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Colleagues;

Attached is an abridged version of a paper I presented at a conference at Fordham Law School in March, which critically examined recent developments in nonprofit regulation. I have performed some academic liposuction on the original piece, because I think much of the content would be too old hat to most everyone in this group even though many of your publications and essays are cited. (I know, forget the paper, show me the citations).

I present the part of the paper that looks at two seemingly new approaches, based on some very old ideas. I call this version "Old Wine in New Bottles. The first is an idea of mine to leverage the resources of attorneys general by creating Charity Commissions under the aegis of the AG. These charity commissions hark back to the charity commissions created under the Statute of Charitable Uses to correct fiduciary breaches by trustees of charitable trusts. Modern procedural analogs are attorney and judicial disciplinary panels.

The second "new" approach examines social enterprise organizations, a development given prominence by Google's announcement that it would contribute \$1 billion and 1 percent of its profits over the next twenty years to a for-profit corporation that would invest in socially beneficial projects. In the U.K there has been cabinet level interest and Parliamentary legislation to promote social enterprise corporations, and I discuss the U.K. Community Interest Corporation. Though I am in favor of almost anything that provides more public benefit, I raise several questions critical of the social enterprise movement.

I look forward to seeing you on the twenty-first.

Jim

OLD WINE IN NEW BOTTLES?

James J. Fishman

Presented to the Nonprofit Forum

June 21, 2007

The first parts of this paper suggest several misconceptions that govern thinking about the nonprofit world. It then traces the federal government's intrusion into traditional state matters of nonprofit law, and criticizes that development. In this section I present a proposal to return the locus of fiduciary regulation and oversight to the state level, and then look at supposedly the latest new thing: social enterprise organizations.

Advisory Charity Commissions under the Aegis of the Attorney General

It is doubtful that there will be a substantial increase in funding for enforcement activity at either the federal or state levels sufficient to improve charities' accountability. The only realistic way to increase nonprofit accountability and to create new norms of fiduciary behavior is to leverage existing regulators' efforts by making them more efficient and in a variant of sector-wide self-regulation: use private citizens in the service of state attorneys general.

It is better for the nonprofit sector and for the efficiency of fiduciary regulation for its locus to be at the state rather than federal level. Almost all charities are incorporated at the state level. Historically, fiduciary norms have been matters of state law. Moreover, at the state or local level, regulation will be carried out at a more

meaningful scale if members of the charity's community can monitor, educate, and, where necessary, put into play the legal mechanisms that institute accountability.

Professor Cass Sunstein has suggested that it is probably best to have a presumption in favor of the lowest possible level of government, because it is closest to the people and therefore most responsive to the people and most likely to be trusted.¹ Local efforts are more responsive to our constitutional structure of federalism, which increasing federal regulation of state responsibilities undermines.

This proposal recommends the creation of advisory charity commissions under the ultimate supervision of state attorneys general. The advisory charity commission structure and procedure, which will be set forth below, has some similarity to the commission procedure established under the seminal Statute of Charitable Uses of 1601,² as well as to contemporary lawyer and judicial disciplinary bodies.

Proposed Charity Commission Procedures

Local charity commissions would be the initial filter for citizen complaints about fiduciary or organizational improprieties by charities. The commissions would serve under the aegis of the state attorney general. In states with a substantial number of charities, such as New York or California, charity commissions could be established on

¹ Cass Sunstein, *Social Norms and Social Roles*, 96 Colum. L. Rev. 903, 952 (1996).

² 43 Eliz., c. 4 (1601). The Statute of Charitable Uses was part of the poor law package of legislation that attempted to solve the poverty problem of the time. The prominence of the Statute's preamble, which created parameters for the definition of *charitable*, reflects the law of unintended consequences. The Statute's primary purpose was to provide a mechanism to make trustees accountable for the proper administration of charitable assets.

the basis of state judicial divisions. Thus, New York has four appellate divisions and would have four charity commissions. The charity commissions would be public-private partnerships, which would imbue them with both a legal and moral authority that a wholly private body or state agency could not engender. They could also serve an educational or remedial function more easily than a governmental enforcement agency alone.

Each charity commission would consist of fifteen unpaid citizens, eight appointed by the governor and seven by the attorney general.³ Some members would be individuals experienced in the nonprofit sector or beneficiaries of nonprofit organizations' activities. Others would be recruited from the general public. The chief administrator of each commission would be an assistant attorney general.⁴ Commissioners would be appointed for three year terms, which would be renewable once.⁵

A citizen could complain about a charity or an official of a nonprofit. She would provide to the commission or its staff information to validate the allegations. The commission would have the powers to investigate, hold hearings, and subpoena witnesses and uncover evidence. Thereafter, it could exonerate the charity or individual, resolve the problem by working with the charity, recommend it to a service organization that might provide assistance, or turn the matter over to the attorney general for routine

³ There is precedence for such cooperation. In New York, the governor and attorney general can appoint a deputy attorney general in charge of the Organized Crime Task Force. N.Y. Exec. L. § 70-a(2).

