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Social Enterprise As Commitment: A Roadmap

Alicia E. Plerhoples*

INTRODUCTION

When launching a social enterprise, the budding entrepreneur has an expansive menu of for-profit entity options to fuse social mission with revenue-producing commercial activities. She can form a low-profit limited liability company,[1] benefit limited liability company,[2] benefit corporation,[3] public benefit corporation,[4] or social purpose

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1. *See, e.g.*, 805 ILL. COMP. STAT. 180/1-26 (2010); WYO. STAT. ANN. §§ 17-29-102–113 (2010); Daniel S. Kleinberger, *A Myth Deconstructed: The "Emperor's New Clothes" on the Low-Profit Limited Liability Company*, 35 DEL. J. CORP. L. 879 (2010); Carter G. Bishop, *The Low-Profit LLC (L3C): Program Related Investment by Proxy or Perversion?*, 63 ARK. L. REV. 243 (2010); J. Haskell Murray & Edward I. Hwang, *Purpose with Profit: Governance, Enforcement, Capital-Raising and Capital-Locking in Low-Profit Limited Liability Companies*, 66 U. MIAMI L. REV. 1 (2011); Robert Lang & Elizabeth Carrott Minnigh, *The L^{3}C, History, Basic Construct, and Legal Framework*, 35 VT. L. REV. 15 (2010).

2. MD. CODE ANN., CORPS. & ASS'NS §§ 4A-1101–1108(a) (West 2013).

3. *See, e.g.*, N.Y. BUS. CORP. LAW §§ 1701–1709 (McKinney 2012); CAL. CORP. CODE §§ 14600–14631 (West 2015); Dana Brakman Reiser, *Benefit Corporation—A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591 (2011) [hereinafter Brakman Reiser, *Benefit Corporation*]; J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications and Benefit Corporation Statutes*, 2 AM. U. BUS. L. REV. 1 (2012) [hereinafter Murray, *Choose Your Own Master*]; William H. Clark, Jr. & Elizabeth K. Babson, *How Benefit Corporations are Redefining the Purpose of Business Corporations*, 38 WM. MITCHELL L. REV. 817 (2012).

4. *See, e.g.*, COLO. REV. STAT. §§ 7-101-501–509 (2014); DEL. CODE ANN. tit. 8, §§ 361–368 (2014); Alicia E. Plerhoples, *Delaware Public Benefit Corporations 90 Days Out: Who's Opting In?*, 14 U.C. DAVIS BUS. L.J. 247 (2014) [hereinafter Plerhoples, *Delaware Public Benefit Corporations*]; J. Haskell Murray, *Social Enterprise Innovation: Delaware's Public Benefit Corporation Law*, 4 HARV. BUS. L. REV. 345 (2014) [hereinafter Murray, *Social Enterprise Innovation*]; Leo E. Strine, Jr., *Making it Easier for Directors to Do the Right Thing*,

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corporation[5] to pursue dual missions simultaneously. These hybrid entities have particular appeal to social entrepreneurs precisely because they eschew many of the regulatory constraints of public charities and secure a social mission within a single for-profit entity. Scholars continue to debate whether these hybrid forms facilitate mission-accountability as a positive matter, and some have called for reform.[6] Nonetheless, a small cohort of hybrid entities have incorporated in numerous states.[7]

As evidenced by their choice of a for-profit form, founders of for-profit social enterprises are committed to market-based mechanisms and business techniques. They seek to employ revenue-generating commercial activities to fund solutions to social and environmental problems. Often, commercial activity is *the* solution to a social or

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4 HARV. BUS. L. REV. 235 (2014); J. William Callison, *Benefit Corporations, Innovation, and Statutory Design*, 26 REGENT U. L. REV. 143 (2014).

5. *See, e.g.*, CAL. CORP. CODE §§ 2500-2517 (West 2014); WASH. REV. CODE. §§ 23b.25.005–25.150 (2014). *See also* 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 (2012) [hereinafter Plerhoples, *Applying Traditional Corporate Law Principles*]. California renamed the "flexible purpose corporation" to "social purpose corporation" as of January 1, 2015. S.B. 1301, 2014 Gen. Assemb., Reg. Sess. (Cal. 2013).

6. *See, e.g.*, Dana Brakman Reiser & Steven A. Dean, *Hunting Stag With Fly Paper: A Hybrid Financial Instrument for Social Enterprise*, 54 B.C. L. REV. 1495 (2013) (discussing the failure of the L3C, benefit corporation and flexible purpose corporation forms to enforce social mission commitments); Dana Brakman Reiser, *Theorizing Forms of Social Enterprise*, 62 EMORY L.J. 681 (2013) (proposing alternative legal mechanisms to ensure pursuit of a social good) [hereinafter Brakman Reiser, *Theorizing Forms of Social Enterprise*]; Murray, *Choose Your Own Master*, *supra* note 3, at 33 (arguing that corporate boards be required to prioritize the stakeholder interests the corporation will pursue); Plerhoples, *Applying Traditional Corporate Law Principles*, *supra* note 5, at 262–63 (proposing a heightened judicial standard of review for director actions for flexible purpose corporations). *But see* Brett H. McDonnell, *Committing to Doing Good and Doing Well: Fiduciary Duty in Benefit Corporations*, 20 FORDHAM J. CORP. FIN. LAW 19, 20 (2014) (arguing that the benefit corporation statutes "got it right. They create enough risk of liability that managers must pay attention to their legal duties, allowing courts to help shape norms of appropriate behavior, while not imposing such high risk that this promising new business form becomes unattractive.").

7. Kate Cooney et al., *Benefit Corporation and L3C Adoption: A Survey*, STAN. SOC. INNOVATION REV. (Dec. 5, 2014), http://www.ssireview.org/blog/entry/benefit_corporation_and_l3c_adoption_a_survey (finding that as of July 2014, 998 benefit corporations and 1,015 low-profit limited liability companies exist in the United States). *See also* Plerhoples, *Delaware Public Benefit Corporations*, *supra* note 4, at 247–80 (finding that fifty-five public benefit corporations were created in Delaware in the first three months of changes to the Delaware General Corporation Law, which allowed the formation of benefit corporations).

environmental problem.[8] Such is the case when for-profit social enterprises hire and train formerly incarcerated, homeless, or other hard-to-employ people.

For-profit social enterprises are "hybrid" enterprises in the sense that they borrow principles from both the charitable and corporate sectors. However, for-profit social enterprises lack the charitable and corporate sectors' principal accountability mechanisms.[9] For-profit social enterprises are not constrained by the doctrines of private inurement and private benefit as charities are. The doctrine of private inurement prohibits distribution of the public charity's net earnings to insiders.[10] The doctrine of private benefit requires that the public charity be organized and operated for a public and not a private benefit.[11] Contrary to these doctrines, which are intended to keep nonprofit managers faithful to the nonprofit's charitable mission, insiders of a for-profit social enterprise are not prohibited from profiting from the firm.[12]

Hybrid entities also lack a principal accountability mechanism of for-profit corporations—shareholder primacy.[13] This lack of accountability puts hybrid entities at risk of mismanagement, director self-enrichment, and corporate waste. Social enterprises are

8. For alternative definitions of social enterprise, see Alicia Plerhoples, *Representing Social Enterprise*, 20 CLINICAL L. REV. 215, 223–34 (2013).

9. *See generally* Lloyd Hitoshi Mayer & Joseph R. Ganahl, *Taxing Social Enterprise*, 66 STAN. L. REV. 387, 432–36 (2014) (discussing the insufficiency of social enterprise law to ensure social mission and the distinctions between for-profit and nonprofit regulator regimes).

10. United Cancer Council, Inc., v. Comm'r, 165 F.3d 1173, 1176 (7th Cir. 1999) (interpreting I.R.C. § 501(c)(3)).

11. "An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest . . . ." 26 C.F.R. § 1.501(c)(3)–(d)(1)(ii) (2014). *See also* Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 838 (1980) (coining the phrase "the nondistribution constraint" to describe the doctrine of private inurement, which prohibits the distribution of corporate assets to insiders).

12. Clark & Babson, *supra* note 3, at 838–39 (describing the benefit corporation as a response to shareholder primacy).

13. Shareholder primacy is "the idea that corporate management's primary responsibility is to promote the economic interests of shareholders." David Millon, *Radical Shareholder Primacy*, 10 U. ST. THOMAS L.J. 1013, 1013, 102–24 (2013). However, shareholder primacy is a relatively weak accountability mechanism for for-profit corporations. *Id.* at 1019–23 (discussing the inability of shareholders to hold directors accountable due to information asymmetry and the protections that directors have from shareholder derivative lawsuits).

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"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 . . . ."[14] Absent legal reform, if "good intentions" are all that social enterprise managers have, what can they do to express, implement, and realize such good intentions? One answer lies in developing governance processes and policies that internalize, express, and self-regulate the social enterprise's commitment to its social mission.

This Article contributes to the field of law and entrepreneurship[15] by presenting a *commitment approach* to social enterprise governance within the bounds of existing social enterprise laws. Commitment to the amelioration of a social or environmental problem is a central attribute of social enterprise. Commitment can operate as an organization's identity, reigning in conflict between social mission and financial profitability when managers face difficult decisions over costs and resource allocation. A commitment approach is one in which for-profit social enterprise founders and the board of directors adopt governance policies and processes that aid in mission accountability, transparency, and stakeholder governance in the early stages of the firm. Adoption of a commitment approach at the highest levels of the organization aids in creating an organizational identity of commitment that reverberates through the entire organization.

This Article presents a roadmap of a commitment approach in the early stages of a social enterprise that is organized as a benefit corporation, public benefit corporation, or social purpose corporation. Part I introduces a fictional start-up social enterprise used to illustrate the proposed commitment approach. This Part also presents a central

14. 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). In another scholar's words, "one of the primary problems with current benefit corporation statutes is the lack of guidance the statues provide for boards of directors." Murray, *Choose Your Own Master*, *supra* note 3, at 27. Directors are told that the must engage in stakeholder governance, but are not told *how*. *Id.*

15. Laura A. Costanzo et al., *Dual-Mission Management in Social Entrepreneurship: Qualitative Evidence from Social Firms in the United Kingdom*, 52 J. SMALL BUS. MGMT. 655, 658 (2014) (defining "entrepreneurship research" as "the scholarly examination of how, by whom, and with what effects opportunities to create future goods and services are discovered, evaluated, and exploited."). *Contra* Benjamin Means, *A Lens for Law and Entrepreneurship*, 6 OHIO ST. ENTREPRENEURIAL BUS L.J. 1 (2011) (arguing that law and entrepreneurship is not a field but a lens or critical perspective that spans various legal fields).

problem facing social enterprises: managing and pursuing dual social and economic missions in a single entity. Part II defines "organizational identity" as "the central and enduring attributes of an organization that distinguish it from other organizations,"[16] and discusses the importance of an organizational identity of commitment to social entrepreneurs in combatting tensions between dual missions. Part III presents a framework for expressing commitment to the amelioration of a social or environmental problem as a central and enduring attribute of an organization's identity through particular governance choices, policies, and procedures. Specifically, this Article calls for a social enterprise that is organized as a benefit corporation, public benefit corporation, or social purpose corporation to (1) declare a social mission that is specific and therefore capable of assessment; (2) task its entire board of directors to safeguard the firm's social mission; (3) embrace normative stakeholder governance that empowers stakeholders to participate in corporate decision-making, and (4) annually evaluate and publicly report its social and/or environmental performance using transparent, standardized, and assessable metrics.

