
A NEW FORM OF BUSINESS ENTITY IS NEEDED TO PROMOTE SOCIAL ENTREPRENEURSHIP: THE NOT-FOR- LOSS CORPORATION¹

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I. THE NEED FOR CHANGE

Philanthropy frequented the headlines in 2006. The personal fortunes of high-profile individuals, such as Warren Buffett, Bill and Melinda Gates, and Richard Branson, became the engines of social change.³ Social entrepreneurship gained serious commercial focus, with awards like the X Prize recognizing social and scientific achievement and corporations like Google dedicating resources to eradicating poverty, stopping climate change and eliminating world hunger. A trend points to a correlation between business and social change.

As this trend continues, the distinction between for-profit and nonprofit blurs, evidencing a decaying, century-old dichotomy, which has become stale to its modern participants. A new corporate structure is needed to bridge the gap—reflecting the power for social change possessed in the traditional for-profit corporation and breathing sustainability into the 501(c)(3) nonprofit. Standing on opposite sides of this divide are the members of each camp, searching for middle

¹ This article is a thought piece intended to propose a new business concept and generate discussion regarding entities that may better foster social entrepreneurship. This article is not meant to be an exhaustive analysis of the proposed not-for-loss corporation. There are still many issues that need to be addressed within the regulatory and tax frameworks. I will note some of these questions in the text and footnotes. This piece may also serve as a starting point for future follow-up articles focused on specific issues.

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³ Carol J. Loomis, *Buffett Gives It Away*, at 56, FORTUNE, July 10, 2006, available at <http://money.cnn.com/2006/06/25/magazines/fortune/charity1.fortune/index.htm>. Warren Buffett pledged to donate 85% of his Berkshire-Hathaway fortune to philanthropic efforts, valued at more than \$40 billion. Five-sixths of the fortune will go to the Bill & Melinda Gates Foundation, the world's largest foundation. *Id.* The Bill & Melinda Gates Foundation is worth an estimated \$30 billion, which was accumulated through Gates' fortune earned at Microsoft. *Id.* The foundation was organized to reduce inequities in the United States and around the world. *See* Bill & Melinda Gates Foundation, at <http://www.gatesfoundation.org>. Specific areas of interest include global health and global health development. *Id.* The Gates Foundation is famously recognized for fighting diseases such as malaria, HIV/AIDS, and tuberculosis, and improving U.S. libraries and high schools. *See* Loomis, *supra*. Richard Branson, founder of Virgin Airlines, pledged the profits from his five airlines and rail company over the next 10 years. Andrew C. Revkin, *Branson Pledges Billions to Fight Global Warming*, N.Y. TIMES, Sept. 21, 2006, available at <http://www.nytimes.com/2006/09/21/science/22warmcnd.html>. Estimated to be \$3 billion, the money will be used to fight global warming by developing a company called Virgin Fuels to explore alternative sources of energy. *Id.*

ground.

In this comment, I will explore the creation of a hybrid corporate entity, coined the “not-for-loss” corporation. I will start by highlighting Google’s philanthropic arm, “Google.org,” as a model for developing the not-for-loss corporation. Second, I will discuss the legal benefits and drawbacks of nonprofit and for-profit entities. Finally, I will outline the proposed not-for-loss corporate structure and provide criticism of the concept.

II. GOOGLE.ORG AND THE SUPERPHILANTHROPISTS

The “superphilanthropists” are emerging.⁴ A younger crowd of philanthropists is stepping up and bringing a wave of change to traditional charity. The group is shaking things up—a sign that they may be fed up with the status quo of non-profit activity and more change is on the way.⁵

Leading the way are groups like the Skoll Foundation and Revolution. The Skoll Foundation, started by Jeff Skoll, the first president of eBay, seeks to advance systemic change in communities around the world through social entrepreneurship.⁶ Likewise, Revolution, founded by Steve Case, is a venture capital holding company that invests in a portfolio of wellness, healthcare, and resorts.⁷ Both companies have found a way to promote philanthropy through traditionally for-profit channels.

Humanitarian and philanthropic efforts have also seen pop culture celebration through the X Prize and TED. The X Prize seeks to foster innovation breakthroughs for the benefit of mankind through competition.⁸ The X Prize offers a \$10 million purse for breakthroughs in aerospace or genomics.⁹ The TED Prize honors individuals who positively impact life on the planet through technology,

⁴ Michelle Conlin, *The eBay Way*, BUSINESS WEEK, Nov. 29, 2004, at 96, available at http://www.businessweek.com/magazine/content/04_48/b3910407.htm. This article was written about the philanthropic efforts of Pierre Omidyar, the founder of eBay. *Id.* He envisioned a philanthropy model that was “bottom-up” when he created the Omidyar Network. *Id.*

⁵ *Id.*

⁶ See Connecting and Celebrating Social Entrepreneurs, <http://www.skollfoundation.com>.

⁷ Catherine Yang, *Another Case Entirely*, BUSINESS WEEK, Apr. 11, 2005, available at http://www.businessweek.com/magazine/content/05_15/b3928093.htm. This article highlights the philanthropic efforts of Steve Case, the co-founder and former chief executive officer of America Online. *Id.* After a disastrous merger with Time Warner, Inc., Case started looking for a new venture to start. *Id.* Betting on the aging baby boomers, Case looked toward the wellness industry, investing in healthcare, fitness, and resorts. *Id.* Revolution was funded by \$500 million of Case’s \$825 million fortune. *Id.* See also Steve Case Launches Revolution, <http://www.revolution.com>. Revolution investments include Miraval, Exclusive Resorts, Flexcar, Lime, and a strategic partnership with Gaiam. Yang, *supra*.

⁸ X Prize Foundation, <http://www.xprize.org>. The X Prize was proposed by Dr. Peter Diamandis in 1995. *Our Story*, <http://www.xprize.org/about/our-story>. The X Prize was modeled after 20th Century scientific competitions that promoted the development of aviation, particularly the \$25,000 Orteig prize that helped motivate Charles Lindbergh to make the first solo flight across the Atlantic Ocean. *Id.*

⁹ *Id.* The Ansari X Prize was offered to the first non-governmental organization to relaunch a reusable 3-person spacecraft twice within two weeks. Ansari X Prize, <http://www.xprize.org/xprizes/ansari-x-prize/>. The X Prize was recently awarded to Mojave Aerospace Ventures for the flight of SpaceShipOne. *Id.*

entertainment, or design.¹⁰ Rather than receiving financial support, TED Prize winners are granted a wish to change the world.¹¹

There appears to be a distinct correlation between some of the most technologically innovative companies and philanthropy. In a move referred to as “shock[ing]” to the philanthropic community, Pierre Omidyar, founder of eBay, Inc., envisioned and created a hybrid philanthropy vehicle.¹² After revolutionizing the world with a marketplace that allowed buyers and sellers to meet online, Omidyar set out to apply his vision to the wealth he recently amassed.¹³ He created the Omidyar Network, a philanthropic organization that housed a non-profit foundation and an arm that would also invest in for-profit companies.¹⁴

Omidyar’s goal was to foster social capital by reinvesting the income from the profit generating investments and using it to leverage and increase charitable giving.¹⁵ “I don’t see why we ought to make an artificial distinction that says for-profit is all about making money and only nonprofit is about helping people,” said Omidyar.¹⁶ Omidyar’s vision of philanthropy was influenced largely by actions of eBay users.¹⁷ “Disabled people on public assistance turned into self-supporting entrepreneurs; Guatemalan villagers started selling their hand-woven wares to people on Park Avenue.”¹⁸ “[I]s it really true,” Omidyar asks, “that business can only be about making money? And is it really true that if you want good things to happen in a community it has to be through a nonprofit?”¹⁹

Enter Google, the search engine giant. Following Google’s corporate strategy of innovation, its philanthropic arm is as unconventional as the rest of the company.²⁰ “Google.org” is the title of the search engine’s new division. However, despite its charitable purposes, it is not a traditional 501(c)(3) tax-exempt charity. Google.org is a *for-profit* corporation.²¹ After surveying the legal

¹⁰ See *About TED*, <http://www.ted.com/pages/view/id/5>. The TED conference is an invitation-only event where the world’s leading thinkers and doers gather to find inspiration. *Id.* TED looks for inventors and entrepreneurs, designers and artists, visionaries and mavericks, protectors, and persuaders. Its goal is to honor and empower those types of people by connecting them to the formidable resources of the TED community. TED’s prize-winners may be very different, but they will have this in common: They will be doing something that has extraordinary potential, something whose positive influence could spread, transcending borders, something that can contribute to the future of life on earth. *Id.*

¹¹ *Id.* Past recipients of the TED Award include Bono and Larry Brilliant. *TED Prize*, <http://www.ted.com/pages/view/id/6>.

