

SOCIAL ENTERPRISE GOVERNANCE

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The social enterprise movement has ushered in a promising new wave of companies using market-based strategies to advance social and environmental change. The longevity and growth of social enterprises will be determined by their ability to balance the complex and often competing interests within these unique business entities. The established corporate governance regime, which predominately addresses the characteristics of public companies, does not provide adequate oversight for promoting good corporate governance within the social enterprise sector. This Article argues that the benefit reporting requirements in hybrid-corporation statutes offer an innovative mechanism for encouraging and maintaining good social enterprise governance. Using the benefit reporting requirements within hybrid-corporation statutes as a model, this Article provides a normative framework and establishes the implementation principles for social enterprise governance across various legal entities. By counseling social enterprises on how to promote participatory democracy and increase the company's capacity to detect and address problems, corporate lawyers serve a critical function in developing social enterprise governance. Using an approach guided by corporate lawyers and informed by social enterprise practitioners would build on the traditional corporate governance paradigm to develop narrowly tailored mechanisms that facilitate a more resilient social enterprise sector.

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INTRODUCTION.....	921
I. SOCIAL ENTERPRISES AND HYBRID ENTITIES	926
A. The Emergence of Social Enterprises	926
1. Case Study #1: Social Mission Achieved through Governance	930
2. Case Study #2: Balancing Stakeholder Participation through Governance.....	931
B. Current Governance Vacuum	932
1. For-Profit Social Enterprises Not Subject to External Oversight.....	933
2. Nonprofit Social Enterprises Lack Internal Oversight.....	937
C. The Rise of Hybrid-Entity Legislation	942
1. Fiduciary Duties Restrict Social Mission Considerations.....	946
2. Nonprofit Structure Restricts Revenue Generation	950
3. The Current Impact of Hybrid Entities	951
II. CORPORATE GOVERNANCE PARADIGMS.....	953
A. Statutory Framework of Corporate Governance.....	954
B. New Governance and Transform Norm Creation.....	958
C. Benefit Reporting as a New Governance Model	961
1. Benefit Reporting Overview	962
2. Benefit Reporting as Value Creation	966
III. TOWARDS SOCIAL ENTERPRISE GOVERNANCE	970
A. Improving Social Enterprise Governance through Reporting	970
1. Criticisms of Mandatory Reporting Less Applicable to Benefit Reports	973
B. Impacts of Reporting on Social Enterprise Governance.....	977
1. Flexibility Engenders Organizational Buy-in	979
2. Stakeholder Governance and Participatory Democracy	979
3. Information Production.....	981
4. Refine Board Composition	981
C. Implementing Benefit Reporting Across Entity Form.....	982
1. Organizational Documents.....	983
CONCLUSION	983

INTRODUCTION

The social enterprise¹ ethos of conducting business fundamentally alters the ways in which a company should be governed because it compels directors and officers to make corporate decisions that account for the divergent interests of the company's stakeholders and to consider the decisions' broader impact on society.² Social enterprises are business ventures that intentionally affect societal good. The sustainability of early-stage social enterprises is particularly vulnerable because they rarely operate at a high profit margin. As a result, the wrong executive decisions are more likely to end the business because there is little operating reserve to sustain the company's recovery. Moreover, social enterprises must constantly manage the conflicting interests of profit returns and social impact,³ which is hard to do. Thus, social enterprises need good corporate governance practices and enforcement mechanisms if the sector will thrive.⁴ Corporate governance describes the system of internal controls to regulate people, processes, and policies within an organization. Social enterprises in the United States are subject to state and, where applicable, federal laws regarding corporate governance. But there is an absence of regulatory oversight to enforce good governance models within the social enterprise sector because most social enterprises do not exceed the

1. See *infra* Part I.A.

2. J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications and Benefit Corporation Statutes*, 2 AM. U. BUS. L. REV. 1, 27-28 (2012) (discussing how directors are instructed to implement stakeholder governance, but are given no guidance about how accomplish that); MODEL BENEFIT CORP. LEGIS. § 101 cmt. (B LAB Jan. 13, 2016), http://benefitcorp.net/sites/default/files/Model%20Benefit%20Corp%20Legislation_2016.pdf [<https://perma.cc/DX3R-7G7X>] (identifying benefit corporations as "a business that operates with a corporate purpose broader than maximizing shareholder value and that consciously undertakes a responsibility to maximize the benefits of its operations for all stakeholders, not just shareholders"); BRIDGES VENTURES LLP, TO B OR NOT TO B: AN INVESTOR'S GUIDE TO B CORPS 12 (Sept. 2015), <http://bridgesventures.com/wp-content/uploads/2015/11/To-B-or-Not-To-B-6-print.pdf> [<https://perma.cc/72FY-8H5A>].

3. Barnali Choudhury, *Serving Two Masters: Incorporating Social Responsibility into the Corporate Paradigm*, 11 U. PA. J. BUS. L. 631, 633 (2009); Dana Brakman Reiser, *Theorizing Forms for Social Enterprise*, 62 EMORY L.J. 681, 684 (2014) ("[E]ventually there will have to be decisions where profit and social good come into conflict and must be traded off.").

4. See Alicia E. Plerhoples, *Social Enterprise as Commitment: A Roadmap*, 48 WASH. U. J.L. & POL'Y 89, 91 (2015) (hereinafter *Social Enterprise as Commitment*) ("One answer lies in developing governance processes and policies that internalize, express, and self-regulate the social enterprise's commitment to its social mission.").

thresholds to initiate government monitoring.⁵ As a result, many social enterprises are in a netherworld of governance⁶ that has not been previously analyzed in social enterprise legal scholarship.

The social enterprise sector is an increasingly growing segment of the U.S. economy.⁷ Impact investing⁸ in the social enterprise sector by institutional investment alone is estimated to be at \$46 billion by conservative figures,⁹ which is a fraction of the estimated \$6.20 trillion in U.S.-domiciled assets currently committed to socially responsible investing.¹⁰ When an industry crumbles, there are ripple effects far beyond the immediate companies' balance sheets, as these events affect customers,

5. Shruti Rana, *Philanthropic Innovation and Creative Capitalism: A Historical and Comparative Perspective on Social Entrepreneurship and Corporate Social Responsibility*, 64 ALA. L. REV. 1121, 1146 (2013) (noting that social enterprises are “operating in a conceptual and regulatory no-man’s-land . . . where their activities may be regulated only by the good intentions of their founders and managers . . .”).

6. Cf. Joseph Stromberg, *A sports governance expert explains why FIFA is so corrupt – and how to fix it*, VOX: CULTURE (last updated June 2, 2015, 1:08 PM), <http://www.vox.com/2015/5/27/8671925/how-to-fix-fifa> [https://perma.cc/55RV-S9P7] (describing how a lack of regulations on international sports associations, such as FIFA and the Olympics, has placed the associations in a “netherworld of governance”).

7. See Brad Edmondson, *The First Benefit Corporation IPO Is Coming, and that’s a Big Deal*, TRIPLE PUNDIT (Feb. 4, 2016), <http://www.triplepundit.com/2016/02/first-benefit-corporation-ipo-coming-thats-big-deal/#> [https://perma.cc/4KAY-YFUV] (“If the Laureate IPO is successful, it will provide a roadmap for institutional investors, family offices and individual investors who want to invest capital in businesses that generate a good return and make valuable contributions to society at large And it will provide a strong counterpoint to skeptics that believe that businesses cannot access institutional capital unless they focus exclusively on maximizing value for shareholders.”) (quoting Luke Stephan, *Can Private Equity Help Make Businesses Good?*, LINKEDIN (Feb. 2, 2016), <https://www.linkedin.com/pulse/can-private-equity-help-make-business-good-luke-stephan?trk=hp-feed-article-title-like> [https://perma.cc/LU6Q-S8CM]).

8. Impact investing refers to investors that are creating direct social impact through “targeted direct equity and debt investments in [social businesses] across developed and emerging markets.” 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 3–4 (Jan. 18, 2013) [hereinafter WHITE PAPER], http://benefitcorp.net/sites/default/files/Benefit_Corporation_White_Paper.pdf [https://perma.cc/GXM6-WM2Z].

9. JP MORGAN & GLOBAL IMPACT INVESTING NETWORK, SPOTLIGHT ON THE MARKET: THE IMPACT INVESTOR SURVEY 6 (2014), https://www.jpmorganchase.com/corporate/socialfinance/document/140502-Spotlight_on_the_market-FINAL.pdf [https://perma.cc/KQJ2-KCR5].

10. US SIF: THE FORUM FOR SUSTAINABLE AND RESPONSIBLE INVESTMENT, REPORT ON US SUSTAINABLE, RESPONSIBLE AND IMPACT INVESTING TRENDS 2014 (2015), http://www.ussif.org/Files/Publications/SIF_Trends_14.F.ES.pdf [https://perma.cc/4R3T-PRYS].

corporate partners, and in some cases even the global economy. Thus, there are significant economic incentives to making sure the social enterprise sector is adequately supported.¹¹ More importantly, there are also societal reasons we want social enterprises, individually and collectively, to be sustainable institutions. Social enterprises can influence social change by improving the lives of those marginalized and excluded in various segments of our society. Socially and environmentally conscious executives might believe that corporate governance mechanisms are not necessary for their businesses because those working in the social enterprise space are not predominately motivated by power and money.¹² However, good corporate governance accomplishes more than mitigating fraud and scandals; it helps companies prevent corporate waste, effectively manage resources, and adapt to changing realities. For every major media story of organizational corruption,¹³ there are many untold stories of small to mid-size businesses that fail in large part due to a lack of corporate governance mechanisms. Good corporate governance practices are necessary for a company's sustainability, resilience, and scale.¹⁴ The long-term social impact goals of social enterprises require that these companies endure and often necessitate growth to reach their target populations. Thus, social enterprises need to develop and promote effective corporate governance across the sector if the promise of the social enterprise

11. See Steven A. Ramirez, *The End of Corporate Governance Law: Optimizing Regulatory Structures for a Race to the Top*, 24 YALE J. ON REG. 313, 354 (2007) ("Corporations are the pivotal store of risk capital in the United States, and the key holder of society's wealth. The manner in which corporations are governed will affect a wide range of national issues—from economic inequality to globalization.").

12. Corporate law scholars have linked the emergence of the social enterprise sector to the 2008 financial crisis. See, e.g., Robert T. Esposito, *The Social Enterprise Revolution in Corporate Law: A Primer on Emerging Corporate Entities in Europe and the United States and the Case for the Benefit Corporation*, 4 WM. & MARY BUS. L. REV. 639, 642-44 (2013) (describing the resurgence of social enterprise as a result of the 2008 recession).

13. See, e.g., *Nine FIFA Officials and Five Corporate Executives Indicted for Racketeering Conspiracy and Corruption*, U.S. DEP'T OF JUSTICE — OFFICE OF PUBLIC AFFAIRS (May 27, 2015), <http://www.justice.gov/opa/pr/nine-fifa-officials-and-five-corporate-executives-indicted-racketeering-conspiracy-and> [<https://perma.cc/8NVL-65J6>] (last updated June 9, 2015). Allegations of FIFA corruption have been an on-going issue for FIFA. See generally LastWeekTonight, *Last Week Tonight with John Oliver: FIFA and the World Cup*, YOUTUBE (June 8, 2014), <https://www.youtube.com/watch?v=DIJEt2KU33I> [<https://perma.cc/AF5Y-RBEV>] (describing FIFA as a "comically grotesque organization," alleging corruption, and providing clips of other media outlets similarly criticizing FIFA).

14. See Ozden Deniz, *The Importance of Corporate Governance for a Well Functioning Financial System: Reforming Corporate Governance in Developing Countries*, 14 DUQ. BUS. L.J. 219, 222 (2012) (arguing that "corporate governance is also a public policy concern" as it enhances local capital markets by attracting investors).

movement¹⁵ is to reach its full potential.

Corporate lawyers¹⁶ not only help companies draft the charter documents that govern the business, they also help companies navigate a complicated network of organizational documents, state corporate law, private contracts, and federal and state regulations.¹⁷ Each of these factors contributes to and influences the governance structure of the company. For this reason, corporate lawyers should have a significant role and lend their expertise to creating corporate governance models and enforcement mechanisms in the social enterprise sector.¹⁸ Legal scholarship to date on social enterprises has primarily focused on comparing,¹⁹ critiquing,²⁰ and theorizing²¹ the new hybrid-entity²² legal forms enacted to accommodate

15. The term “social enterprise movement” is regularly used to describe the increase in visibility and quantity, in roughly a decade, of businesses that use market strategies to make social impact. See Alicia E. Plerhoples, *Can an Old Dog Learn New Tricks? Applying Traditional Corporate Law Principles to New Social Enterprise Legislation*, 13 *TRANSACTIONS: TENN. J. BUS. L.* 221, 222 (2012) [hereinafter *Applying Traditional Corporate Law*].

16. The terms corporate lawyer and transactional lawyer are used interchangeably in this Article to refer to the practice of law that integrates “the substantive business, financial, and lawyering skills needed to consummate business transactions.” Susan R. Jones & Jacqueline Lainez, *Enriching the Law School Curriculum: The Rise of Transactional Legal Clinics in U.S. Law Schools*, 43 *WASH. U. J.L. & POL’Y* 85, 94 (2013). While transactional lawyering has been used in other lawyering scholarship to describe a broad range of skills that includes almost any non-litigation-based practice, this Article narrows the use of the term to the representation of business entities where the legal team interprets, analyzes, and advises on private ordering, statutes, regulations, and case law to assist their clients in realizing their organizational goals and business objectives. In the relevant scholarship, these lawyers are also referred to as deal lawyers.

17. See generally George W. Dent, Jr., *Business Lawyers as Enterprise Architects*, 64 *BUS. LAW.* 279 (2009) (describing the various tasks and services provided by business lawyers).

18. See Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford*, 3 *VA. L. & BUS. REV.* 163, 176 (2008) [hereinafter *Stop Teaching Dodge*] (“When it comes to corporations, lawyers are ship captains.”).

19. See, e.g., Thomas Kelley, *Law and Choice of Entity on the Social Enterprise Frontier*, 84 *TULANE L. REV.* 337, 342-47, 364-76 (2009) (comparing the various business entities chosen by social entrepreneurs).

20. See, e.g., Kyle Westaway & Dirk Sampsel, *The Benefit Corporations: An Economic Analysis and Recommendations*, 62 *EMORY L.J.* 999, 1001 (2013) (noting that the article’s purpose is to “critically analyze[] the benefit corporation’s key elements and pose[] key questions that create uncertainty for courts to resolve”); Joseph Karl Grant, *When Making Money and Making a Sustainable and Societal Difference Collide: Will Benefit Corporations Succeed or Fail?*, 46 *IND. L. REV.* 581, 601-03 (2013) (expressing approval of the changes and growth of benefit corporations).

21. See generally, e.g., Reiser, *supra* note 3 (theorizing forms of social enterprise).

22. The term “hybrid entity” describes those entities formed under a statute that recognizes not only the for-profit nature of the enterprise but also the social mission of the

business commitment to both profit and social impact. This Article expands guidance to social enterprise practitioners and corporate lawyers by arguing that the entire sector, not merely hybrid entities, needs to develop effective governance models and recommending benefit reports as a self-regulating mechanism the sector should adopt to support the development of social enterprise governance.

The Article proceeds in three parts. Part I provides an overview of the corporate governance vacuum in the social enterprise sector and identifies why it is important for social enterprises to think critically about their corporate governance practices. Part II summarizes state statutory governance laws that fail to create adequate systems of accountability. Federal regulations promote accountability through disclosure requirements, but these seldom apply to most social enterprises, which are small, privately owned companies. Thus, the Article argues that the social enterprise sector should adopt a new mechanism that encourages the development and maintenance of good corporate governance. Given the impracticality of expanding government oversight to include small social enterprises, new governance theory²³ provides a framework for understanding how state governments are facilitating social enterprise governance through hybrid-corporation legislation. Finally, Part III outlines how the benefit reporting requirements in hybrid-corporation statutes can promote the development of social enterprise governance models. This section concludes with specific recommendations for corporate lawyers to embed benefit reporting requirements into the DNA of the social enterprise regardless of the legal form. If social enterprise practitioners and corporate lawyers collaboratively develop, document, and disseminate social enterprise governance models through benefit reports, then this collaboration will lead to a stronger, more resilient social enterprise sector that is better prepared to traverse the rough terrain towards sustained social change.

entity, blending the social and profit obligations into one business. This is distinct from a company structure that includes both for-profit and nonprofit entities within the same corporate family. See Ross Kelley, Note, *The Emerging Need for Hybrid Entities: Why California Should Become the Delaware of "Social Enterprise Law"*, 47 *LOY. L.A. L. REV.* 619, 635 (2014) ("Recognizing the limitations and restraints posed on socially geared for-profit organizations, several states have begun to develop a legislative model that blends attributes of traditional for-profit and nonprofit entities into 'hybrid' organizations.").

²³ The term "new governance theory" describes a paradigm shift from top-down, command-and-control regulation to collaborative governance systems. New governance theory rests on the premise that the state alone cannot effectuate societal change and that it therefore needs to engage with private actors to leverage their expertise in dynamic and complex contexts. See *infra* Part II.B.

I. SOCIAL ENTERPRISES AND HYBRID ENTITIES

This section unpacks the term “social enterprise” and explores the rise of hybrid-entity legislation in the development of the social enterprise sector. This part also explains the various contributions that hybrid-entity statutes have already made to expand and strengthen the social enterprise sector. It concludes by remarking that social enterprise governance remains underdeveloped, notwithstanding these new business forms.

A. *The Emergence of Social Enterprises*

The term “social enterprise” does not have a precise definition and as such, while often used, it is also commonly misunderstood. The term is evolving as it continues to be refined and contoured by business and legal practitioners and scholars.²⁴ As the term suggests,²⁵ it describes those business enterprises that intentionally impact societal good.²⁶ Precise

24. Justin Blount & Patricia Nunley, *What is a “Social” Business and Why Does the Answer Matter?*, 8 BROOK. J. CORP. FIN. & COM. L. 278, 279 (2014) (arguing that the definitions for “social enterprise” remains “hopelessly fractured” and “often conflicting”); see also J. Haskell Murray, *Social Enterprise Innovation: Delaware’s Public Benefit Corporation Law*, 4 HARV. BUS. L. REV. 345, 347 (2014) (identifying that the term “social enterprise” is not well defined in the academic literature).

25. Similar to terms such as social worker, social justice, and social change, the word “social” in the term “social enterprise” is a qualifier that focuses on vulnerable populations to the benefit of the greater society. William P. Quigley, *Letter to a Law Student Interested in Social Justice*, 1 DEPAUL J. FOR SOC. JUST. 7, 13-14 (2007) (“One good working definition of ‘social justice’ is the commitment to act with and on behalf of those who are suffering because of social neglect, social decisions or social structures and institutions.”); Reiser, *supra* note 3, at 693-94 (identifying “social good” as an intentionally vague and contested term allowing founders the flexibility “necessary to produce a vibrant and pluralistic civil society.”).

26. MUHANNAD YUNUS WITH KARL WEBER, *BUILDING SOCIAL BUSINESS: THE NEW KIND OF CAPITALISM THAT SERVES HUMANITY’S MOST PRESSING NEEDS* xvii (2010) (defining social business as dedicated *entirely* to achieving a social goal) (emphasis added). *But see* Brenda Massetti, *The Duality of Social Enterprise: A Framework for Social Action*, REV. BUS., Winter 2012/2013, at 59 (defining social enterprises as “an organization where the majority of its social actions: (1) are congruent with the organization’s mission and have some degree of social legitimacy; (2) are community internalizing regardless of whether they are required or chosen; (3) make clear social contributions while producing financial contributions (i.e. profits) that exceed their resource consumption” (emphasis added) (endnote omitted)). In a report to the Roberts Enterprise Development Fund (REDF), Mathematica Policy Research defines social enterprises as “mission-driven businesses focused on hiring and assisting people who face barriers to work.” DANA ROTZ ET AL., *ECONOMIC SELF-SUFFICIENCY AND LIFE STABILITY ONE YEAR AFTER STARTING A SOCIAL ENTERPRISE JOB* xv (2015), <http://redf.org/wordpress/wp-content/uploads/2015/02/REDF-MJS-Final-Report.pdf> [<https://perma.cc/DH2Y-9QA6>].

definitions matter because there is misuse²⁷ and confusion²⁸ about how business ventures are determined to be social enterprises.²⁹ The definitional variations are diverse enough to inspire a semester-long course I teach aimed at better understanding the meaning of the term social enterprise.³⁰ As Marc Lane points out, because the term “social good” is so broad, virtually “every business corporation and every charity could fairly be characterized as a social enterprise. After all, businesses employ people, fulfill the needs and wants of their customers, and pay taxes. Similarly, charities provide altruistic and humanitarian services that would otherwise be performed by government or not at all.”³¹ Several accepted definitions of social enterprise narrow down the concept. The Social Enterprise Alliance,³² a leading organization in the sector, defines social enterprises as “businesses whose primary purpose is the common good. They use the methods and disciplines of business and the power of the marketplace to advance their social, environmental and human justice agendas.”³³ On the other hand, Professors Roger Martin and Sally Osberg’s definition of social entrepreneurship³⁴ focuses on the target market that the enterprise seeks to

27. See, e.g., Jim Schorr & Kevin Lynch, *Preserving the Meaning of Social Enterprise*, STAN. SOC. INNOVATION REV. (Sept. 14, 2012), http://www.ssireview.org/blog/entry/preserving_the_meaning_of_social_enterprise [https://perma.cc/PT8V-W27S] (documenting how Salesforce.com “began using the term ‘social enterprise’ to describe ‘how social and mobile cloud technologies are empowering companies to connect with customers, partners, and employees in entirely new ways’”).