This commitment approach is not presented as a panacea to hybrid corporate forms' weak accountability mechanisms. Rather, the roadmap presented is an attempt to guide social enterprises in implementing existing legal requirements and voluntarily overcoming statutory weaknesses by adopting additional constraints that internalize, self-regulate, and express a commitment to the amelioration of a specific social or environmental problem. Because hybrid corporate forms are new, guidance on implementation is lacking, placing the entire social enterprise sector at risk of marginalization. Without guidance, social enterprises that adopt the hybrid corporate forms may violate the new laws' basic requirements, face "mission drift," and engage in so-called "greenwashing."[17]

16. David A. Whetten, *Albert and Whetten Revisited: Strengthening the Concept of Organizational Identity*, 15 J. MGMT. INQUIRY 219, 220 (2006).

17. *See infra* notes 26–30 (discussing "mission drift" and "greenwashing").

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I. A SOCIAL ENTERPRISE CASE STUDY

A. Nourish Nutritional Bars

Lola Oguntoye is a budding social entrepreneur. Having worked at a community foundation for several years after college, Lola enrolls in business school. While in graduate school, Lola's mother sends her fresh produce from their family farm in Georgia. Lola begins making homemade nutritional bars and smoothies to get her through exhaustive study periods. She shares the bars and smoothies with her friends and often hands them out to homeless people she passes on her way to class. She has stumbled upon an idea. Lola begins plans to launch a social enterprise—Nourish, a producer of food products that combat hunger. Lola envisions that for each Nourish nutritional bar or smoothie sold, Nourish will donate a bar or smoothie to poor and low-income individuals through food banks, community centers, churches, and homeless shelters. Lola also hopes to sustainably and locally source ingredients. Her long-term goals include creating jobs for low-income and hard-to-employ people, possibly by headquartering the company in a low-income community, and working with local nonprofits to create a job-training pipeline.

Lola's business school setting allows her to obtain the business, marketing, and strategic advice of her professors and peers. She receives advice to jettison the smoothie product line and launch solely with nutritional bars. Smoothies require refrigeration and do not have a long shelf life, raising distribution costs. Additionally, food banks are less likely to accept a product that requires refrigeration. She perfects her recipes and launches Nourish in a co-working commercial kitchen not far from campus. She uses her contacts at the community foundation where she previously worked to establish partnerships with food banks, shelters, community centers, and churches to which Nourish bars will be donated. Lola's business school also provides her with the opportunity to network with potential investors. Lola enters several start-up competitions at school, winning one and attracting start-up financing from a group of social impact investors.

Lola is launching a social enterprise with dual missions—social and economic. The earnings from product sales will support the product donations. If they do not, then Lola will have to restructure her operations, at best moving away from a one-to-one ratio of donations to sales, and at worst shuttering the social enterprise. It is likely too, that Lola and Nourish's social impact investors want to profit personally from the social enterprise. Lola expects a salary as the chief executive, but she is dedicated to using the social enterprise to combat food insecurity in low-income neighborhoods. She views this mission as the reason the business exists, as opposed to a business run for profit that sometimes engages in philanthropy. Similarly, Nourish's investors expect a return though, as social impact investors, they may be satisfied with a below-market rate of return.

B. The Problem: Serving Two Masters

Legal scholars refer to a social enterprise's pursuit of dual missions as "serving two masters," i.e. stockholders and stakeholders.[18] Social enterprise founders and managers must manage tensions amongst competing interests by virtue of their firm's pursuit of social and financial value. Management scholars describe these tensions as "dual mission-management."[19] At each step, social enterprise managers must balance commercial activities, "which are critically important for the economic sustainability of the enterprise, with investments aimed at achieving social outcomes."[20] Social enterprise managers also have to manage a diverse set of expectations from multiple stakeholders; such expectations can "vary from the demands for high social value to the demands for high economic value."[21] Dual-mission management affects managers' resource

18. *See, e.g.*, Barnali Choudhury, *Serving Two Masters: Incorporating Social Responsibility into the Corporate Paradigm*, 11 U. PA. J. BUS. L. 631 (2009); Brakman Reiser, *Theorizing Forms of Social Enterprise*, *supra* note 6, at 683; Plerhoples, *Applying Traditional Corporate Law Principles*, *supra* note 5, at 223.

19. *See* Costanzo et al., *supra* note 15, at 659–60 (describing managing the tensions amongst firm's stakeholders as "dual-mission management").

20. *Id.* at 659.

21. *Id.* at 660.

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allocation, investment decisions, and decisions related to employee recruitment and retention.[22] Firms with dual missions also face potential costs such as "organizational inaction or vacillation"[23] and loss of "legitimacy and loyalty"[24] when the firm upholds one mission to internal or external stakeholders who prefer the other mission.[25]

Additionally, dual-mission management may result in "greenwashing."[26] Although originally applied to environmental issues, greenwashing also applies to any firm's claim that its activities or actions improve the environment or society, or address an environmental or social problem. Greenwashing involves diversion, deception, and hypocrisy.[27] Broadly, "there is wrongdoing, distraction in the form of a 'wash,' and at its heart, an underlying structural problem never receives proper redress."[28] Notably, the actions that constitute greenwashing for a specific firm will depend on what the firm has committed to do. A firm cannot engage in greenwashing if it never committed to an underlying environmental or social action. Greenwashing is therefore a particularly acute problem for social enterprises, because they claim to create social and environmental value. For example, Nourish operates a one-to-one donation model. That is, for every nutritional bar sold, Nourish donates one nutritional bar to poor and low-income individuals. Nourish has committed to this one-to-one donation model and would be engaging in "greenwashing" if it instead donated one nutritional bar for every three nutritional bar sold. Nourish's deception would also be illegal under federal truth-in-advertising laws and possibly state charity laws.[29]

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22. *Id.* at 659.

23. Michael G. Pratt & Peter O. Foreman, *Classifying Managerial Responses to Multiple Organizational Identities*, 25 ACAD. MGMT. REV. 18, 22 (2000).

24. *Id.* at 23.

25. *Id.* at 22.

26. Miriam A. Cherry, *The Law and Economics of Corporate Social Responsibility and Greenwashing*, 14 U.C. DAVIS BUS. L.J. 281, 284–86 (2014) (describing the origins and definitions of the term "greenwashing").

27. *Id.*

28. *Id.* at 286.

29. The U.S. Federal Trade Commission enforces truth-in-advertising laws found in the Federal Trade Commission Act, 15 U.S.C. §§ 41–58, as amended. Specifically, it is illegal to disseminate false advertisements. *Id.* § 52. State attorney general offices generally regulate charity laws to "protect[] charitable assets, protect[] consumers and investors from fraud and

A precursor to "greenwashing" is mission drift, "where the pursuit of profit starts to overshadow the pursuit of public benefit."[30] Social and environmental value is often difficult to objectively evaluate and quantify, creating the potential for managers to knowingly or unwittingly focus on financial value for insiders at the expense of social or environmental value. For example, Nourish managers might determine that the company would be more profitable if it reduces the nutritional value of the bars that are donated. This operational shift represents a "drift" away from mission in exchange for profits.

II. MITIGATING THE DUAL-MISSION PROBLEM

As she launches her social enterprise, Lola wants to mitigate the tension between pursuing dual missions. Part II argues that Lola can do so by creating an organizational identity that embraces integrated social and economic missions in the early stages of the social enterprise through governance principles and policies at the highest levels of the organization.

A. Commitment as Organizational Identity

Organizational identity means the collective "central and enduring attributes of an organization that distinguish it from other organizations." Central and enduring attributes of an organization are "[a]ttributes that are manifested as an organization's core programs, policies and procedures, and that reflect its highest values."[31] Attributes are "central and enduring" if they have "passed the test of time or on some other basis operate as 'irreversible' commitments."[32] Managers rely upon central, enduring, and distinctive attributes to ensure that the organization "avoid[s] acting out of character."[33]

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deception, and safeguard[] the general public interest." Dana Brakman Reiser, *Regulating Social Enterprise*, 14 U.C. DAVIS BUS. L.J. 231, 240 (2014). Nonetheless, it is debatable whether state attorney generals have or will invoke the authority to regulate social enterprises. *Id.* at 240–45.

30. Joseph W. Yockey, *The Compliance Case for Social Enterprise*, 4 MICH. BUS. & ENTREPRENURIAL L. REV. 1, 6 (2014).

31. Whetten, *supra* note 16, at 222.

32. *Id.*

33. *Id.* at 221.

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These attributes:

> [F]unction as organizational identity referents for members when they are acting or speaking on behalf of their organization, and they are most likely to be invoked in organizational discourse when member agents are grappling with profound, fork-in-the-road, choices—those that have the potential to alter the collective understanding of "who we are as an organization."[34]

The central and enduring attributes that comprise an organization's identity guide members participating in the enterprise to act consistently with the organization's values. Some businesses may lack any impetus to create an organizational identity, particularly in their early stages when they have insufficient financial resources to create a distinctive identity. Start-ups often do not have financial resources to hire lawyers, accountants, or human resource managers to implement internal controls and policies that aid in creating an organizational identity. Nonetheless a social enterprise is, by definition, a values-based firm. A social enterprise's values comprise its organizational identity. A social enterprise that ignores its organizational identity—its values—is at risk of mission drift, greenwashing, and other problems that arise from dual-mission management.

Values across social enterprises may vary. Some social enterprises may value environmental mission and disregard social justice, or vice versa. Nonetheless, the single value common to all social enterprise is commitment to ameliorating a social or environmental problem, whatever that problem may be, rather than pursuing solely shareholder value. Commitment to the amelioration of an environmental or social problem is a central and enduring attribute of social enterprise. Legal scholars routinely describe social enterprise in terms of commitment.[35] Leo Strine describes commitment as an imperative for benefit corporations:

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34. *Id.* at 220–21.

35. *See infra* notes 37–44; *see also* Murray & Hwang, *supra* note 1, at 17 ("Another problem in choosing the LLC form for social enterprises is the lack of assurance that an LLC is either intended to be or will remain an organization committed to charitable primacy.").

> In particular, the first wave of entrepreneurs who drape themselves in the benefit corporation garb bear a special responsibility for the movement's ultimate fate. If their commitment to social responsibility is simply a green-washed cloak for a desire to squeeze out profits for themselves and stockholders by feigning but not actually having a sincere regard for other corporate constituencies, the benefit corporation movement will quickly lose credibility among socially responsible investors and policymakers.[36]

Professor Joseph W. Yockey writes that "[s]ocial enterprises originate . . . from commitments to larger values (e.g., social justice or environmental sustainability) and apply those values to every strategic decision."[37] Professor Brett McDonnell observes that social enterprises "want to credibly commit in order to encourage the involvement of investors, customers, and employees who want to be involved in an enterprise which cares about more than just the interests of shareholders."[38] Professor Miriam A. Cherry also describes corporate social responsibility (CSR) in terms of commitment.[39] Every firm has a choice about how much it will commit to CSR or pursue a social mission. Some firms view laws as prices to pay when violated rather than obligations to be upheld. Some firms acquiesce to laws to satisfy business stewardship.[40] A slightly greater commitment entails voluntarily engaging in CSR or corporate philanthropy. Some firms "take CSR to the next level, for example, integrating triple bottom line concepts into their definitions of long-term growth and company success."[41] And still yet some firms go beyond triple bottom line business models and commit themselves to charitable, social, or environmental work that is

36. Strine, *supra* note 4, at 249.

37. Yockey, *supra* note 30, at 5.

38. McDonnell, *supra* note 6, at 29 ("Traditional corporation law provides little assistance in helping social enterprises create such a credible commitment.").

39. Cherry, *supra* note 26, at 288.

40. *Id.* ("While that may seem problematic, Professor Joseph Grundfest notes that merely the act of complying means that many important laws, regulations, and decrees that are embodied in regulatory acts are followed; he suggests that on its own compliance results in a large amount of (regulatory-mandated) corporate pro-social behavior.").

