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Hybrid Entities: Distributing Profits With A Purpose

Heather Sertial

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Hybrid Entities: Distributing Profits With A Purpose

Cover Page Footnote

J.D. Candidate, 2012, Fordham University School of Law; B.A., 2009, Economics, Theology, Fordham University. I would like to thank Professor Amelia Uelmen for her invaluable guidance and for making this Note possible, and my family and friends for their endless support.

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HYBRID ENTITIES: DISTRIBUTING PROFITS WITH A PURPOSE

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*Heather Sertial**

This Note elaborates on the introduction of a new legal structure for organizations known as the “hybrid entity.” A hybrid encompasses aspects of both the for-profit model, to generate revenue; as well as the nonprofit model, to distribute funds to a community in need. The objective of this Note is to offer a structural guide to entrepreneurs who are interested in this new model. This Note first examines the limitations of for-profits that would like to contribute to social goals, as well as the limitations of nonprofits that wish to increase their revenues. This Note then discusses two current statutory models for the hybrid: the Low-Profit Limited Liability Company in the United States, and the Community Interest Company in the United Kingdom. Finally, this note elaborates on a current international movement, known as the Economy of Communion, to enable the reader to visualize the social impact of a hybrid structure. In particular, this Note focuses on the intricacies of how to distribute profits in such a model. The Note concludes by offering the Economy of Communion as one efficient means of distributing profits, and enumerates ways the United States' model can learn from its counterparts abroad.

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INTRODUCTION

Both nonprofit and for-profit organizations in the United States and abroad have achieved various levels of success towards their social goals through traditional legal structures. Nonprofits have generated revenue to provide a range of services to the poor, including healthcare, job training, employment, legal services, and education.¹ Likewise, for-profit firms have generated capital to offer investors attractive stock dividends, with investors making their own contributions to corresponding nonprofits.² Nevertheless, both nonprofits and for-profits alike have faced obstacles in attempting to take these contributions a step further. As a result, some organizations have sought out a different

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1. Hadley Rose, Comment, *The Social Business: The Viability of a New Business Entity Type*, 44 WILLAMETTE L. REV. 131, 136 (2007); see also Michael D. Gottesman, Comment, *From Cobblestones to Pavement: The Legal Road Forward for the Creation of Hybrid Social Organizations*, 26 YALE L. & POL'Y REV. 345, 347 (2007).

2. Rose, *supra* note 1, at 155; Matthew F. Doeringer, Note, *Fostering Social Enterprise: A Historical and International Analysis*, 20 DUKE J. COMP. & INT'L L. 291, 303 (2010).

legal structure that would afford them more flexibility.³ One such solution is the new “hybrid entity, which combines aspects of both nonprofit and for-profit entities.”⁴ Two forms of hybrids that have achieved statutory approval are the Low-Profit Limited Liability Companies (“L3Cs”) in the United States and the Community Interest Companies (“CICs”) in the United Kingdom.⁵ Although scholars have examined the legal structure of these new entities,⁶ there has been limited discussion on how hybrids can effectively distribute their profits.⁷

The purpose of this Note is to explore a possible structure that allows hybrids to distribute their profits. Part I discusses the two “classic” structures from which the hybrid structure emerged: nonprofit and for-profit entities. Part I also outlines the limitations faced by the classic structures in achieving their social goals and introduces the hybrid entity as a response to these limitations. Part I concludes by

3. See Celia R. Taylor, *Carpe Crisis: Capitalizing on the Breakdown of Capitalism to Consider the Creation of Social Businesses*, 54 N.Y.L. SCH. L. REV. 743, 758 (2009/2010) (noting that the hybrid model offers the nonprofit component greater flexibility in generating revenue since for-profits, in issuing stock, can generate profit that the nonprofit may not be able to produce).

4. The “hybrid” seeks to generate a substantial amount of revenue, as for-profits do, and also seeks to distribute a large proportion of these profits for social goals, as nonprofits do. See Dana Brakman Reiser, *Governing and Financing Blended Enterprise*, 85 CHI.-KENT L. REV. 619, 619 (2010) (noting that statutory law is catching up with the blurring lines between nonprofit and for-profit entities in both the United States and the United Kingdom); Doeringer, *supra* note 2, at 292 (noting that even though a “hybrid” has various definitions, it can still be understood to be “any business organization which takes into account human society or the welfare of human beings”); see also Taylor, *supra* note 3, at 756 (noting that there are different names for hybrids, such as B Corporation, fourth-sector businesses, social enterprise, and creative capitalism).

5. See *infra* Part II (discussing the legal structures of L3Cs and CICs).

6. See generally, Reiser, *supra* note 4; Doeringer, *supra* note 2; Taylor, *supra* note 3; Rose, *supra* note 1; Gottesman, *supra* note 1.

7. It is generally agreed upon that a proportion of the profits must be used for investment, and some would be distributed for social purposes, but there is no rigid structure for the division of these profits. See Taylor, *supra* note 3, at 758 (stating that some of the portion of the proceeds from the sales of stock could be given to the nonprofit component); see also Doeringer, *supra* note 2, at 310 (noting that the U.K. defines hybrids as businesses with primarily social goals whose surpluses are reinvested for that social goal either in the business or in the community, instead of for the benefit of the shareholders, as in for-profit entities).

highlighting a new international movement, known as the Economy of Communion, which offers hybrid entities a possible structure for the distribution of profits. Part II provides a statutory analysis of the L3C model in the United States, and the CIC model in the United Kingdom, and argues that these models have provided an insufficient structure for the distribution of profits. Part III suggests lessons that these models can learn from their counterparts across the globe, and argues that the Economy of Communion model for distributing profits is an effective distribution structure that could feasibly be applied to both the L3C and CIC models, enabling them to generate revenue while contributing to social goals.

I. PART I: EXPERIMENT—THE NEW HYBRID

In order to understand why the hybrid movement evolved, and why traditional nonprofit and for-profit models face limitations in achieving their social goals, Section A discusses the legal structures of nonprofit and for-profit entities and analyzes the challenges nonprofits face in generating revenue and the challenges that for-profits face in distributing profits to a group other than the shareholders. Next, Section B examines the rise of the hybrid entity, its objectives and its legal structure. Finally, Section C discusses a new Catholic social thought movement, the Economy of Communion, which also uses the hybrid form to achieve social goals.

A. THE TWO CLASSIC MODELS

1. *The Nonprofit Charity*

a. The United States

While U.S. nonprofit organizations are dedicated to serving a community interest, they face various challenges in generating profits.⁸

8. Taylor, *supra* note 3, at 752 (noting that because nonprofits are barred from generating profits they are prevented from taking maximum advantage of the power of the market, even though this impediment has been reduced over time by nonprofits linking themselves to for-profit ventures); *see also* Doeringer, *supra* note 2, at 297 (noting that nonprofits seeking to pursue commercial activities can create obstacles in receiving tax benefits, since nonprofits must meet certain regulation to maintain their tax-exempt status).

For example, in the United States, the defining characteristics of a nonprofit are that the organization is exempted from federal income taxes and able to receive tax-deductible grants.⁹ In order to maintain this tax-exempt status, nonprofits must meet the requirements of various regulations if they attempt to generate profits, namely those of the Internal Revenue Code (“I.R.C.”).¹⁰ For the purposes of this Note, the most important sections of the I.R.C. that detail the requirements of a nonprofit organization are the following: (1) it must be operated exclusively, (2) for an exempt purpose, and (3) profits cannot be used for private or shareholder interest.¹¹ The section posing the most difficulty to nonprofits seeking to generate profits is the “operated exclusively” requirement.¹² The exclusivity test may appear to mean that nonprofits cannot pursue profits unless the business activity is *wholly* directed toward the exempt purpose, however, the exclusivity test actually means that only an *insubstantial* part of the nonprofit’s activities can be in furtherance of a non-exempt purpose.¹³ Nevertheless, determining what level of business activity constitutes an “insubstantial” amount remains a challenge, and exceeding that amount can cause the nonprofit to forego its exempt status.¹⁴ In addition, even if the nonprofit satisfies all the requirements in conducting for-profit activity, it still

9. Doeringer, *supra* note 2, at 296-97; *see also* Taylor, *supra* note 3, at 753 (noting the constraints stemming from the Internal Revenue Code requirements if the nonprofit wants to maintain its tax-exempt status and add for-profit activities).

10. Section 501(c)(3) of the I.R.C. sets out the basic criteria for tax-exempt status for an organization, which is essentially to be organized and operated exclusively for an exempt purpose identified by the Internal Revenue Services, specifically “religious, charitable, scientific, testing for public safety, literary, or educational” purposes, and where earnings *cannot* be used to benefit any private shareholder or individual. I.R.C. § 501(c)(3) (2006).

11. *See id.*

12. Taylor, *supra* note 3, at 753 (noting that this requirement is a more serious concern than the other sections of the statute, if the nonprofit seeks to engage in business activities).

13. *See* Taylor, *supra* note 3, at 753 (noting that when engaging in for-profit activities, the entity must operate primarily for one or more exempt purposes, and under the operational test, only an insubstantial part of activities can be to further a non-exempt purpose); Doeringer, *supra* note 2, at 298 (stating that substantial commercial activity is allowed as long as it furthers the organizations exempt purpose).

14. Taylor, *supra* note 3, at 753; *see also* Doeringer, *supra* note 2, at 298 (noting that it is unclear where the boundaries are that allow an entity to engage in commercial activity and still remain a nonprofit, and that courts have not offered any certainty).

must pay an unrelated business income tax (“UBIT”), which attaches to all business activity that is not substantially related to the nonprofit’s exempt purpose.¹⁵ This tax poses a further disincentive for nonprofits to engage in for-profit activity.¹⁶

Another challenge that nonprofits face in engaging in business activity in the United States is their limited ability to access capital, since they are prohibited from distributing profits to individuals who exercise control over the company.¹⁷ Thus, since nonprofits are barred from equity capital markets and generating a return for investors, nonprofits must rely primarily on grants and donations for their survival, which are often insufficient to further their social goals.¹⁸ Some argue that nonprofits should rely on foundations, or increase their external funding to qualify for Program Related Investments (“PRIs”), which are financial instruments created by the foundation to generate a return for the foundation from the nonprofit entity in which it invests. The primary goal of PRIs is the furtherance of the foundation’s missions.¹⁹ This seems to follow the for-profit model more closely, and is a way for nonprofits to generate returns.²⁰ The problem however, is that PRIs are

15. See I.R.C. § 513(a).

16. Taylor, *supra* note 3, at 754 (noting that the requirement to pay UBIT adds to costs and complexities, thus discouraging nonprofits from engaging in for-profit activity); see also Doeringer, *supra* note 2, at 300 (noting that UBIT serves as a serious restriction on the nonprofit’s activities).

