

## REGULATING SOCIAL ENTERPRISE

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### ABSTRACT

Many of today's entrepreneurs want to commit themselves and their enterprises to something other than a simple bottom line of maximizing value for owners. Instead, they devote their endeavors to more complex missions of pursuing social good while also generating profits. This impulse goes by many names and encompasses entities with varying product lines, business plans, techniques and metrics. For simplicity, this essay will refer to companies pursuing such dual missions as social enterprises. Social enterprises and their founders can make big claims. Some argue their businesses will be more sustainable than traditional for-profits because they consider not only profits, but also people and planet.<sup>2</sup> Others suggest the efficiency and scalability social enterprises offer will help them solve social problems better than traditional nonprofit charities.<sup>3</sup>

A mounting number of state legislatures appear convinced by these arguments. Since 2008, lawmakers across the country have enacted legislation enabling new and specialized forms of organization intended specifically to house social enterprises. The forms include "low-profit limited liability companies," "benefit corporations," "public benefit corporations," "flexible purpose corporations," and "social purpose corporations," thus far, and others may be in the works. Although these organizational forms are still nascent, academics have begun to explore the unique challenges they pose for their fiduciaries, investors,

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<sup>2</sup> See J. Gregory Dees & Beth Battle Anderson, *For-Profit Social Ventures*, in *SOCIAL ENTREPRENEURSHIP* 1, 5–6 (Marilyn L. Kourilsky & William B. Walstad eds., 2003).

<sup>3</sup> See, e.g., *Why B Corps Matter*, B LAB, <http://www.bcorporation.net/what-are-b-corps/why-b-corps-matter> (last visited Sept. 27, 2013) ("Government and the nonprofit sector are necessary but insufficient to address society's greatest challenges. Business, the most powerful man-made force on the planet, must create value for society, not just shareholders. Systemic challenges require systemic solutions and the B Corp movement offers a concrete, market-based and scalable solution.").

and other constituencies.<sup>4</sup> One major problem this work has identified is enforcement. Yet, the opportunity for state attorneys general (“AGs”) – tasked with enforcement in adjacent areas on the state level — has mostly gone unaddressed. This essay concentrates on these forms, and considers what role state attorneys general might play in social enterprise regulation.

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#### I. SOCIAL ENTERPRISE ENFORCEMENT TODAY

In just a handful of years, over one half of the states have adopted one or more legal forms specifically designed to house social enterprises.<sup>5</sup> These forms usually take one of three types: the low-profit limited liability company (L3C), the flexible purpose corporation, or the benefit corporation. Legislation enabling each form grants adopters the ability to embrace twin goals of profits for owners and pursuit of a charitable or social mission. Each also presents a somewhat different enforcement picture, though only one state explicitly contemplates a role for public regulators generally or state attorneys general in particular. This Part will review the basic structure and enforcement context of each of these three archetypal forms.

<sup>4</sup> See, e.g., Thomas Kelley, *Law and Choice of Entity on the Social Enterprise Frontier*, 84 TUL. L. REV. 337, 342 (2009); Dana Brakman Reiser, *Benefit Corporations—A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591, 610 (2011); John Tyler, *Negating the Legal Problem of Having “Two Masters”: A Framework for L3C Fiduciary Duties and Accountability*, 35 VT. L. REV. 117, 141 (2010).

<sup>5</sup> See *Laws, AMS. FOR COMMUNITY DEV.*, <http://americansforcommunitydevelopment.org/laws> (last visited Sept. 27, 2013) (listing 9 states with L3C enabling statutes, only 4 of which also offer benefit corporation legislation); *Legislation*, B LAB, <http://www.bcorporation.net/what-are-b-corps/legislation> (last visited Sept. 27, 2013) (listing 20 states with benefit corporation enabling statutes); see also Corporate Flexibility Act of 2011, CAL. CORP. CODE §§ 2500-3503 (2011) (adopting flexible purpose corporation enabling legislation in California); 79 Del. Laws ch. 122, § 8 (2013) (adopting public benefit corporation form in Delaware); WASH. REV. CODE § 23B.20.010 (2012) (establishing Washington social purpose corporation).