41. *Id.*

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supported or accomplished through commercial activities. Additionally, committing to a social mission is relatively easy "when incentives for profit and social goals align."[42] Committing to a social mission is more difficult when profit and social goals are in conflict.[43]

Thus, a necessary corollary of commitment is constraint. That is, where a social enterprise is committed to its social or environmental mission, it must also constrain itself from taking actions that contradict, ignore, or weaken its social or environmental mission. Such constraint is not typical of for-profit corporations, which can be formed to "conduct or promote any lawful business or purposes."[44] Forms of constraint vary—constraint can arise from law or voluntary action. The latter is the case when firms voluntarily seek special certifications such as "Fair Trade," "B Corp," or "USDA Organic" certifications.[45]

As will be discussed throughout this Article, hybrid corporate forms have weak accountability mechanisms. Therefore, a commitment approach requires a social enterprise to take additional voluntary actions to commit to its social or environmental mission.

B. Implementing Commitment through Governance

Organizational identity can be shaped through intentional construction. One study of social firms in the United Kingdom (UK) suggests that formalization of commitment to dual missions is key to reconciling dual-mission tensions. The study found that:

> [H]igh levels of formalization of both economic and social objectives tend to lessen paradoxes, tensions, and conflicts that

42. *Id.* at 288.
43. *Id.*
44. DEL. CODE ANN. tit. 8, § 101(b) (2014).
45. FAIR TRADE USA, http://fairtradeusa.org/certification (last visited Apr. 13, 2015) (Fair Trade USA certifies businesses through supply chain audits and requiring businesses to purchase supplies from other Fair Trade certified firms); *How to Become a B Corp*, B LAB, http://www. bcorporation.net/become-a-b-corp/how-to-become-a-b-corp (last visited Apr. 13, 2015) (B Lab certifies businesses for their social and environmental performance); USDA Agricultural Marketing Service, http://www.ams.usda.gov/AMSv1.0/nopfaqshowcertified (last visited Apr. 13, 2015) (The USDA certifies farms and handling facilities as "USDA Organic" if they meet certain USDA regulations).

> are generally associated with dual identities. Reconciliation of such apparent dualities/conflicts requires, first of all, a high level of commitment from the upper echelon of the organization. Then formalization is crucial as it gives relevance, via visibility, to such commitment and pursuit of both sides of the mission, so that everybody's actions are purposefully aligned.[46]

Construction of an organizational identity of commitment within an organization happens at the highest level of the organization—within its governing principles and policies. Corporate governance is the collection of processes and practices in place for controlling and directing the corporation.[47] The process of identifying, clarifying, and formalizing the corporation's social and environmental mission through a system of governance can align founder and directors' objectives and reinforce their commitment to such objectives.

Nonetheless, while the UK study suggests that formalization aids in reconciling dual-mission tensions, the size and scope of this single study limit its conclusions.[48] As the social enterprise sector grows, future research must examine how social enterprises successfully manage dual tensions, and the commitment approach proposed in this Article can be tested.[49]

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46. Costanzo, *supra* note 15, at 671. The findings of this study are "context dependent" in that it was a qualitative study of U.K. social firms that may operate differently than social enterprise firms elsewhere. *Id.* at 673.

47. Heiko Spitzeck & Erik G. Hansen, *Stakeholder Governance: How Stakeholders Influence Corporate Decision Making*, 10 CORP. GOVERNANCE: INT'L J. BUS. SOC. 378, 379 (2010) (quoting Adrian Cadbury, *The Corporate Governance Agenda*, 8 CORP. GOVERNANCE: INT 'L REV. 7, 8 (2000)).

48. The UK study is limited pertains to particular UK social firm laws. Costanzo, *supra* note 15, at 673.

49. Insights on dual mission management also derive from empirical studies of stakeholder governance, corporate social responsibility, and environmental sustainability strategies of non-social enterprise firms. *See, e.g.*, Alice Klettner, Thomas Clarke & Martijn Boersma, *The Governance of Corporate Sustainability: Empirical Insights into the Development, Leadership and Implementation of Responsible Business Strategy*, 122 J. BUS. ETHICS 145 (2013) (presenting the results of a empirical analysis of the governance processes and related sustainability strategy used by large Australian companies as disclosed in their annual sustainability reports).

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III. A COMMITMENT APPROACH TO SOCIAL ENTERPRISE

A. Adopt a Hybrid Entity

The commitment approach to social enterprise entails the formal adoption of governance policies and procedures that work to make commitment to the social mission a central and enduring attribute of the social enterprise's organizational identity. Lola's first step to formalize Nourish's commitment to a social mission requires choosing an entity.

Lola could establish multiple entities: one for-profit company to conduct business operations and the second a tax-exempt organization to oversee charitable donations and job training services. The two entities could operate in a parent-subsidiary structure with the nonprofit as the parent entity. Or they could operate in tandem with the relationship governed through a series of contracts. The creation of multiple entities facilitates compartmentalization, "whereby an organization chooses to preserve multiple identities but does not seek to attain any synergies between them."[50] Compartmentalization can reduce dual-mission tensions:

> [T]he multiple identities—of the nonprofit social mission and the for-profit business mission—are continued but kept separate from each other through physical, spatial, or symbolic means to reduce the potential for conflict between the multiple identities of the organization.[51]

Despite the benefits of compartmentalization, hybrid entity forms were created to allow a single entity, rather than multiple entities, to pursue dual missions.[52] Lola also prefers a single entity because she wishes to manage and be involved in both the charitable and profit-making operations. If the operations were split between two entities,

50. Brett R. Smith et al., *Social Enterprises and the Timing of Conception: Organizational Identity Tension, Management, and Marketing*, 22 J. NONPROFIT & PUB. SECTOR MKTG. 123 (2010).

51. *Id.*

52. For a comprehensive discussion of the shareholder primacy, and the limits on for-profit companies to pursue social or environmental missions, see Clark & Babson, *supra* note 3, at 825–38.

and she were to manage both, the charity would be scrutinized by the Internal Revenue Service (IRS) for possible violations of the doctrines of private inurement and private benefit and for impermissible contributions to the for-profit company.[53] Lola would also find burdensome the administrative and financial responsibility of launching two entities simultaneously.

Lola has a range of options if she wishes to launch a single entity,[54] including the new hybrid corporate forms, e.g., the benefit corporation, public benefit corporation, and social purpose corporation. These hybrid corporate forms carry similar legal requirements, with only a few variations. They present off-the-shelf options that aid in creating an organizational identity with a commitment to social mission. This Article proceeds under the

53. For a detailed explanation of the restrictions related to managing nonprofit and for-profit tandem structures, see Ingrid Mittermaier & Joey Neugart, *Operating in Two Worlds: Tandem Structures in Social Enterprise*, 26 No. 1 PRAC. TAX LAW. 5 (2011), *available at* http://www.adlercolvin.com/pdf/social_enterprise/Operating_in_Two_Worlds_Tandem_Structures_in_Social_Enterprise_%28403192%29.pdf.

54. Lola could form Nourish as a C corporation, limited liability company, or non-corporate hybrid forms such as the low-profit limited liability company (L3C) and the benefit limited liability company (benefit LLC). An L3C is a limited liability company formed to attract investment from both the private and nonprofit sectors. An L3C is organized to advance one or more "charitable or education purposes," as defined by the IRC, and may be formed as either a freestanding business with a social purpose or as a for-profit subsidiary of a non-profit organization. *See, e.g.*, 805 ILL. COMP. STAT. ANN. 180/1-26 (West 2014); VT. STAT. ANN. tit. 11, § 3001(27)(A)(i) (West 2013). The L3C form was designed to attract program-related investments (PRIs) by private foundations. J. William Callison & Allan Vestal, *The L3C Illusion: Why Low-Profit Limited Liability Companies Will Not Stimulate Socially Optimal Private Foundation Investment in Entrepreneurial Ventures*, 35 VT. L. REV. 273, 282 (2010); *see also* Bishop, *supra* note 1, at 248–49; John A. Pearce II & Jamie Patrick Hopkins, *Regulation of L3Cs for Social Entrepreneurship: A Prerequisite to Increased Utilization*, 92 NEB. L. REV. 260, 268 (2013). As such, income creation or property appreciation cannot be a significant purpose of the company, and the L3C must not pursue political or legislative purposes. *See, e.g.*, 805 ILL. COMP. STAT. ANN. 180/1-26 (West 2014); VT. STAT. ANN. tit. 11, ch. 21, § 3001(27)(C) (West 2014). A benefit LLC is similar to a benefit corporation, but is a limited liability company. A benefit LLC must have the purpose of creating a general public benefit or a "material, positive impact on society and the environment, as measured by a third-party standard, through activities that promote a combination of specific public benefits." MD. CODE ANN. CORPS. & ASS'NS §§ 4A-1106(a)(1), -1101(c) (West 2013). Specific public benefits include providing individuals or communities with beneficial products or services, promoting economic opportunity beyond the normal creation of jobs, preserving the environment, and improving human health. *Id.* §§ 4A-1106(b)(1), -1101(d). The manager of a benefit LLC must also engage in stakeholder governance in making decisions, such that the manager must consider the effects of any LLC action or inaction on a range of stakeholders, including members, employees, customers, communities, and the environment. *Id.* § 4A-1107(a).

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assumption that Nourish is organized as one of these hybrid corporate forms, and examines each in turn.

1. Benefit Corporation

A benefit corporation is a for-profit entity that has a purpose of creating general public benefit, defined as "a material positive impact on society and the environment, taken as a whole, assessed against a third-party standard, from the business and operations of a benefit corporation."[55] Directors of a benefit corporation must engage in stakeholder governance by considering a wide variety of stakeholders when discharging their duties as directors.[56] Directors cannot pick and choose which stakeholders to consider.[57] Additionally, a two-thirds vote of the shareholders of each class is required to terminate the benefit corporation's status as a benefit corporation[58] or amend the benefit corporation's specific purpose (if it has one).[59] Benefit corporations are also required to prepare an annual benefit report that assesses the company's performance in creating general public

55. MODEL BENEFIT CORP. LEGISLATION §§ 102, 201(a) (2014). A benefit corporation may also choose to identify one or more specific public benefits to support, in addition to its general public benefit mandate. *Id.* § 102 cmt. Specific public benefits include "providing low-income or underserved individuals or communities with beneficial products or services," "protecting or restoring the environment," and "promoting the arts, sciences or advancement of knowledge." *Id.* § 102.

56. *Id.* § 301(a). Directors of a benefit corporation must consider:

> [T]he effects of any action or inaction upon: (i) the shareholders of the benefit corporation; (ii) the employees and work force of the benefit corporation, its subsidiaries, and its suppliers; (iii) the interests of customers as beneficiaries of the general public benefit or specific public benefit purposes of the benefit corporation; (iv) community and societal factors, including those of each community in which offices or facilities of the benefit corporation, its subsidiaries, or its suppliers are located; (v) the local and global environment; (vi) the short-term and long-term interests of the benefit corporation, including benefits that may accrue to the benefit corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the benefit corporation; and (vii) the ability of the benefit corporation to accomplish its general public benefit purpose and any specific public benefit purpose . . . .

Id.

57. *Infra* notes 101–03.

58. § 105(a).

59. *Id.* § 201(d).

benefit against a third-party standard.[60] The report must be accessible to shareholders and the public.[61]

Twenty-six states and the District of Columbia have adopted legislation that allows use of the benefit corporation form.[62] Most have used the Model Benefit Corporation Legislation ("Model Legislation") drafted by lawyer Bill Clark[63] in conjunction with B Lab, the nonprofit organization that lobbies for states' adoption of the benefit corporation form and certifies companies as "B Corp," a designation distinct from the benefit corporation.[64] Some states have adopted slightly modified versions of the Model Legislation. For example, the D.C. Benefit Corporation Statute requires a "benefit director" to sit on a D.C. benefit corporation's board of directors.[65] Among other things, the benefit director is charged with opining on whether the benefit corporation has acted in accordance with its general public benefit.[66] Other states, such as California, do not label any members of the board as "benefit directors" or delegate any duties to specific directors.[67] The Model Legislation requires the boards of publicly traded benefit corporations to appoint a benefit director.[68] For the sake of comparison to other hybrid corporate forms in this Article, unless otherwise noted, any reference to a benefit corporation refers to one formed in a state that has adopted the Model Legislation.

