

Commission on Connecticut's Leadership in Corporation & Business Law



Social Enterprise Law Working Group
Policy Recommendations & Explanations

By James Woulfe & Emma Sifre

Executive Summary

The social enterprise sector, comprised of mission-driven businesses that work to create a positive social or environmental impact, in addition to generating profits, has grown tremendously in the U.S. over the past 10 years. Industry experts project that the size of the sector, almost non-existent in the 1990's, has ballooned to roughly 30,000 companies¹ nation-wide, with an investment industry that has built up around it that is estimated to grow to \$500 billion in total managed assets by 2019.² Millennials, a generation whose employment and spending power is quickly coming to prominence, are no doubt driving this change as well. A recent global survey by the Kaufmann foundation found that 67% of respondents prefer to work for socially responsible companies, and 55% would pay a premium for products and services from companies committed to positive social and environmental impact.³

In conjunction with the growth in the social enterprise sector as a whole, the area of social enterprise law, non-existent just eight years ago, has exploded over the past four years. In that short period of time, over 30 states across the nation have adopted some form of new legal entity specifically for social entrepreneurs. The trend of states adopting legal entities specifically for social entrepreneurs shows no sign of stopping, either. In 2015 alone, it is expected that at least five states⁴ will consider legislation establishing the benefit corporation as a new legal entity, which is currently the most popular form of social enterprise legal entity in the U.S.

While many states have passed legislation enabling these new legal entities for social enterprises, there is no state that has taken up the mantle as the *go-to state* for attorneys and entrepreneurs incorporating their social enterprises, in the way that Delaware has become a haven for Fortune 500 corporations, and Nevada has become attractive for its LLC statute. This lack of leadership in the social enterprise law space presents a clear point of pain in a developing legal market, and an opportunity for Connecticut, which has one of, if not *the* most comprehensive benefit corporation statutes in the United States.

¹ <http://gazette.com/business-on-a-mission-social-enterprises-help-as-well-as-workers-in-pikes-peak-region/article/1507980>

² http://www.monitorinstitute.com/downloads/what-we-think/impact-investing/Impact_Investing.pdf

³ <http://www.nielsen.com/content/dam/corporate/us/en/reports-downloads/2014%20Reports/global-corporate-social-responsibility-report-june-2014.pdf>

⁴ Id.

This report, produced for the Commission on Connecticut's Leadership in Business and Corporation law outlines policy proposals that, if implemented, could help Connecticut become the 'social enterprise state.' The report begins with an explanation of the opportunity to make Connecticut the 'social enterprise state,' followed by short-term, and long-term policy proposals that, if implemented, can make Connecticut a leader in social enterprise law, and an attractive state for social entrepreneurs to establish and grow their businesses.

Short-Term Recommendations

In the next legislative session, there are a number of minor policy proposals that the General Assembly could implement which would position Connecticut to definitively take the mantle as the state with the most comprehensive social enterprise statutes, as well as drive investment into the burgeoning sector.

1. **Benefit LLC** – Connecticut should establish a Benefit LLC, as Oregon and Maryland have, to provide start-up social enterprises with the tax benefits and organizational flexibility of an LLC, and the transparency, accountability, and marketing advantages of the benefit corporation.
2. **Angel Investor Tax Credit** – To incentivize the flow of capital to early stage social enterprise, "Social Enterprise" should be added as an additional investment sector that qualifies under the state's Angel Investor Tax Credit program.
3. **Entity-specific Signifiers** – To reduce confusion among consumers, Connecticut benefit corporations should be required to use a distinct signifier ("Ben. Corp." or "B.C.") instead of using the same signifiers that standard corporations do ("Inc." or "Corp.").
4. **Benefit Reporting Updates** – There should be a technical change to the benefit corporation statute to ensure that benefit corporations in their infancy are not required to file annual benefit reports before they have begun their operations in earnest.
5. **Noisy Withdrawal** – Companies converting from a benefit corporation to another entity should be required to disclose this change to the public and the Secretary of State's office to help prevent greenwashing.

Long-Term Recommendations

As Connecticut looks to position itself as *the* state for social entrepreneurship, it must leverage the intellectual, human, and financial capital within the state to build a legal, regulatory, and financial infrastructure that will make Connecticut a state of first choice for social entrepreneurs looking to do business in the U.S.

1. **Regulatory Infrastructure** – Connecticut should conduct a comprehensive study to determine a plan to implement a regulatory regime to enforce the proper filing of annual benefit reports to ensure compliance with the third-party standard and annual benefit report requirements under the state’s benefit company statutes.
2. **Social Enterprise Liaison** – The Governor should appoint a “Social Enterprise Liaison,” similar to the state’s Nonprofit Liaison, which exists at the cabinet level.⁵ A healthy partnership between the public and private sectors is essential to ensuring a strong and responsive business climate.
3. **Business Law Center** – The state should partner with one or more Connecticut-based law schools to establish a business law center. While the center would have a broad focus on furthering best practices in business law in general, the center could also serve as the epicenter for cutting edge and innovative policy proposals and social enterprise law scholarship, and would help equip Connecticut law students with a best-in-class education in social enterprise law.