⁴ The attorney general and other agencies could loan officials, but the legislature should appropriate a sum for the maintenance of offices.

⁵ Initially, five commissioners would be appointed for three years, five for two years, and five for one year, thereby creating a board with staggered terms.

prosecution. This remedial function could be the most important effect of the charity-commission process, for cumulatively it could inculcate new sectorwide norms of behavior.

When a complaint comes before the charity commission, a panel of three commissioners, randomly selected, would review the allegations and the evidence. If the charges were in any way colorable, the allegations and evidence would be turned over to the assistant attorney general who would promptly serve a copy of the complaint on the accused organization or individual or any other necessary parties and make a preliminary investigation. The assistant attorney general would determine whether the charity commission or the attorney general should have jurisdiction over the allegations. If she has probable cause to believe the allegations are true, the assistant attorney general would be responsible for initially subpoenaing witnesses and evidence which would be presented to the three-person commission. Allegations of wrongdoing would be heard by the three commissioners, who could dismiss the charge, seek additional information, or place the matter before the full commission.

In the words of Judge Learned Hand, “indictments are calamities to honest men.”⁶ The same words apply to charities. Public investigations are a disaster for a charity’s reputation. Therefore, commission investigations and hearings would be confidential, and a prime role of the charity commissions should be to engage in settlement, conciliation, and remediation if necessary, to remove the force of the allegations. It is assumed that many wrongdoings of charities flow out of nonfeasance or ignorance. The

⁶ U.S. v. Garsson, 291 F.2d 646, 649 (S.D.N.Y. 1923).

three-member commissions could provide direction and assistance in bringing the charity into line with procedures, mandates, or law. Under the resolution process, the charity and the commission would sign a settlement agreement whereby the charity would admit any wrongs, might indicate changes it will make to bring itself into compliance, and would agree to present a report within twelve months of the agreement date, outlining the implementation of the suggested changes. These proceedings and settlement would not be made public.

If a settlement could not be reached or there was probable cause for the allegations, the three-member commissions would decide by majority vote to turn the matter to the full commission for a hearing. The hearing before the full commission should also be held *in camera*. The organization or individual (hereinafter called respondent) might file a written answer and appear with or without counsel. If the respondent failed to appear, a default should be entered and the matter turned over to the attorney general for enforcement.

Upon the conclusion of the hearing by the full commission, the matter could be dismissed or settled, or an order could be issued requiring the respondent to take certain steps to implement compliance, to pay the costs of the investigation, and to provide a report in the manner of compliance. If the commission found the respondent innocent of such charges, it should issue an order dismissing those charges which should also be transmitted to the attorney general. The commission's report should not be made public. If the commission found the allegations were correct and no settlement has been reached

or order complied with, the matter should be turned over to the attorney general who would handle it as part of his normal oversight of charities.

When an individual or an organization has been summoned before a three-member panel or the full commission, it might challenge the presence of any of the commissioners for a conflict of interest. If such conflict was found by the other members of the commission, the particular commissioner must recuse herself from hearing the matter. Annually, the charities commissions should issue a report summarizing the number of matters brought to it and their method of disposition. An underlying assumption of these advisory charity commissions is that local enforcement by citizens in the community is the most efficient and effective method of providing accountability and for providing support and encouragement of the charitable sector.

One of the few interludes in history when there was an effective system of oversight of charities was in the first quarter of the seventeenth century. The charity commission procedure created under the Statute of Charitable Uses⁷ provided that upon complaints by local citizens of fiduciary wrongdoing by trustees of charitable trusts, charity commissions would be empanelled at the parish level to examine the charges. The procedure was developed, because of the inadequacies of the Chancery Court in monitoring charitable abuses. Over 1000 decrees were issued by these charity commissions in the period 1597 to 1625, compared to one or two annually by Chancery.⁸

⁷ 43 Eliz. 1 c. 4 (1601).

⁸ *See*, Gareth Jones, *History of the Law of Charity, 1532–1827* 46-51 (1969).

Attorney and judicial disciplinary committees offer useful current analogies in terms of procedure and the use of private citizens backed by the authority of the state. They invoke a public-private citizen partnership. The public agency in the case of attorney and judicial disciplinary proceedings is the court system. The purposes are similar to the charity commissions: protection of the public, punishing wrongdoing where appropriate, serving an educational or warning function if necessary and improving the reputation of the professional area. These disciplinary committees also protect attorneys and judges against unmerited charges. The hearings are civil in nature, but provide a modicum of due process.⁹

The disciplinary panels are composed of private citizens as well as attorneys or judges under the legal authority of a public official, who in appropriate situations can subpoena, investigate and commence disciplinary proceedings. Attorney and judicial disciplinary bodies have a broad range of remedial powers ranging from dismissal of complaints to the filing of formal charges. Because of the damage to reputation that even an unmerited complaint can bring, the hearings are confidential until probable cause is found. They also serve an educational function for those accused of acts that do not rise to the level of a formal investigation.

