foundation and the sixteen recipients of funding from the Charter School Growth Fund<sup>324</sup> prominently mentioned in the pamphlet, none received acknowledgment from the Principal Investigator of Harvard University’s Chartering Practice Project, Dr. Katherine K. Merseeth, in her analysis of high-performing charter schools, such as MATCH.<sup>325</sup>

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315. Kowal, Hassel & Crittenden, *supra* note 309, at 24.

316. *Id.* at 32.

317. *Id.* at 105.

318. *Id.* at 44.

319. *Id.* at 33.

320. *Id.* at 34.

321. *Entrepreneurial Charter Schools*, *supra* note 314, at 325.

322. *See, e.g., Entrepreneurial Charter Schools*, *supra* note 314 *passim* (explaining that the flexibility and independence enjoyed by charter schools allows them to operate on the basis of accountability and competition, rather than government monopoly); Kowal, Hassel & Crittenden, *supra* note 309, *passim* (discussing how charter schools have proven themselves especially effective in improving K-12 education).

323. Kowal, Hassel & Crittenden, *supra* note 309, at 33.

324. *Id.* at 34.

325. KATHARINE K. MERSETH ET AL., *INSIDE URBAN CHARTER SCHOOLS; PROMISING PRACTICES AND STRATEGIES IN FIVE HIGH-PERFORMING SCHOOLS* (Harv. Educ. Press 2009).

*B. If “Any Other Societal Benefit” is Acceptable, then Whose Societal Norms Apply, and Are Those Norms Consistent?*

Another problem with SEL is that what constitutes a “Societal Benefit” will vary significantly from state to state, and an incorporator can subvert the policies of a state by simply incorporating in a different state.

For example, California requires benefit corporations to serve “[t]he accomplishment of any other particular benefit for society.”<sup>326</sup> California recently passed legislation authored by State Senator Ted Lieu that bans discussion about LGBT in schools.<sup>327</sup> Following the Supreme Court’s recent opinions *Hollingsworth v. Perry*<sup>328</sup> and *United States v. Windsor*,<sup>329</sup> all lesbian and gay persons in California may avail themselves of the equal protection of rights under state and federal law, as least as they pertain to marriage.<sup>330</sup> California thus appears to embrace a more modern view of what constitutes the accomplishment of a particular social benefit.

Conversely, Virginia’s constitution states that:

[t]his Commonwealth and its political subdivisions shall not create or recognize a legal status for relationships of unmarried individuals that intends to approximate the design, qualities, significance, or effects of marriage. Nor shall this Commonwealth or its political subdivisions create or recognize another union, partnership, or other legal status to which is assigned the rights, benefits, obligations, qualities, or effects of marriage.<sup>331</sup>

As recently as 2012, strong majorities in the Virginia House and Senate passed legislation prohibiting same-sex couples from adopting children.<sup>332</sup>

Also, within the past decade, the Virginia Secretary of State’s office

326. CAL. CORP. CODE § 14601(e)(7) (West 2012).

327. S.B. 1172, 2012-2013 Leg. Sess., (Cal. 2012).

328. No. 12-144 (U.S. Jun. 26, 2013) (affirming the Ninth Circuit’s dismissal of an appeal by supporters of California’s Proposition 8 after the amendment was struck down).

329. No. 12-307 (U.S. Jun. 26, 2013) (holding unconstitutional under the Due Process Clause section three of the Defense of Marriage Act, which restricted marriage to heterosexual unions).

330. S.B. 54, 2008-2009 Leg. Sess., (Cal. 2009).

331. VA. CONST. art. I, § 15-A (Lexis, current through 2013 Reg. Sess. and 2013 Sp. Sess. I); see also Bill Sizemore, *Effort to repeal Va. Gay-marriage ban fails in panel*, PILOTONLINE (Jan. 14, 2013), <http://hamptonroads.com/2013/01/effort-repeal-gaymarriage-ban-fails-house-panel> (describing a failed repeal effort in 2013).