⁵http://portal.ct.gov/Departments_and_Agencies/Office_of_the_Governor/Learn_More/Governor_s_Nonprofit_Liaison/

Introduction

The area of social enterprise law, non-existent just eight years ago, has exploded over the past four years. In that short period of time, over 30 states across the nation have adopted some form of new legal entity specifically for social entrepreneurs⁶ - individuals who operate mission-driven businesses that work to create a positive social or environmental impact, in addition to generating profits. The trend of states adopting legal entities specifically for social entrepreneurs shows no sign of stopping, either. In 2015 alone, it is expected that at least five more states⁷ will consider legislation establishing the benefit corporation as a new legal entity, which is currently the most popular form of social enterprise legal entity in the U.S.⁸

While many states have passed legislation enabling these new legal entities for social enterprises, there is no state that has taken up the mantle as the *go-to state* for attorneys and entrepreneurs incorporating their social enterprises⁹, in the way that Delaware has become a haven for Fortune 500 corporations¹⁰, and Nevada has become attractive for its LLC statute.¹¹ This lack of leadership in the social enterprise law space presents a clear point of pain in a developing legal market, and an opportunity for Connecticut, which has one of, if not *the* most comprehensive benefit corporation statutes in the United States. This report outlines multiple short-term and long-term policy proposals that, if implemented, could help Connecticut become the 'social enterprise state.'

The Opportunity

Despite the fact that social enterprise legal entities have been passed into law in a majority of the states across the U.S., there is no state that has formally committed to developing an infrastructure - legal or otherwise - to encourage the organization or incorporation of these new entities, or to provide information and solutions for doing so. Some of the most forward-thinking states have provided helpful links to third party resources on their Secretary of the State's website¹², have provided easy-to-use

⁶ <http://benefitcorp.net/>

⁷ Id.

⁸ http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2304892

⁹ Phone conversation with Professor Haskell Murray, J.D. of Belmont University on Thursday, January 29th, 2015

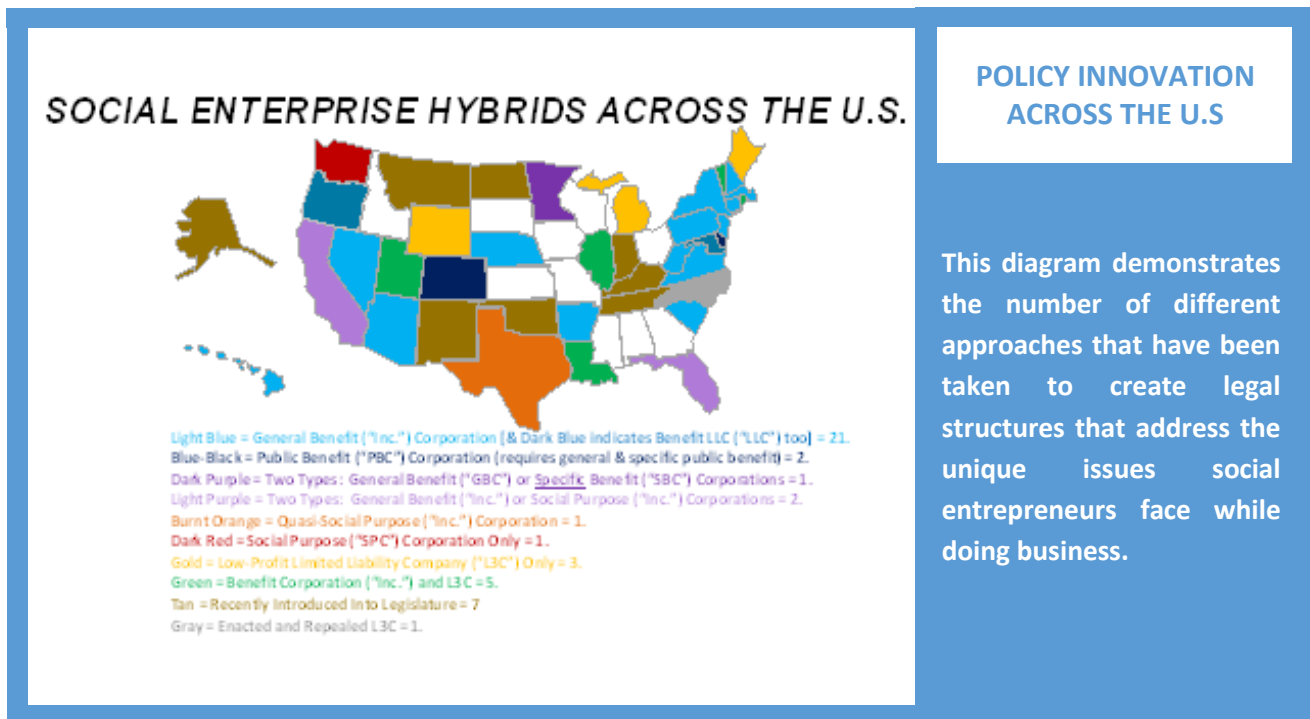
¹⁰ http://corp.delaware.gov/whycorporations_web.pdf

