The fourth sector and the benefit companies: a comparative analysis between the American and the Italian models

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"We are in a new era. For-profit businesses are tackling social and environmental issues, nonprofits are developing sustainable business models, and governments are forging market-based approaches to service delivery. Out of this blurring of traditional boundaries, a different model of enterprise is emerging, driven by entrepreneurs who are motivated by social aims.
When these entrepreneurs begin to create an entity to carry out their ideas, they often face a crippling and seemingly arbitrary question: whether to be a for-profit or a nonprofit. (…)
That's the term (for-benefit) *entrepreneurs are increasingly using to describe organizations that generate earned income but give top priority to an explicit social mission. The hybrid approach they employ can already be found across a wide range of industries and in pursuit of myriad important goals: eliminating homelessness, fighting drug addiction, reducing deaths from malaria, producing renewable energy (…).*
The rise of that sector is likely to reshape the future of capitalism*".*
(Heerad Sabeti, The For-Benefit Enterprise, in Harvard Business Review, November 2011 Issue - emphasis added)

I. Introduction

The "fourth sector" shall be understood as the new model of business that connects profit-seeking and social purposes. The for-benefit companies are identified as the corporate form to carry out these objectives.

The discussion about for-benefit organizations may involve as a consequence of its characteristics and aims new conceptions of the roles of the State and the private sector, provided that the latter is performing activities originally assigned solely to the former. Indeed, they are regarded as representing the convergence of public and private interests in a new way of doing business, in which collaboration and innovation shall also be always present.

II. The attributes

The two main characteristics that distinguish the for-benefit organizations are the commitment to a social purpose and the reliance on earned income. Some consider that additional attributes shall be present in order to characterize a fully realized for-benefit company. They are[1]:

- SOCIAL PURPOSE. The for-benefit corporation has a core commitment to social purpose embedded in its organizational structure;

[1] Check Heerad Sabeti (2011) and the data provided at http://www.fourthsector.net/for-benefit-corporations.

Electronic copy available at: https://ssrn.com/abstract=3010173

- BUSINESS METHOD. The for-benefit corporation can conduct any lawful business activity that is consistent with its social purpose and stakeholder responsibilities;
- INCLUSIVE OWNERSHIP. The for-benefit corporation equitably distributes ownership rights among its stakeholders in accordance with their contributions;
- STAKEHOLDER GOVERNANCE. The for-benefit corporation shares information and control among stakeholder constituencies as they develop;
- FAIR COMPENSATION. The for-benefit corporation fairly compensates employees and other stakeholders in proportion to their contributions;
- REASONABLE RETURNS. The for-benefit corporation rewards investors subject to reasonable limitations that protect the ability of the organization to achieve its mission;
- SOCIAL AND ENVIRONMENTAL RESPONSIBILITY. The for-benefit corporation committed to continuously improving its social and environmental performance throughout its stakeholder network;
- TRANSPARENCY. The for-benefit corporation is committed to full and accurate assessment and reporting of its social, environmental, and financial performance and impact;
- PROTECTED ASSETS. The for-benefit corporation can merge with and acquire any organization as long as the resulting entity is also a social purpose entity. In the event of dissolution, the assets remain dedicated to social purposes and may not be used for the private gain of any individual beyond reasonable limits on compensation[2].

So far, two countries (United States and Italy) have issued laws regulating the for-benefit company and it is possible to say that the regarded ideal additional features are not present in their statutes.

III. What the current legal frameworks provide for

III.1 The American model

The benefit corporations were created in the United States to make less complex the pursuance of social purposes by companies that also desire to make profits.

Benefit corporations were created through states' legislation, being Maryland the first one to adopt it in 2010. Until now, thirty-three states have passed laws and six are working on it[3].

The States' laws can vary in certain points, but the basic provisions were established in what it is called the "model law for benefit corporation"[4].

In United States, benefit corporation is for a profit corporation that also pursues

[2] The asset lock is a controversial topic and the total impossibility of assets´ distribution in the event of dissolution may not be in the best interest of these entities.

