

The logo for K&L GATES, featuring the text in white on an orange rectangular background.

K&L GATES

Legal Considerations for Social Enterprises

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TOPICS TO BE COVERED

- What is a Social Enterprise?
- What is Impact Investing?
- Should My Startup be a For-Profit, Social Benefit, or Non-Profit?
- What are the Types of For-Profit, Benefit, and Non-Profits Social Enterprises?
- What is B Corp Certification?
- Additional Questions?



WHAT IS A SOCIAL ENTERPRISE?

A “social enterprise” is “a business that directly addresses a social need through its products and services.”

**- Jerr Boschee, Adjunct
Social Enterprise Alliance**



REASONS FOR FOUNDING A SOCIAL ENTERPRISE

- **Do something positive for**
 - Society; and/or
 - Environment.
- **Economic Benefit:**
 - Customers.
 - Investors.
- **Possible Funding Sources**
 - Foundations.
 - Impact Investors.



SOCIAL AND ENVIRONMENTAL IMPACT INVESTMENTS

An investment intended to generate positive social and/or environmental impact and generate financial returns involving a diverse group of investors

- Public and Private Partners
- Institutions and Individual Investors



IMPACT INVESTING IN PITTSBURGH



PITTSBURGH FOUNDATIONS; “Programmatic Regional Investments” (PRIs)

Richard King Mellon Foundation Social Impact Investment Challenge

<https://www.rkmf.org/pages/sii-pitch-challenge-landing-page>

CIVIC-MINDED INVESTORS make socially and environmentally motivated investments to benefit the Pittsburgh Region

BNY Mellon Bank’s UpPrize

<https://www.bnymellon.com/us/en/about-us/esg-and-responsible-investment/enterprise-esg/tech-tools-for-social-good.html>

Racial and Gender Lens Investing

Black Tech Nation

<https://blacktechnation.com/>

Common Types of Social Enterprise Entities

For Profits (including C-corps an LLCs)

Social Benefit Entities (including Benefit Corporation& Benefit Company)

Non-Profits (including 501(c)(3) organizations)

Hybrid (Combination) Entities

WHAT ENTITY IS BEST FOR SOCIALLY RESPONSIBLE VENTURES?

- **It Depends...**
 - **What Is My Purpose?**
 - **Source of Funding?**
 - **Management Control?**
 - **Tax Consequences?**
 - **Flexibility?**
 - **Administrative Burdens?**

Advantages of For-Profit Entities

1. Require less explanation

- Easy to raise money as equity or debt.
- Can tap U.S. SBA grants, loans, and technical assistance.
- Easy to sell or shut down (as long as you pay their creditors).
- Extensive precedents on best practices.
- Can convert to a nonprofit more easily than a nonprofit can convert to a for-profit.
- Flexibility of Tax Treatment

Disadvantages of For-profit Legal Entities

- **Branding/Public Perception (although For-Profit can achieve socially responsible branding through other means)**
- **Subject to tax.**
- **Strong fiduciary duty to act in the shareholders' best interests by making money for them.**
- **It may be challenging to obtain foundation grants and non-taxable contributions.**
- **Any social bottom line is not built into the structure but is instead dependent on the leadership.**
- **Limited Flexibility for the Board in Case of Sale of the Company.**

FOR-PROFIT ENTITY CHOICES

- **Three “REAL” choices**
 - **C Corporation**
 - **S Corporation**
 - **Limited liability company**
- **Others**
 - **Sole Proprietorship**
 - **Partnerships**
 - **Limited Partnerships**

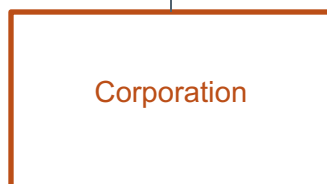
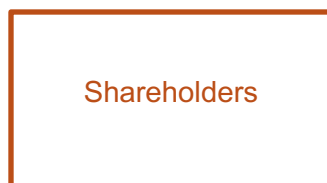


FORM OF FOR-PROFIT ENTITY CONSIDERATIONS

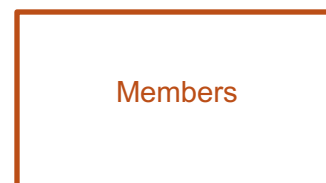
	CORPORATION*	LIMITED LIABILITY COMPANY	S CORPORATION
NO DOUBLE TAX			
FLOW THROUGH			
VC ACCEPTABLE			
LIMITATION ON SHAREHOLDERS			
MEDICARE TAX EFFICIENT			