¹¹ See: <http://www.reviewjournal.com/business/nevada-s-business-climate-14th-us-according-poll-professionals>; and <http://www.nasdaq.com/personal-finance/selecting-state-corporation.stm>.

¹² <http://sos.oregon.gov/business/Pages/benefit-company.aspx>

incorporation forms,¹³ or have provided easy access to public data about social enterprise legal entities.¹⁴ Connecticut, specifically, has developed policy innovations to address perceived issues with legislation in other states.¹⁵

No state, however, has gone to lengths to establish itself as the “Delaware” of social enterprise law, which is to say that no state has specifically undertaken or executed on a mission to establish itself as a leading or highly desirable location to organize a social enterprise, and/or attract other business entities to organize using their social enterprise statutes. This lack of leadership is demonstrated by the differentiation from state to state in social enterprise statutes, the lack of transparency and understanding of the sector as a whole, and the difficulty in most states (due to a lack of foresight/planning) to track the formation of these new entities, and learn about the challenges they face as they launch and scale.



¹³ Connecticut and Nevada offer simple check boxes on their certificate of incorporation forms: http://www.ct.gov/sots/lib/sots/commercialrecording/allforms/cert_of_inc_-_stock_corp.pdf; <http://nvsos.gov/Modules/ShowDocument.aspx?documentid=669>.

¹⁴ <http://sos.oregon.gov/business/Pages/oregon-benefit-companies.aspx>; http://www.sos.wa.gov/corps/search_advanced.aspx

¹⁵ <http://www.smithmoorelaw.com/b-legal-briefing-new-hampshire-and-connecticut-join-the-ranks>

¹⁶ <http://socentlaw.com/2014/08/social-enterprise-law-update-and-map/>

Making Connecticut the ‘*Social Enterprise State*’

Rather than attempt to compete with Delaware, a state that has clearly established a hegemony in the area of corporate law with the operation of its specialized Court of Chancery and Secretary of the State’s office, Connecticut is uniquely situated to capitalize on the opportunity to become *the* state for social entrepreneurship. Although there are a number of reasons that can be cited to support this idea, there are three specific reasons of note.

● *Positive Externalities*

There are considerable positive externalities associated with social entrepreneurship. Social enterprises are for-profit businesses¹⁷ that in some way are dedicated to creating a positive social or environmental impact. While typical businesses provide positive externalities in the form of jobs, and bringing goods or services to market, social enterprises go the extra mile and operate with a social or environmental mission. Social enterprises commonly carry out their mission by hiring individuals from underserved communities, by donating significant amounts of goods, services, or cash to charitable entities, or by offering goods or services that create an inherent social or environmental impact at affordable rates. They create jobs, pay taxes, and make the communities that they operate in better places to live and work.

Connecticut is in a strategic position to reap the positive externalities that social enterprises create partly because of its unique economic conditions. As a leader in technology, innovation, and financial services, Connecticut already has a dynamic network of talent, labor, customers, advisors, and investors in place for social entrepreneurs to tap in to. According to a Bloomberg study, Connecticut is ranked fourth in the nation in innovation with a highly educated and efficient work force.¹⁸ These resources make Connecticut an attractive space for social entrepreneurs looking for a state with infrastructure for establishing a successful business already firmly in place.

Unfortunately, Connecticut is also a state that is plagued by issues with income inequality. While the state is home to some of the wealthiest areas in the country, its urban areas exhibit some of the most

¹⁷ Every social enterprise entity across the U.S. is taxed as either a partnership, an S Corporation, or a C Corporation, and receives no special tax breaks or subsidies at the State or Federal level.

¹⁸ <http://www.bloomberg.com/visual-data/best-and-worst/most-innovative-in-u-dot-s-states>

concentrated areas of poverty in the United States.¹⁹ While many business owners and founders could see this as a reason not to establish their businesses within the state, the social, educational, health, and environmental consequences of income inequality also create opportunities for social entrepreneurs to create positive social impact. The socioeconomic conditions in Connecticut align identically with the mission of social entrepreneurs and create ample opportunity for these entrepreneurs to affect change.

