The Social Enterprise Life Cycle
by Dana Brakman Reiser and Steven A. Dean

The Social Enterprise Life Cycle unfolds at two levels. Collectively, much of the work of advocates for the growth of the social enterprise sector has focused on legitimating the double bottom line through the development of specialized legal forms of organization. Their efforts have been extraordinarily successful in making such forms available, even cracking the gold standard of Delaware law. For social enterprise law to continue to catalyze the expansion of the sector, it must move beyond developing forms of organization to deploying tools for growth. Lawyers and legal scholars can and should turn to designing tools to help entrepreneurs and investors find and trust each other, and to persuade employees, consumers and other key constituencies to have faith in their resolve. Looking forward, social enterprise law might aim to help commitments to social missions survive over time, through successive owners and beyond the demise of any particular entity.

This chapter will chart the challenges of The Social Enterprise Life Cycle, and offer legal tools and technologies designed to help social enterprise—and individual social enterprises—navigate its path. Just as social enterprise writ large seeks legitimacy, growth and, perhaps, a kind of immortality, so too do individual double-bottom-line ventures. Those social enterprises are all for-profit firms that pursue profits for owners while achieving social good. But they are not all alike.

Social enterprises fill every conceivable niche in terms of the products they sell and the services they provide. Over time they also occupy very different positions in The Social Enterprise Life Cycle. While any venture matures through different stages, the hybrid nature of double-bottom-line ventures lends The Social Enterprise Life Cycle particular significance. At distinct points in a social enterprise’s evolution, different threats to its chosen balance of profit and social mission wax and wane.

The Social Enterprise Life Cycle offers a fresh perspective on the needs of for-profit ventures that prioritize a social mission by examining a dynamic common to an otherwise mismatched collection of businesses. Social enterprises defy easy characterization, but they do share features that set them apart from other types of firms. They neither focus on profits for owners to the exclusion of other types of prosperity nor discount profit’s appeal. That freedom from convention imposes a special burden on social enterprises that reveals itself in different ways at distinct times. Discerning the pattern that not only sets social enterprises apart from conventional businesses but also unites them across their differences invites legal interventions capable of addressing those changing needs.

At inception, social enterprises need to ensure they have safe space in which to pursue their dual missions, and to differentiate themselves from other firms in the marketplace. Specialized legal forms can assist in both efforts, legitimizing the double-bottom-line concept internally for fiduciaries and managers, and broadcasting it to investors, employees, suppliers and consumers. As social enterprises seek to demonstrate proof of concept, grow, and scale, their needs for resources increase. To meet them, social entrepreneurs need to identify mission-committed investors, employees and consumers, and persuade them their own mission commitments can be trusted. Here again, the law offers solutions: this time in the form of creative contracts that include reliable signals and enforcement mechanisms. Even as the shadow of senescence falls over social enterprises, deal structures and governance regimes can be designed to steward social mission through sale or dissolution.
Legitimacy

At its core, social enterprise law represents an acknowledgement that for-profit ventures dedicated to furthering a social mission have particular needs and that those unique concerns are legitimate. The emergence of social enterprise organizational forms squarely targets the challenges associated with formation. Resolving the paradox at the heart of each social enterprise just enough to facilitate the creation of a double-bottom-line venture leaves much work to be done.

Forming an entity to serve as a vessel for a social enterprise may not represent a meaningful endpoint, but in many cases it represents an essential first step. Such an entity can, for example, provide limited liability for its creators, freeing them to take the risks necessary for their ventures to take root. Although a nonprofit corporation or limited liability company would deliver that and more, conventional organizational forms may not suit an enterprise that aims to combine private profits and public benefits in roughly equal measures.

Despite the label, a nonprofit corporation faces no constraints on its pursuit of profits. Nonprofit corporations can and do make profits; the law limits only what they can do with them. The net profits of a nonprofit must be reinvested in the entity itself, to produce the goods or services aligned with its charitable mission. A nonprofit cannot distribute net profits to those who control the organization, through an equity stake or other profit-sharing arrangement. It can, however, pay reasonable compensation to its employees, even if those employees are also directors or otherwise possess control over the entity. An entrepreneur wishing to do both good and well could draw a generous salary from a prosperous nonprofit. But even compensation that brushes against the law’s tolerance for reasonableness would hardly offer the same prospect of wealth that the equity upside in a for-profit startup could represent.

For-profit forms offer more freedom for social entrepreneurs to share in the profits their enterprises generate, and, despite their reputation, do not entirely reject the pursuit of a social mission. For example, so long as shares remain in friendly hands, for-profit corporate law tolerates the pursuit of profits alongside other objectives. The extent of that institutional indifference towards purpose can be seen in Justice Alito’s opinion in Burwell v. Hobby Lobby Stores, Inc. As Alito put it, “while it is certainly true that a central objective of for-profit corporations is to make money, modern corporate law does not require for-profit corporations to pursue profit at the expense of everything else, and many do not do so.” Only the latest in a long line of ambiguous judicial pronouncements on the nature of the corporate mandate, such a statement suggests that a conventional corporation could comfortably house a social enterprise. At a minimum, a for-profit corporation can, as Alito suggests, make idiosyncratic choices regarding its aims. Should its purposes include the pursuit of a social mission at the expense of much of the profit it might otherwise earn, unless one or more shareholders challenges it, that choice lies beyond scrutiny.

