



APBCo STATEMENT ON THE ELIGIBILITY OF NON-PROFIT ENTITIES, FOR-PROFIT SMALL BUSINESS ENTITIES, SOCIAL ENTERPRISE ENTITIES AND IMPACT FINANCE TRANSACTIONS FOR PRO BONO LEGAL SERVICES

PURPOSE OF THE STATEMENT

The Association of Pro Bono Counsel (APBCo), a member organization of over 150 attorneys and practice group managers who lead pro bono practices in approximately 100 of the world's largest law firms, provides this Statement of its members' consensus views on methodologies for evaluating the eligibility of several types of organizations and transactions for pro bono legal services.¹

APBCo members have extensive experience assessing and providing pro bono assistance to non-profit organizations, hybrid and for-profit social enterprise organizations, for-profit Small Business Entities (for purposes of this analysis, we refer to both start-up and existing for-profit business entities, other than social enterprise organizations, as "Small Business Entities"), as well as parties to impact finance transactions.² The purpose of this Statement, drawing on our members' experience and insights, is three-fold: (i) to explain key terms; (ii) to provide an analytic framework and appropriate factors to consider when assessing eligibility for pro bono representation³; and (iii) to offer illustrative examples to consider when determining if an entity or transaction is eligible for pro bono legal services. To that end, this Statement seeks to foster clear, effective, efficient, and consistent practices across APBCo member firms. Moreover, this Statement encourages APBCo members to track data relating to pro bono social enterprise and impact finance matters (particularly the number of hours recorded on these matters), as we currently do for Small Business Entities and traditional non-profit work, and to report such data to the Pro Bono Institute ("PBI," to which most APBCo members' firms belong) and the American Lawyer.

¹ This Statement is an expansion upon APBCo's initial Statement on the Eligibility of Non-profit Entities, published in 2008, and is the result of an ongoing dialogue among APBCo members, including formal discussions at membership meetings on March 4 and May 7, 2015. At both meetings, members reviewed the issues, expressed their views, and gave input to the task force members who drafted this Statement. Given the complexity of the issues, and APBCo's deference to the discretion of its members on a case-by-case basis, this Statement represents a consensus rather than unanimity of opinion.

² Given that some APBCo member firms have offices outside the United States, the expectation is that this criteria will be applied globally, with sensitivity to the relative differences in income and asset levels around the world. As a result, therefore, there may be a much greater percentage of the overall legal client population that is eligible for pro bono assistance in certain countries in emerging markets, as opposed to countries in emerged markets.

³ APBCo recognizes an increase in the use of low-bono / reduced rate services for small businesses and for-profit social enterprises. However, that is a business decision that firms must make that should have no relationship to pro bono eligibility, since one of the essential elements for pro bono representation is that the law firm undertaking the matter has no expectation of receiving any legal fee from the client, including but not limited to, a substantially reduced fee.

APBCo members believe that the parameters set forth by PBI are the appropriate foundation from which to base both a definition of pro bono legal services and accompanying commentary and that non-profit corporations, Small Business Entities and social enterprises seeking pro bono legal representation should be evaluated pursuant to a modified version of PBI's Principle 7.⁴ Impact finance transactions, in particular, involve a broad spectrum of organizations, and thus APBCo members believe that parties to impact finance transactions seeking pro bono legal representation should be evaluated on a case-by-case basis pursuant to the factors described in Part IV below. Because social enterprise and impact finance are nascent and rapidly evolving areas of the law, APBCo will closely follow our members experience in those areas for modification of the frameworks discussed herein.

⁴ As used in this Statement, "pro bono legal services" means those services that satisfy the PBI definition and as interpreted by APBCo practices and policies. While this Statement makes suggestions bearing on the PBI definition and related commentary, APBCo members and their law firms are free to adopt broader, narrower or simply different criteria to determine whether they should provide free legal services to non-profit organizations, small business entities and social enterprises and count that, for internal purposes, as "pro bono legal services." However, a more specific uniform definition of which non-profit organizations, small business entities and social enterprises qualify for pro bono legal services is useful in guiding external reporting of our firms' pro bono practices.



PART I: APBCO STATEMENT ON THE ELIGIBILITY OF NON-PROFIT ENTITIES FOR PRO BONO LEGAL SERVICES

1. ANALYTICAL FRAMEWORK FOR NON-PROFITS

A non-profit representation can be treated as a pro bono matter if it satisfies one of the three criteria below. Of course, every situation is unique and there is always room for the application of professional judgment in determining whether a representation qualifies.⁵

A. Mission: A non-profit organization qualifies under the PBI definition when its mission is to serve the indigent or to protect or preserve civil rights, civil liberties, public rights or human rights, regardless of the budget of the organization or its ability to pay attorney fees.

Once a non-profit satisfies the Mission analysis, no further review is necessary. The provision of free legal services to an organization that has a qualifying mission benefits those served by the organization's work. Therefore, in the case where the organization's mission qualifies, the budget of the organization itself is not dispositive.

B. Matter: A non-profit organization that does not meet the Mission analysis at the organization level may still be eligible for pro bono assistance if the specific matter proposed itself presents a qualifying mission. In cases where a non-qualifying organization proposes to engage in a qualifying activity, i.e., one that serves the indigent or fosters human, civil or public rights, the matter should qualify under the PBI definition regardless of the entity's ability to pay attorney fees. If the specific matter satisfies the Mission analysis, no further review is necessary.

C. Means: Where neither Section A nor B above is satisfied, a matter can still qualify for pro bono assistance if the non-profit organization does not have the means to pay for legal services. In these circumstances, the question is whether the organization has sufficient means to afford competent legal counsel to handle the matter presented. This is not always a simple determination. We believe that, in evaluating whether a non-profit organization has sufficient means to afford legal counsel, many factors may be examined, including:

Referral by a Legal Services Organization: In many communities, there are sophisticated legal services organizations that screen and refer non-profit organizations to law firms for pro bono legal services. Law firms rely heavily on such referrals, and absent any clear indication that pro bono representation of a non-profit organization would be inappropriate, such a referral should be a sufficient indication that an organization qualifies for pro bono services.

⁵ Regardless of whether a non-profit organization qualifies under Mission, Matter or Means tests, in making a business decision as to whether to take on a pro bono representation, firms may want to consider other factors such as client readiness and duration or scope of work as further set forth in Part II, Section 2(E).

Financial Criteria: If not pre-screened by a trusted legal services organization, a firm may want to examine statements reflecting the organization's financial condition (such as an IRS Form 990). In particular, firms may wish to consider non-profit organizations' revenues as compared to their overall budgets, executive compensation, and debt-to-asset ratios. If the organization has budgeted for legal fees to cover the proposed matter, this may be an indication that the entity has the means to pay for legal fees. Free services, such as Charity Navigator, that evaluate the management of non-profit organizations may be a useful resource.

Past payment of legal fees or other professional fees: An organization's past payment of legal fees and other professional fees may also be considered. Previous payment of legal fees should not automatically disqualify an organization from pro bono representation. On the other hand, the ability to pay for fees in the past may be a good indication of a current ability to pay. It is worth considering that some legal services may be more difficult to obtain on a pro bono basis in certain jurisdictions. Consequently, past payment of such fees may reflect a necessity that nonetheless was a hardship for the organization. A thorough examination is recommended. The payment of other professional fees may also be considered. Again, in many jurisdictions, other professional services, including accounting, can be difficult to obtain on a pro bono basis.