*A. Low-Profit Limited Liability Companies*

L3C legislation takes the limited liability company as its starting point, and grafts onto this framework just a few important alterations. All of these changes deal with the proper purposes of adopting entities. An L3C “must at all times significantly further the accomplishment of one or more charitable or educational purposes” as defined by the tax code “and will not qualify as a low-profit limited liability company but for the relationship to the accomplishment of those charitable or educational purposes.”<sup>6</sup> In addition, “[n]o significant purpose of the company is the production of income or the appreciation of property. [But t]he fact that a person produces significant income or capital appreciation is not, in the absence of other factors, conclusive evidence of a significant purpose involving the production of income or the appreciation of property.”<sup>7</sup> Importantly, however, failure to satisfy these requirements results only in a change of status from an L3C to an ordinary LLC.<sup>8</sup>

L3C statutes do not add any new layer of enforcement apparatus to that available in ordinary LLCs. In a manager-managed L3C, managers may self-enforce or enforce against one another, by voting down proposals they believe incompatible with their required purposes or even through litigation.<sup>9</sup> Whether manager- or member-managed, L3C members can also challenge the operations of their entities through their rights in governance or litigation.<sup>10</sup> Of course, either of these internal checks is fraught.

First, there is the “two masters” problem.<sup>11</sup> L3Cs, like other social enterprises, are empowered to serve dual goals. Language in the statutes can be

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<sup>6</sup> *E.g.*, ME. REV. STAT. ANN. tit. 31, § 1611(1) (2011).

<sup>7</sup> *E.g.*, *id.* tit. 31, § 1611(2)(c).

<sup>8</sup> *See, e.g., id.* tit. 31, § 1611(3) (“A company that no longer satisfies the requirements of this section continues to exist as a limited liability company and shall promptly amend its certificate of formation so that its name and purpose no longer identify it as a low-profit limited liability company, L3C or 13C.”).

<sup>9</sup> *See* Dana Brakman Reiser, *Governing and Financing Blended Enterprise*, 85 CHI.-KENT L. REV. 619, 625 (2010).

<sup>10</sup> *Id.* at 625-26.

<sup>11</sup> Virtually everyone who has written about specialized entities for social enterprise has used this moniker. *See* Carter G. Bishop, *The Low-Profit LLC (L3C): Program Related Investment By Proxy Or Perversion?*, 63 ARK. L. REV. 243, 243 (2010); J. William Callison & Allan W. 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, 288 (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, 39-40 (2011); Alicia E. Plerhopes, *Can an Old Dog Learn New Tricks—Applying Traditional Corporate Law Principles to New Social Enterprise Legislation*, 13 TENN. J. BUS. L. 221, 223 (2012); Dana Brakman Reiser, *Blended Enterprise and the Dual Mission Dilemma*, 35 VT. L. REV. 105, 105 (2010); Linda O. Smiddy, *Corporate Creativity: The Vermont L3C & Other*

read to suggest that the overall purposes of these social enterprises should prioritize their charitable and educational goals.<sup>12</sup> But, like other specialized forms for social enterprise, the L3C is made to enable both these social goals and profit-making to coexist.<sup>13</sup> Like the common critique of constituency statutes, the worry here is that serving two masters means serving none at all.<sup>14</sup> This can be a problem both for self-enforcement by managers and for the realistic ability of investors to bring successful fiduciary duty claims.

Second, the potentially dynamic preferences of investors undermine their ability to enforce. Perhaps an L3C member will buy in with the goal of achieving both social and financial gains from her investment. If, over time, however, the L3C's managers err on the side of more financial gains, is it realistic to believe that most investors will sue to enforce its charitable and educational goals? Why wouldn't they simply pocket the extra financial gains, perhaps to reinvest them in a charity or another (somehow more trustworthy) social enterprise?<sup>15</sup>

L3C statutes generally do not empower any regulatory body to play a role in enforcement.<sup>16</sup> L3Cs need not make any disclosures, to governmental authorities or to the public. Nor can anyone outside the L3C enforce the obligations of its fiduciaries to comply with its stated purposes.<sup>17</sup> This mirrors the enforcement context for other business entities. Yet, it stands in stark contrast to

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*Developments in Social Entrepreneurship*, 35 VT. L. REV. 3, 7 (2010); Tyler, *supra* note 4, *passim*.

<sup>12</sup> See Murray & Hwang, *supra* note 11, at 27-28; Tyler, *supra* note 4, at 141. I believe the prioritization mandate of L3C statutes is less clear. See Dana Brakman Reiser, *Theorizing Forms for Social Enterprise*, 62 EMORY L.J. 681, 696 (2013).

<sup>13</sup> See, e.g., ME. REV. STAT. ANN. tit. 31 § 1611 (2011).

<sup>14</sup> See Brakman Reiser, *supra* note 4, at 599.