● *Market Expansion*

The social enterprise movement is rapidly expanding. As mentioned above, while it took 30 years to see adoption of LLCs across all 50 states,²⁰ in just over four years, 30 states have already adopted social enterprise statutes.²¹ Additionally, millennials, the fastest growing demographic group,²² prefer to work for these types of impactful companies. In a recent study, 58% of soon-to-be college graduates stated that they would take a 15% pay cut to work for an organization that has values that reflected their own.²³ There is support from consumers as well. A recent study out of NYU's Stern School of Business found that "60 percent of consumers are . . . willing to pay extra for socially responsible products and, on average, those consumers were willing to pay a 17.3 percent premium for them."²⁴

Connecticut's competitive advantage is the number of universities it has and the access to the millennial generation that these colleges grant the state. Connecticut is home to thirty-eight²⁵ colleges and universities, representing tens of thousands of students whose spending power and ability to support, start, or invest in businesses is just beginning to develop. Connecticut's abundance of universities, where social entrepreneurship programs are becoming increasingly more common, means that it is home to a growing educational ecosystem working to create a culture of support for social enterprise. Whether these students will start social enterprises, work for them, invest in them, or simply patronize them, Connecticut's access to university students gives it an exclusive advantage over other states.

¹⁹ <http://trendct.org/2015/05/27/connecticut-has-more-concentrated-poverty-and-wealth-than-most-metros/>

²⁰ https://www.americanbar.org/newsletter/publications/law_trends_news_practice_area_e_newsletter_home/llc.html

²¹ Supra at 11.

²² <http://www.fastcompany.com/3033488/hit-the-ground-running/4-employee-engagement-secrets-from-millennials>

²³ <https://netimpact.org/sites/default/files/documents/what-workers-want-2012-summary.pdf>

²⁴ <http://www.nyu.edu/about/news-publications/news/2013/09/17/stern-study-shows-customers-are-willing-to-pay-more-for-socially-responsible-products-.html>

²⁵ <http://www.univsource.com/ct.htm>

● *Low Barriers to Making Connecticut a Leader*

Another reason to make Connecticut *the* social enterprise state is the low marginal costs associated with doing so. Because Connecticut’s Benefit Corporation Act is already one of the most comprehensive in the country, it will not take much policy innovation or heavy lifting on the part of Connecticut’s legislature to position the state as a national leader in this area, as Connecticut would have a “first to market” advantage within the sector. In the next section, there is a list of short-term and long-term policy innovations that, if passed into law, would position Connecticut as a leading and highly desirable location to organize a social enterprise.

Policy Proposals

The following proposals were developed as a result of a comprehensive nation-wide study of social enterprise statutes and scholarly articles, as well as significant numbers of discussions with attorneys, social entrepreneurs, and experts in social enterprise law. They are designed to work together to make it as simple as possible for entrepreneurs to organize and operate as a social enterprise in Connecticut, for consumers to differentiate them from standard businesses, and to incentivize potential investors to drive capital to social enterprises. While each proposal would have a positive effect on Connecticut’s social enterprise sector if implemented separately, together, they will be much more powerful.

Short-Term Policy Proposals

● Naming

For social entrepreneurs, the ability to clearly differentiate a social enterprise from a regular for-profit business is a key signaling function for attracting customers and investors. Likewise, from a legal standpoint, it is generally seen as important to differentiate between entity types such as corporations and limited liability companies by placing a signifier such as “LLC” or “Inc.” after the name of the business. While some states have created unique signifiers for benefit corporations (for example, Minnesota benefit corporations must put “GBC” or “SBC”),²⁶ every other state that has passed benefit corporation legislation (including Connecticut) treats them like regular corporations, simply requiring the use of “Inc.,” “Corp.,”

²⁶ <http://socentlaw.com/2014/08/social-enterprise-law-update-and-map/>

or “Incorporated” after the business’s name.²⁷ This trend, somewhat strangely enough, is unique to benefit corporations. Other social enterprise entities use their own unique indicators. For example, ‘low-profit limited liability companies are required by law to use “L3C” as a signifier,²⁸ ‘social purpose corporations’ must use “SPC,”²⁹ etc.

To ensure that the distinction between benefit corporations and other corporations is clear, the signifier “BC” or “Ben. Corp.” should be required after the names of all benefit corporations that incorporate in Connecticut.³⁰ This would leave little doubt in the minds of consumers whether or not the company was organized as a benefit corporation. It would also be an added advantage in the fight against greenwashing, a practice whereby businesses without a demonstrable social or environmental mission position themselves as social enterprises as a marketing ploy. Additionally, because it will not include the “G” or “S” before the “BC” of the signifier, as in Minnesota, it will be as simple as possible for those not familiar with benefit corporations to ascertain what exactly the signifier is referring to. Ideally, it would also set a precedent favoring simplicity and uniformity (since the signifier is not state-specific), leading to adoption in other states.