Charity Commissions as Catalysts of Changes in Fiduciary Behavior

This proposal will bring an improvement in fiduciary behavior through education, publicity, and the threat of investigation and prosecution. The charity commissions could

⁹ For a more detailed description of how attorney and judicial disciplinary committees work, *see*, James J. Fishman, *Improving Charitable Accountability*, 62 Md. L. Rev. 218, 279-286 (2003).

reach many organizations and their fiduciaries. Its educational functions and the fear of sanction by the attorney general will force many organizations on the behavioral margin, that have been brought to the attention of the commissions, to change their behavior and governance patterns. Most of these fiduciaries will understand their obligations and internalize them.¹⁰ In due course, new social norms will emerge, expressing higher fiduciary expectations. The charity commissions will encourage adherence to the social norm of following fiduciary rules by increasing the possibility of enforcement and extending the reach, though indirectly, of government investigation.

One area where the charity commissions could encourage new patterns of behavior is conflicts of interest. The commissions could encourage fiduciaries to establish conflict-of-interest policies and to sanitize interested transactions by requiring full, not material, disclosure and by encouraging nonprofits not to include the interested directors or officers for voting or quorum purposes. This could be achieved in a simpler, less expensive, and more effective way than the use of traditional federal or state resources, which are in such short supply. First, the organizations brought before the commissions would be taught, encouraged, or sanctioned to obey these rules. Second, cumulative reporting of the commissions' actions would give publicity to the need to deal with conflicts of interest. Most fiduciaries desire to live up to the norms of society, but they have to know what these norms are. Publicity generated by the charity commissions would signify the seriousness of types of fiduciary breaches.

¹⁰ Cf. Robert Cooter, *Expressive Law & Economics*, 27 J. LEGAL STUD. 585, 585–586 (1998).

The proposed charities commissions offer an effective and efficient method of increasing resources of state regulators at a minimum cost and complement federal initiatives. If successful, the charity commissions will signal that they are not principally enforcement arms but remedial bodies which will build trust and encourage people to report serious problems. They will provide a channel for citizen action resulting from increased transparency provided by the Internet. They will leverage the enforcement capacity of the attorney general and return the focus of regulation to a more local level by involving interested citizens. Because of their breadth of remedial powers, charity commissions can educate charities and resolve minor problems. They can offer a partnership between the nonprofit community and regulators which avoids the problems of industry self-regulation that so often turns into self-protection. They will return the focus of fiduciary regulation to the state or local level, where it belongs and should be more effective at less cost to regulators and to charities. It will allow the Internal Revenue Service to do what it does best: ensuring adherence to the federal tax laws.

B. New Structures for Charitable Activity: Social Enterprise Organizations

Thus far, this paper has criticized some assumptions and recent regulatory developments in the nonprofit world. There has been one encouraging development: the emergence of social enterprise organizations, specifically for-profit vehicles committed to philanthropic activity. This section raises some questions and reservations about social enterprise organizations.

Social enterprise firms have been characterized as for-benefit corporations, that inhabit a “fourth sector” of society composed of organizations driven by social purposes and financial promise that fall between traditional businesses and charities.¹¹ The social enterprise movement is based upon the belief that market forces offer a more flexible, efficient and effective approach to promoting the public good than traditional charitable nonprofits, such as private foundations, which are subject to a restrictive regulatory regime. These organizations would not be concerned with the tax issues that envelope traditional charitable activity. They would be fully taxable, can issue shares of stock and return profits for investors, who would be shielded from shareholder attacks for failing to maximize profits.¹² The private sector will be encouraged to invest in social enterprises, because they will derive a financial return while providing a public benefit.

The most recent American catalyst for social enterprise investment was the announcement that the Google Corporation would pledge one percent of the company’s stock worth \$1 billion, and 1% of its annual profits over the next twenty years to invest in businesses with a social purpose.¹³ Initially, Google established a traditional private foundation to which has been committed \$90 million. The second charitable vehicle, Google.org to which most of the support would be given, is a for-profit corporation. There are two important differences between these philanthropic vehicles. The assets of the Google Foundation must remain permanently in the charitable stream. If the

¹¹ See, Stephanie Strom, *Make Money, Save the World: Businesses and Nonprofits are Spawning Corporate Hybrids*, N.Y. Times, May 6, 2007, §3, et al. Government, private and nonprofit sectors are the three.

¹² See, *Dodge v. Ford Motor Co.* 204 Mich. 459, 170 N.W. 668 (Mich. 1919).