[3] According to the information provided in http://benefitcorp.net/policymakers/state-by-state-status, the States that have already passed the law are: Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Idaho, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Minnesota, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New York, Oregon, Pennsylvania, Rhode Island, South Carolina, Texas, Utah, Vermont, Virginia, Washington D.C. and West Virginia. The States working on it are: Alaska, Georgia, Iowa, Mississippi, New Mexico and Oklahoma.

[4] Available at http://benefitcorp.net/sites/default/files/Model%20Benefit%20Corp%20Legislation_4_16.pdf.

Electronic copy available at: https://ssrn.com/abstract=3010173

general public benefit, which is defined in the model law as a material positive impact on society and on the environment, taken as a whole.

In addition to the mandatory general benefit, the articles of incorporation of a benefit corporation may identify one or more specific public benefits, including: (i) providing beneficial products or services to low income or underserved individuals or communities; (ii) promoting economic opportunity beyond job creation; (iii) preserving the environment; (iv) improving human health; (v) promoting the arts, sciences or knowledge; (vi) increasing capital flow to public benefit entities; and (vii) accomplishing other particular benefits for society or the environment.

A corporation can become a benefit one either because it is incorporated as so or by result of a transaction (e.g., merger) approved by the statutorily-defined quorum in the relevant state of incorporation.

Some benefit corporation statutes require that benefit corporations elect a benefit director and a benefit officer (the benefit director may also serve as the benefit officer).

Benefit corporations are required to publish an annual benefit report and in some States it has to include an assessment of the company's overall social and environmental performance against a third party standard.

The benefit director shall include in the annual benefit report (i) whether the benefit corporation acted in accordance with its general public benefit purpose and any specific public benefit purpose in all material respects during the period covered by the report; (ii) whether the directors and officers complied with the tasks to pursue such interests; and (iii) justification if the benefit director understands that the benefit corporation or its directors or officers failed to act or comply with the public benefit.

Even though directors have to provide their opinions and/or justifications and the report has to be published, it does not have to be audited, which is one of the main critics to this model.

Also, it is claimed that the model legislation does not provide guidance on the specific requirements imposed on the third party to assess and measure the benefit purpose ("these agencies can be as stringent, or not, in their conceptualization of what it means to actually 'create' a public benefit as would best serve their needs and the needs of the benefit corporation that procures their services. In addition, third-party standard setters do not have any authority to revoke benefit corporation status"[5]).

Section 301 of the model law provides that directors are not liable for monetary damages if they observe the duties of care and loyalty. In order words, they are not liable for damages originated by actions or inactions in the course of performing their duties or failure of the benefit corporation to pursue or create general public benefit or specific public benefit as long as they were not interested with respect to the action or inaction and/or he believes the decision has fallen in the best interest of the corporation.

Michael A. Hacker (2016) also criticizes this aspect of the law. He states that holding corporations accountable in the *normal* model generally occurs in two ways: (1) if the entity is a for-profit corporation, directors are brought to task through a derivative suit commenced by the shareholders; and (2) if the entity is a nonprofit organization, directors or trustees are held accountable through legal actions brought by a state attorney general. Under the current benefit corporation model, intended beneficiaries are explicitly denied standing to enforce the creation of a public benefit, both in the courts and in benefit

[5] See the critics drafted by Hacker, Michael A. (2016).

corporations’ internal processes. He says: "*although the benefit corporation movement represents a progressive evolution in corporate law, the current form lacks accountability and enforcement mechanisms necessary to make it a worthwhile contribution to the law*" (pp. 1750-1751).

Besides, even though directors have to consider the impact of a benefit corporation’s activities on stakeholders other than shareholders, benefit corporation legislation denies those constituencies standing to enforce this requirement.