1 [DBR Emory]
2 [Model Act]
3 [Hansmann; note discussion of nonprofit corporation not charitable trusts as typical form for operating nonprofits.]
4 [RMNCA, Hansmann]
5 [RMNCA, see also 4958 and PF rule.]
6 134 S. Ct. 2751 (2014).
7 Id. at 2771.
Of course, the caveat of maintaining control in friendly hands is a significant one. Shareholders hold ultimate – if indirect – control of a corporation through their authority to elect directors. Directors and managers have the power to prioritize social impact over profits in a corporation’s operations, but only for as long as shareholders are willing to abide it. Mounting a coup to unseat a board or its majority raises challenging collective action problems, but a sufficient number of motivated shareholders can certainly “throw the bums (or perhaps the angels, in this case) out.” To protect a for-profit corporation’s social orientation, shareholders committed to this focus must maintain a controlling stake. Doing so will necessarily limit their ability to raise capital, though, as they will only be able to sell so many shares to outside investors whose preferences they cannot trust.

Even preserving a controlling stake will not always safeguard a for-profit’s social objectives from dissenting shareholder opinions. Bookend cases decided nearly a century apart both blocked controlling shareholders from imposing their idiosyncratic preferences to trade social good for incremental profit. In the 1919 *Dodge v. Ford* case, minority shareholders challenged Henry Ford’s refusal to issue dividends in order to employ more workers and to provide them with the income to “build up their lives and their homes.” The minority shareholders won, and the Michigan court opined that “a business corporation is organized and carried on primarily for the benefit of the stockholders.” Directors had no discretion to opt for a reduction of those profits to serve other purposes, no matter how noble. The 2010 *eBay v. craigslist* case yielded a similar result. The Delaware Chancery Court rejected craigslist’s controlling shareholder founders’ claim that defensive tactics to prevent a takeover could be justified by their desire to maintain their site’s “community-service” orientation in the face of pressure to “monetize” it. It explained, “[t]he corporate form in which craigslist operates … is not an appropriate vehicle for purely philanthropic ends, at least not where there are other stockholders interested in realizing a return on their investment.”

Cases like these, although rare, suggest that a controlling stake will not always be enough. To fully protect the social mission of a social enterprise formed as a for-profit corporation, all shareholders must remain committed to it. If a single defection can threaten destabilization of a social enterprise’s core commitments, social entrepreneurs must screen investors very carefully. And the capital they can reach without fear becomes extremely limited.

There is less doctrine and case law upon which to rely in the context of unincorporated for-profit entities, but these forms’ focus on providing flexibility to owners suggests some reason to be hopeful. Among these forms, the limited liability company (LLC) is of particular importance. Combining the limited liability of a corporation and the pass-through tax treatment afforded to partnerships, the LLC has become the vehicle of choice for small businesses, especially those just starting out. Startup social enterprises would be drawn to the LLC form for the same reasons. In addition, LLC law does not share

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8 See, e.g., Del. Gen. Corp. L. § XX.
9 [Elhauge NYU article]
10 170 NW 668, XXX (Mich 1919).
11 16 A.3d 1, XXX (2010).
12 *Id.* at XXX.
13 See David S. Walker, *A Consideration of an LLC for a 501(c)(3) Nonprofit Organization*, 38 William Mitchell L. Rev. 627, 634 & n. 31 (2012) (describing the LLC as the “predominant choice of form in which to organize a business” and citing documents from a variety of states, including Delaware, reporting formation of LLCs far outpaces incorporations).
corporate law’s tradition of devotion to a shareholder value maximization norm. Some LLC statute’s requirements of a “business” purpose for such entities may make their use to house purely nonprofit entities challenging. As social enterprises are for-profit companies, albeit for-profit companies also committed to generating social good, such narrowly focused enabling acts should not block social enterprise from forming as an LLC. Moreover, many LLC statutes including the most current uniform acts broaden the proper purposes for LLC formation to “any lawful purpose,” sometimes specifically noting that such purposes include those not for profit. The LLC form’s openness and flexibility with regard to purpose should make it attractive to those social entrepreneurs who fear the shadow of cases like Dodge and eBay.

The considerable latitude granted LLC owners (called “members”) should further reinforce this preference. LLC law’s touchstone is flexibility for owners. Enabling statutes contain defaults for entity governance, but almost all of them can be altered or waived in an adopting entity’s operating agreement – including even the fiduciary duty of loyalty. An LLC’s governance is largely structured by the choices made in its operating agreement. Owners can negotiate these contracts express a dual mission without fear, and can impose internal mechanisms for enforcement. Most important among these are limitations on transfer. The financial interest attendant to LLC memberships is freely transferable but governance rights are not. As a matter of default, existing members must approve acceptance of new members, even new members who purchase the financial interests of an existing member. If existing members do not trust a potential transferee, they can block her access to governance rights.

Unfortunately, the boon of flexibility also makes LLCs inapt to achieve the expressive goals crucial at formation. Although the for-profit LLC form is ripe for adaptation to the needs of particular social enterprises, the form’s very flexibility means adopting it says little about a particular entity. To know if a specific LLC is a dual mission entity, various audiences would need to examine its operating agreement and the hearts of its investors. Moreover, for those without counsel, such highly adjustable forms will be difficult to design and manage. Precisely because of its malleability, an LLC is simply not designed as off-the-rack legal form to legitimize dual-mission entities.

A social enterprise can inhabit any of the organizational forms described above. Non-profits do not proscribe profits nor do for-profit corporations always prohibit a substantial social mission. An LLC can be almost anything its owners seek. None of these forms, however, lend legitimacy the combination of profit and mission that defines a social enterprise.

Over the past decade, a variety of innovative forms have been designed to fill precisely that gap, responding to the absence of such a safe and ready-made form for dual mission enterprises. Each of these forms expressly permits adopting entities to pursue both profit for owners and social good, and each allows – though none forcefully requires – adopting entities to prioritize social objectives over

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14 See id. at 642-47.
15 See id.
16 [Ribstein treatise]
17 [Ribstein treatise]
The first of these forms was the Vermont Low-Profit Limited Liability Company and, over time, a number of other jurisdictions have developed state specific forms. Today, however, the benefit corporation is the clear current frontrunner.