<sup>15</sup> If an L3C has a private foundation member who invests as a program-related investment, perhaps the foundation's independent fiduciary responsibilities will lead it to play this enforcement role. See Brakman Reiser, *supra* note 9, at 651. But, this may limit an L3C's access to other capital if more traditional investors believe the private foundation's enforcement will result in diminished financial return. In fairness, private foundations placing PRIs were the type of investors for which the L3C was originally envisioned. But, there is nothing in the statutes that limits the use of the form to entities with private foundation investors and, the little empirical research on the question suggests that thus far, PRIs to L3Cs have been limited or non-existent. See Elizabeth Schmidt, *Vermont's Social Hybrid Pioneers: Early Observations and Questions to Ponder*, 35 VT. L. REV. 163, 178 (2010) ("Most of the respondents [in an empirical study of L3C founders] acknowledged that the possibility of PRI funding was either unimportant or not a major reason they chose the L3C business form. Several claimed they would have started their social enterprises even if the PRI possibility did not exist. . . . [T]he major reason the L3C came into existence – to facilitate PRI funding for social enterprises—was not the major reason these early adopters chose this business form.").

<sup>16</sup> See, e.g., Brakman Reiser, *supra* note 4, at 614.

<sup>17</sup> It is possible that the IRS might play a shadow enforcement role here. See Brakman Reiser, *supra* note 11, at 110.

the situation for charities, over which the state attorney general is granted broad powers of oversight and enforcement.<sup>18</sup>

The Illinois statute is an important outlier here. The Illinois L3C statute specifies that L3Cs and their “chief operating officer[s], director[s], or manager[s]” qualify as “trustee[s]” under the state’s Charitable Trust Act.<sup>19</sup> Under that Act, trustees are subject to the Attorney General’s registration and reporting requirements, which include opening registration and reporting documents to public inspection, as holders of charitable assets.<sup>20</sup> The AG has broad investigatory, subpoena and enforcement powers over trustees, including the ability to seek punitive damages.<sup>21</sup> Further, the Act outlines the minimal duties of trustees in such a way that might preclude Illinois L3C fiduciaries from pursuing any activities other than those in line with their charitable or educational missions.<sup>22</sup>

The statute is unclear as to whether the status of Illinois L3Cs and their fiduciaries as trustees under the Act applies to all of their roles, or only when they act as stewards of “charitable” assets. Either way, the statute’s explicit invocation of a regulatory role is unique. But, if the former position is taken, it would appear to undermine the ability of L3Cs to distribute profits to owners that is fundamental to L3Cs’ ability to house truly dual-mission social enterprises. On the other hand, a more measured approach would suggest that Illinois L3Cs and their fiduciaries will be held to the same standards as their nonprofit corporate or charitable trust counterparts only when they deal with the assets of the organization dedicated to their charitable and educational missions. This interpretation would give the entities and their fiduciaries more discretion when dealing with other L3C assets or decisions. Such an approach, while initially attractive in not explicitly precluding dual mission entities from adopting the L3C form in Illinois, would likely create serious line-drawing problems.

### *B. Flexible Purpose Corporations*

The flexible purpose corporation (FPC) uses a corporate form as a frame, but again makes important alterations. Founders must identify in a flexible purpose corporation’s articles one or more special purposes for it, which can be

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<sup>18</sup> See MARION FREMONT-SMITH, *GOVERNING NONPROFIT ORGANIZATIONS* 305-06 (Belknap Press 2004).

<sup>19</sup> 805 ILL. COMP. STAT. 180 / 1-26(d) (2010).

<sup>20</sup> See 760 ILL. COMP. STAT. 55 / 5-7 (2014).

<sup>21</sup> See *id.* 55 / 9, 10, 12, 16.

<sup>22</sup> See *id.* 55 / 15 (Note especially subsection (a)(5), which states that trustees are subject to a duty “[t]o not make non-program loans, gifts, or advances to any person, except as allowed by the General Not For Profit Corporation Act of 1986,” which, if applied to all of the property of the L3C, would appear to preclude member distributions.).

either purposes to which a charitable corporation could be dedicated or a large range of other purposes.<sup>23</sup> The latter include “promoting positive short-term or long-term effects of, or minimizing adverse short-term or long-term effects of, the flexible purpose corporation’s activities upon [t]he flexible purpose corporation’s employees, suppliers, customers, and creditors, [t]he community and society, [or t]he environment”.<sup>24</sup> The flexible purpose corporation and its fiduciaries are empowered to pursue both ordinary business purposes and the special purpose or purposes so identified.<sup>25</sup> For a flexible purpose corporation to transform into an ordinary for-profit corporation, or indeed to make any change in the particular special purpose or purposes it has selected, the board must approve an amendment to the articles or an appropriate transaction, and the shareholders must consent by a supermajority shareholder vote.<sup>26</sup> Additionally FPC directors are permitted, though not required, to consider the special purpose or purposes of their corporations in making decisions, along with shareholder value maximization.

