

CHAPTER 2

PURPOSES, PRIORITIES, AND ACCOUNTABILITY UNDER SOCIAL BUSINESS STRUCTURES: RESOLVING AMBIGUITIES AND ENHANCING ADOPTION¹

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ABSTRACT

This chapter demonstrates that social business models do not meaningfully prioritize or impose accountability to “social good” over other purposes in ways that (a) best protect against owners changing their minds or entry of new owners with different priorities and (b) enable reliable accountability over time and across circumstances. This chapter further suggests a model – a “social primacy company” – that actually prioritizes

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“social good” and meaningful accountability to it. This chapter thus clarifies circumstances under which existing models might be most useful and are not particularly useful, especially as investors, entrepreneurs, employees, regulators, and others pursue shared, common understandings about purposes, priorities, and accountability.

Keywords: Hybrid business models; social good; benefit corporation; social purpose corporation; L3C; impact investing

INTRODUCTION

Understanding financial capital, revenue flow, and human resources are among the inquiries that captivate almost every enterprise, including those that operate in the “social” space. From founding and startup through sustainability and growth, these are the essential questions that permeate the thinking and planning of founders, investors/owners, directors, managers, their advisors, and thus also researchers.

Those involved with and who strive to better understand “social” enterprise are or should be inquiring about two additional categories: priority of purposes and accountability to them. After all, these are the characteristics that ostensibly distinguish social business efforts from those of traditional business, at both the entity and movement levels.

- What are the underlying purposes? How are they prioritized, especially when they collide? How do they withstand changed minds and circumstances or new people with different priorities?
- How are enterprises and their decision makers held accountable for staying true to those priorities? Who can enforce accountability? To what end is accountability enforced: outcomes or process?

In addition to founders, owners, and managers, these considerations often also impact whether and how others choose to engage a social business: especially employees but also contractors, suppliers, customers, and others. For instance, millennials are increasingly dominating the workforce (Buckley, Viechnicki, & Barua, 2015), and there is evidence that they are attracted to employers who prioritize attention to the social implications – positive and negative – of their decisions and behaviors (Deloitte, 2016). Millennials are also twice as likely to invest in a socially aware or focused enterprise (Morgan Stanley, Feb. 2015). Thus, these types of questions are of overtly growing, direct relevance to all types of companies.

These distinguishing questions also affect policymakers, regulators, and those who inform them as they wrestle with questions about whether to

provide beneficial tax treatment or to grant preferences in procurement processes, whether to exempt from application of securities and crowd funding requirements, how to treat fiduciary duties, whether to impose charitable trust burdens and oversight, whether formal structures matter more or less than informal arrangements, and how to otherwise satisfy their responsibilities.

These questions also have threshold implications for researchers, whether seeking to understand a given enterprise, a movement writ large, or some aspect of the expanse in between. At a minimum, the above questions open enormous possibilities for undertaking comparative analyses regarding impact, outcomes, operations, resources, opportunity costs, and a nearly unlimited variety of other filters enabled through variations of the above lenses.

This chapter seeks to provide a framework for approaching the above questions, and in doing so identify and address certain misnomers, misunderstandings, and mythologies that have created ambiguity that may be inhibiting adoption in practice and expansion of these efforts. In part II, this chapter discusses how traditional business, 501(c)(3) organizations, and the current menu of social business forms generally treat priorities of purpose: whether to profitability and owner value, charitability, broader social good, or flexibility. Part III analyzes various approaches to accountability for pursuing those purposes and priorities: whether to owners, to the public more broadly, and as provided for (or not) as a matter of law. Part III also clarifies the extent to which actual outcomes or impact is incorporated into accountability approaches.

Among the conclusions that emerge from those discussions are the chasmic gaps in how current approaches prioritize social purposes (or not) and accountability for pursuing such purposes as actual outcomes. To further demonstrate those gaps, Part IV describes a proposed “social primacy company” as a juxtaposition to show what priority of and meaningful accountability to social purposes might look like – not as a replacement of the existing approaches but as a complement to them.

PRIORITIES

Every private sector entity has priorities. This does not mean single-minded pursuit of only one purpose. It simply recognizes that at some point(s) decision makers will have to choose from among the entity’s intended purposes, whether competing or complementary. It also means that there are certain degrees of consistency and predictability that might be generally expected or understood based on the entity’s form.

At one end of the purpose spectrum are businesses that seek to maximize owner financial value – the “traditional” approach. Whether this is a fiduciary mandate is a subject of debate (Tyler, Absher, Garman, & Luppino,

2015: 274–278), but there is enough uncertainty and consequent risk about deviating from that premise that directors/managers of traditional businesses (and their lawyers) are frequently dissuaded from elevating social purpose over owner value in their decision making, at least absent an agreement to that effect and that releases liability for exercising it.