● Benefit LLC

The ‘benefit LLC’ is an elegant solution to an issue that many attorneys have identified with the benefit corporation - the issue of double taxation. Benefit corporations can be taxed under either subchapter C, or subchapter S of the federal tax code, which in turn affects state tax status.³¹ The earnings of subchapter C corporations are taxed once at the corporate level, and then again when dividends are paid out, hence the term “double taxation.”³² Subchapter S corporations receive pass-through tax treatment, meaning that any earnings or losses are passed through to the personal income statements of the owners of the corporation.³³ This is known as “single” taxation.

²⁷ Brewer, Cass, Social Enterprise Entity Comparison Chart (August 1, 2014). Available at SSRN: <http://ssrn.com/abstract=2304892>

²⁸ <http://www.cga.ct.gov/2011/rpt/2011-R-0344.htm>

²⁹ <http://apps.leg.wa.gov/rcw/default.aspx?cite=23B.25&full=true#23B.25.040>

³⁰ Some people use the term “B Corp” to refer to a benefit corporation. A “b corp,” however, is a certification offered by B Lab, the non-profit organization that developed the first benefit corporation act. Any for-profit organization, regardless of its legal structure, can become a “certified b corp.” Requiring Connecticut benefit corporations to call themselves “b corps” would likely breed even more confusion that what currently exists when it comes to the difference between the “b corp” certification, and the “benefit corporation” legal entity. To learn more, visit <http://ctinnovations.com/resource/70/BCorpsvsBenefitCorps>

³¹ <http://benefitcorp.net/what-makes-benefit-corp-different/benefit-corp-and-nonprofits>

³² <http://www.inc.com/guides/starting-a-c-corp.html>

³³ <http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/S-Corporations>

It is quite obvious why a startup social entrepreneur would not prefer subchapter C tax status, and would choose to elect subchapter S tax status. Unfortunately, there are significant downsides to electing subchapter S tax status. To do so, all shareholders of the business must be U.S. Citizens, and must be natural persons (no investment companies allowed).³⁴ Additionally, S corporations may only issue one class of stock, and there may be no more than one hundred shareholders of the corporation.³⁵ With the myriad issues that subchapter S taxation causes, many Connecticut practitioners working with social entrepreneurs have been reticent to recommend the benefit corporation as a legal structure to their start-up clients, and have called for adoption of legislation establishing “benefit LLCs,” which are available now in two states, Oregon and Maryland.³⁶

Benefit LLCs are treated identically to LLCs for tax purposes. They receive all of the benefits S Corporations do with pass-through taxation, but without the onerous obstacles. Much like its statutory sister the benefit corporation, the benefit LLC is required to provide both a general public benefit (“a material, positive, impact on society and the environment”)³⁷ and (if desired) a specific public benefit.³⁸ In addition, like benefit corporations, benefit LLCs are required to submit an annual benefit report which includes an assessment of the business’s social and environmental impact by an independent third party, and include a narrative discussing the extent to which a specific and/or general public benefit has been created, along with any circumstances which hindered the creation of a specific and/or public benefit by the benefit LLC.³⁹ All other elements of the benefit LLC are identical to and subject to the same laws as a traditional LLC.

Because the LLC is a hybrid legal entity that is extremely flexible (it has a partnership’s tax structure and the limited liability of a corporation), it is possible for critics to question the utility associated with creating a new, separate legal entity based on the LLC that accomplishes nothing a regular LLC cannot (technically) already do. Proponents would answer by citing the lower transaction costs and branding advantages of the benefit LLC. In a law review article by J. Haskell Murray, a frequent scholarly contributor to the area of social enterprise law, he states that “[s]ocial investors want transparency, accountability,

³⁴ Id.

³⁵ Id.

³⁶ <http://socentlaw.com/2014/08/social-enterprise-law-update-and-map/>

³⁷ S.B. 595, 2011 Gen. Assemb, Reg. Sess. (Md. 2011).

³⁸ Id.

³⁹ Id.

and measurability, but each of those increases transaction costs for the social entrepreneur. Social entrepreneurs with their often very small companies, need easy points of entry.”⁴⁰

Murray later suggests that benefit LLCs, along with “increased automation of organizational documents”⁴¹ will help provide budding social entrepreneurs with a ready-made framework for organizing their social enterprise, through the use of the benefit LLC framework and model organization documents. The benefit LLC can offer startup social entrepreneurs an alternative to creating benefit corporations, providing the easy point of entry discussed by Professor Murray, and minimizing transaction costs. Simple articles of organization forms provided by the Secretary of the State’s office would allow entrepreneurs to form a benefit LLC with the check of a box. This can be contrasted to the current situation, where a social entrepreneur that wants to use an LLC must pay an attorney to draft special provisions creating a reporting framework, and laying out a social or environmental purpose for the business.