¹² Conlin, *supra* note 4.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ Conlin, *supra* note 4.

¹⁹ *Id.*

²⁰ See *Company Overview*, <http://www.google.com/intl/en/corporate/>. “‘Googol’ is the mathematical term for a 1 followed by 100 zeros... The term was coined by Milton Sirota, nephew of American mathematician Edward Kasner, and was popularized in the book, ‘Mathematics and the Imagination’ by Kasner and James Newman. Google’s play on the term reflects the company’s mission to organize the immense amount of information available on the web.” *Id.*

²¹ Katie Hafner, *Philanthropy Google’s Way: Not the Usual*, N.Y. TIMES, Sept. 13, 2006, at A1,

landscape, the company found the restrictions on nonprofits too limiting. Thinking outside the box, Google.org created a hybrid structure within the for-profit arena, suggesting a new model for charities and nonprofits to follow.²²

To understand the rationale behind Google.org's structure, a brief overview of the company's history and philosophy is crucial. Google was born in a small California garage in 1998. Even since its earliest years, Google has publicly acknowledged its interest in donating profits to help global causes.²³

Now, Google serves as one of today's most influential and ubiquitous names on the Internet.²⁴ Despite this stature, Google's rise to power happened quickly. The company was founded by two Stanford Ph.D students: Larry Page and Sergey Brin.²⁵ The students were pioneering a different theory for operating the search engine.²⁶ Search engines, such as Webcrawler, Lycos, Infoseek, and Excite, gave results based on counting the number of times a search term appeared on a page.²⁷ The students presumed that a webpage would be more relevant if it had a lot of other webpages linking to it.²⁸ Their theory was to rank pages with the most backlinks, which come from other webpages with many backlinks.²⁹

Google received a big break in 1999, when Altavista, a popular search engine at the time, relaunched as a web entry portal.³⁰ This change was undesirable for many of its users, who subsequently went looking for another search engine and found Google. Like Altavista's, Google's interface sported an uncluttered, minimalist design.³¹ The streamlined appearance attracted users who did not want to search webpages filled with banner ads and visual distractions, and

available at <http://www.nytimes.com/2006/09/14/technology/14google.html>. This article, featured on the cover of The New York Times, highlighted Google's innovative view of philanthropy and introduced Dr. Larry Brilliant as executive director of Google.org. *Id.*

²² *Id.*

²³ Hafner, *supra* note 21. "In advance of the company's initial public offering in August 2004, Mr. Page and Mr. Brin told potential investors that they planned to set aside 1 percent of the company's stock and an equal percentage of profits for philanthropy." *Id.*

²⁴ Danny Sullivan, *Nielsen NetRatings Search Engine Ratings* (2006), <http://searchenginewatch.com/showPage.html?page=2156451>. "The Nielsen NetRatings MegaView Search reporting service measures the search behavior of approximately 500,000 people worldwide. These web surfers have real-time meters on their computers which monitor the sites they visit. This metered information is compiled to produce NetRatings results." *Id.* Nielsen NetRatings released in July 2006 show Google as the search engine leader at 49.2% of Internet searches; more than double its closest competition. *Id.* Yahoo is second with 23.8%, MSN in third with 9.6%, AOL in fourth with 6.3%, and Ask in fifth with 2.6%. *Id.* Other search engines comprised the remaining 8.5%. *Id.*

²⁵ DAVID A. VISE, *THE GOOGLE STORY* 5 (Delacorte Press 2005). This book is the narrative story inside the creation and growth of Google, Inc. *Id.* The author celebrates many projects in development at Google, including the process of digitizing books from the libraries at Stanford, Harvard, the University of Michigan, the New York Public Library, and Oxford. *Id.* The goal is to eliminate the need for the physical library by putting as many of these books online and making them searchable. *Id.*

²⁶ *Id.* at 44.

²⁷ *Id.* at 35.

²⁸ *Id.* at 35-36.

²⁹ *Id.*

³⁰ *Id.* at 40-42; 45-46.

³¹ Jim Hu, *AltaVista: In search of a turning point*, CNET News.com (2001), http://news.com/2100-1023_3-270869.html.

it was backed by Google's power search engine.³²

Google's use of advertising is largely responsible for its rise to power.³³ The company enhances search results by displaying advertisement associated with the search term.³⁴ Revenue is generated each time a user clicks on advertisement, allowing Google's system to better connect advertisers with their target market.³⁵

Google's first round of funding came in the form of \$100,000 from Andy Bechtolsheim, co-founder of Sun Microsystems, and was quickly increased to \$1 million.³⁶ In six months, the next round of financing came in contributions from venture capital firms.³⁷ When it came time for the next round of financing through a public offering in 2003, Microsoft approached Google with a possible merger or partnership, but the deal never materialized.³⁸

The heralded Google initial public offering came earlier than the company hoped.³⁹ In the SEC filings, Google stated that its "growth has reduced some of the advantage of private ownership. By law, certain private companies must report as if they were public companies. The deadline imposed by the requirement accelerated our decision."⁴⁰ In 2004, Google filed for an IPO to raise as much as \$2,718,281,828.⁴¹

From the beginning, Google's founders coined the motto "Don't Be Evil" and warned investors that they planned to make substantial investments in social issues.⁴² Prior to the IPO in August 2004, Page and Brin told potential investors Google planned to set aside 1 percent of the company's stock plus an equal percentage of profits for philanthropy.⁴³

Google is in the information business. The company's mission is "to organize the world's information and make it universally accessible and useful."⁴⁴ The company is on the fast track to accomplishing this, whether through the recent

³² *Id.*

³³ Vise, *supra* note 25, at 121-29.

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.* at 48.

³⁷ *Id.* at 62-69.

³⁸ John Markoff and Andrew Ross Sorkin, *Microsoft and Google: Partners or Rivals?*, N.Y. TIMES (2003), <http://www.nytimes.com/2003/10/31/technology/31net.html?ex=1382936400&en=2a3168df9852f090&ei=5007&partner=USERLAND>.

³⁹ SEC filing [Google, Inc., "Form S-1/A" filed 5/21/2004].

⁴⁰ *Id.*

⁴¹ [SEC filing "S-1 Registration Status" filed 4/29/04]. This number was intentional Google humor. 2,718,281,828 represents the mathematical constant *e*, which is the natural logarithm. *e* ≈ 2.718281828.

⁴² SEC filing [Google, Inc., Form S-1/A filed 5/21/2004]. "Don't be evil. We believe strongly that in the long term, 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 forgo some short term gains. This is an important aspect of our culture and is broadly shared within the company."

⁴³ Hafner, *supra* note 21; see also SEC filing [Google, Inc., Form S-1/A filed 5/21/2004] stating, "We intend to contribute significant resources to the foundation, including employee time and approximately 1% of Google's equity and profits in some form. We hope someday this institution may eclipse Google itself in terms of overall world impact by ambitiously applying innovation and significant resources to the largest of the world's problems."

⁴⁴ *Company Overview*, <http://www.google.com/intl/en/corporate/index.html>.

purchase of YouTube or the quest to digitize the millions of books in some of the world's great libraries.⁴⁵ Its overarching goal: the perfect search engine—a search engine that could understand exactly what the user wants and give that answer back to them.⁴⁶

Google's first large-scale public display of philanthropy was the creation of the Google Foundation.⁴⁷ The foundation was a non-profit endowed with \$90 million.⁴⁸ Even at that point, the vision was broad. As Sergey Brin and Larry Page said in an Annual Report founder's letter, they created the Google Foundation "which we hope will eventually eclipse even Google in changing the world for the better."⁴⁹

Another step forward for Google was the Google Grants program, which began in 2002.⁵⁰ Google Grants was established to grant free advertising to nonprofits.⁵¹ Selected causes include poverty, human rights, and environmental issues.⁵² Google Grants has donated \$33M in advertising to more than 850 non-profit organizations in 10 countries.⁵³ Current Google Grants participants include the Grameen Foundation USA, Doctors Without Borders, Room to Read, and the Make-a-Wish Foundation.⁵⁴

With the Foundation established, the company began exploring new models of its organization in order to fund for-profit and nonprofit social entrepreneurs.⁵⁵ "We want to do something that is innovative," said Sheryl Sandberg, vice president of global online sales and operations.⁵⁶ As the result of its quest for innovation, Google created a for-profit arm called Google.org.⁵⁷

Google.org received seed money from its parent, Google, Inc., in the amount of approximately \$1 billion, with the orders to focus on global warming, poverty, and disease.⁵⁸ Along with this announcement, Dr. Larry Brilliant was chosen as Executive Director of the division.⁵⁹ Dr. Brilliant, a medical doctor, was a natural

⁴⁵ Vise, *supra* note 25, at 9.