This does not mean that decision makers cannot operate in industries historically considered charitable. They can and do (e.g., education and health care). Nor does it mean that businesses cannot operate in areas normally in the realm of government. They can and do (e.g., prisons, toll roads, military support, etc.). Businesses also can contribute to charity, consider social goods like how decisions affect employees, environment, and communities, and otherwise engage in corporate social responsibility, as long as ultimately connected to owner value. When traditional business firms operate in socially conscious ways and produce social benefits, they do so within the constraints of a duty to pursue financial profits for their owners; thus, they are primarily responsive to market dynamics, not to social purpose except to the extent the social purpose overlaps with short-term or long-term for-profit purposes.

When a conflict arises in a traditional business among competing purposes, the predominant view is that the law remains rooted in primacy of distributable profits and enhanced capital value. That purpose and its ordering can be modified by owners, even to prioritize charity or social good over owner value, subject to causes of action and remedies for breach of contract and their respective limitations.

Charitable purposes are on the opposite end of the spectrum. Technically, there is no specific form on this end. What exists is a statutory ordering of purpose under state and federal laws that permit tax exemption and deductible charitable contributions. Such entities must be organized and operated exclusively for charitable purposes and with no more than incidental private benefit (I.R.C. §§ 501(c)(3) and 170(b)). Unlike traditional businesses that can contract around duty to owner value in favor of charitable outcomes, tax-exempt charitable organizations do not have owners to make such compromises. Thus, their directors and managers cannot abdicate priority of charitable purposes with impunity.

One of the new social business forms also prioritizes charitable purposes. Low profit limited liability company (L3C) statutes require that adopters significantly further charitable purposes as defined by IRC 501(c)(3) and they cannot have owner value as a significant purpose (Vt. Stat. Ann. tit. 11, § 3001(27)(A)). Thus, the L3C tolerates multiple purposes but legally orders and weights them such that furthering “charitable” purposes – not just

“social” good – is the mandated priority (Brakman Reiser, 2013; Tyler et al., 2015: 267).

In addition to owner value and “charitable” pursuits, a third category of purposes could be “social good.” This is an amorphous and all-encompassing term, which to have any useful application must have *some* definition, even if it is subject to later expansion and iterations. Although charitable purposes advance social good, conceptions of “social good” are generally broader than “charitable,” so there must be something about “social good” that is additive to charity. Prioritizing owner value has generated a tremendous amount of social good – improved standards of living, advances in human welfare, economic growth, prosperity, jobs, and even personal and community fulfillment. So “social good” in our context must mean something else.

The statutes that enable the two primary social business corporate forms – benefit corporation and social purpose corporation – address this challenge to a degree. Benefit corporations must serve general public benefit by having “a material positive impact on society and the environment taken as a whole as reported against an independent third party standard” (Model Benefit Corporation Legislation, § 102). They also *may* pursue specific public benefit(s) that encompass a variety of purposes, charitable and otherwise.² Further and perhaps most importantly, directors of benefit corporations *must* consider how their decisions affect shareholders, employees, environment, community, short term and long term, and other subsets of social good, all of which interests are expressly recognized as in the “best interests” of the enterprise (Geczy, Jeffers, Musto, & Tucker, 2015: 93–97; Tyler, 2010).

Social purpose corporation statutes require that directors consider the effects of decisions on identified social goods “in addition to or together with” shareholder value (Cal. Corp. Code § 2602), which effectively ensures that directors have the flexibility to choose from among different purposes – owner value, employees, creditors, environment, community, various charitable interests, etc. – as circumstances suggest.

These enabling statutes suggest reasonably concrete and specific approaches to defining “social good.” But they neither mandate priorities nor assign relative weighting among purposes, even vis-a-vis owner financial value! Nowhere in the benefit corporation enabling statutes are discrete purposes prioritized above or below any other purposes. In fact, Minnesota’s public benefit corporation statute expressly forbids such prioritizations except to the extent declared in organizing documents (Minn. Stat. Ann. § 304A.201 sub. 1(2)).

Instead, directors may prioritize or neglect shareholders or social good as long as they *consider* the impact of their decisions on the other interests and

stakeholders. Minnesota's public benefit corporation presents a sort of exception in that it prohibits directors from directly, regularly giving presumptive or permanent priority to any interest or stakeholder without a clear delineation in the articles of incorporation (*Id.*).

Consequently and in contrast to the L3C, the corporate social business form statutes do not distinctively prioritize "social good." More correctly, these statutes prioritize flexibility and the ability to choose, protect directors from liability for considering other than shareholder monetary interests, and thus explicitly modify traditional approaches accordingly. Stated differently and despite providing reasonable definitions of distinctive social good, these statutes recognize that different circumstances may support prioritizing different purposes and, thus, different decisions at any given time.