28. See M. Tina Dacin et al., *Social Entrepreneurship: A Critique and Future Directions*, 22 ORG. SCI. 1203, 1203 (2011) (“[A]s a nascent field, social entrepreneurship scholars are in the midst of debates involving definitional and conceptual clarity . . .”).

29. See Schorr & Lynch, *supra* note 27 (“For years, this new realm of hybrid ventures has struggled to define itself in a cohesive way, and the lack of a general consensus on terminology in this arena has been a constraint on the development of social capital markets, supportive policy environments, and other key pieces of the ecosystem needed to catalyze the growth of the field.”).

30. *Social Enterprise & Empowerment Clinic*, THE UNIVERSITY OF CALIFORNIA HASTINGS COLLEGE OF THE LAW, <http://www.uchastings.edu/academics/clinical-programs/clinics/socialenterpriseandeconomicempowerment/index.php> [https://perma.cc/6ZD3-MCQQ] (last visited May 9, 2016).

31. MARC J. LANE, SOCIAL ENTERPRISE: EMPOWERING MISSION DRIVEN ENTREPRENEURS 6 (2011).

32. Social Enterprise Alliance is a membership organization for social enterprises with local chapters across the United States. For more information, see the About Social Enterprise Alliance page, SOCIAL ENTERPRISE ALLIANCE, <https://www.se-alliance.org/about#ourrole> [https://perma.cc/Z7U9-C358] (last visited May 9, 2016).

33. LARRY D. WATSON & RICHARD A. HOEFER, DEVELOPING NONPROFIT AND HUMAN SERVICE LEADERS: ESSENTIAL KNOWLEDGE AND SKILLS 4 (2014) (reproducing the definition provided by Social Enterprise Alliance, which definition no longer appears on the Social Enterprise Alliance Website as of May 9, 2016).

34. “Social entrepreneurship,” a term that is at times used interchangeably with the

serve and makes the meaning of social change more explicit:

We define social entrepreneurship as having the following three components: (1) identifying a stable but inherently unjust equilibrium that causes the exclusion, marginalization, or suffering of a segment of humanity that lacks the financial means or political clout to achieve any transformative benefit on its own; (2) identifying an opportunity in this unjust equilibrium, developing a social value proposition, and bringing to bear inspiration, creativity, direct action, courage, and fortitude, thereby challenging the stable state's hegemony; and (3) forging a new, stable equilibrium that releases trapped potential or alleviates the suffering of the targeted group, and through imitation and the creation of a stable ecosystem around the new equilibrium ensuring a better future for the targeted group and even society at large.³⁵

More generically, Professor Filipe M. Santos defines social enterprises to be those businesses with a predominant strategic focus on value creation³⁶ over value capture^{37, 38}, which explains why social enterprises are often in the business of providing services to socially neglected populations because that is where the potential for value creation is highest. Professor Dana Reiser concisely summarizes her general idea of a social enterprise as “an organization formed to achieve social goals using business methods.”³⁹

Another working definition of social enterprises are those for-profit businesses whose primary objective is to make social impact and nonprofits that incorporate market-based, commercial strategies to achieve their mission.⁴⁰ Social enterprises often operate at the intersection of profit-

term “social enterprise,” is often the act of running or managing a social enterprise. *But see, e.g.,* Raymond Dart, *The Legitimacy of Social Enterprise*, 14 *NONPROFIT MGMT. & LEADERSHIP* 411 (2004) (using the terms “social enterprise” and “social entrepreneurship” interchangeably). Social entrepreneurs are those founders of social enterprise.

35. Roger L. Martin & Sally Osberg, *Social Entrepreneurship: The Case for Definition*, *STAN. SOC. INNOVATION REV.*, Spring 2007, at 35, http://ssir.org/images/articles/2007SP_feature_martinosberg.pdf [<https://perma.cc/8XWP-YGMR>].

36. Filipe M. Santos, *A Positive Theory of Social Entrepreneurship*, 111 *J. BUS. ETHICS* 335, 337 (2012) (defining value creation as the aggregate increase in utility of society's members after accounting for the opportunity cost of all the resources used in that activity).

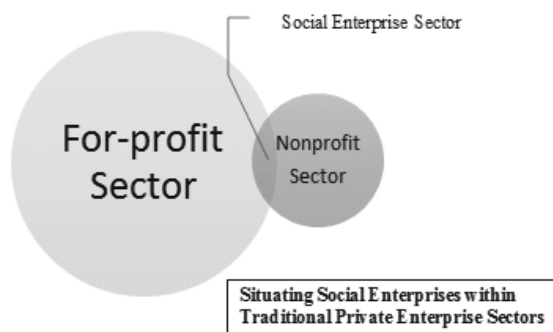
37. *Id.* (defining value capture as the portion of value created by the activity after accounting for the cost of resources that the focal actor mobilized).

38. *Id.* at 339; *See also* LANE, *supra* note 31, at 4 (defining social enterprises “as one not motivated by profit, in that any profit motive takes a back seat to a mission centered on curing an acute social malady”).

39. Reiser, *supra* note 3, at 681.

40. *See* LANE, *supra* note 31, at 7 (noting that social enterprises are “thinking about

generating enterprises and social change organizations. Realizing that a social enterprise is either a for-profit or a nonprofit challenges assumptions about both sectors of business. It is necessary to emphasize that the term describes more than the archetypical charity that often comes to mind. The nonprofit social enterprise may have a business model that is most commonly used in for-profit businesses. One example is an e-commerce company that uses an online platform to market and sell artisan crafts. It is also equally important to understand that companies formed as traditional for-profit entities can effectively operate as social enterprises. Newcomers to the social enterprise field tend to associate the term social enterprise with nonprofits exclusively. The for-profit social enterprise should have a clearly articulated mission that could make it eligible for federal tax-exemption, as its business income is substantially related to a tax-exempt purpose. Thus, for many social enterprises, the company could have easily chosen to be formed as a for-profit entity or a nonprofit corporation.



The common theme in each of the aforementioned definitions is that a substantial variety of business models and legal entity forms are contained within the social enterprise sector, from traditional for-profits to nonprofits to hybrid entities. Although social enterprises have existed for more than a century,⁴¹ recent hybrid-entity legislation has catapulted the social

social impact every day and, in that quest, are going about the serious business of applying strategic planning and management tools to social causes”).

41. See *About Us*, GOODWILL INDUS. INT’L, INC., <http://www.goodwill.org/about-us/> (quoting founder Rev. Edgar J. Helms as describing Goodwill, founded in 1902 and today a \$4 billion nonprofit, as an “industrial program as well as a social service enterprise . . . a provider of employment, training and rehabilitation for people of limited employability, and a source of temporary assistance for individuals whose resources were depleted”); see also Antony Page & Robert A. Katz, *Freezing Out Ben & Jerry: Corporate Law and the Sale of a Social Enterprise Icon*, 35 VT. L. REV. 211, 211-17 (2010) (describing Ben & Jerry’s

enterprise movement to national attention and given new visibility to the growing sector.⁴² While the type of legal entity is an important part of understanding how a social enterprise can form, on a day-to-day basis corporate governance is also essential to determining the success of the social enterprise.⁴³ As the following case studies exemplify, achieving a social mission requires thought and guidance regarding the corporate governance structure of the social enterprise.

1. Case Study #1: Social Mission Achieved through Governance

Imagine a social enterprise that has the primary goal of using professional, long-term employment to empower its individual employees to disrupt cycles of poverty, substance abuse, and recidivism. This social enterprise is formed as a limited liability company (LLC) to allow the managers to raise capital from outside investors and the flexibility to operate the company in a manner that best supports the company mission. The core purpose of the company is not to simply employ but to restore dignity to its employees. The managers of the LLC, thus, want the employees to be involved in various operational decisions that will affect their work and the direction of the business. For example, employees are expected to provide insight on management structure, new software, expansion of product offerings, and employee scheduling. Employees are encouraged to provide feedback and share ideas about what the company should be doing better.

Thus, systematic employee participation in the operations of the company is a fundamental aspect of how the company seeks to achieve its social mission. Engaging employees in a transparent, democratic process is a significant means to achieving the enterprise's social mission of employee empowerment. Yet, at the entity formation stage, the company

Homemade, Inc. as an iconic social enterprises in the early 1980s with a double-bottom line business model, which they called “double-dip,” was well known for its commitment to prioritizing progressive social goals over profits).

42. See HEERAD SABETI WITH THE FOURTH SECTOR NETWORK CONCEPT WORKING GROUP, *THE EMERGING FOURTH SECTOR: EXECUTIVE SUMMARY 4* (2009), <https://www.aspeninstitute.org/sites/default/files/content/docs/pubs/4th%20sector%20paper%20-%20exec%20summary%20FINAL.pdf> [https://perma.cc/6HT9-DC9A] (“The Fourth Sector is emerging organically, the collective result of thousands upon thousands of initiatives at the individual organizational level.”).

43. See Renato Garcia, Comment, *Re-Engineering Georgia's Corporate DNA: A Benefit Analysis and Practicality Assessment for Benefit Corporation Legislation in Georgia*, 6 J. MARSHALL L.J. 627, 677 (2013) (identifying that the social enterprise “formula is far from perfect, giving rise to criticisms about conflicts of interest and the latent inefficiency of considering multiple stakeholder interests”).

was provided no legal counsel on how to establish a governance system through which employees would participate in operational decisions. As a result, the company engages in ad hoc employee voting and collects irregular feedback from the employees. The employees do not have consistent access to financial reports and company documents to inform their feedback. A key component of the company's social mission is to be accomplished through innovative, decision-making structures and processes; yet the company has no format through which to implement this social mission. Without an established governance system uniquely designed to engage the employees in decision-making, there is no mechanism for determining if the company is achieving its social mission. Moreover, even when employees have ad hoc opportunities to provide meaningful contributions, they lack the information necessary to keep the managers accountable to the social mission of the company.⁴⁴ Thus, this social enterprise that seeks to empower employees through democratic participation in decision-making has yet to disrupt the default "feedback loop that breeds . . . hubris at the senior executive levels"⁴⁵ and marginalizes employee perspectives.

2. Case Study #2: Balancing Stakeholder Participation through Governance

Imagine another social enterprise with the mission to reduce hunger in densely populated cities by connecting businesses with excess food to food banks, shelters, and other nonprofits who will distribute the food to individuals in need. The company is formed as a traditional, for-profit corporation with outside shareholders and generates income by charging a subscription fee to businesses to pick up and drop off their excess food. The social enterprise provides logistical support to ensure that its business customers receive donation receipts so they can track their annual charitable giving. Consistent with traditional corporate governance practices, the board is composed of executives and investor representatives. Thus, the company is in regular contact with and must be responsive to investors and its business customers. However, the mission of the social enterprise is to reduce hunger, not merely to provide pick-up services for businesses with excess food. The traditional board composition of

44. See Tom C.W. Lin, *The Corporate Governance of Iconic Executives*, 87 NOTRE DAME L. REV. 351, 366 (2011) ("[F]ew outside parties are capable of meaningfully critiquing and checking executive decisions, given the economic and organizational advantages of corporate officers.").

45. *Id.* at 376.

management and investor representation “is procedurally designed to maximize shareholder wealth,”⁴⁶ not innovate to end food insecurity.⁴⁷

To maintain its ingenuity, the company will need to gather and incorporate feedback and ideas generated from the end-users of the service — i.e., individuals suffering from food insecurity and, perhaps, the nonprofit food distributors.⁴⁸ How well this for-profit social enterprise gathers and incorporates information from its end-users will determine its success at developing new avenues to reduce hunger. However, questions remain regarding obtaining the end-user feedback and how to incorporate it with investor interests, especially where the feedback and the investor interests conflict. This social enterprise needs a mechanism for determining how it will collect various interests from its stakeholders and balance those interests where they do not align. A well thought-out corporate governance policy and information structure would likely make a significant difference for this social enterprise because the balancing of these stakeholder interests is vital to the long-term sustainability of this company.

B. *Current Governance Vacuum*

Most social enterprises are not hybrid entities⁴⁹ but are formed as traditional for-profit companies or nonprofit corporations. Social enterprises are not required under the current governance regime to regularly evaluate and critically examine their corporate governance practices. While some federal and state standards of corporate governance

46. Westaway & Sampselle, *supra* note 20, at 1004.

47. See Daniel S. Shah, *Lawyering for Empowerment: Community Development and Social Change*, 6 CLINICAL L. REV. 217, 247 (1999) (“[T]he optimistic idea that the rich can gain while helping the disadvantaged has meant in practice that the priorities of the empowered take over those of the disempowered even in the very programs which were meant to mitigate this general trend.”).

48. JEFFREY PFEFFER & GERALD R. SALANCIK, *THE EXTERNAL CONTROL OF ORGANIZATIONS: A RESOURCE DEPENDENCE PERSPECTIVE* 43-44 (1978) (“Organizations could not survive if they were not responsive to the demands from their environment. But, we have noted that demands often conflict and that response to the demands of one group constrains the organization in its future actions, including responding to the demands of others. This suggests that organizations cannot survive by responding completely to every environmental demand. The interesting issue then becomes the extent to which organizations can and should respond to various environmental demands, or the conditions under which one social unit is able to obtain compliance with its demands. By understanding the conditions of the social control of organizations, we believe it is possible to understand how organizations decide to comply with, or attempt to avoid, influence.”).

49. See Plerhoples, *supra* note 4, at 90 (“[A] small cohort of hybrid entities have incorporated in numerous states.”).

are already established, there are few mechanisms for ensuring that social enterprises adhere to these standards. Most for-profit social enterprises are closely-held companies that might not rise to the level that would require scrutiny from federal regulatory agencies or state attorneys general. Thus, it is not surprising that there is a vacuum of corporate governance practices in the social enterprise sector even though, for many of these companies, their governance is a means to achieving their social mission.

1. For-Profit Social Enterprises Not Subject to External Oversight

Pursuing profit-making and a social mission does not always lead to the same business decisions.⁵⁰

“Blended value, . . . [after all], could easily remain purely aspirational . . . [as] pursuing profit and social good will not always lead in the same direction Even if the stars align at the outset, eventually there will have to be decisions where profit and social good come into conflict and must be traded off.”⁵¹

Therefore, for-profit social enterprises must be diligent in how they reach business decisions and transparent about documenting their decision-making processes. However, there are few oversight mechanisms that hold a social enterprise accountable for documenting these decisions and good corporate governance.

State laws establish the basic framework of distributing responsibilities within the company⁵² but are not sufficient to ensure that the flow of power is properly maintained in the best interest of the company.⁵³ Outside monitoring from government agents is often required to hold companies accountable to good governance practices. For example, the federal government monitors and enforces corporate governance practices through disclosure requirements that are in place to ensure that boards and managers follow the law.⁵⁴ In the wake of global financial

50. Reiser, *supra* note 3, at 684.

51. *Id.*

52. *See infra* Part II.A.

53. JONATHAN R. MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 71 (2008) (“[T]he institution of the board of directors, as we know it, is not a reliable corporate governance device. [Even if the] [b]oards of directors will not inevitably fail in the task of objectively monitoring management . . . [t]hey cannot . . . be expected to succeed reliably.”).

54. LOUIS D. BRANDEIS, OTHER PEOPLE’S MONEY AND HOW THE BANKERS USE IT 92 (Frederick A. Stokes Co. 1914) (“Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.”).

crises and high profile events such as the collapse of Enron,⁵⁵ the federal government has been increasingly focused on minimizing risky financial transactions and improving the corporate governance of large corporations. Federal reforms such as the Public Company Accounting Reform and Investor Protection Act of 2002, commonly known as the Sarbanes-Oxley Act (“SOX”),⁵⁶ and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”)⁵⁷ are aimed at improving the corporate governance of large corporations. SOX imposes new responsibilities on corporate management, requirements for auditing firms, requirements for financial transactions, and procedures for conflicts of interests.⁵⁸ The law focuses on requiring independent directors and established board processes.⁵⁹ Under SOX, “directors can also face criminal liability for fraudulently influencing, coercing, or misleading an accounting firm during an audit, with the intention of rendering the audit report misleading.”⁶⁰ Less than a decade later, in 2010, Congress enacted

55. Leading up to the demise of Enron, “[c]ompany executives created high expectations among investors regarding the company’s growth potential and their unique skill-set to reach it, producing for a time an extraordinarily high stock market valuation. Meanwhile, the economic reality was turning out to be more sobering. Increasingly aggressive, apparently fraudulent, steps were taken to report financial results and conditions that would not deflate investors’ expectations in a way that would put the managers’ jobs, compensation and perquisites – not to mention social status and self-esteem – immediately at risk.” Donald C. Langevoort, *Managing the “Expectations Gap” in Investor Protection: The SEC and Post-Enron Reform Agenda*, 48 VILL. L. REV. 1139, 1139 (2003).

56. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745-810 (codified as amended in scattered sections of 15, 18, 28, and 29 U.S.C.).

57. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) [hereinafter Dodd-Frank Act] (codified as amended in scattered sections of 5, 7, 12, 15, 22, 26, 28, 31, and 42 U.S.C.).

58. See Neil H. Aronson, *Preventing Future Enrons: Implementing the Sarbanes-Oxley Act of 2002*, 8 STAN. J.L. BUS. & FIN. 127, 132–34 (2002) (noting that the Sarbanes-Oxley Act of 2002 changes the oversight of auditing firms and strengthens auditing standards); Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (and It Just Might Work)*, 35 CONN. L. REV. 915, 920 (2003) (identifying auditors, accountants, corporate officers, lawyers, securities analysts, credit rating agencies, and investment banks, among other groups, as designated for study or regulation by the Sarbanes-Oxley Act of 2002).

59. Another benefit of independent directors is that their outside perspectives can “serve as valuable advisers to the board and management about the company’s market, geographic, and product directions.” SPENCERSTUART, SPENCER STUART BOARD INDEX 2014 3 (2014), https://www.nyse.com/publicdocs/nyse/listing/Spencer_Stuart_Board_Index_2014.pdf [https://perma.cc/S456-MLLA].

60. Stephen Glove & Robert Treuhold, *Corporate governance and directors’ duties in the United States: overview*, PRACTICAL LAW CO. (Feb. 1, 2013), <http://us.practicallaw.com/9-502-3346> (last visited May 9, 2016).

Dodd-Frank, which was “the most ambitious attempt since the New Deal legislation of the 1930s to regulate and reform not only the financial services industry, but also corporate governance.”⁶¹ For example, Section 972 requires public companies to disclose in their annual proxy statements why they have or have not chosen to separate the roles of chairman and chief executive officer.⁶² These regulations, for good reason, do not apply to non-publically traded companies. As a result, the primary federal legislation aimed at improving corporate governance is not applicable to most for-profit social enterprises, which are relatively small businesses.

The federal government also enforces good corporate governance for companies that issue securities through disclosure requirements under the Securities and Exchange Commission (“SEC”).⁶³ Securities regulation helps create a strong marketplace by promoting integrity in corporate governance and financial reporting. The SEC regulates the securities industry, establishes disclosure requirements for corporations, and regulates communications between the board and shareholders. U.S. public corporations are required to disclose a wide range of information in annual and quarterly reports, as well as in the proxy statements.⁶⁴ A company’s annual report filed with the SEC contains, among other items, an internal control report that must state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting and identify the framework used by management to evaluate the effectiveness of the corporation’s internal controls.⁶⁵ Any director who makes or causes the making of any false or misleading statement in a document filed with the SEC can be held personally liable for the misstatement.⁶⁶

It is unlikely that private companies, not otherwise required to, would implement these specific reporting procedures because the corporate governance requirements “are a jumble of [various] statutes, rules, forms and schedules”⁶⁷ that the average company would not be able to decipher

61. Jonathan F. Foster, *Another View: Improving Corporate Governance*, N.Y. TIMES: DEALBOOK (Jun. 11, 2010, 11:10 AM), <http://dealbook.nytimes.com/2010/06/11/another-view-how-to-improve-corporate-governance/> [https://perma.cc/54LV-NBE6].