Over 30 states have now adopted benefit corporation enabling legislation, which in the main follow a pattern established and advocated by a group called B Lab. B Lab is a nonprofit organization dedicating to “serving a global movement of people using business as a force for good.” It offers a variety of certification, benchmarking and other services to dual-mission businesses that wish to broadcast and verify their social commitments. Its flagship product, “B Corp” certification, is available to for-profit companies that (1) adopt governing documents indicating their socially-oriented purposes and instructing their leaders to consider factors beyond profit in making decisions and (2) score sufficiently highly on its proprietary social impact assessment tool. The first requirement can be met – and in some cases must be met – by adopting a benefit corporation form. B Lab worked with attorneys and advocates to create model benefit corporation legislation, which it continuously updates, and has been pivotal in pushing for adoption of these statutes around the country.

Due to this common model, most benefit corporation statutes share four core components. They begin by varying standard corporate law provisions on corporate purpose, which tend to allow formation for any lawful or lawful business purpose, to require adopting entities to have a “purpose of creating general public benefit.” General public benefit is defined as “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.” The third party standard is another hallmark of benefit corporation legislation – each adopting entity must select a third-party standard by which it will assess itself, which standard may but need not be B Lab’s assessment tool. This variation on for-profit corporate law’s standard purpose provisions perhaps best demonstrates the expressive function of benefit corporation statutes. It broadcasts that adopting benefit corporations will and must be different from traditional for-profits, and different precisely because of their double bottom lines.

The other common features of benefit corporation legislation backstop this commitment to a degree. Provisions on fiduciary conduct require directors to consider the effects of their decisions not only on shareholders, but also on employees, suppliers, customers, the community, society, even the local and global environment, as well as “the ability of the benefit corporation to accomplish its general public benefit purpose.” Benefit corporation statutes do not instruct fiduciaries to prioritize the interests of

19 This chapter is focused on social enterprises and social enterprise law in the U.S. It is worth noting, however, that the UK’s community interest company does impose a prioritization mandate, in contrast to U.S. forms. [CIC statute and Guidance] The UK also established a dedicated CIC regulator. [CIC statute and Guidance] This chapter, however, focuses its attention on the U.S.
20 [Vt. Statute]
21 Note SPC in California and Washington, Maryland Benefit LLC, Delaware PBC (last will be discussed more infra).
22 http://www.bcorporation.net/what-are-b-corps/about-b-lab
23 [B Lab site]
24 [B Lab site]
25 [B Lab site]
26 [B Lab site]
27 Model Benefit Corporation Legislation §201(a).
28 Model Benefit Corporation Legislation §102.
29 Model Benefit Corporation Legislation §301(a)(1).
any of the constituencies on this laundry list over each other or over the interests of shareholders, but they provide protection from *Dodge* or *eBay* type claims if fiduciaries choose to do so. Shareholder voting provisions increase the difficulty of shaking of a dual purpose; corporate charter amendments or transactions that will result in the creation or termination of benefit corporation status must be approved by two-thirds of shareholders. Finally, benefit corporation statutes impose disclosure requirements. Shareholders must receive annual benefit reports that again identify their chosen third-party standard, and assess their achievement with reference to it.

The benefit corporation is not the only specialized legal form for U.S. social enterprises, but thus far it has penetrated much further than its competitors. Even with this dominance, however, Delaware’s public benefit corporation (PBC) form could outpace it in entity adoptions. Delaware incorporation is the gold standard for business forms, and while small and closely-held businesses typically form in their home states, those with plans (or even pipedreams) of accessing outside capital prefer Delaware. It created the PBC in 2013 in part in recognition of its place as a market leader, and it would be foolish to count Delaware out this early in the game.

The PBC legislation identifies adopting entities as those “intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner,” sending an expressive message much like that found in benefit corporation legislation. The two statutes' supermajority voting requirements are also quite similar. The Delaware approach, however, differs from the benefit corporation in three important respects. Each PBC must select and identify in its articles at least one specific public benefit it plans to pursue; such designation is optional for benefit corporations. Unlike the laundry list consideration required of benefit corporation directors, PBC boards are instructed to “balance[] the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct, and the specific public benefit or public benefits identified in its certificate of incorporation.” Delaware’s disclosure requirements are also more limited, most notably in that they do not require the use of a third-party standard. Indeed, the use of a third party standard for any purpose under the PBC law is entirely optional. Despite these significant differences, B Lab has loudly welcomed Delaware into the benefit corporation fold.

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30 See Model Benefit Corporation Legislation §102.
31 Model Benefit Corporation Legislation §401(a)(4).
33 Del. Code Ann. tit. 8 § 362(a).
34 Compare Del. Code Ann. tit. 8 § 362(a) with Model Benefit Corporation Legislation §XX.
35 Compare Del. Code Ann. tit. 8 § 365 with Model Benefit Corporation Legislation §XX.
36 Compare Del statute (requiring disclosure only to shareholders and only every two years) with Model Legislation (requiring annual disclosures to shareholders and the public)
37 Del Statute XXX
Whether one of these forms will emerge as the victor or many statutory flowers continue to bloom, the benefit corporation and its hybrid siblings legitimize choices that might otherwise remain consigned to the margins. Although it would violate the spirit—and perhaps the letter—of the “nondistribution constraint,” a nonprofit manager who considers herself a social entrepreneur may boost her compensation to serve as a modest alternative to an equity upside. Such an overreach will go unchallenged unless an overburdened state attorney general or the IRS happens to take notice and use their limited resources to seek correction. Conversely, the sole shareholder of a for-profit may elevate social mission confident that whatever a court might decide if given the opportunity, no one has the right to bring such a lawsuit. LLC owners can contract among themselves to adopt and enforce a double-bottom line, but the limited defaults imposed by statute will not structure such a solution for them. The law may be impotent to punish such choices, but neither does it embrace them.