¹³ Nicole Wallace, *Blending Business and Charity*, Chron. Phil. Sept. 28, 2006 available at <<http://philanthropy.com/premium/articles/v18/i24/24001401.htm>>; Katie Hafner, *Philanthropy Google’s Way: Not the Usual*, N.Y. Times, Sept. 14, 2006 at A1.

foundation decides to dissolve, its assets remaining after liabilities have been paid must be distributed to another section 501(c)(3) organization.¹⁴ If Google.org dissolves, its remaining assets can be refunded to donor-investors. A second difference is that the Google Foundation cannot return profits or dividends to its donors, whereas Google.org may declare dividends to investors.¹⁵ Other businesses and entrepreneurs, such as private equity funds, have also formed large pools of capital for social purposes outside of charitable tax exempt structures.¹⁶ These “social enterprise organizations,” as they are called, have appeared both in the United States and the United Kingdom.

For-profit public benefit ventures raise several questions. Are they charities? Are they a new phenomenon? Are they more efficient and effective than traditional charities? Are social enterprises permanent entities or merely reflections of transitory stock market success or rising earnings? Should they receive tax benefits? If so, under what circumstances?¹⁷ Do social enterprise organizations live up to their hype?

“Social entrepreneurships” or “social enterprises” are phrases with many

¹⁴ Treas. Reg. § 1.501(c)(3)-1(b)(4).

¹⁵ I.R.C. § 501(c)(3) requires in part that no part of the net earnings of an exempt organization can inure to the benefit of any private shareholder or individual. Charities can pay interest on tax-exempt bonds they have issued.

¹⁶ See, Stephanie Strom, *What’s Wrong With Profit*, N.Y. Times, Nov. 13, 2006 at F1; Jenny Anderson, *A Hedge Fund With High Returns and High Reaching Goals*, N.Y. Times, Nov. 13, 2006 at F14.

¹⁷ For an argument that for-profit entities should receive the same tax advantages as nonprofits, see, Eric Posner & Anup Malani, *The Case for For-Profit Charities* (September 2006). University of Chicago Law & Economics, Olin Working Paper No. 304 Available at SSRN: <http://ssrn.com/abstract=928976> [There is no good argument for making those tax subsidies available only to charities that adopt the nonprofit form.]

meanings, some with almost religious overtones.¹⁸ One definition is that it is an organization for “people who use the techniques of business to achieve positive social change.”¹⁹ The U.K.’s new Office of the Third Sector, a cabinet level office that has promoted a social enterprise initiative, defines social enterprises as “businesses with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximize profits for shareholders and owners.”²⁰ There are programs in social entrepreneurship at leading business schools.²¹

An assumption underlying the use of the social enterprise structure is that because they are for-profit, they will utilize modern business techniques, and therefore will be more efficient and effective than their charitable counterparts. This attitude ignores the fact that many nonprofit organizations use modern business principles to achieve their goals and by any standard are efficient. Correspondingly, many for-profit firms are inefficient. The recognition that philanthropy should not necessarily be attached to a tax exempt vehicle is a salutary development. There is so much that needs to be done. In

¹⁸ “Social entrepreneurs play the role of change agents in the social sector by:
Adopting a mission to create and sustain social value (not just private value),
Recognizing and relentlessly pursuing new opportunities to serve that mission,
Engaging in a process of continuous innovation, adaptation and learning,
Acting boldly without being limited by resources currently in hand, and
Exhibiting heightened accountability to the constituencies served and for the outcomes created.”

J.G. Dees, *The Meaning of Social Entrepreneurship*, available at <http://faculty.fuqua.duke.edu/centers/case/files/dees-se.pdf>. See also, Gordon M. Bloom, *The Social Entrepreneurship Collaborative (SE Lab): A University Incubator for a Rising Generation of Leading Social Entrepreneurs*, The Hauser Center for Nonprofit Organizations, Working Paper 31 (2006).

¹⁹ J. Chio & W. Meehan, *Ashoka: Innovations for the Public (North American Program)* Stanford Case Number SM-64.

²⁰ Office of the Third Sector, *An Action Plan Scaling New Heights*, 10 (Cabinet Office 2006) available at www.cabinetoffice.gov.uk/thirdsector.

²¹ Columbia <www2gsb.columbia.edu/socialenterprise/>; Duke <www.fuqua.duke.edu/centers/case/>; Harvard www.hbs.edu/socialenterprise/; New York University www.stern.edu?berkeley/social; Oxford www.sbs.ox.ac.uk/skoll/; Stanford www.gsb.stanford.edu/csi/; Yale www.pse.som.yale.edu/;

certain areas, such as cross border giving, a for-profit vehicle may have more flexibility and fewer transaction costs than a private foundation.²²

The United Kingdom Approach to Social Enterprise, The Community Interest Company

According to the British government there are an estimated 55,000 social enterprise type organizations in the U.K.²³ Social enterprises are businesses with social objectives whose surpluses are *primarily* reinvested for that purpose in the business or in the community, rather than being driven by the need to maximize profits for investors. Since July 2005, social enterprises firms have had statutory backing and can register as a specific type of corporation, a Community Interest Company (CIC).²⁴ As of April 2007 nearly nine hundred such organizations have been formed.²⁵ What distinguishes the Community Interest Company from Google.org is the permanence of assets devoted to community interest or social enterprise use. There is a statutory lock on a CICs assets, a partial nondistribution constraint.²⁶ The asset lock means that, if upon dissolution there