17. Taylor, *supra* note 3, at 754 (“Law prohibits nonprofits from ‘distributing profits, or net earnings to individuals who exercise control over them, such as its directors, officers or members.’”) (quoting Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 501 (1981)).

18. See Doeringer, *supra* note 2, at 301-02; Taylor, *supra* note 3, at 754 (noting that nonprofits remain primarily dependent on grants and donations for survival, without which they must pay high costs for capital).

19. See Taylor, *supra* note 3, at 754 (explaining that PRIs are one way for nonprofits to receive external funding without engaging in for-profit activities); see also Gottesman, *supra* note 1, at 349-50 (“PRIs, which are investments, primarily in the form of loans, in for-profits that help accomplish the foundation’s goals.”); see also Thomas J. Billitteri, Aspen Institute, Nonprofit Sector Research Fund, *Mixing Mission and Business: Does Social Enterprise Need a New Legal Approach? Highlights from an Aspen Institute Roundtable 5* (2007), available at http://www.community-wealth.org/_pdfs/news/recent-articles/04-07/report-billitteri.pdf (noting that a PRI might be a loan, loan guarantee, or even an equity investment in a commercial enterprise that has a charitable purpose).

20. Taylor, *supra* note 3, at 754 (noting that PRIs would model the for-profit model more closely by offering foundations financial and programmatic returns); see also

not widely used.²¹ PRIs require complex documentation which increases legal and administrative costs, and they do not have a coordinated market which limits the ability of smaller foundations to enter the field.²² Furthermore, PRIs must assume the risk of evaluating and monitoring the legitimacy and performance of the nonprofit entity, and the foundation can incur penalties via excise taxes if the IRS decides an investment is not in furtherance of the foundation's goals.²³

b. The United Kingdom

The nonprofit legal structure in the United Kingdom (U.K.), known as a charity, is similar in many ways to that of the United States.²⁴ Similar to the United States, U.K. charities can engage in a limited amount of commercial activity, but only if the activity directly furthers the entity's charitable purpose beyond simply raising funds.²⁵ If the charity wants to raise more than an insubstantial amount of commercial activity, it must set up a separate limited liability company²⁶ called a "trading company," and that company's profits can then be donated to the charity.²⁷ The difficulty is that the trading company cannot give beyond its surplus because doing so increases administrative costs, and it will face complications in adhering to regulatory requirements.²⁸ Recognizing these limitations on hybrid activity, the Social Enterprise

Doeringer, *supra* note 2, at 316 (noting that PRIs create the possibility of raising a significant amount of capital for hybrid entities).

21. Gottesman, *supra* note 1, at 350 (observing that in practice, nonprofits rarely make PRIs).

22. Taylor, *supra* note 3, at 755.

23. See Billitteri, *supra* note 19, at 5-6 (noting that foundations rarely make PRIs because of the strict limitations placed on them, such as incurring penalties if the IRS decides an investment is inconsistent with the foundation's mission); see also Gottesman, *supra* note 1, at 350 (contending that one reason why nonprofits do not make PRIs is because they fear they will be subject to excise taxes if they make an investment in a for-profit that the IRS decides is not in furtherance of the foundation's goals).

24. See Doeringer, *supra* note 2, at 311.

25. *Id.*

26. These are similar to Limited Liability Companies in the United States. See *infra* note 36 and accompanying text.

27. Doeringer, *supra* note 2, at 311.

28. *Id.* at 312.

Unit recommended to Parliament that the government create a new business entity geared towards the needs of hybrid activity.²⁹ This was the CIC, discussed in Part II.B

2. The For-Profit Firm

a. The United States

United States for-profit firms have a legal duty to maximize shareholder profits, so if tensions arise between maximizing profit and maximizing public benefit, directors are legally obliged to choose profit over public benefit.³⁰ This is expressed in *Dodge v. Ford*:

A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself. . . .³¹

Therefore, the “shareholder profit maximization” duty may make it difficult for corporations when they act to promote the social good.³² The challenge faced by for-profits is that while they can generate profits, for-profits have difficulty committing to a social mission.³³ For example, a for-profit may want to act for the social good by giving donations, either to boost employee morale, or to gain public approval.³⁴ It is

29. *Id.*

30. Gottesman, *supra* note 1, at 350.

31. 204 Mich. 459, 507 (1919).

32. See Doeringer, *supra* note 2, at 304 (“[T]here still remains the risk of shareholder derivative suits if profits are not reinvested to create economic gains or distributed to the shareholders. Consequently, the social enterprise’s interest in reinvesting profits toward social purposes could easily be viewed as conflicting with the shareholders’ interest of increasing the economic return on their shares.”).

33. Gottesman, *supra* note 1, at 350 (“[T]he primary problem for-profits face in our binary legal system is an inability to commit themselves to achieving social goals.”); Taylor, *supra* note 3, at 747 (“The profit-maximizing, shareholder-primacy model of corporate law leaves little room to consider how corporations might act to promote the social good.”).

34. See, e.g., *A.P. Smith Mfg. Co. v. Barlow*, 98 A.2d 581, 585-86 (N.J. 1953) (holding that a New Jersey pipe manufacture company could make donations to Princeton University even though this was not recognized in the company charter). The

arguable that corporations can fulfill their desire to act for the social good by raising revenues and then giving donations or grants to the charitable purpose.³⁵ Yet a limitation to this theory is that donations exceeding ten percent of profits are taxed at the corporate income tax rate, giving corporations a disincentive to donate large or “unreasonable” amounts.³⁶

It can also be argued that the limited liability company (“LLC”), another for-profit entity form distinct from a corporation, can be used as a business vehicle to further social goals, as opposed to use of a hybrid entity.³⁷ For example, in most jurisdictions, including Delaware, LLC law allows the company to establish voting interests in any manner the company chooses, and does not require the LLC to comply with the standards of publicly traded corporations (if they do not trade publicly).³⁸ Furthermore, under Delaware law, LLCs can eliminate fiduciary duties of owners and members in their charters to one another, the entity, or third parties, making it possible for the LLC to state in its operating agreement that its mission is social good, not profit-

Barlow court reasoned that as long as there was some benefit to the company—in this case local recognition might bring the company more business—activity outside shareholder primacy must be allowed. *Id.*

35. See *Doeringer*, *supra* note 2, at 304 (noting that for-profits can donate to corresponding charities, and are allowed tax-deductions for up to 10% of their profits); see also I.R.C. § 170(c)(2)(A)(2006).

36. See *Doeringer*, *supra* note 2, at 304 (noting that donations to charity above 10% are taxed at the corporate income tax rate. Although state laws do not restrict donations to this 10% level, the laws are interpreted to authorize only “reasonable” giving. Courts have applied the 10% level from the tax code, thereby providing some guidance to determine if a charitable gift is “reasonable” and amounts to actionable corporate waste); see also *Billitteri*, *supra* note 19, at 3 (“The charitable activities of many commercial firms suggest that in the absence of discriminatory tax treatment, for-profit charities would flourish.”) (internal quotations omitted).

37. Taylor, *supra* note 3, at 751 (noting that LLCs offer a great deal of flexibility to create any management structure preferred); DEL. CODE ANN. tit. 6, § 18-1101(b) (2011) (“It is the policy of [Delaware’s LLC statute] to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.”).

38. DEL. CODE ANN. tit. 6, § 18-301(d) (non-economic ownership interests); *id.* § 18-302(a) (voting interests); Taylor, *supra* note 3, at 751 (“LLCs need not comply with federal regulations and standards imposed upon publicly traded corporations or the listing standards of the various exchanges if they do not trade publicly.”).

maximization.³⁹ Nevertheless, the LLC model may still be seen as an unattractive vehicle to further social goals since LLCs will not receive the tax advantages that nonprofits receive, and the complete elimination of fiduciary duties, though permitted, has yet to be tested.⁴⁰ Indeed, the LLC model was not traditionally intended to allow businesses to actively advance social good.⁴¹ It therefore stands to reason that a straight LLC model may not be the best model to organize a business with the purpose of advancing a social good.⁴²

b. The United Kingdom

The United Kingdom also has a similar for-profit structure to the United States.⁴³ United Kingdom Company Law is similar to U.S. Corporate Law,⁴⁴ insofar as the main goal for a U.K. company is profit-maximization.⁴⁵ The most recent form of company law, the limited liability partnership (“LLP”), was passed in 2000.⁴⁶ The structure of the LLP adopts elements of existing rules and principles of both partnership

39. See DEL. CODE ANN. tit. 6, § 18-1101(c).

40. Taylor, *supra* note 3, at 752; see also Craig Langstraat & Dianne Jackson, *Choice of Business Tax Entity after the 1993 Tax Act*, 11 AKRON TAX J. 1, 5 (1995) (noting that LLCs were designed to combine pass-through attributes of the partnership and limited liability).

41. See Langstraat & Jackson, *supra* note 40, at 6 (reasoning that while the model may be flexible enough to accommodate such ventures, there may be problems of identifying the goals of any particular LLC, which would cause confusion as to which are the traditional LLCs and the socially intended LLCs. This would blur clarity in the marketplace, an important tool when advancing social good); see also Taylor, *supra* note 3, at 752.

42. See Taylor, *supra* note 3, at 752.

43. See Doeringer, *supra* note 2, at 311 (noting that before passage of the CIC into the U.K. Companies Act, the options in the United Kingdom were similar to those available in the United States: limited companies and charities).

44. Compare Companies Act, 2006 (Eng.), with DEL. CODE ANN. tit. 8 (2011).

45. See Stuart R. Cross, *The Community Interest Company: More Confusion in the Quest for Limited Liability?*, 55 N.I.L.Q. 302, 305 (2004) (“[C]ompanies legislation was not designed with the needs of smaller scale community-based social enterprises in mind [T]he company ‘brand’ is almost exclusively associated with profit-making.”); see also *supra* notes 30-32 and accompanying text (citing to *Dodge v. Ford*, which legalizes the “shareholder profit maximization” duty on behalf of directors).