Since it provides precisely such a blessing—benefit corporation law expressly calls for insider profits and benefits for the broader public—forming a benefit corporation serves social entrepreneurs with a considerable expressive victory. Less intimate than the Supreme Court’s embrace of same-sex marriage in *Windsor* and *Obergefell* and less radical than the prospect of the legalization of recreational marijuana, hybrid organizational forms designed to accommodate both profit and social mission represent an equally dramatic policy shift, offering official acceptance of what had previously only been grudgingly tolerated. In some cases, the use of a hybrid form would change few facts on the ground. That might be true if a small social enterprise formed as a nonprofit could successfully distribute all of its profits as salary or a closely held for-profit could successfully elevates social mission over profits.

The benefit corporation and its counterparts have a significance that such a perspective ignores. To understand why, consider what the law has already done to accommodate non-financial motives alongside a profit imperative. In response to the threat of a challenge to a board’s decision regarding a potential acquisition, constituency statutes broadened the range of permissible corporate objectives by statutorily providing discretion for directors to consider and act on the interests of employees, creditors and the community even if their decisions sacrificed potential profit for shareholders. When invoked by a corporate board, the practical impact of a constituency statute would be to add further hurdles for would-be litigants to overcome in seeking to challenge a board’s choice on the grounds that another would have been more profitable. Although it might sometimes prove decisive, the limited immunity provided by constituency statutes primarily serves to reinforce the perception that a corporate social mission represents a transgression rather than an achievement.

Embracing a hybrid organizational form allows a social enterprise to break free of that dynamic. Becoming a Delaware public benefit corporation ensures that the pursuit of a social mission alongside profits ceases to be a mere eccentricity to be indulged. Instead, the adoption of a purpose-built entity allows a social enterprise to boldly declare its unconventional approach to business. When ventures become public benefit corporations, they can proudly broadcast the change. Method, the sustainable cleaning product company, includes its incorporation as a benefit corporation in the “Beyond the Bottle”


39 [Hansmann]

40 [Sources on feeble AG resources (MFS, Bograd) and dwindling IRS enforcement budget (Brody & Owens)]

41 [Fairfax, Tyler: describe statutory scheme of constituency statutes]
portion of its website. It explains that this move “formally incorporated our mandate for sustainability into the DNA of our company. [T]his unique corporate structure enables method to practice more enlightened business that balances profits with environmental and social responsibility.”42 In contrast, opting into the protection of a constituency statute is a nonpublic decision that happens in a boardroom, with the hope that it will never need to come to light in a courtroom.

Seizing the social enterprise mantle has been made easier by the advent of hybrid social enterprise forms. Rather than treating the refusal to embrace a narrow mandate as a sin to be absolved, the benefit corporation and other specialized legal forms offer ventures pursuing both profits and a social mission a way to unapologetically telegraph their unconventional approach to capitalism to customers and other audiences. Thus far, actual companies have not adopted specialized legalized form as swiftly as state legislatures have embraced them. Studies are limited and data collection is challenging, but optimistic counts place the number of actual entities formed under any of the relevant statutes at 5000 or fewer, ten years after the adoption of the first state enabling statute.43 Perhaps these anemic numbers suggest the expressive victory of these statutes is complete at state adoption, and individual entities need not use the new forms to enjoy it. Or, they may simply indicate a slow and steady uptake of a new form that will eventually take off. Whatever the explanation, after the confetti and balloons celebrating the advent of specialized forms have been cleared away, the hard work of transforming potential into achievements must begin. In this second phase of The Social Enterprise Life Cycle, intentions – however legitimate and sincere – no longer suffice.

Growth

The success a social enterprise seeks requires commitments no less robust than those that sustain for-profits and nonprofits. The growth of both social mission and financial profit must be anchored by meaningful contributions from employees and investors. Attracting the sort of human capital and financial resources needed to fuel a social enterprise means promising stakeholders that the rug will not be pulled out from under them without warning. Just as the law can provide the tools to legitimate a social enterprise, it can help create those prospective assurances.

Despite their many achievements, the benefit corporation and other current U.S. legal forms for social enterprise do not have the teeth to do so. The benefit corporation and other specialized forms permit adopting firms and their fiduciaries to prioritize social mission over private profit, but they do not impose any obligation that they do so. Without such a hierarchy, social commitments are easy to express but nearly impossible to enforce. A benefit corporation board that considers the interests of employees and the environment in every decision it makes but consistently opts to favor profit for shareholders instead is well within the bounds of its obligations. They would be legally required to issue reports that might apprise shareholders of their true orientation, but current compliance with benefit corporation disclosure requirements is dismal. But even if a shareholder knew and objected – despite her probably fatter wallet as a result of the board’s profit-first orientation – she would have no leg to stand on in litigation and a massive collective to overcome if she tried to remove the board by vote.

43 [Murray, Cooney; B Lab; Talley, etc.]
These forms also permit more fundamental moves to abandon public benefit despite considerable lack of consensus. If two-thirds of a benefit corporation’s shareholders vote for a merger that would remove its public benefit orientation, the remaining shareholders are powerless to stop it. The managers of a low-profit limited liability company, which must “significantly further[] the accomplishment of one or more [tax-exempt] charitable or educational purposes,”[^44] can simply stop serving those purposes and shift its activities and operations to single-mindedly pursue profit, and suffer no consequences. It would morph by operation of law into a conventional LLC, but nobody would necessarily know and, more importantly, nobody could object. When social entrepreneurs seek financial and human capital outside their closest and most intimate circles, both sides must be able to trust each others’ social commitments are genuine and enforceable.[^45] Opting into benefit corporation or another U.S. specialized form for social enterprise will not be enough to satisfy many of these crucial, but understandably skeptical, parties.[^46] Fortunately, organizational form is not the only technology the law has to offer them.

