

Legal Aspects of Starting a Social Enterprise



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What is a “social enterprise”?

- Choosing a form for your enterprise
 - Mission
 - Financing
- Protecting your intellectual property
- Key employment issues
- Key contracts and terms

Choosing a Form for Your Social Enterprise

- **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?**

- Equity ownership
- Profit motive: maximize return for shareholders
- Limited liability structure

- **Formation**

- Articles of organization, by-laws, annual maintenance (meetings, file reports)

- **Management**

- Directors
 - Elected by stockholders
 - Duty of care; duty of loyalty; business judgment rule
- Officers
- Incentive compensation

For-Profit Corporation (cont.)

■ Ownership

- Owners
 - Founders and employees
 - Investors
 - IPO
- Distribute profits to owners through dividends
- Transfer ownership through purchase/sale of stock

■ Financing

- Sale of equity to investors
 - Friends, family, outside investors
- Debt
- Sale of goods or services

Massachusetts Nonprofit Corporation

■ Similar to for-profit corporation except:

- Mission: must have a religious, charitable, scientific, testing for public safety, literary, or educational purpose
 - Duty of care – duty of “obedience”
- Articles of organization: dissolution clause
 - Remaining assets are distributed to another charity
- No owners – held “in trust” for public
- Oversight by Attorney General and IRS
- Tax exemption
- “Membership”

■ May apply for tax-exempt status (IRS)

- Process
- No part of the net earnings of the organization may inure to the benefit of any private shareholder or individual
- Form: publicly supported or private foundation

■ Attorney General oversight

- AG ensures that charitable funds are used for intended charitable purposes
 - Day to day operations; conflicts of interest
 - Asset sale
 - Dissolution

■ Financing

- Fundraising: tax deductible donations and grants
- Loans
- Sale of goods or services

Making the Choice

	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"> ■ Investors ■ Loans ■ Earned income 	<ul style="list-style-type: none"> ■ Tax deductible 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

Additional Factors to Consider

- Marketing advantages of nonprofit form
- Evolution of acceptable for-profit behavior?
 - Corporate social responsibility
 - Environmental and charitable activities
- Sustainability in the chosen form
 - Financing/fundraising
 - Employee compensation
- Exit strategy
 - Sale
 - IPO
 - Distribution of assets to another charity

“Hybrid” Enterprises?

- **L3C – Low-Profit Limited Liability Companies (VT.)**
 - An LLC formed with a primary charitable mission and a secondary profit concern
 - Designed to satisfy requirements for program related investments (PRIs) from private foundations
 - No 501(c)(3) tax-exempt status
 - Note: There is little to no precedent for how L3Cs will be received by the IRS, investors, states, and private foundations

- **SRC – Socially Responsible Corporations?**
 - A corporation committed to maximizing both shareholder profit and social impact
 - Legislation proposed in Minnesota and Hawaii

- **Double and triple bottom lines**

Protecting Your Intellectual Property

Types of Intellectual Property

- Patents
- Copyrights
- Mask works (a form of copyright)
- Trade secrets
- Trademarks

- What's patentable?
- How to get patent rights
 - Invent and register
 - Buy (get an assignment of rights)
 - License (get the right to use for your social enterprise)
 - Trade, mix and match – a “for-profit” patent owner may be willing to license in return for commercial rights.

- What's copyrightable?
- How to get copyrights
 - Create
 - Register (optional but worthwhile)
 - Commission a work made for hire (a trap for the unwary)
 - Get an assignment of rights
 - License
 - Trade, mix and match

- What can be protected as a trade secret?
- What steps have been taken to protect secrecy?
- Employee-consultant invention and non-disclosure agreements

- What is protected by a trademark?
 - Identity
 - Source or origin
 - Goodwill
- Types of marks
 - Word marks
 - Trademarks
 - Service marks
 - Distinguished from company names
 - Logos
 - Domain names
 - Trade dress

- How to establish trademark rights
 - Adopt strong marks:
 - Strong: arbitrary/fanciful, suggestive
 - Weak: descriptive – secondary meaning required
 - Too weak to call your own: generic
 - Use them in commerce! How?
 - Trademarks
 - Service marks
 - Trade dress
 - Register (optional in the U.S. but very important; required everywhere else)
 - Intent to use
 - Statement of use

Avoiding Infringement

- “I paid for it!” – The Independent Contractor Problem
- “Everybody does it!” – The Internet Problem
- “SE licensed it from him!” – The Importance of Indemnification
- “SE licensed it to me!” – More Indemnification/ Disclaimers
- “How could this be patented???” – The Obviousness Problem
- “We didn’t know! How could we?” – The Trademark Search

Types of Agreements Involving IP

- Assignments
- Employment agreements
- Agreements with independent contractors
- License agreements
- Manufacturing agreements
- Other vendor agreements (materials, etc.)
- Customer agreements

Key Employment Issues

Key Employment Issues

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

Key Contracts and Terms

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

Typical Contract Components

- Proper identification of parties
- Proper identification of services or goods to be delivered
- Term and termination
- Payment terms
- Representations and warranties; disclaimers
- Breach and its remedies
- Limitations of liability
- Indemnity



Questions?

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