46. *Id.* at 302. The LLP is only available for use by those carrying on business in the United Kingdom, therefore making it unavailable for not-for-profit organizations. See *id.* at 303.

and company law in the United Kingdom.⁴⁷ The LLP was thought to be able to suit social enterprise efforts, but this proved inadequate.⁴⁸ Therefore, with company law leaving its owners with the primary responsibility of profit-maximization, the U.K. government saw it appropriate to form the CIC, discussed in Part II.B.⁴⁹

B. THE HYBRID ENTITY: OBJECTIVE AND LEGAL STRUCTURE

The characteristic that distinguishes the hybrid entity from the classic models discussed above is its purpose. While hybrids do ordinarily work within the capitalist structure by operating a business, their goals are not purely financial and their primary duty extends beyond serving shareholder interest.⁵⁰ Their purpose is to succeed financially *and* to do good for the community.⁵¹ Therefore, the hybrid provides a helpful structure to meet the needs of organizations with broader purposes.⁵²

47. *Id.* at 304.

48. *Id.* at 302 (“The UK Company Law Review (CLR) also sought to make the limited liability company more attractive to smaller businesses.”); *id.* at 304 (noting that the LLP is inherently corporate in nature, and thus the process of adopting a corporate character for the LLP intertwined with partnership law principles gives rise to a potential weakness in the LLP).

49. *See id.* at 306 (reasoning that the establishment of the CIC, drawing on company law but with additional constraints and features, makes it suitable for small scale, community-based nonprofit social enterprises familiar with the company form).

50. *See* Billitteri, *supra* note 19, at 4 (“[H]ybrid groups typically work within the capitalist system, earning income and operating in a businesslike manner, but their goals are not purely financial and their duty is far broader than serving just the interests of shareholders.”); *see also* Doeringer, *supra* note 2, at 293 (defining hybrids as entities who operate in the commercial sector, but whose core interests are traditionally associated with the nonprofit sector).

51. *See* Billitteri, *supra* note 19, at 4 (“[T]hey strive not only to succeed financially but also to do good, using a blend of traditional corporate methods and progressive social approaches such as sharing governing power with employees and community members and hewing to rigorous outcome standards.”); *see also* Doeringer, *supra* note 2, at 292 (noting that hybrids are business organizations, but they also take into account the welfare of human beings).

52. An example of this could be nonprofits that want to pursue commercial activities, or for-profits that want to contribute to social goals on a greater level. *See* Billitteri, *supra* note 19, at 8 (“[T]here is a considerable gap between what people want from the organizations they interact with as stakeholders and what they are actually getting. Required are new organizational models that can do a better job of meeting

Although the exact structure varies among firms, hybrid models ordinarily connect the goals of a for-profit corporation and a nonprofit charity.⁵³ One example of a well-known social enterprise is Google.org, which is a for-profit company that is also dedicated to social benefit.⁵⁴ Google.com funded Google.org with a grant of three million shares, and has pledged to contribute one percent of its annual profits to Google.org.⁵⁵ What is unique about Google.org is that, in addition to funding grants to support social causes, it also makes for-profit investments, which encourages employees to participate directly in furthering changes in company policy.⁵⁶ While Google.org's structure may vary from other hybrids, it serves as a good example of a for-profit company that takes social issues into consideration.

people's needs under these new and unprecedented circumstances.") (internal citation omitted).

53. Taylor, *supra* note 3, at 756; *see also* Gottesman, *supra* note 1, at 345 (noting that the hybrid expresses the efforts that for-profits and nonprofits have made to converge upon a middle ground).

54. Taylor, *supra* note 3, at 757 (observing that Google.org is a for-profit company, with the declared purpose of taking on social issues); *see also* Gottesman, *supra* note 1, at 345-46 (noting that Google.org is legally classified as a for-profit, but acts like a nonprofit foundation by making grants to organizations to address social issues).

55. Explaining their rationale for this, the founders of the company stated that "we will be better served – as shareholders and in all other ways – by a company that does good things for the world even if we forego some short-term gains." Taylor, *supra* note 3, at 757 (quoting Larry Page & Sergey Brin, Amendment No. 9 to Registration Statement (Form S-1), Letter from the Founders: "An Owner's Manual" for Google Shareholders (Aug. 18, 2004)) (noting that Google.com has committed \$75 million in investments and grants, a grant of three million shares, and one percent of its annual profits, to Google.org); *see also* *About Us: What is Google.org?*, GOOGLE.ORG, <http://google.org/about.html> (last visited Apr. 9, 2011). A grant of shares is a restricted stock award by a company to an individual (usually an employee) that requires either no or a nominal payment by the recipient. *Definition of Restricted Stock*, MIMI.HU, http://en.mimi.hu/stockmarket/restricted_stock.html (last visited Apr. 9, 2011).

56. Taylor, *supra* note 3, at 757 ("Google.org is untraditional in that it also makes for-profit investments, encouraging Google employees to participate directly and lobbying public officials for changes in policies."); *see also* *About Us: What is Google.org?*, GOOGLE.ORG, <http://google.org/about.html> (last visited Apr. 9, 2011).

1. Purpose Behind the Economics: Economy of Communion Project in Italy and Brazil

a. Background and History

As later discussed in Part II, many of the statutory requirements to form these hybrid entities require a “charitable or educational” purpose.⁵⁷ Indeed, many statutes state as a requirement that “but for the charitable purpose, the company would not have been formed.”⁵⁸ Such a prerequisite directly relates the purpose of the entity to the distribution of profits, as a portion of the profits would be re-distributed to the charitable purpose. This relationship can be more clearly illustrated with an examination of the Economy of Communion (“EoC”), a social movement focused on companies and raising revenue to further social good.⁵⁹

The EoC emerged as a project within the *Focolare* Movement, which traces its origins to Trent, Italy during World War II (hereinafter “the Movement”).⁶⁰ By 1943, the prolonged warfare had devastated the industrial and agricultural infrastructure of Italy, leaving many in severe poverty.⁶¹ When Trent was heavily bombed, many lost their homes and their loved ones.⁶² Chiara Lubich, the founder of the Movement, and her friends tried to respond to the immediate needs of the people and relieve their suffering by living out the Christian message of helping others.⁶³

57. See *infra* Parts II.A (discussing L3Cs), II.B (discussing CICs).

58. See VT. STAT. ANN. tit. 11, § 3001(27)(A)(ii) (2011). To date, there has not been any significant case law concerning this statute.

59. See *infra* notes 72, 76-77 and accompanying text (describing the social goal behind generating profits in the EoC model).

60. See LORNA GOLD, *NEW FINANCIAL HORIZONS: THE EMERGENCE OF AN ECONOMY OF COMMUNION* 40 (2010) (observing that the origins of the Movement can be traced back to the city of Trent, during the Second World War); see also THOMAS MASTERS & AMY UELMEN, *FOCOLARE: LIVING A SPIRITUALITY OF UNITY IN THE UNITED STATES* 24 (2011) (noting that the first Focolare house emerged out of a response to WWII disasters).

61. See GOLD, *supra* note 60, at 41 (characterizing the severe poverty, brutality, and suspicion by neighbor and friends in northern Italy in 1943, which led to the destruction of many communities); see also MASTERS & UELMEN, *supra* note 60, at 24 (noting that air raids destroyed neighborhoods and homes).

62. See *supra* text accompanying note 60.

63. See GOLD, *supra* note 60, at 41-42; see also MASTERS & UELMEN, *supra* note 60, at 24-25 (noting that Chiara and some of her friends did not escape to the mountains

Although she had no intention of starting an organization of any kind, what emerged was an inter-faith and multi-cultural global movement, grounded in values that are common to all, such as increasing love, peace, and understanding.⁶⁴ For her various contributions to building a culture of dialogue and understanding between people of different religions, social classes and ethnic backgrounds, Lubich has been awarded numerous honorary degrees and appointed an Honorary President of the World Council for Religions for Peace in 1997.⁶⁵

The meaning of the word “*focolare*” has an interesting relation to the Movement at large. There are four translations for the Italian word *focolare*: “hearth,” “fireside,” “furnace,” and “home,” meaning more than just a home, but the most intimate image of family, love, security, and warmth.⁶⁶ Thus, it is no coincidence that *focolare* became the title of a global movement that promotes peace and unity in the world.⁶⁷ At the root of the Movement, is a commitment to treating everyone as “family,” as a way of uniting people to one another to work as a community to further social good.⁶⁸

with family, but instead lived in a small apartment and sheltered others who were forsaken).

64. See GOLD, *supra* note 60, at 59 (noting that although the Movement is most developed in Italy, Brazil, Argentina, and the Philippines, all countries with a high population of Catholics, the Focolare “is not the exclusive domain of Christians, [but] . . . has brought about a greater understanding between peoples of different religious traditions . . . who translate the basic principles of love into their own theological traditions”); see also MASTERS & UELMEN, *supra* note 60, at 34 (noting that inter-faith dialogue has developed with Buddhist, Hindu, Muslim and Jewish friends).

65. See GOLD, *supra* note 60, at 39; see also MASTERS & UELMEN, *supra* note 58, at 35 (recognizing Lubich’s honorary citizenships in various countries).

66. GOLD, *supra* note 60, at 51; see Amelia Uelmen & Luigino Bruni, *Religious Values and Corporate Decision Making: The Economy of Communion Project*, 11 FORDHAM J. CORP. & FIN. L. 645, 647-48 (2006) (“Focolare was the nickname given to the initial group because of the warm family-atmosphere that people found at the first informal gatherings.”).

67. GOLD, *supra* note 60, at 39 (noting that it was not a coincidence that *focolare* became the first nickname and eventually title of the Economy of Communion Project); see also Uelmen & Bruni, *supra* note 66, at 648 (noting that the Movement’s specific aim is to work for unity within the Church for relationships of peace and understanding between people of different religions, cultures, and social backgrounds).

68. See GOLD, *supra* note 60, at 40; see also Uelmen & Bruni, *supra* note 66, at 648 (noting that the Movement’s early lifestyle reflected a profound cultural intuition—that the essence of human experience is to be “in communion.”).