Flexible purpose corporation directors and shareholders are also the only ones empowered to enforce their special purpose commitments. They can do so through governance, as in the shareholder vote discussed above, or through fiduciary litigation. Again the two masters problem and potentially dynamic preferences of both directors and shareholders limit the ability of these enforcement efforts to effectively police flexible purpose corporations’ devotion to their special purposes.<sup>27</sup> No other constituencies, even those specified as the beneficiaries of the corporation’s special purpose or purposes, are given standing to enforce these purposes or the broader duties of the FPC’s leaders.<sup>28</sup>

Regulators, too, are left out of the enforcement picture. Founders of a flexible purpose corporation must file their initial articles of incorporation with the secretary of state.<sup>29</sup> A flexible purpose corporation must also make public its required annual reports to shareholders, which will address both its financial well-being and its special purpose achievements and setbacks.<sup>30</sup> Savvy consumers, potential employees, or the media may use these reports to investigate an individual FPC or differentiate among several of them. These tools, however, are not filed with the AG or other state regulators. While state AGs retain the ability to engage in consumer protection or anti-fraud actions against any

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<sup>23</sup> See CAL. CORP. CODE § 2602(b)(2)(B) (2013).

<sup>24</sup> See *id.*

<sup>25</sup> See CAL. CORP. CODE § 2604 (2012).

<sup>26</sup> See, e.g., CAL. CORP. CODE § 3002 (2012).

<sup>27</sup> See Dana Brakman Reiser, *The Next Big Thing: Flexible Purpose Corporations*, 2 AM. U. BUS. L. R. 55, 71-81 (2012).

<sup>28</sup> See CAL. CORP. CODE § 2900(b) (2013).

<sup>29</sup> CAL. CORP. CODE § 2600 (2012).

<sup>30</sup> See CAL. CORP. CODE § 3500(a)-(b) (2012).

offending individual or entity, legislation envisions no special or official role for them in policing FPCs.

### *C. Benefit Corporations*

The benefit corporation form shares much in common with the flexible purpose corporation; it is a corporate entity at its core and it relies heavily on investor enforcement. There are, however, two important differences. First, benefit corporations introduce the concept of a third-party standard, by which organizations seeking benefit corporation status must be evaluated. Benefit corporation legislation requires adopting entities to “have a purpose of creating general public benefit.”<sup>31</sup> “General public benefit” is 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.”<sup>32</sup> In turn, a “third-party standard” is:

A recognized standard for defining, reporting, and assessing corporate social and environmental performance that is:

- (1) Comprehensive because it assesses the effect of the business and its operations upon the interests [of employees, customers, the community, society and the local and global environment].
- (2) Developed by an entity that is not controlled by the benefit corporation.
- (3) Credible because it is developed by an entity that both: (i) has access to necessary expertise to assess overall corporate social and environmental performance; and (ii) uses a balanced multistakeholder approach 189 to develop the standard, including a reasonable public comment period.

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<sup>31</sup> Model Benefit Corp. Legislation § 201 (William H. Clark, Jr. et al. 2013), *available at* [http://benefitcorp.net/storage/documents/Model\\_Benefit\\_Corporation\\_Legislation.pdf](http://benefitcorp.net/storage/documents/Model_Benefit_Corporation_Legislation.pdf). For simplicity’s sake, I reference Model Legislation developed by proponents of the benefit corporation form here, rather than the somewhat varying state enactments.

<sup>32</sup> *Id.* at § 102.

(4) Transparent because the following information is publicly available:

(i) About the standard:

(A) The criteria considered when measuring the overall social and environmental performance of a business.

(B) The relative weightings, if any, of those criteria.

(ii) About the development and revision of the standard:

(A) The identity of the directors, officers, material owners, and the governing body of the entity that developed and controls revisions to the standard.

(B) The process by which revisions to the standard and changes to the membership of the governing body are made.

(C) An accounting of the revenue and sources of financial support for the entity, with sufficient detail to disclose any relationships that could reasonably be considered to present a potential conflict of interest.<sup>33</sup>

The third-party standard provides a metric against which the benefit bona fides of a particular entity may be evaluated. Importantly, though, the legislation does not require the third-party that creates a standard to apply this metric to an aspiring benefit corporation or to certify its compliance. Instead, individual benefit corporations must apply the third-party's standard to themselves. If a given benefit corporation finds itself able to make the grade, it qualifies for benefit corporation status. Thus, to the extent that third-party standard setters are added to the benefit corporation's enforcement picture, they play only a limited and indirect role. They do not serve as initial gatekeepers, and have no power to remove benefit corporation status or challenge the activities or fiduciaries of even those entities that opt to use the standards they promulgate.