62. Dodd-Frank Act, Pub. L. No. 111-210, §972, 124 Stat. 1915 (2010) (codified at 15 U.S.C. § 78n-2).

63. See *Business Roundtable v. S.E.C.*, 647 F.3d 1144, 1148-49 (D.C. Cir. 2011) (holding that Rule 14a-11 was “arbitrary and capricious” and reaffirming that SEC rule-making requires strong empirical evidence to justify the costs and benefits of the rule).

64. 17 C.F.R. §240.14a-3 (2015).

65. 15 U.S.C. § 7262 (2012).

66. 17 C.F.R. § 240.10b-5 (2015).

67. Gregory S. Porter, *What Did You Know and When Did You Know It?: Public Company Disclosure and the Mythical Duties To Correct and Update*, 68 FORDHAM L. REV.

without sophisticated legal representation.⁶⁸ Moreover, the federal monitoring and enforcement system should not be expanded to all social enterprises given limited government resources and the potential financial burden federal reporting would place on the social enterprise sector.

To the extent that most social enterprises are raising capital, it is likely through private placement transactions that are exempt from federal securities registration requirements. Social enterprises are likely to have a limited number of shareholders with whom management has close relationships and who believe in the mission of the enterprise. In theory, shareholders monitor the decisions of corporate boards,⁶⁹ often by reference to corporate earnings. However, active shareholder monitoring may be less likely for social enterprises because corporate earnings and profit metrics are not the only indicators of business success. As a result, below market indicators may not give rise to shareholder scrutiny into the corporate practices.

For these reasons, there are limited internal and regulatory controls encouraging small, for-profit social enterprises to adopt good corporate governance practices. In the absence of legal requirements, companies are not likely to prioritize or see the value in thinking deeply about corporate governance issues. However, for-profit social enterprises would greatly benefit from documenting their governance practices and working to innovate unique governance models. Corporate reporting would help social enterprises better articulate how their competitive edge is achieving both their profit and social outcomes. As traditional businesses are increasingly moving into recording their own social impact,⁷⁰ social

2199, 2199 (2000).

68. Regulatory compliance is also expensive. Public companies expend a significant amount of capital resources on complying with SOX, for example, and that cost of compliance continues to rise. A majority, fifty-eight percent, of large public companies surveyed estimated they spent more than \$1 million on SOX compliance in 2014 alone. PROTIVITI, INC., SOX COMPLIANCE – CHANGES ABOUND AMID DRIVE FOR STABILITY AND LONG-TERM VALUE 6 (May 2015), <http://www.protiviti.com/en-US/Documents/Surveys/2015-SOX-Compliance-Survey-Protiviti.pdf> [<https://perma.cc/GV7W-YKGR>].

69. David Millon, *Radical Shareholder Primacy*, 10 U. ST. THOMAS L.J. 1013, 1019–23 (noting that shareholder primacy is a weak accountability mechanism for for-profit corporations). *But see* George W. Dent, Jr., *Corporate Governance Without Shareholders: A Cautionary Lesson From Non-Profit Organizations*, 39 DEL. J. CORP. L. 93, 114–16 (2014) (arguing that shareholder primacy is the foundational accountability mechanism for good corporate governance).

70. *See, e.g., 2015 Corporate Social Responsibility Report*, CISCO, <http://csr.cisco.com/pages/csr-reports> [<https://perma.cc/25ZQ-HAJ3>] (last visited May 9, 2016) (providing links to corporate social responsibility reports); *Sustainability Report 2014/15*, FORD (2015),

enterprises have faced increasing competition for investment dollars and customer attention. For many social enterprises, their competitive advantage is the theory of social change within their business model. But to maintain their momentum, social enterprises will need to remain at the forefront of crafting and disseminating their social impact narrative.⁷¹ As experts in the field have observed, there is “more bleed between social enterprises and traditional businesses,”⁷² meaning they are each increasingly taking on the characteristics of the other. This requires social enterprises to be more cost effective than their traditional peers in creating and articulating social change.⁷³ If social enterprises can articulate and measure their social impact over time in a systematic way that could significantly improve their ability to attract funding.⁷⁴ Therefore, the measurement of the social impact through a reporting process is fundamental to the long-term financial health of a for-profit social enterprise regardless of the type of legal entity.

2. Nonprofit Social Enterprises Lack Internal Oversight

A significant number of social enterprises are formed as nonprofits. “Contrary to popular belief, private philanthropy is not the main source of nonprofit revenue; rather, over forty percent of nonprofit revenue is derived from fees for services performed.”⁷⁵ In part, because of the steadily

15/index.html [https://perma.cc/Y8F5-678L] (last visited May 9, 2016) (reporting on its corporate sustainability in 2014/2015); *Performance with Purpose: Sustainability Reporting*, PEPSICO, <http://www.pepsico.com/Purpose/Performance-with-Purpose/Sustainability-Reporting> [https://perma.cc/DJC7-BLJX] (last visited May 9, 2016) (providing links to sustainability reports).

71. See Claudia Cahalane, *Social enterprises must continue momentum in social impact reporting*, THE GUARDIAN (Oct. 10, 2012, 11:01 AM), <http://www.theguardian.com/social-enterprise-network/2012/oct/10/social-enterprise-momentum-impact-reporting> [https://perma.cc/LAB6-2BCW] (“[S]ocial enterprises need[] to get involved with shaping existing and emerging tools for reporting”).

72. *Id.*

73. See John Anner, *Jessica Alba and the Impact of Social Enterprise*, STAN. SOC. INNOVATION REV. (Sept. 26, 2014), http://ssir.org/articles/entry/jessica_alba_and_the_impact_of_social_enterprise [https://perma.cc/ZQ4Z-VY7N] (“[W]ith 28 million small and medium enterprises in America, benefit corporations need to stand out from the crowd on the basis of their added social value.”).

74. Reiser, *supra* note 3, at 684. (“Social entrepreneurs want to convey to investors that their entities will provide a different and better overall return — doing more for investors’ pocketbooks than a charitable donation and more for their souls than an ordinary stock or bond.”).

75. Denise Ping Lee, Note, *The Business Judgment Rule: Should it Protect Nonprofit*

decreasing government support and limited philanthropic dollars in grants, nonprofits have increasingly looked to market-based strategies and revenue streams to cover their operation costs.⁷⁶ As a result, a sizeable percentage of nonprofits are also social enterprises, because they use market-based strategies to pursue or sustain their charitable purpose.⁷⁷ The blurred lines of a nonprofit with a business enterprise means that nonprofit directors often have many of the same corporate responsibilities as for-profit directors but generally with less financial resources and often no compensation for their time and effort.

Thus, it is not surprising that the nonprofit sector often comes under scrutiny for failings of corporate governance.⁷⁸ Scandals within the nonprofit sector illustrate that good intentions are not sufficient to replace good governance practices.⁷⁹ The “ineffectiveness of nonprofit corporate

Directors?, 103 COLUM. L. REV. 925, 929 (2003).

76. Evelyn Brody, *Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms*, 40 N.Y.L. SCH. L. REV. 457, 457 (“[A] distinction [between nonprofits and for-profit corporations] long believed to be a difference of kind turns out to be a difference of degree.”); Karen A. Froelich *Diversification of Revenue Strategies: Evolving Resource Dependence in Nonprofit Organizations*, 28 NONPROFIT & VOLUNTARY SECTOR Q. 246, 246 (1999).

77. “A recent Bridgespan Group survey of nonprofit executives found that half of these practitioners expected that earned income would play an important role in their organizations’ future.” Jim Schorr, *Social Enterprise 2.0: Moving Towards a Sustainable Model*, STAN. SOC. INNOVATION REV., Summer 2006, at 12, <http://community-wealth.org/sites/clone.community-wealth.org/files/downloads/article-schorr.pdf> [<https://perma.cc/BYF5-9KYJ>].

78. See Chongmyong Lee & Branda Nowell, *A Framework for Assessing the Performance of Nonprofit Organizations*, 36 AM. J. EVALUATION 299, 299 (2015) (“As a result of a growing emphasis on accountability in government funding, nonprofits are under increasing pressure to demonstrate excellence in performance in order to secure financial resources similar to their public and private counterparts.”); see, e.g., Michael McDonald & Brian Chappatta, *Madoff Haunts Yeshiva as University Slides to Junk: Muni Credit*, BLOOMBERG (Jan. 21, 2014, 9:36 PM), <http://www.bloomberg.com/news/articles/2014-01-22/madoff-haunts-yeshiva-as-university-slides-to-junk-muni-credit> [<https://perma.cc/G4VA-UUED>] (quoting a Moody’s analyst explaining why Moody’s Investors Service cut the university’s rating to an unprecedented four levels below investment grade, “‘It’s about their management.’”); Philip Rucker, *United Way Fundraising Rises after Scandal-Induced Plunge*, WASH. POST (Nov. 30, 2007), <http://www.washingtonpost.com/wp-dyn/content/article/2007/11/29/AR2007112902007.html> [<https://perma.cc/G568-PCUP>] (describing how corporate executive theft and mismanagement led to lost fundraising and a damaged reputation); Stephanie Strom & Campbell Robertson, *As Its Coffers Swell, Red Cross is Criticized on Gulf Coast Response*, N.Y. TIMES (Sept. 20, 2005), <http://www.nytimes.com/2005/09/20/us/nationalspecial/as-its-coffers-swell-red-cross-is-criticized-on-gulf-coast-response.html> [<https://perma.cc/8E3N-Q9QU>] (describing the public’s frustration with the Red Cross’s practice of not fully utilizing donations designated for particular relief, but instead allocating those funds to other programs).

79. See Faith Rivers James, *Nonprofit Pluralism and the Public Trust: Constructing a*

governance and the virtual absence of accountability constraints” has not gone without considerable criticism.⁸⁰ Calls for governance reform within the nonprofit sector have not made much impact in part because nonprofit corporate governance operates without much government oversight.⁸¹ The limited law on nonprofit corporate governance is fragmented primarily between corporate law and tax law.⁸² Because of the business structure and nonprofit corporate law statutes, directors of nonprofit social enterprises have fiduciary duties that mirror the obligations of for-profit directors.⁸³ While nonprofit directors are held to high standards as stewards of assets dedicated to the public benefit,⁸⁴ they are provided with little guidance for how to implement organizational oversight.

Professor George Dent argues that nonprofit corporate governance is less effective than for-profit corporate governance in part because nonprofit directors do not know what directorship entails, and, as a result, the CEO, not directors, governs the nonprofit with little oversight.⁸⁵ Nonprofit directors often have insufficient information to make informed decisions and provide executive oversight and evaluation. The existence of shareholders in a for-profit business is a means to the ends of information

Transparent, Accountable, and Culturally Competent Board Governance Paradigm, 9 BERKELEY BUS. L.J. 94, 96 (2012) (noting that poor governance has contributed to the perception that the independent sector should improve the governance model).

80. Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631, 653 (1998).

81. See James, *supra* note 79, at 95 (noting that nonprofits still operate in an independent manner, “outside of heavy government control”); see also Thomas H. Boyd, Note, *A Call to Reform the Duties of Directors Under State Not-For-Profit Corporation Statutes*, 72 IOWA L. REV. 725, 741-42 (1987) (explaining that the New York statute specifically addresses the board’s “power to make and retain investments on behalf of the corporation”).

82. Thomas Lee Hazen & Lisa Love Hazen, *Punctilios and Nonprofit Corporate Governance — A Comprehensive Look at Nonprofit Directors’ Fiduciary Duties*, 14 U. PA. J. BUS. L. 347, 351 (2012) (“There is no single unified body of law that applies to charities and other nonprofits. Instead, the law in this area is fragmented Instead, the law regulating nonprofit and charitable governance remains an amalgam of trust law, corporate law, and tax law.”).

83. *Id.* at 356.

84. *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928) (“A trustee is held to something stricter than the morals of the market place.”).

85. See, George W. Dent, Jr., *Corporate Governance Without Shareholders: A Cautionary Lesson From Non-Profit Organizations*, 39 DEL. J. CORP. L. 93, 99-100 (2014) (discussing why nonprofit boards frequently do not govern); see also Evelyn Brody, *The Board of Nonprofit Organizations: Puzzling Through the Gaps Between Law and Practice*, 76 FORDHAM L. REV. 521, 534 (2007) (“In the case of nonprofits, some observers believe that the absence of shareholders emphasizes an inappropriate reversal of the power relationship between the board and the officers.”).

generation because for-profit corporations have to produce regular annual reports and provide disclosures to shareholders. Professor Dent argues that shareholder governance works particularly well because shareholders have a variety of enforcement tools at their disposal.⁸⁶ Regardless of how unlikely shareholders are to use these enforcement tools,⁸⁷ Professor Dent argues that the possibility of litigation serves as an effective accountability mechanism.⁸⁸ While he is particularly negative about the quality of nonprofit governance, Professor Dent admits that similar poor governance characteristics are also found in for-profit companies.⁸⁹ While helpful in identifying the shortcomings within nonprofit governance, it is clear that these issues are not unique to the nonprofit sector.⁹⁰ Thus, Dent establishes the existence of a correlation between poor corporate governance and no shareholders without establishing that no shareholders causes poor governance. Professor Dent's analysis, for example, does not compare the governance practices between nonprofits and for-profit companies that have similar operating budgets. One would likely find even more governance similarities between nonprofits and for-profits with similar operating budgets than Professor Dent acknowledges in this article. If nonprofits had a mechanism for regularly producing information and disseminating it to directors, then this would address many of the

86. See Dent, *supra* note 85, at 108 (describing how shareholders use the threat of a policy resolution for shareholder vote to “generate[] publicity that criticizes management.”).

87. See Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1644 (2001) (explaining that shareholder wealth maximization is a non-legally enforceable rule because of the judiciary's hesitation to question business judgments); see also Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 Nw. U. L. REV., 547, 573 (2003) (“Shareholders exercise virtually no control over either day-to-day operations or long-term policy.”); Lin, *supra* note 44, at 367 (“[M]any institutional shareholders lack proper economic incentives and organizing mechanisms to meaningfully engage in shareholder activism.”).

88. See Dent, *supra* note 85, at 108-09 (“The outside directors may not feel much of a personal stake in these battles; they may be unwilling to wage a public campaign against the shareholders just to preserve the privileges of the managers.”).

89. *Id.* at 106-108 (noting the possibility that “the board's self-selected slate of nominees [can run] unopposed,” that “most directors who have failed to obtain a majority [shareholder] vote remain in their positions,” and that shareholder policy resolutions “often fail, and even when approved they are usually not binding on the board.”). See also Douglas Litowitz, *The Corporation as God*, 30 J. CORP. L. 501, 525 (2005) (“For a while it was hoped that the condition of shareholder powerlessness would be remedied by the rise of institutional shareholders Unfortunately, this has not exactly worked The end result . . . is that the modern corporation is essentially a self-perpetuating oligarchy of managers largely immune from input by shareholders, employees, and directors.”).

90. Dent, *supra* note 85, at 112-13 (comparing nonprofit boards to the functioning of large public companies).

governance weaknesses that Dent identifies. In other words, it may be the collection of information and thoughtful review of company performance at various levels that creates a divide in company performance, not shareholder governance versus nonprofit governance as Dent posits.

Many of the suggested measures for improving nonprofit boards also serve as critiques of for-profit boards. The common recommendations for nonprofit boards include the carefully planned division of authority,⁹¹ clear definition of organizational goals, and standards for review of executive performance.⁹² Implementing these suggestions would depend on the volition of the directors, as there is no external force to compel their adoption.⁹³ State attorneys general have the authority to oversee charitable organizations within their jurisdictions to prevent the mismanagement of the public's donations. However, they exert limited influence on nonprofit governance and often intervene late to resolve nonprofit issues.⁹⁴ The California Nonprofit Integrity Act of 2004 (the "Integrity Act"),⁹⁵ for example, was an extension of the federal corporate governance resurgence;⁹⁶ it requires that any charity registered with the California Office of the Attorney General, receiving annual gross revenues of \$2 million or more, must form an audit committee.⁹⁷ The goal of the Integrity Act is to increase the scrutiny of high asset nonprofits, which account for a significant amount of wealth within this country.⁹⁸ However, these

91. JOHN TROPMAN & THOMAS J. HARVEY, *NONPROFIT GOVERNANCE: THE WHY, WHAT, AND HOW OF NONPROFIT BOARDSHIP* 7–9 (2009).

92. DENNIS D. POINTER & JAMES E. ORLIKOFF, *THE HIGH-PERFORMANCE BOARD: PRINCIPLES OF NONPROFIT ORGANIZATION GOVERNANCE* 23–79 (2002).

93. See Nicole Gilkeson, *For-Profit Scandal in the Nonprofit World: Should States Force Sarbanes-Oxley Provisions Onto Nonprofit Corporations?*, 95 *GEO. L.J.* 831, 852–53 (2007) (noting that under-enforcement of nonprofit regulation in California will likely continue due to the limited resources of the California Attorney General).

94. See *Paterson v. Paterson Gen. Hosp.*, 235 A.2d 487, 495 (N.J. Super. Ct. 1967) (acknowledging the multiple duties of Attorney General's office which necessarily make nonprofit oversight sporadic and neglected).

95. California Nonprofit Integrity Act of 2004, 2004 CAL. STAT. 919 (codified as amended in scattered sections of CAL. BUS. & PROF. CODE and CAL. GOV'T CODE).

96. Gilkeson, *supra* note 93, at 847 ("The California Act is ineffective because it relies on a solution tailored for the for-profit sector—auditing requirements—instead of crafting a solution to address issues in the nonprofit sector.").

97. CAL. GOV'T CODE § 12586(e)(2) (2005).

98. The nonprofit sector contributed an estimated \$984.9 billion of the U.S. economy in 2015, composing 5.4 percent of the country's gross domestic product. *National Data: National Income and Product Accounts Tables, Table 1.3.5: Gross Value Added by Sector*, U.S. DEPT. OF COMMERCE, BUREAU OF ECONOMIC ANALYSIS tbl. 1.3.5, <http://www.bea.gov/iTable/iTable.cfm?ReqID=9&step=1#reqid=9&step=3&isuri=1&903=24> [<https://perma.cc/5YDK-8QB6>] (last visited June 6, 2016); see also *Nonprofits Worth \$887.3 Billion to U.S. Economy*, *NONPROFIT TIMES* (Oct. 28, 2014),

financial audit requirements only apply to large nonprofits and are unlikely to influence the governance of emerging nonprofit social enterprises.

Perhaps the most significant agency for influencing nonprofit corporate governance is the Internal Revenue Service (IRS), which determines at the federal level whether a nonprofit qualifies for tax-exempt status. Through the application of the Internal Revenue Code's requirements for federal recognition of tax-exemption and the annual income tax reporting requirement, the IRS "attempts to reduce the potential for conflict of interest transactions by requiring disclosure of insider relationships, questioning relationships, and agreements that might result in excess benefit transactions, and explicitly suggesting that organizational bylaws include a comprehensive conflict of interest provision."⁹⁹ While helpful, outside of these limited circumstances, nonprofit social enterprises are not counseled on how to balance and manage competing interests within a sustainable business. Arguments have been made for how voluntary clubs can complement and support enforcement of legal and regulatory obligations on nonprofit directors.¹⁰⁰ Professor Brakman Reiser, for example, argues that while financial disclosure standards are the most developed for nonprofits, there is still a lack of enforcement of governance and mission accountability post nonprofit incorporation.¹⁰¹ "Performance measurement in the nonprofit sector is complicated by the fact that nonprofits often pursue missions whose achievement is difficult to measure."¹⁰² In short, there are few tools for monitoring and supporting nonprofit governance.¹⁰³ Thus, nonprofit social enterprises would greatly benefit from a mechanism by which to document and refine their corporate governance.

C. *The Rise of Hybrid-Entity Legislation*

Laws to support the growth of the social enterprise sector have focused almost exclusively on developing new legal entity forms. Starting

<http://www.thenonprofitimes.com/news-articles/nonprofits-worth-887-3-billion-u-s-economy/> [<https://perma.cc/8CX8-75H9>] ("The tax-exempt sector in the United States represented 5.4 percent of the nation's gross domestic product (GDP) during 2012, contributing \$887.3 billion to the economy.").