Any of the above business forms, traditional and social, can be modified by agreement of the owners to change director duties and permit consideration and even priority of interests other than financial value, especially under the L3C model that generally promotes member/owner freedom to contract key aspects of their business relationships and operations, including deviation from presumed norms such as fiduciary duties ([Miller, 2014](#): 318; [Tyler, 2010](#)).

Using a contract to modify priorities to emphasize social good ultimately depends on a single owner or agreement among owners to pursue and maintain priority of non-owner interests. Even when differentiating among classes of owners such as the founders of Google did ([Brakman Reiser, 2010a, 2010b](#)), the ability to deviate from owner value rests on a contractual commitment – whether legal or moral. However, and as is discussed further below, depending on contract causes of action and remedies has limits.

Inevitably, founders, investors, and operators of businesses – regardless of form – will be forced to choose from among owner value, charitable purposes, or social good. Ultimately and more so than verbal declarations or words on paper (even in a statute), what gives purposes actionable priority is accountability and approaches to it. As such, accountability to purposes and their priorities is a necessary complement to social businesses both as to theory and in practice.

ACCOUNTABILITY

In the private sector, three key factors differentiate accountability to priorities: (1) how accountability is pursued generally; (2) who can pursue it; and (3) who is being held to account. How the different forms approach these factors shapes how founders, investors, employees, managers, policy makers,

and regulators identify and consider options, evaluate the usefulness of any given form for particular purposes, and fulfill their respective responsibilities in practice.

How is Accountability Pursued and by Who?

The three primary means by which accountability occurs for our purposes are as a public matter, as a practical matter through owner ability to remove and replace directors/managers, and as a legal matter through causes of action and remedies under breach of contract or fiduciary duty. Each method is partly differentiated by who may invoke it and effectiveness for imposing consequences.

Public Accountability

Public accountability always exists to some degree, and its potential has expanded as social media has evolved (or some say devolved) the ability to quickly reach large, consequential numbers of people at even cursory levels. But its effectiveness as a matter of consequence depends on persuading enough others to act on a point of view.

Who may invoke it is unlimited and includes any person or group that wants to care, pretend to care, or be perceived as caring. Anyone can undertake a campaign that influences decision making, priorities, and behavior, even people who have just heard or dreamed things they like or don't like. Likewise, companies and their advocates can undertake campaigns to promote awareness of accomplishments and successes – real, perceived, or imagined.

Public accountability is agnostic as to its object or its form. Its web catches traditional or modified business, social businesses, 501(c)(3) public charities, and private foundations. Just ask the Susan G. Komen Foundation, Wounded Warriors, and other charities that have been embroiled in public relations nightmares!

The benefit and social purpose corporations are predisposed toward harnessing public accountability, particularly given reduced legal accountability. Benefit corporations must periodically – usually annually – report against independent third-party standards by providing such reports to shareholders, posting them on websites, and otherwise making them publicly available as prescribed by statute (Del. Code Ann. tit. 8, §§ 366(c)(2) (2015); [Murray, 2015](#); [Wirth, 2015](#)). Social purpose corporation statutes similarly require public posting of goals and performance against them.

All reports are internally generated and none must be externally audited or formally verified or even vetted. Even so, businesses are likely to arise to provide external audits or verifications much as accountants, auditors, the Financial Accounting Standard Board (for private entities), Government Accounting Standards Board (for U.S. state and local government), and the Public Company Accounting Oversight Board do for financial statements. B Lab, the Global Impact Investing Network, or others might standardize “social impact” metrics enough to ground formalized external analyses and opinions. In the meantime, investors, employees, managers, customers, suppliers, other members of the public, policy makers, and regulators should understand that self-reporting is the basis for public accountability, which is reactionary and not always well- or reliably-informed.

Ultimately, it may be media that has the pivotal role in the efficacy of public accountability, further emphasizing the importance for media to properly understand purposes, priorities, and accountability.

Practical Accountability

Except for 501(c)(3) organizations that cannot have owners, all of the forms – traditional and modified for-profit, benefit and social purpose corporations, and L3C – presume that some requisite volume of owners, usually a majority, have authority to hold directors, managers, and operators to account. After all, that majority elects directors and managers and can replace those they believe are responsible (or irresponsible) for decisions, results, or effort with which they disagree. As such, that majority generally dictates priorities and enforces accountability thereto.

The ease with which such accountability is invoked correlates directly with the number of owners. Fewer owners means fewer people to convince to join a coalition of accountability. As the number of owners grows, practical accountability becomes less useful as the ability to impose consequences for deviation diminishes.

The benefit corporation supplements dependence on owner accountability by allowing appointment of a benefit director (MCBL, § 302(a)(1)) or delegated authority to a third party to enforce its purposes (MCBL, § 305(c)(iv)). There is no requirement that benefit corporations do either (MCBL, §§ 302(a)(1) and 302(b)), and it is not clear that either device is being voluntarily adopted. Even so, generally a majority of shareholders can amend or rescind those appointments or delegations, thus reverting to practical owner accountability.