The second major difference between the benefit and flexible purpose corporation forms relates to the obligations of their fiduciaries. Benefit corporation directors are required to take account of a long list of considerations when making decisions.

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<sup>33</sup> *Id.* Not all jurisdictions' benefit corporation legislation incorporates all of these elements into the definition of a third-party standard. Many require only transparency and independence, and do not address comprehensiveness and credibility. *See, e.g.,* VA. CODE ANN § 13.1-782 (West 2011).



In discharging the duties of their respective positions and in considering the best interests of the benefit corporation, the board of directors, committees of the board, and individual directors of a benefit corporation: (1) ***shall*** consider the 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....<sup>34</sup>

This mandate contrasts with the FPC's permissive approach, which merely allows directors to consider both shareholder value and the organization's selected special purpose or purposes. By imposing a mandate and providing a lengthy list of required considerations, benefit corporation approach draws many more and potentially conflicting interests into directors' deliberations than in the FPC.

This element of benefit corporation legislation also has an impact on enforcement. Although benefit corporations shareholders can sue to enforce directors' obligations, including in a special benefit enforcement proceeding authorized by many statutes,<sup>35</sup> the extensive list of required directorial considerations exacerbates the two masters problem already present in the L3C

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<sup>34</sup> Model Benefit Corp. Legislation § 301(a)(1), available at [http://benefitcorp.net/storage/documents/Model\\_Benefit\\_Corporation\\_Legislation.pdf](http://benefitcorp.net/storage/documents/Model_Benefit_Corporation_Legislation.pdf).

<sup>35</sup> See, e.g., VA. CODE ANN. § 13.1-790(A) (West 2011).

and FPC forms. Directors have an easy response to challenges, so long as they can point to one of the many interests on this list that was furthered by their actions.<sup>36</sup> Thus, successful shareholder suits will be even more difficult to bring than in traditional for-profit corporations, if a shareholder even bothers. If a benefit corporation's leadership should decide to pursue profit over its general public benefit, many shareholders would simply sit back and enjoy the greater returns, perhaps investing some portion of them in another social enterprise or a nonprofit. Third-party standard-setters, beneficiaries, or other interested parties cannot bolster shareholder efforts, as only shareholders are granted standing to sue.<sup>37</sup>

## II. POTENTIAL CONTRIBUTIONS OF ATTORNEYS GENERAL

The enforcement picture for social enterprises today is quite limited. Without enforcement of their blended missions, however, it is difficult to see how these entities can succeed as viable constructs for housing social enterprises. Why would investors seeking a combination of financial and social gains place their capital into a structure that promises to pursue both goals, but has few teeth to ensure it? Why would entrepreneurs seeking to blend their aspirations to generate profits and social good adopt a form without safeguards to protect this dual vision? Enforcement is key, and current forms' reliance on fiduciary self-policing or investor-only accountability is suboptimal. This Part considers the potential for state attorneys general, already operating in the adjacent space of charity regulation, to add valuable enforcement expertise and resources.

The first question, of course, is whether charity regulators should view enforcement in the social enterprise context as part of their mandate. Regulating social enterprise might fit in with at least three goals of state attorneys general and their charity regulators: protecting charitable assets, protecting consumers and investors from fraud or deception, and safeguarding the general public interest.<sup>38</sup> If it will serve any of these relevant goals, state attorneys general may opt to dedicate resources to social enterprise enforcement.

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<sup>36</sup> See Brakman Reiser, *supra* note 4, at 600; see also Brakman Reiser, *supra* note 27, at 78.

<sup>37</sup> Model Benefit Corp. Legislation § 301(d), available at [http://benefitcorp.net/storage/document/s/Model\\_Benefit\\_Corporation\\_Legislation.pdf](http://benefitcorp.net/storage/document/s/Model_Benefit_Corporation_Legislation.pdf). (“A director does not have a duty to a person that is a beneficiary of the general public benefit purpose or a specific public benefit purpose of a benefit corporation arising from the status of the person as a beneficiary.”).