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60. *Id.* § 401.

61. *Id.*

62. Kevin Ercoline, *Beyond Puffery: Providing Shareholder Assurance of Societal Good Will in Crowdfunded Benefit Corporations*, 64 AM. U. L. REV. 169, 178 (2014); *see also State by State Legislative Status*, BENEFIT CORP INFO. CTR., http://benefitcorp.net/state-by-state-legislative-status (last visited Feb. 16, 2015). This count of twenty-six states that have adopted the benefit corporation includes Delaware, Colorado, and Minnesota, which have adopted the "public benefit corporation," a variation of the benefit corporation form. *See* discussion *Infra* Part III.A.1.

63. BENEFIT CORP. INFO. CTR., *Model Legislation*, http://benefitcorp.net/attorneys/model-legislation (last visited Apr. 13, 2015).

64. *The Nonprofit Behind B Corps*, B LAB, http://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps (last visited April 13, 2015); *supra* note 45.

65. D.C. CODE § 29-1303.02 (West 2015).

66. *Id.*

67. *See, e.g.*, CAL. CORP. CODE §§ 14600–14631 (West 2015) (no references to a "benefit director" are found within the California Corporations Code).

68. MODEL BENEFIT CORP. LEGISLATION § 302(a).

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2. Public Benefit Corporation

The public benefit corporation is similar to, but distinct from, the benefit corporation.[69] The public benefit corporation form has been adopted in Delaware,[70] Colorado,[71] and Minnesota.[72] Because Delaware is the most prominent state for corporate law, references to public benefit corporations in this Article refer to those formed in Delaware. Like the benefit corporation, the Delaware public benefit corporation is also a for-profit entity structured to produce a public benefit[73] and operate in a "responsible and sustainable manner."[74] However, the public benefit corporation must adopt a specific public benefit and identify it in its certificate of incorporation.[75] The certificate of incorporation can only be amended with the approval of two-thirds of the outstanding shares of each class of voting and non-voting stock of the corporation.[76] A public benefit corporation is not required to assess its performance against a third-party standard, but Delaware law explicitly allows the corporation to adopt a third-party standard.[77] Benefit reports are only required biennially and need not be accessible to the public.[78]

69. *See* Plerhoples, *Delaware Public Benefit*, *supra* note 4, at 254–55.
70. DEL. CODE ANN. tit. 8, § 362 (2014).
71. COLO. REV. STAT. § 7-101-503 (2014).
72. MINN. STAT. ANN. § 304A.102 (West 2015).
73. DEL. CODE ANN. tit. 8, § 362(a) (2014). Public benefit is defined as "a positive effect (or reduction of negative effects) on 1 or more categories of persons, entities, communities or interests (other than stockholders in their capacities as stockholders) including, but not limited to, effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature." *Id.* § 362(b).
74. *Id.* § 362(a).
75. *Id.* § 362(a)(1).
76. *Id.* § 363(c).
77. *Id.* §§ 362(a)(1), 366(c)(3).
78. *Id.* § 366(b), (c)(2).

3. Social Purpose Corporation

Social purpose corporations are for-profit corporations that may pursue social or environmental benefit along with financial profit. The social purpose corporation form has been adopted in California,[79] Washington,[80] and Florida.[81] Again, each state has varying legal requirements despite the common nomenclature. Under the Washington Business Corporation Act, social purpose corporations must "promote positive short-term or long-term effects of, or minimize adverse short-term or long-term effects of, the corporation's activities upon any or all of (1) the corporation's employees, suppliers, or customers; (2) the local, state, national, or world community; or (3) the environment."[82] The California Social Purpose Corporation Act contains similar language regarding the purpose of a California social purpose corporation.[83] Alternatively, a California social purpose corporation can be organized for "[o]ne or more charitable or public purpose activities that a nonprofit . . . is authorized to carry out."[84] This Article refers to both Washington and California social purpose corporations.

A social purpose corporation may also adopt and pursue one or more specific social purposes.[85] Under Washington law, the board of directors of a social purpose corporation must annually prepare a

79. CAL. CORP. CODE §§ 2500–17 (West 2014).
80. WASH. REV. CODE §§ 23b.25.005–.150 (2014).
81. FLA. STAT. ANN. § 607.504 (West 2014).
82. WASH. REV. CODE ANN. § 23B.25.020 (West 2014).
83. One of the authorized purposes of a California social purpose corporation is:

> The purpose of promoting positive effects of, or minimizing adverse effects of, the social purpose corporation's activities upon any of the following, provided that the corporation consider the purpose in addition to or together with the financial interests of the shareholders and compliance with legal obligations, and take action consistent with that purpose:
>
> (i) The social purpose corporation's employees, suppliers, customers, and creditors.
>
> (ii) The community and society.
>
> (iii) The environment.

CAL. CORP. CODE § 2602(b)(2)(B) (West 2014)
84. CAL. CORP. CODE § 2602(b)(2)(A) (West 2014).
85. WASH. REV. CODE ANN. § 23B.25.030 (West 2014); *see also* CAL. CORP. CODE § 2602(b)(1)(A)–(B) (West 2014).

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social purpose report in accordance with a third-party standard and make it publicly accessible.[86] Under California law, the board of a social purpose corporation must prepare a special purpose management discussion and analysis (special purpose MD&A) assessing the corporation's performance with respect to its special purpose.[87] Under both Washington and California law, a two-thirds vote of shareholders of each class is required to amend the corporation's social purpose.[88] Both Washington and California law also allow the firm's articles of incorporation to require a shareholder vote greater than two-thirds. Delaware law and the model benefit corporation legislation do not grant such flexibility.[89]

4. Branding and Signaling Value

Each of these corporate forms provides branding value to a social enterprise. Indeed, legal scholars have previously noted that the main benefit of such forms is branding.[90] In one qualitative study, management scholars examined the identity tension between dual missions of nonprofit social enterprises.[91] The study suggests that a social enterprise that incorporates a dual mission from its inception "experience[s] relatively less identity tension"[92] than a business that adopts a social mission or a nonprofit that adopts a commercial

86. WASH. REV. CODE ANN. § 23B.25.040(2)(b) (West 2014); *What is Required from SPCs?*, SOCIAL PURPOSE CORPS., http://www.spcwa.com/how_to_spc/spc-responsibilities/ (last visited Jan. 24, 2015).

87. CAL. CORP. CODE § 3501 (West 2014) (The special purpose current report must be made public "to the extent consistent with reasonable confidentiality requirements, shall cause the special purpose current report to be made publicly available by posting it on the social purpose corporation's Internet Web site or providing it through similar electronic means").

88. WASH. REV. CODE ANN. § 23B.25.090 (West 2014); CAL. CORP. CODE § 3000(b) (West 2014).

89. DEL. CODE ANN. tit. 8, § 363(c)(1) (2014); MODEL LEGISLATION § 201(d).

90. Brakman Reiser, *Benefit Corporations*, *supra* note 3, at 622 (arguing that social entrepreneurs pick hybrid entity forms in order to create a brand, but noting that "[w]hether the benefit corporation form can effectively function as such a brand . . . depends on whether it is a credible proxy for truly dual mission entities."); *see also* Murray, *Choose Your Own Master*, *supra* note 3 (noting that "public branding" in the form of sanctioned hybrid corporate forms can confer significant benefits on social enterprise).

91. Smith, *supra* note 50, at 108.

92. *Id.* at 120.

activity well into its life cycle.[93] The early adoption of a hybrid form—and hence a dual mission—signals to investors, customers, employees, and other stakeholders that the firm intends to pursue social or environmental value, and not solely shareholder value. This signaling may attract directors, investors, and employees committed to the dual mission.[94]

There are many drawbacks to the hybrid corporate forms. Potential investors may not be knowledgeable about the new forms and therefore be hesitant to invest. The corporate form is as yet untested, with no case law interpreting the fiduciary duties of directors, making it a potentially risky choice for directors and investors alike. Social enterprise founders will also need to attract investors who are comfortable with the enterprise pursuing social value along with financial value.[95] Importantly, no hybrid corporation has gone public, raising questions about the viability of scaling a hybrid corporation.[96]

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93. *Id.* at 120–23.

94. *Cf.* Dana Brakman Reiser, *Governing and Financing Blended Enterprise*, 85 CHIC.-KENT L. REV. 619, 643 (2010) (discussing how the branding value of certified B corporations may attract directors, investors, and employees who value blended enterprise).

95. *Id.* at 650 ("All of a B corporation's investors, however, must be willing if not eager to invest their funds in an entity that will not pursue the funds' growth as its predominant objective. Thus, whether the B corporation form will increase the financing available for blended entities depends largely on the success of its branding efforts and the size of the market for investments such as these.").

96. Etsy Inc., a certified B corporation, went public in April 2015, and raised $267 million, indicating some appetite for social enterprises by mainstream investors. Additionally, by the terms of its B corporation certification with B Lab, Etsy must convert to a Delaware public benefit corporation by August 1, 2017 or lose its certification. If Esty converts, it could be the first publicly traded Delaware public benefit corporation and pave the way for future public hybrid corporations. Alex Barinka, *Etsy's IPO Is a Direct Challenge to Wall Street's Beliefs*, BLOOMBERG.COM (Apr. 2, 2015, 10:17 AM), http://www.bloomberg.com/news/articles/2015-04-02/etsy-s-ipo-is-a-direct-challenge-to-wall-street-s-beliefs ("The company's certification will eventually run out, and then Etsy has two choices: It can let it expire, or it would have to change to what's considered a legally recognized public benefit corporation—a move that would codify its responsibility to "stakeholders" (employees, community members, and other noninvestors) alongside its fiduciary responsibility to shareholders. No publicly traded company has done that yet, and the barrier is high. It would require approval of the board as well as an "extraordinarily high vote" of 90 percent of the shareholders."); *see also* J. Haskell Murray, *Etsy's Dilemma*, BUS. L. PROF. BLOG (Mar. 20, 2015), http://lawprofessors.typepad.com/business_law/2015/03/etsys-dilemma-.html; Hiroko Tabuchi, *Etsy I.P.O. Tests Pledge to Balance Social Mission and Profit*, N. Y. TIMES (Apr. 16, 2015), http://www.nytimes.com/2015/04/17/business/dealbook/etsy-ipo-tests-pledge-to-emphasize-social-mission-over-profit.html.

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By adopting a hybrid corporate form, entrepreneurs like Lola commit to a dual mission at the outset of the organization and signals to stakeholders the company's intention to pursue dual missions. Nonetheless, adopting a hybrid corporate form will not suffice if it is the only step taken. Given weak statutory accountability mechanisms adoption of a hybrid corporate form is an initial, minimal step.

B. Declare a Specific Mission

The next step in the proposed commitment approach requires defining a social mission. The benefit corporation, public benefit corporation, and social purpose corporation forms each allow Nourish to establish and state a social mission in Nourish's corporate charter.

1. Benefit Corporation

Benefit corporations formed in states using the Model Legislation must pursue a general public benefit, or "a material positive impact on society and the environment, taken as a whole, assessed against a third-party standard, from the business and operations of a benefit corporation."[97] As comments to the Model Legislation explain, "the concept of general public benefit requires consideration of *all of the effects* of the business on society and the environment."[98] This legal requirement has been criticized as vague and impractical, and an exacerbation of the "dual mission-management" problem because it requires directors to promote a "material positive impact" across multiple factors "taken as a whole."[99] Directors are not given the legal authority to prioritize certain impacts over others:

> Requiring social enterprise directors to consider an unprioritized group of stakeholders while also requiring a corporate purpose that looks at societal and environmental impact as a whole is not only unworkable, but could also exclude corporations with a more specific mission. A

97. MODEL BENEFIT CORP. LEGISLATION § 102.
98. *Id.* § 102 cmt. (emphasis added).
99. Murray, *Choose Your Own Master*, *supra* note 3, at 32–33.