It is true that the model legislation provides for a “benefit enforcement proceeding”, i.e., any claim or action or proceeding for failure of a benefit corporation to pursue or create general public benefit or a specific public benefit purpose set forth in its articles, or violation of any obligation, duty, or standard of conduct provided in the law, such as failure of posting the annual report. However, this proceeding may be commenced or maintained only: (1) directly by the benefit corporation; or (2) derivatively by: (i) a person or group of persons that own at least 2% of the total number of shares of a class or series outstanding at the time of the act or omission complained of; (ii) a director; (iii) a person or group of persons that own 5% or more of the outstanding equity interests in an entity of which the benefit corporation is a subsidiary at the time of the act or omission complained of; or (iv) other persons as specified in the articles of incorporation or bylaws of the benefit corporation (i.e., the last possible group of people is contingent on shareholders' decision). In other words, solely the company, its shareholders or parent´s shareholders and the directors have standing to seek the benefit enforcement.

In sum, monetary damages are not available; the only remedy is specific performance by a restricted group of people.

The already mentioned Hacker (2016) defends that the state attorneys general, who are entitled to seek enforcement and oversight of charities, should have the same powers regarding benefit corporations.

Concerning the termination of the benefit corporation, the model legislation establishes that as with an election of benefit corporation status, the termination may be accomplished either directly by an amendment of the articles or indirectly through a fundamental transaction. It was not established an asset lock, solely a requirement of minimum status vote for the approval of a sale of assets.

Concerning the tax regime, in the United States, there isn't a special tax regime for benefit corporations. Benefit corporation only affects requirements of corporate purpose, accountability and transparency[6].

One interesting remark is that the states of Oregon, Maryland and Pennsylvania permit both corporations and limited liability companies to adopt the benefit company form - BLLC[7].

III.2 The Italian model

On 28 December 2015, Italy became with Puerto Rico the first jurisdictions besides the US to allow companies to register as a benefit society[8]. The national law is the 2016 Stability Law (Law No. 208) and the regulation is found in Sections 376-384 of its Article 1[9].

[6] Check http://benefitcorp.net/faq.

[7] Check http://socentlawtracker.org/#/bllcs.

[8] According to the information provided at http://benefitcorp.net/international-legislation.

[9] Available at http://www.gazzettaufficiale.it/eli/id/2015/12/30/15G00222/sg.

It was necessary to introduce a law permitting the possibility to include a benefit purpose in the corporate acts, given that the country´s Civil Code mentions that the aim of a company is the pursuance of profits (see article 2247 of Italian Civil Code). Indeed, benefit companies may somehow contribute to empower the classification between companies without a social benefit and companies with a social purpose, which somehow clashes with the idea that all companies should mandatorily embrace social responsibilities[10].

The new Italian legislation characterizes the *società benefit* as any type of company (not only corporations) that aims at the distribution of profits, but also pursues one or more common benefit goals in favor of other stakeholders, including people, communities, territories and the environment, cultural heritage, social activities, entities and associations, by working in a responsible, sustainable and transparent way. Ultimately, it is a qualification, and not a type of company.

The articles of association of the *società benefit* must indicate the specific benefit goal(s) and how they will be reached.

The common benefit can be a positive impact or reduction of a negative impact in mentioned areas.

The law expressly mentions that managers/directors have to manage the company taking into consideration the interests of stakeholders affected by the company's activities. The articles of association of a *società benefit* have also to identify the person(s) responsible to be entrusted with functions and tasks aimed at the pursuance of the statutory goal(s).

Failure to comply with these obligations can constitute a breach of the duties imposed on directors by the law and/or the corporate acts. Indeed, item 381 of the Stability Law mentions that the failure of achieving the purposes can lead managers to be liable in the same way managers respond regarding their general responsibilities in "traditional" enterprises: "*L'inosservanza degli obblighi di cui al comma 380 puo' costituire inadempimento dei doveri imposti agli amministratori dalla legge e dallo statuto. In caso di inadempimento degli obblighi di cui al comma 380, si applica quanto disposto dal codice civile in relazione a ciascun tipo di societa' in tema di responsabilita' degli amministratori*".

The benefit company has to disclose a report annually (to be attached to the balance sheet and published in its website) informing the purposes it intends to achieve, the measures already adopted to reach them and the reasons for not having so, if it is the case. In addition, the company has to assess the social impact of its activities in accordance with the attachment 4 of the law, and describe the goals it intends to accomplish in the next fiscal year.

