

NEW YORK UNIVERSITY  
JOURNAL OF LAW & BUSINESS

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VOL. 9

Special Issue 2013

No. 2

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*Editor's Note: In accordance with his role as emcee of the New York University Journal of Law & Business 2012 Fall Conference on the Law & Finance of Social Enterprise, Mr. Westaway composed this introduction to our Special Issue. It eloquently illustrates the breadth of change occurring under the umbrella of social enterprise, which pieces of the puzzle our authors and commenters have addressed in this issue, and what unanswered questions remain. We hope that our efforts and those of our authors and commenters will foster additional scholarship in this exciting area of law and business.*

BEYOND BLACK AND WHITE: THE NEW PARADIGM  
OF SOCIAL ENTERPRISE

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For too long we have been living in a black-and-white world. Historically, the capitalist system has assumed that an organization is either a for-profit (which exists to maximize profit) or a non-profit/charity (which exists for a charitable purpose).<sup>1</sup> At the center of the black-and-white paradigm is the non-distribution constraint placed on charities, on the one

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1. For one brief look at this history, see DAVID BORNSTEIN & SUSAN DAVIS, *SOCIAL ENTREPRENEURSHIP* pt.1 [Defining Social Entrepreneurship] (2010). For a detailed history of Anglo-American charity, see Thomas Kelley, *Rediscovering Vulgar Charity: A Historical Analysis of America's Tangled Nonprofit Law*, 73 *FORDHAM L. REV.* 2437, 2466-67 (2005).

hand,<sup>2</sup> and the duty of for-profit companies to maximize shareholder value, on the other.<sup>3</sup>

Although the Internal Revenue Service permits tax-exempt charities to make money,<sup>4</sup> the Service does not permit that money to flow back to funders or managers of the charities except in the form of reasonable employee compensation.<sup>5</sup> Courts continue to uphold this black-and-white paradigm, as well, especially through the enforcement of the duty of for-profit companies to maximize shareholder value. For example, in the 2010 case involving eBay, Inc. and Craigslist, Inc., the Delaware Court of Chancery stated:

[T]here is nothing inappropriate about an organization seeking to aid local, national, and global communities by providing a website for online classifieds that is largely devoid of monetized elements. Indeed, I personally appreciate and admire Jim's and Craig's desire to be of service to communities. The corporate form in which craigslist operates, however, is not an appropriate vehicle for purely philanthropic ends, at least not when there are other stockholders interested in realizing a return on their investment. Jim and Craig opted to form craigslist, Inc. as a for-profit Delaware corporation and voluntarily accepted millions of dollars from eBay as part of a transaction

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2. See *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919); Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sep. 13, 1970; but see Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford*, 3 VA. L. & BUS. REV. 163, 176 (2008) ("Corporations seek profits for shareholders, but they seek others [sic] things, as well, including specific investment, stakeholder benefits, and their own continued existence. Teaching *Dodge v. Ford* as anything but an example of judicial mistake obstructs understanding of this reality.").

3. See generally BRUCE R. HOPKINS, THE LAW OF TAX-EXEMPT ORGANIZATIONS § 20.1 (2011) (discussing the prohibition of private inurement for certain tax-exempt organizations); see also *Inurement/Private Benefit—Charitable Organizations*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/Charities-&Non-Profits/Charitable-Organizations/Inurement-Private-Benefit-Charitable-Organizations> (last visited Apr. 7, 2013).

4. For example, in the fiscal year ending in 2011, the Metropolitan Museum of Art had total revenue of \$470 million and total expenses of only \$345 million. *Metropolitan Museum of Art*, GUIDESTAR, <http://www.guidestar.org/organizations/13-1624086/metropolitan-museum-art.aspx> (last visited Apr. 16, 2013).

5. See *supra* note 3.

whereby eBay became a stockholder. Having chosen a for-profit corporate form, the craigslist directors are bound by the fiduciary duties and standards that accompany that form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders. The "Inc." after the company name has to mean at least that.<sup>6</sup>

There is a strong debate whether a legal duty to maximize shareholder value actually exists.<sup>7</sup> As a practical matter, whether the legal duty to maximize shareholder value exists is largely irrelevant since most directors and corporate lawyers counseling directors tend to take the most risk-averse position in order to avoid shareholder derivative suits. Thus, even if the duty does not exist, the prevailing norm of maximizing shareholder value entrenches this black and white paradigm.