> corporation with a focused and specific public purpose at its core is more likely to pursue that purpose because the objective is more easily identified by directors. A more specific public purpose (or a prioritizing of certain stakeholders within a more general public purpose) would also provide a more workable system of board accountability.[100]

Benefit corporations formed in states that follow the Model Legislation have the option of declaring a specific public benefit.[101] However, this option does not aid in mitigating the dual-mission management problem. The Model Legislation makes clear that the corporation's declaration of a specific public benefit does not substitute for the general public benefit: "The identification of a specific public benefit under this subsection does not limit the purpose of a benefit corporation to create general public benefit . . . ."[102] Even while declaring a specific public benefit, directors and officers of a benefit corporation must pursue both the general public benefit and specific public benefit, and are unable to focus solely on a specific social mission.[103]

2. Public Benefit Corporation

Delaware public benefit corporations, must create a public benefit, or "a positive effect (or reduction of negative effects) on [one] or more categories of persons, entities, communities or interests (other than stockholders in their capacities as stockholders) including, but not limited to, effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature."[104] The public benefit overlaps with, and expands upon, the exempt purposes for 501(c)(3) organizations found in the Internal Revenue Code.[105] Moreover, unlike the benefit

100. *Id*.
101. MODEL BENEFIT CORP. LEGISLATION § 201(b).
102. *Id.*
103. *Id.*
104. DEL. CODE ANN. tit. 8, § 362(b) (2014).
105. I.R.C. § 501(c)(3) (2010). Exempt purposes are "religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic

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corporation, the public benefit corporation's public benefit can be tailored to its operations. When forming the public benefit corporation, the incorporator can choose "[one] or more categories of persons, entities, communities or interests" to benefit, rather than pursue positive impact across multiple stakeholders.[106]

Delaware law further requires that one or more *specific* public benefits—as opposed to general public benefits—be stated in a public benefit corporation's certificate of incorporation.[107] For example, the incorporator of a public benefit corporation could presumably choose to prioritize a scientific impact on the public rather than an environmental one.

3. Social Purpose Corporation

The articles of incorporation of a California social purpose corporation must enumerate the corporation's special purposes.[108] This requirement echoes the duty of public benefit corporations to identify specific public benefits (whereas this is optional for benefit corporations). Additionally, the articles of incorporation must contain one of two general social purposes. The articles must include either (1) a statement that the corporation is organized to engage in "charitable or public purpose activities that a nonprofit public benefit corporation is authorized to carry out;"[109] or (2) a statement that the corporation has the purpose of:

> [P]romoting positive effects of, or minimizing adverse effects of, the social purpose corporation's activities upon *any* of the following, provided that the corporation consider the purpose in addition to or together with the financial interests of the shareholders and compliance with legal obligations, and take action consistent with that purpose:

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facilities or equipment), or for the prevention of cruelty to children or animals." *Id.* However, 501(c)(3) organizations must be "organized and operated exclusively" for an exempt purpose. *Id.* Public benefit corporations do not have to exclusively pursue a public benefit.

106. DEL. CODE ANN. tit. 8, § 362(b) (2014).

107. *Id.* § 362(a)(1).

108. CAL. CORP. CODE § 2602(b)(2)(A) (West 2015).

109. *Id.*

(i) The social purpose corporation's employees, suppliers, customers, and creditors.

(ii) The community and society.

(iii) The environment.[110]

Statutory interpretation of the word "any"—as opposed to "all"—indicates that not all stakeholders need be considered by a social purpose corporation under California law. Therefore, a California social purpose corporation can tailor its operations to benefit a group of particular stakeholders.

4. Define a Specific Social Mission

Declaring a specific public benefit or special purpose facilitates mission accountability. Such a declaration requires directors to prioritize a specific mission rather than have more diffuse obligations.[111] A drawback of the benefit corporation form is that the Model Legislation does not allow prioritization of public benefits—all affects of the business on society must be considered.[112]

Lola considers whether to adopt a specific public benefit or special purpose for her company, but anticipates tension between Nourish's social and economic missions. Declaring a specific public benefit or social purpose binds the firm to a particular social mission. The specific mission is a defining feature of Nourish's organizational identity of commitment.

However, problems may result from adopting a narrow, specific public benefit or special purpose. If the mission is stated too narrowly, the corporation may be unable to pursue new and unexpected social or economic opportunities that do not align with its stated mission. For example, if Nourish's specific mission identifies Lola's local community as the targeted beneficiaries of Nourish's donated goods, Nourish will be constrained from serving other communities unless it amends its specific public benefit statement in its articles of incorporation. In order to maintain flexibility, Lola

110. *Id.* § 2602(b)(2)(B) (emphasis added).
111. Murray, *Choose Your Own Master*, *supra* note 3, at 32–33.
112. *See* discussion *supra* notes 101–03.

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could craft a specific public benefit that is categorical and generic. For example, Nourish's specific public benefit could state: "Nourish seeks to ameliorate the effects of poverty around the world." This specific public benefit provides the social enterprise with flexibility to shift future operations away from combating hunger if new opportunities arise. Nonetheless, such a categorical and generic description fails to provide a distinct standard against which the company's social and environmental performance can be assessed. As a benefit corporation, public benefit corporation, or social purpose corporation, Nourish must issue an impact report assessing the extent to which it has promoted its specific public benefit.[113] An overly broad and vague statement of its specific public benefit or special purpose is not capable of assessment, and therefore does not contribute to corporate accountability. Here, for example, it is unclear which poverty issues Nourish will target. This statement also fails to provide any guidance to directors on what particular constituencies to prioritize. Furthermore, such vagueness may be taken as a sign of the lack of commitment to a social mission or greenwashing.[114]

As a consequence of the above concerns, Nourish adopts the following statement in its corporate charter: "Nourish's specific public benefit [or special purpose] is to ameliorate hunger, food insecurity, and the by-products of hunger and food insecurity in disadvantaged, poor, and low-income communities." This social mission identifies hunger and food insecurity as the societal problems Nourish will ameliorate, and identifies disadvantaged, poor, and low-income communities as the targets of Nourish's operations.

Lola can enhance accountability to the company's social mission by making Nourish's specific public benefit or special purpose publicly available, and not solely embedded in a quasi-public document like its corporate charter. Lola plans to embed Nourish's specific public benefit or special purpose statement in all of the company's internal and external materials. Placing the statement on internal documents, like employee manuals and governance policies,

113. *See* discussion Part III.E.

114. Cherry, *supra* note 26, at 285 (citing *The Seven Sins*, UNDERWRITERS LABS, http://sinsofgreenwashing.org/findings/the-seven-sins (last visited Jan. 22, 2014)). "Vagueness" is one of the Seven Sins of greenwashing. *Id.*

conveys a committed organizational identity to employees. Similarly, placing the statement on external documents such as contracts and promotional materials communicates a committed organizational identity to vendors, distributors, suppliers, and nonprofit partners. Placing the statement on the corporation's website exhibits to consumers an organizational identity of commitment to this particular social mission.

C. Commitment & Oversight from the Board

Nourish's specific public benefit or special purpose statement will also help Lola recruit directors for the board. A commitment approach to social enterprise requires the entire board to act as the fiduciary of the corporation's social mission, as well as commit to govern the corporation through stakeholder engagement, as will be discussed below. A social enterprise's board can formalize its duties through a document that puts prospective and current board members on notice of their duties. Board duties general to corporations include the duty of care[115] and the duty of loyalty.[116] Legal duties required of the directors of a hybrid corporate form include the directors' duty to balance the pecuniary interests of the corporation's stockholders and stakeholders, and the duty to promote the corporation's declared public benefit or special purpose. With the help of an attorney, Lola creates a "Board Roles and Responsibilities" document to provide to each potential board member to advise them of their board duties, including those particular to being a hybrid corporation.

Notably, neither the public benefit corporation nor social purpose corporation statutes create a separate board or officer role for overseeing the production of the public benefit statement or social purpose report, or for promoting the public benefit or social purpose. In contrast, the board of directors of a benefit corporation may appoint an independent benefit director.[117] The primary role of the benefit director is to opine in the benefit report:

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115. *See, e.g.*, CAL CORP. CODE §§ 309, 2700, & 5231(a) (West 2015) (codifying the duty of care for corporations, social purpose corporations, and nonprofit corporations).

116. *See, e.g.*, *id.* §§ 310 & 5233 (codifying prohibition of certain conflicts of interest).

117. MODEL BENEFIT CORP. LEGISLATION § 302(a) & (b). "Independent" means that the benefit director has no material relationship with the benefit corporation or a subsidiary of the

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> (1) Whether the benefit corporation acted in accordance with its general public benefit purpose and any specific public benefit purpose in all material respects during the period covered by the report.
>
> (2) Whether the directors and officers complied with sections 301(a) [relating to directors' standard of conduct] and 303(a) [relating to officers' standard of conduct], respectively.
>
> (3) If, in the opinion of the benefit director, the benefit corporation or its directors or officers failed to act or comply in the manner described in paragraphs 1 and 2, a description of the ways in which the benefit corporation or its directors or officers failed to act or comply.[118]

The benefit director's role provides transparency to shareholders "as to whether the directors have adequately discharged their stewardship of the benefit corporation and its resources."[119]

In the Model Legislation, the benefit director's role is limited. The benefit director does not implement the corporation's general public benefit; implementation is the responsibility of the benefit officer. The benefit officer has "the powers and duties relating to the purpose of the corporation to create general public benefit or specific public benefit."[120] The benefit officer also prepares the benefit report on which the benefit director opines.[121] The benefit officer position is optional,[122] and the benefit director may also serve as the benefit officer.[123]

Although the Model Legislation declares the benefit director as the principal overseer of the corporation's general public benefit, it would be folly for the rest of the board of directors to take a laissez-

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benefit corporation, other than his or her capacity as the benefit director. *Id.* § 102. The benefit director cannot be or have been an employee of the benefit corporation within the last three years, or have a beneficial or record ownership of the benefit corporation of five percent or more. *Id.*

118. *Id.* § 302(c).
119. *Id.* § 302 cmt.
120. *Id.* § 304(b)(1).
121. *Id.* § 304(b)(2).
122. *Id.* § 304(a).
123. *Id.* § 302(b).

faire approach to pursuing and safeguarding the social enterprise's mission. Just as "the board of a tax-exempt organization is collectively responsible for developing and advancing the organization's mission,"[124] all directors must meet the standard of conduct required by law. A benefit corporation's board and its individual directors are tasked with considering the impact of corporate actions on various stakeholders and the corporation's general public benefit.[125] Similarly, all officers of the corporation must consider the impact of the corporate actions on stakeholders if "the officer has discretion to act with respect to a matter" and "it reasonably appears to the officer that the matter may have a material effect on the creation by the benefit corporation of general public benefit or a specific public benefit . . . ."[126] Consequently, a committed approach to a social mission does not confine the oversight or implementation role to just a few corporate actors. The approach requires commitment from the highest level of the organization—the board of directors as a whole and any officers or management in a position to make strategic decisions on behalf of the corporation.

D. Embrace Normative Stakeholder Governance

The proposed commitment approach also requires that directors embrace normative stakeholder governance.[127] Stakeholder governance refers to a governance method by which directors and officers of a corporation consider the financial and non-financial returns to the corporation's stakeholders.[128] Stakeholders may include employees, shareholders, creditors, suppliers, customers, the

124. BRUCE R. HOPKINS & VIRGINIA GROSS, NONPROFIT GOVERNANCE: LAW, PRACTICES, AND TRENDS 14 (1st ed. 2009).

125. MODEL BENEFIT CORP. LEGISLATION § 301(a).

126. *Id.* § 303(a).