⁴⁶ *Our Philosophy*, <http://www.google.com/corporate/tenthings.html>.

⁴⁷ Sheryl Sandberg, *About Google.org* (2005), <http://googleblog.blogspot.com/2005/10/about-googleorg.html>.

⁴⁸ BUSINESS WEEK, *Philanthropy 2005* (2005), http://www.businessweek.com/magazine/toc/05_48/B39610548philanthropy.htm. The initial investment of \$90 million ranks Google's foundation alongside the biggest U.S. corporate givers. Wells Fargo reported gifts of \$93 million and Target reported gifts of \$107.8 million in 2005. Business Week's 2005 Survey of Top Corporate Givers. *Id.*

⁴⁹ GOOGLE, INC., 2005 ANNUAL REPORT 10 (2006).

⁵⁰ Google Grant, <http://www.google.com/grants/>.

⁵¹ Jim Hopkins, *Google Foundation May Invest in For-Profit Firms*, USA TODAY (2005), http://www.usatoday.com/money/industries/technology/2005-04-26-google-usat_x.htm.

⁵² Google Grants, <http://www.google.com/grants/> (last visited Feb. 1, 2008).

⁵³ See <http://www.google.org>.

⁵⁴ *Id.*

⁵⁵ Hopkins, *supra* note 51.

⁵⁶ *Id.*

⁵⁷ See <http://www.google.org>.

⁵⁸ Hafner, *supra* note 21.

⁵⁹ *Google Names Larry Brilliant as Executive Director of Google.org* (2006), <http://www.google.com/intl/en/press/pressrel/brilliant.html>.

choice for the position.⁶⁰ As an epidemiologist, Dr. Brilliant spent almost a decade in India with the World Health Organization vaccinating people for smallpox.⁶¹ After that, he went to Silicon Valley to found The WELL, the first electronic community and a meeting place for some of the world's brightest minds, and chaired other Silicon Valley technology companies.⁶² Dr. Brilliant also brought with him the goal of developing an online open source code early warning system for detecting disease pandemics.⁶³

Google's intellectual approach to philanthropy is different than that of traditional charities. The company is not trying not to support causes, but find initiatives that will be sustainable and can receive economies of scale.⁶⁴ As Dr. Brilliant said:

We'll have three big areas: climate crisis, global public health, and global poverty, not necessarily in that order. I'm going to approach this the way a venture capitalist would – map out the industry to see what the gaps are. You fund an initiative, learn what works, and ask, 'Will it scale?'⁶⁵

Google avoided the non-profit structure because of constraints in how it could spend money under section 501(c)(3) of the Internal Revenue Code.⁶⁶ It wanted the flexibility of funding start-up companies, forming partnerships with venture capitalists, and lobbying lawmakers.⁶⁷ Dr. Brilliant highlighted the organization's mix of legal structures, noting that, "We are not really a foundation. It's a bit of a 501(c)(3), a bit of a C corp, and a bit of an academic environment. I can play more of the keys on the keyboard. A 501(c)(3) can't lobby. A 501(c)(3) can't invest in a company or build an industry. It may be that the only way to deal with climate change is to create an industry or build companies."⁶⁸

An initial mandate for Google.org is to "reduce dependence on oil while alleviating the effects of global warming" by developing an "ultra-fuel-efficient plug-in hybrid car engine."⁶⁹ The proposed engine is expected to run on a combination of ethanol, electricity, and gasoline.⁷⁰ Working with scientists and

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² Harriet Rubin, *Dr. Brilliant vs. the Devil of Ambition*, FAST COMPANY (2000), <http://www.fastcompany.com/online/39/brilliant.html>.

⁶³ Hafner, *supra* note 21; See also "TED Prize Wishes: Larry Brilliant's Wish," at <http://www.ted.com/tedprize/2006/larry.cfm>. The global detection system could detect new diseases and disasters as they emerge. "The system should be transparent, with basic information freely available to everyone, preferably in their own language and will be independent of any single government, any single company, any single UN agency, but will offer its alerts, data, [and] access to all." *Id.*

⁶⁴ See generally Evan Ratliff, *Feeling Lucky*, WIRED (2006), <http://www.wired.com/wired/archive/14.07/brilliant.html>.

⁶⁵ See *id.*

⁶⁶ Hafner, *supra* note 21.

⁶⁷ *Id.*

⁶⁸ Ratliff, *supra* note 64.

⁶⁹ Hafner, *supra* note 21.

⁷⁰ See CalCars, <http://calcars.org>. CalCars is a group of entrepreneurs, environmentalists, engineers and other citizens working to spur adoption of efficient, non-polluting automotive technologies. A

hybrid engine developers, Google.org is purchasing a small fleet of cars and converting the engines to achieve gas mileage exceeding 100 miles per gallon.⁷¹

Google's latest interests of global warming and hybrid cars may seem a few steps outside its mission and core competency of information. As a result, Google.org may raise questions from shareholders regarding the duty of loyalty.⁷² Google faces important legal issues in its creation of Google.org.⁷³ One billion in corporate funds were taken away from investors, which could have been paid out in the form of dividends.⁷⁴ Since this money is applied directly to an arguably non-business purpose, it may open Google up to potential liability from stockholders for a due care cause of action.⁷⁵ This use of money will constantly be subject to the scrutiny of investors, who may challenge the organization's decisions.⁷⁶

Although Google's philanthropic efforts are worthy of admiration, stockholders looking to squeeze every penny out of their investment may question the company's motives.⁷⁷ Its unique structure will also raise eyebrows, particularly with such a prominent company taking an innovative approach to social causes.⁷⁸ These issues will be examined in more depth in the remaining portions of this article.

III. NONPROFIT HISTORY AND LEGAL ISSUES

The nonprofit sector contributes significantly to the economy of the United States.⁷⁹ The sector controls more than \$1 trillion in assets and earns approximately \$700 billion annually.⁸⁰ Nonprofit corporations face increased challenges for revenue and financial sources, competing with other nonprofit and

plug-in hybrid electric vehicle (PHEV) is similar to current hybrids on the market, but have an extension cord that allows the owner to plug in to any 120-volt outlet. *Id.* at <http://calcars.org/vehicles.html>. The PHEV operates primarily on the electric battery, but with the gas tank as a backup. *Id.*

⁷¹ Hafner, *supra* note 21.

⁷² *Id.*

⁷³ Hopkins, *supra* note 51.

⁷⁴ Hafner, *supra* note 21.

⁷⁵ Hopkins, *supra* note 51.

⁷⁶ For instance, the Google.org directive for developing a hybrid car could raise potential conflict of interest questions. Google founders Larry Page and Sergey Brin previously made substantial investments in Tesla Motors, a Silicon Valley car company that is building electric cars. *See* www.teslamotors.com.

⁷⁷ Hopkins, *supra* note 51.

⁷⁸ Hafner, *supra* note 21.

⁷⁹ Gail Lasprogata & Marya N. Cotten, *Contemplating "Enterprise": the Business and Legal Challenges of Social Entrepreneurship*, 41 AM. BUS. L.J. 67 (2003). This article was written to advise social service organizations contemplating for-profit enterprise. It argues that the nonprofit sector is in a financial crisis and outlines four entrepreneurial strategies as solutions to sustaining a social mission. *Id.* at 68. The authors argue that there are risks to nonprofit organizations entering the for-profit arena, such as losing sight of the original mission and tax consequences. *Id.* at 100-11.

⁸⁰ *Id.* at 67.

for-profit entities.⁸¹ Nonprofit organizations traditionally rely on government and private foundation grants, individual donations, and fees for services.⁸² However, economic and political forces have created a financial crisis for nonprofit organizations, leading these organizations to start looking for unconventional sources of funds.⁸³ An exploration of this current position of nonprofits must start with a look at its historical and legal underpinnings.

A. *The Nonprofit is Born*

The private nonprofit is one of the oldest corporate structures in the United States.⁸⁴ The colonies were settled under private corporate charters organized for the public purpose of governing the new territory.⁸⁵ The Massachusetts Bay Company is credited as the first American board of directors and it made no distinction between for-profit or nonprofit status.⁸⁶

A struggle between private control and accountability to the public erupted soon after the founding of Harvard College in 1636.⁸⁷ Throughout the college's growth, its corporate charter was redrafted several times, as the institution sought more autonomy, while representing the public interest and property it was granted.⁸⁸ Harvard's early presidents battled with colonial legislators, who tried to gain political control of the college by appointing government-approved internal directors.⁸⁹ John Leveritt, president of Harvard from 1708-1724, argued for what stands as "the starting point of a distinctly American method of institutional governance."⁹⁰ Leveritt insisted that, for the welfare of the college, the legislator not appoint its internal directors.⁹¹ This exchange was an important step in securing the independence of corporations, by allowing the board to be neither governmentally controlled nor self-serving, while promoting the good of the institution and ensuring its accountability to the public.⁹²

A major milestone for the legitimacy of nonprofits in the United States came through a Supreme Court decision handed down by Chief Justice Marshall.⁹³ In 1816, the state of New Hampshire, in a movement led by its governor, used its

⁸¹ *Id.* at 68.