99. James, *supra* note 79, at 100.

100. Dana Brakman Reiser, *Filling the Gaps in Nonprofit Accountability: Applying the Club Perspective in the U.S. Legal System*, in NONPROFIT ACCOUNTABILITY CLUBS: VOLUNTARY REGULATION OF NONPROFIT AND NONGOVERNMENTAL ORGANIZATIONS (2008).

101. *Id.*

102. Lee & Nowell, *supra* note 78, at 300.

103. Hazen & Hazen, *supra* note 82, at 361.

in 2007,¹⁰⁴ jurisdictions enacted legislation on new legal forms to enable founders of social enterprises to explicitly claim social mission and profit-making in a single entity.¹⁰⁵ To date these new legal entities include the low-profit limited liability company (or “L3C”),¹⁰⁶ the benefit LLC,¹⁰⁷ the benefit corporation (or “b-corp”),¹⁰⁸ and the social purpose corporation.¹⁰⁹ These hybrid-entity statutes are the first new corporate forms with a national scope to be introduced into American corporate law since the limited liability partnership in 1991.¹¹⁰ Generally, these hybrid entities

104. For example, L3C became an official entity in Vermont on April 30, 2008. VT. STAT. ANN. tit. 11, § 3001 (2008). See also OR. REV. STAT. § 60.047(2)(e) (enabling an articles of incorporation “provision authorizing or directing the corporation to conduct the business of the corporation in a manner that is environmentally and socially responsible.”); Judd F. Sneirson, *Green Is Good: Sustainability, Profitability, and a New Paradigm for Corporate Governance*, 94 IOWA L. REV. 987, 1019 (2009).

105. See Reiser, *supra* note 3, at 685 (“One of the most basic things social entrepreneurs seek in a specialized legal form is safe space to declare that their entities are committed to a new and different goal — pursuing both profit and social good.”).

106. The L3C retain the flexibility and protections of the standard LLC while integrating the Internal Revenue Code definitions of “charitable” and “educational” purpose. Dana Thompson, *L3Cs an Innovative Choice for Urban Entrepreneurs and Urban Revitalization*, 2 AM. U. BUS. L. REV. 115, 146 (2012). If the L3C ceases to comply with the Internal Revenue Code definitions, it automatically converts into a traditional LLC. *Id.* at 150; see also Reiser, *supra* note 3, at 690 (“The L3C adds charitable or education purpose requirements to an otherwise standard LLC framework.”).

107. The benefit LLC relies on the traditional LLC framework but requires the entity to pursue a general public benefit that is evaluated by a third-party standard. MD. CODE ANN., CORPS. & ASS’NS §§ 4A-1101 to -1108 (LexisNexis 2013), amended by 2013 Md. Laws. ch. 527 (S.B. 697) (codifying benefit LLCs); OR. REV. STAT. §§ 60.750-66.770 (2014). Oregon is one of a few states that provides for the benefit LLCs; the greater number of benefit LLCs over benefit corporations in Oregon suggests that the LLC format often works better for small businesses. See *Active Benefit Companies*, STATE OF OREGON, <https://data.oregon.gov/Business/Active-Benefit-Companies/baig-8b9x> [<https://perma.cc/KW9L-MSDG>] (last visited Apr. 15, 2016) (listing the active benefit corporations in the State of Oregon).

108. By statute the b-corp must pursue an articulated general public benefit, defined as “a material positive impact on society and the environment, . . . assessed against a third-party standard” MODEL BENEFIT CORP. LEG. § 102 (B LAB Jan. 13, 2016). A b-corp is not synonymous with a company that has received certification from the organization B Lab, although both are called “benefit corporations.” To be certified by B Lab as a benefit corporation an entity does not have to be incorporated or be a b-corp under state statute.

109. See Alexandra Leavy, *Necessity Is the Mother of Invention: A Renewed Call to Engage the SEC on Social Disclosure*, 2014 COLUM. BUS. L. REV. 463, 482-83 (2014) (describing the requirements of the Social Purpose Corporation).

110. See Alysa Christmas Rollock, *Professional Responsibility and Organization of the Family Business: The Lawyer As Intermediary*, 73 IND. L.J. 567, 587 n.2 (1998) (noting that Texas was the first state to enact a statute allowing limited liability partnerships in 1991); Cf. Justin Blount & Patricia Nunley, *Social Enterprise, Corporate Objectives, and the Corporate Governance Narrative*, 52 AM. BUS. L.J. 201, 201 (2015) [hereinafter *Corporate*

have been met with excitement¹¹¹ and embraced by various segments within both the business and legal communities.¹¹² But scholars have also documented the potential dangers and unintended consequences of segregating social enterprises into separate legal entities, namely succumbing to the theory that traditional for-profit entities require directors to prioritize profit maximization in their corporate decision-making.¹¹³

Objectives] (“[A] more recent corporate entity development is the rise of the ‘social enterprise.’”).

111. Kyle Westaway, *Something Republicans and Democrats Can Agree On: Social Entrepreneurship*, STAN. SOC. INNOVATION REV. (Apr. 17, 2012), http://ssir.org/articles/entry/something_republicans_and_democrats_can_agree_on_social_entrepreneurship [<https://perma.cc/X4EE-AF4Y>].

112. Mike Isaac & David Gelles, *Kickstarter Focuses Its Mission on Altruism Over Profit*, N.Y. TIMES (Sept. 20, 2015), <http://www.nytimes.com/2015/09/21/technology/kickstarters-altruistic-vision-profits-as-the-means-not-the-mission.html> [<https://perma.cc/GM3J-JHYE>]; Heerad Sabeti, *The For-Benefit Enterprise*, HARV. BUS. REV. (Nov. 2011), <https://hbr.org/2011/11/the-for-benefit-enterprise> [<https://perma.cc/833C-DUL6>]. Embracement by these communities will help these hybrid entities succeed. Cf. DERRICK BELL, SILENT COVENANTS 64-69 (2004) (cautioning that interest-convergence, the apparent reconciliation of competing values, among the disenfranchised and empowered populations that lead to possibly effective remedies will not ultimately achieve promised structural change because these results will be abrogated at the point they threaten the empowered); Derrick Bell, *Brown vs. Board of Education and the Interest Convergence Dilemma*, 93 HARV. L. REV. 518, 518 (1980) (describing how the divergence of interests makes integration less feasible).

113. Blount & Nunley, *supra* note 24, at 312 (“The danger of creating new entity forms is that in the long term, limiting social enterprise to certain entity forms may result in marginalizing the value creation concepts of social enterprise to a subset of business entities, which has the potential to limit social enterprise’s impact on society. The creation of new hybrid entities also tacitly gives credence to the widely held but inaccurate view that standard, for-profit corporations can legally justify misconduct or unethical decision-making as the relentless pursuit of profits required by corporate law.”); Joseph W. Yockey, *Does Social Enterprise Law Matter?*, 66 ALA. L. REV. 767, 800 (2015) (“[S]ome maintain that benefit corporations statutes actually create a harmful dichotomy between ‘profit-only’ corporations and ‘responsible’ corporations. The argument is that, by resting on the false premise that managers of traditional corporations must prioritize profits above all else, the benefit corporation form undermines efforts to convince *all* corporate managers that CSR-driven activities are consistent with their fiduciary duties.” (emphasis in original)); *see also* Joan Heminway, *Random Thoughts on the Beneficiaries of Corporate Board Decision Making*, BUSINESS LAW PROF BLOG (June 10, 2015), http://lawprofessors.typepad.com/business_law/2015/06/random-thoughts-on-the-beneficiaries-of-corporate-board-decision-making.html#more [<https://perma.cc/J575-2J3U>] (noting that for “states, like Tennessee, [that] have not expressly adopted in legislative or judicial rule-making a shareholder wealth maximization norm . . . the enactment of benefit corporation legislation may (unwittingly) be construed as an endorsement of the notion that directors of [traditional] for-profit corporations . . . are required to consider only or primarily . . . the pecuniary interests . . . of shareholders.”); Mark A. Underberg, *Benefit Corporations vs. “Regular” Corporations: A Harmful Dichotomy*, HARV. L. SCH. F. ON

Although currently most social enterprises are not formed as a hybrid entity,¹¹⁴ the hybrid entities still serve an important and growing segment of the social enterprise sector. Hybrid entities are visible representatives for the recent rise in social enterprises even if they are a relatively small percentage of social enterprises. Hybrid entities also help create the counter-norm for what it means to be a social enterprise in the public perception because they are off-the-shelf legal forms that contemplate profit returns and social mission. Hybrid entities allow the emerging sector to better define which businesses fit the definition of a social enterprise. The legal structures of hybrid entities would not be advantageous for traditional charity-focused nonprofits that do not have a substantial revenue stream because hybrid entities do not provide a favorable tax treatment.¹¹⁵ Similarly, it is not clear that a traditional for-profit business would benefit from forming as a hybrid entity. Thus, it is a fair assertion that, for all practical purposes, the vast majority of hybrid entities are social

CORP. GOVERNANCE & FIN. REG. (May 13, 2012), <http://corpgov.law.harvard.edu/2012/05/13/benefit-corporations-vs-regular-corporations-a-harmful-dichotomy/> [<https://perma.cc/FXG9-M8FB>] (“[V]iewed from a broader corporate governance perspective, the [benefit corporation] initiative — however well-intentioned — has troubling implications. The problem is that its primary rationale rests on the mistaken, though widely-held, premise that existing law prevents boards of directors from considering the impact of corporate decisions on other stakeholders, the environment or society at large. This crabbed view of directorial fiduciary duties perpetuates the unfortunate misconception that existing law compels companies to single-mindedly maximize profits and share price, and in so doing undermines the very values that corporate governance advocates should seek to promote: responsible, sustainable corporate decision-making by companies of any stripe.”). *But see* MODEL BENEFIT CORP. LEG. § 101(b) (B LAB Jan. 13, 2016) (“Application of business corporation law generally. — The existence of a provision of this [chapter] shall not of itself create an implication that a contrary or different rule of law is applicable to a business corporation that is not a benefit corporation. This [chapter] shall not affect a statute or rule of law that is applicable to a business corporation that is not a benefit corporation.” (emphasis omitted)).

114. Exact numbers and percentages are hard to pin down because of the limited empirical data on the social enterprise sector. *See* Anner, *supra* note 73 (noting the “decided lack” of empirical data on social enterprises). “There are 1008 companies that are certified B corporations.” *People Using Business as a Force for Good*, B LAB, <https://www.bcorporation.net/b-the-change> [<https://perma.cc/9TZF-6DV5>] (last visited May 9, 2016). There is also the Social Enterprise Database with approximately 1,800 social enterprises listed. *Social Enterprise Database*, GIVE TO GET JOBS: FOR-PROFIT JOBS THAT GIVE BACK, http://givetogetjobs.com/social-enterprise.php?keywords=&zip=&zip_radius=&x=69&y=22 [<https://perma.cc/RLM5-PNLX>] (last visited May 9, 2016).

115. *See* Lloyd Hitoshi Mayer & Joseph R. Ganahl, *Taxing Social Enterprise*, 66 STAN. L. REV. 387, 421 (2014) (“[T]he creation of these new hybrids does not create any new tax categories or treatments. The different types of hybrid corporations . . . are treated the same as more typical state law corporations.”).

enterprises, even though the community of social enterprises reaches beyond hybrid-entity forms.

The argument for enacting hybrid-entity legislation is that traditional for-profit and nonprofit legal entities frustrate the potential of a social enterprise, forcing “a founder to choose between two equally inadequate categories.”¹¹⁶ Regardless of their legal necessity,¹¹⁷ one cannot deny the important normative discourse that hybrid-entity legislation has sparked about the role for-profit companies ought to play within society.¹¹⁸

1. Fiduciary Duties Restrict Social Mission Considerations

The principal argument for hybrid-entity legislation is that fiduciary duties of traditional for-profit entities, particularly a for-profit corporation,¹¹⁹ force the directors and officers to prioritize owner maximization of profit, with no carve out to preserve the social mission of

116. Reiser, *supra* note 3, at 683. See also WHITE PAPER, *supra* note 8, at 1 (“The sustainable business movement, impact investing and social enterprise sectors are developing rapidly but are constrained by an outdated legal framework that is not equipped to accommodate for-profit entities whose social benefit purpose is central to their existence.”).

117. See, Blount & Nunley *supra* note 110, at 223 (arguing that hybrid entities are “an overly complex solution to the relatively basic core difference between a social enterprise and a traditional for-profit business — a different corporate objective. By focusing on this basic distinction, a much simpler, but more effective, approach to reform can be devised that addresses the heart of the problem.” (footnote omitted)).

118. See TEDx, *TEDxPhilly – Jay Coen Gilbert – On Better Businesses*, YOUTUBE (Dec. 1, 2010), <https://www.youtube.com/watch?v=mGnz-w9p5FU> [<https://perma.cc/E2CM-UNGN>], at 10:10 (“Right now our capitalist system is not serving society; it’s serving shareholders. And we can’t run around expecting different outcomes until we change the rules of the game.”).

119. See *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919) (“A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end . . . and does not extend to . . . other purposes.”); PRINCIPLES OF CORP. GOVERNANCE § 2.01 (AM. LAW. INST. 1994) (“a corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain.”). See also THOMAS J. BILLITTERI, *MIXING MISSION AND BUSINESS: DOES SOCIAL ENTERPRISE NEED A NEW LEGAL APPROACH?* 14 (2007),

https://www.aspeninstitute.org/sites/default/files/content/docs/pubs/New_Legal_Forms_Report_FINAL.pdf [<https://perma.cc/4XMZ-2SF8>] (“[T]raditional corporations have a duty to maximize financial returns for shareholders, broadening that mandate to include a duty to a social mission could require revisions in state corporate law.”). *But see Stop Teaching Dodge*, *supra* note 18, at 165-68 (explaining that the Michigan Supreme Court’s “offhand remark” regarding the powers of directors is “judicial dicta, quite unnecessary to reach the Court’s desired result” because the case deals “with controlling shareholders’ duties not to oppress minority shareholders” not directors’ fiduciary duties as it is often relied on).

the entity.¹²⁰

Thus, it is often espoused that the fiduciary duty to maximize profits prevents or, at least, limits the ability of directors and officers to consider social goals at the risk of reducing profits.¹²¹ But as other scholars have noted, corporate law does not require that shareholder maximization be the sole objective of a for-profit entity.¹²² Courts routinely protect the decisions of directors under the judicial doctrine called the “business judgment rule”¹²³ as long as any rational business purpose could have

120. See Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 33, <http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html> [<https://perma.cc/TV3J-VNjX>] (“In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society.”).

121. See Blount & Nunley, *supra* note 24, at 304-06 (recognizing and rejecting the shareholder primacy argument for which many commentators argue).

122. See, e.g., Virginia Harper Ho, “*Enlightened Shareholder Value*”: *Corporate Governance Beyond the Shareholder Stakeholder Divide*, 36 J. CORP. L. 59, 74 (2010) (“Indeed, neither case law nor corporate statutes impose on directors and officers an obligation to maximize shareholder wealth. Even in Delaware, whose corporate code is less receptive to stakeholder interests than many other state corporate statutes, there is no requirement that management decision-making maximize shareholder wealth or even be justified solely in terms of shareholder interests.”); John A. Pearce II, *The Rights of Shareholders in Authorizing Corporate Philanthropy*, 60 VILL. L. REV. 251, 251 (2015) (“Despite any misimpressions to the contrary, corporate statutes do not dictate that directors have a singular duty to pursue profit-maximizing activities.”); *Stop Teaching Dodge*, *supra* note 18, at 172 (“[T]he notion that corporate law as a positive matter ‘requires’ companies to maximize shareholder wealth turns out to be spurious.”); Yockey, *supra* note 113, at 770 (“Proponents miss the mark when they argue that benefit corporation laws are necessary to enable firms to put social goals on par with profits. Indeed, corporate law already provides entrepreneurs with much of what the benefit corporation form claims to offer.”); see generally, Lisa M. Fairfax, *Doing Well While Doing Good: Reassessing the Scope of Directors’ Fiduciary Obligations in For-Profit Corporations with Non-Shareholder Beneficiaries*, 59 WASH. & LEE L. REV. 409 (2002) (discussing directors’ fiduciary duties in various contexts as the law exists and is changing).

123. See *Int’l Ins. Co. v. Johns*, 874 F.2d 1447, 1458 (11th Cir. 1989) (describing the judicial deference given the board as the business judgment rule); *Smith v. Van Gorkam*, 488 A.2d 858, 872 (Del. 1985) (explaining that the “business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors” and thus rest on the “fundamental principle . . . that the business and affairs of a Delaware corporation are managed by or under its board of directors”); PRINCIPLES OF CORP. GOVERNANCE § 4.01 (AM. LAW INST. 1994) (outlining the duty of care required by directors and officers to a corporation, subject to the business judgment rule); Douglas M. Branson, *The Rule That Isn’t A Rule - the Business Judgment Rule*, 36 VAL. U. L. REV. 631, 632 (2002) (summarizing the development, role, and applicability of the business judgment rule for modern directors).

possible future benefit to the shareholders.¹²⁴ As Professor Lynn Stout argues, there is “judicial eagerness to protect directors” such that even when they fail to offer long-run shareholder benefits, the court will often make the connection for the directors.¹²⁵ There are few legal scholars who would not agree that, apart from limited defensive¹²⁶ and change of control decisions,¹²⁷ “the business judgment rule will shelter corporate directors from liability for virtually all operational decisions.”¹²⁸

Although corporate law does not require directors and executives to prioritize shareholder maximization in all decisions,¹²⁹ the widely-held, public perception is that profit objectives dominate traditional for-profit companies.¹³⁰ Those profit maximizing objectives, the perception

124. *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1373 (Del. 1995) (“[T]he business judgment rule shields directors from personal liability if, upon review, the court concludes the directors’ decision can be attributed to any rational business purpose.”); *see also* Lin, *supra* note 44 at 369 (“Courts historically have shown great procedural and substantive deference to the decisions and judgments of corporate executives.”).

125. *Stop Teaching Dodge*, *supra* note 18 at 171.

126. Directors are provided significantly less deference when the courts review decisions undertaken defending takeover attempts. *See Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954-55 (Del. 1985) (holding that directors have the benefit of the business judgment rule only if the directors can first demonstrate a legitimate threat to a corporate policy and that their response was reasonable given the threat posed); *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 35 (Del. Ch. 2010) (“Directors of a for-profit Delaware corporation cannot deploy a [corporate mission] to defend a business strategy that openly eschews stockholder wealth maximization – at least not consistently with the directors’ fiduciary duties under Delaware law.”).

127. *See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (finding that when the company is broken up and shareholders are forced to sell their shares, the board has a duty to maximize shareholder wealth by getting the highest possible price for the shares). *But see* Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1204 (2002) (providing examples of the Delaware Supreme Court systematically cutting back the situation where *Revlon* applies).

128. Reiser, *supra* note 3, at 687.

129. *See Page & Katz*, *supra* note 41, at 231-32 (discussing how profit maximization may be the norm, but that norm is likely unenforceable in courts that regularly grant boards of directors deference under the business judgment rule).

130. *See* Lynn A. Stout, *The Shareholder Value Myth*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (June 26, 2012), <http://corpgov.law.harvard.edu/2012/06/26/the-shareholder-value-myth/> [<https://perma.cc/E5MV-UADS>] (“Shareholder-value thinking dominates the business world today. Professors, policymakers, and business leaders routinely chant the mantras that public companies ‘belong’ to their shareholders; that the proper goal of corporate governance is to maximize shareholder wealth; and that shareholder wealth is best measured by share price (meaning share price today, not share price next year or next decade)”). *See also Corporate Objectives*, *supra* note 110, at 233-34 (“Because of the contractual uniformity around the default corporate objective of shareholder wealth maximization, the public perception of the rigidity of the for-profit corporate does not match the reality of flexibility allowed by law. This perception had led

contends, will inevitably compromise any social goals in the company's decision-making. For this reason, legal theorists Edward Rock and Michael Wachter characterize profit maximization as a “non-legally enforceable rule or standard” or norm.¹³¹ They acknowledge that competitive theory is a strong motivator to maintain the standard of executives maximizing corporate profits.¹³² But they argue that the standard is not legally enforceable.¹³³ Courts are extremely reluctant to intervene in claims “that managers are not maximizing firm value” and, thus, reliably reject these shareholder claims.¹³⁴ Although not legally enforceable, the norm of profit maximization is still a dominant force in for-profit company decision-making — so much so that legally enforceable rules are unnecessary to perpetuate this practice across industry.