The contracts that form the heart of financial instruments both familiar and exotic can create reliable enforcement, and thus generate the assurances and trust so pivotal to growing a social enterprise. As we have argued elsewhere,[^47] a contingent convertible debt instrument could be designed to reassure investors skeptical of a social enterprise’s commitment to balancing social mission against profit. Flexible Low-Yield (FLY) Paper – long-term, below-market yield notes whose holders can convert their interests to equity if an entrepreneur sells her shares – does that by handing them the social enterprise equivalent of a poison pill.[^48] FLY Paper gives investors reassurances that they are not being played for the fool by an entrepreneur spinning tales of social good to unlock cheap capital and turn it into gold for herself on sale. The holders’ right to convert their debt into equity if such a sale occurs makes the possibility of one less likely, and greenwashing endeavors by faithless entrepreneurs less attractive.

Equally important, FLY Paper purchasers demonstrate their social commitments to entrepreneurs by purchasing a long-term, low-yield investment. Entrepreneurs’ suspicions can be further assuaged by FLY Paper investors’ role as lenders only, with no say in the venture’s governance unless and until a conversion event occurs. Having made low-cost capital available to a social enterprise, FLY Paper creditors have no power to compel it to consent to a sale or other transaction that would threaten its social mission. FLY Paper makes a social enterprise’s commitment to its social mission sticky by deputizing investors to watch over it. Certainly unorthodox, but potentially effective at guarding against enumerated threats.

Different types of contracts could serve similar roles, potentially enlisting the strength of a wide range of constituencies, including employees and customers.[^49] For-profit ventures have long relied on options to

[^45]: [DBR & Dean BCLR, OUP book]
[^46]: This is yet another possible explanation for the limited uptake of these forms thus far.
[^47]: [DBR & Dean BCLR, OUP book]
[^48]: In the heyday of hostile takeovers, the poison pill emerged as a potent protection of a corporate board’s discretion to chart a corporation’s course. [Cox & Hazen treatise] This legal mechanism deters unwanted suitors from acquiring more than a smattering of a corporation’s equity ownership without the board’s blessing. Unless the board disarms the poison pill, the creation of a potentially influential position automatically provides new shares to everyone else – undermining most or all of the acquirer’s erstwhile gains.
[^49]: DBR & Dean Seattle article provides detail on alternative financial instruments.
ensure the loyalty of employees.\textsuperscript{50} Social enterprises could turn that practice on its head, using options to empower employees to police their commitment to a social mission.

Executives charged with guiding the success of a business often receive an equity stake in it.\textsuperscript{51} In theory, that makes their compensation a function of the firm’s fortunes, aligning the interests of decision makers and the shareholders they serve. Any equity would accomplish that end, but the types of options ordinarily awarded to high-ranking employees do more. Such options typically vest over time.\textsuperscript{52} That ensures that those powerful employees will have an incentive to act in the long-term, or at least not just the very short-term, interests of the business.

One could embrace the core notion of establishing clear expectations for the relationship between employer and employee but reorient it around a balance between profit and social mission. Here, options held by a different cross-section of employees—rank and file rather than executives—might vest if the type of events that would trigger FLY Paper were to occur. A sale of a controlling stake by insiders within a given number of years, for example, would give employees the power to seize control from those new owners.\textsuperscript{53} The employee owners of these social enterprise options have no power to initiate a sale but can block one.

Approving such a mechanism would allow insiders to lash themselves to the proverbial mast to demonstrate their commitment to balancing social mission and profit. Not every prospective employee would value such an affirmation. The self-selecting few willing to prioritize mission would, of course, be precisely those a social enterprise would prefer to hire. Confident that no quick sale designed to line insiders’ pockets will derail their shared commitment, employees could dedicate themselves to ensuring its lasting success.

Pairing employees’ right of exit—quitting—with voice represents a model that could be extended to encompass consumers. Customers obviously enjoy considerable freedom to turn their back on a business that abandons its commitment to social mission. A twist on a traditional customer loyalty program—here designed to ensure fidelity to customers rather than from them—could permit consumers to play the same role as the employees can by holding the social enterprise options considered above.

A social enterprise loyalty program would offer consumers assurances rather than discounts. Purchasing an option designed to vest if insiders attempt to cash in would give a social enterprise’s customer base the power to serve as its anchor. Crowdfunding platforms like Kickstarter aggregate small contributions into fuel for fledgling ventures.\textsuperscript{54} Often, startups offer backers an opportunity to purchase products, relying on payments from those backers as seed capital.\textsuperscript{55} Purchasing a loyalty option bundled with

\begin{footnotesize}
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\item [50] [cite]
\item [51] [Hannes & Tabbach, 539-40]
\item [52] [cite]
\item [53] Of course, the trigger for any of these types of arrangement need not be limited to sale of the founder’s stake. If reliable mission-specific benchmarks can be developed and tracked, these might be used to create more sensitive enforcement mechanisms. For a discussion of the challenges posed by designing and utilizing performance metrics for social enterprises, see [Dadush, DBR & Dean OUP, etc.].
\item [54] [Schwartz, etc.]
\item [55] [Kickstarter, Indiegogo examples]
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goods or services could help a social enterprise to grow while also strengthening its commitment to social mission.