⁸² *Id.*

⁸³ *Id.*

⁸⁴ Peter D. Hall, *A History of Nonprofit Boards in the United States*, BOARD SOURCE E-BOOK SERIES (2000), 3, <http://www.boardsource.org>. Peter Dobkin Hall is the Hauser Lecturer on Nonprofit Organizations in the Kennedy School of Government at Harvard University. In this article, Hall outlines the historical development of nonprofit organizations in the United States. He details the legal, governmental, and economic aspects that shaped the evolution of the nonprofit, and the responsibilities of its board of directors, into what it is today. *Id.* at 3.

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.* at 5.

⁸⁸ *Id.*

⁸⁹ Hall, *supra* note 84, at 4.

⁹⁰ *Id.* at 6.

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Trs. of Dartmouth Coll. v. Woodward*, 17 U.S. 518 (1819).

legislative powers to take over Dartmouth College.⁹⁴ The state supreme court, which was elected by the governor in its entirety, determined that, because the corporation was for public benefit, the state legislature had power over its affairs.⁹⁵

The case attracted a lot of attention and granted certiorari by the Supreme Court under the argument that it violated Article I, section 10 of the Constitution, which prohibits the state from interfering with the obligation of contracts.⁹⁶ The legal team representing Dartmouth drew the distinction between charitable corporations and other kinds of corporations.⁹⁷ They showed that charitable organizations are private and follow the will of their donors, and that the government's role is to promote this charitable intent through the granting of nonprofit status.⁹⁸ Thus, the nonprofit was still subject to public accountability, but the government did not have authority to redirect its funds.⁹⁹

Peter Dobkin Hall summarized Chief Justice Marshall's conclusion by stating: "If charitable gifts and charitable institutions were subject to the perpetual threat of legislative interference, no sensible person would be willing to make donations for charitable, educational, or religious purposes."¹⁰⁰ Further, Dobkin writes, the Chief Justice "[a]dvanced the notion that the will of the public could be expressed by other than electoral and governmental means. In doing this, it legitimated the idea of private associational initiative in the public interest."¹⁰¹

Nonprofit organizations in the United States grew exponentially in the mid-twentieth century.¹⁰² In 1950, the IRS estimated there were 50,000 nonprofits.¹⁰³ This figure grew to 250,000 by the mid-1960's and more than one million by the mid-1980's.¹⁰⁴ Along with this growth came increased government scrutiny.¹⁰⁵ After hearings in 1969, Congress passed a tax reform bill that enacted rigorous registration, reporting, and accountability requirements.¹⁰⁶ These restrictions changed the face of traditional nonprofits and started a trend toward professionally staffed, income generating organizations.¹⁰⁷

B. Nonprofit Advancements

The next major advancement toward the blurring boundaries between for-profit and nonprofit entities came with the adoption of the Model Nonstock

⁹⁴ *Id.* at 574-79.

⁹⁵ *Id.* at 518-19.

⁹⁶ *Id.* at 627.

⁹⁷ *Id.* at 637-40.

⁹⁸ Hall, *supra* note 84, at 10-11.

⁹⁹ *Id.*

¹⁰⁰ *Id.* at 11.

¹⁰¹ *Id.*

¹⁰² *Id.* at 21.

¹⁰³ Hall, *supra* note 84, at 21.

¹⁰⁴ *Id.*

¹⁰⁵ See generally Hall, *supra* note 84.

¹⁰⁶ *Id.* at 22.

¹⁰⁷ *Id.* at 22-23.

Corporation Statute drafted by the American Bar Association in 1964.¹⁰⁸ The statute brought nonprofits closer to for-profit corporations by allowing them to be organized for any legal purpose.¹⁰⁹ The statute was revised in 1987 to include three categories of organization: public-benefit corporations, mutual-benefit corporations, and religious corporations.¹¹⁰ Under the previous “strict trust standard,” self-dealing and conflict of interest were prohibited.¹¹¹ Like modern corporate law, the new statute permitted the conflicts of interest as long as the board was fully informed and the conflict was not contrary to the nonprofit’s best interest.¹¹²

Nonprofit and for-profits firms are driven by the same “economic force motives.”¹¹³ These forces include, “the desire for a reputation as a worthy recipient of future trade, be it donations, purchase of services, government contracts, or labor.”¹¹⁴ A primary difference emboldened by 501(c)(3) is the “nondistribution constraint.”¹¹⁵ This constraint on a distribution of profits functions as a “bond” to the public stating that the charity is more trustworthy than the for-profit enterprise.¹¹⁶ This nondistribution constraint gives the public image of a halo effect around the nonprofit enterprise.

However, the nondistribution constraint has its drawbacks.¹¹⁷ “The absence of shareholders demanding profits enables the organization to relax into productive inefficiencies, or to cross-subsidize activities the patron would not want to pay for.”¹¹⁸ The nondistribution constraint also limits the managerial talent because stock options cannot be offered as a recruitment tool.¹¹⁹

¹⁰⁸ *Id.* at 23.

¹⁰⁹ *Id.* The nonprofit no longer had to be organized for only educational, charitable, or religious purposes.

¹¹⁰ Hall, *supra* note 84, at 23.

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ Evelyn Brody, *Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms*, 40 N.Y.L. SCH. L. REV. 457, 461 (1996).

¹¹⁴ *Id.*

¹¹⁵ 25 U.S.C.S. § 501 (2006). Section 501(c)(3) of the Internal Revenue Code states: “Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), 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.”

¹¹⁶ Brody, *supra* note 113, at 463.

¹¹⁷ See generally Brody, *supra* note 113, at 535.

¹¹⁸ *Id.*

¹¹⁹ See generally Meg Sommerfeld, *A Good Techie Is Hard to Find*, THE CHRONICLE OF PHILANTHROPY (Apr. 20, 2000). The article details the difficulty nonprofits have in finding qualified computer and technology employees. For instance, in a survey by Computerworld magazine, the average salary paid to a director of information technology in a for-profit company was \$83,000 in 1999. *Id.* The same position in nonprofit companies had a salary of \$56,000. *Id.* Examples of nonprofit organizations that are feeling the pressure of losing technology personnel to the for-profit

There are risks to nonprofits considering commercial activity.¹²⁰ First, nonprofits risk undermining their legitimacy by commercializing.¹²¹ It may even distract nonprofit managers from the core social mission to focus on entrepreneurial activities.¹²² Subsequently, volunteers and donors may become discouraged and withdraw support, particularly if commercial activities rise to a level where donations appear futile.¹²³ Finally, nonprofits run the risk of losing sight of their missions altogether.¹²⁴

The risk of losing tax-exempt status may be the greatest risk nonprofits face when commercializing.¹²⁵ If this is lost, nonprofits will be obligated to pay corporate income taxes and back taxes.¹²⁶ There is no bright line test for determining how much unrelated business activity is too much.¹²⁷ A presumption of fifty percent has been suggested.¹²⁸

C. Private Investment and Nonprofits

Housing Pioneers, Inc. v. Commissioner, 58 F.3d 401 (9th Cir. 1995), illustrates how social good can be stymied by nonprofit restrictions.¹²⁹ Housing Pioneers was a public benefit nonprofit development company created “to provide innovative and affordable housing to low income and handicapped persons, including providing housing for pre-release and post-release persons who are or have been incarcerated in prisons.”¹³⁰ Housing Pioneers signed a management agreement with Grant Square Properties, a for-profit partnership. The nonprofit portion of the company was necessary to keep reduced rental prices by alleviating the property tax.¹³¹ The Tax Court declared that:

Even though [the property tax reductions] are to be used exclusively for the purpose of reducing the rents or otherwise maintaining the

corporate world include Oxfam America, the American Red Cross, and the American Lung Association. *Id.*

¹²⁰ See generally William Foster and Jeffrey Bradach, *Should Nonprofits Seek Profits?*, HARVARD BUSINESS REVIEW (Feb. 1, 2005). In this article, Foster and Bradach explore the trend toward nonprofits taking on commercial functions. The authors outline how foundations are “zealously urging nonprofits to become financially self-sufficient.” *Id.* at 94. They argue that moving toward a commercial nature is hurting the nonprofit sector because nonprofit managers are too optimistic, often over exaggerating projected financial returns and underestimating the difficulty of transitioning to an increasingly for-profit business model. *Id.* The authors conclude that there is a low-likelihood that nonprofits will see significant earned income advantages from adopting commercial functions. *Id.* at 100. Non-profits should take a mission-first approach to commercial activity because the nonprofits exists to serve areas that the commercial market cannot adequately reach. *Id.*

¹²¹ Lasprogata, *supra* note 79, at 100.

