

Legal Aspects of Starting a Social Enterprise



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A black and white photograph of a modern office hallway with glass-walled cubicles and a person sitting at a desk in the distance.

Harvard Business School Business Plan Contest Social Venture Track

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- Charitable Donations Group
- C3 BioEnergy
- Living Power Systems
- Uplift
- Extend Fertility
- Physica Solutions

Today's Topics

- Choosing a form for your enterprise
- Basic equity issues
- Basic intellectual property issues
- Basic employment issues
- Key contracts
- Questions

Choosing a Form for Your Social Enterprise

What is a “social enterprise”?

Making the Choice

- **Questions**
 - Mission and message
 - Funding
 - Sustainability
 - Exit

Legal Forms

	For-Profit	Nonprofit
Mission	<ul style="list-style-type: none"> ■ Profit motive 	<ul style="list-style-type: none"> ■ Religious, charitable, scientific, testing for public safety, literary, or educational purpose
Funding	<ul style="list-style-type: none"> ■ Equity investments ■ Loans ■ Earned income 	<ul style="list-style-type: none"> ■ Donations and grants ■ Loans ■ Earned income
Ownership	<ul style="list-style-type: none"> ■ Private persons 	<ul style="list-style-type: none"> ■ None ■ Note: AG and IRS
Taxes	<ul style="list-style-type: none"> ■ Pay taxes 	<ul style="list-style-type: none"> ■ Tax-exempt ■ Note: UBIT

- **For-profit enterprise**

- Sole proprietorship
- Corporation
- Partnership
- Limited liability company

- **Nonprofit enterprise (tax-exempt)**

- Non-stock corporation
- Trust

- **Hybrid enterprise?**

For-Profit Corporation

- **What is it?**

- Almost always a “C corporation”
- Profit motive: maximize return for shareholders
- Limited liability structure; double taxation

- **Formation**

- Certificate of Incorporation, by-laws, annual maintenance (meetings, file reports)

- **Management**

- Board of Directors
 - Elected by stockholders
- Officers
 - Named by Board
- Both are fiduciaries: duty of care/loyalty; business judgment rule

For-Profit Corporation (cont.)

■ Equity Ownership

- Stock holders are owners
 - “Internal” - Founders, directors, officers and other employees
 - “External” - Investors
 - Public market
- Distribute assets upon liquidation
- Distribute proceeds upon merger or asset sale
- Achieve liquidity through IPO

For-Profit Corporation (cont.)

- **Internal Equity (Common Stock)**
- **“Founders” Shares**
 - Issue shares as early as possible
 - Use “reverse vesting” – even for yourself
 - Critical tax consequences (e.g. 83(b) election)
- **Shares to employees, new hires**
 - Restricted stock vs. stock options
 - Avoid “percentages” – focus on number of shares

For-Profit Corporation (cont.)

- **“External” Equity (usually Preferred Stock)**
- **Choosing investors wisely**
 - Keep it simple, especially early on
 - Best angel and venture investors offer more than just money
 - Be mindful of securities law issues
- **Understand what “preferences” really mean**
 - Liquidation preference
 - Anti-dilution protection
 - Board representation
 - “Protective provisions”

Contrast: Nonprofit Corporation

- **Source of funds**
 - No equity

- **Tax exemption**
 - Except unrelated business taxable income (“UBTI”)
 - No private benefit or private inurement
 - Form: publicly supported or private foundation

Contrast: Nonprofit Corporation (cont.)

■ Use of funds

- Religious, charitable, scientific, testing for public safety, literary, or educational purposes
- Oversight by Attorney General and IRS
 - Use of assets
 - Public trust
- Articles of organization: dissolution clause
- “Exit”

■ Structure

- No owners – assets held “in trust” for public
- Be careful about arrangements with for-profit entities

“Hybrid” Enterprises?

- **L3C – Low-Profit Limited Liability Companies**
 - An LLC formed with a primary charitable purpose
 - Designed to satisfy requirements for program related investments (PRIs) from private foundations
 - No section 501(c)(3) tax-exempt status
 - Untested

- **Responsible Business or Benefit Corporations?**
 - Social and environmental purposes and financial profit
 - Legislation proposed; Philadelphia tax credit

- **Multiple entity structures**

Protecting Your Intellectual Property

Types of Intellectual Property

- Patents
 - New and useful invention or process
- Copyrights
 - Original work of authorship (any medium)
- Trade secrets
 - Valuable information, maintained in secret
- Trademarks
 - Distinctive, associated with service or product

Key Intellectual Property Issues

- Founders, employees, and consultants –
 - Assignment of inventions agreements
- Confidentiality agreements
- Agreements with manufacturers, vendors, customers
- Have the right to use the intellectual property of others
- License to others the use of your intellectual property
- Protect intellectual property
 - Use
 - Registration

Key Employment Issues

Key Employment Issues

- Restrictive agreements with prior employers
- Student status
- Immigration status
- Terms of employment
 - At will
 - Term of employment (inadvertent or explicit)
- Employee or independent contractor
- Exempt or non-exempt status
- Payroll taxes and withholding obligations
 - Potential personal liability for officers and directors

Key Contracts

Initial Contracts to Consider

- Employment agreements/offer letters
- Agreements among founders
- Non-disclosure agreements
- Development and non-competition agreements
- Financial agreements
 - Stock purchase agreements (for-profit enterprises)
 - Loan agreements
 - Private foundation grants and PRIs
 - Private donations (nonprofit enterprises)
- Intellectual property licenses
- Insurance



Questions?

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