Nature and extent of the legal services requested: Firms may also consider the nature of the specific matter when determining whether an organization can afford legal services. Some matters may require specialized legal expertise the cost of which may be prohibitive. Some matters might not be undertaken but for the availability of pro bono assistance. Some matters might be crucial to the continued viability of the organization. On the other hand, certain matters, like some plaintiff-side litigation, can routinely be handled by contingent-fee lawyers.

Constituency Served: If a non-profit organization is exclusively or primarily serving a constituency of persons of relatively substantial means, the organization may be able to afford legal fees even though the organization itself may not have funds immediately available to pay legal counsel. For instance, a 501(c)(3) non-profit homeowners' association funded by members' dues, not in a low-income area, or a 501(c)(6) trade organization of well-funded corporations would likely fail to qualify for pro bono assistance if it has the ability to obtain funding through its membership. Thus, APBCo recommends using closer scrutiny when the requesting organization is one that mainly serves those of substantial means.

Affiliation of the individual proposing the pro bono representation: When a pro bono representation is proposed for a private non-profit membership organization with which the individual proposing that representation is affiliated — e.g., private schools, synagogues, churches — the request should be given close scrutiny. If the matter would likely have qualified regardless of the individual's affiliation, representation may appropriately be considered pro bono legal services.

2. EXAMPLES ILLUSTRATING ANALYTICAL FRAMEWORK FOR NON-PROFIT ENTITY EVALUATION

These hypothetical scenarios are intended to illustrate the application of the Mission-Matter-Means Framework described above.

A. A firm partner sits on the board of a statewide legal services organization. The organization has many lawyers on staff and an annual revenue stream of many tens of millions of dollars, most of which is funded by the state. The organization seeks corporate governance advice.

Commentary: This organization fulfills the Mission test — the beneficiaries of its work are the indigent — and no further inquiry is necessary. The fact that a lawyer serves on the board of or is otherwise substantially involved with a non-profit organization that meets the Mission or Matter test does not disqualify the project, since the ultimate beneficiaries of the legal services qualify for assistance.

B. A firm partner is a member of a wealthy congregation in a major city which is winding up its affairs. The congregation has, for many years, provided community services and periodically has opened its doors to the homeless. The congregation has about \$300K in the bank and a church building worth about \$6 million. The congregation seeks real estate counsel to assist with the below-market rate sale of the church building to another non-profit which serves low-income individuals. Proceeds from the sale will be donated to another religious non-profit that will serve the poor.

Commentary: This proposed representation fulfills the Matter test because the ultimate beneficiaries of the particular matter — legal assistance on the sale of the property — are low-income individuals. Under these circumstances, the firm partner's involvement is irrelevant.

C. A fee-generating client asks the firm to assist a children's museum that has an annual revenue stream of approximately \$10 million and a single large asset, their building, valued at approximately \$30 million. The museum needs help with a corporate governance question. The museum's annual operating expenses average approximately \$11 million and the museum has been operating at a deficit for the past three years. Approximately half of the museum's educational programs are targeted at low-income communities. Additionally, the museum offers free attendance to local schools and non-profits.

Commentary: First, the fact that a fee-generating client of the firm made the request is irrelevant. By themselves, neither the fact that some organizational programs are directed towards low-income individuals nor the fact that the museum offers free admittance to some, but not all, qualifies the organization under the Mission test described above. Similarly, the proposed Matter is not, itself, directed specifically at low-income individuals. However, despite the large revenue stream and the major asset, the non-profit organization has been operating at a deficit for several years and, therefore, the organization could qualify under the Means test described above.

D. A large environmental conservation non-profit seeks counsel regarding the establishment of a web-based program whereby individuals can purchase and own (and protect from development) tracts of land in the Amazon. The non-profit will take a percentage of the funds from each transaction to finance its operations and purchase even more undeveloped land. The non-profit hopes to raise \$100 million through this project.

Commentary: The purpose of the organization, to protect a public right in the environment, fulfills the Mission test and no further inquiry is necessary. The amount of funds the organization raises is

irrelevant; requiring the non-profit to devote resources to legal fees would dilute the impact of its mission.

E. A non-profit charter school serving a range of students is faced with criminal liability stemming from the actions of a former principal. The school seeks counsel to respond to a broad subpoena and faces the possible loss of its charter. The school has annual revenue of more than \$25 million.

Commentary: It is not clear from the hypothetical that either the organization itself or the proposed project primarily serves low-income individuals. Assuming that it does not, the proposed representation fails the Mission and Matter tests. However, although the organization has a very large revenue stream, it is facing an extraordinary and unbudgeted legal expense – the equivalent of bankruptcy – and therefore is unlikely to be able to afford legal fees. Therefore this matter may qualify under the Means test.

F. A non-profit 501(c)(6) trade organization that supports women in technology seeks pro bono help reviewing a lease. The organization’s mission is to support and further women’s participation in technology industries. It offers members discounted health insurance and retirement plans and assistance in negotiating with labor unions. The organization has a revenue stream of about \$5 million.

Commentary: The organization presented above does not appear to serve low-income individuals as its primary purpose. As the proposed matter likewise does not involve service to low-income individuals, it also fails the Matter test. Finally, the substantial revenue stream would make it quite unlikely, absent other compelling reasons, that this organization would pass the Means test. (If the proposed representation involved a different project, such as a program to recycle computers and distribute them to low-income children, the Matter test might be satisfied.)

G. A large, well-funded urban art museum decides to support an affiliated museum in a rural area by providing it with funding, operational advice and intellectual property licenses. The affiliate is a separate legal entity, not owned by the urban museum, and has limited funding with no budget for legal expenses. The affiliate has requested pro bono legal services with respect to its opening and operation, including the negotiation of the affiliation agreement with the larger museum.

Commentary: Since the proposed client is the rural affiliate, not the well-funded urban museum, the analysis must focus on that entity. While it does not appear to qualify under the Mission or Matter criteria, it does appear that this community organization has limited means and would therefore qualify for pro bono legal services.

H. A national non-profit organization hired XYZ law firm for a fee to provide an opinion on a corporate governance issue. The general counsel of the organization seeks a second opinion, pro bono, from your firm. The organization’s sole mission is programming for poor people.

Commentary: This organization qualifies under the Mission test, although a firm might choose not to provide free legal services for business reasons.

I. XYZ Bank is downsizing and offers packages to employees who will volunteer to leave. Jim Johnson, a bank employee who is also a Harvard business school graduate, has always wanted to work with the children of recovering drug addicts. He takes the bank’s substantial package of two years’ salary, which will allow him to start a non-profit in an underserved neighborhood to

work with the kids. He will not be using any of his personal funds to fund the organization. He seeks pro bono assistance in forming the non-profit.

Commentary. The proposed representation fills the Mission test, which analyzes the purpose of the nascent organization. The personal finances of the incorporator are irrelevant — the client is the non-profit which will be formed and the beneficiaries of the non-profit organization's work are low-income individuals.

J. The conservative alternative student newspaper at a wealthy suburban public high school is told that it cannot publish a criticism of the school's support of Black History Month. The newspapers' student editors have asked the firm to file a lawsuit under the First Amendment challenging what it alleges is censorship by the school administration.

Commentary: It is not relevant that the student newspaper is not an incorporated non-profit. Neither is it relevant that the cause itself may be unpopular nor that the school district and the students are not of limited means. The proposed representation fulfills the Matter test because it addresses an issue of civil rights.