The Focolare began as a small scale project, but was spread throughout the world by word of mouth and seemingly chance meetings, as well as through the example of people involved in the Movement.⁶⁹ For example, the Movement spread to Brazil after a member of a religious order from Recife, Brazil visited Italy and met with members of the Movement in 1957.⁷⁰ Since then, the Movement has disseminated throughout Brazil, and has generated over one hundred social welfare projects.⁷¹

Soon enough, however, the *Focolare* founders realized that a simple sharing of material goods and resources was no longer a sufficient strategy to overcome the unequal distribution of wealth on a global scale, and the idea emerged to extend into the business and industry realm to meet the needs of beneficiaries on a larger level.⁷² This “superior communion of goods” is now known as the “Economy of Communion,” and officially originated in 1991 in Sao Paulo, Brazil, and later spread worldwide.⁷³ Brazil is the second largest economy to consist of EoCs, with 84 businesses (11%).⁷⁴ Italy is the largest, having 242

69. See GOLD, *supra* note 60, at 42-43 (noting that the Focolare spread through Brazil almost by chance meetings and personal contacts in the 1950s, and its spread in Brazil epitomizes the spread of the Movement in many countries); see also Uelmen & Bruni, *supra* note 66, at 649 (noting that Lubich was touched by Brazilians’ strong desire to have a more effective impact on the social problems in the country).

70. See GOLD, *supra* note 60, at 42-43 (noting that the monk started the same Movement when he returned to Brazil. Several Focolare followers gave up their modest standard of living and actually decided to live in the shacks similar to those in Recife, Brazil, giving what they had to the poor of the village and treating them as their equals. Eventually, they were able to convince the authorities to build a basic infrastructure on the island, and now the village has a school, health center, a pediatric hospital, a sewing workshop, and a brick factory).

71. GOLD, *supra* note 60, at 43.

72. GOLD, *supra* note 60, at 84-85; see also Uelmen & Bruni, *supra* note 66, at 649 (noting that Lubich reflected on starting normal, for-profit businesses to increase employment and create profits).

73. GOLD, *supra* note 60, at 36; see also Uelmen & Bruni, *supra* note 66, at 649 (noting that *Focolare* spread throughout the globe).

74. GOLD, *supra* note 60, at 92-93; see also Luigino Bruni, *Economy of Communion: Between Market and Solidarity*, in CATHOLIC SOCIAL THOUGHT: TWILIGHT OR RENAISSANCE 241-42 (J.S. Boswell & F.P. McHugh eds. 1999) (noting that as of 1999, 761 firms belonged to the EoC project, including 246 in Italy, 172 in Western Europe, 60 in Eastern Europe, 45 in North America, 49 in Central America,

businesses (33%), Germany follows with 84 businesses (7%), and the United States (5%).⁷⁵ *Focolare* followers created a “culture of giving,” forming small commercial businesses that distributed profits to the poor, while keeping enough to sustain the businesses.⁷⁶ New possibilities emerged out of starting normal, for-profit businesses, which could increase employment opportunities and create profits.⁷⁷ Twenty years later, 700 businesses worldwide follow the EoC Model.⁷⁸ Most are small and medium in size, but some have more than one hundred employees, and they consist of various sectors in production and service.⁷⁹ The United States alone has about forty-five EoCs, including an import-export business, a law office, an accounting firm, an environmental consulting firm, a tutoring business, a violin shop, an apparel labeling shop, a goat farm, several restaurants and a chocolate factory.⁸⁰

b. A Model for Distributing Profits

In addition to uniting people to further social good and creating a “culture of giving,” the EoC also presents a unique approach to the distribution of profits.⁸¹ The profits from an EoC business are generally split into three parts, according to the discretion of the business: the first

and 82 in Brazil). Differences between the two preceding sources may be attributed to different time periods.

75. GOLD, *supra* note 60, at 92-93.

76. GOLD, *supra* note 60, at 36, 85; *see also* Bruni, *supra* note 74, at 240 (noting that the “culture of giving” is a practical way for sharing the communion of goods among all members).

77. *See* Uelmen & Bruni, *supra* note 66, at 649-50; *see also* Bruni, *supra* note 74, at 240 (noting that businesses, new and existing, have adhered to this project by changing the way they operate their business).

78. Uelmen & Bruni, *supra* note 66, at 650 (noting that as of 2006, there are over 700 businesses that follow the EoC model); *see also* Bruni, *supra* note 74, at 241 (noting that as of 1991, there are 761 firms that belong to the EoC project).

79. Uelmen & Bruni, *supra* note 66, at 650; *see also* GOLD, *supra* note 60, at 103-04 (explaining that EoCs operate within a number of sectors in the economy, including production/manufacturing, services, and retail sales).

80. Uelmen & Bruni, *supra* note 66, at 650-51 (naming some of the 45 EoC businesses in the United States, as of 2006); *see also* GOLD, *supra* note 60, at 106 (noting that there are over 50 businesses with an EoC structure, as of 2010).

81. *See generally* GOLD, *supra* note 60, at 88-94 (noting that the desire to generate profits to share became one of the chief motivations behind starting up new businesses); *see also* Uelmen & Bruni, *supra* note 66, at 650 (noting that a structure based on this purpose could divide profits into three equal parts).

part is given to the materially poor, often directly linked to *Focolare* networks; the second part is kept in the firm for reinvestment; and the third part is used to sustain elements of infrastructure which promote and preserve what is known as the “culture of giving,” including programs for education and formation to help people live according to its values.⁸² After the owner decides how much he or she wants to reinvest in the company, the rest of the profits can be split equally between assisting those in need, and shaping activities for a culture of giving.⁸³ In order to insure that the needs of the materially poor within *Focolare* communities are met, since 1994, profits from EoC businesses have been supplemented by personal donations from *Focolare* members.⁸⁴ Thus, this division of profits can be seen as a useful model for any business with a charitable purpose for reasons discussed in Part III.⁸⁵

Notably, participation in the EoC and sharing profits is entirely voluntary among business owners and shareholders.⁸⁶ Neither group has any legal obligation to give a portion of their profits to the EoC, but rather a decision to share the profits has to come from the people within the business itself.⁸⁷ This structure provides the for-profit with the freedom of participating in the EoC to whatever extent it desires,

82. GOLD, *supra* note 60, at 89, 93 (“the novelty of the project was initially seen as the division of the profits into three parts”: one part would be distributed to those in need, another would be re-invested into the company, and the third would be used to fund the infrastructure necessary to promote the culture of giving, i.e., model towns, publishing houses, formation centers); Bruni, *supra* note 74, at 241 (noting that profits would be divided as such: one part would go to those in need, as in the early Christian communities; another would be used for the growth of the firm; and the last part would be used to develop structures to form “new people”, or people formed by love in the “culture of giving”).

83. See GOLD, *supra* note 60, at 93 (noting that the amount of reinvestment to be kept within the firm is at the discretion of the business owner); see also Uelmen & Bruni, *supra* note 66, at 650 (reasoning that one part should be used for the development of the business).

84. GOLD, *supra* note 60, at 93 (noting that since 1994, business profits have been supplemented by personal donations from people within the Movement, which have been redistributed either through network structure of the Movement, or through more structured development projects).

85. See *infra* Part III (CICs and L3Cs could use the EoC model).

86. GOLD, *supra* note 60, at 89 (noting that if the EoC sharing was not voluntary, the possibility of reaching “communion” between people would be taken away).

87. *Id.* at 89-90.

without having to fit their agenda into some rigid guideline.⁸⁸ While this freedom provides the possibility for widespread ownership by giving as many people as possible the chance to participate in the project in some form, it may have a negative impact on the shareholders, such as generating smaller dividends.⁸⁹ As a result, the majority of the shareholders must agree with the ideals of the Focolare and be willing to forgo these returns.⁹⁰ As one could imagine, this may mean that EoC and other hybrid entities adopting this model would have a difficult time operating as a publicly traded company, or in situations where management is separate from ownership.⁹¹ Nevertheless, it is possible that the growth of ethical investment funds within the stock market could stand as one method for raising business capital in an EoC model, or EoC companies could advocate for shareholders to forego dividends altogether and donate them to the EoC.⁹²

88. *Id.* at 90.

89. *See id.* at 90-91 (noting that the shareholders must receive less, and this decision must be consciously chosen by the shareholders, not forced on them).

90. *See id.* at 91 (contending that one of the initial objectives of the EoC was to ensure that the majority of the shareholders shared in the Focolare ideals and were prepared to forgo their dividends).

91. *See id.* at -57 (noting that the issue of whether the EoC could be applied in situations where management is separate from ownership will have to be considered as the EoC develops); *see also* Uelmen & Bruni, *supra* note 66, at 673-74 (noting that although EoC businesses probably will not be publicly traded on the U.S. stock exchange, the EoC model still strongly resembles the U.S. model of a for-profit business, and the EoC model may still serve as a multi-dimensional way to reflect on economic, legal, social and managerial aspects of business life).

92. *See* GOLD, *supra* note 60, at 157 (“The growth of ethical investment funds within the stock market could provide one avenue for raising business capital in the future. Future listed EOC companies would take this trend one step further by advocating that shareholders forgo dividends altogether and donate them to the EOC.”). One example of troubles that an EoC may face was seen in the following: An EoC business in the Philippines, *Giacomino’s Pizzas*, was formed in 1991 by its owner and director, Noel Castro, after he was inspired by the idea of the Economy of Communion and thus, created this pizza and pasta family business. The business expanded and saw rapid growth, with fifteen restaurants countrywide. But this growth presented serious problems, requiring high levels of capital investment. Thus, they decided to sell the company to their competitors to protect the interests of the employees, and even though the company lost its EoC status, they used the profits to create new, smaller ventures with similar objectives, such as Chinese fast food (*Ho Lee Chow*). *Id.* at 105-106.

Finally, the EoC differs from other business models in at least four distinct ways when compared to a standard company.⁹³ First, pay structure is organized differently in the EoC model. Under the EoC, employers increase wages to reward employees for the extra effort they put into the company, and to maximize efficiency of the company.⁹⁴ Second, the EoC provides for unique recruitment policies.⁹⁵ EoC companies, for instance, have as one goal the hiring of more employees and giving those employees who make mistakes a second chance; the EoC business reintegrates those facing difficulties into the work environment, yet balances this principle with maximizing efficiency.⁹⁶ Third, EoC companies use participative management, which encourages workers to participate in decision-making within the business.⁹⁷ For example, this can include organizing councils, meetings, and other formal structures to foster increased communication between different levels of authority.⁹⁸ Finally, EoC companies take action to promote community spirit within the business.⁹⁹ This could involve events to increase the social interaction among employees, including parties for the employees' children.¹⁰⁰

93. *Id.* at 136.

94. *See id.* (noting that the first internal change within EoC ventures was a re-evaluation of the companies' compensation practices, such as wage increases to fulfill EoC obligations to the poor, and to maximize the efficiency of the company. One way this could be accomplished is if a certain group in need was given employment at the EoC).