Benefit enforcement proceedings are similarly voluntary, and although retroactive in their fact gathering, they are prospective only in their consequences

(MCBL, § 102). That is, they are not remedial or punitive and thus may not be much of a deterrent. Instead, a court may order that directors fulfill their duties and satisfy required statutory elements. Monetary damages – and as such substantive consequences – are not available (Clark, 2012: 28). This form of prospective only accountability is representative of the least functional dimension of the law. As “bad things” occur in the past, future actions get limited while the past infractions and their effects remain. This allows for an accretion of practices that are contrary to intended policy and give rise to other unintended consequences and confusion that ultimately undermine broader efforts to advance social engagement.

Practical owner accountability is essential, and the benefit and social corporations’ undertakings are appropriately voluntary rather than mandatory, especially given their emphasis on the priority of flexibility. However, non-majority investors, directors, and managers should be aware of their limited ability to hold others to account for their own preferences or priorities, even those on which there was previous agreement. They may not have enough votes to remove or replace directors or managers who deviate and may not be able to pursue legal causes of action or remedies when flexibility is the priority.

Policy makers and regulators also should understand the strengths and gaps of depending on accountability to owners and limiting legal accountability before providing preferential tax treatment, giving preference points or status in procurement processes, or exempting from regulatory compliance when based on form alone. Strong practical accountability for prioritizing flexibility and weak legal accountability for prioritizing social good leaves open paths to pursue owner value at the expense of social good, which may or may not be what policy intends.

Legal Accountability

To the extent it has not been subverted, the last approach to accountability is grounded in law and exists by virtue of contract, fiduciary duties, and regulatory standing to intervene in certain circumstances.

Contract

There is a long history of ventures that have successfully contracted around profit maximization to permit consideration and even prioritization of interests other than owner financial value. They work and will continue to work especially for those that are merely socially tolerant, but relying on contract

causes of action and remedies has hurdles for imposing meaningful consequences, especially for businesses wanting priority of social impact.

One hurdle is that parties to contracts change their minds, whether the original owners/contracting parties or parties added or substituted later. What might once have been a seemingly inviolate commitment to social good can dissipate or disappear. Parties can then amend their contracts either formally with new documentation with the agreement of all involved or informally by ignoring breaches with tacit or explicit acquiescence of all. Moreover, once contracting parties acquiesce in a breach, the new normal for the contract may be the condition created by the breach such that courts are not likely to allow a party to change its mind and claim breach later.

Nothing in contract law can overcome such unanimity among the parties, including actions by third parties who will not be recognized by a court as having legitimate claims absent the highly unusual circumstance of having been expressly named in the contract as a third-party beneficiary. Consequently, there usually is no third-party accountability under contract.

It may be that not all the parties to the contract agree with the re-prioritization. Even then existing contract law has two additional hurdles that are likely to be significant barriers: proving damages and causation. First is that enforcing a contract requires that the party claiming breach prove economic, financial damages (Restatement, 1981, § 346; Farnsworth, 1979: 1147). If the claimant made money from the breach, proving their damages will be very difficult at best.

What if the venture and contracting parties lose money instead of making it? Contract law also requires that the party claiming breach prove causation; that is that the damages were caused by the breach. However, in a social venture the likelihood of profitability may be less likely or even remote from the start. If so, losses may be ascribed to the business model rather than to the breach or at least it will be challenging to prove that the breach caused the losses rather than the business model. The plaintiff might get an order requiring future compliance but that does not account for past violations nor is it likely to dissuade beneficial breaches (Farnsworth, 1970: 1150–1154; Restatement, 1981, § 357 cmt. A).

Consider the following scenario. Three people – Geddy, Neal, and Alex – decide to open a healthy food grocer in an urban neighborhood. As the sole owners and managers of the enterprise, all three agree that their priority is providing such options in and for otherwise underserved areas, and they put that intention in a writing signed by each of them. Two years later, they realize that their costs for opening and maintaining their stores is higher than expected and leaves very, very little profit in an already low margin business. They decide to subsidize those costs by opening healthy food stores in suburban areas. Seven years later and as their respective families grow and grow up

and their kids begin going to college, they realize that the suburban stores are very profitable and college expenses are manageable for all. So they decide to focus only on opening and operating those stores without opening any new urban stores and by closing those that are not self-sustaining, which leaves only one urban store that they also ultimately close.

Under those facts, there is a contract; it has been breached; but none of the parties enforce it for whatever reason.

Suppose that at the “seven-year later” mark, Neal objects to the decision to prioritize and (effectively serve) only urban stores. He tells the other two about his concerns and that they are breaching their original agreement. They ignore him, and he sues for breach of contract. What are his damages, especially given the stores’ profitability and Neal’s ability to pay for his kids’ college with the distributions to owners?

