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CORPORATE CITIZENSHIP

New hybrid business entities combine business, social missions

A social entrepreneur has a mission: to launch a successful business, but also to combine profitability with a broader societal purpose. Whether that purpose is environmental sustainability or fair trade, it may not always be compatible with maximizing profits.

That's where boards of traditional business corporations face a dilemma. Sell the company to the highest bidder, or to one that will carry out the company's social mission? Corporate boards generally have a duty to maximize shareholder value in approving a sale or merger. That may mean an obligation to opt for money over mission, or face legal action.

The good news is that Washington businesses may soon have another option.

A Washington State Bar Association committee has designed a proposed new corporate form, tentatively called a "social purpose corporation," to provide greater flexibility for social entrepreneurs and boards. The proposal would allow a Washington business corporation to elect to identify a specific social purpose in addition to its business purpose. An electing corporation would be required to carry out its business purposes in a manner intended to promote positive effects (or minimize adverse effects) of its activities on its employees, suppliers, customers, the community and society, and the environment, rather than solely on its shareholders.

A social purpose corporation could change or eliminate its specified social purpose only with a two-thirds vote of each class of voting shares. This rule is designed to enable entrepreneurs to maintain the corporation's mission in its early stages if new investors seek to shift the company from its original social purpose. The corporation would have to provide a report annually to its shareholders on its efforts to promote its social purpose.

The proposed legislation is expected to be introduced during the 2012 legislative session.

Other states have adopted or are considering similar approaches to address the emerging need for hybrid legal forms that combine business and social missions. California is considering legislation to create "flexible purpose corporations," similar to the proposed social purpose corporation. Maryland and Vermont have adopted "benefit corporation" statutes, which require the corporation to create a "material positive impact on society and the environment."

The benefit corporation legislation was championed by B Lab, a nonprofit based in Pennsylvania that promotes using business to solve social and environmental problems. B Lab has convened a panel that certifies corporations that meet specific social, environmental and transparency standards as "B corporations."

SOCIAL ENTREPRENEURS



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More than 330 businesses have been certified as B corporations. These include financial services firms seeking to attract investments from nonprofit endowments, green builders, and even law firms. The drafters of the proposed Washington legislation contemplate that a social purpose corporation would be able to qualify for certification as a B corporation.

While these new hybrid corporate forms blur the line between traditional business corporations and nonprofits, they are fully taxable entities. Social entrepreneurs who hope to attract foundation grants and charitable contributions should choose a nonprofit corporation with federal tax classification as a Section 501(c)(3) charity, rather than a hybrid.

Another new hybrid form, the low-profit limited liability company, or "L3C," is designed for the limited purpose of attracting "program related investments," or "PRIs," from private foundations. Vermont, Illinois, Michigan, and other states have passed L3C legislation.

The tax law requires private foundations to expend 5 percent of their asset value annually to further charitable purposes. One way for a foundation to meet this payout requirement is to make a PRI. PRIs can include equity investments in for-profit ventures that further a charitable objective, such as development of a vaccine for use in the developing world. Foundation PRIs are subject to strict tax law requirements. As a result, only the largest and most sophisticated foundations tend to make PRIs.

The L3C form was intended to make PRIs a viable option for a broader range of foundations. An L3C is a limited liability company (LLC) that has as its primary purpose achieving a socially beneficial goal. Generating a profit is only a secondary goal. (The name is a play on 501(c)(3), but the LC3 is not itself a charity.)

A private foundation that invests in an L3C may in theory find it simpler to ensure that its investment will qualify as a PRI, because the L3C statute includes some of the tax law requirements for PRIs. The L3C form offers little practical advantage, however. Use of the L3C form does not by itself guarantee that a private foundation's investment will qualify as a PRI. A foundation's investment in a traditional LLC can, if properly structured, qualify as a PRI just as easily.

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