95. *See id.* at 137 ("The second main internal change was a new attitude toward creating employment. Half of the EoC businesses decide to employ more people.").

96. *See id.* at 137 (noting that more people were employed, and employees were viewed through the lens of the EoC, especially young people with difficulties, i.e., giving a young boy with drug problems a second chance, even if he did not understand what was being said or contributed in terms of productivity). However, workers are still hired and fired; thus many EoC businesses try to find a balance between not harming the business, as well as not harming the long-term plan of work they have. *Id.* at 138.

97. *See id.* at 139.

98. *See id.*

99. *See id.* at 140 (noting that social activities could also increase the community spirit within the business).

100. *Id.* at 141.

II. PART II: UNITED STATES AND UNITED KINGDOM MODELS

The United States and United Kingdom models of hybrid entities are the most practical hybrids to discuss in this Note. Because statutes have been passed in both countries detailing aspects of their legal structures,¹⁰¹ this Note is able to explore both frameworks in order to propose a feasible structure to distribute profits. Indeed, neither the L3C or CIC statutes, nor commentary discussing the statutes, have provided a model for how these hybrids can distribute their profits. Part II proceeds by first explaining the legal structures of these models. Section A begins by discussing the legal structure and statutory implications of L3Cs in the United States, acknowledging the apparent weaknesses in this model. Section B then discusses the more developed and concrete legal structure of CICs in the United Kingdom. This Section concludes by suggesting that both models, in fact, face a lack of defined structure for distributing profits.

A. THE UNITED STATES MODEL: LOW-PROFIT LIMITED LIABILITY COMPANIES

1. Objectives and Legal Structure

One example of a hybrid entity that has received a reasonable amount of attention in the United States is the L3C, as evidenced by the passage of L3C statutes in five states.¹⁰² The L3C is a specific type of Limited Liability Company (“LLC”) that shares a similar structure.¹⁰³

101. See *infra* Parts II.A.1, II.B and accompanying text. Belgium also attempted using a hybrid form by creating a corporate form called *Société à Finalité Sociale* (“SFS”). Doeringer, *supra* note 2, at 308. However, SFSs have not been widely used, due to their lack of clear advantages. *Id.* at 309.

102. See *infra* notes 125-126 and accompanying text (listing statutory provisions for L3Cs). Another hybrid in the United States is the “B Corporation,” which takes into account the interests of the community and the environment along with shareholder interests. See Billitteri, *supra* note 19, at 12. This Note does not discuss B Corporations because the L3C is more developed in several ways. See Reiser, *supra* note 4, at 642 (stating that the B Corporation only offers moral, rather than legal assurances to non-shareholder interests, and that stakeholders have no structural rights in governance). It remains to be seen whether B Corporations will have strong teeth. *Id.* at 643; see also *infra* notes 125-130 and accompanying text (discussing L3C statutes).

103. See *infra* note 130 and accompanying text (stating that the L3C reverts back to an LLC if it doesn’t meet certain requirements). See also Doeringer, *supra* note 2, at

One difference, however, is that the L3C is structured to be able to receive Program Related Investments (“PRIs”) from foundations, which are grants that enable the foundation to generate a return from the nonprofit entity.¹⁰⁴ Another difference is that while L3Cs are organized as LLCs—they are designated as “low-profit organizations” with specific charitable or educational goals—L3Cs are for-profit in the sense that they can distribute profits, and are nonprofit in the sense that they are organized for charitable purposes.¹⁰⁵

The L3C’s objective in being able to qualify for PRIs is that doing so signals to the market that these entities do have a for-profit structure but will also participate to some extent in the furtherance of social goals.¹⁰⁶ PRIs have an essential role in the structure of the L3C hybrid model.¹⁰⁷ PRIs are basically investments made by nonprofit, tax-exempt private foundations that are entitled to two forms of special treatment:

316 (noting that the similarities that L3Cs have to LLCs is that both models generally limit owners’ liability to their investment, and both use contracts to operate as either a partnership or corporation. This allows the L3C, like the LLC, to issue equity to raise capital); Reiser, *supra* note 4, at 621 (explaining that the L3C retains much of the LLC’s flexibility, and the L3C takes the LLC form as its base).

104. See *supra* notes 19-22 and accompanying text; see also Doeringer, *supra* note 2, at 316 (“[T]he crucial difference between the L3C and the LLC (and for-profit corporations) is that the format is designed to make it easy for L3Cs to receive PRIs from foundations. This creates the possibility of raising a significant amount of capital for social enterprises.”); Reiser, *supra* note 4, at 622 (contending that the L3C model was intended to fit into various LLC bases so that properly formed L3Cs would qualify to receive PRIs).

105. Taylor, *supra* note 3, at 761; see also Billiteri, *supra* note 19, at 13 (noting the use of an LLC to advance a social mission).

106. Taylor, *supra* note 3, at 762; see also Reiser, *supra* note 4, at 622 (noting that the inventors of the L3C designed the entity to meet PRI criteria, which is generally to meet a charitable purpose).

107. See *supra* notes 19-20 and accompanying text (discussing the benefit of PRIs); see also Taylor, *supra* note 3, at 755 (noting that “PRIs could provide non-profits a valuable source of revenue because they are beneficial for both the provider and the recipient, they are flexible, and they make economic sense”); see also Doeringer, *supra* note 2, at 317 (noting that PRIs can be an extremely valuable resource, as demonstrated by the Ford Foundation’s use in 1968, “when it committed \$10 million for investments in socially beneficial companies rather than the traditional grants to charities. Congress quickly followed by adding PRIs to the list of acceptable disbursements of foundation assets in the Tax Reform Act of 1969. Since that point, the Ford Foundation has committed \$400 million in PRIs.”) (citing Ford Foundation, *Investing for Social Gain: Reflections on Two Decades of Program-Related Investments* 7-12 (1991)).

first, like most grants, PRIs can constitute part of the five percent “distribution percentage” that private foundations must use for charitable purposes annually; secondly, PRIs are not considered “jeopardizing investments,” which can subject private foundations to costly excise taxes.¹⁰⁸ Additionally, in order for an investment to qualify as a PRI, its primary purpose must be to “accomplish one or more of the purposes described in section 170(c)(2)(B) of the Internal Revenue Code.”¹⁰⁹ Likewise, L3Cs have the same “purpose” requirement, precisely to signal to private foundations and other investors that it is an entity created to meet the PRI requirements.¹¹⁰

Another important aspect of PRIs is their tax classification. In terms of taxation, the L3C adopts the tax treatment of LLCs,¹¹¹ which are taxed as partnerships.¹¹² Thus LLCs, and by extension, L3Cs, are treated as “pass through entities,” where the entity itself is not subject to taxation on its income, but profits and income are allocated to the members who pay taxes according to their *own* tax status.¹¹³ For example, if the member has tax-exempt status—i.e., a public charity or a private foundation—the profits it earns can avoid federal income tax.¹¹⁴

Furthermore, the LLC governance structure is fairly flexible, which stands to benefit the L3C’s social agenda.¹¹⁵ For example, customized

108. Reiser, *supra* note 4, at 622; *see also* Doeringer, *supra* note 2 at 317 (holding that foundations can make PRIs that count toward the 5% requirement, and also accomplish an exempt purpose). Thus, PRIs would benefit a L3C.

109. *See* I.R.C. § 170(c)(2)(B) (2006) (defining a “charitable or educational purpose” as: “organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals”); Reiser, *supra* note 4, at 622.

110. I.R.C. § 170(c)(2)(B); Reiser, *supra* note 4, at 623 (requiring the entity to be formed for a charitable purpose reinforces the L3C’s position as an entity created to meet the PRI requirements).

111. *See* Reiser, *supra* note 4, at 623 (“the L3C relies heavily on the tax treatment of LLCs to produce its desired effect.”).

112. *See id.* (“since 1997, LLCs have been treated as partnerships under federal income tax law.”). Partnerships only have one level of tax, unlike Corporations, which are taxed twice. Treas. Reg. § 301.7701-2(a)(2009).

113. *See* 26 U.S.C. § 701 (2006); Reiser, *supra* note 4, at 624.

114. *See* 26 U.S.C. § 701 (2006); Reiser, *supra* note 4, at 624.

115. *See id.* at 625-26 (“the hallmark of LLC law is flexibility”). L3Cs can have either a member-managed LLC, which resembles a general partnership where many of the members are also the owners; or it can have a manager-managed LLC, which resembles a limited partnership where ownership and management are separated. *Id.*

rules in the company's operating agreement could specify the social mission of the organization, alternative uses for proceeds, or interests of the company other than shareholder profit-maximization.¹¹⁶ In addition, the operating agreement can also restrict the transferability of shares to ensure that only those who agree with the ideals of the social mission would become involved with the company.¹¹⁷ Each of these modifications helps L3Cs encourage their social agenda by ensuring that the company's goals extend beyond shareholder profit-maximization and appeal to a board class of investors.¹¹⁸

Despite the structural advantages of L3Cs discussed above, difficulties in determining whether PRIs are trustworthy investments presents a weakness in the model.¹¹⁹ Specifically, it is cumbersome and costly to determine what qualifies as a PRI, since foundations have yet to use PRIs on a large scale.¹²⁰ Furthermore, L3C statutes require L3Cs to follow IRS mandates, and foundations are hesitant to use PRIs with L3Cs, without the IRS issuing an official statement that investments in L3Cs constitute PRIs.¹²¹ As a result, L3Cs attempt to make it easier and

See also Taylor, *supra* note 3, at 762 (noting the LLC is flexible, and maintains a recognized business model).

116. *See* Taylor, *supra* note 3, at 762 (signifying that the operating agreement can be drafted to include express provisions regarding the organization's social mission and interests other than profit maximization); *see also* Reiser, *supra* note 4, at 627 (noting that default provisions in the operating agreement may be varied to a significant degree).

117. Taylor, *supra* note 3, at 762; *see also* Reiser, *supra* note 4, at 629 (noting that transferability of shares will impact the governance and financing of L3Cs).

118. Taylor, *supra* note 3, at 762 (noting that this method is a way for members to ensure that the goals of the L3C and the Board of Directors does not only focus on shareholder profit-maximization); *see also* Reiser, *supra* note 4, at 629 (noting that this L3C framework could appeal to both foundations and a broader class of investors).