Suppose instead that the market for healthy food turns downward and even the suburban stores lose money and must close. Neal had already objected to the decision, and now he has financial damages to claim. However, how can he establish that the breach (i.e., the decision to focus on suburban stores) caused the losses when the urban stores were not financially sustainable either and were also losing money. There was a contract; it was breached; there were damages; but was there causation?

Neal might be able to get an order from a court requiring that the company re-prioritize urban stores per the agreement. Geddy and Alex instead exercise their right to terminate the agreement. What is Neal’s recourse then? He has nothing meaningful under contract law or as a practical matter as a minority owner. He might be able to take to social media with information to try to prompt action from a critical mass of people who care and are willing to act.

Although accountability through contract can and does work in some instances, it is avoidable by agreement or neglect and has only limited ability to preserve priority of purpose because of challenges proving damages and causation. As such, the presence of a factual breach does not necessarily mean that anyone can do anything about it legally.

Fiduciary

Fiduciary accountability focuses less on financial damages, broadens the pool of those who can pursue claims, and expands remedies for violation.

Unlike practical owner accountability that depends on a majority coalition or liability under contract that only a party can enforce, anyone owed fiduciary duties can pursue breach of those duties on their own or on the

organization's behalf. Thus, any owner, director, manager, or officer might enforce fiduciary duties, even if in a minority.

Although plaintiffs still must prove damages, the concept is not restricted to financial losses (Demott, 2006). Consider an enterprise that specifically deprioritizes owner value as a fiduciary matter. If a group of directors prioritizes owner value anyway and, in doing so, generates distributable profits, a single owner can hold those directors accountable for violating their duties even though they made money for the owners. That single owner might be able to force disgorged profits or pursue punitive damages to remedy past violations and encourage future compliance.

There are at least three problems. First, allowing plaintiffs to gain financially from others' inappropriate neglect of fiduciary priorities would be hypocritical. Therefore, recovery should benefit the intended social purposes that are the agreed upon priority, although the plaintiff should not be worse off financially for having enforced fiduciary priorities.

Second, owners typically do not owe fiduciary duties as owners to fellow owners, except in certain circumstances regarding minority interests (Berchem, 2012; *In re Atlas Energy Litigation*, 2010). A court will need to decide whether an owner's efforts to subvert fiduciary priorities are enough of an intervention to justify accountability for its breach. It seems that owners of a social business with fiduciary priorities should not be able to subvert those priorities with impunity. Otherwise, directors themselves are the last and perhaps only bastion for protecting social priorities. Because directors serve at the pleasure of the owners, this may be no protection at all, in which case social business risks being a mere fiction.

Third is difficulty determining when such duties apply to social good in available structures. Duties exist to owner value in traditional for-profit enterprises and to charitable purposes in 501(c)(3) entities. Modified traditional for-profits arguably displace fiduciary with contractual duties. Because benefit and social purpose corporations prioritize flexibility rather than any given purpose, finding a breach of duty would be unlikely unless due consideration is not given to specified interests or stakeholders. L3C statutes prioritize furthering charitable purposes and deprioritize owner value, so fiduciary accountability should exist within the L3C form but only to the narrower concept of charitable purposes rather than social good more broadly.

Under existing circumstances and apart from tax-exempt nonprofits and possibly the L3C, it seems as if fiduciary duty accomplishes very little for legal accountability to social good in businesses of any current form. Investors, employees, policy makers, regulators, their respective advisors,

researchers, and others should know that such duty and accountability thereto does not exist.

Regulatory

Social businesses are still subject to the multitude of laws and regulations that apply to traditional business: consumer protection, employment discrimination, intellectual property, environmental, licensing and permitting, workers and unemployment compensation, OSHA, wage and hour, truth in advertising and lending, securities, etc. Certain of these might have unique applications in a social context to prevent deceit and encourage informed decision making.

For instance, misrepresenting a specific enterprise and its purposes and priorities could create liability for those who make such misrepresentations, including under securities laws. That is, telling prospective investors that the company prioritizes social good (i.e., “profits” in the form of “social benefits”) when its practices instead prioritize owner value could – and should – be such a misrepresentation that, in addition to claims by the deceived investors, might give regulators grounds for intervening and pursuing consequences. Or consider a social purpose corporation that selects education as its specific public benefit. If that enterprise represents to the public that its sole priority is the welfare and academic attainment of students, it might be violating truth in advertising or consumer protection laws because of statutory obligations to consider impacts on owner value in its decision making.

If a situation is egregious enough, a state regulator might assert that certain activities exceed the scope of the entity’s authority or ability, which may support enjoining future actions inconsistent with the required priorities, undoing certain actions, dissolving the enterprise, and/or having owners held personally responsible for the entity’s liabilities or forced to disgorge unduly gained profits.