In the same way that the black-and-white film was a limited paradigm that failed to capture the full spectrum of color, the for-profit/non-profit paradigm has failed to recognize the full spectrum of organizations. This black-and-white paradigm is overly simplistic and is being strained under the weight of innovation.

In the seminal 1939 film *The Wizard of Oz* there is a legendary scene where the film bursts from black-and-white into color. Color film changed forever what we imagined film could be. The law is currently going through its own *Wizard of Oz* moment, whereby the law is moving beyond a strict for-profit/non-profit dichotomy. A new, third choice is emerging: the *for-purpose* organization. For-purpose organizations are organizations that seek innovative, market-based solutions to social and/or environmental challenges. These organizations are also commonly referred to as *social enterprises* because of the application of entrepreneurial tactics to solve social or environmental problems.

Since 2008, states across the country have begun to introduce new legal structures into their corporate law to accom-

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6. eBay Domestic Holdings, Inc. v. Newmark et al., 16 A.3d 1, 34 (Del. Ch. 2010).

7. See, e.g., Brian M. McCall, *The Corporation as Imperfect Society*, 36 DEL. J. CORP. L. 509 (discussing various theories of the corporation, including contract- and property-based theories, and defending a conception of the corporation as an imperfect society).

moderate social entrepreneurship: the low-profit limited liability company ("L3C"),<sup>8</sup> the benefit corporation,<sup>9</sup> the flexible purpose corporation,<sup>10</sup> the benefit LLC<sup>11</sup> and the social purpose corporation.<sup>12</sup> Two of these structures (the L3C and the benefit corporation) have been adopted in multiple states, while the others have only been adopted in one state.

As these emerging legal structures become more widely adopted by states across the United States, novel legal questions arise. In this issue, John Tyler's article<sup>13</sup> compares the different forms of charitable hybrid entity structures and considers the effect of regulating these entities as charitable trusts. Concluding that such regulation would effectively undermine half of the hybrid entities' dual purpose by prohibiting the distribution of profits, Tyler considers alternative methods for state regulation and oversight of charitable hybrid entities. David Spenard argues in his comment<sup>14</sup> that state regulation of the L3C form is both inevitable and desirable, and that L3C advocates would best serve their cause by assisting state regulators in the development of tailored, reasonable regulation of charitable hybrid enterprises. Jill Manny's comment<sup>15</sup> challenges the effectiveness of the L3C form altogether, arguing that the form should be avoided in favor of other types of

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8. See *Laws*, AMERICANS FOR COMTY. DEV., <http://americansforcommunitydevelopment.org/laws.html> (last visited Apr. 7, 2013).

9. See *State by State Legislative Status*, BENEFIT CORP., <http://benefitcorp.net/state-by-state-legislative-status> (last visited Apr. 7, 2013).

10. See Deborah Sweeny, *The Good of Flexible Purpose Corporations*, TRIPLE PUNDIT (Nov. 12, 2012), <http://www.triplepundit.com/2012/11/good-flexible-purpose-corporations/>.

11. See Amy McNeal, *Change Matters Becomes Maryland's First Benefit LLC*, BMORE MEDIA (June 7, 2011), <http://www.bmoremedia.com/innovation/news/changemattersbenefitllc060711.aspx>.

12. See *Social Purpose Corporation*, WASHINGTON SECRETARY OF STATE CORPORATIONS AND CHARITIES DIVISION, <http://www.sos.wa.gov/corps/SocialPurposeCorporation.aspx> (last visited Apr. 7, 2013).

13. John Tyler, *Analyzing Effects and Implications of Regulating Charitable Hybrid Forms as Charitable Trusts: Round Peg and a Square Hole?*, 9 N.Y.U. J.L. & BUS. 535 (2013).

14. David Edward Spenard, *The Cycle of Innovation and Regulation: The Development of a State Charity Regulatory Dialectic for Charitable Investment in Social Enterprise Activity Through a Limited Liability Company Structure*, 9 N.Y.U. J.L. & BUS. 603 (2013).

15. Jill Manny, *Much Ado About Nothing: A Comment on Tyler's Paper on Regulating Charitable Hybrids*, 9 N.Y.U. J.L. & BUS. 587 (2013).

entities more suited to the “dual purpose” of profit distribution and social mission.