***Benefit Corporations are taxed as corporations, and Benefit LLCs are taxed as LLCs.**

Corporate Structure v. LLC Structure

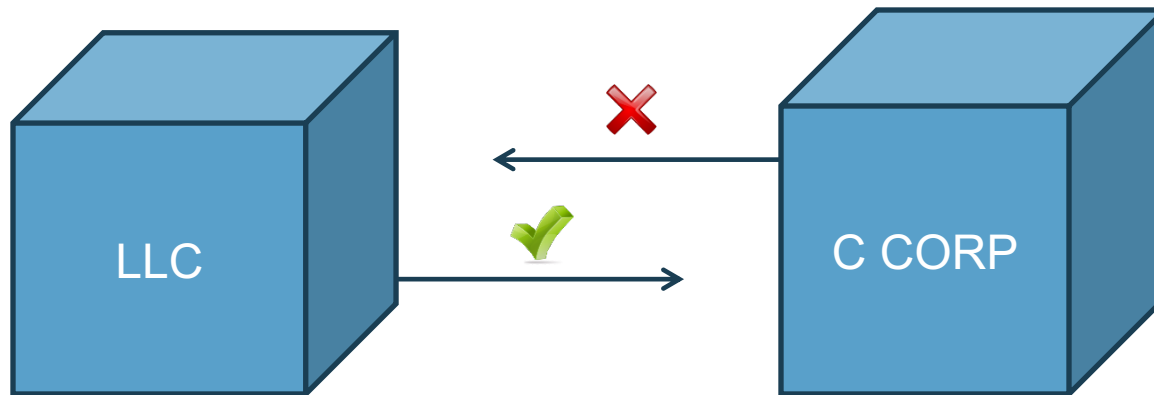


Managed by Directors/Officers



Managed by Managers or Members

CHANGING COURSE



STATE-CREATED SOCIAL ENTERPRISE ENTITIES

- Purpose: “General Public Benefit” or a Specific One
- Adopted in 37 States (including Pennsylvania and Delaware).
 - Benefit Corporations (38 States, including PA and Delaware; 6 Pending)
 - Benefit LLCs (3 States, including PA)
 - Low Profit Limited Liability Companies (LC3) (8 States, 4 Pending)
 - Social Purpose Corporations (4 States)
- Taxation: May be Taxed as a C Corporation, S Corporation, LLC or Partnership
- Map of Different State Social Enterprise Entities
 - <http://socentlawtracker.org/#/map>

BENEFIT CORPORATIONS

- For-profit entity that is “intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner”.
- Affirmative duties on directors to consider different stakeholders.
- Adopted in 38 States
- Taxation: May be Taxed as a C Corporation, Partnership or as an S Corporation.



BENEFIT LLCs

- **Adopted in 6 States, so far:
Pennsylvania, Delaware, Maryland,
Utah, Kansas and Oregon (pending
in Connecticut)**

BENEFIT CORPORATION & BENEFIT LLC ADVANTAGES

- **Great Marketing Tool**
- **Strong Commitment to Social Purpose**
- **Legal Protection for Directors**
- **Flexibility for the Board in Case of Sale of the Company**
- **Possible access to Impact Investors & Foundation Funding**

BENEFIT CORPORATION & BENEFIT LLC DISADVANTAGES

- **Traditional Investor Hesitancy / Raising Funds.**
- **Legal Uncertainty/Fewer Legal Precedents.**
- **Additional Reporting and Disclosure Requirements.**
- **No Tax Incentives.**
- **Control can be more diffuse**
- **Exit options may be more constrained than with for profit**

EXAMPLE OF LOCAL FOR-PROFIT TURNED SOCIAL BENEFIT ENTITY: THREAD INTERNATIONAL

- **Began as Pennsylvania For-Profit**
- **Switched to Delaware Benefit Corporation**
- **Why?**

The logo for Thread International, featuring the word "thread" in a bold, lowercase, sans-serif font. The letter "r" is stylized with a horizontal line through its middle.The logo for First Mile, featuring the words "FIRST" and "MILE" stacked vertically in a bold, uppercase, sans-serif font. A diagonal line with circular endpoints at both ends crosses the space between the two words.