PART II: APBCO STATEMENT ON THE ELIGIBILITY OF FOR-PROFIT SMALL BUSINESS ENTITIES FOR PRO BONO LEGAL SERVICES

1. OVERVIEW

APBCo members routinely and increasingly assess requests for pro bono assistance from small and/or start-up for-profit business entities. This increase has been caused in large part by a fluctuating economy that in recent years has resulted in heightened focus on, and the importance of, the creation and success of small businesses. Driving these evolving priorities is, among many factors, the desire to increase employment opportunities as a stimulus to improving the economic status of low-income communities and individuals. In response to this growth, numerous entities, including traditional legal aid and pro bono agencies, and law school clinics, have created programs to assist these nascent businesses and the individuals responsible for their development. For small and/or start-up for-profit business entities that seek to produce both financial as well as a positive social return, please refer to Part III, APBCo Statement on the Eligibility of Social Enterprise Entities and Impact Finance Transactions for Pro Bono Legal Services.

Because APBCo is dedicated to enhancing access to justice for those who otherwise would not be able to afford competent counsel, we recommend that APBCo's guiding principles encompass pro bono work for Small Business Entities whose principals and whose place in the community align with APBCo priorities.

Consistent with the purposes of the general PBI definitional guidelines, Small Business Entities seeking pro bono representation should initially be evaluated for eligibility according to three factors: (i) the principal(s)' income; (ii) the entity's finances; and (iii) the impact of the entity on the community.

If a Small Business Entity does not qualify for services based on the principal/s' individual finances, the Entity may still be eligible for pro bono representation based on the limited finances of the entity itself (if the entity already is operational) and the beneficial impact of the entity on a low-income community, so long as each of the principals' household income(s) remain below 500% of the Federal Poverty Guidelines. This "Individual income, Entity income, and Impact" or "IEI" test -- and other important factors -- are detailed below.⁶

⁶ PBI's 2008 "What Counts" states: "... where the individuals behind the venture themselves would be eligible for pro bono legal services or where the venture benefits society and is the functional equivalent of a non-profit, the for-profit business could be eligible for pro bono legal services associated with that venture." PBI then enumerates several factors to consider if the individuals creating the business do not themselves qualify for pro bono legal services: "... the business venture could still qualify if: the primary mission of the business venture is to assist and enhance the well-being of low-income people and groups; the revenues from the business venture, if any, support that mission and assist people of limited means; the business venture possesses insufficient operating funds to pay for legal and other professional services; and the pro bono relationship is considered, from the beginning, of limited duration."

2. ANALYTICAL FRAMEWORK FOR SMALL BUSINESS ENTITIES

Requests to represent for-profit business entities on a pro bono basis should satisfy the eligibility assessment described below. Of course, every situation is unique so there should always be room for the application of professional judgment in determining whether a particular representation qualifies for pro bono services.⁷ Below are guidelines for assessing eligibility for pro bono representation, including a number of key individual factors to be considered when making those assessments, which APBCo believes fulfills our organizational goals and purposes. However, APBCo recognizes that regional economic and cultural differences may require the application of these guidelines to be followed with some degree of flexibility and discretion when applied to the realities of the circumstances under which member firms make decisions as to whether to accept a particular representation. APBCo expects its members to use the below-described eligibility factors as a framework, and to apply sound business judgment when assessing the applicability of these criteria, and working with these guidelines, in their own communities and firms.

When assessing requests for pro bono legal services from a Small Business Entity, a three-part IEI analysis should be employed. Initially, the income of the individual principal(s) of the entity should be examined. If that does not result in qualification for pro bono services, an analysis of the entity's overall finances is to be made, and an assessment of its impact on the community must follow. This IEI analysis, in summary, assesses the ability of any Small Business Entity to afford competent counsel based on a series of factors:

i. Initially it should be determined whether the Small Business Entity is a start-up business or whether it is an ongoing entity, as those terms are defined in Section 2(A) below.

ii. If a start-up Small Business Entity does not meet the Individual Income requirements, it may still qualify for pro bono representation if an analysis of the business' impact on the community, including an examination of particularly identified factors, is such that a firm determines the community will be best served by providing the requested legal representation, so long as the Individual Income remains within 500% of the Federal Poverty Guidelines.⁸

iii. If the Small Business Entity is a start-up business and the individual principal(s) of each have income that falls within 300% of the Federal Poverty Guidelines then the entity qualifies for pro bono representation.

iv. If the Small Business Entity is on ongoing business, then even if the principals' individual income falls below 300% of the Federal Poverty Guidelines, the income of the entity itself must be examined and it must fall below standards prescribed below.

v. The request for pro bono representation from all ongoing Small Business Entities, where the individual principal(s)' income falls between 300% and 500% of the Federal Poverty Guidelines and where the entity income also meets thresholds described below, must also be adjudged, as a last phase of eligibility analysis, by the impact of the business on the community.

⁷ In preparing this analysis, APBCo surveyed numerous public interest organizations that provide legal and financial services to Small Business Entities. This review of criteria included the collection of written guidelines from, as well as personal interviews conducted with, organizations in diverse regions of the United States. While no definable consistency of approach was discovered, the recommendations outlined here reflect analysis premised on the array of practices examined. A list of those organizations surveyed is available upon request.

⁸ The Federal Poverty Guidelines are issued each year by the U.S. Department of Health and Human Services.

vi. Notwithstanding the foregoing, APBCo recommends that if the individual income of the principal(s) of any Small Business Entity exceeds 500% of the Federal Poverty Guidelines that the business be deemed ineligible for pro bono representation.

A. **Individual Income: Ability to Afford Counsel**

The first step in assessing eligibility of both start-up enterprises and existing businesses is to examine the income and assets of the individual principal or principals of the Entity, just as a law firm would otherwise assess whether an individual client is eligible for any type of pro bono representation. Whatever financial criteria are used to assess qualification for any type of pro bono representation of an individual can be equally applied when examining the pro bono bona fides of a Small Business Entity. For a start-up entity, with no record of revenue or profits, if each individual principal meets a firm's standard guidelines for income/asset eligibility, then the business is eligible for pro bono legal services. For an existing, ongoing business, the income of the entity should also be assessed and must meet the Entity Income requirements set forth in Section 2(B), below. For purposes of this analysis, a business with at least one year of operational record, or other reliable indication of income, revenue and expense information, will be considered an "ongoing business."

1. **Assessing Ability to Pay**

i. **Income of Individual Principals⁹**: APBCo suggests that if each individual principal of a start-up Small Business Entity has household income of not more than 300% of the Federal Poverty Guidelines that the proposed business client be presumed financially eligible for pro bono representation. APBCo's survey of public interest organizations, referenced in footnote 2, above, indicated that 300% of the Federal Poverty Guidelines was roughly the national average below which prospective clients generally are deemed eligible for small business-related pro bono legal representation. Firms may need to adjust this individual income threshold to account for significantly higher or lower costs of living in different regions of the United States. It is assumed that APBCo members and their firms will exercise reasonable judgment, based on community realities and norms, in adjusting this guideline as deemed necessary. As is described below, APBCo recommends that any Small Business Entity whose principals have income exceeding 500% of the Federal Poverty Guidelines be deemed ineligible for pro bono representation.¹⁰

⁹ APBCo recognizes that undergraduate and graduate students are among individuals seeking pro bono legal assistance with Small Business Entities. We acknowledge that students may qualify for pro bono legal services, but caution that assessment of student-based requests for services may differ, at least to some degree, from assessment of requests submitted by other potential clients. By their nature, many students may appear to qualify as low-income, but they may in fact have increased access to capital or other resources, such as family support, and, consequently, may not represent the targeted population of disadvantaged individuals without access to justice for whom we prioritize our efforts. It is recommended that students not be deemed eligible for pro bono legal services only because they are students with limited personal income; but rather that their finances and access to resources be examined more carefully. For example, much the way other pro bono clients are deemed eligible for service because they have been adjudged low-income by the appropriate governmental agencies, and receive need-based public benefits as a result, students who receive need-based financial aid from a recognized institution of higher learning ought to be considered eligible for service without further assessment.