²² The advantages of social enterprise firms compared to traditional charities are discussed in Robert Wexler, *Social Enterprise: A Legal Context*, 54 Exempt Org. Tax Rev. 233 (2006); *see also*, Rosie Parr, *Charities Showing Interest*, 157 Sol. J. 226 (2007). For a criticism of the social enterprise approach for nonprofits, *see*, Ben Casselman, *Why 'Social Enterprise' Rarely Works*, Wall St. J. June 1, 2007 at W3.

²³ Office of the Third Sector, Cabinet Office, 2006 Social Enterprise Plan available at <http://www.cabinetoffice.gov.uk/third%5Fsector/social%5Fenterprise/action%5Fplan/>. The author wishes to thank Betsy Buchalder Adler for introducing me to Community Interest Companies.

²⁴ Companies (Audit, Investigations and Community Enterprise) Act, 2004, c. 27 (.Eng.).

²⁵ Community Interest Regulator, List of Community Interest Companies, April 2007 available at www.cicregulator.gov.uk/cosearch/companylist/shtml. Previously, social enterprise organizations have existed in a variety of structural formats: companies limited by share or by guarantee without share capital, partnerships, limited partnerships, cooperatives or societies for the benefit of the community. Parr, *supra* note 149 at 226. Companies limited by shares are traditional corporations. A company limited by guarantee is an alternative type of incorporation used primarily for nonprofit organizations that require corporate status. It does not have shares but has members, who are guarantors instead of shareholders. The guarantors give an undertaking, as little as £1, which is the limitation of liability of the guarantors if the company is dissolved. Until the Charities Act of 2006, Companies limited by guarantee were the only incorporated forms available as charities.

²⁶ Companies Act 2004, Part 2 Community Interest Companies § 31; Community Interest Company Regulations 2005, S.I. 2005/1788, ¶ 23. [hereinafter Community Interest Company Regulations].

are residual assets remaining after the payment of liabilities, the assets can be distributed to members or shareholders but only up to the paid in value of the shares held.²⁷ If there are residual assets after distribution to members, the remaining assets must remain in the community interest stream and be distributed to another CIC named in the articles of the company or distributed as the Regulator of Community Interest Companies directs.²⁸

On a continuum CICs are somewhere between for-profit firms and traditional charities. The justification for statutory backing was that until 2006, the purposes for which charities could be formed were more limited than in the United States. Community Interest Companies can be formed for any lawful purpose, but must provide benefit to the community. Their formation is governed by an expansive community benefit test, which is broader than the public benefit test that must be met to be classified as a charity.²⁹ A Community Interest Company will satisfy the community benefit test if “a reasonable person might consider that its activities are being carried on for the benefit of the community.”³⁰ As yet, there are no tax benefits from adopting CIC status.

A major difference between a charity and a for-profit firm is that the latter has the ability to issue shares and declare dividends.³¹ CICs can have shareholding investors and

²⁷ *Id.* at ¶23 (§§ 1-3).

²⁸ *Id.* at §§ 4-11. A CIC cannot distribute assets to members by way of redemption or purchase of shares or reduction of share capital. *Id.* at ¶¶ 24, 25.

²⁹ *See*, Charities Act, 2006, c.50, Part 1 §§ 1-5.

³⁰ Companies Act 2004, Part 2 Community Interest Companies §35(2). “Community “ includes a section of the community, whether in Great Britain or elsewhere. *Id.* at §35(5). The regulations add that for the purposes of the community interest test, any group of individuals may constitute a section of the community if they share a readily identifiable characteristic; and other members of the community of which that group; forms part do not share that characteristic. Community Interest Company Regulations, *supra* note 153 at ¶ 5.

³¹ Companies Act 2004, Part 2 Community Interest Companies § 30.

pay dividends, which are limited by regulation.³² Another distinction is that English charities cannot reimburse board members and managing directors but CICs can.³³

CICs offer the advantages of limited liability. They can engage in more commercial activity than a charity but are less regulated. CICs must file an annual report describing how its activities benefited the community and provide financial information as to dividends, interest paid, and compensation of directors, but the reporting is less extensive than that required for charities.³⁴ The CIC sector is overseen by the Regulator of Community Interest Companies, who has publicly stated that regulation will be by a ‘light touch’.³⁵ While many administrative agencies exercise a light touch or lax oversight, it is rare for a regulator to admit so upfront. Whether light touch means no touch remains to be seen. The Regulator has substantial reserve powers.³⁶

The CIC-social enterprise sector is involved in all parts of the economy. They include local community and business enterprises, environmental and social welfare

³² Community Interest Company Regulations ¶¶ 17-22. The dividend cap regulations are complicated. Basically, the share dividend cap, a maximum rate for determining dividends per share, is a percentage of the paid up value of a CIC share which can be five basis points higher than the Bank of England’s base lending rate. The aggregate dividend cap, a cap for determining the maximum aggregate dividends that can be declared, is set at 35% of a company’s distributable profits. There is also a cap on the interest that can be paid on debt. The Regulator of Community Interest Company can adjust the caps. The members or shareholders cannot vote to amend or remove the asset lock. Tangible assets can be sold but the proceeds must remain asset locked.