The path from concept to implementation of either an employee- or consumer-driven mission security mechanism will not be free of obstacles. But conditions have never been more favorable. Historically, a broad exemption has shielded employee stock option grants from costly federal and state securities regulation.⁵⁶ Those same securities laws, however, made it very difficult for small businesses to put equity in the hands of small investors other than workers.⁵⁷ New rules designed to smooth the way for startups to raise capital from the crowd could serve equally as well to permit small purchases of equity stakes by employees and consumers.⁵⁸ Contractual mechanisms like those sketched here could empower investors, rank-and-file employees, or even consumers to monitor the fidelity of insiders, ensuring that those with the means and the motive to sacrifice mission for profit resist temptation.

Of course, social entrepreneurs might also seek authentication by outside parties as a way to convince investors, employees, consumers of their social commitments. B Lab, discussed earlier, has played a prominent role in developing one such private certification for social enterprises. A firm that imposes upon its directors a duty to consider the interests of multiple constituencies and scores highly enough on the B Lab’s “B Impact Assessment,” can lay claim to certified B Corp status. A certified B Corp can license the B Corp mark for use on its products and promotional materials, declaring to every potential investor, employee and customer that it is no ordinary business. It remains early days for the B Corp mark, but the cultural relevance of fair trade coffee⁵⁹ and dolphin-safe tuna⁶⁰ demonstrate the potential power of private certifications.

B Lab, of course, wants B Corp certification to become well-known and easily understood, and doing so requires it to be both accessible to those seeking certification and reliable for the certification’s potential users. Core to these efforts has been the development of the primarily self-administered, but extremely dynamic, B Impact Assessment. Applicants seeking to become certified B Corps engage in a comprehensive internal review of their own operations, using B Lab’s free online tool.⁶¹ Recognizing that many factors will affect a company’s ability to produce social impact, the B Impact Assessment tailors the questions it asks, as well as the weightings the answers receive in determining the final score, to the size of the applicant and the industry and geography in which it operates.⁶² Applicants have an opportunity to discuss their preliminary results with B Lab staff, before submitting a final version and required supporting documentation.⁶³ B Lab reviews these materials for applicants scoring at least 80

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⁵⁶ SEC Rule 701 [“adopted pursuant to Section 3(b) of the Securities Act of 1933”] provides a special exemption from burdensome registration requirements for compensatory equity awards.

⁵⁷ [DBR & Dean InLR; OUP book]

⁵⁸ See 2012 JOBS Act and implementing regulations. The crowdfunding regulations offer even small startups opportunities to raise modest amounts of equity without becoming subject to costly registration requirements, creating a possible alternative to Rule 701 for these options.

⁵⁹ [Cite fair trade literature and example certifiers]

⁶⁰ [Cite certification program site]

⁶¹ The tool was developed by a Standards Advisory Council made up of business, philanthropy and social enterprise experts, who biennially revisit and revise it. [Cite B Lab site and Brookings paper.] B Lab has also formed a number of working groups, relying again on outside experts, to design addenda to the Assessment for companies in particular industries or market segments. [Cite B Lab site and Brookings paper.]

⁶² [Dorff, Seattle]

⁶³ https://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/performance-requirements
points and conducts background checks\textsuperscript{64} before permitting a company to license the B Corp mark. Certification lasts for two years, and ten percent of certified companies are selected for audit each year.\textsuperscript{65}

The founders of B Lab argue that companies need to embrace social objectives “\textit{to stay competitive, to meet the higher expectations of the next generation of consumers and employees who want to align their purchases with their values and to bring their whole selves to work every day.}’’\textsuperscript{66} As of this writing, just over 2000 firms were certified B Corps.\textsuperscript{67} Far greater penetration will be necessary for a B Corp status to enter the vernacular and create significant network effects. Time will tell whether the requirements and policing of B Corp certification will suffice to provide the assurances entrepreneurs, investors, employees and consumers require to contribute a social enterprise’s growth.

But B Lab’s own actions imply it believes more is required. It recently created a new product, the Global Impact Investing Ratings System (GIIRS), a certification designed with investors in mind. The GIIRS process begins with the B Impact Assessment, but proceeds through a more extensive vetting process and offers users more granular information about particular firms and funds.\textsuperscript{68} While the B Corp certification is an on-off switch, GIIRS gives firms and funds a tiered rating in multiple categories.\textsuperscript{69} This differentiated product demonstrates that the various constituencies required for growth may require different levels of assurance of a social enterprise’s social commitments. While simple B Corp status may be enough to satisfy consumers purchasing a single item for current use, investors with more skin and longevity in the social enterprise game will likely demand more certainty.

Further, B Lab’s staunch advocacy for benefit corporation legislation suggests it believes private certification cannot accomplish all that a legal form could. Perhaps recognizing the limits of private certification both in terms of access and visibility, B Lab has continued to urge state legislatures to embrace benefit corporation legislation as a kind of state-sponsored certification. Forming a conventional for-profit or nonprofit entity can communicate volumes about the intentions and obligations of its guardians. Each constitutes a powerful brand readily available to anyone at a moment’s notice and at negligible cost. B Lab argues that formation as a benefit corporation can likewise identify firms that prioritize goals beyond financial profits to a range of constituencies.\textsuperscript{70}

As discussed earlier, we are less sanguine about the ability of specialized legal forms – at least as currently available in the U.S. – to provide assurances stakeholders need to contribute to social enterprises’ growth. Current hybrid forms are long on permission and legitimation, but short on enforcement. Legal forms that leverage the B Corp certification with the strength of a state-sponsored form will have little effect unless and until that imprimatur is made more meaningful.

We are more optimistic about the potential of private certifications, especially those offered by entities like B Lab that are committed to changing and refining their offerings. Through these efforts, certifiers may be able to provide the kind of reliable enforcement needed to assure to entrepreneurs, investors,

\textsuperscript{64} https://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/performance-requirements
\textsuperscript{65} https://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/make-it-official-2
\textsuperscript{67} B Lab, https://www.bcorporation.net/
\textsuperscript{68} http://giirs.nonprofitsoapbox.com/companies/get-rated-companies
\textsuperscript{69} http://giirs.nonprofitsoapbox.com/companies/companies
\textsuperscript{70} [B Lab site]
employees and consumers that they can trust each other. Like the FLY Paper, employee options and customer loyalty programs discussed above, private certifications are ultimately creatures of contract. Both parties agree that certified entity meets the qualifications required to be certified and the certifying entity promises to pay for the right to use the mark the certifying entity controls.