¹⁰ One source of guidance APBCo members may find useful in assessing ability to pay, including income thresholds, cost of living and the like, are the guidelines put forth by the U.S. Department of Housing and Urban Development (HUD). HUD provides regional guidelines for income and fair housing which some legal service providers also consider. As is described above, APBCo understands that in assessing the eligibility of prospective clients whose incomes do not meet the Federal Poverty Guidelines, firms may use their discretion and best business judgment in applying regional realities when deciding which engagements to accept. This can include an examination of HUD-provided regional, comparable guidelines and can be used by firms to determine that for the firm's particular

ii. Liquid Assets: In addition, a firm may look to the liquid assets of the principal(s) of the proposed client. While there is no standard criteria for assessing the level at which such assets would make a proposed client ineligible for pro bono representation, a subjective evaluation may be necessary. We suggest that if the amount of liquid assets is sufficient to permit the payment of reasonable attorney fees, including fees charged by solo or small firm practitioners, without putting the individual principal(s) in a position of financial hardship, then the proposed client should be deemed ineligible. We recommend a standard threshold of \$50,000 in liquid assets, an amount above which eligibility should be denied, absent compelling countervailing circumstances. Again, a firm's reasonable business assessment, based on regional economic differences, may be a controlling factor in making these eligibility determinations.

2. Legal Services Provider Pre-Screening¹¹: In many cities around the country, legal aid organizations that focus on serving small or start-up businesses have established income/asset financial eligibility standards. Firms that have worked with these organizations, and have come to trust and rely upon the eligibility assessments made, may give deference to the decision-making of reputable, trusted legal aid community organizations. Law firms often rely heavily on referrals made by these organizations, and absent any clear indication that pro bono representation of a for-profit entity would be inappropriate, such a referral can be a sufficient indication that a proposed client qualifies for pro bono legal services.

If a start-up Small Business Entity satisfies the individual-based financial guidelines for eligibility under this Section 2(A) and therefore is determined to have insufficient financial resources to be able to afford counsel, the proposed client is deemed eligible for pro bono legal services and no further assessment is required. However, if the proposed start-up client does not satisfy the criteria under this Section 2(A) because individual income exceeds threshold levels (e.g. is over 300% but less than 500% of Federal Poverty Level), the next step in the assessment is to review the proposed client's eligibility under Section 2(C), below. If the proposed client is not a start-up entity, but rather is an ongoing business as defined in Section 2(A), and if the income of the principal(s) are at less than 500% of the Federal Poverty Guidelines, then assessment of eligibility should proceed to Section 2(B), below.

B. Entity Income

If the potential client is an existing, ongoing for-profit business entity (as defined above in Section 2(A)), firms must also examine the finances of the Small Business Entity itself to determine if "the business venture possesses insufficient operating funds to pay for legal and other professional services." A decision on entity eligibility should take into account the totality of the financial position of the business.

1. Sales/Profits: It is APBCo's recommendation that if profits do not exceed \$75,000 per year and annual gross sales do not exceed \$250,000, that the proposed client, absent countervailing

community, a fair interpretation of these APBCo guidelines necessitates possible acceptance of representation when the client's finances meet a particular percentage of the community income average.

¹¹ Many requests for legal advice and representation from Small Business Entities are referred to firms by law school clinics. These clinical programs have proliferated in recent years and are becoming a more common source of referral opportunities. APBCo acknowledges that some of these clinics serve individuals and entities that would not qualify for services from traditional legal services organizations. The primary mission of many such clinics is the education and training of law students. Firms should use caution when considering pro bono representation for clients referred from clinics whose guidelines allow higher-income individuals to be served.

circumstances, be deemed presumptively eligible for services.¹² If profits and sales exceed those levels, the presumption should be that pro bono representation is not recommended. Similar to the discussion in Section 2(A), above, this determination may be geographically sensitive: business income that is low for New York City could be considered high in a smaller market city or rural area. Thus, there is no bright line here and some degree of business judgment ought to be exercised by firms assessing these requests for representation. It is recommended that community norms be examined, that assessment be made about the allocation and use of revenue/profits, and that if the entity's profits, divided among the principals, exceed 300% of the poverty guidelines, but are less than 500%, that the eligibility of the business for pro bono service still be subject to examination under Section 2(C), below

2. Staff Salaries/Expenses: In conjunction with examination of the suggested threshold amounts of sales and profits, a careful analysis should be made of the size of the business operation, its recent rate of growth, the sophistication of the paid employees of the business, the salaries paid as compared to the market rate for other similar for-profit entities in the geographic area, as well as other related business expenses. If salaries and other necessary costs are minimal, the assessing law firm can take into account those facts in making an overall determination of the financial position of the proposed client. For example, if the business principals are taking no salary or a substantially reduced salary as compared to market salaries for a comparable position at similarly sized organization, this could help a firm decide to provide limited pro bono assistance.

3. Professional Fees: Firms are encouraged to determine if the proposed client pays or has paid attorney or other professional fees, without endangering the financial position of the ongoing business activities of the entity. If the company has engaged such professionals, a presumption may arise that pro bono representation is not appropriate. As discussed in Section 1(C) on page 4 above, however, other factors may overcome this assumption, but it remains a threshold issue that should be addressed.

4. Affordable Access to Third Party Funds: Firms should also assess the ability of the proposed client to access affordable capital, whether through loans, mortgages, credit, investors, or other sources. The ability of the proposed client to pay attorney fees without enduring severe financial hardship could be significantly affected by potential access to such possible funding. Firms are encouraged to undertake whatever reasonable due diligence is required in order to make this determination.

Having completed this analysis, if the entity has insufficient funds for the payment of commercial legal services as determined under this Section 2(B) of the IEI analysis, with the principals' income falling under 300% of the Federal Poverty Guidelines, the proposed client is deemed to be economically eligible for pro bono representation. However, if the entity is not eligible under this Section 2(B) because income exceeds the guideline standards (and principals' income is over 300% of Federal Poverty Guidelines and less than 500%), the firm should proceed to Section 2(C) – Community Impact -- before making a final determination as to eligibility for pro bono representation.

C. Impact on Community

In any situation where the individual principals of either a start-up Small Business Entity or an ongoing Small Business Entity do not themselves qualify for pro bono representation under Section 2(A) above (i.e., their income exceeds 300% of the Federal Poverty Guidelines but does not exceed 500%), the impact of the small business on the local community should be considered in determining whether the

¹² In examining the eligibility criteria set forth by legal aid providers across the country, research revealed widely-disparate levels below which the amounts of sales, profits and revenue acceptably could fall. The levels stated in this Section 2(B) reflect an amalgam of factors, including APBCo member practices, legal aid guidelines, governmental programmatic eligibility, and member expertise.

representation may still qualify for pro bono legal services. Similarly, if an ongoing Small Business Entity has met the financial guidelines outlined in Section 2(B), the impact of that business on the local community must be examined before finally determining eligibility for pro bono representation.