When the prioritized purpose is flexibility, when priorities are contractual, or when fiduciary duties are speculative – in other words, *in most existing social businesses* – the regulator’s efforts to enforce social good as a priority are not likely to succeed or be undertaken at all, provided no one is intentionally misleading others or pursuing their own interests over those to whom they owe a duty of loyalty.

Accountability with Regard to What?

In discussions of social enterprise, “outcomes” and “impact” often seem to be used in conjunction with “accountability” without distinguishing among

the types of accountability – practical, public, or legal – or being clear about that to which accountability is ultimately owed, whether process or results.

Process

Across the spectrum of forms, whether traditional, 501(c)(3), or social, legally enforceable duties of care are to decision-making processes and not to particular outcomes. For it to be otherwise would punish risk taking (even when done responsibly), stifle innovation and expansion, and dissuade service on boards and in management.

For traditional businesses, no one can successfully sue under breach of a fiduciary “duty of care” solely for not selling enough product, not making enough money, or not increasing value to certain levels. Courts do not presume to second-guess informed business decisions made by business leaders in good faith and consistent with the duty of loyalty. They can be sued for not prioritizing owner value, in which case outputs and outcomes might reflect where priorities were placed, but liability is not likely unless it can be demonstrated that decision makers acted in bad faith or elevated personal interests over the company and owners interests – in other words that they breached their duty of loyalty, which is not protected by the business judgment rule (Del. Corp. Code §102(b)(7); *In Re Disney Litigation*, 2006: 751–752.).

Similarly, 501(c)(3) entities and their directors are not (and should not be) held legally accountable for not reducing homelessness or eliminating hunger, not presenting cultural experiences of sufficient quality, not having students achieve their academic potential, not timely preventing or curing enough disease, or otherwise. Applying the “commensurate test” to derive a “community care” standard being applied to 501(c)(3) hospitals might be construed as a type of inputs-based test, but the test focuses on numbers and ratios of demographics served rather than effectiveness of underlying care (IRS Form 990, Sch. H). Some states and local communities have begun defining “charitability” for purposes of property tax exemption as having outcome-like qualities. In both instances, however and without commenting on the merits underlying the test or its application, what is at stake for failing the test is favorable tax treatment rather than individual legal liability.

Legal liability can attach if a 501(c)(3)’s outcomes evidence decision making that deprioritized charitable purposes and prioritized private benefit, but poor outcomes themselves are not alone sufficient for legal liability. Thus, as with traditional businesses, legal liability is essentially impossible to process absent fraud, illegality, impermissible self-dealing, conflict of interest, or bad faith.

As for the emerging social business forms, legal accountability, to the extent it exists, also actually focuses on decision-making processes and not outcomes or impact, absent egregious wrongdoing. Enabling statutes do not independently require success nor do they purport to punish failure, which, again, is as it should be. To impose legal liability for failure to achieve outcomes would create disincentives for people to join or contribute to the efforts of social business forms. Given that one of the purposes of the forms is to encourage more engagement in trying to solve or mitigate social problems (Clark & Vranka, 2012: 27; Tyler et al., 2015: 249), imposing legal liability for outcomes of decisions made in good faith would defeat that very intent.

Outcomes/impact

Outcomes still matter a great deal for practical and public accountability.

Owners care about outcomes, and they hold the people they entrust with managing and operating the business to account for the intended results at any given moment. Ultimately, and as the sole arbiters of practical accountability, a majority of owners can replace decision makers who do not meet owner expectations, whatever those might be.

Outcomes also can still matter for public accountability, as can effort. Employee morale and enterprise culture – and thus productivity – can be shaped by outcomes, efforts and perceptions about purposes, priorities, and success in their pursuit. Opinions and behavior of customers, suppliers, contractors, creditors, media, advocates, antagonists, and others also can be heavily influenced by outcomes.

There are degrees to which the social business forms use the power of brand overall as a means of public accountability so that the forms themselves and the entities that adopt them are recognized as presumed to be “doing good” (Tyler et al., 2015: 260–266). For instance, all benefit corporations are linked because they are “benefit corporations”; therefore, the brand integrity of the form itself matters, especially during these early years as identity and associations are developing. Thus, high profile successful adopters matter just as one or a small group of abusers can damage the whole.

The charitable sector is similar. Public accountability for organizations and the sector are significant. Scandals from a decade ago substantially affected charitable giving and activity for more than the organizations involved. The sector still bears scars despite overwhelming evidence of pervasive compliance, good intentions, constructive execution, and even positive outcomes!

As with the 501(c)(3) sector, public accountability incorporates incentives and means for social businesses and the movement’s adopters to be vigilant

about how individual members contribute to the burgeoning reputations. Of course, vigilance should not be confused with omniscience, which in the name of advancing social enterprise can paradoxically distort public accountability's productive characteristics and damage the very thing purportedly being advanced.