B CORP CERTIFICATION

- **Third Party Certification, like LEED or Fair Trade certification**
- **Not a Legal Entity, although you must be a Benefit Corporation or Benefit LLC to get certified.**
- **Requirements**
 - **Purpose**
 - **Amendment of Certificate of Incorporation**
 - **Annual Reporting Requirements**
 - **Other Burdens**



B CORP CERTIFICATION

- **Advantages**
 - **Commitment to Social Purpose**
 - **Access to Community of Other B Corps**
 - **Marketing Tool for Consumers**
 - **Does Not Intimidate Investors**
- **Disadvantages**
 - **No Tax Incentives**
 - **Costly and time-consuming certification process**
 - **Stringent Annual Reporting Requirements**
- **You can now complete a Benefit Report for Free, but you need to pay for certification** (Approximately 5,000 have completed report v. 2,500 who have paid for B Corps Certification)



NOT-FOR-PROFIT ENTITIES (NONPROFITS)

- What Is a Non-Profit Organization?
 - An organization formed under a state's nonprofit corporation statute
 - To qualify for tax-exempt status, must have a charitable, educational, or scientific purpose (IRS application required)



NONPROFIT CORPORATION ADVANTAGES

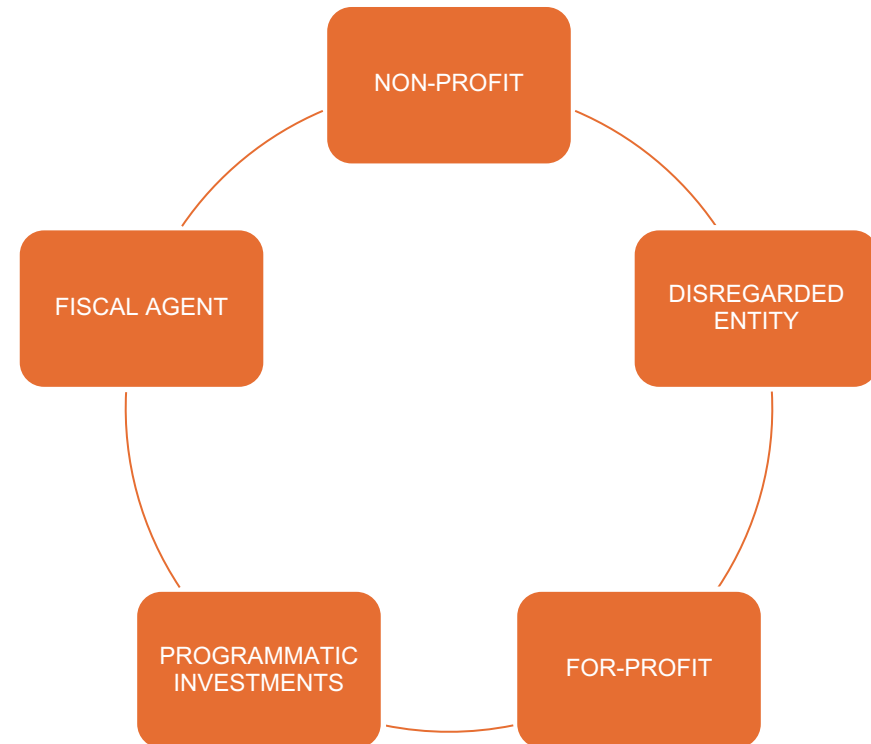
- **Liability protection**
- **No conflict between the venture and the social objectives**
- **Tax-exempt status**
 - **Exemption from federal income tax**
 - **May be prerequisite for state tax benefits**
 - **501(c)(3) status – tax-deductible contributions**
- **Can accept grants directly from foundations**
- **Individuals receive a tax deduction for Contributions to non-profit**

NONPROFIT CORPORATION DISADVANTAGES

- A Non-profit is “owned” by the public, so there are no investors, and the only exit is to transfer the assets to another non-profit
- Sharing control and governance - Control is with board of directors, not the founder – “founder’s syndrome” is when founder thinks he is in control of non-profit
- Usually dependent on traditional charitable fundraising
 - Grants are difficult to get and involve complicated applications and agreements
 - Charitable events are labor intensive and often lose money
- Limitations on compensation and distributions
- Public scrutiny and Attorney General oversight
- Less confidentiality
- Restrictions associated with tax-exempt status (including taxation and limitations on unrelated business income)
- Complex legal rules, both state and federal

FOR-PROFIT/NON-PROFIT HYBRID ENTITIES

- **Governance structures and/or contracts that bind a for-profit and nonprofit together in a hybrid structure.**
- **Advantage is that the nonprofit and the for-profit entities each retain the advantages that are unique to those legal structures.**
- **Disadvantage: They are complicated! Make sure you have a lawyer who understands all the restrictions!**



QUESTIONS?

Thank you!