119. *See* Reiser, *supra* note 4, at 628 ("Because the PRI regulations specifically bar foundations from contemplating a financial return as a motive for investment, this tranche of members would be given scant or very remote rights to distributions."); *see also infra* notes 119-122 and accompanying text.

120. *See* Doeringer, *supra* note 2, at 317 ("[I]t can be difficult for foundations to determine when they can make acceptable PRIs with companies achieving an exempt purpose and producing a profit."); *see also* Taylor, *supra* note 3, at 755 (noting that PRIs are not widely used because making a PRI requires complex documentation, and there is no coordinated market for PRIs).

121. *See supra* note 104 and accompanying text (discussing when jeopardizing investments can arise); Reiser, *supra* note 4, at 647 (noting that if the IRS issued a

less costly for foundations to determine when they can safely invest with PRIs by remaining focused on exempt purposes.¹²² One solution in terms of re-investing in funds, is for L3Cs to access funds through “layered investing,” which would use PRIs to invest in the L3C at a below-market rate of return.¹²³ This low return investment will allow the L3C to contribute to a larger share of profits toward market-oriented investors, which would raise their potential economic return.¹²⁴

2. Statutory Implications

In order to understand the feasibility and necessity of a hybrid entity that allows for distribution of profits, it is helpful to examine a legal structure of a statutory model, the L3C. In the United States, five states have passed L3C statutes: Vermont was the first in April 2008,¹²⁵ and Illinois, Michigan, Utah, and Wyoming followed in 2009.¹²⁶ It is perhaps too early to tell how the L3C will function in practice, however, it has “quickly become a widely available choice of form.”¹²⁷ Take for instance, the Vermont statute which has the following requirements:

- (A) (i) The company significantly furthers the accomplishment of one or more charitable or educational purposes within the meaning

ruling, which it has not done yet, that a state-sanctioned L3C would pre-qualify as a proper PRI, foundations’ fears of investing in PRIs would be eased); Doeringer, *supra* note 2, at 321 (noting that the IRS has not issued a statement that will automatically allow investments in L3Cs to count as PRIs, and thus, many foundations are hesitant to use PRIs with L3Cs because of the chance that their investments will be labeled as “jeopardizing investments”).

122. See Doeringer, *supra* note 2, at 319 (For example, each L3C is contractually bound to an exempt purpose. If the L3C stops operating for that exempt purpose, it will cease to be a L3C and revert back into an LLC, and the foundations will know not to commit PRIs to the company); see also Taylor, *supra* note 3, at 762 (stating that the main intent of the L3C is to signal to foundations that the entity qualifies to receive PRIs).

123. Doeringer, *supra* note 2, at 319.

124. *Id.*

125. VT. STAT. ANN. tit. 11, § 3001(27) (2008).

126. See 805 ILL. COMP. STAT. 180/1-26 (2009); MICH. COMP. LAWS § 450.4102(m) (West 2009); UTAH CODE ANN. § 48-2c-412 (LexisNexis 2009); WYO. STAT. ANN. § 17-15-102(a)(ix) (2009). Each jurisdiction has followed a similar pattern. See Reiser, *supra* note 4, at 621. This Note focuses on the Vermont statute, since it was the most recently passed. See *infra* notes 121-24 and accompanying text.

127. Reiser, *supra* note 4, at 620-21.

of Section 170(c)(2)(B) of the Internal Revenue Code of 1986, 26 U.S.C. § 170(c)(2)(B),¹²⁸ and (ii) would not have been formed but for the company's relationship to the accomplishment of charitable or educational purposes; (B) No significant purpose of the company is the production of income or the appreciation of property; (C) No purpose of the company is to accomplish one or more political or legislative purposes within the meaning of Section 170(c)(2)(D) of the Internal Revenue Code of 1986, 26 U.S.C. § 170(c)(2)(D),¹²⁹ (D) If a company that met the definition of this subdivision (23) at its formation at any time ceases to satisfy any one of the requirements, it shall immediately cease to be a low-profit limited liability company.¹³⁰

Although section A may provide, for example, that a company “significantly furthers . . . charitable or educational purposes . . .,” there is no explicit mention of profit distribution in L3C statutes.¹³¹ Nevertheless, it seems clear from exploring the statutory language that no explicit limitations have been outlined restricting how investors interested in the L3C form can distribute their profits; rather, it appears that broad discretion is given to the owner to determine how he or she wishes to manage the structure of the company.¹³² This leaves open the possibility of implementing a new structure for profit distribution, such as the EoC model, that will be compatible with the L3C's legal structure.¹³³

128. I.R.C. § 170(c)(2)(B) (2006) provides that a “charitable or educational purpose” is “organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals.”

129. I.R.C. § 170(c)(2)(D) provides that a political or legislative purpose is one “which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office”.

130. VT. STAT. ANN. tit. 11, § 3001(27) (2008).

131. See *supra* notes 125-26, 128-30 and accompanying text (no mention of profit distribution in the L3C statutes).

132. See VT. STAT. ANN. tit. 11, § 3001(27) (2008).

133. See *id.*

B. THE UNITED KINGDOM MODEL: COMMUNITY INTEREST
COMPANIES

The main hybrid form in the United Kingdom is the CIC.¹³⁴ CICs were created and amended into the U.K. company law in 2004 primarily to “improve access to finance . . . and preserve assets and profits solely for social purposes.”¹³⁵ Since the 2004 amendment, over five thousand CICs in the United Kingdom have been created, showing the rapid spread of this movement.¹³⁶

Most of the CIC framework is guided by U.K. company law, and is regulated by the CIC regulator, a new office of the Regulator of Companies.¹³⁷ Like other U.K. companies, CICs must register and then apply to the Regulator for their special community interest status.¹³⁸ One unique characteristic of the CIC is that it must meet a “community interest benefit test,” which is satisfied “if a reasonable person might consider that its activities are being carried on for the benefit of the community.”¹³⁹ The CIC must submit a report detailing its community interest achievements annually to the Regulator to see if the company’s activities are really being carried on for the benefit of the community.¹⁴⁰

134. This form is available in England, Wales, Scotland, and Northern Ireland. *See* Reiser, *supra* note 4, at 630; *see also* The Regulator of the Community Interest Companies, *Community Interest Companies Information Pack*, DEP’T. FOR BUS. INNOVATION & SKILLS, 4 (Mar. 2010), <http://www.bis.gov.uk/assets/bispartners/cicregulator/docs/leaflets/10-1387-community-interest-companies-information-pack.pdf> (hereinafter *Information Pack*).

135. Reiser, *supra* note 4, at 630.

136. There are currently 6,100 companies registered as CICs. *See* The Regulator of the Community Interest Companies, *List of Community Interest Companies (2009)*, DEP’T. FOR BUS. INNOVATION & SKILLS, <http://www.bis.gov.uk/cicregulator/cic-register> (last visited January 31, 2012).

137. Taylor, *supra* note 3, at 765; *see also* The Regulator of the Community Interest Companies, *Homepage*, DEP’T. FOR BUS. INNOVATION & SKILLS, <http://www.cicregulator.gov.uk/> (last visited Jan. 29, 2011).

138. *See* Companies (Audit, Investigations, and Community Enterprise) Act, 2004 c. 27, § 36 (Eng.) (stating that the Regulator must decide whether the company is eligible to be formed as a community interest company).

139. *See id.* at § 35(4).

140. *See id.* at § 34(1) (requiring that directors of a community interest company prepare an annual report (“community interest company report”) in respect of each financial year regarding the company’s activities during the financial year); The Regulator of the Community Interest Companies, *Frequently Asked Questions*, DEP’T. FOR BUS. INNOVATION & SKILLS, 11 (Oct. 2009), <http://www.bis.gov.uk/assets/bis>

Notably, the community benefited does not have to be in the United Kingdom, allowing for this enterprise to be used worldwide.¹⁴¹ Nevertheless, this test is generally not satisfied if the CIC aims to benefit a small number of people or support a particular political party.¹⁴² The Regulator has defined “small” or “community” to mean a group that can be clearly defined *and* considered a genuine section of the community, as viewed by a reasonable person.¹⁴³ For example, “my family,” “my friends” or “regular drinkers of ABC beer,” are unlikely to be eligible to form a CIC, since they would be benefiting only a small group of people with no indication of a charitable purpose.¹⁴⁴

As for taxation, CICs are not entitled to any tax exemptions or benefits.¹⁴⁵ With respect to, CICs are required to only have one director, as opposed to other companies which must have two or more directors.¹⁴⁶ Further, in a typical company, directors must pursue the interests of shareholders, and the only other interests they may consider

partners/cicregulator/docs/leaflets/09-1648-community-interest-companies-frequently-asked-questions-leaflet.pdf (hereinafter *FAQ*) (ensuring the government’s oversight that CICs act in the public interest by requiring CICs to produce an annual report “on how they are delivering for the community and how they are involving their stakeholders in their activities”).

141. Doeringer, *supra* note 2, at 313; *see also Information Pack, supra* note 134, at 9 (reasoning that the community will usually be wider than just the members of the CIC).

142. Doeringer, *supra* note 2, at 313.

143. *See Information Pack, supra* note 134, at 9 (noting that a community is defined “against the overall background of the view which a reasonable person would take of what constituted a section of the community for the purposes of the community interest test”).

144. *See supra* notes 138-40 and accompanying text.

145. *See Reiser, supra* note 4, at 631 (“[I]n the area of taxation, CIC status does not confer any benefits beyond those available to other U.K. companies.”); The Regulator of Community Interest Companies, *Information and Guidance Notes* § 7.6 (2008), <http://www.bis.gov.uk/cicregulator/guidance> (hereinafter *Information and Guidance Notes*) (“CICs will not receive tax breaks from the Inland Revenue by virtue of their legal status.”). Thus, if a charity decides to convert into a CIC, it will automatically lose its charity tax status. *Id.* at 2.4.1.