THE “SOCIAL PRIMACY COMPANY”

The preceding analyses expose substantive gaps for those wanting accountability to social good as the priority over owner value. The vehicles that come closest are those modified by contract, but they lack entrenchment, and remedies are limited. The L3C also comes close but is narrowly tailored to furthering 501(c)(3)'s charitable purposes and probably is too easily converted to a traditional LLC (Tyler, 2013a, 2010). The corporate social business forms prioritize flexibility rather than social good and therefore lack the requisite focus or accountability. Table 1 summarizes that discussion and further demonstrates this gap.

If social good is a priority for investors, founders, directors, managers, employees, policy makers, consumers, suppliers, etc., how might gaps be closed?

Consider a “social primacy company” (SPCo) in which priority of purpose is pursuing social good (Tyler et al., 2015: 283, 323, and Appendix A). Of course, the term “social” must be defined, and the litany of options from the benefit corporation's specific public benefit and the social purpose corporation provide as good a start as any.

An SPCo structure would allow a company to make distributable profits an important aspect of the firm but would prohibit the company from prioritizing profits over purpose. Essentially, profits could be no higher than second in priority to “social” purpose when making decisions. Further and unlike any of the existing business structures, an SPCo would make these priorities and ordering explicitly and genetically fiduciary. Not just a matter of contract or being a part of the majority but fiduciary in a way that not only provides internal causes of action and remedies but that might enable the state attorney general to enforce the social purposes as a matter of the entity's essence and authority to exist available under state law empowering statutes.

As in all other forms, decision-maker legal duties in the SPCo would be to processes by which decisions are made rather than to specific outcomes or impact – absent fraud, illegality and duty of loyalty breaches. That is, the

Table 1. Comparing Accountability and Purposes/Priorities Across Forms

ACCOUNTABILITY						
Mechanism					Fiduciary accountability for what?	
Owner		Social pressure	Legal/damages ^a		Loyalty and following process	Outcomes/results
			Fiduciary	Contract		
<i>Profits:</i>	For-profit	For-profit	For-profit	For-profit	For-profit:	
<i>Social good:</i>	Modified for-profit	Modified for-profit	Social primacy company	Modified for-profit?	Social primacy company	
<i>Charitable:</i>	L3C, modified for-profit	501(c)(3), L3C, modified for-profit	501(c)(3) L3C	Modified for-profit?	501(c)(3) L3C	
<i>Flexibility:</i>	Benefit corporation, social purpose corporation, modified for-profit	Benefit corporation, social purpose corporation, modified for-profit	Benefit corporation, social purpose corporation, modified for-profit	Benefit corporation? Social purpose corporation? Modified for-profit?	Benefit corporation, social purpose corporation, modified for-profit	

^aNot addressed are potential causes of action for securities fraud, consumer protection, truth in advertising, and other regimes not dependent on form or structure.

duty is to ensuring that decision makers have enough relevant information upon which to base their decision, that they are free of conflicts of interest, and that decisions are otherwise objectively fair and reasonable. In other words, the same type of business judgment rule that applies in for-profit and non-profit contexts would apply in the SPCo context as well. To approach it in any other way would be to punish reasonable risk taking, inhibit innovation, and discourage participation.

The SPCo's clear priority of social purpose could enhance owner ability to hold directors/managers and other owners to account on duty of loyalty grounds if they pursue financial rewards ahead of the company's stated social purpose(s). Thus, the questions by which to hold the decision maker accountable should focus on whether or not the social purpose guided the decision, not whether or not the social purpose was impacted, at least not for legal accountability. If there is no impact, then the owner(s) can make a different determination as to whether or not the firm is better off with another decision maker(s).

One key way to understand whether decision makers have relevant information and are prioritizing social purposes could be how they approach assessment as a reflection of priorities (Tyler, 2013b). What data and information is the organization collecting? What is it measuring and assessing? Over what periods of time? Using what benchmarks? Compared against what goals and objectives? How are the foregoing data and information incorporated into decision making? These same considerations likely have even more persuasive usefulness for public accountability and for owners, both of which remain relevant for the SPCo.

Public accountability is important for SPCo's outcomes and is likely enhanced by its explicit ordering of priorities. As for practical owner accountability, the SPCo would extend fiduciary duties and priority of social good to owners, who might enforce that priority with only one share or interest. Thus, a single owner might pursue punitive damages, disgorged profits, other equitable relief, and dissenter's rights in the event of a transformation of the company to another form. Of concern is the ability of one owner to cause unnecessary distractions and waste time and other resources.

Just like existing social business and traditional forms, including those formed under 501(c)(3) and state nonprofit laws, the SPCo would not vest (and expressly disclaims) rights of action in third parties. That being said, ordering of priorities could expand how state attorneys general or directly harmed third parties might pierce the corporate veil, characterize breaches as *ultra vires*, and pursue personal liability and other remedies, including disgorged profits.