127. *See infra* notes Part III.D.5.

128. For a decisive description and defense of stakeholder theory, see Robert Phillips, R. Edward Freeman & Andrew C. Wicks, *What Stakeholder Theory Is Not*, 13 BUS. ETHICS Q. 479 (2003). *See also* RAJ SISODIA, JAG SHETH & DAVID WOLFE, FIRMS OF ENDEARMENT: HOW WORLD-CLASS COMPANIES PROFIT FROM PASSION AND PURPOSE, at xi (2d ed. 2014) (arguing that companies that use "stakeholder relationship management" have a competitive advantage and realize higher returns).

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community members of the community in which the corporation operates, and the natural and physical environment the corporation affects. As will be examined below, the hybrid corporation laws vary in requiring stakeholder governance. The board of a public benefit corporation or benefit corporation is required to engage in stakeholder governance. Whether the board of a California social purpose corporation must engage in stakeholder governance depends on which one of two special purposes it adopts. The board of a Washington social purpose corporation has discretion whether to engage in stakeholder governance.

1. Benefit Corporation & Public Benefit Corporation

According to the Model Legislation and the Delaware Corporate Code sections relating to the public benefit corporation, directors of either corporation must engage in stakeholder governance. Benefit corporation directors must consider the effects of any corporate action on a wide range of stakeholders.[129] Similarly, the Delaware public benefit corporation statute states that directors must manage the corporation "in a manner that *balances* [(i)] stockholders' pecuniary interests, [(ii)] the best interests of those materially

129. For example, when discharging their duties, directors of a New York benefit corporation must consider:

> (A) the ability for the benefit corporation to accomplish its general and any specific public benefit purpose;
>
> (B) the shareholders of the benefit corporation;
>
> (C) the employees and workforce of the benefit corporation and its subsidiaries and suppliers;
>
> (D) the interests of customers as beneficiaries of the general or specific public benefit purposes of the benefit corporation;
>
> (E) community and societal considerations, including those of any community in which offices or facilities of the benefit corporation or its subsidiaries or suppliers are located;
>
> (F) the local and global environment; and
>
> (G) the short-term and long-term interests of the benefit corporation, including benefits that may accrue to the benefit corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the benefit corporation . . . .

N.Y. BUS. CORP. LAW § 1707(a) (McKinney 2012).

affected by the corporation's conduct, and [(iii)] the public benefit or public benefits identified in its certificate of incorporation."[130] Professor J. Haskell Murray notes that the word "balance" used in the Delaware statute may be "more onerous" than the word "consider" used in the Model Legislation:

> "Balance" could mean giving exactly equal weight to each factor, but more likely means giving some weight to each factor. "Consider," however, only requires directors to think about each factor and could allow directors to completely disregard a factor after considering it. It is unclear from the commentary whether Delaware's use of "balance" over "consider" was purposeful or important to the drafters.[131]

Statutory interpretation of the words "balance" and "consider" is not likely to be settled until a court interprets them, or state legislatures provide additional guidance.

2. California Social Purpose Corporation

Whether directors of a California social purpose corporation must engage in stakeholder governance seemingly depends on the special purpose that the corporation has chosen. A California social purpose corporation must choose one of two special purposes. The corporation can adopt "[t]he purpose of promoting positive effects of, or minimizing adverse effects of, the social purpose corporation's activities upon any of the following, ...:

> (i) The social purpose corporation's employees, suppliers, customers, and creditors.
>
> (ii) The community and society.
>
> (iii) The environment.[132]

Alternatively, the social purpose corporation can adopt "one or more charitable or public purpose activities that a nonprofit public benefit

130. DEL. CODE ANN. tit. 8, § 362(a) (2014) (emphasis added).
131. Murray, *Social Enterprise Innovation*, *supra* note 4, at 355.
132. CAL. CORP. CODE § 2602(b)(2)(B)(i)–(iii) (West 2015).

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corporation is authorized to carry out."[133] The former special purpose expresses stakeholder governance, similar to the public benefit corporation and benefit corporation. The later special purpose has little to do with stakeholder governance and instead allows the social purpose corporation to act as a for-profit charity.

Regardless of whether the former or latter special purpose is chosen, the California Act also grants directors significant discretion in determining which factors to consider when discharging their duties. The California Social Purpose Corporation Act (California Act) states that:

> In discharging his or her duties, a director shall consider those factors, and give weight to those factors, *as the director deems relevant*, including the overall prospects of the social purpose corporation, the best interests of the social purpose corporation and its shareholders, and the purposes of the social purpose corporation as set forth in its articles.[134]

A director can weigh factors "as the director deems relevant."[135] This language implies that a director can prioritize constituents and factors using her business judgment.[136] Whether this statutory interpretation of fiduciary duties will hold true remains to be seen. There has been no case law to test the fiduciary duties of directors of California social purpose corporations.

3. Washington Social Purpose Corporation

Unlike directors of a public benefit corporation or benefit corporation, directors of a Washington social purpose corporation are permitted, but not required, to consider various stakeholders when

133. *Id.* § 2602(b)(2)(A).
134. *Id.* § 2700(c) (emphasis added).
135. *Id.*
136. *Id.* The business judgment rule for a California social purpose corporation is codified: "A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner the director believes to be in the best interests of the social purpose corporation and its shareholders, and with that care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances." *Id.* § 2700(a).

performing their duties.[137] A "social purpose" under Washington law is a business purpose carried out "in a manner intended to promote positive short-term or long-term effects of, or minimize adverse short-term or long-term effects of, the corporation's activities upon any or all of (1) the corporation's employees, suppliers, or customers; (2) the local, state, national, or world community; or (3) the environment."[138] The Washington statute contains permissive, non-restrictive language with respect to director duties to ensure the social purpose: "in discharging his or her duties as a director, the director of a social purpose corporation *may* consider and give weight to one or more of the social purposes of the corporation as the director deems relevant."[139] The use of the permissive word "may" instead of the obligatory word "shall" could be interpreted to allow directors to disregard social purposes when carrying out their duties. Additionally, a director can consider what social purposes she "deems relevant."[140] Whether this permissive language was intended or the result of poor drafting is unclear.

4. Constraint with Flexibility in Execution

Where consideration of social mission and stakeholders is not required, but permissive—as with the Washington social purpose corporation—dual mission tensions may be exacerbated. Without legal requirement, directors and managers need not make their strategic or management decisions based on the social enterprise's social mission or affected stakeholders. Directors are essentially given a blank check to align their fiduciary duties with any set of stakeholders, including shareholders. Additionally, where consideration of stakeholders cannot be prioritized—as with benefit corporations following the Model Legislation[141]—obligations may be too diffuse to manage as directors attempt to account for all stakeholders. Requiring stakeholder governance, but giving directors discretion to prioritize stakeholders may aid in dual mission

137. WASH. REV. CODE ANN. § 23B.25.050(2) (West 2012).
138. *Id.* § 23B.25.020.
139. *Id.* (emphasis added).
140. *Id.*
141. *See* discussion *supra* Part II.B.1.

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management. This approach—taken by the Delaware public benefit corporation and the California social purpose corporation if the stakeholder governance special purpose is chosen—provides a legal constraint with flexibility in how to execute it. The flexibility provided, however, must be put to good purpose. Directors should not use the wide discretion granted to them by the hybrid corporate statutes to pick and choose amongst stakeholders to benefit themselves or solely enhance the corporation's financial bottom line. Directors must work to create a meaningful framework for prioritizing stakeholders and obtaining stakeholder input in a manner that enhances stakeholder value and aligns with the corporation's social mission. This framework then acts as the basis for which directors and management make their strategic and management decisions on behalf of the social enterprise. A commitment approach therefore requires putting such a framework in place to provide guidance to decision-makers. A possible framework is discussed below.

5. Stakeholder Participation & Power

Stakeholder theory has "conceptual breadth. The term means different things to many different people and hence evokes praise or scorn."[142] Instrumental stakeholder governance dictates that "the corporation needs to pay attention to only those stakeholders who can affect the value of the firm."[143] According to this subtheory, stakeholder governance is an instrument of shareholder wealth maximization. In contrast, normative stakeholder theory has a "moral foundation."[144]

> Normative stakeholder theory . . . grants stakeholder claims intrinsic value due to the moral rights of any individual affected by corporate conduct. Central questions of normative stakeholder theory consider rights and duties of the actors

142. Phillips, Freeman & Wicks, *supra* note 128, at 479.

143. Spitzeck & Hansen, *supra* note 47, at 380; *see also* Phillips, Freeman & Wicks, *supra* note 128, at 496.

144. Phillips, Freeman & Wicks, *supra* note 128, at 481.

> involved and how a just balance of concerns of different stakeholders can be achieved.[145]

Because instrumental stakeholder theory relies on shareholder wealth maximization it is antithetical to social enterprise, the purpose of which is to pursue both social and financial value. The proposed commitment approach to social enterprise thus rejects instrumental stakeholder governance and embraces normative stakeholder governance. Utilizing normative stakeholder governance, social enterprise directors should implement stakeholder engagement mechanisms that empower stakeholders to participate in corporate decision-making.

Spitzeck and Hansen conducted a qualitative study of forty-six organizations and identified seventy-six different stakeholder engagement mechanisms.[146] Spitzeck and Hansen categorized the stakeholder engagement mechanisms according to stakeholder power and stakeholder scope. Stakeholder power "refers to the level of influence stakeholders are granted in corporate decision making."[147] On one hand, stakeholders can be given no power to participate in any decision-making.[148] On the other hand, stakeholders can possess power to make corporate decisions.[149] "Scope refers to the breadth of power in corporate decision making and usually spans along the line of deciding on isolated local issues to decisions affecting the general business model of the organization."[150] The researchers analyzed the forty-six organizations for evidence of how each corporation's demonstration of stakeholder engagement actually impacted corporate decision-making. Their results showed that 74 percent of the corporations took "an instrumental approach in granting stakeholders more access to corporate decision making."[151] An instrumental approach to stakeholder engagement contrasts sharply with normative stakeholder governance:

145. Spitzeck & Hansen, *supra* note 47, at 380.
146. *Id.* at 381.
147. *Id.* at 380.
148. *Id.*
149. *Id.*
150. *Id.*
151. *Id.* at 387.

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> From an instrumental perspective, stakeholder governance needs to give a voice to powerful stakeholders in order to secure their contribution to the success of the firm. This line of thought usually conceptualizes stakeholder dialogue strategically and is oriented around the needs of the organization such as risk management or the realization of opportunities.[152]

For these corporations, the stakeholder engagement mechanisms provided stakeholders with low to intermediate levels of power. Sixty-one percent of companies examined granted stakeholders low levels of power through stakeholder engagement mechanisms such as (i) stakeholder dialogues through forums and meeting and (ii) stakeholder advisory roles through which groups of stakeholders provide non-binding advice to the corporation.[153] Spitzeck and Hansen note that "when engagement and influence do not come together, it can lead to frustration of stakeholders."[154]

Spitzeck and Hansen did find evidence of more impactful stakeholder engagement mechanisms. These mechanisms include what the authors call (i) "issues collaboration" whereby a limited number of stakeholders have a high level of power over discrete issues, such as local initiatives; and (ii) strategic collaboration whereby stakeholders are integrated into innovating on new products and services.[155] However, Spitzeck and Hansen found that very high levels of stakeholder power were attainable only by one group of stakeholders: customers.[156] Spitzeck and Hansen conclude:

> An instrumental dialogue might help companies to share strategies and innovate, but it is not capable of aligning the worldviews of those inside with those outside the corporate boundaries. An instrumental approach to stakeholder governance represents a single-loop learning mechanism which does not encourage reflection on core values and principles

152. *Id.* at 380.
153. *Id.* at 384.
154. *Id.* at 386.
155. *Id.* at 385–86.
156. *Id.* at 386.