146. *See Reiser, supra* note 4, at 632 (explaining that CICs organized as private companies *may* have one director, while other companies *must* have two or more); *FAQ, supra* note 140, at 13 (stating that since the CIC is not a public limited company which must have two directors, it is only required to have one director).

are those of employees, or other factors related to the company.¹⁴⁷ Conversely, in a CIC, the director's main objective is to look out for the interests of other stated community purposes, and thus their goals are *not* to solely benefit shareholders.¹⁴⁸ CIC law also prepares a role for its members in the CICs governance structure, depending on whether the CIC is limited by shares, or limited by guarantee.¹⁴⁹ For example, in a CIC limited by shares, the members are generally shareholders; whereas in a CIC limited by guarantee, the members will generally be donors or members admitted according to the terms specified by the CIC.¹⁵⁰ Although members do not hold any management rights as U.S. shareholders do, they do possess notable rights such as the election and removal of directors, amending the company's original documents, and approving major transactions.¹⁵¹ Members should also monitor the performance of the directors, who are responsible for ensuring that the CIC is meeting the requirements of the community interest test.¹⁵²

147. See Companies Act, 2006, c. 46, § 172 (Eng.) (“A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole”); see also Reiser, *supra* note 4, at 632 (“In a typical company limited by shares, directors should pursue the interests of the shareholder members in good faith and need only consider other interests such as employees or the environment in their decision-making.”).

148. See Reiser, *supra* note 4, at 632 (noting that a director of a CIC or other company who has purposes other than shareholder-profit maximization (i.e., charities set up as companies limited by guarantee), has these alternative stated purposes as his or her primary goals); *Information and Guidance Notes*, *supra* note 145, at § 2.3 (noting that the CIC's activities are carried on for the purpose of benefiting a particular community).

149. Reiser, *supra* note 4, at 633; *Information and Guidance Notes*, *supra* note 145, at § 9.1.3.

150. See *Information and Guidance Notes*, *supra* note 145, at § 9.1.3 (“In a company limited by shares, the members are usually the shareholders subject to the provisions included in the articles of association. In a company limited by guarantee, the members are usually the subscribing guarantors and others admitted to membership according to the articles of association.”).

151. See *id.* (“Although the day to day running of the company may be delegated to the directors, subject to company law and the articles of association of the company, the ultimate control of the CIC and responsibility for major policy and other decisions rests with the members For example, they can appoint and dismiss the directors, delegate powers to the directors, declare dividends, approve major transactions and change the constitution of the company.”).

152. *Id.*

Moreover, another unique characteristic of the CIC is that its assets are subject to an “asset lock.”¹⁵³ This essentially ensures that the CIC’s assets are used, or “locked up” for the charitable purpose.¹⁵⁴ The asset lock prohibits the CIC from disposing of assets for less than their fair market value, except if the disposal is in furtherance of the CIC’s specific community benefit purpose, or if it transfers the assets to another CIC or charity.¹⁵⁵ Thus, if the CIC is dissolved, the asset lock ensures that after all liabilities have been paid out, the remaining assets will be transferred to another CIC, a charity, or a foreign equivalent to a charity upon dissolution.¹⁵⁶ Essentially locking assets into community benefit purposes, the Regulator views the asset lock as a fundamental feature of the CIC financial structure.¹⁵⁷

In addition to the asset lock, CICs also have important financial limits regarding dividends. The CIC is allowed to pay out dividends to its members only if the Regulator authorizes such dividend payments through regulations.¹⁵⁸ The Regulator has subjected these dividend payments to three types of restrictions: first, dividends per share may not exceed five percent if issued before April 6, 2010, and shares issued after this date shall be capped at twenty percent of the paid-up value of a share; second, the total dividends for all shares cannot exceed thirty-five

153. *See id.* at § 6.1.

154. *Id.*

155. *Id.* (stating that the “asset lock” ensures that the CIC’s assets are used for the community purpose for which the CIC was formed, and if the assets are transferred out of the CIC, the transfer must satisfy one of these requirements: the CIC retains the value of the assets transferred, it is made to another asset-locked body (CIC or charity) or other asset-locked body with the consent of the Regulator, or is otherwise made for the benefit of the community); *see also* Reiser, *supra* note 4, at 634-35 (noting that the asset lock prohibits disposal of the assets for less than their fair market value, except if the assets are given to another CIC or charity. Upon dissolution, assets may *not* be paid out to directors, members or shareholders, but must be transferred to another entity whose assets are devoted to a community benefit. This is a *fundamental* feature of the CIC). *But see* Taylor, *supra* note 3, at 766 (noting that the asset lock is a limitation, since it may inhibit potential investors from investing in the entity, and courts in other jurisdictions may view the asset lock as an unwarranted restraint on capital).

156. Doeringer, *supra* note 2, at 313; *Information and Guidance Notes*, *supra* note 145, at § 4.3.

157. *See supra* notes 155-56 and accompanying text; *see also* Reiser, *supra* note 4, at 635.

158. Companies (Audit, Investigations, and Community Enterprise) Act, 2004 § 30(1) (Eng.).

percent of distributable profits; third, unused dividends cannot remain unused for more than five years.¹⁵⁹

One example of a successful CIC is NextGenUS, a community broadband company that provides high-speed internet, and the only current national CIC in the United Kingdom.¹⁶⁰ NextGenUS chose the CIC form because it focuses on community benefit, and because the company wanted to differentiate itself from competition, including distinguishing its structural form.¹⁶¹ The company distributes its profits by reinvesting sixty-five percent of the profits earned in the community and by using an asset lock.¹⁶² Although one can assume that the other thirty-five percent is used for company purposes, NextGenUS does not explicitly state that assertion; the community is free to spend the sixty-five percent as it pleases, with regulations issued by the CIC.¹⁶³ Thus, this may offer a helpful model for someone desiring to set up a CIC, and looking for a concrete way to distribute the company's profits, since we see that the community really controls how profits are spent.¹⁶⁴ However, smaller companies may not be able to adopt this model. Thus, while both the CIC and the L3C have various legal structural requirements neither statutes nor commentary on these hybrids have offered a practical model for distributing their profits for those who have an interest in the hybrid form. The EoC model offers one resolution to this issue.

III. PART III: LINKING HYBRID FORMS WITH EOC PROFIT SHARING

Although the CIC model may have some advantages over the L3C model, neither model has provided a concrete structure for the distribution of profits.¹⁶⁵ In order to provide guidelines for a clear profit-distribution method, Part III seeks to combine aspects of the EoC profit-

159. *FAQ*, *supra* note 140, at 16.

160. *See Community Interest Companies*, NEXTGENUS.CO.UK, <http://www.nextgenus.co.uk/cic/> (last visited Jan. 5, 2011).

161. *Id.*

162. *Id.*

163. *Id.*

164. *Id.*

165. *See supra* Part II.A-B; *see also infra* notes 173-76, 179-80 and accompanying text (reasoning that the CIC was passed in national, rather than regional law, and it gained public approval by the United Kingdom).

sharing structure with the characteristics of both L3Cs and CICs. Specifically, Part III of this Note proceeds by first providing some general lessons the United States' L3C model can learn from the United Kingdom's CIC model in Section A. Next, Section B argues that the EoC profit-sharing model is a useful structure for the L3C model. Finally, Section C argues that the EoC profit-sharing model can also be a useful structure for the CIC model in the United Kingdom.

A. WHAT THE UNITED STATES CAN LEARN FROM ABROAD AND THE DISTRIBUTION OF PROFITS

Compared to the L3Cs complete flexibility,¹⁶⁶ CIC governance and financial limitations impose a rather rigid structure and framework.¹⁶⁷ The CIC appears to be fostering enthusiasm in social enterprise and is helping provide much needed revenue streams for social services in the United Kingdom.¹⁶⁸ Therefore, it has been argued that U.S. policy-makers need to learn from the different experience of the United Kingdom.¹⁶⁹ The reasoning behind this argument is, at least in part, that the U.K. government has shown it is capable of succeeding in: (1) increasing access to capital, and (2) creating an environment to ensure the public is aware of social enterprise.¹⁷⁰ Indeed, the United Kingdom has succeeded in increasing its assets to capital, and the United States can follow by endorsing the allocation of PRIs from foundations to L3Cs.¹⁷¹

166. See *supra* notes 103-105, 131-33 (discussing the flexibility of the L3C model).

167. See Reiser, *supra* note 4, at 636 (stating that the fairly rigid structure of CICs empowers both shareholders and a dedicated external regulator to enforce); see also *supra* notes 148-49 and accompanying text (discussing shareholder rights in a CIC); *supra* notes 9103-105, 131-33 (discussing the flexibility of the L3C model).

168. See Doeringer, *supra* note 2, at 322 (noting that the CIC has succeeded in increasing access to capital for social enterprises); see also Reiser, *supra* note 4, at 648 (commenting that the CIC seems to be the most likely hybrid form to confront the greatest challenges in financing hybrid forms).

169. Doeringer, *supra* note 2, at 321; see also Reiser, *supra* note 4, at 651 (commenting that while the L3C may be subject to the same lack of rigor and efficiency as charities, the CIC offers a high degree of structural enforcement through its community benefit test, asset lock, and capped dividends).

170. See Doeringer, *supra* note 2, at 321; see also Reiser, *supra* note 4, at 652 (stating that the CIC does not solely rely on private and internal enforcement, but has a public backup system, at least for enforcing social commitments).

171. See Doeringer, *supra* note 2, at 322 (stating that to increase capital as the CIC has done, foundations need to feel comfortable making PRIs to L3Cs); see also Reiser,

This can be done through federal legislation, and the Council of Foundations is currently advocating for such legislation “to create a streamlined system of fast-tracked review by the IRS where the L3Cs could apply for certification to receive PRIs.”¹⁷² It is further argued that the United States should consider achieving a uniform definition of social enterprise and invest in programs, in order to garner public support, and thus greater investment in such hybrid entities.¹⁷³

Furthermore, there are a number of other factors that have arguably contributed to the United Kingdom’s success with its hybrid form that has not been replicated in the L3C model.¹⁷⁴ First, the CIC was amended into the United Kingdom’s company law, which is nationwide, rather than regional.¹⁷⁵ This is in contrast to L3Cs, which in the United States are created through state statutes, rather than federal.¹⁷⁶ This makes the process much slower and allows for differences to arise between different jurisdictions.¹⁷⁷ Moreover, until now, L3Cs have not received approval from the IRS that they can invest in PRIs.¹⁷⁸

In addition, the United Kingdom has achieved public approval of the CIC form, while similar visibility and acceptance is still wanting in the United States.¹⁷⁹ For example, the United Kingdom instituted the

supra note 4, at 647 (noting that if the IRS does not ensure the safety of making PRIs, potential funds will not be accessed).

172. Doeringer, *supra* note 2, at 322; *see supra*, note 121 and accompanying text; *see also* Issue Paper, Council on Foundations, *Allow Foundations to Make Program-Related Investments to L3Cs*, COUNCIL ON FOUNDATIONS, (Mar. 2009).