<sup>38</sup> Although state constitutional, statutory and common law provisions on the role and authority of attorneys general differ, authority over charitable assets and consumer protection is nearly universal. See STATE ATTORNEYS GENERAL: POWERS AND RESPONSIBILITIES 183, 208 (1990); William P. Marshall, *Break Up the Presidency?: Governors, State Attorneys General, and Lessons from the Divided Executive*, 115 YALE L.J. 2446, 2452 (2006). Many state AGs also have clear and broad common law or *parens patriae* powers to protect the public interest. See STATE ATTORNEYS GENERAL, *supra*, at 27-39; Marshall, *supra*.

State attorneys general safeguard assets devoted to charity within their states through a combination of oversight activities including mandated disclosures, investigations, and civil suits challenging the actions of charities and their fiduciaries. To the extent that assets of a social enterprise are dedicated to charitable purposes, at least to the extent they are irrevocably so dedicated, attorneys general may rightly view themselves as having a role in social enterprise enforcement.

But will social enterprises typically hold assets dedicated to charitable purposes? Under the three legal forms described here, at least as to assets perpetually dedicated to charitable purposes, the answer is no. Neither L3Cs, nor FPCs, nor benefit corporations require any portion of their assets or revenues to be dedicated irrevocably to charitable purposes. Even if one interprets the L3C as requiring prioritization of charitable purposes during the entity's lifetime,<sup>39</sup> an L3C can be instantly and seamlessly converted to an ordinary for-profit LLC merely by changing its purposes and activities. When such a transformation occurs, there is no sequestration of assets for the entity's formerly charitable purposes. All assets are then available to be put to purely for-profit purposes. Illinois' statutory specification of L3Cs as trustees of charitable assets would appear to vary this typical result. Other than in this one state, however, it is difficult to square the basic structure of the L3C form with perpetually charitable characterization of its assets.

Perhaps, even outside Illinois, while an L3C maintains its charitable and educational purposes, the requirement that pursuing income or asset appreciation cannot be a substantial purpose of an L3C suggests that all or some portion of its assets are charitable. Thus, they would come within the ambit of AGs' protective mandate. It is difficult to make even this limited argument with respect to FPCs or benefit corporations, the enabling legislation for which makes no suggestion that charitable purposes are required or must be pursued over other purposes or priorities. An FPC may, but need not, be founded for charitable purposes; it might instead be founded to benefit "employees, suppliers, customers, [or] creditors,"<sup>40</sup> purposes very unlikely to qualify as charitable under state law. FPC directors are permitted to choose among the purposes of pursuing value for owners and the FPC's special purpose in their decision-making, and the statute imposes no strict prioritization regime. A benefit corporation must be founded to pursue some "general public benefit," but likewise this benefit need not be a strictly charitable purpose.<sup>41</sup> Further, benefit corporation statutes often explicitly eschew any required ordering of organizational priorities.<sup>42</sup> Although social enterprises surely

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<sup>39</sup> See generally Murray & Hwang, *supra* note 11, at 27-28; Tyler, *supra* note 4, at 141.

<sup>40</sup> CAL. CORP. CODE § 2602(b)(2)(B)(i) (2014).

<sup>41</sup> See, e.g., MD. CODE ANN., CORPS. & ASS'NS § 5-6C-06(a)(1) (2012).

<sup>42</sup> Model Benefit Corp. Legislation § 301(a)(3), available at [http://benefitcorp.net/storage/documents/Model\\_Benefit\\_Corporation\\_Legislation.pdf](http://benefitcorp.net/storage/documents/Model_Benefit_Corporation_Legislation.pdf). (noting that directors "need not give priority to

occupy some of the same space as nonprofit charities, and significant adjacent space pursuing social good, their organizational forms should not alone suffice to characterize their assets as charitable.<sup>43</sup>

Protecting investors and consumers from fraudulent and deceptive practices is another important part of the mandate of state attorneys general, and it could also impel them to regulate and enforce in the social enterprise space. Indeed, the charitable solicitation focus of many state attorneys' general in regulating charities can be seen as a marriage of AGs' concern for charitable assets and donors as a unique type of consumer or investor.<sup>44</sup> Social enterprises make claims to consumers and investors, especially about the blended character of their enterprises. Like in the charitable sphere, it can be difficult for consumers, investors, or anyone to determine whether the social goals of the enterprise are being met. And, the inherent tension between profit and social goals complicates matters further. The "good guy" claims of social enterprises coupled with the difficulty of assessing them may make social enterprises particularly attractive to charlatans, and particularly dangerous for well-meaning consumers and investors. Attorneys general seeking to protect their citizens from deceptive schemes might thus target social enterprises for special attention and scrutiny.