> . . . . [I]t is not enough to remain at the stage of dialogue and issues advisory where the real stakeholder impact usually remains unobservable. In order to make stakeholder governance sustainable, corporations also need to provide stakeholders with real power in order to address the issues which are important to them.[157]

Spitzeck and Hansen's findings are consistent with another important qualitative study consisting of interviews with corporate managers, the "big five" accounting firms, consultants, and NGOs about social and ethical accounting, auditing, and reporting in the UK. In this 2001 study, the researchers conclude that stakeholder "dialogue" through focus groups, meetings, and forums is insufficient to facilitate meaningful stakeholder engagement.[158]

> For stakeholder engagement to lead to a meaningful extension of corporate accountability, as opposed to representing merely a sophisticated management tool, there clearly needs to be some mechanism by which stakeholder views can feed directly into corporate decision-making and by which stakeholders can hold management to account . . . . [T]here is need for administrative reform . . . to be accompanied by institutional reform designed to empower stakeholders via instituting more participatory forms of corporate governance.[159]

The researchers conclude that "the radical edge of the early social audit movement, with its emphasis on holding to account powerful economic organisations has been effectively displaced by business imperatives . . . [A] process of stakeholder management has

157. *Id.* at 387.

158. David L. Owen, Tracey Swift & Karen Hunt, *Questioning the Role of Stakeholder Engagement in Social and Ethical Accounting, Auditing and Reporting*, 25 ACCOUNT. FORUM 264, 265 (2001). "The 'business case' orientated approach underpinning SEAAR [social and ethical accounting, auditing and reporting] leads to, at best, a 'soft' form of accountability, whereby organisations engage in stakeholder dialogue for the purpose of voluntary self-reporting on their trustworthiness as part of reputation building process. . . [S]uch a process, which has no institutional rights to information built into it, does little to promote notions of participative democracy as current power differentials between organisations and their non-financial stakeholders remain unaltered and hence 'mutual vulnerability' fails to be established." *Id.* at 275.

159. *Id.* at 272.

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effectively displaced any meaningful moves towards expanding corporate accountability towards stakeholders."[160] Contrary to the central argument in this Article, the researchers denounce voluntary, self-regulation and ponder whether stakeholder engagement can ever amount to more than "rhetoric, spin, or indeed blatant corporate propaganda" in the absence of legal reform.[161] Notably, the study conducted focused on for-profit companies, and not the recent US legal reforms that created hybrid corporations. Hybrid corporations have legally forgone shareholder primacy in favor of pursuing social and financial value; it remains to be seen whether the stakeholder engagement process of these hybrid corporations leads to "corporate spin" or more meaningful corporate accountability. Because hybrid corporate forms are new,[162] empirical studies of their stakeholder engagement processes has yet to be conducted. Nonetheless, both studies suggest that stakeholder engagement must move beyond rhetoric and dialogue. Impactful stakeholder engagement requires that stakeholders be given power to influence and participate in corporate decision-making.

a. Stakeholder Vetoes & Enforcement Rights

One way to grant stakeholders power is to grant them veto power over corporate decisions that might adversely affect the corporation's social mission. Spitzeck and Hansen's study provides an example of informal veto power in a case study of a sustainability-drive fruit drink company called "innocent."[163] McDonald's wanted to partner with innocent to provide innocent's drinks in McDonald's Happy Meals.[164] Understanding the risk to its "reputation for sustainability,"

160. *Id.* at 274–75.

161. *Id.* 277–78.

162. Maryland was the first state to enact benefit corporation legislation in 2010. B Lab, *Maryland First State in Union to Pass Benefit Corporation Legislation*, CSRWIRE (Apr. 14, 2010, 10:57 AM), http://www.csrwire.com/press_releases/29332-Maryland-First-State-in-Union-to-Pass-Benefit-Corporation-Legislation. California enacted flexible purpose corporation law (since renamed social purpose corporation) in 2012. The Corporate Flexibility Act of 2011, S.B. 201, 2011 Gen. Reg. Sess. (Cal. 2011).

163. Spitzeck & Hansen, *supra* note 47, at 383.

164. *Id.*

innocent polled its regular customers on the potential partnership.[165] Seventy-two percent of innocent's regular customers said that they agreed with the partnership, and innocent moved ahead with the partnership.[166] However, this approach to empowering stakeholders requires careful execution to grant stakeholders actual power. Corporate managers must commit to accepting the results of stakeholder polling or voting, even if not formally required by law or by the corporation's charter. This approach may also be limited to discrete issues where the appropriate stakeholders can be identified. Stakeholders must also be responsive and knowledgeable about the issues at hand for this stakeholder engagement mechanism to work.[167]

Social enterprise directors might seek to empower stakeholders through a legal veto right. Each of the hybrid corporate forms provides a "mission lock"[168] whereby the social enterprise's public benefit or social purpose set forth in the corporate charter can only be amended by supermajority vote of its shareholders.[169] However, only shareholders can vote on charter amendments. Other stakeholders have no voting authority. A social enterprise must look to other methods to give stakeholders power to lock in social mission. Rather than provide stakeholders with an *ex ante* right to lock in social mission, social enterprise directors might look for ways to provide stakeholders an *ex post* right to enforce, or correct deviations from, social mission. *Ex post* enforcement rights can be accomplished in one of two ways, depending on the hybrid corporate form.

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165. *Id.*

166. *Id.*

167. *See* Owen, Swift & Hunt, *supra* note 161, at 279 ("Compliance with statute/standard reporting . . . is, for example, liable to generate far more in the way of transparency of corporate actions than dialogue (or monologue?) with relatively ill-informed stakeholders can achieve.").

168. For a comparison of "mission lock" methods for social enterprises in G8 countries, see Orrick, Herrington & Sutcliffe LLP, *Balancing Purpose and Profit: Legal Mechanisms to Lock in Social Mission for "Profit with Purpose" Businesses Across the G8*, THOMPSON REUTERS FOUNDATION, (2014), http://www.trust.org/contentAsset/raw-data/1d3b4f99-2a65-49f9-9bc0-39585bc52cac/file (last visited Mar 11, 2015).

169. DEL. CODE ANN. tit. 8, § 363(c) (2014); MODEL BENEFIT CORP. LEGISLATION § 201(d); CAL. CORP. CODE § 3000(b) (West 2015); WASH. REV. CODE ANN. § 23B.25.090 (West 2012). The supermajority voting requirement is a form of "mission lock" but admittedly it does not provide absolute assurance that shareholders won't "sell out" and alter, reduce, or void the social enterprise's commitment to social mission. Brakman Reiser & Dean, *supra* note 6, at 1505–06.

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First, the Model Legislation allows directors or shareholders owning two percent of outstanding shares of a benefit corporation to bring a derivative benefit enforcement proceeding "for failure of a benefit corporation to pursue or create general public benefit or a specific public benefit purpose."[170] Notably, the Model Legislation also allows a benefit corporation's corporate charter or bylaws to grant the right to bring a benefit enforcement proceeding to any other person.[171] Therefore, to facilitate "mission lock," the directors or shareholders of a benefit corporation could grant standing in its corporate charter or bylaws to a particular group of stakeholders, or—though not advisable because it is impractical—all of the company's stakeholders at large. Who comprises the group of stakeholders would be entirely context dependent. The stakeholders empowered with enforcement rights might be the individual, community, or nonprofit beneficiaries that the social enterprise seeks to help. Directors might also look outside of stakeholder groups to subject-matter experts, such as representatives of independent nonprofits working in the same field. However, there are risks in granting enforcement rights to non-stockholder stakeholders. Stakeholders consist of heterogeneous groups with their own agendas to advance. For example, employees' interests in living wages and health benefits may be in conflict with customers' interests in keeping prices low. Each stakeholder group will have their own agendas to advance. The directors of a hybrid corporation must carefully consider whether to grant enforcement proceeding rights to representatives from all or particular groups of stakeholders.

Second, under Delaware law, stockholders of a public benefit corporation can bring a derivative suit to enforce directors' duty to balance (i) stockholders' pecuniary interests, (ii) "the best interests of those materially affected by the corporation's conduct, and (iii) the . . . public benefit or public benefits identified in its [the corporation's] certificate of incorporation."[172] However, stockholders

170. MODEL BENEFIT CORP. LEGISLATION § 305(c). A benefit enforcement proceeding is "[a]ny claim or action or proceeding for: (1) failure of a benefit corporation to pursue or create general public benefit or a specific public benefit purpose set forth in its articles; or (2) violation of any obligation, duty, or standard of conduct under this [*chapter*]." *Id.* § 102.

171. *Id.* § 305(c)(iv).

172. DEL. CODE ANN. tit. 8, §§ 365(a), 365(b), 367 (2014).

must hold at least two percent of the corporation's outstanding shares to have standing in a derivative suit.[173] Washington and California social purpose corporations can be "sued in the same manner as a [traditional] corporation"—derivatively by its shareholders.[174] Although Delaware law does not permit granting standing to non-stockholders, directors of a public benefit corporation could facilitate its commitment to its social mission by providing standing to bring a derivative suit to stakeholders through a donation of at least two percent of its outstanding shares to stakeholders. The shares could be donated to a trust or nonprofit, or group of nonprofits, specifically tasking them with this enforcement right through a shareholder agreement.[175] The corporation would need to maintain this two percent share ownership through additional donations of stock to the third party with each new stock issuance. Shares of a social purpose corporation could be similarly issued.

6. Nourish's Stakeholder Engagement Plan

As a starting point for creating a framework that prioritizes and engages stakeholders, Lola sets out to define Nourish's stakeholders based on the company's stated specific public benefit or special purpose. Recall that Nourish's specific public benefit or special purpose is "to ameliorate hunger, food insecurity, and the by-products of hunger and food insecurity in disadvantaged, poor, and low-income communities." In light of this mission, Lola identifies the company's initial stakeholders to include its shareholders; employees; customers; the individuals who receive donated products; disadvantaged, poor, and low-income communities that the company

173. *Id.* § 367.

174. WASH. REV. CODE ANN. § 23B.25.080 (West 2012); CAL. CORP. CODE § 2502.03 (West 2015) ("A social purpose corporation may be sued in the same manner as a corporation as provided in the Code of Civil Procedure.").

175. The idea of granting enforcement rights to a third party watchdog has been proposed in the context of Ello's conversion to a Delaware public benefit corporation. Ello is a social media rival to Facebook. Upon becoming a Delaware public benefit corporation, Ello announced that it would never sell ads on its platform or sell the private data of its users to third parties. Jeff John Roberts, *Ello makes a bold promise for an ad-free social network, but omits key details*, Oct. 24, 2014, https://gigaom.com/2014/10/24/ello-makes-a-bold-promis-for-an-ad-free-social-network-but-omits-key-details/ (last visited June 5, 2015).

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targets; community partners that distribute donated products; distributors and retail stores; suppliers and their employees; and the physical and natural environment affected by the production of nutritional bars. By initially defining Nourish's stakeholders Lola has taken the first steps in creating an action plan to engage stakeholders, a stakeholder engagement plan. A stakeholder engagement plan defines stakeholders, describes reasons to engage with stakeholders, describes the level of engagement that the company expects to have with each category of stakeholders, and sketches a plan for such engagement.[176] There is no one-size-fits-all stakeholder engagement plan, and such a plan must be multi-faceted. "[C]orporations . . . require a broad range of stakeholder governance mechanisms depending on the readiness of the organization and the task at hand."[177] Moreover, the process of developing a plan necessarily involves several iterations to ensure the engagement of stakeholders, as well as future modification when constituencies and firm operations grow or change. Lola commits Nourish's board to annually reassess and revise its stakeholder engagement plan.