Hybrid entities, thus, are a powerful step towards disrupting the profit maximization norm within for-profit companies.¹³⁵ The hybrid-entity forms allow founders, directors, and officers to preempt the common conception that profit objectives will eventually govern business decision-making by explicitly designating the dual social mission commitment of the company.¹³⁶ The hybrid-entity form also establishes a clear expectation for owners¹³⁷ about the direction of the company that should mitigate owner

to an inaccurate but honestly felt need from social entrepreneurs for new business entities.”); *Stop Teaching Dodge*, *supra* note 18, at 164 (noting that the general public pays little attention to the scholarly debate regarding the legal purpose of the corporation).

131. Rock & Wachter, *supra* note 87, at 1643 (“The most striking example of a transfirm [non-legally enforceable rule or standard] of the corporation seems to be ‘maximize profits.’”).

132. *Id.* at 1644.

133. *Id.*

134. *Id.*

135. *See, e.g.*, Press Release, Ello, PBC, A Better Way (Oct. 20, 2014), <https://ello.co/wtf/downloads/ello-pbc.pdf> [<https://perma.cc/8B2P-WFHJ>] (“Ello exists for your benefit, not just to make money.”); Jonathan Shieber, *Ello Raises \$5.5 Million, Legally Files as Public Benefit Corp. Meaning No Ads Ever*, TECHCRUNCH (Oct. 23, 2014), <http://techcrunch.com/2014/10/23/ello-raises-5-5-million-legally-files-as-public-benefit-corp-meaning-no-ads-ever/> [<https://perma.cc/Q68J-4YUN>] (discussing Ello's ability to raise significant venture capital funds despite rejecting traditional revenue streams based on ads and selling user data).

136. Reiser, *supra* note 3, at 684 (“Rather than hiding these dual aspirations [of profit-making and social mission] behind a veneer of ‘business as usual’ or under the halo of selflessness, these founders want to claim their social enterprise’s blended missions explicitly.”).

137. *See* Celia R. Taylor, *Berle and Social Businesses: A Consideration*, 34 SEATTLE U. L. REV. 1501, 1510 (2011) (explaining that charter documents are contracts “that provide the discipline and incentives that corporations expect from fiduciaries”); *see also* PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01 n.6 (AM. LAW. INST. 1994) (“[T]here is little doubt that [social mission decisions] would normally be

concerns down the line. Traditional for-profit legal entities may provide the executives and directors with the legal right to consider non-shareholder stakeholders and social mission, but the hybrid entities typically mandate a requirement for executives and directors to consider the mission.¹³⁸ Thus, the argument goes, hybrid entities remove speculation and position the social mission in a prominent place within the company decision-making.

2. Nonprofit Structure Restricts Revenue Generation

On the other hand, the argument is that the nonprofit legal form¹³⁹ is also insufficient for social enterprises because it does not provide the same potential for growth and retaining talent as for-profit legal entities. While all directors and officers must maintain the social mission of the nonprofit,¹⁴⁰ the inability¹⁴¹ to raise capital through equity investment¹⁴² frustrates the company's ability to scale and attract competitive talent. Retaining talent over the life of the nonprofit is also a serious barrier because a nonprofit business cannot provide equity incentives to its employees unlike lean, for-profit start-ups. The limit on commercial activity directly related to the tax-exempt purpose of most nonprofits imposes yet another obstacle to growth. The tax-exempt status of the

permissible if agreed to by all the shareholders. Such an agreement might be embodied in the certificate of incorporation, or not.”).

138. See, e.g., MODEL BENEFIT CORP. LEGIS. § 301(a) (B LAB Jan. 13, 2016) (“[D]irectors . . . shall consider the effects of any action or inaction upon . . . the ability of the benefit corporation to accomplish its general public benefit purpose and any specific public benefit purpose.”).

139. Although nonprofits can be formed as corporations, charitable trusts, or LLCs, this Article recognizes that most nonprofit entities are formed as corporations and, thus, will use nonprofit and nonprofit corporation interchangeably.

140. See Harvey J. Goldschmid, *supra* note 80, at 641 (noting that nonprofit directors should be “principally concerned with the effective performance of their nonprofit’s mission”).

141. See Clara Miller, *The Equity Capital Gap*, STAN. SOC. INNOVATION REV. 41, 42 (Summer 2008), http://www.socialimpactexchange.org/sites/www.socialimpactexchange.org/files/publications/equity_capital_gap.pdf [<https://perma.cc/E897-WBCG>] (highlighting the difference between for-profit corporations’ ability to solicit equity capital, and nonprofits restrictions in doing so because individuals are prohibited from owning and distributing profits in a nonprofit corporation).

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

nonprofit social enterprise means that executives cannot use all possible business strategies to support the business that would otherwise be available if the entity was for-profit.¹⁴³ The effect of limited commercial activity means that many nonprofits depend on charitable donations from the public and grants from the philanthropic sector. This is particularly problematic for social change organizations or companies that pursue counter-cultural objectives, as many social enterprises seek to do.¹⁴⁴ Generally, the philanthropic sector financially supports those organizations that are not engaged in radically altering established power structures.¹⁴⁵ This means that social change organizations have a particularly hard time finding funding and financial stability. “The hope is that the hybrid nature of a social enterprise will allow firms to bypass the structural and financing obstacles that confront . . . nonprofits so they can address social issues in innovative ways.”¹⁴⁶

3. The Current Impact of Hybrid Entities

While approximately three-quarters of state jurisdictions now provide for some hybrid-entity form,¹⁴⁷ a limited number of social enterprises have

143. See Reiser, *supra* note 3, at 682, 685-89 (describing the assertion that “social enterprises can do more good for more people than traditional nonprofits because their financing and business methods make them more efficient, effective, and scalable.”).

144. See William A. Bottiglieri et al., *The Regulation of Non-Profit Organizations*, 9 J. BUS. & ECON. RESEARCH, no. 9, 2011, at 51 (noting that nonprofit organizations often receive funding based on projects, which “can become problematic if the organization is not currently working on a specific project which has caught the attention of the public”).

145. See Rickke Mananzala and Dean Spade, *The Nonprofit Industrial Complex and Trans Resistance*, 5 SEXUALITY RESEARCH & SOC. POL’Y 53, 57-58 (2008), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1201022 [<https://perma.cc/G27F-T4ZY>] (“The process of successfully applying for funding, including having 501(c)(3) status or a fiscal sponsor, researching applicable grants, writing formal funding requests using specific jargon, having an awareness of current trends in funding, and having personal relationships with philanthropic professionals requires skills and relationships that are concentrated in people with educational, class, and race privilege.”). *But see* Alex Daniels, *Ford Shifts Grant Making to Focus on Inequality*, CHRONICLE OF PHILANTHROPY (June 11, 2015) <https://philanthropy.com/article/Ford-Shifts-Grant-Making-to/230839> [<https://perma.cc/64LF-NWAN>] (explaining why the Ford Foundation, a leader in philanthropy, has changed its grant making focus to support broad social-change movements and providing more operating expenses, president Darren Walker said a consistent theme was that people “especially nonprofit leaders, feel that foundations aren’t investing in building their institutions, building their capacity, and making them more durable and fortified”).

146. Yockey, *supra* note 113, at 773.

147. See Brewer, Minnigh & Wexler, *Social Enterprise by Non-Profits and Hybrid Organizations*, Portfolio #489, *Social Enterprise Hybrids Across the U.S.*, BLOOMBERG BNA

adopted these new legal entities.¹⁴⁸ Different hybrid entities have different potential reasons why founders and managers may not be selecting them. For the L3C, the reasons posited include the lack of clarity regarding its taxation status and ability to attract program-related investments from private foundations.¹⁴⁹ For the benefit corporation statutes, one reason is the lack of precedent for how courts will enforce the fiduciary duties under this corporate form.¹⁵⁰ By creating new legally enforceable fiduciary duties to additional stakeholders, hybrid entities require managers and directors to serve “two masters,” also described as “dual mission-management.”¹⁵¹ Thus, hybrid entities potentially generate more ambiguities and uncertainty than solutions. There is also the issue that corporate lawyers, who social entrepreneurs consult with for entity formation counsel, are not generally comfortable advising their clients to experiment with these new entity forms.¹⁵²

(2014), <http://socentlaw.com/wp-content/uploads/2015/03/Social-Enterprise-Hybrids-Map-Mar-2015.pdf> [<https://perma.cc/7M9Q-3NAG>] (providing a map showing various hybrid-entity forms as they do or do not exist in the United States).

148. See Mayer & Ganahl, *supra* note 115, at 389 (estimating that over “1000 of these new entities now exist”).

149. See Thompson, *supra* note 106, at 145-50 (discussing the reluctance of foundations to make program-related investments (PRIs) to L3Cs because it may be unclear whether it constitutes a proper PRI or improper “jeopardizing investment” for tax purposes, and the “low-profit” designation of L3Cs deters other types of investment). Program-related investments are tax-exempt investments, often low-interest loans or investments with an anticipated low return on investments, which private foundations make in nonprofit and social enterprise programs that further the tax-exempt mission of the private foundation. For additional information regarding program-related investments, see *Program Related Investments*, I.R.S., <https://www.irs.gov/Charities-&-Non-Profits/Private-Foundations/Program-Related-Investments> [<https://perma.cc/QT6F-KNYX>] (last visited May 11, 2016).

150. See Mark J. Loewenstein, *Benefit Corporations: A Challenge in Corporate Governance*, 68 BUS. LAW. 1007, 1027-34 (2013) (highlighting the numerous conflicts that arise when benefit corporation directors must make a decision, requiring directors to weigh many factors and consider multiple constituents, which leads to inferior decision-making practices); Murray, *supra* note 2, at 27 (criticizing the lack of guidance for directors in carrying out their fiduciary duties).

151. See *Applying Traditional Corporate Law*, *supra* note 15, at 223 (describing the “two masters” issue for social enterprises as enterprises having a profit motive, but with social or environmental missions still at their core); Laura A. Constanzo et al., *Dual-Mission Management in Social Entrepreneurship: Qualitative Evidence from Social Firms in the United Kingdom*, 52 J. SMALL BUS. MGMT. 655, 659-60 (2014) (discussing the divisive nature of some business corporation structures due to competing interests).

152. See J. Haskell Murray, *An Early Report on Benefit Reports*, 118 W. VA. L. REV. 25, 43 (2015) [hereinafter *An Early Report on Benefit Reports*] (noting the relative novelty of the benefit corporate form to some attorneys, and the misinformation among companies and legal sources when discussing benefit corporations); *Stop Teaching Dodge*, *supra* note 18, at

Another barrier to social enterprises incorporating as hybrid corporations is the perceived hardship in the benefit reporting requirement.¹⁵³ Hybrid-corporation statutes have, for the first time, included regular reporting requirements that are regulatory in nature, requiring social enterprises to measure impact and provide transparency about the company's social mission.¹⁵⁴ Traditional corporate statutes do not require similar public transparency. Corporate lawyers and companies may be hesitant about the potential expense and effort of regularly producing these benefit reports. But as explored above, selecting a traditional for-profit or nonprofit entity can lead to deficiencies in corporate governance and, thus, jeopardizes the sustainability of the social enterprise. In fact, the legal entity selected for the social enterprise may not matter as long as the company has the appropriate corporate governance structure in place. That said, the benefit reporting required of hybrid corporations may be an incredibly helpful tool in facilitating the social enterprise sector to develop and share corporate governance platforms that balance profit and mission.

Corporate lawyers working with social enterprises need an effective vocabulary to articulate the value of the benefit reporting requirements contained in the hybrid-corporation statutes. This Article continues the conversation on the contributions of hybrid-corporation statutes by explaining the impact that benefit reporting requirements could have on increased social enterprise governance, if adopted by social enterprises regardless of their legal form. Improved corporate governance across all social enterprise legal forms is necessary for a more effective and sustainable social enterprise sector.

II. CORPORATE GOVERNANCE PARADIGMS

The established corporate governance paradigm provides standards for transparency and accountability, but the regulatory governance regime is largely based on regulating and monitoring public companies. However, all companies, even small social enterprises, need robust corporate governance enforcement mechanisms because business entities, regardless of size, contain a variety of divergent interests that need to be aligned. Corporate law plays a major role not only in helping companies align these

174 (noting that it takes "a certain degree of boldness to depart from [corporate law] tradition.").

153. See *infra* Part II.C for more details on the requirement of various benefit reports.

154. See Yockey, *supra* note 113, at 799 (discussing the unique public/private characteristics of benefit corporation enabling laws).

divergent interests by requiring a system of checks and balances among the board of directors, executives, and owners, but also by establishing legal liability for the breach of fiduciary duties amongst these parties. In addition to the statutory framework of corporate governance, companies and industries have developed norms that function as a *de facto* corporate governance regime to promote best practices and a state of mind around balancing interests. Currently, the limited corporate governance enforcement and norm development in the social enterprise sector means there are not adequate governance mechanisms for these unique entities. Social enterprises are, thus, particularly vulnerable to risk and mishaps that could otherwise be avoided with sustained corporate governance practices.

A. *Statutory Framework of Corporate Governance*

Corporate governance refers to the rules and structures for effective business oversight that bring a balance of power between the divergent interests of the managers, directors, and owners in furtherance of the company's goals. Effective corporate governance is achieved by the adherence to standards of behavior and performance demands.¹⁵⁵ There is a well-developed, for-profit legal framework defining the rights and responsibilities of three social systems: directors, managers, and shareholders. When implemented effectively, corporate governance provides several systems to ensure that the company is run efficiently and achieving its primary purpose, whether that be maximizing shareholder value for a for-profit company or advancing the specified tax-exempt purpose of a nonprofit corporation. Effective corporate governance results in well-managed companies that have the capacity to outperform their competitors and exist for a long time.¹⁵⁶

This section explores the various factors that make up the components of the United States corporate governance regime. Both federal and state laws play a foundational role in helping companies align the divergent interests among the executives, the board of directors, and the owners. Regulatory agencies also influence and impose corporate governance standards. Lastly, market demands and the globalization of business also have an increasingly profound influence on corporate governance best

155. See Chris Mason et. al., *From Stakeholders to Institutions: The Changing Face of Social Enterprise Governance Theory*, 45 MGMT. DECISION 284, 293 (2007) (discussing the creation of explicit or implicit standards that reflect the needs of the primary beneficiary of the corporation).

156. Varun Bhat, *Corporate Governance in India: Past, Present, and Suggestions for the Future*, 92 IOWA L. REV. 1429, 1435–36 (2007).

practices.

The primary purpose of corporate governance in a for-profit entity is to align the defining characteristic of corporate design, separation of ownership¹⁵⁷ and control.¹⁵⁸ The legal innovation of the for-profit corporation allowed for the growth of the modern economy by stratifying constituencies that have pluralist interests within the entity.¹⁵⁹ The interests of shareholders and managers, who act on behalf of the shareholders to operate the business, do not always coincide.¹⁶⁰ Management may engage in reckless or fraudulent business practices to maximize short-term benefits that increase the value of their annual bonuses, create stock price distortions, or improve their working conditions at the expense of the shareholders' ownership value.¹⁶¹ In theory, the board curtails the actions of the managers to the benefit of the shareholders by providing supervision, reviewing business decisions, and establishing corporate policies. But the directors who serve on the board are often key executive managers and independent directors who are selected by the very managers they are supposed to oversee. Thus, the objective of good corporate governance to harmonize those pluralist interests for the common goal of the legal entity is not likely achieved by mere structure alone.

There are three commonly recognized categories of corporate law:

157. Investors contribute capital in exchange for ownership of the corporation and avoid liability past the amount of their investment for the acts of the corporation.

158. See ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATIONS AND PRIVATE PROPERTY* 84-90 (Transaction Publishers ed. 1991) (classifying the varying degrees of separation between ownership and control among the two hundred largest American corporations).

159. DAVID BORNSTEIN & SUSAN DAVIS, *SOCIAL ENTREPRENEURSHIP: WHAT EVERYONE NEEDS TO KNOW* 4 (2010) ("Historians have pointed to one event that occurred during the Renaissance as among the most significant in modern history: the creation of the limited-liability joint-stock corporation. This legal innovation made it possible and attractive for investors to pool capital to build companies that could grow virtually without limit.").

160. See, e.g., Lucian Arye Bebchuk et al., *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 753-54 (2002) (highlighting the fact that directors may inadvertently deviate from optimal executive compensation plans due to several external factors, which leads to rent in the form of excessive executive compensation that is contrary to shareholder interests).

161. See JAY SAMIT, *DISRUPT YOU!: MASTER PERSONAL TRANSFORMATION, SEIZE OPPORTUNITY, AND THRIVE IN THE ERA OF ENDLESS INNOVATION* 96 (2015) ("CEOs will gladly overpay for [a] company if the acquisition enables them to keep their jobs. This is why so many acquisitions end up adding no value to the acquirer. The CEO is not risking his or her career with the purchase of a company; on the contrary, the CEO is buying another chance to keep his or her job."); see also STEPHEN M. BAINBRIDGE, *CORPORATE GOVERNANCE AFTER THE FINANCIAL CRISIS* 198 (2012) ("[D]otcom era frauds typically involved cooking the books so as to raise — or at least support — the firm's stock price so that the managers could profit from their stock options.").

“(1) ‘internal’ corporate law (that is, the requirements set out in an individual corporation’s charters and bylaws); (2) state corporate codes; and (3) corporate case law.”¹⁶² The state statutory and case law where the company is incorporated establishes the basic framework for the responsibilities and the role of the board as well as imposes the division of responsibilities and fiduciary duties on officers, directors, and shareholders¹⁶³ to better distribute power within a corporation. Arguably at the center of the pluralist interests of the company is the board of directors,¹⁶⁴ which collectively is the governing body upon which the state statutory codes impose the most requirements.¹⁶⁵ The role of the board is to formulate corporate policies and oversee the managers and officers who implement those policies through the day-to-day operations of the company.¹⁶⁶ The role of the board is to appoint, oversee, and compensate senior management; review budgets and strategies; and scrutinize the financial reporting and capital structure of the company. Thus, one of the board’s priorities is the ongoing assessment of its effectiveness in performing this oversight function.¹⁶⁷

This statutory emphasis on the board is what Professor Bainbridge refers to as a “board-centered system of corporate governance,”¹⁶⁸ which is in contrast to previous orientations in corporate law that were shareholder-

162. *Stop Teaching Dodge*, *supra* note 18, at 168.

163. *See, e.g.*, DEL. CODE ANN. tit. 8, § 211(b) (2015) (requiring the corporation to hold annual shareholders meetings to elect the directors); *Id.* § 211(d) (2009) (allowing shareholders to call special meetings if the corporation’s organizational documents allow them to do so).

164. STEVEN BAINBRIDGE, *THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE* 32-35 (2008) (hereinafter BAINBRIDGE, *THE NEW CORPORATE GOVERNANCE*) (arguing that the contractarian theory of the corporation posits that the board of directors is the corporate nexus); PHILIP STILES & BERNARD TAYLOR, *BOARDS AT WORK: HOW DIRECTORS VIEW THEIR ROLES AND RESPONSIBILITIES* 4 (2001) (highlighting that “the board [of directors] is the link between the shareholders of the firm and the managers entrusted with undertaking the day-to-day operations of the organization”).

165. *See, e.g.*, DEL. CODE ANN. tit.8, § 141(a) (2015) (“The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of the board of directors”).

166. Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1, 5 (2002).

167. STEVEN BAINBRIDGE, *THE NEW CORPORATE GOVERNANCE*, *supra* note 164, at 11-12, 15 (arguing that “there must be mechanisms to ensure director accountability” and that “the board has virtually unconstrained freedom to exercise business judgment.”).

168. *Id.* at 4 (stating that “[u]nder all corporation statutes, the key players in the formal decision-making structure are the members of the board of directors who are empowered to make or delegate to employees most decisions affecting the business and affairs of the corporation.”).

centric¹⁶⁹ or managerial-centric.¹⁷⁰ Historically, statutory corporate law has a “strong emphasis on collective decision-making by the board,”¹⁷¹ in large part to counter-balance the pathologies of corporate managers who, if left un-checked, could engage in self-serving decision-making. For example, in California the corporate code requires at least two directors if the corporation has more than one shareholder.¹⁷² State corporate law, as modified by the corporation’s charter documents, provides that the board can exercise all of the corporation’s powers.¹⁷³ However, certain decisions and transactions require shareholder approval, such as mergers and amendments to the charter documents.¹⁷⁴

Directors owe the corporation and its shareholders fiduciary duties. Principally, there are two duties: the duty of care, which requires a director to make informed prudent decisions, and the duty of loyalty, which requires the director to place the interest of the corporation above her own personal interest in a transaction or decision. In determining whether a board of directors has satisfied its fiduciary duties of care, the courts apply the business judgment rule, which assumes the fiduciary duties of care have been satisfied unless there is an interested director and a duty of loyalty issue.¹⁷⁵ Directors’ decisions may be more strictly scrutinized with respect to certain transactions, including a change of control of the corporation. But corporation codes and case law only provide the basic framework of corporate governance.¹⁷⁶ Despite these state-imposed duties and structure,

169. Shareholder primacy assumes that the shareholders should control the corporation, in some ultimate fashion, as they are the appropriate beneficiaries of director fiduciary duties and corporate governance. STEVEN BAINBRIDGE, *THE NEW CORPORATE GOVERNANCE*, *supra* note 164, at 10.