332. See, e.g., Chris Johnson, *White House responds to Va. anti-gay adoption bill*, WASHINGTON BLADE (Feb. 7, 2012), <http://www.washingtonblade.com/2012/02/07/white-house-responds-to-va-anti-gay-adoption-bill>; Steve Williams, *Virginia Senate Approves Anti-Gay Adoption Bill*, CARE2 (Feb. 23, 2012, 2:00 PM), <http://www.care2.com/causes/virginia-senate-approves-anti-gay-adoption-bill.html>.

approved a corporation which intended to “manufacture and market[ ] . . . tobacco products in a way that each year kills over 400,000 Americans and 4.5 million other persons worldwide.”<sup>333</sup> However, states like California and New York have passed laws prohibiting smoking in a number of places.<sup>334</sup> As the preceding examples show, what may be socially beneficial in some states may also be socially repugnant in other states.

Some level of discomfort thus arises relative to leaving what constitutes socially beneficial business behavior under law in the hands of any third party with potentially great conflicts of interest. Simply put, what constitutes socially beneficial activity is highly subjective, regardless of the internal affairs doctrine.<sup>335</sup>

### C. Concerns of State and Federal Conflicts

#### 1. Federalism<sup>336</sup>

This sub-part discusses a federalism concern anecdotally by examining two state statutes and one federal statute. A broader discussion of the federalism implications of SEL relative to tax law exists *infra* in Part IV.

Even as Colorado lobbyists once successfully repelled entrepreneurs’ attempts to pass SEL in the state, Colorado voters passed an initiative to re-legalize personal use of marijuana.<sup>337</sup> But California’s mix of legalized medicinal marijuana<sup>338</sup> and SEL causes federalism concerns. Specifically, California’s benefit corporation legislation indicates that a “specific public benefit” exists when a business organization formed as a benefit

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333. Corp. Charter, Licensed to Kill Inc., COMMONWEALTH OF VA. STATE CORP. COMM’N (Apr. 1, 2003) (on file with the University of Pennsylvania Journal of Business Law).

334. See, e.g., CAL. LAB. CODE § 6400 (West 2007) (creating the nation’s first tobacco smoking ban in California workplaces in 1995); N.Y. PUB. HEALTH LAW § 1399-o (McKinney 2003) (restricting smoking tobacco in New York).

335. Cf. CAL. CORP. CODE § 2115 with *VantagePoint v. Examen, Inc.*, 871 A.2d 1108 (Del. 2005) with RESTATEMENT (SECOND) OF CONFLICT OF L. § 301 (1971) (illustrating that the internal affairs doctrine among which state law applies to a corporate action is not as clear-cut as some people may otherwise believe).

336. This sub-part discusses a federalism concern anecdotally by examining two state statutes and one federal statute. A broader discussion of the federalism implications of SEL relative to tax law exists *infra* in Part IV.

337. Press Release, State of Co., Gov. Hickenlooper Signs Amendment 64 Proclamation, Creates Task Force to Recommend Needed Legislative Actions (Dec. 10, 2012), available at <http://www.colorado.gov/cs/Satellite/GovHickenlooper/CBON/1251634887823>.

338. *Medical Marijuana Program*, CAL. DEP’T OF PUB. HEALTH, <http://cdph.ca.gov/programs/mmp/pages/default.aspx>.

corporation “improv[es] human health.”<sup>339</sup> In 2003, California’s legislature passed Senate Bill 420,<sup>340</sup> which extended the Compassionate Use Act of 1996<sup>341</sup> and took effect in 2004.<sup>342</sup> Senate Bill 420 re-legalized marijuana use in California for specific limited purposes in which a physician prescribes medicinal marijuana to a patient in a program overseen by California’s Department of Health Services<sup>343</sup> and the state’s attorney general. Physicians prescribe medicinal marijuana to patients who suffer from conditions such as AIDS, arthritis, cancer, chronic pain, migraines, or any other persistent medical symptom that “[i]f not alleviated, may cause serious harm to the patient’s safety or physical or mental health.”<sup>344</sup> This law demonstrates that individual ownership of one’s body via compassionate patient treatment options serves to improve the public health. But federal law conflicts.<sup>345</sup>

As a result, an enterprise that appears qualified to form specifically as a California benefit corporation raises the question of how socially beneficial an enterprise may be. By fulfilling its specific state statutory purpose, such an enterprise may comport completely with state-level SEL. However, that enterprise would not only violate federal law, but would also subject its customers to potential federal prosecution and imprisonment.