Small businesses that qualify for pro bono legal services are typically located in low-income, under-resourced neighborhoods and are intended to benefit their local communities both financially and socially. Often, the Small Business Entities are brought to the attention of law firms by legal services providers or community development organizations whose business it is to know the community and its needs. Community economic development in these communities is, and has for many years been, a local, state and national priority. Contributing to revitalization and stabilization of such communities is an important outcome of small business pro bono representation. In addition, small business clients are typically self-selecting, and in assisting the business, firms are often also assisting the families who run them. Due to the importance of focusing pro bono legal services on low-income individuals or entities, APBCo recommends that should a firm determine the Small Business Entity requesting pro bono services is a venture that benefits society, either in work or purpose, such an impact on the community of the proposed enterprise should be given substantial weight in determining eligibility.¹³ We urge firms in these situations to delineate the bases for their acceptance decisions.

Among the factors to be considered when examining “impact” are:

1. Community Benefits: Firms should research and examine such measures of impact as whether the business will be conducted in an economically disadvantaged area, whether the business will create job opportunities for low-income local residents, whether job training opportunities will be part of the business plan, whether the business will be minority-owned or women-owned, whether similar businesses exist in the area, whether the business will attract investors and consumers to an otherwise depressed area of the community, and other similar factors.

2. Character of the Business: As is examined elsewhere, firms are encouraged to assess whether the proposed business has a specific community-minded mission or purpose. A Small Business Entity with such a mission may qualify for pro bono legal services. If the proposed business is intended to be operated with a public purpose, including the enhancement of the economic, health or social condition, and the overall benefit of low-income and disadvantaged people and groups, but the Small Business Entity exceeds the financial eligibility requirements outlined above, additional analysis will be required. See Part III, APBCo Statement on the Eligibility of Social Enterprise Entities and Impact Finance Transactions For Pro Bono Legal Services.

D. Financial Bar to Representation

APBCo does not recommend that a Small Business Entity be eligible for pro bono representation if the household income of the individual principal(s) is greater than 500% of the Federal Poverty Guidelines. Above that level, absent other considerations described above, including regional economic differences, it is recommended that the presumption be that the proposed client can afford, or access, legal representation such that the payment of attorney fees will not interfere with its operational financial success.

¹³ Assessing the benefit to society of the work of a Small Business Entity such that financial eligibility may be secondary in determining appropriateness for pro bono representation is much the same as the analysis of the “mission” of a proposed non-profit client discussed in Part I, the APBCo Statement on the Eligibility of Non-Profit Entities for Pro Bono Legal Services. Because the mission of small for-profit entities is indeed profit, however, there must be some upper cap on the income of the individual principals.

E. Other Considerations

APBCo understands and fully expects that even if a Small Business Entity is deemed to be eligible for pro bono services, a firm may exercise its independent business judgment and decide not to represent that potential client. Such decisions may be based on issues impacting a particular firm and its own business interests. APBCo further acknowledges that the following factors may be important in making a decision whether to engage the proposed client and suggest that these issues be considered as part of the overall assessment by a firm when evaluating the appropriateness of expending limited pro bono resources on a requested project:

1. Client Readiness: The readiness of a proposed client to begin or maintain a proposed business may be a factor for firms to consider. Regardless of the financial eligibility of a proposed client, a firm may make a business decision that the firm's pro bono resources are better expended on clients whose preparation and chances of success are greatest. The start-up time for a business to mature can be evaluated, as can be the general readiness of the principals to proceed. The principal's own training, experience and potential for success can be assessed and evaluated. Firms may choose to evaluate the proposed client's community ties, length of time living or working in the local community and levels of community support. Firms may decide not to offer pro bono representation, despite the financial eligibility of a proposed client, after examining these types of factors. The readiness of a client to proceed and succeed should not be considered a financial eligibility factor but rather should be treated as part of the business decisions being made during the case evaluation process by a law firm.

2. Documentation: In assessing the overall financial position of a for-profit business entity requesting pro bono legal services, firms should request documentation supporting whatever representational decisions are made. Firms are encouraged to request copies of documents that include:

- Business plans;
- Two years of individual tax returns;
- Two years of entity tax returns (if an ongoing business);
- Lists of co-owners, directors, investors;
- Proposed job creation;
- Likely impact on the surrounding community; and
- Evidence of the financial position of those individuals or entities.

Letters of recommendation or references can be requested, if practical. Resumes, background experience, and training should all be considered when appropriate.

3. Limited Time Duration of Legal Services: As the circumstances of a small business client change over time, firms are encouraged to re-assess on an annual, or more frequent basis, a client's continued eligibility for pro bono legal services. Indeed, any pro bono legal service provided to a for-profit entity should be time-limited in nature. Firms should carefully consider adapting their engagement letters to clarify any limits on the duration or scope of the representation, as well as the expectation that the client's eligibility will be re-evaluated periodically.

4. Nature of the Work: Much like non-profit clients, Small Business Entities typically seek legal assistance to address a range of issues. Common issues include corporate formation, compliance with government regulations, contracts, intellectual property, consulting arrangements, employment issues, and commercial leasing. Similarly, firms regularly provide legal representation in varying formats, including educational seminars, brief advice consultations, and full representation for specific legal issues. After a business is deemed eligible pursuant to the IEI methodology, the type of legal work provided is up to the firm.

Small Business Entities may also require assistance in litigation matters. Although APBCo does not recommend that financial eligibility guidelines differ depending on the type of work being requested, it is understood that this may be a factor in a firm deciding whether to accept an engagement. Firms are urged to consider the likelihood that the private marketplace would accept such a representation, understanding that the complexity of a proposed litigation matter might make it appropriate for handling by only a large, major private law firm. Consequently, given the competence that may be required, APBCo expects that the type of legal need and the probability of finding appropriate counsel may be a consideration in a firm deciding whether to accept a particular pro bono representation. The assessment of these factors is left to the sound judgment of individual firms.

3. EXAMPLES ILLUSTRATING ANALYTICAL FRAMEWORKS FOR “IEI” SMALL BUSINESS ENTITY EVALUATION

These hypothetical examples are intended to illustrate the application of the Individual-Entity-Impact framework described above.

A. A husband and wife work odd jobs doing handiwork and sewing, but have no full-time employment. Their annual household income is \$38,000 which puts them just under 250% of the Federal Poverty Guidelines. They own a small home and have roughly \$35,000 in savings. They used an online program to obtain a patent for a great product they developed involving sewing machinery. They were approached by a local businessman who wants to purchase their patent or start a new company with them. They visit their local legal aid organization seeking an experienced business and intellectual property attorney to advise them, help them protect any other rights they have and to ensure their interests are protected in this new company so they can make a living and ultimately hire more people. The legal aid organization asks if you will help this couple.

Commentary: This couple, as principals of a start-up Small Business Entity, would be eligible for pro bono services under the Individual Income test. Their individual and household income falls under 300% of the Federal Poverty Guidelines and they have limited liquid assets or access to funds to pay an attorney to help them. The fact that they may ultimately make quite a bit of money from their patent and new company does not disqualify them from service for the initial guidance. The fact that they were pre-screened by a legal aid organization should give further comfort that they meet financial eligibility guidelines. No further inquiry is needed.