170. See Walter Werner, *Corporation Law in Search of Its Future*, 81 COLUM. L. REV. 1611, 1612 (1981) (noting that the corporation “was run by managers who were accountable only to themselves and could blink at obligations to shareholders and society.”).

171. Bainbridge, *supra* note 166, at 19.

172. CAL. CORP. CODE § 212(a) (2015).

173. *Id.* § 208 (2015).

174. See, e.g., DEL. CODE ANN. tit. 8, § 242(b) (2015) (requiring shareholder approval of a board’s proposed amendment to charter); *Id.* § 271(a) (2016) (requiring a majority shareholder approval to sell or exchange all or substantially all of its property and assets).

175. There is the likelihood that any number of board decisions could have the potential to increase the long-term benefit to the corporation. Thus, courts allow a great scope in determining if the decision could be in the long-term interests of the company. STEPHEN M. BAINBRIDGE, *CORPORATION LAW AND ECONOMICS* 242 (2002) (“[T]he duty of care tells directors to exercise reasonable care in making corporate decisions . . . [but] the business judgment rule says that courts must defer to the board of directors’ judgment absent highly unusual exceptions.”).

176. BAINBRIDGE, *THE NEW CORPORATE GOVERNANCE*, *supra* note 164, at 20 (“The statutory model of corporate governance is splendidly minimalist. Corporation codes

there is still concern that boards are not meaningfully accountable within the company.¹⁷⁷

Most states allow a corporation to eliminate or limit directors' personal liability to the corporation or its shareholders for breach of their fiduciary duty of care.¹⁷⁸ Corporations often adopt provisions in their certificates of incorporation eliminating directors' liability to the fullest extent permitted by law, which in Delaware means that directors are not liable unless they breach their duty of loyalty or act in bad faith.¹⁷⁹ Despite these statutory guidelines and case law, there is so much flexibility in exercising the duty of care that the best interests of the company are not adequately enforced by state corporate law alone.¹⁸⁰ The contractual relationships within the firm that the statute creates, while helpful for establishing the basic structure of the corporation, are inadequate to govern all the relationships of the company.¹⁸¹ Thus, a company also needs good internal policies and structures to regulate its corporate governance.

B. *New Governance and Transfirm Norm Creation*

Statutory corporate laws are necessary to establish the basic framework of distributing responsibilities within the company but are insufficient to ensure sharing of information and balancing of competing interests in good corporate governance. The substance of good corporate governance is not mandated by the state but enacted and adopted by the company in charter documents, policies, and procedures. Governance scholars theorize that corporate law creates a framework that will facilitate

provide only very limited guidance as to proper roles for boards of directors.”).

177. Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 278, 290 (1999) (arguing that directors “are not subject to direct control or supervision by anyone, including the firm’s shareholders.”).

178. See, e.g., DEL. CODE ANN. tit. 8, § 102(b)(7) (2015) (allowing for “eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director,” except as otherwise specified in that section of the statute).

179. *Id.*

180. See ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, G20/OECD PRINCIPLES OF CORPORATE GOVERNANCE 15 (2015), <https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf> [<https://perma.cc/WD96-NGZT>] (emphasizing the importance of public enforcement and regulatory authorities in promoting and maintaining good corporate governance).

181. Rock & Wachter, *supra* note 87, at 1640. See also Litowitz, *supra* note 89, at 508 (“As a force of legitimation, corporate law lays down a thick rhetorical gloss to convey the impression that corporate governance is a realm of procedure, fairness, consensus, and business judgment.”).

the development of standards that will privately regulate the company.¹⁸² As Professors Rock and Wachter summarize, “the myriad transactions that take place inside the [company] are largely (but not entirely) protected by the fundamentally different governance mechanism, one that is almost entirely not legally enforceable.”¹⁸³ Decisions within the company, they argue, are largely “governed by norms rather than law.”¹⁸⁴ Norms differ from law in that they are not legally enforceable. The task each company must achieve is to establish those norms that enhance their accountability to stakeholders and allow them to resolve problems within the company.

Another characteristic of norms is that they form what is often referred to as company culture, because norms influence behaviors and social interactions.¹⁸⁵ Of course not all norms are conducive to the company’s success.¹⁸⁶ Desirable norms serve “a coordinating function, making it more likely that employees will do what they are supposed to do when they are supposed to do it.”¹⁸⁷ Some norms “are top-down, with senior management choosing and enforcing them. Others emerge bottom-up and might then be adopted and enforced by the firm. Still others can become a kind of counterculture, enforced not by the firm but by the employees themselves.”¹⁸⁸ The role of the board is to determine which desirable norms support the success of the business. To be adopted within the company as a norm, the norm needs to be consistent with the company’s mission and broader values.

Furthermore, norms are not merely limited to a company but can reach across an industry. These norms across firms are what Professors Rock and Wachter refer to as “transfirm” norms.¹⁸⁹ These desirable transfirm norms are often what we refer to as best practices in an industry. For example, the notion that directors have board term limits is an instance of a transfirm norm. Board terms are instituted to mitigate groupthink and deference to executive decisions. New perspectives on the board can prevent inertia and can inspire new directions for the company. In other words, transfirm

182. Yockey, *supra* note 113, at 770, 802-06.

183. Rock & Wachter, *supra* note 87, at 1640 (this is in contrast to “the transactions between the firm and its suppliers, customers, and other parties who work outside of the boundaries of the firm are largely (but by no means entirely) governed by legally enforceable contracts.”).

184. Edward B. Rock & Michael L. Wachter, *Corporate Law as a Facilitator of Self Governance*, 34 GA. L. REV. 529, 534 (2000).

185. Rock & Wachter, *supra* note 87, at 1642.

186. *Id.* at 1643.

187. *Id.* at 1642.

188. *Id.* at 1642.

189. *Id.* at 1643-45.

norms are an important element of how companies and industries are resilient through change and help promote and reinforce desirable corporate behavior. Thus, the legal system has strong incentives for supporting the development of these transfirm norms in various industries. How the legal system effectively influences non-legally enforceable norms is the challenge scholars have devoted much time to researching.¹⁹⁰

New governance theory¹⁹¹ not only provides a theoretical framework to address how government can facilitate desirable transfirm norms but also explains the potential impact of hybrid-corporation statutes on the development of social enterprise governance. The umbrella term “new governance” describes the unifying principles among several strains of legal scholarship.¹⁹² One of the core principles of new governance theory is a commitment to stakeholder problem-solving and the development of norms facilitated through state intervention that is ultimately shaped and informed by practitioner implementation and innovation.¹⁹³ “[N]ew governance . . . refers to a collection of ideas for governance where law serves as a launching point for a multi-dimensional approach to addressing complex social and economic challenges.”¹⁹⁴ New governance maintains that the state is an important component as a facilitator rather than a regulator, while the implementation of policy is left to those individuals with the subject matter expertise. For state-imposed laws to function under the new governance model, the laws need to be flexible and adaptable to allow for experimentation at the implementation stage. This flexibility, which can also be characterized as ambiguity, requires the collaboration of both legal and industry forces to achieve the desired outcomes.

New governance methods are particularly useful with complex industries, markets, or problems because they enable “the development of holistic, creative, cross-disciplinary, cross-jurisdictional, and cross-

190. *Id.* at 530-32.

191. The term “new governance theory” describes a paradigm shift from top-down, command-and-control regulation to collaborative governance systems. New governance theory rests on the premise that the state alone cannot effectuate societal change and that it therefore needs to engage with private actors to leverage their expertise in dynamic and complex contexts. The traditional, hierarchical regulation approach, “which is generally adversarial and punitive,” places the state in opposition to private actors, while new governance models engender partnership, revision, and collaboration. David Hess, *Social Reporting and New Governance Regulation: The Prospects of Achieving Corporate Accountability through Transparency*, 17 BUS. ETHICS Q. 453, 453 (2007).

192. Jaime Alison Lee, “*Can You Hear Me Now?*”: *Making Participatory Governance Work for the Poor*, 7 HARV. L. & POL’Y REV. 405, 405 (2013).

193. *Id.* at 406.

194. Yockey, *supra* note 113, at 799.

institutional solutions.”¹⁹⁵ Case studies have qualitatively demonstrated improved outcomes when new governance methods are used to address complex issues.¹⁹⁶ Corporations are isomorphic in that they internalize institutional norms and function within the same statutory regimes,¹⁹⁷ and, thus, can be conducive to developing transfirm norms through new governance methods.

Applying this literature to social enterprises, a new governance perspective to analyzing hybrid-corporation statutes recognizes that the new “legal forms and structures can send important signals that help to form a consensus around particular norms.”¹⁹⁸ Because desirable transfirm norms can coalesce into industry best practices, hybrid-corporation statutes can also be interpreted as an attempt to create best practices within the nascent social enterprise sector. This warrants further examining the normative impact hybrid-corporation statutes may have on solving governance issues within the social enterprise sector.¹⁹⁹

C. *Benefit Reporting as a New Governance Model*

The benefit reporting requirements within hybrid-corporation statutes have quasi-regulatory characteristics that make them unique among the corpus of corporate law.²⁰⁰ These regular reporting requirements also provide the authoritative foundation upon which social enterprises can develop, document, share, and refine corporate governance models and practices within this sector. In enacting hybrid-corporation statutes, the state’s primary role has been to facilitate and promote collaboration among social enterprise practitioners to, among other things, develop governance norms. Not only could the benefit reporting requirements lead to new governance practices for hybrid corporations, but these statutory frameworks could also establish the *de facto* market forces that influence and maintain good corporate governance in the social enterprise sector.

195. Lee, *supra* note 192, at 412.

196. *Id.* at 416.

197. Mason et al., *supra* note 155, at 293 (demonstrating that organizational action converges “where regulatory and other external environmental conditions are supportive of it.”).

198. Yockey, *supra* note 113, at 801.

199. See Susan Sturm, *Second Generation Employment Discrimination: A Structural Approach*, 101 COLUM. L. REV. 458, 520-22 (2001) (discussing the law’s normative impact on context-based problem solving to eliminate employment discrimination within individual companies).

200. Yockey, *supra* note 113, at 799.

1. Benefit Reporting Overview

State legislatures, at the behest of B-Lab pioneers,²⁰¹ have innovated corporate statutory laws by creating hybrid corporations such as the benefit corporation and the social purpose corporation. Additionally, they have also, for the first time, included regular reporting requirements that are regulatory in nature and resemble the federal securities reporting requirements.²⁰² The reporting requirements apply to the hybrid entity, regardless of the company's size or number of shareholders. These "benefit reports" requirements vary from state to state in aspects such as how often they need to be produced and distributed to the stakeholders, the necessary components of the reports, and the standards used to measure the company's social impact. Despite these differences, the benefit reports share more in common than not as the primary objectives of all benefit reports is to measure impact and provide transparency about the company's social mission. The following outlines the key characteristics in the benefit report statutory requirements.

a. *Model B-corp: accountability focused reporting requirements*

The Model Benefit Corporation Legislation (the "Model") is the most widely adopted hybrid-corporation statute.²⁰³ The benefit corporation under the Model (the "Model B-corp") is required to send an annual benefit report to shareholders "[w]ithin 120 days following the end of the fiscal year of the benefit corporation or at the same time the benefit corporation delivers other annual reports to shareholders."²⁰⁴ The Model B-corp benefit report must be posted to a publically available portion of the company's website or provided free of charge upon request.²⁰⁵ This annual benefit

201. WHITE PAPER, *supra* note 8, at 5.

202. Yockey, *supra* note 113, at 799.

203. Murray, *supra* note 24, at 346-48; *State by State Status of Legislation*, B LAB, <http://benefitcorp.org/policymakers/state-by-state-status> [https://perma.cc/Z4ZH-GVY8] (explaining that to date, the Model has been adopted in at least 31 states including Arizona (2014), Arkansas (2013), California (2012), Colorado (2014), Connecticut (2014), District of Columbia (2012), Florida (2014), Hawaii (2011), Idaho (2015), Illinois (2013), Indiana (2015), Louisiana (2012), Massachusetts (2012), Maryland (2010), Minnesota (2015), Montana (2015), Nebraska (2014), Nevada (2014), New Hampshire (2015), New Jersey (2015), New York (2012), Oregon (2014), Pennsylvania (2013), Rhode Island (2014), South Carolina (2012), Tennessee (2016), Utah (2014), Vermont (2011), Virginia (2011), and West Virginia (2014)) (last visited May 11, 2016).

204. MODEL BENEFIT CORP. LEGIS. § 402(a)(1)-(2) (B LAB Jan. 13, 2016).

205. *Id.* at § 402(b)-(c).

report must also be filed with the Secretary of State, with a fee to offset the additional administrative cost to collect and sort through the reports.²⁰⁶

The reporting categories are vague for the Model B-corp and, thus, vary at the state level.²⁰⁷ Oregon, for example, requires the company's disclosure of: the actions and methods used to provide a general or specific public benefit; any circumstances that hindered or prevented a benefit; and how well the benefit company met or exceeded the third-party standard.²⁰⁸ The Model requires that the Model B-corp assess its overall social and environmental performance on a yearly basis using an independent third-party standard.²⁰⁹ There must also be a compliance statement from the benefit director.²¹⁰ However, the assessment does not need to be audited or certified by a third party.²¹¹ The reasoning for the third-party standard, which is described as the lynchpin to the Model B-corp,²¹² is that it will prevent the benefit corporation from using an assessment tool that is merely self-serving. However, third-party standards vary significantly,²¹³ resulting in a lack of consistency among the current benefit reports. For instance, there is also significant latitude in what the benefit corporation reports or not under the various third-party standards.

The Model does not, however, expressly include an enforcement mechanism specifically related to either the truthfulness or even the existence of those reports.²¹⁴ As a result, a number of benefit corporations have not provided or even produced the required benefit reports, and there

206. *Id.* at § 402(d). For example, Rhode Island requires a \$60 filing fee and Massachusetts requires a \$75 filing fee with the annual benefit report. R.I. GEN. LAWS ANN. § 7-5.3-13 (West 2016); MASS. GEN. LAWS ANN. ch. 156E, § 16 (West 2016).

207. Murray, *supra* note 24, at 359.

208. OR. REV. STAT. § 60.768(2) (West 2016).

209. MODEL BENEFIT CORP. LEGIS. § 401(a)(2) (B LAB Jan. 13, 2016).

210. *Id.* § 401(a)(5) (referencing MODEL BENEFIT CORP. LEGIS. § 302(c) which describes annual compliance statement requirements).

211. *Id.* § 401(c).

212. Reiser, *supra* note 3, at 690-91 (“These third-party standards lies at the heart of the benefit corporation concept.”).

213. *How Do I Pick a Third Party Standard?*, BENEFIT CORPORATION, <http://benefitcorp.net/businesses/how-do-i-pick-third-party-standard> [<https://perma.cc/4LZX-SFUH>] (last visited May 19, 2016) (providing a non-exhaustive list of third-party standards for benefit reporting); *see also An Early Report on Benefit Reports*, *supra* note 152, at 49 (noting that “the quality of the [third-party] standard used is not currently regulated.”).

214. Theoretically, shareholders can bring a claim under the benefit enforcement proceeding process. But without monetary liability for failure to pursue or create a general public benefit, it is not likely that shareholders would go through the expense or trouble of bringing such a case against the benefit corporation. MODEL BENEFIT CORP. LEGIS. § 305 (B LAB Jan. 13, 2016); Westaway & Sampsel, *supra* note 20, at 1075.

has been little to no action taken to correct these statutory violations. The Model has been criticized for this lack of an enforcement mechanism.²¹⁵

b. *Delaware PBC: board-centered reporting requirements*

The majority of public corporations in the United States and over sixty percent of the Fortune 500 are incorporated in Delaware.²¹⁶ For this reason, among others, Delaware is a recognized leader in corporate law. Not surprisingly, Delaware established its own version of a benefit corporation statute called the public benefit corporation (the “PBC”), which in several ways resembles the Model B-corp. One of the material differences between the PBC and the Model B-corp are the deviations in the benefit reporting requirements.²¹⁷ The PBC must include:

- (1) The objectives the board of directors has established to promote such public benefit or public benefits and interests;
- (2) The standards the board of directors has adopted to measure the corporation’s progress in promoting such public benefit or public benefits and interests;
- (3) Objective factual information based on those standards regarding the corporation’s success in meeting the objectives for promoting such public benefits or public benefits and interests; and
- (4) An assessment of the corporation’s success in meeting the objectives and promoting such public benefit or public benefits and interests.²¹⁸

The PBC promotes a board-centered approach and provides for flexibility at each critical component of the benefit report. PBCs, for example, do not have to assess their impact using an independent third-party standard, unless specified in the corporation’s certificate of incorporation.²¹⁹ Thus, under the Delaware statute, the board is empowered to use its own assessment tool, to determine if the report needs to be made public,²²⁰ and determine if assessment needs to be conducted more than once every other year.²²¹ The benefit report needs to be produced no less

215. *An Early Report on Benefit Reports*, *supra* note 152, at 44.

216. *About Agency*, STATE OF DELAWARE — DIVISION OF CORPORATIONS, <http://www.corp.delaware.gov/aboutagency.shtml> [<https://perma.cc/R6S7-UWW3>] (last visited May 11, 2016).

217. Alicia E. Plerhoples, *Delaware Public Benefit Corporations 90 Days Out: Who’s Opting In?*, 14 U.C. DAVIS BUS. L.J. 247, 254 (2014).

218. DEL. CODE ANN. tit. 8, § 366(b) (2015).

219. *Id.* § 366(b)(2) (2015).

220. *Id.* § 366(c)(2) (2015).

221. *Id.* § 366(c)(1) (2015).

than biennially in Delaware.²²²

c. California SPC: governance focused reporting requirement

California is the most populous state to pass hybrid-entity legislation and is a strong economic engine globally.²²³ The disruptive trends in California influence what happens in other regions of business. It is also considered the leading jurisdiction in the developing social enterprise economy and is the domicile of one of the highest number of hybrid entities formed to date.²²⁴ The state enacted a benefit corporation statute based on the Model B-corp.²²⁵ However, in addition to the benefit corporation, California is among the few states to also offer the social purpose corporation (“SPC”),²²⁶ formerly named the flexible purpose corporation (“FPC”).²²⁷

The SPC is a for-profit alternative to the traditional corporation and the California benefit corporation. While the SPC integrates the majority of the characteristics of the former FPC, in addition to the name change, the amendments require the directors of SPCs to consider the social purposes set forth in the articles of incorporation in their decision-making.²²⁸ All SPCs regardless of size and number of shareholders must now prepare social-purpose annual reports including management discussion and analysis (“MD&A”) concerning the company’s operations and performance

222. *Id.* § 366(b)(2) (2015).

223. Samantha Masunaga, *We’re No. 8: California near top of world’s largest economies*, L.A. TIMES (Jul. 2, 2015, 1:21 PM), <http://www.latimes.com/business/la-fi-california-world-economy-20150702-story.html> [https://perma.cc/CH8Y-NXV6] (last visited May 19, 2016).

224. Empirical data collected to date shows that Nevada has the most companies incorporated as benefit corporations, followed by Oregon, Delaware, Colorado, New York and California. See ELLEN BERREY, *How Many Benefit Corporations Are There?* 1 (May 5, 2015), SOCIAL SCIENCE RESEARCH NETWORK, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2602781 [https://perma.cc/36TT-G99X] (Click “Download This Paper”) (last visited May 11, 2016).

225. See CAL. CORP. CODE §§ 14600-14604 (2012).

226. See *Id.* §§ 2600–2604 (2015); see also WASH. REV. CODE ANN. § 23B.25.005 (2012).

227. However, a flexible purpose corporation incorporated under the Corporate Flexibility Act of 2011 is not required to change its status to a social purpose corporation and any reference in the California Corporations Code to social purpose corporation is deemed a reference to “flexible purpose corporation” as well. See CAL. CORP. CODE §§ 2601(b)(2), (b)(3)(A) (2015).