## 2. State Law Concerns

A recent decision by California’s Department of Aging, a branch of the state’s Health and Human Services Agency, demonstrates that even the state does not believe benefit corporations to be a beneficial entity choice. For example, California’s Department of Health Care Services (“DHCS”) has restricted all Community-Based Adult Service (CBAS) providers to non-profit status,<sup>346</sup> the same status held by a B Lab-certified B Corp.

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339. CAL. CORP. CODE § 14601(e)(4) (West 2012).

340. S.B. 420, 2003 Leg., 625 Ch., § 11362(h) (Cal. 2003) (enacted).

341. *Id.*

342. CAL. HEALTH & SAF. CODE, §§ 11362.9 (2003) (codifying part of S.B. 420 and indicating an effective date of January 1, 2004).

343. CAL. HEALTH & SAF. CODE, § 11362.71 (2013).

344. *Id.* at § 11362.7.

345. *See* discussion of Berkeley Patients Group, *supra* note 238 and accompanying text (referencing federal criminal law listing marijuana as a schedule one controlled substance).

346. Memorandum from CBAS Branch to Community-Based Adult Services Center Administrators and Program Directors (Dec. 31, 2012), *available at* [http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&ved=0CDAQFjAA&url=http%3A%2F%2Fwww.caads.org%2Fpdf%2Fpdf%2Fcbas\\_2012\\_12\\_31\\_cda\\_notice\\_provider\\_requirements\\_postponed.pdf&ei=YmJsUtbqJMWpkAehrIGQAQ&usg=AFQjCNHabweM13xV\\_abV3eAIMaMBCTCikg&sig2=\\_pSDou7Q5Yz02faSFnsA5Q&bv=55123115,d.eW0](http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&ved=0CDAQFjAA&url=http%3A%2F%2Fwww.caads.org%2Fpdf%2Fpdf%2Fcbas_2012_12_31_cda_notice_provider_requirements_postponed.pdf&ei=YmJsUtbqJMWpkAehrIGQAQ&usg=AFQjCNHabweM13xV_abV3eAIMaMBCTCikg&sig2=_pSDou7Q5Yz02faSFnsA5Q&bv=55123115,d.eW0) (announcing that the DHCS has postponed, but not eliminated, the requirement that CBAS providers be restricted to nonprofit legal status).

V. COMPARATIVE ANALYSIS: HISTORY, PURPOSE, GOVERNANCE, TAXATION, AND SCALABILITY

Having discussed the foundational history, purpose, governance, taxation, and scalability traits regarding (1) the major traditional U.S. liability-shielded entities; (2) L3Cs, FPCs, benefit corporations, and entities who pay B Lab for a certification; (3) several case studies of international socially focused enterprises; and (4) the smoke and mirrors behind B Lab's business operations, I now turn to a comparative analysis of each trait and entity type. This Part demonstrates that entities created under SEL might be better regulated by a state's department of redundancy department, rather than by a department of corporations. As illustrated below,<sup>347</sup> and contrary to the entrepreneurs' spurious assertions, nothing advanced by SEL negates Friedman's proposition that companies may choose to have eleemosynary purposes, so long as the owners want to employ that goal.