Beyond the emerging legal forms, capital is being deployed to social enterprise in unique or new forms such as program-related investments,<sup>16</sup> crowdfunding<sup>17</sup> and Flexible Low-Yield Paper<sup>18</sup> and social impact bonds.<sup>19</sup> In this issue, Deborah Burand explores the possibility of using elements of the social impact bond in combination with existing international debt buy-down mechanisms to finance social change in the developing world.<sup>20</sup> Rebecca Leventhal provides a more detailed description of the development of the social impact bond and the benefits and challenges associated with its implementation.<sup>21</sup> Ana Demel asks tough questions about the relative cost and riskiness associated with the social impact bond and variants like the one proposed by Burand.<sup>22</sup>

Though this issue addresses two important questions, we are aware that any exploration into the emerging field of social enterprise law only uncovers greater opportunity for exploration. Below are a few questions that should be carefully considered in future social enterprise law scholarship.

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16. See David A. Levitt, *Investing in the Future: Mission-Related and Program-Related Investments for Private Foundations*, PRAC. TAX LAW., Spring 2011, at 33, 34-36.

17. Doug Rand, *The Promise of Crowdfunding for Social Enterprise*, WHITE HOUSE OFFICE OF SOCIAL INNOVATION AND CIVIC PARTICIPATION (June 28, 2012, 6:15 PM), <http://www.whitehouse.gov/blog/2012/06/28/promise-crowdfunding-social-enterprise> (last visited Apr. 7, 2013).

18. See Dana Brakman Reiser & Steven Dean, *Hunting Stag with FLY Paper: A Hybrid Financial Instrument for Social Enterprise*, B.C. L. REV. (forthcoming 2013) (discussing a new financial instrument that allows investors both to commit to a social enterprise's social mission and to hold the social enterprise accountable to that mission).

19. *Commerce and Conscience: A New Way of Financing Public Services Gains Momentum*, ECONOMIST (Feb. 23, 2013), <http://www.economist.com/news/finance-and-economics/21572231-new-way-financing-public-services-gains-momentum-commerce-and-conscience>.

20. Deborah Burand, *Globalizing Social Finance: How Social Impact Bonds and Social Impact Performance Guarantees Can Scale Development*, 9 N.Y.U. J.L. & BUS. 447 (2013).

21. Rebecca Leventhal, *Effecting Progress: Using Social Impact Bonds to Finance Social Services*, 9 N.Y.U. J.L. & BUS. 511 (2013).

22. Ana Demel, *Second Thoughts on Social Impact Bonds*, 9 N.Y.U. J.L. & BUS. 503 (2013).

- (1) How should courts and directors interpret the new fiduciary duties created by the emerging legal structures?
- (2) What does enforcement of the new fiduciary duties look like in each of the emerging legal structures?
- (3) The benefit corporation statute requires a third-party assessment to ensure social and environmental performance, but who is governing the third-party assessor to ensure that the assessors are not watering down their standards?
- (4) How can a social enterprise ensure that the venture will continue its social or environmental mission after a merger or acquisition?
- (5) How defensible is the B Corporation<sup>23</sup> certification's language in a company's organizing documents when faced with a shareholder derivative suit in Delaware?
- (6) Should the emerging legal structures be granted tax-preferential treatment?
- (7) How do impact investors incorporate social and environmental performance metrics into the investment documents for social enterprises?
- (8) What further financial innovations can be created to provide capital to the social enterprise sector?
- (9) Where are the ripest opportunities to create innovative public-private partnerships?
- (10) Is there a clear decision-making model to guide social entrepreneurs in selecting the best legal structure for their venture?

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23. An organization called B Lab promotes the adoption of benefit corporation laws (which make the benefit corporation available as a legal form, like the limited liability company or the partnership); separately, the organization also manages a program that certifies qualifying organizations (whatever their legal form) as "B Corporations" in the way Fair Trade certifies products. See *Benefit Corp. vs. Certified B Corp*, BENEFIT CORP, <http://benefitcorp.net/what-makes-benefit-corp-different/benefit-corp-vs-certified-b-corp> (last visited Apr. 7, 2013); see also *The Non-Profit Behind B Corps*, B CORPORATION, <http://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps> (last visited Apr. 7, 2013).

- (11) What are the legal requirements and best practices for creating and managing hybrid social enterprises, those organizations with both a for-profit and non-profit arm?

This is an important moment in the history of capitalism. The dawn of the age of social enterprise is testing a radical idea, that the market can be effectively leveraged to create a more conscious capitalism that generates not only financial wealth but a positive social and environmental impact as well. The social entrepreneur is challenging the black-and-white paradigm and presenting a new world of possibilities. We practitioners and academics have the privilege and the responsibility to counsel and guide social entrepreneurs in this strange new land. Both practitioners and academics must work side by side and learn from each other in order to build the road of social enterprise for future generations to follow.