173. *See* Doeringer, *supra* note 2, at 322 (contending that for success, the government needs to help generate a broad, unified understanding social enterprise); *see also* Reiser, *supra* note 4, at 647 (noting that the success of the L3C would be dependent on the public, and how willing they would be to invest in an entity with a blended mission).

174. *See supra* notes 125-26 and accompanying text (explaining that L3C statutes were passed under state legislation, rather than federal legislation, or the equivalent “national law” in the United Kingdom).

175. *See supra* notes 48-49 and accompanying text.

176. *See supra* notes 125-26 and accompanying text.

177. *See supra* notes 132-33 and accompanying text (noting the broad discretion given to L3Cs in determining their legal structure).

178. *See id.*; *see also supra* notes 19-22, 119-24 and accompanying text (commenting on the caution taken in using PRIs).

179. *See* Doeringer, *supra* note 2, at 321 (asserting that one lesson to be learned from the United Kingdom is the importance of creating an environment where the public is aware of and receptive to the benefits of social enterprise); *id.* 324 (“if

“community benefit test” to reassure the public that CICs were truly serving the community.¹⁸⁰ The United States can enforce similar regulations through the IRS, or by having the secretaries of state lightly monitor the L3C activities.¹⁸¹ Nonetheless, it is essential for the government to provide the support and benefits to companies necessary to foster the growth of these new social hybrids and to publicize the potential positive impact of social enterprise.¹⁸²

1. *How Profits Can be Distributed Within the L3C Model*

Since the L3C model has a more flexible structure than the CIC, a particularized approach needs to be taken to address how profits should be distributed.¹⁸³ As previously discussed, the L3C model does not have any limitations as to how profits can be distributed, or the proportion in which profits may be split between reinvestment and the beneficial purpose.¹⁸⁴ The L3C statute simply requires that the company: (i) significantly further a charitable or educational purpose; (ii) would not have been formed but for the charitable purpose; (iii) not pursue or otherwise involve itself in any political purposes; and (iv) not include income production or property appreciation as a significant purpose of the L3C.¹⁸⁵ The EoC model of a three-part profits sharing entity is one plausible structure that can work into the L3C’s loose structure and provide a clear method of profit distribution.¹⁸⁶ Under this model, the first group of profits would be distributed to those in need—that is, the

governments want to facilitate the growth of social enterprise, it is essential that they provide support and benefits for companies entering the sector.”)

180. Doeringer, *supra* note 2, at 323 (asserting that the community benefit test and the distribution limits help build public support for social enterprises by assuring the public that CICs are serving the community).

181. Doeringer, *supra* note 2, at 324.

182. See Doeringer, *supra* note 2, at 324 (noting that the government’s efforts to publicize the potential positive impact of social-enterprise has enhanced the CIC’s branding power).

183. See *supra* notes 103-105, 131-33 and accompanying text.

184. See *supra* notes 128-130 and accompanying text.

185. See *supra* notes 128-30 and accompanying text (providing the IRS’ definition of a “charitable purpose” and aspects that are prohibited by the L3C).

186. See *supra* notes 81-85 and accompanying text (describing the three ways profits can be distributed: to the charitable purpose, reinvestment, and infrastructure).

charitable purpose at hand.¹⁸⁷ The second part, reinvestment, could be kept in the business to foster a return, which is another main goal of the L3C.¹⁸⁸ Finally, the third part would be used to maintain the infrastructure of the company or to contribute to organizations related to the charitable purpose.¹⁸⁹

Like the EoC model, the decision to invest the L3C's profits in a charitable purpose would have to be the voluntary choice of both the directors and the shareholders.¹⁹⁰ Indeed, if a company stops engaging or contributing to the EoC, it simply loses its EoC status.¹⁹¹ Likewise, if an L3C stops engaging in its charitable purposes, it would immediately lose its "L3C" status and continue as an LLC.¹⁹² Furthermore, the underlying purposes of the EoC also fit within the statutory limitations of the L3C.¹⁹³ For example, in the Vermont statute, section (A)'s "charitable or educational purpose" is defined by 170(c)(2)(B) of the Internal Revenue Code, which includes, "religious, charitable, scientific, literary, or educational" purposes.¹⁹⁴ The values of the EoC would easily fit under religious or charitable.¹⁹⁵ One advantage of the EoC model is that it is specifically designed to increase employment.¹⁹⁶ Given the current high rate unemployment rate in the United States, the EoC model might provide an additional benefit through its various sectors of production and services.¹⁹⁷

187. See *supra* notes 81-84 and accompanying text.

188. See *id.*

189. See *id.*

190. See *supra* notes 86, 88 and accompanying text (the EoC model must be the voluntary choice of the directors and shareholders).

191. See *supra* note 92 (providing an example of how an EoC lost its EoC status).

192. See *supra* note 122 (L3C lose their L3C status if they cease to operate in furtherance of the charitable purpose).

193. See *supra* note 133 and accompanying text.

194. See *supra* notes 128-29 and accompanying text (referring to the Vermont L3C statute).

195. See *supra* notes 109-10, 128 and accompanying text (naming the purposes for which a L3C may be organized).

196. See *supra* notes 77, 96 and accompanying text (EoC designed to increase employment).

197. See *id.*; see also *Economic Situation*, BUREAU OF LAB. STATS., <http://www.bls.gov/cps/> (last visited December 31, 2011) (noting that as of December 2011, the unemployment rate in the United States was 8.5%); *supra* note 79 and accompanying text (noting that most EoCs consist of small to medium size companies in various sectors in production and service).¹⁹⁷

2. *How Profits Can be Distributed Within the CIC Model*

Even with the CIC's more rigid structure, the specific three-fold structure of EoC profit sharing and its governance characteristics should still be able to fit well within the CIC model. In terms of the company's governance structure, the EoC gives room for widespread participation in ownership among both the shareholders and directors, such that shareholders must actually agree to forego dividends and agree with pursuing the charitable purposes of the company.¹⁹⁸ This would likely serve as one way of satisfying the community benefit test, and would also be included in the annual CIC report, which details how the directors are involving the stakeholders in the company's activities.¹⁹⁹ Moreover, CICs, which are only required to have one director but allow members to participate in the governance aspects of the company, would also fit in neatly to the EoC model, given its flexibility.²⁰⁰

Moreover, under existing requirements CIC profits must primarily be used for the benefit of the community and dividends cannot exceed the cap amount issued by the Regulator.²⁰¹ While the EoC does aim to increase revenue, its main goal is to continue to fight poverty and unequal distribution of wealth on a global scale, such that shareholders may even need to forego dividends to achieve this goal.²⁰² Likewise, the CIC has as its central ambition the "charitable purpose," and therefore its existing regulations are unlikely to be incompatible with the incorporation of the EoC model.²⁰³ Since the CIC also seeks to raise revenue, the EoC model of distributing profits to the poor, re-investing a portion of profits in the company, and leaving a portion for

198. *See supra* notes 86-90 and accompanying text (discussing the shareholder's role in the EoC).

199. *See supra* notes 139-43 and accompanying text (discussing the requirements of the community interest test and the annual report).

200. *See supra* note 146 and accompanying text (noting that CICs only require one director, and members of CICs also have significant rights).

201. *See supra* notes 139-44, 153-59, 148-49 and accompanying text (detailing CIC characteristics to ensure that profits are kept for the benefit of the community, including the community benefit test, the asset lock, and capped dividends).

202. *See supra* notes 88-90 and accompanying text (noting that to meet the charitable purpose requirement, shareholders may receive lower dividends).

203. *See supra* notes 68, 72-76, 139-40 and accompanying text (noting the charitable purposes of the EoC and the CIC).

infrastructure, would fit well within the requirements of a community benefit test (i.e., the poor) and capped dividends (i.e., reinvestment).²⁰⁴

Furthermore, not only would the CIC benefit from aspects of the EoC model, but its “community benefit test” would actually directly contribute to the goals of the EoC,²⁰⁵ such as funding companies to alleviate unequal distribution of wealth and assisting the less fortunate.²⁰⁶ In addition, the EoC model would work particularly well with the CIC model, given that the CIC, like the EoC, aims for the enterprise to be used worldwide.²⁰⁷ Moreover, the “asset lock” aspect of the CIC would also work well with the EoC model, since if the EoC/CIC model were to dissolve, the profits could remain within the EoC community.²⁰⁸ Indeed, the CIC statute allows for profits to be distributed to other CICs or charities, even abroad.²⁰⁹

CONCLUSION

Ultimately, it is worthwhile to highlight that both CIC and L3C hybrid legal structures are tied to charitable purposes. Indeed, a charitable purpose is the key behind the legal structure and the distribution of profits for each hybrid. Despite possessing developed terms within their legal structures, further discussion on profit distribution is wanting in order to help these entities effectively distribute a portion of their profits to a charitable purpose.

This Note has explored the feasibility and benefits of incorporating aspects of the EoC profit distribution structure into the CIC and L3C models. Dividing profits into three portions: one portion for the charitable purpose, one for reinvestment in the firm, and the third for

204. See *supra* notes 81-84, 139-44, 158-59, and accompanying text (merging CIC ideas of the community benefit test and capped dividends, and the EoC three-fold profit-sharing structure).

205. See *supra* note 139-44 and accompanying text (discussing the community benefit test).

206. See *supra* Part I.C.1 (discussing the EoC and its mission).

207. See *supra* note 141 and accompanying text (noting that the CIC can be used worldwide); see *supra* notes 69, 73-75 and accompanying text (noting that the EoC evolved into a worldwide movement, and listing the main countries that have EoC companies).

208. See *supra* notes 153-54 and accompanying text (discussing the asset lock).

209. See *supra* note 155-57 and accompanying text (discussing asset distribution after dissolution).

infrastructure, provides a concrete and organized way to balance the dual purpose of these hybrids, which is to increase capital and contribute to the greater good of society. Significantly, the EoC profit-sharing model is both rigid enough to provide a concrete structure, but flexible enough to leave uncapped specific amounts for any of the three parts. Applying this profit structure to the CIC and L3C models will likely help these hybrids focus more on their charitable purposes, and provide further clarity on whether it is in the company's best interest to keep the majority of profits in reinvestment, or for the charitable purpose.

Finally, this Note has recognized that various aspects of these hybrids still remain undeniably vague, such as the meaning of "charitable purpose" and what constitutes a reasonable amount to donate to the charitable purpose. Nevertheless, EoC characteristics, and particularly profit distribution, provide a starting point to creating a more organized way to distribute these hybrid entities' profits.