³³ Community Interest Company Regulations, *supra* note 26 at ¶¶ 30-33.

³⁴ Companies Act 2004, Part 2 Community Interest Companies § 34. Community Interest Company Regulations *supra* note 153 at ¶¶ 26-28.

³⁵ See, Dept. Trade & Industry, Community Interest Companies: The Regulator of Community Interest Companies 10-11 (2005) available at <http://www.sel.org.uk/docs/cicfactsheet2.pdf>; Regulator of Community Interest Companies: Report to Secretary of State for Trade & Industry: Year to 31 March 2006 (April, 2007). The statute specifies that the “Regulator must adopt an approach which is based on the principle that those powers should be exercised only to the extent necessary to maintain confidence in community interest companies. Companies Act 2004, Part 2 Community Interest Companies § 41(1).

³⁶ These include powers of investigation, audit, civil proceedings, appointment and removal of directors, winding up and dissolution of CICs and transferring assets and shares. Companies Act 2004, Part 2 Community Interest Companies §§ 41-50.

organizations, mutual organizations such as cooperatives, day care and recycling centers, low cost housing or preservation efforts.³⁷ They are particularly useful vehicles for joint projects with units of government.³⁸

The Uniqueness of the Social Enterprise Form

From much of the publicity, one would surmise that social enterprise organizations, like the Google phenomenon itself, are something new. In fact involvement in social benefit activities regardless of the structure of the organization or benefits of tax exemption runs deep in Western history. Most philanthropic activity has been based not upon tax advantage but religious principle.³⁹ It is sometimes overlooked

³⁷ Political activities are not considered for the benefit of the community unless incidental to other activities if a reasonable person would consider them carried on for the benefit of the community. Community Interest Company Regulations, *supra* note 26 at ¶ 4. An activity is not carried on for the benefit of the community if a reasonable person might consider that activity benefits only the members of a particular body or the employees of a particular employer. *Id.* at ¶ 5.

³⁸ Many local government units engaged in redevelopment or providing social services would rather work with a CIC than a charity, because managing directors can be paid a market rate, which is not possible for charities, the assumption being that professional management will be more cost efficient. Interview with Rosie Parr, Solicitor, April 25, 2007.

³⁹ *Deut.* 15:7 [“If there is among you anyone in need, a member of your community in any of your towns within the land that the lord your God is giving you, do not be hard hearted or tight fisted toward your needy neighbor.”]; *Deut.* 15: 10-11 [“Give liberally and be ungrudging when you do so, for on this account the Lord your God will bless you in all your work and in all that you undertake.”]; Matthew 6:1 “Give to him who asks you do not run away”; Matthew 5:41-42 [“Give to everyone who begs from you and do not refuse anyone who wants to borrow from you.”] Bruce M. Metzger & Roland Murphy, ed. Bible (New Revised Standard Version (Oxford 1991); Qur’ān 57:18 [“Lo! Those who give alms, both men and women, and lend on to Allah a goodly loan, it will be doubled for them, and theirs will be a rich reward.”] Qur’ān 2:177 [“Piety does not lie in turning your face to East or West:

Piety lies in believing in God,
The Last Day and the angels
The Scriptures and the prophets,
And disbursing your wealth out of love for God
Among your kin and the orphans,
The wayfarers and mendicants,
Freeing the slaves, observing your devotional obligations,
And in paying the zakat and fulfilling a pledge you have given,
And being patient in hardship, adversity, and times of peril.
These are the men who affirm the truth,
And they are those who follow the straight path.”] *The Meaning of the Glorious Koran trans. By Marmaduke Pickthal* (Everyman’s Library 1992); *See also*, Robert Bremner, Giving 11-20 (2000); Kevin

that the charitable deduction dates only from 1917,⁴⁰ the estate tax from the following year,⁴¹ and the gift tax from 1924.⁴² Though philanthropic impulses of the more affluent today are usually driven by tax considerations, the nearly eighty percent of American taxpayers, those who do not itemize their deductions, give without regard to the tax consequences.⁴³

From a historical perspective social enterprise corporations are nothing new. In England in 1841 the Metropolitan Association for Improving the Dwellings of the Industrious Classes was formed “for the purpose of providing the labouring man with an increase of the comforts and conveniences of life, with full compensation to the capitalist.”⁴⁴ After four years of effort the Association raised shares totaling £20,000. It obtained a royal charter of incorporation to limit liability of the shareholders, “and as a feeling then existed that too large a profit should not be made out of the class of tenants intended to be benefited, the charter limited the rate of dividend to 5 percent.; any

C. Robbins, *The Nonprofit Sector in Historical Perspective: Traditions of Philanthropy in the West*, 13, 14-15, 19-29 in *The Nonprofit Sector: A Research Handbook* 267 (Walter W. Powell & Richard Steinberg, eds., 2d ed. 2006).