While many may consider Friedman to be a radical capitalist, a more mainstream yet "ardent libertarian" entrepreneur has demonstrated that large, scalable, public companies may have a social purpose.<sup>348</sup> For instance, John Mackey founded and became the CEO of Whole Foods, a specialty grocer with a social mission. Mackey indicated that his position was not hostile to capitalism but instead recognized that the "enlightened corporation should try to create value for *all* of its constituencies."<sup>349</sup> Mackey indicated that Whole Foods measured its success

by how much value we can create for all six of our most important stakeholders: customers, team members (employees), investors, vendors, communities, and the environment . . . There is, of course, no magical formula to calculate how much value each stakeholder should receive from the company. It is a dynamic process that evolves with the competitive marketplace.<sup>350</sup>

So unlike B Lab, Mackey measures the success of his business by looking at multiple distinct stakeholder groups. Additionally, Mackey chastised B Lab certified B Corporations because "B corporations fall far short of being revolutionary," as "B corporations appear to violate the

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347. See *infra* tbl. 1 (summarizing the entity forms and rules regarding their governance, purpose, taxation, scalability and disclosures).

348. *Rethinking the Social Responsibility of Business*, WHOLE FOODS, <http://www.biology.iupui.edu/biocourses/Biol540/pdf/WholeFoodsJohnMackeySR.pdf> (last visited Dec. 11, 2013).

349. *Id.*

350. *Id.* See also JOHN MACKAY & RAJ SISODIA, CONSCIOUS CAPITALISM: LIBERATING THE HEROIC SPIRIT OF BUSINESS 293-97 (2013) (critiquing as well Triple Bottom Line accounting's neglect of "a wider and more nuanced view of stakeholders" and a failure to emphasize "purpose, leadership, management, and culture . . .").

important principle that owners should ultimately control the corporation . . . . The [B-corporation] system protects the management from owners.”<sup>351</sup> Underscoring Mackey’s theoretical writings and practical corporate accomplishments, the following chart suggests that no legitimate basis supports SEL’s existence.

Table 1

ENTITY	GOVERNANCE	PURPOSE	TAXATION	SCALABILITY	DISCLOSURES
S-Corp	Owners or Agents	Whatever agreed to in charter.	Pass through taxation.	Not scalable beyond 100 shareholders.	None required but unlimited disclosures permitted.
C-Corp	Few meaningful rights for equityholders	Whatever agreed to in charter.	“Double taxation.”	Scalable to publicly traded entity.	None required unless publicly held; unlimited disclosures permitted unless securities laws prohibit.
LLCs/LLPs	Owners or Agents	Whatever agreed to in charter and operating agreement.	Check-the-box option, but often pass-through taxation.	LLCs can trade publicly.	None required but unlimited disclosures permitted.
Int’l Entities	Owners or Agents	Nation-specific.	Nation-specific.	Nation-specific.	Nation-specific, but <i>see, e.g.</i> , South Africa, mandating disclosure of social activities for all companies, not just special social enterprises.
L3Cs	Owners or Agents – essentially the same as LLC.	Further one or more charitable or educational purposes; the significant purpose of the business cannot be production of income or appreciation of property; purpose cannot be to achieve political or legislative	No tax benefits and no pass-through taxation.	No scalability, because cannot have profit motive.	None required; unlimited disclosures permitted.

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351. Mackey & Sisodia, *supra* note 350.

		purpose.			
FPCs	Directors may consider best interests of the FPC, its equityholders, and any special purpose interest in charter.	Charter must identify a public benefit purpose.	Not recognized by IRC for pass-through taxation.	No limits on scalability but would likely need to reorganize.	Must disclose non-financial info, including a specific MD&A section addressing the special purpose <sup>352</sup> and what the FPC did during the reporting period to achieve the special purpose. Governance assessment may be conducted internally.
Benefit Corps.	Directors must consider stakeholders who have no enforcement rights; uncertain if directors owe shareholders fiduciary duties.	Must have specific public benefit and general public benefit assessed against a third-party standard; internal statutory tensions	No federal tax benefits or pass-through taxation.	Scalable, like a C Corp.	Disclosures required to third party-assessor, but unlimited disclosures permitted.
Certified B Corps.	No rules.	No rules.	Taxation follows entity type, not certification from B Lab.	Scalability follows entity type. To date, no publicly held corporation sees a need for B Lab's seal of approval.	Only what B Lab requests in its questionnaire.