With regards to branding, the use of the ‘benefit LLC’ signifier can help signal to businesspeople and consumers alike that it operates with a fundamentally different purpose than the typical LLC, and that it is attempting to solve social problems with market-based solutions. As noted in the previous section, rather than forcing the greater public to examine mission statements, corporate reports, etc. consumers can look to the signifier following the business’s name and receive “some assurance that the company is attempting to improve society and the environment,”⁴² thus providing a substantial boost to the marketing efforts of nascent social enterprises, which would normally not have sufficient funds to differentiate themselves from typical for-profit ventures.

When it comes to making Connecticut *the* state for social enterprise law, making benefit LLCs available is absolutely crucial. Oregon, whose Benefit Corporation Act went into effect on January 1st, 2014, has 83 benefit corporations that have incorporated to date.⁴³ In stark contrast, Oregon’s benefit LLC, which also became available on January 1st, 2014 has 466 users of the entity.⁴⁴ While it is difficult to ascertain for certain why this is the case, it can almost certainly be attributed to the fact that the LLC form

⁴⁰ Murray, *supra* note 2 (manuscript at 42).

⁴¹ *Id.* at 43.

⁴² *Id.*

⁴³ Sos.oregon.gov/business/Pages/Oregon-benefit-companies.aspx (Last accessed August 1st, 2015)

⁴⁴ *Id.*

is preferred by attorneys when establishing start-up businesses, due to the flexibility and tax advantages that the form provides.

Connecticut, where the benefit corporation entity has been available for just five months, had 49 companies that incorporated as a benefit corporation as of August 1st, 2015, a number which is growing.⁴⁵ Both Oregon and Connecticut have similar populations (CT - 3.5 million, OR - 3.9 million),⁴⁶ and while there is no way to tell whether Connecticut would have a similar adoption rate of benefit LLCs as Oregon has had, judging from initial feedback by social entrepreneurs and attorneys who have weighed the pros and cons of becoming a benefit corporation, the issues associated with electing subchapter S tax status has proven to be insurmountable for many interested in formally organizing their business as a social enterprise under Connecticut law.

● Angel Investor Tax Credits

There are a number of tax credits available to various types of businesses within Connecticut. Perhaps the most relevant to social entrepreneurs is the Angel Investor Tax Credit. Social entrepreneurs, not unlike typical entrepreneurs, are on a constant quest for access to investment capital. Because the majority of the social enterprises currently operating in Connecticut are at the startup phase, incentivizing investment in this stage of company is crucial if the state is to become a leader in the development of the social enterprise law sector.

Currently, the Angel Investor Tax Credit is structured in such a way that investors can receive a 25% tax credit (up to a total of \$250,000 in credits) on investments of \$25,000 or more.⁴⁷ The businesses must be Connecticut-based, and engaged in the fields of bioscience, advanced materials, photonics, information technology, or clean technology.⁴⁸ Since changes to the credit were put into place in 2012 to lower the amount of investment capital need to qualify for the credit (from \$100,000 to \$25,000), there has been increased use of the credit.⁴⁹ According to an article published shortly after the changes to the

⁴⁵ <https://data.ct.gov/Business/Benefit-Corporation-Data/r8fi-whh5>

⁴⁶ <http://www.census.gov/popest/data/state/totals/2014/index.html>

⁴⁷ <http://ctinnovations.com/angels>

⁴⁸ <http://ctinnovations.com/pdf/Angel%20Legislation.pdf>

⁴⁹ http://articles.courant.com/2012-06-08/business/hc-angel-investor-credits-20120608_1_angel-investors-tax-credit-start-up-firms

credit were made, “the number grew with 84 angel investors pledging \$8.6 million in 23 companies as compared to 13 angel investors pledging \$2.4 million to 9 companies in the six month prior to revision.”⁵⁰

To promote investment in Connecticut social enterprises, the Angel Investor Tax Credit should be modified to include “social enterprise” as a sixth business category eligible for the tax credit. To do so would likely require the development of a statutory definition of what constitutes a “social enterprise” for purposes of the tax credit. There is no precedent for developing such a definition in the U.S., but definitions for similar cutting edge sectors have been defined by statute for the purposes of tax credits. In Connecticut, the state’s “New Reinsurance Reinvestment Fund Tax Credit” legislation, which was passed in 2010, defines a “green technology business” for example.⁵¹ While the statutory term “social enterprise” should be defined as a benefit corporation, or benefit LLC to encourage the use of the entities, it will be necessary to add additional language to ensure that companies recognized as “social enterprises” are in compliance with the reporting requirements of the benefit corporation or benefit LLC statutes.