⁴⁰ War Revenue Act, ch.63 § 1201(2), 40 Stat. 300,330 (1917).

⁴¹ Revenue Act of 1918, ch. 18, § 403(a)(3), 40 Stat. 1057, 1098 (1919).

⁴² Revenue Act of 1924, ch. 234, §§ 319-24, 43 Stat. 253, 313-316. See, David E. Pozen, *Remapping the Charitable Deduction*, 39 Conn. L.Rev. 531, 537-38 (2006).

⁴³ In 2003, 29.6% of tax returns itemized charitable deductions. AAFRC Trust for Philanthropy, *Giving USA 2005*, at 67 tbl.1 (2005). In dollar terms, itemizers typically account for around 80% of total individual donations. See, e.g., Cong. Budget Office, *Effects of Allowing Nonitemizers To Deduct Charitable Contributions* 6 fig. 1 (2002), available at <http://www.cbo.gov/ftpdocs/40xx/doc4008/12-13-CharitableGiving.pdf>. cited in Pozen, *supra* note 170 at 553. Those who take the standard deduction as a group are poorer but more generous in relation to percentage of income donated compared to more affluent taxpayers.

⁴⁴ Charles Gatliff, *On Improved Dwellings*, 38 J. Statistical Society 33 (1875), reprinted as Charles Gatliff, *On Improved dwellings and Their Beneficial Effect on Health and Morals, and Suggestions for their Extension* 1 (Edward Stanford 1875).

surplus, after providing a guarantee fund not exceeding 15,000 £ to be applied in extension of the object [surplus profits going to expand the organization's operations].”⁴⁵

The Association built blocks of apartments for multi-family occupancy, and was a model for other semi-philanthropic, semi-investment vehicles that were based on business principles. By the 1870s the Association had erected 6,838 dwellings at a cost of £1,209,359 and claimed to have paid for the five years from 1869 to 1874 a dividend of 4 1/2 percent.⁴⁶ Many enlightened factory owners built housing for their employees and received a below market return. There were mixed motives. Efforts to improve employee welfare through decent housing, later pejoratively termed ‘company towns’, tied employees to their jobs.

In 1874 a member of Parliament, U.J. Kay-Shuttleworth, addressed the House of Commons about the work being done in building improved habitations by various Societies and Companies, “some of a philanthropic character, others half philanthropic and half commercial, some of a purely commercial character, many of which were set on foot and are carried on by private individuals who have shown an example for others to follow.”⁴⁷ Urging private developers to invest in renovated housing, because community benefit projects could be profitable he stated:

“Some companies, it must be admitted, have been failures: others have paid very little; but when wisely managed they have set an example which private

⁴⁵ Id. at 2.

⁴⁶ Id. at 14.

⁴⁷ 218 Parl. Deb. H.C. (3rd Ser.)(1874) 1960-1961.

individuals and speculators may follow, for they show that dividends at the rate of 5 per cent. can be obtained.”⁴⁸

The Office of the Third Sector, traces social enterprise organizations back to the Rochdale Society of Equitable Pioneers, one of the early cooperatives, whose principles or rules were widely adopted by the cooperative movement.⁴⁹ One of the principles was payment of limited interest on capital.⁵⁰ There is also a long tradition in the U.K. of cooperative mutual benefit societies. There are two forms of such societies: bona fide cooperatives run by their members as was Rochdale, and community benefit societies, which are run for the benefit of their communities. Recent legislation has allowed these organizations to choose to have asset locks for the benefit of the community.⁵¹

In the United States the phrase “public benefit corporation” is currently used as a synonym for a 501(c)(3) charity, but its original meaning was a for-profit corporation that provided a social benefit.⁵² During the Colonial period business corporations were few and of little importance. Many of the Colonial business corporations would be considered cooperatives or quasi-philanthropic entities today. They were incorporated for the

⁴⁸ Id. at 1963-1964.

⁴⁹ Office of the Third Sector, *Social Enterprise Action Plan: Scaling New Heights* (Cabinet Office 2006) available at

http://www.cabinetoffice.gov.uk/third_sector/documents/social_enterprise/se_action_plan_2006.pdf

⁵⁰ Another principle was that profits would be distributed to each member in proportion to the amount of money expended at the stores. The Rochdale Society of Equitable Pioneers was a group of weavers and other artisans who formed a cooperative in 1844, opening a store that sold food, and developed a series of rules and principles for cooperative organization. Though the Rochdale Pioneers weren't the first cooperative, their principles adopted internationally. See, W. Henry Brown, *The Rochdale Pioneers: A Century of Co-operation* 22 (1944); George Douglas Howard Cole, *The Rochdale Principles: Their History and Application*, 3-6 (Rochdale Memorial Lecture 1947).