B. A graduate student at the University of Virginia started a for-profit limited liability company to sell athletic gear targeted towards student softball teams with hopes of expanding his business to sell specialty team gear more broadly in Virginia and on the internet. He does not have any other employment, although he does receive a \$20,000 annual program-related stipend. He has no significant assets and receives financial aid to pay for his schooling. He started the company by borrowing money from fellow students and friends. In its first year the LLC lost \$5,000. In its second year, gross receipts were \$15,000 with total profit of \$1,500 and ordinary business income loss of \$24,000. Any money he does make goes back into the company. The student needs to negotiate a contract with the University Bookstore and calls you because you went to college together and he knows you are an attorney.

Commentary: This individual would be eligible for pro bono services under the Individual Income test. His annual income falls under 300% of the Federal Poverty Guidelines. As an ongoing Small Business Entity, he would also qualify under the Entity Operational Income test. His company is not profitable and he is not even earning a salary. He was able to raise some money to start his business, but with the company in pre-revenue stage, his funding dried up and with no liquid assets, the company cannot afford

to retain an attorney. The fact that the student receives financial aid to pay for schooling further suggests this is not someone with sufficient assets to pay legal fees. As this request comes directly from the client, the firm would have to do some independent verification of his financial status. If in this example the student was not on financial aid and had over \$50,000 in funds available to him, he would not be eligible. Note that if in this example the requested legal work was not time bound contract review, but rather to assist in potential litigation due to his competition with the University Bookstore, a firm might choose not to take this matter on pro bono because of the lack of time limited work.

C. A fee-generating client asks the firm to assist a small limited liability company which was started by a former intern, now a full-time student, with some intellectual property issues. The company was not set up as a social enterprise, although it does have a strong social mission. The company runs a website which sells natural lip balms and lotions. For every product sold, the company donates \$0.25 to a U.S. nonprofit operating in Africa focused on helping low income children with medical issues. The founder has spent some money in the past on professional fees to form the company, but claims she paid a reduced fee. The client is earning an income through the company which puts her above 300%, but less than 500%, of the Federal Poverty Guidelines. She uses the funds to pay for her schooling and to pay one employee. At present, after paying salaries, production and other expenses, donations to the nonprofit charity represent over 50% of the company's net profits. However, as the company grows they will likely make up a smaller percentage of the proceeds. Gross sales for the prior year were \$200,000.

Commentary: The fact that a fee-generating client has made the request is irrelevant to the decision. Although a student, the principal of the company is earning a living from the proceeds of her company and is able to pay herself a salary that puts her above 300% of the Federal Poverty Guidelines. Thus, she does not meet the Individual Income test. However, because the principal is still within 500% and this is an ongoing business, firms should still look at the entity's income. This would pass the Entity Income test because the entity has under \$250,000 in gross sales. Given that the entity is able to pay some salaries and has paid professional fees and that the principal also appears to have some access to capital, this is a closer call which warrants looking at impact. The company does have a strong social purpose which is to support disadvantaged children in Africa. The fact that a notable percentage of the company's net revenues are now donated to a non-profit which helps poor children might be a factor a firm could use to offer pro bono services. To qualify based on impact, a firm would want to do additional research into the company and its business plan. Any work should be limited in scope with the pro bono nature of the relationship re-evaluated before doing any further work because of the company's intent to donate a smaller percentage of its proceeds in the future. On balance, with the current facts this would probably pass the IEI test.

D. A law firm is approached by a non-profit that offers various types of assistance to individuals seeking to get started in the restaurant business and empower small business development. The non-profit would like legal advice with respect to contracts, but is also looking for attorneys to advise the clients it serves. Among other services, they offer clinics to individuals to address legal needs in starting up and running restaurants. Most, but not all, of the clients come from economically disadvantaged areas and seek to open their businesses in poorer communities, to employ others, and bring about positive economic change. There is, however, no income screening done for clients attending the clinics.

Commentary: The work for the non-profit would be assessed under APBCo's Mission-Matter-Means guidelines set forth in Part I. The work for individual clients in the clinics would qualify if the individual clients meet the Individual Income Test or, if the restaurant is an existing business, if the corporation meets the Entity Income Test. Even if they did not meet either of these tests, provided the requisite finances do not exceed 500% of the Federal Poverty Guidelines, the work would likely qualify under the

Impact on Community Test because most of the clients are looking to open their restaurants in economically disadvantaged neighborhoods and to employ others in those communities. The problem here is that the clinic does not do income screening and so volunteer attorneys might not know in advance if a given client would qualify for pro bono legal service. Given the mission of the non-profit running the legal clinics and the strong likelihood that clinic clients will meet all parts of the IEI analysis, attorneys should be able to assist clients on a pro bono basis. However, if a clinic client requires follow up direct representation, the law firm would likely want to do further income screening to verify eligibility for additional work.

E. A small gaming company that manufactures add-on pieces to action figurines (such as shields and swords) featured in a popular futuristic war-game seeks legal assistance. The company is owned by a single principal who works out of his parents' garage. The company has no other employees except it does pay independent contractors to assist with design work. The principal earned less than \$40,000 the prior year. Any income he does earn goes directly back into the company. His company is sued in federal court by a large corporation alleging over 100 trademark and copyright violations. The principal visited a local arts referral organization which qualified him for assistance, but which does not handle litigation matters and thus sent him to your law firm. The arts organization does screen for income, but has a sliding scale and so qualifies clients who are above the Federal Poverty Guidelines.