● Noisy Withdrawal

As an additional transparency measure, benefit corporations that opt to become a regular, for-profit entity should make this transition visible to the public. In a Quinnipiac University School of Law Law Review article, authors Tyler, Absher, Garman, and Luppino recommend that hybrid forms should have a “noisy withdrawal” provision.⁵² This provision would require a benefit company to file a public notice in the event of its transition into a non-benefit company entity.⁵³ A noisy withdrawal would ensure that any attempt by a benefit corporation to forgo its social or environmental purpose would be made known to regulatory officials, creditors, customers, suppliers, and the public at large.

● Availability of Annual Benefit Reports

Under Connecticut’s benefit corporation statute, a benefit corporation must file its annual benefit report either within 120 days of the end of its fiscal year, or at the same time that it files any other annual report to shareholders. As written, this requirement creates issues when a business incorporates as a

⁵⁰ Understanding the Angel Investor Tax Credit, by Diego Mas Gonzales

⁵¹ <http://www.cga.ct.gov/2010/ACT/PA/2010PA-00075-R00HB-05435-PA.htm>

⁵² Luppino, Anthony J. and Absher, Evan and Garman, Kathleen and John, Tyler, Producing Better Mileage: Advancing the Design and Usefulness of Hybrid Vehicles for Social Business Ventures (October 6, 2014).

⁵³ Id.

benefit corporation and has less than nine months before its fiscal year winds down. It essentially requires them file an annual benefit report without having been in operation for a full year.

Recognizing this oversight, Rhode Island passed legislation amending their statute so that benefit corporations are only required to file their first benefit reports the year following the year of the entity's incorporation.⁵⁴ Benefit corporations are still required to file an annual benefit report 120 days after the end of their fiscal year, but this new language ensures that young benefit corporations are not required to expend precious time and resources to become compliant with the reporting requirements at a time where they have created little or no positive social or environmental impact.

Long-Term Policy Proposals

- Creating a 'Best in the Nation' Benefit Company Regulatory Framework

Understanding Benefit Company Regulation

Benefit corporations and benefit LLC statutes supplement existing corporate or LLC law in the states where they have been passed. As a result, they are creatures of corporate or LLC law respectively, and do not create entirely new bodies of law, as other social enterprise legal entities have. That being said, however, because benefit companies create new duties for directors and officers, and create new requirements that these companies must comply with, they are subject to additional restrictions and potential penalties that typical corporations or LLCs are not subject to, as discussed below.

Benefit Company-Specific Regulations

The annual benefit report requirement in the benefit company statutes that have been passed throughout the majority of states across the U.S. were put in place to increase the transparency and accountability of businesses purporting to create a positive social or environmental impact.⁵⁵ Generally, an annual benefit report must include the results of a third-party assessment of the company's positive social and environmental impact, as well as a narrative description of the company's pursuit of a positive social and environmental impact, and whether that pursuit was hindered in any way.⁵⁶ The reports are required to be posted on the company's public-facing website, or provided free of charge to anyone

⁵⁴ <http://webserver.rilin.state.ri.us/BillText15/HouseText15/H6039.pdf>

⁵⁵ <http://ssrn.com/abstract=1988556>

⁵⁶ *Id.*

requesting the report if the company does not have a website. In all but a few states that have external mechanisms to enforce the proper and timely filings of annual benefit reports, the enforcement of the reporting requirements of the majority of benefit company statutes is left up to internal actors within a benefit company.⁵⁷

External Enforcement Mechanisms

If a benefit company does not properly produce an annual benefit report, or file it on time, there is little that consumers, employees, competitors, or other third parties can do to compel the company to file the report on time. In a few select states, the Secretary of the State's office has the ability to administratively revoke the benefit company's status as a benefit company, and revert it to a standard corporation or LLC.⁵⁸ In the majority of states, however, there is no direct third-party mechanism for enforcing the annual benefit reporting requirements under the statutes.

Rather than provide third parties the direct ability to enforce compliance with benefit company statutes, proponents of benefit company legislation made a case that the consumers and the press would favor companies that were compliant with the benefit company statutes, and punish companies that were not compliant. Generally, legislatures were persuaded by the line of thinking supporting the idea that market forces created a proper third-party mechanism for policing the sector. Some states, however, have developed express penalties for not filing an annual benefit report.⁵⁹ Among the states that have developed penalties, no two are alike. Approaches range from revoking a benefit corporation's status as such, to providing attorney's fees and other compensation to shareholders that bring a benefit enforcement proceeding to compel the publishing of an annual benefit report.⁶⁰

Internal Enforcement Mechanisms

If a benefit company does not properly produce an annual benefit report, or file it on time, there is a first-party enforcement mechanism available to ensure that the requirements are complied with,

⁵⁷ Id.

⁵⁸ Although this means of policing the benefit corporation sector ensures that non-compliant benefit corporations are purged from a state's cohort of benefit corporations, it is not a perfect solution. An unintended consequence of this policy is that it give directors or officers of a benefit company who do not have the requisite 2/3rds shareholder vote to undo benefit company status a back door means of undoing the status.