To avoid using stakeholder governance merely as a means of creating shareholder value, which would constitute instrumental stakeholder governance, Lola also wants to empower stakeholders to participate Nourish's management. She creates a stakeholder advisory board whose mission is to identify nonprofit organizations and community groups or associations that can represent the interests of Nourish's stakeholders. The groups will hold seats on Nourish's board of directors. Additionally, the groups will be granted a stock interest that collectively represents two percent of the outstanding stock of Nourish. By holding 2 percent of the outstanding stock, the groups will collectively have standing to bring a derivate suit to

176. Various consulting, management, and NGOs aid firms in creating stakeholder engagement plans. Manuals that focus on particular sectors also exist. For example, the International Finance Corporation, a member of the World Bank, periodically publishes a stakeholder engagement manual for companies working in developing countries. INTERNATIONAL FINANCE CORPORATION, STAKEHOLDER ENGAGEMENT: A GOOD PRACTICE HANDBOOK FOR COMPANIES DOING BUSINESS IN EMERGING MARKETS (2007), *available at* http://www.ifc.org/wps/wcm/connect/938f1a0048855805beacfe6a6515bb18/IFC_Stakeholder Engagement.pdf?MOD=AJPERES

177. Spitzeck & Hansen, *supra* note 47, at 387.

enforce (i) Nourish's pursuit of its general and specific public benefit (if Nourish is organized as a benefit corporation), or (ii) the directors' fiduciary duties to balance its specific public benefit against stockholders' and stakeholders' interests (if Nourish is organized as a public benefit corporation).

With the help of an attorney, Lola also creates an internal governance policy that dictates that Nourish's board will consult and poll its stakeholders on major corporate decisions that would lead Nourish to deviate from its defined social mission, or create reputational risks to Nourish's brand value as a social enterprise. The initial steps in stakeholder engagement are manageable for a start-up social enterprise like Nourish.

E. Commit to Assessment, Transparency, and Accountability Through Social Reporting

Hybrid corporations must produce regular reports that assess the corporation's performance in carrying out its mission, so called social accounting reports.[178] Although the requirements of each social accounting report differ, the purpose remains the same:

> The annual benefit report is intended to permit an evaluation of that 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. The annual benefit report is also intended to reduce "greenwashing" (the phenomenon of businesses seeking to portray themselves as being more environmentally and socially responsible than they actually are) by giving consumers and the general public a means of judging whether a business is living up to its claimed status as a benefit corporation.[179]

178. MODEL BENEFIT CORP. LEGISLATION §§ 401–02; DEL. CODE ANN. tit. 8, § 366(b) (2014); CAL. CORP. CODE § 3500(b) (West 2015).

179. MODEL BENEFIT CORP. LEGISLATION § 102 cmt. (commenting on the definition of "Third-Party Standard").

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Social reporting is central to a hybrid corporation's commitment to its social mission.

1. Public Benefit Corporation

Delaware requires that a public benefit corporation provide a "statement as to the corporation's promotion of the public benefit" to shareholders at least every two years.[180] The public benefit statement 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 benefit 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.[181]

2. Benefit Corporation

Benefit corporations must produce a benefit report for shareholders similar to the public benefit statement.[182] However, while benefit reports must be made publicly available,[183] public benefit statements do not.[184] Additionally, unlike a public benefit

180. DEL. CODE ANN. tit. 8, § 366(b) (2014).
181. *Id.*
182. MODEL BENEFIT CORP. LEGISLATION § 401.
183. *Id.* § 402(b).
184. DEL. CODE ANN. tit. 8, § 366(c)(2) (2014). Delaware law allows, but does not require, public benefit statements to be made public. *Id.*

corporation,[185] a benefit corporation must assess and measure its performance against a third-party standard that is comprehensive, credible, and transparent, and is also "developed by an entity that is not controlled by the benefit corporation."[186] Therefore the benefit report must also state (i) "the process and rationale for selecting or changing the third-party standard used to prepare the benefit report,"[187] (ii) the reason for any inconsistent application of the third-party standard or any "change to that standard from the one used in the immediately prior report,"[188] and (iii) "any connection between the organization that established the third-party standard . . . [and] the benefit corporation, including any financial or governance relationship which might materially affect the credibility of the use of the third-party standard."[189]

3. Social Purpose Corporation

California social purpose corporations must produce an annual special purpose MD&A along with standard corporate financial statements.[190] Among other requirements, the special purpose MD&A must identify and discuss material actions taken to achieve the corporation's special purpose, "the impact of those actions, including the causal relationships between the actions and the reported outcomes, and the extent to which those actions achieved the special purpose objectives for the fiscal year."[191] Like the benefit report, the special purpose MD&A must also discuss the standards used to measure the special purpose objectives, including the rationale and process for selecting such standards and "any material changes" to the standards over the course of the fiscal year.[192]

185. *See id.* § 366(c)(3). Delaware law allows, but does not require, public benefit corporations to use a third-party standard to assess the corporation's promotion of the public benefit. *Id.*

186. MODEL BENEFIT CORP. LEGISLATION § 102.

187. *Id.* § 401(a)(1)(iv).

188. *Id.* § 401(a)(2)(ii).

189. *Id.* § 401(a)(6).

190. CAL. CORP. CODE § 3500(b) (West 2015).

191. *Id.* § 3500(b)(2).

192. *Id.* § 3500(b)(4).

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4. Beyond Rhetoric

The production of such a social accounting report consumes time and resources that start-up companies generally do not have. Nonetheless, a social accounting report aids the social enterprise in expressing and creating a committed approach to its mission. Social accounting reports are intended to create transparency to shareholders. And if made public, as required of benefit corporations and social purpose corporations[193] and permitted of public benefit corporations, the report also provides transparency to non-stockholder stakeholders by giving them an opportunity to scrutinize the corporation's performance. However, social accounting reports that are not transparent and are simply "rhetoric" contribute to mission drift and greenwashing.

Additionally, transparency is not synonymous with accountability where stakeholders are not given authority to hold corporate actors directly accountable.[194] Because non-stockholder stakeholders cannot bring a derivate suit against a hybrid corporation, they lack direct accountability. Social accounting reports, therefore, only offers non-stockholder stakeholders indirect accountability. Indirect accountability is the ability to influence or shape the corporation's action or behavior through less formal means and is derived from non-legal sources such as public shaming or negative publicity from media and third-party watchdogs, boycotts by consumers, the refusal to do business with the corporation, or the resignation of employees (or inability to recruit talented employees). Social accounting reports facilitate indirect accountability to non-stockholder stakeholders by allowing stakeholders to vote with their feet rather than through any formal process. But indirect accountability is only viable to the extent that (i) a social accounting report is truthful and transparent, and (ii) stakeholders are well-informed and organized enough to take

193. Washington social purpose corporations must make their social purpose reports publicly available on their websites. WASH. REV. CODE ANN. § 23B.25.150(1) (West 2012). California social purpose corporations must make their special purpose MD&A reports publicly available on their websites "to the extent consistent with reasonable confidentiality requirements." CAL. CORP. CODE § 3500(b) (West 2015).

194. *See* discussion *supra* Part III.D (noting that shareholders may bring derivative lawsuits against hybrid corporations, but non-shareholder stakeholders cannot).

adverse action should the report show that the social enterprise fails to meet social and environmental standards. Returning to the qualitative study of corporate managers and accounting firms discussed above, the researchers concluded that true transparency in social reporting is difficult to achieve.[195] Social reporting is not standardized, which allows reporting companies to derive their own metrics and inhibits outsiders from comparing these metrics across companies.[196]

5. Nourish's Social Reporting Plan

At a minimum, the proposed commitment approach requires that Nourish produce an annual, rather than biennial, social report that Nourish makes public. Nourish also adopts third-party standards by which to assess its social performance, rather than develop internal standards.[197] Although Nourish could customize internal standards to Nourish's operations, the use of third-party standards allows stakeholders to compare Nourish to other social enterprises and provides some confidence that Nourish has not cherry-picked favorable outcomes and disregarded unfavorable outcomes. Nourish also commits to an assessment that provides annual auditing, so that

195. Owen, Swift & Hunt, *supra* note 158, at 372.

196. *Id.* at 271–72 ("There was indeed a broad level of support for further moves toward standardisation on the part of many big five and corporate respondents who pointed to the need to combat window dressing and develop common indicators in order to promote comparison between the performance of different companies").

197. Nourish can choose from among a number of third party standards, including the B Impact Assessment; Ceres Roadmap to Sustainability; Global Reporting Initiative; Good Guide Company Ratings; or Sustainability Quotient. B Lab developed the B Impact Assessment. *Performance Requirements*, B LAB https://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/performance-requirements (last visited Apr. 17, 2015). The Ceres Roadmap is designed to provide a comprehensive platform for sustainable business strategy and for accelerating best practices and performance. CERES, http://www.ceres.org/ (last visited Apr. 17, 2015). The Global Reporting Initiative (GRI) is a network-based organization that produces a comprehensive sustainability reporting framework that is widely used around the world. GLOBAL REPORTING INITIATIVE, http://www.globalreporting.org/ (last visited Apr. 17, 2015). Good Guide's mission is to provide authoritative information about the health, environmental and social performance of products and companies. GOOD GUIDE, http://goodguide.com/ (last visited Apr. 17, 2015). Sustainability Quotient (UL/SQ) is a comprehensive enterprise-level sustainability program to facilitate the integration of corporate sustainability best practices in enterprises that is built upon third-party verifiable standards such as UL 880. SUSTAINABILITY QUOTIENT, http://www.sustainabilityquotient.com/ (last visited Apr. 17, 2015).

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Nourish's social accounting reports are not self-reported.[198] Nourish commits to making its social reporting transparent. Moreover, because Nourish has granted some of its stakeholders enforcement rights, these stakeholders are organized and capable of holding Nourish directly accountable for pursuing its social mission. Nourish's social reporting works in conjunction with its stakeholder engagement plan to enhance Nourish's commitment to its social mission.

CONCLUSION

This Article has proposed a roadmap for social enterprises formed as a benefit corporation, public benefit corporation, or social purpose corporation to meet the requirements of social enterprise laws as well as voluntarily strengthen their commitment to the pursuit of dual missions. The proposed approach accomplishes this through governance and the creation of an organization identity that prioritizes commitment to a social mission in order to guide directors and managers in their dual-mission decision-making. Because social enterprise laws have weak accountability mechanisms, social enterprises have no choice but to turn to voluntary governance policies and procedures to (i) mitigate dual-mission tensions, and (ii) internalize as well as publicly express their commitment to ameliorating a social or environmental problem. The proposed commitment approach requires the social enterprise to (i) focus on a defined social or environmental mission, (ii) tasks directors with overseeing the social mission, (iii) engage stakeholders in a manner that empowers them to participate in corporate decision-making and hold the enterprise accountable for failure to pursue its social mission, (iv) provide stakeholders with a right to enforce the social

198. The B Impact Assessment offered by B Lab is a self-reporting system. If a company gets a score of eighty on the Assessment (i.e., the threshold for certification), B Lab staff will ask for "supporting documentation" for eight to twelve "randomly selected" questions from the Assessment to verify the company's score. B Lab also selects 10 percent of certified B Corps for on-site review each year; and certified B Corps must take the B Impact Assessment every two years and obtain a minimum score of eighty points to retain the certification. *Performance Requirements*, B LAB, https://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/performance-requirements (last visited Apr. 17, 2015).

mission, and (iv) use transparent, standardized, and assessable metrics in annual social reporting. As hybrid corporate forms proliferate, empirical research should be conducted to elucidate if and how social enterprises are able to successfully navigate dual-mission tensions and remain committed to their social missions.

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