Such attachment 4 provides that the evaluation shall be carried out by an external and trustworthy entity and comprise the analysis of the company's governance, including its responsibility and transparency towards the social purposes, labor and environmental aspects, and the impact on other stakeholders, like suppliers and community. It is not mentioned specific indicators for this assessment. It is likely that companies will use the already known standards, like Global Reporting Initiative (GRI) and the B Lab Impact Assessment (BIA)[11].

Italian benefit companies are monitored by the Anti-Trust Agency and can be subject to the same penalties provided for companies performing deceptive advertisement and to

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[10] About the mandatory conception of corporate social responsibility (CSR), check Denozza, Francesco & Stabilini, Alessandra (2013) and Sjåfjell, Beate (2011, 2013, 2014).

[11] Check http://societabenefit.com/cosa-sono-le-societa-benefit/bilancio-relazione-annuale-delle-societa-benefit/.

the provisions of the Italian Consumer Code.

Until now, no tax benefits have been established contemplating benefit companies in the country.

The national benefit corporation portal mentions that there are twenty three companies registered as benefit companies as of January 2017 and eight of them in the IT sector[12].

IV. Comparative analyses of the American and Italian models of benefit companies

The main differences between the American and Italian models can be summarized as follows:

(i) Any type of company mentioned in the Section V, Titles V and VI, of the Italian Civil Code can become a benefit society, not only corporations (as it is in the majority of US states, e.g., Delaware);
(ii) In Italy, the benefit company is a qualification and not a - new - legal type of enterprise;
(iii) The articles of association of the *società benefit* must include specific benefit goals, who will be in charge of them and how the responsible person will act in order to achieve these benefit goals. The US benefit corporation does not require a specific benefit purpose (it can be added to the general benefit or not). The Italian law demands companies to be more specific regarding the benefit goals and responsibilities to achieve them;
(iv) In Italy, the public benefit is defined as a positive impact or reduction of negative effects in one or more social areas mentioned in the law. In Delaware[13], for example, it's the same ("*Public benefit means a positive effect (or reduction of negative effects) on 1 or more categories of persons, entities, communities or interests (other than stockholders in their capacities as stockholders) including, but not limited to, effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature*"). But the US model legislation[14] mentions that the public benefit has to be a material positive impact ("*General Public Benefit - A material positive impact on society and the environment, taken as a whole, assessed against a third-party standard, from the business and operations of a benefit corporation*");
(v) US benefit corporation directors are exonerated from personal liability for an act or omission unless the act or omission constitutes self-dealing, willful misconduct, or a knowing violation of law. In Italy, the law is stricter, given that the failure to comply with the obligations to balance the interests of the different stakeholders can constitute a breach of the duties imposed on directors by law and articles of association. However, stakeholders possibly affected by directors´ failure still do not have specific legal standing to pursue enforcement or possible damages. According to the Circular No. 19 dated as of June 20, 2016, drafted by the Italian Joint Stock Companies Association (*Associazione fra le società italiane per azioni - Assonime)*, the liability of the board in a benefit company should observe the following

[12] Check http://societabenefit.com/le-societa-benefit/page/2/.
[13] Available at http://delcode.delaware.gov/title8/c001/sc15/.
[14] Available at http://benefitcorp.net/attorneys/model-legislation.

standards[15]:

- Directors of a benefit company have the same duties and obligations (*inter alia*, no conflict of interest) provided by the law for those of any other kind of company (s.r.l., s.p.a. etc.);
- Directors of a benefit company are therefore liable before the company if they do not manage it observing their duty of balancing the interests of the shareholders and of the other stakeholders indicated in the bylaws;
- Shareholders may not act against the directors if they privilege social interests instead of the profit maximization;
- Shareholders may act against the directors if they do not meet the benefit purpose;
- The "business judgement rule" also applies to the benefit company, and therefore decisions adopted by the directors may not give rise to liability if they reveal to be wrong, provided that they are adopted with due diligence and in the interest of the company;
- Directors are liable if they do not name a responsible for the pursuance of the common benefit;
- Before third parties, specifically the potential people benefiting from the social purpose mentioned in the articles of association, the liability can only exist due to a contractual or legal violation. The articles of association is considered to be a contract between shareholders and doesn´t involve third parties (i.e., non-financial stakeholders). Thus, potential liability before third parties should be grounded on extra-contractual responsibility, i.e., third parties may act against the directors in case of negligence (*colposi*) or unlawful conduct (*dolosi*) in accordance with the provisions of Articles 2395 (*Azione individuale del socio e del terzo*) and 2043 (*Risarcimento per fatto illecito*) of the Italian Civil Code.