¹²² Foster, *supra* note 120, at 94.

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ *Id.* at 104.

¹²⁶ *Id.* at 104-05.

¹²⁷ *Id.*

¹²⁸ Foster, *supra* note 120, at 104-105.

¹²⁹ See generally *Hous. Pioneers Inc. v. Comm’r*, 58 F.3d 401 (9th Cir. 1995).

¹³⁰ *Housing Pioneers, Inc.*, 58 F.3d at 401.

¹³¹ *Id.* at 402.

affordability of the residential units, [they] inure indirectly at least to the benefit of the non-exempt partners in that the partnerships are thereby relieved of the necessity of maintaining rents at a level sufficient to cover operating expenses which would otherwise have to be paid out of partnership capital.¹³²

The Ninth Circuit Court of Appeals upheld the Tax Court's ruling, concluding that the purposes were "'inextricably' meshed."¹³³

In contrast, *Plumstead Theatre Society, Inc. v. Commissioner*, opened the door for a limited amount of private investment in nonprofit organizations.¹³⁴ In this case, the Plumstead Theatre Society created a nonprofit organization to promote performing arts, including the production of the play "First Monday in October."¹³⁵ To perform this play, Plumstead shared capitalization costs by selling a portion of interests in the profits to outside investors through a limited partnership.¹³⁶ These limited partners included two individuals and a for-profit corporation.¹³⁷ The Tax Court held that this venture was not operated for the benefit of private individuals because they were *only* limited partners.¹³⁸ The limited partners were not shareholders in or officers or directors of Plumstead itself, and full management control was expressly reserved for Plumstead.¹³⁹ The court in *Housing Pioneers* drew a distinction between it and *Plumstead* because two of the investors in the Housing Pioneers nonprofit were simultaneously investors in the for-profit organization.¹⁴⁰ The results of this case follow that investment can be made in nonprofit organizations, even with the expectation of positive returns. However, private investors must relinquish all managerial control and nonprofit organizations must walk a fine line between passive limited partners and active investors.

The message of the court is clear: current tax law does not permit for-profit and nonprofit entities to get too close. However, the answer to the question, "how close is too close?" is not so easy to determine. From the resulting ambivalence, a socially valuable project, which is only possible with the benefit of tax-exempt status, is prohibited when the benefit inures partially to a private corporation. On the other hand, the socially valuable project may not be possible without the private investment, if government grants are unavailable.

As a brief history of the American nonprofit organization illustrates, both entities are essentially cast from the same mold. Over time, the legal and

¹³² *Id.* at 402-03.

¹³³ *Id.* at 403.

¹³⁴ See generally *Plumstead Theatre Soc'y, Inc. v. Comm'r*, 675 F.2d 244 (9th Cir. 1982).

¹³⁵ *Id.* at 245.

¹³⁶ *Id.* at 244-45. The limited partners would have made a profit from their investment in this nonprofit, but the play was produced at a loss. *Id.*

¹³⁷ *Id.* at 245.

¹³⁸ *Id.*

¹³⁹ *Id.*

¹⁴⁰ *Housing Pioneers*, *supra* note 129, at 404.

economic differences have changed by degree, but not kind.¹⁴¹ Since a formal splitting, nonprofit governance has grown increasingly close to that of for-profit corporations.¹⁴² The dichotomy was not one that was not specifically enumerated by the founders of the United States or drafters of the Constitution. If anything, the founders likely saw the corporation and public benefit as mutually inclusive ideas. However, the distinction grew out of dissention between the government and the private sector over the control of public welfare. Since then, history has seen cycles of loosening of governmental reigns followed by tightening in more specific areas. In any case, the nonprofit arena is one of continual evolution as the needs of citizens and public efficiency have beckoned.

IV. FOR-PROFIT LEGAL ISSUES

Philanthropy can challenge a for-profit business.¹⁴³ First, not all markets are available to for-profit companies due to the barriers to entry.¹⁴⁴ Second, people might see for-profits as untrustworthy.¹⁴⁵ Third, corporations are limited by business purposes. And, fourth, for-profits are continually subject to the scrutiny of shareholders seeking to maximize wealth. Although the first two challenges are worthy of substantial discussion, the scope of this article will be limited to the third and fourth challenges listed above.

In general, the decisions and actions of for-profit companies must have a business purpose.¹⁴⁶ In other words, actions and expenditures by a corporation cannot be frivolous or antithetical to the goals of the corporation. Minor charitable donations are often incidental to the benefit of employees or characterized as beneficial to a company by increasing goodwill. For large-scale social impact, however, philanthropic decisions made with disregard to the corporate bottom line could threaten the philanthropic goals altogether.

A. Business Purpose

Regarding Google's stance on business purpose, Dr. Brilliant said, "We're not doing it for the profit. And if we didn't get our capital back, so what? The emphasis is on social returns, not economic returns."¹⁴⁷ Google's position resembles that of the Ford Motor Company in the early 20th Century as a leader in technology with ambitious humanitarian goals. However, in the case of *Dodge v.*

¹⁴¹ Brody, *supra* note 113.

¹⁴² See generally *Dartmouth Coll.*, *supra* note 93; see generally *Plumstead Theatre Soc'y*, *supra* note 134.

¹⁴³ See generally Social Edge, <http://www.socialedge.org>.

¹⁴⁴ The cost might be too high, where nonprofits can make the entrance on account of favorable tax conditions. As in *Housing Pioneers*, the development company gained access to a market unavailable to a for-profit business by leveraging the tax incentive of a non-profit business.

¹⁴⁵ See generally Foremski. Foremski notes that when a for-profit business does philanthropic work, it sounds like the business is trying to make money from social causes. *Id.* For-profit philanthropy may also appear to be a corporate formality to generate goodwill. *Id.*

¹⁴⁶ See generally *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919).

¹⁴⁷ Hafner, *supra* note 21, at A1.

Ford, Ford made its philanthropic decisions with an “obvious” departure from its business purpose.¹⁴⁸

In *Dodge v. Ford*, John F. Dodge brought suit against Ford Motors for a failure to pay out dividends.¹⁴⁹ In 1916, Ford decided that his company would only pay regular dividends, despite the prosperity of the company.¹⁵⁰ The company paid \$1,200,000 in dividends, leaving \$58,000,000 to reinvest.¹⁵¹ Henry Ford, President of Ford Motor Company, had a humanitarian dream of making cars cheaper for the average person, so that every person could own one.¹⁵² Henry Ford said in his future policy for the company: “My ambition is to employ still more men; to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes. To do this, we are putting the greatest share of our profits back into the business.”¹⁵³

Henry Ford gave the court the impression that the Ford Motor Company made too much money and generated profits that were too high.¹⁵⁴ The court cited an “obvious” difference between humanitarian expenditures of corporate funds to benefit employees, which the court considered minor, and expenditures to benefit mankind, which the court concluded were at the expense of others.¹⁵⁵ As examples of minor humanitarian expenditures, the court suggested a hospital for company employees or the employment of agencies to improve working conditions.¹⁵⁶ The business, the court determined, was primarily for the benefit of stockholders. As a result, the Ford Motor Company had an obligation to distribute its dividends.¹⁵⁷

The case of Ford Motor Company is strikingly similar to that of Google. The directors of Google are retaining a substantial amount of money in the company, which it could pay out in the form of dividends.¹⁵⁸ The purpose for retaining money is not incidental. It does not directly benefit Google employees, but rather it has general humanitarian purposes.¹⁵⁹ As Sheryl Sandberg explained,

We want to fund what’s best for the world. We do not approach Google.org as furthering our own corporate interests at all. We approach it as doing whatever is best for the world. We are a technology company, so it’s obvious there are technology-related things we think can make a big difference and we want the legal

¹⁴⁸ *Dodge*, 170 N.W. at 684.

¹⁴⁹ *Id.* at 679-80.

¹⁵⁰ *Id.* at 683.

¹⁵¹ *Id.*

¹⁵² *See generally Dodge*.

¹⁵³ *Id.* at 683.

¹⁵⁴ *Id.* at 683-84.

¹⁵⁵ *Id.* at 684.