The beauty and power of contracts lies in their ability to turn aspirations and promises that one might easily distrust into enforceable obligations. Only drafters’ creativity limits their ability to design contracts to provide the assurances social entrepreneurs, investors, employees and customers require. To enable dual mission ventures to flourish in the growth stage of the The Social Enterprise Life Cycle, this creativity need only be unleashed.

Preservation

To secure the external commitments that make it possible for a social enterprise to weave together financial rewards for those with control with the greater good, a venture’s own dedication to maintain that balance must be robust. It need not, however, be permanent. A charity owes an obligation to remain fixed on its original charitable mission, or in some cases another charitable course. But social enterprises are valuable in part because of their far greater capacity for change. Like conventional for-profit ventures, a social enterprise can and must evolve according to the demands of the marketplace.

Social enterprises that have successfully made the leap from promising startups into mature businesses will eventually need to transition to new hands. The social entrepreneurs and investors who own even flourishing dual mission ventures will sometimes want – or need – to sell their stakes. And, many social enterprises will struggle, like all other categories of small business. In what has been the most feared scenario, a social enterprise can even become the target of a takeover. And, of course, every human entrepreneur should plan for succession, even if he or she plans to stay with a business until her last possible moment.

Yielding independence by being acquired need not be tantamount to capitulation for a social enterprise any more than it would be for a conventional for-profit firm. Conventional wisdom treats the acquisition of a social enterprise, especially when it will be combined with a larger conventional business, as a nullification of the latter’s social mission, and cautionary tales abound. But history demonstrates that such a result can be prevented, and offers lessons for planning for sales and transitions even in less dramatic contexts.

When Unilever famously acquired Ben & Jerry’s, many assumed it would mean the end of the target’s commitment to the environment and its employees. In fact, thanks to an array of corporate governance mechanisms and contract terms deployed to prevent just that, the acquisition ultimately preserved many of those commitments and led the larger Unilever brand to adopt some more socially-conscious practices. The sale agreements included a number promises by Unilever, some of which lasted only for the near term – like a promise not to lay off workers for two years, which was kept only to the letter when layoffs followed just over two years later – and others for the long-term – like the commitment to continue and increase contributions to the Ben & Jerry’s foundation indefinitely and to pay

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71 [MFS, Restatement of Trusts]
72 [Edmonston, Page & Katz, DBR & Dean OUP]
Ben & Jerry’s employees a living wage. Many of the long-term commitments also came with powerful enforcement rights, including a provision for cost-shifting if litigation were required.

Even more potent than this is the deal’s creation of a unique governance system for Ben & Jerry’s going forward. Although the company would be a wholly-owned subsidiary of Unilever, the overwhelming majority of the Ben & Jerry’s first post-sale board of directors were individuals with ties to Ben & Jerry’s – not Unilever – including the original founders. Unilever was empowered to select just two members of the eleven-member board going forward, and the board itself controls succession of the remaining seats. The sale agreements grant this board primary responsibility for “preserving and enhancing the objectives of the historical social mission of the company as they may evolve,” and for “safeguarding the integrity of the essential elements of the brand” including product standards, use of its trademark and leadership decisions. The post-acquisition road for Ben & Jerry’s has not always been smooth, but over the past decade the Ben & Jerry’s board has taken an active role in ensuring its social commitments endure, and Unilever itself has been evolved in part due to its experience with the Ben & Jerry’s brand.

Of course, few social enterprises will have the star power that Ben & Jerry’s did. The reputation and value of its megabrand enabled it to secure concessions few will be able to replicate. Indeed, even though Unilever touted its recent acquisition of Seventh Generation as following the successful Ben & Jerry’s blueprint, the governing board it created will not have the kind of independence that the Ben & Jerry’s board did. But the uniqueness of Ben & Jerry’s position does not undermine the core lessons to be drawn from its sale.

Flexibility to preserve mission depends on assets, and deal terms and governance structures are the legal tools that allow sellers capitalize on that flexibility. Sometimes, a social enterprise’s profitability will be inextricably bound up with its social commitments. In this ideal scenario, even purely financially-focused buyers will maintain the enterprise’s social orientation – doing so aligns with self-interest. Not every small or startup social enterprise will reach this ideal plane. But even for those who do not, their options for mission preservation will generally expand in tandem with the value of the enterprise’s assets. When valuable assets attract buyers, social entrepreneurs and investors negotiate from a position of strength. They can design the deal terms, including its structure and financing, to secure and enforce commitments to maintain mission – especially if they are willing to make concessions on price in return. If they so choose, entrepreneurs and investors who consider exit at the

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73 See EDMONSON, at 170-80.
74 See id.
75 See id. at XX.
76 See id. at 171.
77 See Martine Geller, Unilever Says Its Socially Responsible Brands Outperform Rest, REUTERS, May 4, 2015, at http://www.reuters.com/article/us-unilever-sustainability-idUSKBN0NQ02G20150505; see also Unilever’s CEO on Making Responsible Business Work, HARVARD BUSINESS REVIEW, May 2015, at https://hbr.org/2012/05/unilevers-ceo-on-making-respon. [Insert quote from Polman.]
78 [Unilever site]
79 [B the Change report]
80 [SSRN Hybrid Ideal, Hurt article]
81 DBR & Dean, OUP.
outset can even design their own governance and contract rights to allocate control over exit in mission-enhancing ways.\textsuperscript{82}

In gloomier circumstances, adaptation to the demands of the marketplace may mean dissolution, or even bankruptcy. Just as it helps social enterprises to take root and to grow, the law can help to ensure that even such radical transformations do as little violence as possible to a social enterprise’s core goals. Although the law limits the autonomy of insolvent ventures and imposes even sharper constraints on bankrupt businesses, a venture’s demise need not mean the complete elimination of its mission.