As we can see, the main similarity among the two models is that the benefit companies still do not resolve the distributive conflict between stakeholders and represents an instrument at the control of shareholders, who have the total autonomy to decide when to become a benefit company and the goals they want to achieve. Benefit companies do not empower stakeholders[16]. The integration of social and environmental concerns in their business operations is voluntary, because they choose to be incorporated as so and/or to include the social/benefit purpose as a company´s objective in accordance with the relevant legal requirements.

And the fact that it was needed the issuance of a law to allow these for-benefit enterprises to exist can contribute to reinforce the understanding that without a specific law saying the opposite, firms exist solely to maximize the value of their shareholders´ investments. What we defend is the opposite, i.e., all for-profit companies should have social and environmental concerns in addition to the pursuit of profits, adopting responsible business practices.

In both models, it is inexistent an effective or efficient board liability - efficiency as a tool to compel the ones running the company to actually implement what is written in the by-laws and other formal documents issued by the company. And from the moment it is

[15] This circular is not hard law, but solely represents the understanding of such association on how the law should be interpreted.

[16] See in this regard, Denozza, Francesco & Stabilini, Alessandra (2017).

recognized a duty to observe the interests of stakeholders or a public benefit as a corporate objective, the affected people should be granted standing to seek – at least – the enforceability of the policies and measures described in the company´s statutes and its code of ethics or sustainability reports.

In addition, the laws should have been more stringent concerning the measurement of the impact. Both systems impose measurement as a legal requirement, but they do not define the indicators to proceed with this measurement. Because practice has shown several examples of greenwashing[17] and poor social responsible practices, it is highly important to have indicators reflecting the net social plus generated by the benefit company, also differentiating what the company does because it is required by the law and what it does in addition to the law.

Italy has opened the possibility of a benefit company being subject to the deceptive advertising law and to the anti-trust authority, which may be able to guarantee a more responsible management, offering an additional protection to some stakeholders. On the other hand, any stakeholder not comprised in the ambit of consumers and anti-trust authorities (workers, for example) does not count on an entity able to monitor and/or represent his/her interests. As Francesco Denozza and Alessandra Stabilini (2017) mention, it seems that the law prioritizes the consumers, and not all the stakeholders, and not in their condition of non-financial participants of the company´s activities, but as counterparties of the company´s relations in the market.

Finally, companies should be allowed to become a for-benefit only if they were able to create a net positive impact taken as a whole, as the US model law provides for, and not focus on one specific social purpose (as Italian law requires) and poorly performs in other areas.

V. Conclusion

The fourth sector comes with interesting and important conceptions and expressly embraces the possibility of companies to pursue both profits and public benefits, but the legal frameworks still need to improve in order to guarantee that the firms representative of this new sector – for-benefit companies – are indeed able to accomplish in practice what should be the ultimate aim of their creation, i.e., the empowerment of non-financial stakeholders in order to achieve socially responsible practices.

[17] Writing about why CSR shall be mandatory, Beate Sjåfjell (2011, Why Law Matters…) emphasizes (p. 8): "Defining CSR as voluntary thereby may promote corporate social irresponsibility through the incentives for using CSR as marketing and even green-washing, in the fully understandable race to win markets and achieve profit. Green-washing may go beyond misleading CSR reports – the area of environmental disclosure research indicates that it is sometimes the worst companies that give the best environmental reports. Green-washing may also take place through the practice of transferal, with companies apparently acting responsibly in the richer parts of the world, while in fact basing their profits on irresponsible sub-contracts that they hope to conceal from their wealthier consumers".

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