228. *Id.* at § 3500(b) (2015). FPCs were not required to pursue a general society benefit like the benefit corporation and FPC directors were not required to include social purposes in their decision-making, but had the flexibility to do so.

with respect to its special purposes. Similar to the Model B-corp's annual benefit report, the social-purpose annual report anticipates a discussion of management strategy and skills. The social-purpose reports are also required after certain events, such as significant capital expenditures that may have a negative effective on the company's social purpose.²²⁹ Thus, the SPC social-purpose annual report is analogous to the aforementioned benefit reporting requirements. However, there are no specifics about what should be included in the social-purpose annual report, which enables SPCs to neglect disclosing or discussing where they did not advance their social purpose. The SPC statute does not require an independent third-party standard to measure progress, which limits the accountability the social-purpose annual report may provide.

2. Benefit Reporting as Value Creation

Each of these hybrid-corporation statutes can be understood from a new governance perspective as the state encouraging social enterprise practitioners to develop governance norms. "A new governance [take] on self-regulation [would suggest] that the state should allow private actors in specific industries or sectors to shape the standards and practices that govern their affairs."²³⁰ The benefit report requires discussion of overall company performance, which necessarily requires an examination of corporate governance practices, without dictating specific mandates about what the governance practices should be.²³¹ The Model states that the

annual benefit report is intended to permit an evaluation of . . . performance so that the shareholders can judge how the directors have discharged their responsibility to manage the corporation and thus whether the directors should be retained in office or the shareholders should take other action to change the way the corporation is managed.²³²

Similar to the MD&A section of SEC registration statements and

229. *Id.* at § 3501 (2015). For FPCs with less than 100 shareholders that followed certain procedures, the companies were also not required to measure and disseminate their performance against a third-party standard in a benefit report, as benefit corporations are required to do. *See Id.* § 3502(h) (2012).

230. Yockey, *supra* note 113, at 802-03.

231. *See generally* Jessica E. Sowa et. al, *No Longer Unmeasurable? A Multidimensional Integrated Model of Nonprofit Organizational Effectiveness*, 33 NONPROFIT AND VOLUNTARY SECTOR Q. 711 (2004) (discussing a method to evaluate nonprofit effectiveness).

232. MODEL BENEFIT CORP. LEGIS. § 102 cmt. on Third Party Standard (B LAB Jan. 13, 2016).

periodic reports filed under the Securities Act of 1933 and Securities Exchange Act of 1934, a social enterprise's MD&A section of the benefit report should discuss its business as a whole and include explanations of the various segments of the business necessary to understanding the company's entire operations. A MD&A section of a benefit report would be the appropriate place for the company to explain the governance model of the social enterprise and how it facilitates the stated social mission, including mechanisms for gathering and incorporating stakeholder feedback in the strategy of the company. Because reporting on the "objectives the board of directors has established to promote [the] public benefit"²³³ will necessitate a consideration of the governance model, the periodic and regular compositions of these benefit reports would allow the social enterprise an opportunity to examine its corporate governance structure and make strategic decisions about moving forward. In addition, this annual or biennial review of the company better fulfills the board's obligations to provide management oversight, a commonly criticized missing component in social mission organizations.

A criticism of the benefit reporting requirements is that they are ambiguous. But the apparent lack of statutory direction for benefit reporting is appropriate to provide social enterprise practitioners the autonomy to determine the necessary elements of the report.²³⁴ One of the core principles of new governance theory is a commitment to practitioners developing the implementation through problem-solving and experimentation. In furtherance of this, "new governance . . . intentionally lacks formal procedural or substantive rights, and contains only non-binding initiatives,"²³⁵ to provide practitioner flexibility and buy-in. To the extent that clear best practices emerge from the social enterprise sector for drafting the benefit reports, these are factors that could be included in the various state statutes through amendments with the support of the social enterprise community. However, "[a] detailed, rules-based approach to reporting might also suffocate firms, stifle innovation, and decrease intrinsic motivation,"²³⁶ which also explains why the current lack of detail in the benefit report requirement is appropriate.

There is no indication that social enterprise practitioners or corporate

233. DEL. CODE ANN. tit. 8, § 366(b)(1) (2015).

234. Hess, *supra* note 190, at 455 ("New Governance operates not by setting strict standards on regulated entities, but by setting the boundaries that allow experimentation to occur at a more local level and then allowing the lessons from those experiences to update standards and possibly be transferred to other areas.")

235. Lisa T. Alexander, *Reflections on Success and Failure in New Governance and the Role of the Lawyer*, 2010 WIS. L. REV. 737, 742 (2010).

236. *An Early Report on Benefit Reports*, *supra* note 152, at 48-49.

lawyers perceive the benefit reports as a governance tool. For social enterprises incorporated as hybrid corporations, the early data on benefit reporting reveals an “abysmal benefit report compliance rate (below ten percent).”²³⁷ An important role that corporate lawyers should play is in articulating how an examination of governance is an essential aspect of company performance. Corporate lawyers are an indispensable component of the federal corporate governance paradigm and compose significant components of the disclosure reports for public companies. The professional responsibility rules of the legal profession add legitimacy to the federal reporting process.²³⁸ Social enterprise practitioners’ do not perceive benefit reports as necessary in part because there is no government enforcement of this statutory requirement.²³⁹ But there is an opportunity for social enterprises to substantially use this tool; and, thus, corporate lawyers should explain the long-term value of regular reporting and not merely the short-term expense to produce.

a. *Benefit report perceived as marketing tool*

Generally the benefit report is characterized as a marketing and branding tool for social enterprises²⁴⁰ not a corporate governance mechanism. Proponents of the Model B-corp have emphasized the benefit report as useful for customers, likening the report to a branding tool for the

237. *Id.* at 26.

238. Every state prohibits a lawyer from assisting a client’s crime or fraud and requires a lawyer to withdraw from any related representation when continued representation would assist a client’s crime or fraud. Most states (37) permit, and four of them require, a lawyer to disclose confidential information to prevent a client’s criminal fraud. Eighteen states permit a lawyer to disclose confidential information to rectify or mitigate a past client fraud. *See, e.g.*, MODEL RULES OF PROF’L CONDUCT r.1.2(d) (AM. BAR ASS’N, Discussion Draft 1983) (“A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent”); MODEL CODE OF PROF’L RESPONSIBILITY Canon 7-102(A) (AM. BAR. ASS’N 1980) (requiring a lawyer to not conceal, counsel, assist, or otherwise participate in a client’s illegal or fraudulent actions). *See also* Roger C. Cramton et. al., *Legal and Ethical Duties of Lawyers after Sarbanes-Oxley* (Bos. U. Sch. of L. Working Paper No. 04-20, 2010), <http://www.bu.edu/law/workingpapers-archive/documents/koniak-et-al-sarbanes-oxley-04-20.pdf> [<https://perma.cc/Q22N-BYZG>].

239. Failure to provide the report does not have a consequence on the status of the social purpose corporation. *See, e.g.*, WASH. REV. CODE § 23B.25.150(4) (West 2016) (“The failure to furnish to shareholders a social purpose report required by subsection (1) of this section does not affect the validity of any corporate action.”).

240. WHITE PAPER, *supra* note 8, at 3 (explaining that the reporting standards are designed to make it easier “for a consumer to tell the difference between a ‘good company’ and just good marketing.”); *see also* Reiser, *supra* note 3, at 684 (summarizing that the ultimate goal of social entrepreneurs who select a hybrid-entity form is brand recognition).

company.²⁴¹ “Many of the few [benefit] reports that are currently available are self-promotional and do not provide much value to a reader looking for a full, fair evaluation of the business.”²⁴² Often the reports that have been produced are not comprehensive and focus on reporting quantifiable aspects of the mission impact and not the overall performance of the company as stated in the Model or SPC statutes. If hybrid corporations regularly produce annual benefit reports with little substance and marketing puffery, it is unlikely that these benefit reports will contribute significantly to the sector.²⁴³

Suggestions to improve the benefit reports have included providing more quantifiable data points like the “percentage of revenue donated to charities, hours per employee donated to charities, recycling per employee (in pounds), and percentage of employees paid a living wage.”²⁴⁴ But these reforms continue to focus on the benefit report as a marketing tool and do not transform the established perception of this requirement. This narrow conception of benefit reports has not been sufficiently interrogated in social enterprise scholarship, and thus the sector has not embraced the generative power of the benefit reporting requirement.

b. *Founder perception of reporting as arduous and unnecessary*

The perceived costs of producing and distributing benefit reports is also a hurdle for social enterprise practitioners considering various forms of business entities. If benefit reports do not create value for the social enterprise, then hybrid corporations are likely “to use the weakest [and less expensive] standard available [and] provide little to no useful information to the market, and waste company resources in the process.”²⁴⁵ Of the hybrid corporations in existence, empirical data suggests that the vast majority of them “are not complying with the statutory benefit reporting requirements,”²⁴⁶ perhaps the best indication of the relatively low priority social enterprise practitioners have placed on these reports.²⁴⁷ Corporate

241. WHITE PAPER, *supra* note 8, at 20.

242. Murray, *supra* note 24, at 360.

243. *Id.* at 361. “Reports alone provide little value if they fail to inform stakeholders or support a dialogue that influences the decisions and behaviour of both the reporting organization and its stakeholders.” SUSTAINABILITY REPORTING GUIDELINES, GLOBAL REPORTING INITIATIVE 9 (2002).

244. *Id.* at 360.

245. *Id.* at 361-62.

246. *An Early Report on Benefit Reports*, *supra* note 152, at 42.

247. *But see An Early Report on Benefit Reports* *supra* note 152, at 43 (noting that the lack a reporting might also be due to the lacking of familiarity with benefit reporting

lawyers who understand the advantages of corporate reporting need to advise social enterprises at the entity formation stage about how the regular reports can engender good corporate governance. Even if the founders decide not to incorporate the company as a hybrid corporation, they need to understand and be advised about including benefit reporting into the fabric of their social enterprise. Corporate lawyers have the expertise and the opportunity, particularly at the entity formation stage, to explain to social enterprise practitioners the potential long-term impact of including benefit reporting as a self-regulatory governance tool.

III. TOWARDS SOCIAL ENTERPRISE GOVERNANCE

Federal regulations for enforcing and promoting good corporate governance are not readily applicable to the social enterprise sector. Most social enterprises are either small for-profits not subject to federal regulation, or nonprofits with limited government oversight after entity formation. Thus, it is not surprising that the social enterprise sector has not advanced new corporate governance models that accommodate the needs and complexity of the social enterprise ethos. A self-regulatory reporting tool would not only strengthen an individual social enterprise's governance practices, but the dissemination of these benefit reports would help establish governance norms tailored to the social enterprise sector. Benefit reporting requirements provide a mechanism for social enterprises to reflect on and revise their corporate governance, which should strengthen their competitive advantage in the market place. An important role for corporate lawyers is to advise social enterprises on the positive effects that benefit reporting could have as a governance mechanism and to draft the reports with the company. Because social enterprises can exist in a variety of legal entities, there are a variety of corporate governance models that could be developed. Legal counseling needs to explain why benefit reporting, as a foundational aspect of any social enterprise regardless of the legal form, promotes good governance and sustainability. Corporate lawyers should refine their counsel on benefit reporting and social enterprise governance accordingly.

A. *Improving Social Enterprise Governance through Reporting*

Social enterprises need practitioner-informed models of good corporate governance that allow them to balance their social mission and

generally).

commercial activities. As outlined above, when understood in the context of new governance theory, benefit reporting practices can help social enterprises develop and maintain good corporate governance. The benefit reporting requirements in hybrid-corporation statutes offer a mechanism for documenting, sharing, and refining social enterprise governance models, which are necessary for the long-term success of these companies. Poor corporate governance affects performance and sustainability. Good governance systems engender accountability, communication, commitment, and justice.²⁴⁸ Currently, the social enterprise sector does not have external oversight or market focuses that adequately encourage the development and refinement of best practices for social enterprise governance.

Corporate lawyers can fill the gap between state facilitation of transfirm norms and practitioner expertise to develop social enterprise governance models. Corporate lawyers understand the traditional corporate governance best practices and can play a vital role in implementing and designing new governance models unique to the social enterprise sector. Transactional lawyers have demonstrated that they “have the potential to add value in no small part by translating their clients’ and the government’s policy goals into the practical mechanisms of private ordering.”²⁴⁹ Corporate lawyers also are the conduits through which information within a sector moves between firms to help share lessons learned through experimentation. For corporate lawyers to be effective in helping social enterprises develop innovative governance models, they should understand the benefit reporting process as an opportunity to critically reflect on and memorialize social enterprise governance practices. Corporate lawyers would be instrumental in helping not only hybrid corporations understand the value of benefit reports through a new governance theoretical lens, but also in counseling all social enterprise entity forms on adopting benefit reporting as a self-regulatory mechanism.

Hybrid corporations constitute only a portion of the social enterprise sector. For benefit reporting to be transformative to the sector, all social enterprises, regardless of entity form, should incorporate regular benefit reporting as a fundamental component of the entity. If benefit reports are encouraged and composed by corporate lawyers and informed by social enterprise practitioners’ experiences, then benefit reports have the potential to become an industry standard on which impact investors can rely for

248. See Litowitz, *supra* note 89, at 526 (“The profit motive has always favored secrecy, but justice requires transparency.”).

249. Nestor M. Davidson, *Values and Value Creation in Public-Private Transactions*, 95 IOWA L. REV. 937, 943 (2009).

helpful information about the potential success of the social enterprise. This would further entrench the practice into the sector. Once entrenched, benefit reporting will likely also be relied on by the sector and other stakeholders for informing governance practices in new and emerging social enterprises.

A large part of corporate governance is creating systems of accountability so that directors can oversee managers, shareholders and donors can oversee the board, and the government can oversee the operations of the business. Reporting and disclosure requirements have historically been the primary basis for regulators to create accountability and ensure that corporate governance is maintained within the company.²⁵⁰ Regular reporting requirements provide a systemic way to measure and monitor various levels of conduct and board oversight. The process of preparing the report requires the company to review company decisions, finances, and purpose. In this way, reporting promotes the development and strengthening of communication channels across the company's key stakeholders, such as the board, managers, and owners or donors. Companies can often identify and resolve issues without mandated intervention from a regulating third-party if they take the self-reporting process seriously. Self-regulation has often led "to greater levels of collaboration among firms, stakeholders, and policy groups on matters ranging from corporate best practices to market benchmarks and performance standards."²⁵¹ The engagement with corporate lawyers, consultants, and accountants to prepare the benefit reports would also highlight issues for management and the board's consideration. Reporting also allows the company to regularly refine its messaging, evaluate its progress, and adapt to changing environments. For these reasons, benefit reporting can be an effective mechanism to ensure good social enterprise governance.

Although empirical data establishes a relationship between the lack of corporate governance and poor financial performance, good corporate governance is not a panacea for business success.²⁵² Nonetheless, it stands

250. Hillary A. Sale, *Banks: The Forgotten(?) Partners in Fraud*, 73 U. CIN. L. REV. 139, 139 (2004) (noting company reporting is "the chief method for cleansing fraud").

251. Yockey, *supra* note 113, at 803.

252. Ben Emukufia Akpoyomare Oghojafor et al., *Poor Corporate Governance and Its Consequences on the Nigerian Banking Sector*, 5 SERB. J. MGMT. 243, 247 (2010). Generally, the link between good corporate governance and economic returns is thinly supported by empirical evidence. See e.g., Duc Hong Vo & Tri Minh Nguyen, *The Impact of Corporate Governance on Firm Performance: Empirical Study in Vietnam*, INT'L. J. ECON. & FIN., June 2014, at 1 (examining empirical research on relationship between corporate governance and firm performance in Vietnam); Tek Lama, *Empirical Evidence on*

to reason that the process of reflection through regular disclosures, with appropriate company action based on the information discovered through the reporting process, facilitates the long-term sustainability of the company.²⁵³ This is particularly important in the social enterprise sector where sustained social change is the touchstone for a successful company, rather than maximizing corporate profits. Professors DiMaggio and Powell suggest that institutional pressures will lead organizations to model themselves upon established firms to garner legitimacy, a process they refer to as isomorphism.²⁵⁴ While formal pressures may originate from the government, the legal environment or important stakeholders (e.g., funders or partners), normative pressures, they argue, will lead organizations to adopting structures and practices based on norms and values promoted by successful institutional actors.²⁵⁵ As the social enterprises that regularly engage in benefit reporting establish themselves as market leaders, other social enterprises in the sector are likely to adopt the practice of reporting and documenting governance models to advance their social mission and help ensure a sustainable business.

1. Criticisms of Mandatory Reporting Less Applicable to Benefit Reports

While annual reporting is a standard practice for public companies, regulatory reporting has not achieved the full impact of its potential to improve corporate governance.²⁵⁶ There are limitations on what regular

the Link Between Compliance with Governance of Best Practice and Firms' Operating Results, 6 AUSTL. ACCT. BUS. & FIN. J., no. 5, 2012, at 63 (examining 60 sample firms to establish the relationship between corporate governance and operating performance). *But see* MARK HIRSCHHEY ET AL., *CORPORATE GOVERNANCE AND FIRM PERFORMANCE* 85 (1st ed. 2009) (“Despite repeated attempts by academics to show an irrefutable link between [corporate governance and shareholder returns], the results are largely inconclusive. Some empirical studies find important linkages between corporate governance and financial performance measures. Yet, other research . . . reports mixed and often weak results.”).

253. See Erica Beecher-Monas, *Corporate Governance in the Wake of Enron: An Examination of the Audit Committee Solution to Corporate Fraud*, 55 ADMIN. L. REV. 357, 380-87 (2003) (discussing how most directors unconsciously make self-interested decisions, tend to be over-confident, and operate on cognitive dissonance).

254. Paul J. DiMaggio & Walter W. Powell, *The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields*, 48 AM. SOC. REV. 147, 151 (1983) (identifying that “when goals are ambiguous, or when the environment creates symbolic uncertainty, organizations may model themselves on other organizations” that they perceive to be more legitimate and successful).

255. *Id.*

256. Omri Ben-Shahar & Carl E. Schneider, *The Failure of Mandated Disclosure*, 159 U. PA. L. REV. 647, 679 (2011) (“Mandated disclosure is not doomed to fail, but it rarely

reporting can be expected to achieve. The following sections outline two of the major criticisms of mandatory, regulatory reporting requirements. This Article argues, however, that much of this criticism is less applicable to a voluntary benefit reporting process for social enterprises.

a. *Information overload not applicable to most social enterprises*

One criticism is that companies simply focus on fulfilling the duty of disclosing rather than reporting information of any real substance. In other words, although public companies may disclose the required information, too much is produced to be adequately scrutinized or questioned. As others have explained, “[t]he explicit disclosure requirements of the federal securities laws are detailed and extensive, and the task public companies face in complying with the explicit disclosure requirements is daunting.”²⁵⁷ Moreover, large companies with substantial amounts of information have the ability to bury potentially questionable facts or accounting practices in intentionally large disclosures that no stakeholders have the time or energy to carefully sift through.²⁵⁸ The quantity and “complexity of many [mandatory] disclosures, the innumeracy and illiteracy of many readers, and the burden of accumulating amounts of disclosure . . . [all] limit the effectiveness of [regulatory reporting requirements].”²⁵⁹ The ability for a

succeeds Rarely can each actor accomplish all that is needed, and therefore mandated disclosures rarely work as planned.”).

257. Porter, *supra* note 67, at 2255.

258. See Celia R. Taylor, *Drowning in Disclosure: The Overburdening of Securities & Exchange Commission*, 8 VA. L. & BUS. REV. 85, 87 (2014) (referring to the SEC as “a disclosure dumping ground”); see also Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L. Q. 417, 433 (2003) (discussing how disclosures will not protect investors or result in better decisions if investors cannot process all of the information, which can be too long, complex or buried within large disclosures).