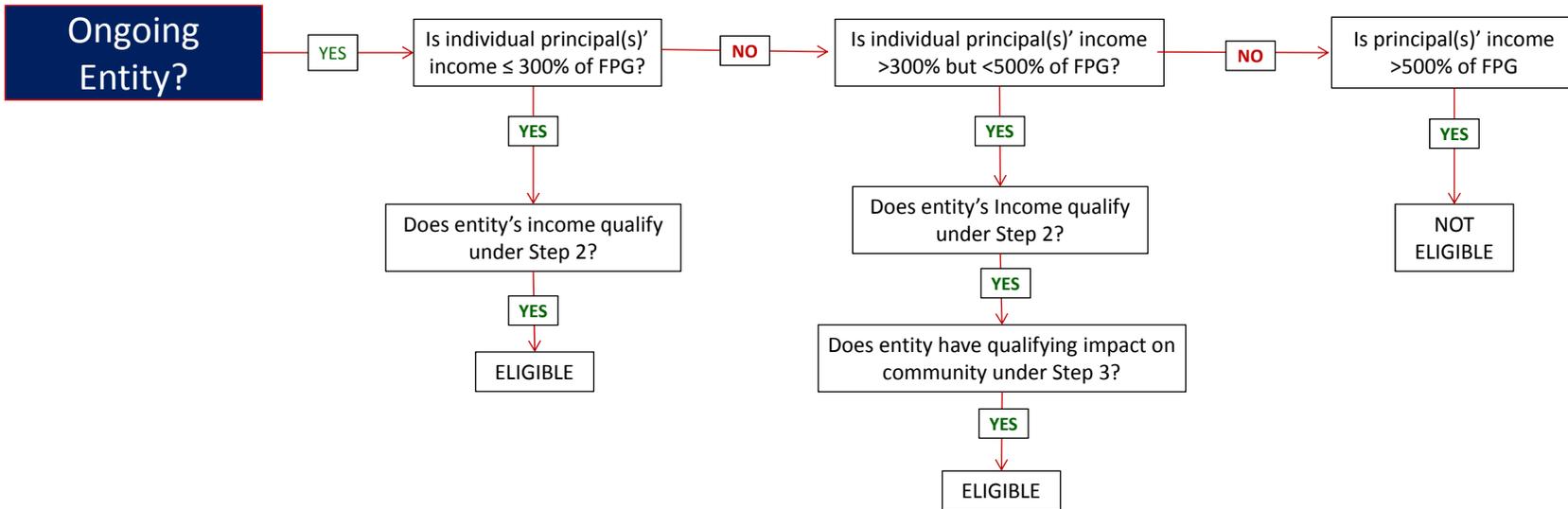
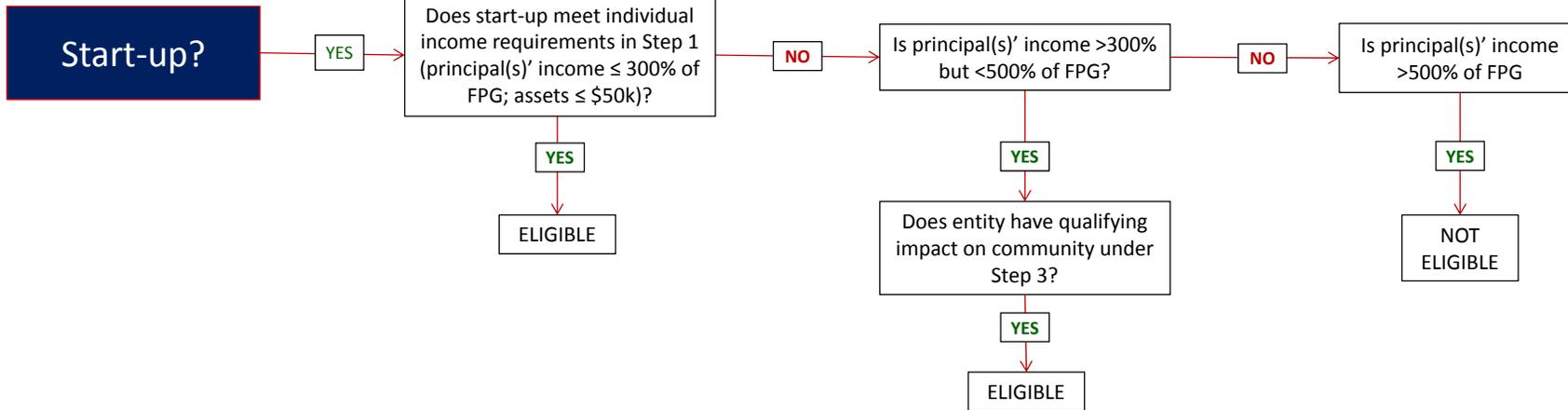
Commentary: The individual principal of the business would not be eligible for pro bono legal services because his income puts him over 300% of the Federal Poverty Guidelines. In this case, the referring organization does not do strict income screening and so a firm would want to verify that the income screening is in line with their own guidelines. If he is within 500% of the guidelines, we can move on to look at entity income. Although the business is already in existence, it has minimal profits and doesn't pay any employees other than small jobs by independent contractors. The facts here do not state whether the client has access to third party funds to allow him to pay for attorneys' fees. A firm might want to do some additional research to confirm, but assume the non-profit arts organization did assess for access to capital in deciding to qualify the client. Thus, this client does pass the Entity Income part of the test. The client would not be eligible under the Impact on Community analysis because his company is not a venture that benefits society, does not and is not likely to employ a number of people and is not serving persons of limited means, and does not have another clear social purpose. The client fails two of the three tests in this analysis and the work requested would likely involve very costly and lengthy litigation. Thus, this matter would not qualify for pro bono representation.

F. An innovation center housed in the engineering school of a public university and funded by a non-profit foundation helps undergraduate and graduate students (and occasionally faculty) develop and patent new inventions and create small businesses to market and capitalize them. The center reaches out to your law firm to provide legal counsel to serve the corporate and intellectual property needs of these young entrepreneurs on a pro bono basis. The center does not screen the potential clients for personal income, assets or financial aid on the presumption that students, especially at public universities, are typically low-income, and because it really does not want to exclude students who have patentable and marketable good ideas on the basis of income. The center's mission is to teach young people how to be successful entrepreneurs, which ultimately helps the community because successful small businesses create jobs and are generally good for the economy.

Commentary: In this case, the work requested would be directly for the entrepreneurs who come to the center. Given that no legal service provider is doing income screening of the individuals, a firm would need to do its own evaluation to determine if a given client meets the Individual Income test and qualifies as low income. There are also not existing entities to screen because the work is to create new

businesses. We do not have enough information about the impact that these patents and new businesses would have so additional research would also be required. For these reasons, a firm could not assume that clients sent from the innovation center qualify for pro bono assistance without independent verification of the clients. If the center is itself a qualifying non-profit under APBCo's Mission Matter Means set forth in Part I, a firm might be able to do work for the center, but regardless the work for the individual entrepreneurs would not qualify absent independent verification.

Chart of Small Business (IEI) Analysis



Key Factors to Consider Under IEI Analysis: 1) Type of entity (start-up or ongoing); 2) Income of individual principal(s) (includes income, liquid assets and general focus on ability to pay); 3) Income of entity (includes sales/profits; staff salaries/expenses; professional fees paid; affordable access to capital); 4) Impact of entity/work on the community (includes community benefits, character of business); 5) Other considerations such as client readiness, limited duration and nature of work).



PART III: APBCo STATEMENT ON THE ELIGIBILITY OF FOR-PROFIT SOCIAL ENTERPRISE ENTITIES AND IMPACT FINANCE TRANSACTIONS FOR PRO BONO LEGAL SERVICES

1. DEFINING “SOCIAL ENTERPRISE” AND “IMPACT INVESTING”

This Statement acknowledges that there is no universally accepted definition of the term “social enterprise.” Social enterprises may adopt traditional corporate forms (such as the non-profit, C Corp or LLC), a tandem structure of for-profit and non-profit entities, or newly authorized corporate forms, such as the benefit corporation.¹⁴ For the purposes of this Statement, APBCo adopts the following definition of social enterprise: *any for-profit business venture that seeks to produce both financial as well as positive social and/or environmental returns.* See Appendix A for a discussion of the different legal structures available to social enterprise organizations. For firms working with non-profit social enterprises or non-profit controlled tandem structures, the proper analysis is Mission, Matter, Means as set forth in Part I, *supra*.

There is more certainty regarding the term “impact investing,” which is now recognized as a distinct investment strategy within the larger universe of socially responsible investing (SRI). Where SRI traditionally employs negative screens to weed out socially, environmentally, or ethically irresponsible companies, impact investing uses positive screens to identify socially responsible and environmentally sustainable investments.

For the purposes of this Statement, APBCo adopts the following definition of impact investing: *investments made into companies, organizations and funds with the intention to generate measurable social and environmental impact alongside a financial return.* Impact investments can be made in both emerging and developed markets, and target a range of returns from below market to market rate, depending on the circumstances. Impact investments share three fundamental elements: (i) intentionality; (ii) expectation of financial return; and (iii) a commitment to impact measurement.¹⁵ Impact investments are intentional because, but for the expected social or environmental returns, the investment would not be made. Impact investments are also made with the expectation of a financial return. Lastly, and perhaps most importantly, impact investments require some degree of measurement and reporting on the social

¹⁴ This Statement is limited to corporate forms available in U.S. jurisdictions. However, APBCo members acknowledge that the adoption of new corporate forms designed for social entrepreneurs is a global phenomenon. See Orrick, Herrington & Sutcliffe LLP, UnLtd & Thomson Reuters Foundation, *Balancing Profit and Purpose: Legal Mechanisms to Lock in Social Mission For ‘Profit and Purpose’ Businesses across the G8* (Dec. 2014), available at <http://www.trust.org/contentAsset/raw-data/1d3b4f99-2a65-49f9-9bc0-39585bc52cac/file>.