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ Ratliff *supra* note 64, at 1. The total amount contributed to Google.org is greater than \$1.15 billion. *Id.* Google.org received approximately 3 million shares of Google stock and receives one percent of annual profits. *Id.*

¹⁵⁹ *See generally Sandberg, supra* note 47.

flexibility to invest in developing those ideas.¹⁶⁰

Google acknowledges the critical eye of its skeptics, who believe shareholders may revolt at a downturn in performance.¹⁶¹ Google argues, more or less, that philanthropy is not an idea separate from the company; rather, it is part of Google's makeup.¹⁶² The flexibility for philanthropic purposes is a core competency of the company.¹⁶³ "This is part of the DNA of Google," Sandberg said, "and it's part of what you are investing in."¹⁶⁴ As a result, Google effectively operates under the notion that its shareholders are on notice.¹⁶⁵ More than mere awareness, this stance follows, investors should favor the company's philanthropic decisions.

Google's founders view the search giant's core competency as being able to organize information efficiently and store it cheaply.¹⁶⁶ They suggest that this competency can overcome one of the most challenging aspects of biology and genetics.¹⁶⁷ For instance, a database and indexing aid for the science of genomics could lead to new discoveries.¹⁶⁸ As a result, their plan is to develop a search engine fusing science, medicine, and technology, with the goal of curing disease and creating healthier lives.¹⁶⁹

¹⁶⁰ *Googling For Charity*, BUSINESS WEEK, Oct. 20, 2005, available at <http://www.businessweek.com/technology/content/oct2005/tc20051020.721687.htm>. This article was written in 2005, soon after Google.org was first established. The article establishes some of the groundwork for the company's future philanthropic interests. *Id.* It also includes an interview with Sheryl Sandberg, vice president of global online sales and operations at Google. *Id.*

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ *Id.* Sandberg said, "[Shareholders] did know they were investing in [philanthropy]. We think it's important not just for the world, but for our company. Efforts like this and thinking out of the box are part of what make Google special and what drives us to have the innovation, which is what shareholders are buying when they purchase our stock."

¹⁶⁴ *Id.* Sandberg said, "The important thing for our shareholders is that before any of them became shareholders, this was announced as part of what we filed to the public and before the IPO. When we were raising funds and giving people the opportunity to become shareholders, Larry [Page] and Sergey [Brin] said very clearly to the world, we are going to take 1% of our equity and profits, and we are going to do philanthropic work with it."

¹⁶⁵ *Id.*

¹⁶⁶ Vise, *supra* note 25, at 281-83.

¹⁶⁷ *Id.* at 282.

¹⁶⁸ *Id.* at 283. The search engine technology developed at Google may find substantial use in the scientific arena, particularly in DNA and genome research: "Dr. Alan E. Guttmacher, deputy director of the National Human Genome Research Institute, said Google's involvement in genetics is particularly meaningful because of its capacity to search and find specific genes and genetic abnormalities that cause diseases. He also said that its massive computing power can be used to analyze vast quantities of data with billions of parts—quantities that scientists in laboratories do not have the capacity to process. The old model of a scientist working in a lab, he said, is going to be replaced by the new paradigm of a researcher working at a computer, connected to databases through the Internet, and doing simulations in cyberspace. "Until recently, the challenge has been gathering data," Guttmacher said. "Now, the bigger challenge is organizing and assessing it. Google-like approaches are the key to doing that. It completely accelerates and changes the way science is done. We are beginning to have incredible tools to understand the biology of human diseases in ways we never have before, and to come up with novel ways to prevent and treat them." *Id.*

¹⁶⁹ *Id.* at 282. "Google may help accelerate the era of personalized medicine, in which understanding an individual's precise genetic makeup can contribute to the ability of physicians and counselors to tailor health care treatment, rather than dispensing medications or recommending

Google is also focused on developing clean, renewable energy with both a business and social purpose.¹⁷⁰ Google's network of hundreds of thousands of computers requires enormous quantities of energy.¹⁷¹ As a business purpose, Google's growth is limited by the availability and cost of power. The developments of investments by Google.org serve both Google's purpose as well as developing energy sources for the world. In particular, Google focused on Nanosolar, Inc., a firm specializing in thin-film solar cells.¹⁷² The founders see energy-related experiments as a logical extension of their future plans for Google and Google.org.¹⁷³ They envision wireless web access in every corner of the globe, with the only thing holding Google back being the limits of access to electricity.¹⁷⁴

Google may have found an underlying business purpose for many of its humanitarian investments.¹⁷⁵ Despite that, the company insists its purposes are purely philanthropic.¹⁷⁶ However, one is hard pressed not to notice the business purpose behind many of these initiatives. One might even wonder whether Google's claims are merely to downplay its equally interesting business prospects, ranging from genomics to energy.

B. Shareholder Challenges

Even if Google suggests a business purpose for its philanthropic efforts, the board of directors could still be put on the defense by a challenge from shareholders. In particular, those who take Dr. Brilliant's philanthropic-purposes-only explanation at face value will have the most latitude to argue. It is also possible that shareholders might object, asking for funds to be redirected if Google's boom takes a dip.¹⁷⁷ This fear may account for the rapid disbursement of funds to Google.org, which was approved by Google's board.¹⁷⁸

The challenge from shareholders is one that all for-profit companies face. If corporate philanthropic trends continue to expand, like the benchmark set by

treatments based on statistics." *Id.*

¹⁷⁰ *Id.* at 288.

¹⁷¹ *Id.*

¹⁷² Vise, *supra* note 25, *see also* Nanosolar, <http://www.nanosolar.com>. Thin-film solar cells have the advantage of being "printed on plastic sheets that can be integrated into roofs, walls, and other surfaces transparently, eliminating the typical solar cell eye sore."

¹⁷³ Vise, *supra* note 25, at 288.

¹⁷⁴ *Id.* at 288-89. Eric Schmidt, chief executive officer, said, "When you look at the Amazon and you say, 'Why aren't there any Internet users?' it's because there is no power ... And people are working on this. So we'll get them all, even the people in the trees. It's just a matter of getting them power and some kind of device." *Id.*

¹⁷⁵ Hafner, *supra* note 21, at A1.

¹⁷⁶ *Id.*

¹⁷⁷ *Id.* Tax lawyers skeptics wonder whether "directors might be tempted to take back some of the largess in an economic downturn." *Id.* "It's possible the shareholders of Google might someday object, especially if we go into an economic depression and that money is needed to shore up the company." *Id.*

¹⁷⁸ *Id.* "The company has said it plans to spend the money over the next 20 years, and the Google board recently approved a more rapid disbursement rate, \$175 million over the next two years."

Google, directors will have to defend philanthropic business judgments in the face of angry investors. The case *Shlensky v. Wrigley* determined that a shareholder's derivative lawsuit could only be brought if the conduct of the directors bordered on illegality, fraud, or conflict of interest.¹⁷⁹ As a result, shareholders will most likely only be able to find the latter two categories.

In *Shlensky*, Wrigley, a majority shareholder and director of the Chicago Cubs, refused to install lights at Wrigley field.¹⁸⁰ Due to work and lifestyle habits, attendance at daytime baseball games was falling and most professional baseball teams began installing lights to play more profitable night games.¹⁸¹ Wrigley cited legitimate reasons not to install lights: baseball is a day game, goodwill is fostered with neighbors because the lights would be a disturbance, and that maintenance would be more costly.¹⁸² As a result, the court found that none of these reasons bordered on illegality, fraud, or conflict of interest.¹⁸³

The challenges facing corporate philanthropy run deep. The actions of a corporation, particularly in the public arena, are open to many scrutinizing eyes and the boundaries of corporate governance. As the contrasting *Dodge* and *Shlensky* cases demonstrate, the actions of corporations are also open to the interpretation of judges, who must determine the motives of philanthropic choices balanced against the interest of shareholders. For many companies, the risk associated with a corporate governance lawsuit may not be worth the philanthropic effort.

V. THE NOT-FOR-LOSS CORPORATE ENTITY

Google's model may call for the creation of a new business entity. This entity would be a hybrid of for-profit and nonprofit structures. The current structure is imperfect because Google is paying taxes on what it would not be taxed on if it were a non-profit. The benefit is that Google may realize a return on its investment if it is successful. However, if the company had chosen a non-profit structure, Google would be less incentivized to give money as the benefit would only be a deduction from taxes.

“[Page and Brin] believe [the] for-profit status will greatly increase their philanthropy's range and flexibility. It could, for example, form a company to sell the converted cars, finance that company in partnership with venture capitalists, and

¹⁷⁹ *Shlensky v. Wrigley*, 237 N.E.2d 776 (App. Ct. Ill. 1968). William Shlensky, a stockholder of the Chicago National League Ball Club, Inc. filed suit against the directors for negligence and mismanagement. *Id.* at 777. Shlensky asked for the installation of lights at Wrigley Field and damages from the lack of night baseball games. *Id.* The baseball industry was moving toward night games. *Id.* In 1966, every member of the baseball league other than the Cubs scheduled all of its weekday home games at night. This was done to maximize attendance and profit. *Id.* Plaintiff argues that defendant-owner Philip Wrigley refused to install lights because his personal opinion is “that baseball is a ‘daytime sport’ and that the installation of lights in night baseball games will have a deteriorating effect on the surrounding neighborhood.” *Id.* at 778.