259. *An Early Report on Benefit Reports*, *supra* note 152, at 37; see also Lin, *supra* note 44, at 367-68 (adding that “the economic incentives do not properly encourage most individual investors to educate themselves by reading securities disclosures Many institutional investors, for instance, are transient investors focused on quarterly or annual returns for their portfolio of numerous investments. Therefore it makes little sense for them to engage in prolonged shareholder activism and monitoring, where they bear much of the costs of the fight, and their competitors can free-ride the benefits of their efforts.”); ARTHUR LEVITT, TAKE ON THE STREET: HOW TO FIGHT FOR YOUR FINANCIAL FUTURE 44 (2003) (explaining his frustration reading mutual fund prospectuses and coming to the conclusion they were “written in impenetrable legalese, by and for securities lawyers”); Steven Davidoff Solomon, *Corporate Governance Issues Grow More Complex*, N.Y. TIMES: DEALBOOK (Oct. 21, 2011), <http://dealbook.nytimes.com/2011/10/21/corporate-governance->

board, and to a greater extent the federal government, to substantively monitor risks and provide oversight through a reporting process necessarily diminishes when applied to multinational institutions.²⁶⁰ However, there are few social enterprises currently in existence that compare in size or magnitude to the multinational institutions that have failed despite being subject to extensive reporting requirements.²⁶¹ While there are significant social enterprises such as The Honest Company, Inc. or Revolutionary Foods,²⁶² the vast majority of social enterprises tend to be smaller companies that, even with growth potential, are likely to remain privately-held companies. Thus, the quantity and complexity of information to be disclosed and reported would often be more manageable for social enterprises.

b. *Increased access to justice minimizes the financial costs*

Another major criticism of reporting requirements is that the expense of regulatory reporting outweighs the objectives of mandated disclosures. There is no doubt that the cost of regulatory reporting is significant for public companies. Many of these costs are spent on corporate lawyers and accountants who are required to have specialized expertise on regulatory compliance across several evolving areas of law. Maintaining systems of monitoring public companies is also time consuming and expensive for the federal government given that “[p]ublic corporations are extraordinarily intricate institutions that pursue complex, large-scale projects.”²⁶³ Public companies can “resemble political nation-states with multiple constituencies.”²⁶⁴ For this reason, it can take years before federal agencies detect and correct problems of poor corporate governance or other

issues-grow-more-complex/ [https://perma.cc/A4GZ-2B29] (highlighting that even with robust reporting requirements there are still “boards like the one at Enron, which was highly rated for corporate governance but made foolish — and ultimately disastrous — decisions”).

260. Aronson, *supra* note 58, at 131 (discussing the SEC’s systemic failure to regulate Enron as evidence by its lack of review of financial statements from 1997 to 2002, when the company collapsed).

261. An example of a multinational social enterprise is Mondragon Corporation, Spain’s tenth largest business group with approximately 74,000 employees and cooperative owners. For more information see *Mondragon Corporation*, MONDRAGON, <http://www.mondragon-corporation.com/eng/> [https://perma.cc/DE27-GY7N] (last visited May 19, 2016).

262. The Honest Company may be the first California social enterprise to have an initial public offering. Douglas MacMillan & Rolfe Winkler, *Jessica Alba’s Startup, Honest, Valued at \$1.7 Billion*, WALL ST. J. (Aug. 13, 2015) <http://www.wsj.com/articles/jessica-albas-startup-honest-valued-at-1-7-billion-1439477917> [https://perma.cc/S7EE-WMAX].

263. *Stop Teaching Dodge*, *supra* note 18, at 175.

264. *Id.*

misdeeds.

Issues of extensive cost, however, are less applicable to benefit reporting because there are few requirements that control benefit reports of hybrid corporations, and benefit reporting by other entity forms would be self-regulated by the individual companies. Moreover, pro bono corporate representation is an underutilized resource that social enterprises could use to offset the financial burdens of benefit reporting. Many law firms provide pro bono representation to nonprofit entities.²⁶⁵ Nonprofit social enterprises within the applicable pro bono client guidelines should access pro bono corporate counsel to help draft the benefit reports. Law firms should also be encouraged to provide access to pro bono services or deferred payment fee structures to for-profit social enterprises. Although operating through a for-profit model, for-profit social enterprises often have limited financial bandwidth as profits are often reinvested back into advancing the social mission. Their limited financial resources and focus on social mission make them analogous to nonprofit organizations and, thus, law firms should recognize them as eligible pro bono clients. Pro bono options for corporate lawyers should be expanded to include for-profit social enterprise in part because “business law pro bono still remains more of a potential than a realization.”²⁶⁶ However, even if a law firm does not include for-profit social enterprises in their pro bono policy, law firms could increase social enterprise access to corporate lawyers by implementing a *per se* deferred payment policy for for-profit social enterprises. Under this fee structure, for example, payments could be deferred until the social enterprise closes a significant funding round or a liquidating transaction. This is a common fee structure for start-up technology companies because law firms recognize that emerging companies need access to corporate lawyers and that investing preventative legal resources in early-stage companies can have significant financial returns. Drafting MD&A sections and conducting diligence for benefit reports would be excellent training and exposure for junior associates who need to learn how to compose disclosure materials for their public company and private-equity clients. Thus, providing pro bono or deferred payment representation to social enterprises would be advantageous for law firms as well as social enterprises.

265. Scott L. Cummings, *The Politics of Pro Bono*, 52 UCLA L. REV. 1, 44 (2004) (“Referral organizations focused on linking transactional business lawyers with nonprofit and small for-profit organizational clients have gained increased attention within the pro bono system.”).

266. James L. Baillie, *Fulfilling the Promise of Business Law Pro Bono*, 28 WM. MITCHELL L. REV. 1543, 1563 (2002).

In addition to expanded pro bono and deferred payment policies at law firms, business law clinics should also include advising clients as they prepare benefit reports in their list of client services. With the drastic increase in business law clinics over the last decade,²⁶⁷ many law schools across the country now have the capacity to assist social enterprises compose regular benefit reports and assess their corporate governance practices in the process.²⁶⁸ A goal of many business law clinics is to not only prepare law students for the impending rigors of corporate practice, but also to close the access to justice gap for marginalized constituencies. Similar to junior associates at law firms working pro bono, law students in business law clinics would benefit from the experience of conducting diligence, composing benefit reports, and advising their social enterprise clients as they think critically about their current governance practices. Moreover, recognizing the impact that business law clinics could have in helping social enterprises develop governance models that address the complexities of their businesses, benefit reporting representation would be an appropriate client matter for these clinical programs to take on. As a result of increased access to law firms and business law clinics, the relative financial burden of benefit reporting to social enterprises would be significantly less than the cost of compliance for public companies with intricate reporting requirements under SOX, Dodd-Frank, or other reporting required by the SEC.

B. *Impacts of Reporting on Social Enterprise Governance*

Promoting good social enterprise governance does not require expansion of federal or state oversight to small social enterprises, which could impede growth in the sector with the increased cost of government regulation.²⁶⁹ The innovation of benefit reports in hybrid-corporation

267. See Jennifer Fan, *Institutionalizing the USPTO Law School Clinic Certification Program for Transactional Law Clinics*, 19 LEWIS & CLARK L. REV. 327, 332 n. 14 (2015) (identifying 188 transactional law clinics as of August 1, 2014). See also Jones and Lainez, *supra* note 16, at 93 (noting that in 2013 there were more than 140 transactional clinics at just over 200 American Bar Association approved law schools, which is a 2700% increase over the 5 transactional clinics reported in 1992).

268. See Alina S. Ball, *Disruptive Pedagogy: Incorporating Critical Theory in Business Law Clinics*, 22 CLINICAL L. REV. 701 (2015); Alicia E. Plerhoples, *Representing Social Enterprise*, 20 CLINICAL L. REV. 215 (2013); Patience Crowder, *Transactional Community Lawyering: Introducing Denver Law's New Community Economic Development Clinic*, DEN. L. REV. ONLINE (Apr. 22, 2011), <http://www.denverlawreview.org/dlr-onlinearticle/2011/4/22/transactional-community-lawyering-introducing-denver-laws-ne.html> [https://perma.cc/M3CR-UQRB].

269. See Martin Lipton & Jay W. Lorsch, *A Modest Proposal for Improved Corporate*

legislation has given the social enterprise sector a method for incorporating regular reporting into the fabric of the entity form to improve and track good governance practices. The sector should broadly embrace the practice of regular reporting and support the development of good corporate governance that would flow from its implementation. Even if benefit reporting is not adopted universally across all social enterprises, the reporting process would yield a positive impact to participating social enterprises and a net positive for the sector.

The marketplace can be an effective compliance officer.²⁷⁰ The positive response from impact investors and donors, and the sustainability of the participating social enterprises, will determine whether benefit reporting takes hold as a transfirm norm within the social enterprise sector. Corporate lawyers are often characterized as gatekeepers, but they are also norm facilitators.²⁷¹ Thus, the intimate involvement of corporate lawyers in the benefit reporting process is necessary to facilitate the positive outcomes, as outlined below, in the social enterprise sector.²⁷²

Governance, 48 BUS. LAW. 59, 59 (1992) (“The problem is not the system of laws, regulations, and judicial decisions which are the framework of corporate governance.”).

²⁷⁰ See Anita Indira Anand, *An Analysis of Enabling vs. Mandatory Corporate Governance: Structures Post-Sarbanes-Oxley*, 31 229, 236 (2006) (arguing that companies “may have specific incentives to disclose their governance practices” to prevent “devaluation of the firm by the market” and the “network externalities that could occur if they do not adopt governance practice.”).

²⁷¹ See Martin C. McWilliams, Jr., *Guardians Adrift: The Social Anthropology of the Corporate Gatekeeper Professions*, 46 U. LOUISVILLE L. REV. 225, 262-63 (2007) (explaining that the law provides insight into a culture’s perceptions and norms); see also Susan Sturm, *The Architecture of Inclusion: Advancing Workplace Equity in Higher Education*, 29 HARV. J.L. & GENDER 247, 333 (2006) (describing “lawyers working within organizations to use a capacity-building orientation simultaneously to advance core institutional values and to achieve compliance with the law.”); Rutheford B. Campbell, Jr. & Eugene R. Gaetke, *The Ethical Obligation of Transactional Lawyers to Act as Gatekeepers*, 56 RUTGERS L. REV. 9, 68 (2003) (characterizing the Model Code of Professional Conduct as a “pronouncement of societal norms”); John Gerard Ruggie, *Global Governance and “New Governance Theory”: Lessons from Business and Human Rights*, 20 GLOBAL GOVERNANCE: A REVIEW OF MULTILATERALISM AND INTERNATIONAL ORGANIZATIONS 5, 14 (Jan.-Mar. 2014) (explaining how the involvement of corporate lawyers in the development of the UN Human Right Council Guiding Principles had the cascading effect of “raising its visibility within companies to general counsel and even chief executive officer levels, rather than being confined to corporate social responsibility departments.”).

²⁷² See Lisa T. Alexander, *supra* note 235, at 741-42 (noting that while the role of lawyer remains underdeveloped in new governance scholarship, there is an emphasis on the need for collaborative lawyering).

1. Flexibility Engenders Organizational Buy-in

One of the criticisms of externally imposed reporting requirements is the difficulty of assessing whether the company is simply fulfilling an imposed requirement or if there is a genuine culture of corporate governance that permeates the company.²⁷³ While institutional investors generally express support for corporate governance reforms, empirical evidence has shown that investors believe that “the most important point to emphasize is the maintenance of self-regulation.”²⁷⁴ A voluntary benefit reporting system as suggested in this Article allows for social enterprise directors and executives to make determinations about the reporting process and define the contours of the report so that the product and process are helpful for the company. Executive and board participation in the design of the benefit reporting process could therefore engender the long-term engagement that is necessary to shift the culture towards prioritizing good corporate governance.

2. Stakeholder Governance and Participatory Democracy

As mentioned above, stakeholder engagement is what contributes to the foundationally distinct nature of social enterprise governance. Stakeholders are “[a]ny identifiable group or individual who can affect the achievement of an organization’s objectives, or who is affected by the achievement of an organization’s objective.”²⁷⁵ The participation of stakeholders in social enterprise governance is significant to the sector’s success because “stakeholders who feel included in the corporate decision-making process demonstrate a higher level of emotional investment and commitment to the firm’s mission.”²⁷⁶ Participatory governance, which meaningfully engages stakeholders in resolving problems affecting them,²⁷⁷ is another component of social enterprise governance that makes it distinct

273. See Ruth V. Aguilera, *Corporate Governance and Director Accountability: An Institutional Comparative Perspective*, 16 BRIT. J. MGMT. S39, S43 (2005) (“One of the problems with codes of good governance is that it is hard to assess whether or not codes are simply a box-ticking corporate governance tool decoupled from a transformation in the firm’s corporate governance culture.”).

274. JILL SOLOMON & ARIS SOLOMON, *CORPORATE GOVERNANCE AND ACCOUNTABILITY* 137 (John Wiley & Sons, Ltd. 2004).

275. R. Edward Freeman & David L. Reed, *Stockholders and Stakeholders: A New Perspective on Corporate Governance*, 25 CAL. MGMT. REV. 88, 91 (1983).

276. Yockey, *supra* note 113, at 804.

277. Lee, *supra* note 192, at 405 (“In recent decades, courts, legislatures, administrative agencies, and other institutions all have used participatory-governance approaches to tackle complex problems of law and public policy.”).

from traditional models of corporate governance. Part of what makes stakeholder governance particularly difficult for social enterprises is that their key stakeholders are often members of marginalized populations. Recall the social enterprise case studies in Part I where stakeholders in social enterprise Number One included employees who were formerly incarcerated,²⁷⁸ and the stakeholders in social enterprise Number Two included individuals suffering from food insecurity.²⁷⁹ What makes social enterprises potentially revolutionary is the possibility that “marginalized stakeholders—those who traditionally have had little influence on matters of governance and who are subject to subordination under the systems under reform—can meaningfully participate in the process.”²⁸⁰ Often in practice, however, “marginalized stakeholders do not actually influence the outcome, the participatory process becomes merely ‘cosmetic’ and affirmatively subverts the good-governance aims that it is meant to achieve.”²⁸¹ This is problematic because “[m]arginalized stakeholders are uniquely positioned to offer [social enterprises] information, perspectives, and ideas, as well as to serve as a check on more established actors who might otherwise use New Governance processes to further regulatory capture.”²⁸²

For these reasons, social enterprises need guidance and support to intentionally create governance models that can prioritize and manage relations with stakeholders, particularly the marginalized stakeholders they serve and seek to empower.²⁸³ “The normative foundation of the stakeholder-focused organization provides legitimacy for [the] existence” of social enterprises, as social enterprises are often “created by people who are closely linked with the community they intend to serve.”²⁸⁴ If social enterprises do not develop meaningful ways to engage marginalized stakeholders into their governance, it would not only undermine the legitimacy of individual businesses but also threaten the growth of the sector.²⁸⁵ The benefit reporting process can provide a contemplative

278. See *supra* Part I.A.i.

279. See *supra* Part I.A.ii.

280. Lee, *supra* note 192, at 406.

281. *Id.*

282. *Id.* at 409–10.

283. See Mason et. al., *supra* note 155, at 288 (“[G]overnance structures should facilitate managing the claims of the stakeholders they serve.”).

284. *Id.* at 284.

285. See Lisa T. Alexander, *Stakeholder Participation in New Governance: Lessons from Chicago’s Public Housing Reform Experiment*, 16 GEO. J. ON POVERTY L. & POL’Y 117, 174–76 (2009) (identifying how limited stakeholder participation contributed to the failures of HOPE VI in Chicago case studies).

opportunity for the social enterprise to evaluate whether its current governance structure is accomplishing the goals of stakeholder governance. Once weaknesses in the governance structure are acknowledged, the social enterprise can work with its corporate lawyer to refine and revise its governance structure to address those weaknesses and improve the deliberative process when making decisions that invoke competing interests amongst stakeholders.

3. Information Production

Directors often lack sufficient information to make informed decisions and provide effective executive oversight. Similarly, executives and managers benefit from having better access to information on the performance of the company. Many of the widely accepted measures for improving corporate governance in small companies, such as clearly defined division of authority, organizational goals, and standards for review of executive performance,²⁸⁶ require the company to have access to information on its performance and documentation of lessons learned through its operation.

Thus, the type and quality of information that social enterprises include in their benefit report can have a significant influence on improving the governance of the company. To date, benefit reports have often focused on documenting quantifiable data without including a more comprehensive analysis of the company's performance. Moving forward, corporate lawyers should advise their social enterprise clients on the value of preparing benefit reports that also capture qualitative information on how the company is incorporating those lessons learned on corporate governance into the structure of the business. This information would become more valuable as it builds on lessons learned in the previous years. The benefit reports could, for example, highlight changes from the previous year's benefit report whenever possible to save the company time in preparing the report and save the investors' and stakeholders' time in reviewing the report. This approach would not only give the reader a chance to compare different organizations in the field but also better evaluate the progress of the social enterprise over time.

4. Refine Board Composition

One of the attributes of regular reporting on corporate governance is

286. See *supra* Part I.B.ii.

that the process of gathering information and reviewing it with the board provides the directors an opportunity to self-reflect and to determine whether the board's current composition is appropriate for the needs of the company. Social enterprises that develop models for incorporating stakeholder participation become better at collecting information on the company, which will likely influence how directors make decisions about who serves on the board. The process of reporting can also encourage boards to address whether additional expertise is needed in the boardroom to provide the company with better oversight. The board of any social enterprise should have a mixture of functional skills and access to information on how to assess the company's social impact as well as evaluate the market-based strategies. Successful boards will want to foresee where the company is headed in the future and have individuals with the appropriate expertise on the board to help the company move forward in strategic directions. There is a relationship between board composition and firm performance.²⁸⁷ Social enterprise boards must therefore engage in strategic planning about their composition. In addition to reviewing the characteristics and contributions of individual directors, the benefit report would provide social enterprise boards an opportunity to evaluate its effectiveness in providing the executives and managers with sufficient oversight and guidance.²⁸⁸ This reflection and evaluation is not likely to occur in the social enterprise sector without the information produced and reviewed during a regular reporting process.

C. *Implementing Benefit Reporting Across Entity Form*

A social enterprise can elect when to engage in a reporting process; but if it is not a fundamental aspect of the company identity, other activities will likely arise that are more urgent, but not more important, than regular reporting. Thus, corporate lawyers advising and counseling social enterprise clients on how to bake benefit reporting and accountability into the fabric of the entity form is a necessary component of advancing social enterprise governance.

287. See Deborah L. Rhode & Amanda K. Packel, *Diversity on Corporate Boards: How Much Difference Does Difference Make?*, 39 DEL. J. CORP. L. 377, 395 (2014) (noting that female directors and directors of color have different life experiences that allows for them to bring "a wider range of options and solutions to corporate issues") (quoting Lisa M. Fairfax, *Clogs in the Pipeline: The Mixed Data on Women Directors and Continued Barriers to Their Advancement*, 65 MD. L. REV. 579, 590 (2006)).

288. See JOHN L. WARD, CREATING EFFECTIVE BOARDS FOR PRIVATE ENTERPRISE 3-4 (1991) (explaining that the board serves as a sparring partner for the company executives to test their strengths and weaknesses before products and ideas reach the marketplace).

1. Organizational Documents

In drafting organizational documents for a social enterprise, corporate lawyers should advise their clients to consider integrating regular reporting that is analogous to the benefit reporting requirements for hybrid corporations. Reporting requirements can be included in the bylaws of a corporation or the operating agreement of a LLC, or a company policy. Corporate lawyers should also advise their social enterprise clients on the value of establishing a benefit officer²⁸⁹ position as an effective way of maintaining this self-regulatory process. Some audit committees, for example, have strengthened the evaluation and replacement of a corporation's independent auditor. In similar fashion, a benefit officer position designates an individual to ensure that the social enterprise engages in the reporting process in a thoughtful and consistent manner.

CONCLUSION

The social enterprise movement is still in its infancy and has yet to develop governance practices and models that account for the complexity of this sector. This dearth of social enterprise governance models is problematic given the complications of the competing interests within each social enterprise. The hybrid-corporation statutes address this current vacuum in social enterprise governance by providing benefit reporting as a mechanism to document, disseminate, and refine good governance practices. These new corporate law statutes should be viewed as norm creating vehicles; as benefit reporting can play an important role as a governance mechanism within the social enterprise sector. Benefit reporting cannot be transformative if only marginally adopted by the limited number of hybrid corporations currently in existence. Thus, all social enterprises, regardless of entity form, should take advantage of regular benefit reporting to hone their corporate narrative and develop appropriate stakeholder governance models. Corporate lawyers can serve an important function in advancing social enterprise governance by advising their clients how to integrate into the foundation of the company a benefit reporting system and participating in the report drafting process.

The process of regular benefit reporting would facilitate the establishment of governance models unique to the social enterprise sector. The knowledge and participation of social enterprise practitioners is critical

289. See MODEL BENEFIT CORP. LEGIS. § 304 (B LAB Jan. 13, 2016) (defining functions of a benefit officer).

to the success of this new governance experiment to promote social enterprise governance. Thus, corporate lawyers will need to work collaboratively with social enterprise executives to design and implement benefit reporting processes. The contributions and expertise of corporate lawyers in developing good social enterprise governance can lead to more sustainable social enterprises, which would ultimately foster a more equitable and inclusive economy.