⁵⁹ Id. at 60.

⁶⁰ Id.

called a “benefit enforcement proceeding.” A benefit enforcement proceeding allows a benefit director, and officer, or a shareholder with greater than 5% of the outstanding shares of the organization (generally) to ask a court for an injunction, and require the benefit corporation to comply with the annual benefit reporting requirements.⁶¹ Benefit enforcement proceedings can also be used to enforce any other requirement laid out in the certificate of incorporation or articles of organization pertaining to the organization’s general or specific public benefit.

Effectiveness of the current regulatory regime

Whether or not benefit enforcement proceedings will be effective in policing the benefit company sector remains to be seen. So far, there has not been a benefit enforcement proceeding that has been initiated anywhere in the U.S. This is especially surprising, given the lack of compliance with benefit corporation’s annual benefit report requirements nationally. Although there is no reliable data demonstrating the level of compliance with the benefit company statutes nationally, in a recent web search by this author, it appeared that less than 100 annual benefit reports had been posted to the web. This comes despite the fact that over 1,000 benefit corporations have incorporated since 2010.⁶²

● Policy recommendation

Any attempt to change the regulatory regime in order to increase compliance with transparency measures would be unwise without input from all the potential stakeholders that could be affected by such a decision. A group of all the stakeholders should be convened to form a Social Enterprise Panel that will be responsible for overseeing a study on social enterprise law on a national and international scale, and develop policy recommendations to ensure:

1. Connecticut consumers, service providers, and entrepreneurs are well-educated about benefit company entities, how they are used, and the reporting requirements associated with the entities;
2. High compliance with the annual benefit reporting and specific/general public benefit purpose requirements included in the Connecticut statute;
3. Connecticut is seen as the preeminent state for social enterprise law and policy.

⁶¹ Id.

⁶² http://www.ssireview.org/blog/entry/benefit_corporation_and_l3c_adoption_a_survey

The panel will ultimately determine whether or not the current enforcement mechanisms for benefit companies within the state are truly effective, and present their findings to the General Assembly. Input from stakeholders will ensure that the study will be holistic and as objective as possible. As a result, any new polices developed in response to the study will balance both the rights of the public to be informed about the social and environmental impact of a benefit company, and also the potential chilling effect that policies can have on the desires of entrepreneurs or attorneys to use or recommend Connecticut's benefit company statutes.

- Connecticut Business Law Center

A Business Law Center should be established at the University of Connecticut School of Law, as prescribed by L. Francis Huck. Connecticut's unique set of demographics, socioeconomic conditions, and policy infrastructure has primed the state to take on the role as the nation's hub of social enterprise. Without a highly knowledgeable and supportive legal community, however, Connecticut's assets are lost. A Business Law Center would train Connecticut's lawyers to be experts in the field of business law, including expertise regarding benefit companies.

This is of particular importance to benefit companies because they are relatively new legal entities. Inherent in any new form of business is reluctance among lawyers to counsel their clients to take on that form due to a general lack of legal precedent and inexperience with the form. The establishment of a Center would equip Connecticut attorneys with relevant information about benefit companies so that they can make informed decisions about how to advise their clients, and how to contribute to the evolution of its policy.

- Benefit Company Liaison

The Governor should appoint a Benefit Corporation Liaison similar to the nonprofit Liaison that currently exists for nonprofit organizations in Connecticut.⁶³ A healthy partnership between the public and private sectors is essential for providing goods and services to Connecticut's residents and the creation of a Social Enterprise Liaison would strengthen this relationship.

⁶³http://portal.ct.gov/Departments_and_Agencies/Office_of_the_Governor/Learn_More/Governor_s_Nonprofit_Liaison/

A Liaison could improve the ways that the state communicates with benefit corporations by serving as a spokesperson on behalf of the state, as well as advocate on behalf of benefit companies. Because benefit companies are new legal entities, they will have a unique, and evolving set of concerns about how to navigate an increasingly complex global marketplace. Having a single position designated for communicating between state government and the private sector would send a powerful message to social entrepreneurs and offer a newfound legitimacy to the movement. It would not only offer support to existing social entrepreneurs, but would also show entrepreneurs outside of the state that Connecticut is supportive of this new way of doing business. Ideally, the appointee would be housed within the Department of Economic and Community Development.

Conclusion

It is clear that there is a tremendous opportunity for Connecticut to become the national leader in social enterprise law. To become a national leader, however, the legislature must seize the opportunity at hand, and introduce legislation enabling the policies discussed above. The policies in this report have been crafted in such a way as to drive increases in the number of companies that use social enterprise entities within the state, to make it easier for consumers to gain access to information about these businesses, and to encourage investment in them, all with minimum fiscal impacts from a state budgeting perspective.