¹⁸⁰ *Id.* at 777.

¹⁸¹ *Id.* at 777-78.

¹⁸² *Id.* at 778.

¹⁸³ *Id.* at 780.

even hire a lobbyist to pressure Congress to pass legislation granting a tax credit to the consumers who buy the cars.”¹⁸⁴

Not only are the incentive structures different, but existential distinctions between for-profit and nonprofit entities may also be equally challenging to structure effectiveness. “Non-profit status carries a ‘saintly’ aura in our society, while a ‘for-profit charity’ sounds distasteful, it smacks of trying to make money from social causes.”¹⁸⁵ As a result, nonprofit organizations will have difficulty attracting the money and for-profit organizations will have difficulty attracting the people dedicated to social change. Even Dr. Brilliant was skeptical of joining Google because of its for-profit status.¹⁸⁶

A hybrid model called a “not-for-loss” corporation should be created to solve these existential differences and spur investment and efficiency. The not-for-loss corporation could find middle ground between the two structures. Unlike a charitable non-profit, the not-for-loss corporation could return money to investors and reinvest the would-be-profit in itself. And, unlike the for-profit corporation, tax incentives could be available to investors, while the not-for-loss would allow investors to recoup their investment. The structure of a not-for-loss corporation would be similar to the structure of municipal bonds extended to private corporations.¹⁸⁷

The not-for-loss could have more expanded purposes than current non-profit requirements. Currently, non-profit entities are limited exclusively to “religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals.”¹⁸⁸ A hybrid structure could be adapted to include social purposes, as the word “charitable” is inapplicable. The social purposes would also have to be limited so that the structure was not exploited.¹⁸⁹ This dilemma is faced by nonprofit structures, which risk for-profit businesses masquerading as tax-exempt nonprofit organizations, and have had the non-profit status properly revoked.¹⁹⁰ The not-for-loss structure would only be applied to

¹⁸⁴ Hafner *supra* note 21.

¹⁸⁵ Tom Foremski, *Google.org: Charity or Profitable Business?*, ZDNET, (Sept. 20, 2006) at <http://blogs.zdnet.com/Foremski/?p=120>. Journalist Tom Foremski is a former *Financial Times* columnist who now writes for his own website, the Silicon Valley Watcher. The Silicon Valley Watcher focuses on “the business and culture of innovation” in Silicon Valley. See www.siliconvalleywatcher.com. His website and weblog express popular and innovative ideas in the Silicon Valley business community.

¹⁸⁶ Hafner *supra* note 21.

¹⁸⁷ *Municipal Bonds*, U.S. Securities and Exchange Commission, <http://www.sec.gov/answers/bondmun.htm>. “Municipal bonds are debt securities that states, cities, counties, and other governmental entities issue to raise money for public purposes—such as building schools, highways, hospitals, sewer systems, and other special projects. A primary feature of many municipal securities is that the interest you receive is generally exempt from federal income tax. The interest may also be exempt from state and local taxes if you live in the state where the bond is issued.”

¹⁸⁸ 26 U.S.C.S. § 501 (2000).

¹⁸⁹ For instance, one might argue that a traditionally for-profit business broadly fits the “social purpose” requirement by merely creating jobs. The interpretation of a social purpose would have to be sufficiently narrowed.

¹⁹⁰ *Church of Scientology of California v. Comm’r of Internal Revenue*, 823 F.2d 1310 (9th Cir.

businesses with a primary social purpose.¹⁹¹

Unlike nonprofits, which operate primarily from charitable donations, the not-for-loss corporation could be funded through equitable investors and be self-sustaining. A drawback of nonprofits is the amount of money spent in fund raising.¹⁹² To buy \$1 worth of nonprofit program, a donor has to give more than \$1 to cover overhead costs.¹⁹³ For-profit entities, on the other hand, aim to reduce overhead and increase return. The hybrid company should achieve similar returns, by encouraging nonprofits to become self-sustaining and reduce overhead.

Return on investment must be capped so that tax deductions are not taken advantage of and income returned is tax-free. For example, the return could be capped at prime, or pegged to the T-Bill.¹⁹⁴ This would allow the not-for-loss investor to recoup the investment and account for inflation. The income returned tax-free would function similar to that of the municipal bond.¹⁹⁵ The municipal bond is a debt security used to raise money for public purposes, such as building schools, highways, and hospitals.¹⁹⁶ The primary feature of the municipal bond is that it exempts investors from federal income tax on the interest they receive.¹⁹⁷

The not-for-loss corporation could be exempt from lobbying restrictions – a drawback of the nonprofit structure. For Google, the lobbying restriction was an important factor in its choice of entity.¹⁹⁸ Its initial three mandates of the climate crisis, global public health, and poverty could require government action through legislation and debt relief.¹⁹⁹

Additionally, the not-for-loss could be subject to the same disclosure of tax return requirements of nonprofits.²⁰⁰ Added disclosure reduces risk of for-profit

1987). In this case, the tax commissioner revoked the nonprofit status of the Church of Scientology. The rationale of the tax court is that the church operated for a substantial commercial purpose and its earning inured to the benefit of founder L. Ron Hubbard, his family, and a for-profit corporation controlled by Scientology officials. *Id.* at 1312-13.

¹⁹¹ I.R.C. § 503(c)(3) exempts organizations as nonprofits as long as no part of the net earnings inures to the benefit of any private shareholder or individual. The not-for-loss title, on the other hand, might be available to organizations as long as no part of net earnings inures to the benefit of shareholders beyond the capped interest rate.

¹⁹² See generally, Woods Bowman, *Should Donors Care About Overhead Costs? Do They Care?*, NONPROFIT AND VOLUNTARY SECTOR QUARTERLY, vol. 35, no. 2, June 2006.

¹⁹³ *Id.*

¹⁹⁴ The current T-Bill rate is 5.10% as of Feb. 21, 2007. See <http://www.bankrate.com/bnm/ratewatch/treasury.asp>.

¹⁹⁵ The risk from a not-for-loss investment could be higher than a municipal bond because the government backs the municipal bond. This could create an argument for a higher interest rate. However, an increasing interest rate must be balanced against the danger that the not-for-loss will evolve into a marketplace where investors are motivated by return alone, and not for the promoting social entrepreneurship. With this in mind, the not-for-loss market may be better served by an interest rate that is limited and consistent despite the level of risk.

¹⁹⁶ *Municipal Bonds*, *supra* note 187.

¹⁹⁷ *Id.*

¹⁹⁸ Hafner, *supra* note 21.

¹⁹⁹ Hafner, *supra* note 21.

²⁰⁰ <http://www.irs.gov/charities/article/0,,id=139231,00.html>. “In general, exempt organizations must make available for public inspection certain annual returns and applications for exemption, and must provide copies of such returns and applications to individuals who request them.”

corporations abusing the not-for-loss entity.²⁰¹

A. *Spectrum of Structures*²⁰²

	Non-Profit	Not-For-Loss	For-Profit
Motives	Purely philanthropic	<i>Balance of commercial and philanthropic</i>	Purely commercial: Maximization of shareholder value
Methods	Mission-driven	<i>Balance of mission and market</i>	Market-driven
Goals	Social value creation	<i>Social and economic value creation</i>	Economic Value creation
Source of funds	Donations and government grants	<i>Investors and retained earnings</i>	Investors and retained earnings
Destination of Income	Directed toward mission activities of nonprofit organization	<i>Reinvested in mission activities or operational expenses and/or retained for business growth and development</i>	Distributed to shareholders and owners
Sustainability	Sustained by continued donations and grants	<i>Self-sustaining</i>	Self-sustaining

²⁰¹ Hafner, *supra* note 21.

²⁰² www.virtueventures.com. This chart was adopted from Virtue Ventures and modified.

B. Grameen Bank As Example

The hybrid may not be a solution for every organization. Commercialization may not be applicable to every cause. However, the Grameen Bank is an example of social organization that is self-sustaining as a hybrid entity.