AGs' interest in promoting the public interest in their jurisdictions, however, might lead them to consider social enterprise enforcement for just the opposite reasons. Like so many others, AGs may be intrigued by the promise of social enterprise. The idea of harnessing the efficiency of business methods and the power to scale that for-profit capital enables in order to create social benefits for those in need is attractive and exciting. But, as discussed above, this promise is unlikely to be realized without some enforcement mechanism to allow entrepreneurs and investors to ensure each other of their commitments to dual mission. If AGs believe that successful social enterprises can enhance their communities and help solve social problems, they may devote resources to social enterprise enforcement to increase its chances of success.

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the interests of a particular person or group . . . over the interests of any other person or group unless the benefit corporation has stated in its articles of incorporation its intention to give [such] priority."). The New York legislation adopting the benefit corporation form does impose a requirement that such entities prioritize social good, but this position is unusual. *See* N.Y. BUS. CORP. §1706(a) (McKinney Supp. 2012) ("[t]he purpose to create general public benefit shall be a limitation on the other purposes of the benefit corporation, and shall control over any inconsistent purpose of the benefit corporation.").

<sup>43</sup> The FPC statute is careful to state its terms should not "be construed as negating existing charitable trust principles or the Attorney General's authority to enforce any charitable trust created," CAL. CORP. CODE § 2700, and an individual FPC might take actions that would deem some or all of its assets charitable ones.

<sup>44</sup> *See* Evelyn Brody, *Accountability and the Public Trust*, in *THE STATE OF NONPROFIT AMERICA* 471, 479 (Lester Salamon ed., 2002).

Legislatures might also draft AGs into social enterprise enforcement. As noted earlier, currently only the Illinois L3C enabling statute expressly creates a role in social enterprise enforcement for state attorneys general. In other work, I have argued that to create a fruitful specialized form for social enterprise, they must be required to prioritize social good and a realistic and consistent enforcement structure must exist.<sup>45</sup> If state legislatures take up the call to add or enable enforcement architecture for social enterprise, they could decide to enlist attorneys general to play a role in regulation.

Attorneys general certainly have skills and competencies that could be used to enforce the obligations of social enterprises and their leaders. The disclosure system AGs use to regulate charities could be adapted to apply to social enterprises.<sup>46</sup> Demanding registration and reporting could helpfully compel social enterprises and their leaders to reflect on their activities. Indeed, the FPC and benefit corporation forms already require significant annual disclosures to be made to their shareholders and publicly posted.<sup>47</sup> Requiring this or a more structured disclosure to be submitted to state attorneys general might also alert regulators to sham entities and bad actors.

Charity regulators also already regularly deal with enforcing fiduciary duties. In particular, they have expertise dealing with the challenging question of defining care and loyalty (and, in some cases in some jurisdictions, obedience) in the context of entities pursuing social good. Unlike in the for-profit context, where a single bottom line of profit-maximization can often be used to assess performance, charities frequently pursue missions that are fuzzy and dynamic. The expertise AG charity regulators have in dealing with these entities may help them deal with the complexity created by social enterprises' dual and often-conflicting purposes. There is the possibility, of course, that AGs tasked with enforcing social enterprise would concentrate too much on ensuring fidelity to social mission and too little on ensuring their focus on profits.<sup>48</sup> But, other potential enforcement resources, including investors and the market, might complement or mitigate such an uneven AG enforcement focus.<sup>49</sup>

Additionally, attorneys general have significant relevant expertise in their consumer protection bureaus. Much as they track and penalize unscrupulous auto

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<sup>45</sup> See Brakman Reiser, *supra* note 12, at 692.

<sup>46</sup> State AGs would not be able to accept the federal Form 990 informational tax return in lieu of specialized state disclosures for social enterprises, as many do for nonprofits. As discussed *infra*, social enterprises are not now and are unlikely to be granted federal tax benefits and are therefore not required to complete such forms.

<sup>47</sup> A few statutes also require benefit corporations to file their required annual reports with a state official. See, e.g., MASS. GEN. LAWS ANN. ch. 156E, §§ 15–16 (West Supp. 2012); N.J. STAT. ANN. § 14A:18-11(d)(1) (West Supp. 2011). See also HAW. REV. STAT. § 420D-13 (2012) (specifically noting that the state's involvement with entity filings is "ministerial").

<sup>48</sup> See Brakman Reiser, *supra* note 12, at 721.

<sup>49</sup> See *id.* at 721-22.

dealers and Ponzi schemers, AGs steeped in consumer protection may be able to spot duplicitous marketing by social enterprises. AGs' broad investigatory and prosecutorial powers in both the consumer protection and charity regulation contexts could also be deployed to challenge and punish social enterprises that make misleading claims to consumers, solicit capital on terms unfair to investors, or fail to live up to the claims they make or terms they undertake.