If an enterprise can be dissolved while assets remain, a number of paths to such preservation will be available. Legal dissolution occurs not in a single moment, but through a process of paying creditors and distributing to owners any assets that remain. The firm’s assets may be liquidated to make these distributions in cash, or, as long as creditors are satisfied, owners may agree to in-kind distribution.\textsuperscript{83} If a social enterprise begins the dissolution while sufficient assets remain to meet its obligations to creditors, owners can negotiate to place mission-critical assets – perhaps inventory or intellectual property – into hands that will continue to use it to generate social impact. As assets dwindle, social entrepreneurs and investors intent on preserving their entities’ social commitments will need to confront reality and take decisive action. If they wait too long to pursue mission-enhancing strategies for dissolution, these options may become foreclosed by creditors’ superseding claims.

Insolvency shifts power from fiduciaries and the owners they represent to creditors – who may or may not be committed to the entity’s social mission. Creditors’ power becomes further entrenched if insolvency is managed through the federal bankruptcy process. In a bankruptcy to liquidate a social enterprise, creditors take control with the assistance of a court-appointed trustee. The trustee will decide what to change, if anything, about the venture’s operations, in order to obtain the most value for creditors.\textsuperscript{84} In a bankruptcy reorganization, the social enterprise’s leadership can remain empowered to act for the business, but their decisions too must be made to protect the interests of creditors.\textsuperscript{85} Rather than pursuing mission, or even balancing it with a concern for financial return for owners, those piloting bankrupt social enterprises will be required to preserve their ventures’ assets to satisfy creditors’ claims.

Although insolvency will likely never be part of the business plan, understanding the key role that creditors play in this context underscores the importance of choosing the right lender at the outset. If a social enterprise enters the dissolution process while assets remain, impact-first lenders might agree to take a discount on return of their principal to allow those funds to be devoted to completing a mission-critical project. Or, if bankruptcy means a social enterprise’s equity holders will find their stake eliminated but a non-profit creditor will take control of the venture’s core assets, bankruptcy could reinforce mission rather than weakening it.

No matter who the lenders may be, the terms that they negotiate with borrowers before any money changes hands are likely to determine the fate of a venture’s social mission if insolvency looms or bankruptcy becomes unavoidable. Unlike equity, debt takes whatever form the parties choose. Along with the interest rate and the duration of the loan, they might agree to additional terms governing the

\textsuperscript{82} Id.
\textsuperscript{83} [Cox & Hazen]
\textsuperscript{84} [Collier, BR statute]
\textsuperscript{85} See 1-15 COLLIER ON BANKRUPTCY ¶ 15.04[2][a] (emphasis mine).
disposition of assets with unique value for the social enterprise’s mission. In liquidation, creditors might bind themselves to offer a specific charity a right of first refusal, an opportunity to purchase a patent or to take over a long-term contract. For example, granting a global health charity the right to purchase a patent on a social enterprise’s dissolution – perhaps even at a favorable rate – might help to ensure that the medication it developed remains available to vulnerable populations. Or, a work integration social enterprise that provided culinary industry training to recent immigrants and held a contract to supply baked goods to upscale hotels, could negotiate a provision granting an immigrant support charity the right to take the contract over should the social enterprise dissolve.

Like at formation and in periods of growth, the law can provide real assistance to social enterprises concerned with mission preservation as ownership shifts or entities dissolve. Legal forms contemplate the ends their adopting entities will meet, and well-drafted financial instruments address the consequences of sale or dissolution for the parties to them. In the distinct contexts of sale and dissolution, though, new and different legal tools will often be the most effective ones. After all, no legal form for social enterprise will lock in mission perpetually – doing so would defeat the purpose of a double bottom line and merely replicate charitable forms. Financial instruments that plan for mission-preservation can be powerful signals of parties’ intentions and enforcement tools when those plans are triggered, but many social enterprises will not have issued such specially-tailored instruments. Yet all social enterprises will, eventually, come to an end. Not every social enterprise will have a business model that lends itself to mission-conserving maneuvers, but creative deal structures will often reveal possibilities at the end of The Social Enterprise Life Cycle.

**Conclusion**

Social enterprise law has made great progress, but for lawyers to be true allies of dual mission ventures, they must press on. Specialized forms have legitimated social enterprises’ double bottom lines, providing them pride of place among the taxonomy of legal entities. To build on this expressive victory, and help successful social enterprises grow and scale, lawyers should turn to drafting creative contracts to reassure their stakeholders of each other’s commitments. Whether these contracts are self-enforcing, like FLY Paper or employee options, or rely on eternal bodies like certifiers, their power to signal and secure mission commitments is key to their force. Furthermore, successful or not, all social enterprises will eventually face the challenge of preservation. No leader or investor can last forever, and if social enterprise stakeholders want to steward their missions beyond their lifetimes or investment horizons, planning for succession and the possibility of dissolution is crucial. When contemplating these difficult moments, law can provide comfort and solutions – at least for those social enterprises with assets. Deal structures, contract terms and governance can all be deployed with mission in mind.

Social enterprises are far from homogenous, but they do all confront a life cycle that challenges their mission commitments in particular and predictable ways along its path. This chapter has begun the project of designing legal tools to accommodate and assist firms at each stage of The Social Enterprise Life Cycle. We look forward to their continued refinement over time.