The SPCo could also address the perverse incentive for an owner to gain financially while enforcing social good. For instance, a minority owner or

director sues to enforce the fiduciary duty to priority of social purposes and wins. Part of the recovery or award could be based on a court assessing punitive damages or disgorging the profits generated by the breach. This could create a moral hazard where the claimant benefits financially from failure to prioritize social purposes. It seems disingenuous at best, if not hypocritical, for that minority owner or director to receive a financial windfall while purportedly acting in the name of enforcing social good. Of course, the person should not be left financially worse off because of successful efforts to enforce social priorities, which means that any award should cover her or his costs and expenses.

Under our proposed SPCo, after finding breach of duty, ascertaining the intended social good, and ensuring that the plaintiff is not financially benefited or harmed, a court might distribute the financial recovery to the SPCo after removing the breaching owners or directors. Alternatively, the court might award the recovery to 501(c)(3) entities or government bodies that most closely serve those intended social purposes. This approach harnesses public accountability by giving charities, the media, and the public incentives to pay attention, identify breaches, and notify state attorneys general (Tyler et al., 2015).

It seems that this type of clarity in priority of purpose and legal accountability would be useful. At a minimum, the SPCo enhances understanding of and discussions about strengths and gaps of existing approaches to social business. That clarity and critical understanding can only help:

- Entrepreneurs seeking capital to fuel social benefit missions.
- Investors who should know whether the priorities they bargained for – social or profit – are enforceable.
- Employees choosing to pursue their passion consistent with their employer's declared mission, especially millennials.
- Customers incorporating social concerns into decisions about what they buy and how much they spend.
- Media reporting on social businesses.
- Policy makers considering how to remove barriers and provide incentives to facilitate social change for the better.

CONCLUSION

Demand for social business structures that enable priority of social purposes has existed for decades, perhaps even over the centuries in some ways. The last decade has been fertile in providing formalized structures as clear alternatives

to profit maximization and shareholder value, including the introduction of flexibility to choose among profits and social interests as a purpose. The last decade has also seen the emergence of public accountability as an innovation in formal accountability. What has not been seen is a business form or structure that formally prioritizes social good over profits with accountability to that priority.

As a result, there has been confusion that has, arguably, inhibited adoption of the forms. Consider that in the five years since Maryland enacted the first benefit corporation statute, there have been over 2 million new companies formed in the United States but only about 4,000 benefit corporations. Perhaps, slow adoption has been due to lack of interest or lack of awareness by founders or investors or their advisors. Perhaps, it is because of confusion about the realities of what the purposes are or can be, what their priorities are or can be, and the nature of accountability thereto. Confusion among regulators and enforcement officials likely contributes to confusion among investors and entrepreneurs, and thus inhibits adoption, because legal risks are not easily assessable and returns are even less projectable than under traditional circumstances.

Perhaps clearer understandings of the purposes being pursued, their priority, and their approaches to accountability will reduce confusion and spur adoption. Having a formalized structure – as one among several alternatives – that unambiguously and clearly identifies and prioritizes purposes and accountability thereto would help both as an option in its own right but also as a juxtaposition to enhance that which is available under other forms.

STATUTES, CASES, AND GUIDANCE

Cal. Corp. Code § 2602.

Del. Code Ann. tit. 8, §§ 366(c)(2) and 102(b)(7) (2015, current through 79 Del. Laws, Ch. 443).

In re Atlas Energy Resources LLC, Unitholder Litigation, C.A. No. 4589-VCN (Del. Ch. Oct. 28, 2010).

In Re: Walt Disney Company Derivative Litigation, 906 A.2d 27, 74 (Del. 2006).

I.R.C. §§ 501(C)(3) and 170(b).

IRS Form 990, Sch. H.

Minn. Stat. Ann. § 304A.201 sub. 1(2) (West, Westlaw through 2014 Reg. Sess.).

Vt. Stat. Ann. tit. 11, § 3001(27)(A) (LEXIS through 2013 Adjourned Sess.).

Model Benefit Corp. Legislation (2014) (hereinafter “MBCL”) at §§ 102, 302(a)(1), 302(b), and 305(c)(iv). Retrieved from http://benefitcorp.net/sites/default/files/documents/Model_Benefit_Corp_Legislation.pdf.

3 Restatement (Second) of Contracts §§ 346 and 357 cmt. A (1981).

NOTES

1. None of the authors have support from any third parties nor do they have any financial interest in or derive financial benefit from the direct applications of their research or publication of this chapter.

2. The MBCL § 102 defines “specific public benefit”: “(1) providing low-income or underserved individuals or communities with beneficial products or services; (2) promoting economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business; (3) protecting or restoring the environment; (4) improving human health; (5) promoting the arts, sciences, or advancement of knowledge; (6) increasing the flow of capital to entities with a purpose to benefit society or the environment; and (7) conferring any other particular benefit on society or the environment.”

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