As most attorneys general are elected officials, they also have an important link to the people. This political reality provides them with legitimacy to determine whether a jurisdiction's citizenry is interested in seeding successful social enterprise. Citizens might desire to do so in order to achieve the efficiency and scalability gains for social good creation addressed above. Alternatively, citizens might clamor for businesses to be more accountable, socially responsible, or sustainable, and developing a social enterprise sector might be part of answering such demands. Thus far, legislatures have been the political actors at the forefront of developing forms for social enterprise. Just one serious social enterprise scandal might, however, convince an AG of the political value of enforcement in this area.

The looming question here is whether AGs will be *able* to undertake the cost of enforcement in this new and uncharted area. Unfortunately, the resource picture is bleak. In these times of economic fragility, states are strapped or worse. Even in good times, AG offices are perennially understaffed and under-resourced. It has become a commonplace to remark on the staggeringly low funding and personnel levels of AG charity regulators in particular.<sup>50</sup> Without an external injection of funding or a damaging public scandal, it is difficult to see how AGs could add a serious level of social enterprise enforcement to their overcrowded agendas. Despite their fit for the job, there is simply little state attorneys general can be expected to add.

Furthermore, unlike in the charity context, federal tax authorities cannot be counted upon to complement or reinforce state enforcement efforts. As yet, none of the specialized forms for social enterprise developed in the states qualify for any federal tax benefits. They are not tax-exempt, nor do they offer contributors tax-deductibility, and these tax benefits are not on the horizon. Congress certainly will not extend charitable tax-exemption and deductible contributions to social enterprises based simply on an entity's adoption of L3C, FPC, or benefit corporation forms, given their complete lack of a reliable enforcement apparatus. In the era of fiscal cliffs, debt-ceiling negotiations, and

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<sup>50</sup> See Thomas Lee Hazen & Lisa Love Hazen, *Duties of Nonprofit Corporate Directors-Emphasizing Oversight Responsibilities*, 90 N.C. L. REV. 1845, 1879 n. 163 (2012) (cataloguing scholarship on the topic).

rising tax burdens, Congress or the Department of Treasury are also highly unlikely to adopt significant specialized tax benefits for social enterprises.

### III. CONCLUSION

Unfortunately, invoking the regulatory authority of state attorneys general is no panacea for the weaknesses of social enterprise enforcement. While simply forming as a social enterprise should not subject an entity to the attorney general's jurisdiction over charitable assets, social enterprise enforcement could fit within various parts of AGs' mandates. Attorneys general certainly have authority to enforce against consumer or other fraud or deception by social enterprises. They could also engage in enforcement to help make social enterprise more effective, either as part of pursuing the public interest of their jurisdictions and their citizens or in response to legislation imposing a regulatory role upon them. AGs' experience and skills would translate well to crafting a disclosure system for social enterprises, monitoring and enforcing the obligations of their fiduciaries, and detecting, investigating, and prosecuting bad actors. Moreover, their positions as elected representatives will help them determine the level of such enforcement the public desires.

Accomplishing any of this will require resources. Current resources for AG enforcement are low and subject to pressure to cut costs, not increase them. Charities bureaus, in particular, are always pressed for funds and personnel. The federal government is unlikely to play a role, and there is little likelihood of significant resource increases from states in the near future. Thus, despite their propriety and capacity for the job, attorneys general will not make up for the deficiencies in enforcement in L3Cs, FPCs and benefit corporations.

Those who want social enterprise to succeed and who realize that enforcement is pivotal should thus look elsewhere.<sup>51</sup> If states want to create forms of organization to entice and enable social enterprise, legislatures must begin by setting a clear prioritization of social good within the specialized entities they enable.<sup>52</sup> Such prioritization would ameliorate, though not completely solve, the multiple masters problems inherent in social enterprises. Further, it would be a first step at enabling enforcement by investors, and self-regulation by social enterprises, third parties or both.<sup>53</sup> Even if no new resources become available for AG enforcement, as seems likely, their existing consumer protection and in certain cases charitable asset and general public interest protection goals will lead

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<sup>51</sup> 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) (proposing enforcement of a social enterprise's dual mission through a specialized financial instrument).

<sup>52</sup> See Brakman Reiser, *supra* note 12.

<sup>53</sup> See *id.*

them to act as backstop. Although admittedly on a smaller scale, this combination of enforcement resources might not be so different from what is seen in the charity context.