⁵¹ Cooperatives and Community Benefit Societies Act, 2003, c.15 §1.

⁵² Early corporate charters, particularly in the recitals of their purposes, emphasized that the corporate purposes were public in the sense of managing and ordering trade as well as the private goal of earning profit for shareholders. See Samuel Williston *3 Select Essays on Anglo-American History* 201 (1909).

purpose of erecting bridges, building or repairing roads, or promoting ends of general public utility.⁵³ They seemed to fit the current definition of social enterprises.

After Independence most states actively encouraged the incorporation of private associations that performed vital public services.⁵⁴ In the beginning of the nineteenth centuries incorporation was by petition to the legislature. Corporate charters were given to those who were thought to be public stewards rather than private ones.⁵⁵ New England led the new nation in the creation of corporations, both for-profit and charitable. The early business corporations were strictly limited in purpose and were expected to serve the public good.

Some Reflections and Further Questions about Social Enterprise Organizations

The CIC reflects a particular need in the U.K. legal landscape because of the restrictiveness of the pre-2006 public benefit test for charities, and the lack of fit for some mutual benefit and social welfare organizations in its tax scheme. One of the advantages of the multi-category I.R.C. section 501 is it provides a tax-exempt home somewhere for most of the organizations that fit under the CIC umbrella. Two major differences between CICs and American social enterprise organizations are the asset lock and the investor's right to receive limited dividends.

⁵³ Joseph Standcliffe Davis, *Essays in the Earlier History of American Corporations* 87, 98, 103 (1917). Other early corporations would be considered mutual-benefit organizations or trade associations such as the marine societies formed for the purpose of bringing together mariners of a particular port. *See generally* Robert Seavoy, *The Public Service Origins of the American Business Corporation*, 52 *BUS. HIST. REV.* 30, 38–39 (1978);

⁵⁴ ROBERT SEAVOY, *THE ORIGINS OF THE AMERICAN BUSINESS CORPORATION 1784–1855*, 255 (1982).

⁵⁵ Peter Dobkin Hall, *A Historical Overview of the Private Nonprofit Sector*, in *THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 4* (Walter W. Powell ed., 1987).

In the United States social enterprises consciously blur the line between charity and for-profit activity. At what point does an investment have philanthropic objectives and when does it become a business decision? Much will rest on whether the project is successful and investors find the activity sufficiently profitable. Determining social benefit is no easy task as nonprofits attempting to qualitatively measure mission success have learned. Social benefit success may take years to achieve or determine by which time circumstances change. Profitable companies backing such efforts may in time suffer losses. Independent companies get taken over, and firm's policies may change.

Let's assume Google is taken over by a private equity firm and becomes Blackstone-Google. In an effort to cut costs and close unprofitable operations, Blackstone-Google revokes the policy of donating the one percent of its profits to Google.Org, and calls in outstanding loans. There is nothing to prevent this from happening. In contrast the Google Foundation would continue to exist, its endowment intact. If it decided to go out of business, any remaining assets would be given to another charity. This is not a hypothetical situation. Ben & Jerry's, the ice cream manufacturer, had a policy of donating to charity a certain percentage of its profits. When the corporation was purchased by Unilever that largesse ended.⁵⁶ In contrast, a corporation whose charitable activities are channeled through a private foundation will give in good times and bad to the annoyance of investors and employees. In 1997 when Boeing laid

⁵⁶ Strom, *Make Money, Save the World*, *supra* note 11. The Body Shop and The And 1 Corporation, which also contributed a percentage of their profits to charity, suffered the same fate when acquired.

off thousands of employees and suffered a \$178 million loss, it still spent \$ 51.3 million on philanthropy.⁵⁷

Social enterprise or for-benefit corporations represent an interesting opportunity to expand philanthropy and good works. They are not charities and do not offer the permanence of the private foundation. A concern about social enterprise activities such as Google.org is whether they will be fair weather donors. Should there be tax incentives to assure or at least encourage that these sorts of ventures remain the course? Should for-profit companies be eligible for program related investments from private foundations? Should there be a trade off of providing tax benefits to such firms in exchange for an asset lock? This could draw them closer to the charity side of the continuum without harming their flexibility.

If social enterprise organizations expand the amount of resources devoted to public benefit, it is all to the good, but it is necessary to keep in mind the limitations of this approach. They are not charities. One should scale down their expectations and remember they are not new structures for nonprofit activity, but old wine in new bottles.

⁵⁷ Marianne Jennings & Craig Cantoni, *Manager's Journal: An Uncharitable Look at Corporate Philanthropy*, Wall St. J. Dec. 22, 1998 at A18.