The Grameen Bank reflects the proposed hybrid not-for-loss organization.²⁰³ Founded by Dr. Muhammad Yunis, the Grameen Bank is a self-sustaining microfinance institution making drastic changes in the social and economic climate of Bangladesh. The Grameen Bank provides small loans to help landless villagers, primarily women, fund their own businesses or improve community infrastructure.²⁰⁴ As the short-term loans are paid back, the line of credit is gradually increased. Overall, the Grameen Bank has extended more than \$1.5 billion in loans.²⁰⁵ Its repayment rate is 97%, comparable to that of Chase Manhattan Bank.²⁰⁶

The Grameen Bank model is founded on trust. Villagers do not have to show credit history or provide collateral.²⁰⁷ The only qualification is that they fall below a certain poverty threshold.²⁰⁸ The villager must then join a five-member group, which is part of a forty-member center.²⁰⁹ Once in a group, each villager is responsible for the loans of every other member.²¹⁰ Selectivity of group members and peer-pressure keep the bank members accountable.²¹¹

The Grameen Bank has expanded beyond small loans by helping villagers acquire intermediate-level technology.²¹² Grameen Telecom, a cell phone network run by the bank's borrowers, allowed cell phone service to become a commodity that villagers could sell.²¹³ Grameen Energy is an expansion into solar power with the goal that bank members could erect solar arrays and sell the power.²¹⁴

Dr. Yunus sees his bank as an example of reinvented capitalism, which he

²⁰³ Grameen Bank translates literally to "bank of the villages."

²⁰⁴ DAVID BORNSTEIN, *THE PRICE OF A DREAM: THE STORY OF THE GRAMEEN BANK*, (1996). This book shares the story of the development of the Grameen Bank. It highlights the bank's origin, documenting founder Muhammed Yunus' story, as well as the bank's successful results.

²⁰⁵ *Id.* at 19.

²⁰⁶ *Id.* at 20.

²⁰⁷ *Id.* at 38-41.

²⁰⁸ *Id.* at 20. This threshold is determined by the Grameen Bank and Bangladesh poverty levels.

²⁰⁹ *Id.*

²¹⁰ *Id.*

²¹¹ *Id.*

²¹² *Id.* at 24.

²¹³ *Grameen Telecom*, <http://www.grameen-info.org/grameen/gtelecom/>. Grameen Telecom promotes and implements information technology in the rural areas of Bangladesh. The division's objective is to provide universal access to technology to those underserved with a goal of serving 100 million people. *Id.* Grameen Telecom also gives some borrowers the employment of choosing cell phone sales and service as their occupation funded through the Grameen loans. *Id.*

²¹⁴ *Grameen Telecom*, <http://www.grameen-info.org/grameen/gshakti/index.html>. As a member of the Grameen family, Grameen Energy develops renewable energy technologies for rural areas of Bangladesh. Grameen Energy "envisages a future where rural households of Bangladesh, would have access to environment friendly and pollution free energy at affordable costs." *Id.*

calls a “socially conscious capital enterprise.”²¹⁵ Grameen Bank “. . . is a business that scrupulously controls costs and aims at profitability *and* a social program whose mandate is to end poverty and hunger.” Profit comes through interest rates that are four points above the commercial rate, due to the cost of facilitating small loans. “Rather than injecting capital into the economy at the altitude of corporate investors, as tax cuts or special incentives, it was injected at ground level, as loans to the poor.”²¹⁶

Like Google.org, the Grameen Bank created a hybrid entity to fits its needs. It is a model of sustainability and capitalism in the area of poverty reduction, which was, traditionally, regarded as a non-profit social issue.

C. Criticism of a Not-For-Loss Entity

Although a not-for-loss entity is appealing, the possibility is not without its criticism. This section will briefly introduce two main categories of criticism and provide general responses. First, philanthropic investments are relatively achievable through current corporate governance structures. Second, there are various regulatory issues that need to be considered before a not-for-loss entity could be put in place.

Pepperdine School of Law Professor Janet Kerr argues that “social entrepreneurship decisions within the public sector are supported by corporate governance laws.”²¹⁷ Professor Kerr explains that, under developing statutes, directors of public companies are allowed to consider other constituents, aside from shareholders, when making decisions.²¹⁸ Further, the social entrepreneurship decisions are investments, which ultimately benefit the shareholder through return.²¹⁹

Google.org demonstrates that many of the intended results of the not-for-loss entity may be achievable under the current corporate structure.²²⁰ *Plumstead Theatre Society* also provides a lot of latitude for nonprofit corporations to offer investment opportunities through limited partnership as a way to capitalize projects.²²¹ Similarly, it is a fairly common practice for companies and organizations to utilize the benefits of both structures by simultaneously applying both for-profit and nonprofit vehicles.

²¹⁵ Bornstein, *supra* note 204, at 26.

²¹⁶ *Id.* at 26.

²¹⁷ Janet Kerr, *Social Entrepreneurship and the Maximization of Shareholder Wealth: A New Approach to Fulfilling Corporate Fiduciary Duties*, 1 (unpublished). Janet Kerr is a professor and executive director of the Geoffrey H. Palmer Center for Entrepreneurship & Law at Pepperdine University School of Law. In Professor Kerr’s article, she identifies corporate governance statutes that give credence to directors in making social entrepreneurial decisions. Professor Kerr analyzes various formulas and metrics available to directors to show maximization of shareholder wealth through double and triple bottom-line strategies. She concludes that social investments fulfill fiduciary duties and increase the long-term value of the firm.

²¹⁸ *Id.*

²¹⁹ *Id.*

²²⁰ Hafner, *supra* note 21.

²²¹ *See generally Plumstead*, 675 F.2d at 244.

However, all these entities come up short of what *could* be achieved for social entrepreneurship by melding the two forms. For instance, Google.org lacks the tax breaks and “aura” of nonprofits engaged in the same work.²²² *Plumstead*, on the contrary, walks a thin-line between passive partner and active shareholder, as well as lacking many of the opportunities associated with for-profit businesses.²²³ Finally, those organizations with simultaneous structures must bifurcate activities between the two entities, requiring diligence in the separation process. The not-for-loss entity would provide a consistent, streamlined vehicle for social entrepreneurship, benefiting these companies that are parsing together entities under the current disjointed statutory scheme to achieve less-than-ideal results.

The regulatory issues associated with proposing a new entity could consume an entire series of articles.²²⁴ These issues start with whether the market for these entities is public or closely-held. This article considers the not-for-loss entity in the context of a closely-held corporation. Even in this setting, further questions would have to be answered, such as how shares would be valued or how one might cash out. In the setting of a publicly-traded market, the not-for-loss corporations could be extremely valuable in moving social entrepreneurship to a larger scale of use. Here, securities regulations would be important, including adopting new accounting standards to value the resulting social performance or allowing the open market to dictate value.²²⁵

Regulatory issues in need of further investigation include tax consequences. The not-for-loss corporation will face an amount of fraud at least equivalent to that of the nonprofit. An accountability mechanism of tax transparency, similar to that placed on nonprofits, would have to be applied to the not-for-loss. However, this level of accountability could deter for-profit corporations from adopting a not-for-loss structure if they were faced with increased disclosure requirements.²²⁶ On the other end of the spectrum, the not-for-loss entity may eliminate the need for the nonprofit form altogether.

Although these questions may seem imposing, the barriers may not be that great. The not-for-loss entity could conform closely to existing regulatory standards and fit within the current framework to fill the gap for social entrepreneurship.

²²² [Socialedge.org](http://www.socialedge.org/discussions/business-models/creating-a-hybrid-for-profit-non-profit-social-enterprise-structure), *Creating a Hybrid For-Profit/Non-Profit Social Enterprise Structure*, <http://www.socialedge.org/discussions/business-models/creating-a-hybrid-for-profit-non-profit-social-enterprise-structure>.

²²³ See generally *Plumstead*, 675 F.2d at 244.

²²⁴ For the most part, these issues remain outside the scope of this article, but may become the focus of follow-up articles.

²²⁵ Kerr, *supra* note 217. Her article outlines various formulas for accounting social benefit created by corporations.

²²⁶ Hafner, *supra* note 21. “Shareholders may not like the fact that the Google.org tax forms will not be made public, but kept private as part of the tax filings of the parent, Google, Inc.” *Id.*

VI. CONCLUSION

Social entrepreneurs have spoken—a new form of business entity is needed. The traditional dichotomy of nonprofit and for-profit entities is archaic. The distinction was an artificial creation that arose out of a legislative struggle for control of charitable donations. The evolution of global development, and its intersection with humanitarian need, demands a corporate structure that promotes social investment. The suggested not-for-loss corporation follows a natural progression and melding of these two corporate vehicles.

The not-for-loss entity is not only a viable model, but also a model substantially improved upon from its siblings, the nonprofit and for-profit. Organizations like Google.org demonstrate both its conceptual possibility and its value. If created, the not-for-loss corporation will be the catalyst for social entrepreneurship, promoting greater investment in socially responsible, self-sustaining business.