The foregoing chart thus illustrates that no need exists for SEL. Current corporate entities may be governed by owners or managers, may possess any corporate purpose agreed to in the corporate charter, have understandable federal taxation regimes, are scalable, and have no limitations on disclosures, so long as the disclosures are consistent with applicable securities laws. If all of these features currently exist, then, logically, why enact SEL to create new entities whose material difference from existing entities is a lack of accountability to the very stakeholders and shareholders with whom they claim to concern themselves? If the

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352. CAL. CORP. CODE § 3500 (West 2012).

global underperformance of socially responsible mutual funds relative to their benchmarks is any indication of how SELs perform,<sup>353</sup> then why create SEL and SEL-related entities that seem to ensure lower returns for equity investors?

#### CONCLUSION

The use of the cloak of social responsibility harms the foundations of a free society . . . . [T]he doctrine of ‘social responsibility’ taken seriously would extend the scope of the political mechanism to every human activity. It does not differ in philosophy from the most explicitly collectivist doctrine. It differs only by professing to believe that collectivist ends can be attained without collectivist means.<sup>354</sup>

—Milton Friedman

As Professor Bainbridge indicates, “[n]o one seriously denies that corporate conduct generates negative externalities,”<sup>355</sup> and as Professors Page and Katz stated, “[e]very state has expressly legalized corporate philanthropy.”<sup>356</sup> Accepting that SEL ought to exist reflects an erroneous assumption that business owners currently cannot contractually agree to receive lower (or perhaps higher) profits in the name of some greater good. For example, free from SEL’s mandates, conscious capitalism<sup>357</sup> has demonstrated a robustly successful past and appears to have a bright future for equity holders and stakeholders alike. Furthermore, assuming the general theory that economic actors respond to incentives, then the entrepreneurial proponents of SEL should acknowledge that the appropriate legislation to make businesses socially beneficent would be

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353. Luc Renneboog, *The Performance of Socially Responsible Mutual Funds*, QFINANCE 5 (2013), <http://www.qfinance.com/contentFiles/QF02/glus0fcl/1n/0/the-performance-of-socially-responsible-mutual-funds.pdf> (“SRI [Socially Responsible Investment] funds in all countries on average underperform the stock market index, and SRI funds in all countries on average underperform conventional (non-SRI) funds.”); *see also* Steven Goldberg, *Five Great Green Funds*, KIPLINGER (2008), <http://socialinvesting.about.com/gi/o.htm?zi=1/XJ&zTi=1&sdn=socialinvesting&cdn=money&tm=569&f=00&tt=14&bt=0&bts=0&zu=http%3A/www.kiplinger.com/columns/value/archive/2008/va0520.htm> (indicating that socially responsible mutual funds underperform traditional equity funds by 100 basis points per year).

354. Friedman, *supra* note 11, at 123-24.

355. Bainbridge III, *supra* note 6, at 8.

356. Page & Katz, *supra* note 6, at 1352; *see also* Model Bus. Corp. Act § 3.02(13) (2010) (granting corporations general powers to do all things necessary to carry out its business).

357. *See* MACKAY & SISODIA, *supra* note 350, at 23-36 (noting that companies such as Whole Foods Market, Google, Panera Bread, Starbucks, and others have successfully utilized this model to be profitable corporations).

passing laws that *removed* liability shields from a firm's owners and agents. Such a legislative shift in the legal landscape would ameliorate corporate moral hazards, remove government incentives from formation decisions,<sup>358</sup> and allow for a return to a closer form of pure market capitalism. Rather than legislatively adding additional government-created liability shields that incentivize irresponsible and morally hazardous behaviors, entrepreneurs advocating SEL ought to consider focusing on eliminating corporate forms altogether. Doing so, however, would not only be impractical, but also crippling to advocates who push the benevolent-in-theory SEL that functions in practice as the self-creating and self-reinforcing cottage industry of entrepreneurship.

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358. See *supra* notes 32-36 and accompanying text (describing ethically questionable practices associated with early corporate formation in the United States).