¹⁵ Global Impact Investing Network, *About Impact Investing*, <http://www.thegiin.org/cgi-bin/iowa/resources/about/index.html#2>.

and environmental performance of the underlying investment, thereby ensuring transparency, accountability and the continued development of reliable non-financial impact metrics.¹⁶

2. ANALYTICAL FRAMEWORK FOR SOCIAL ENTERPRISES

In 2008, PBI published a revised version of the Law Firm Pro Bono Challenge Principles.¹⁷ Principle 7 and the comments thereto provide an analytic framework for determining the eligibility of for-profit organizations for pro bono legal representation.

Due to the unique, blended-value nature of for-profit social enterprises that pursue the profit motive and the enhancement of the economic, health, or social condition and overall well-being of low-income and disadvantaged people and groups, APBCo members believe that the Principle 7 framework should be modified for cases in which a social enterprise seeks pro bono legal representation. Of course, every situation is unique and thus APBCo members should leave room for the application of professional judgment in determining whether a proposed representation qualifies for pro bono legal services.

Principle 7, as modified for social enterprises, is as follows:

In general, for-profit business ventures are rarely eligible for pro bono legal services. However, because social enterprises are organized to produce positive social and environmental benefits, they are much more likely to qualify for pro bono legal services than traditional for-profit businesses. There are two ways in which a social enterprise may qualify for pro bono legal services. First, where the individuals behind the venture themselves would be eligible for pro bono legal services. Second, if the individuals behind the social enterprise do not themselves qualify for pro bono legal services, the entity may qualify for pro bono legal services if it satisfies the following criteria:

1. the social enterprise pursues, as part of its stated mission and purpose, the enhancement of the economic, health or social condition and overall well-being of low-income and disadvantaged people and groups, and the revenues from the social enterprise, if any, are used to support its social, or environmental mission;
2. the social enterprise possesses insufficient operating funds to pay for legal services and would not otherwise be paying legal fees, or the social enterprise has sufficient revenue but the matter for which the entity is seeking pro bono representation is integral and related to its social or environmental mission; and
3. the pro bono relationship is viewed, from its inception, as being “time bound” – to last only until the social enterprise becomes profitable from a market perspective and can, *inter alia*, pay for reasonably priced and competent counsel without sacrificing its mission.¹⁸

¹⁶ This statement has been developed by law firm leaders in the social enterprise and impact finance space utilizing their experience in considering eligibility determinations at their firms, in addition to comments received from different stakeholders in the legal services field generally who specialize in these areas.

¹⁷ PRO BONO INST., *Law Firm Pro Bono Challenge: Commentary to Statement of Principles* (2014), available at <http://www.probonoinst.org/wp-content/uploads/Law-Firm-Challenge-Commentary-2014.pdf>.

¹⁸ There is an analogous analytic framework that may provide some comfort and guidance from the non-profit community’s “program related investments” or PRI that allows non-profits to invest in for-profit companies whose work is in alignment with the non-profit’s mission.

These relationships require careful ongoing monitoring. Eligibility determinations will be made on a case-by-case basis and re-evaluated regularly over time.

A. Threshold Eligibility: Modified Principle 7 observes that for-profit businesses are “rarely eligible” for pro bono legal services. While this generalization still holds true for purely profit-driven enterprises, APBCo members acknowledge that social enterprises are committed to identify and pursue social and environmental missions that benefit a wide range of stakeholders and it may be appropriate to assist these enterprises achieve their social and environmental missions. Indeed, the blended-value purpose of social enterprises renders these organizations more likely to qualify for pro bono legal services than their traditional for-profit counterparts. ABPCo member firms are encouraged to continue their efforts to assist those who seek to harness the power of business to solve social and environmental problems. Threshold eligibility determinations are similar to the Mission analysis found in Part I, *supra*, but unlike the Mission analysis, a threshold determination is not dispositive of the issue.

B. Owners’ Eligibility: Social enterprise is a global phenomenon and the founders of these organizations do not come from any particular geographic region or socio-economic class. Accordingly, the owners of social enterprises may, themselves, qualify for pro bono legal representation under traditional Federal Poverty Guidelines established for the provision of pro bono legal services. Accordingly, ABPCo members should refer to Part II, *supra*, for the analysis of owners’ eligibility. However, given the blended-value missions of social enterprises, APBCo members do not believe that the individual income levels of the owners of a social enterprise should be dispositive in determining their eligibility for pro bono legal services.

C. Entity Eligibility: Even when the owners of a social enterprise do not personally qualify for pro bono legal services, Modified Principle 7 makes clear that the entity itself may qualify. In such cases, the social enterprise must satisfy the criteria set forth in subsections (1)-(4) below.

1. Mission & Purpose: Many social enterprises have as their stated corporate purpose some formulation of a general or specific public benefit that satisfies the Mission & Purpose criteria described in this subsection (1). However, as noted in the Appendix, the breadth of permissible corporate purposes under social enterprise enabling statutes encompasses missions that may not specifically target “low-income or disadvantaged people or groups,” such as, for example, “preserving or improving the environment” and “promoting the arts or sciences.” In cases where the mission of the social enterprise does not directly affect low-income or disadvantaged individuals, APBCo members should use their professional judgment, with reference to the “public rights” criteria provided for in PBI’s definition of “What Counts,” to determine if the purpose of the social enterprise is one that is nevertheless deserving of pro bono legal representation.

2. Revenue Allocation: The social enterprise’s revenues, if any, must be used to support the mission of the organization. Currently, the vast majority of social enterprises are early-stage start-up organizations, and are therefore likely to be in a pre-revenue stage of development. Where the social enterprise is pre-revenue, this criterion is inapplicable. Where the social enterprise does produce revenues, APBCo members may consider the following factors in determining whether the revenue allocation satisfies this subsection (2): (i) whether the organization has dedicated itself to contributing a significant and material percentage of its revenues to charitable or nongovernmental organizations; (ii) whether the formational documents of the organization require it to reinvest a significant percentage of the revenues back into the business; (iii) whether the social enterprise has entered into commercial co-venture partnerships with charitable or nongovernmental organizations; (iv) whether investors in the

social enterprise made investments in the venture without an expectation of a market rate of return; and (v) the social enterprise's historic dividend payout ratio,¹⁹ if any.

3. Sufficiency of Funds: Because most social enterprises are early-stage start-up ventures, they will often not possess sufficient funds to pay for legal services. Of course, the legal needs and the funding necessary to satisfy those needs will vary widely, depending on the circumstances. This threshold eligibility is similar to the Means analysis found in Part I, *supra*.

4. Time-Bound Nature of Engagement: Finally, pro bono representation of for-profit social enterprises should be time-bound. This criterion can be satisfied in a variety of ways and should be clearly communicated in the engagement letter. For example, the pro bono representation may terminate (i) when the social enterprise begins to generate revenue; (ii) when the social enterprise closes its first round of financing; or (iii) when the annual profits of the social enterprise exceed a predetermined amount. ABPCo members should use their professional judgment, taking the totality of the circumstances into account, in determining the temporal scope of the engagement.

3. ANALYTICAL FRAMEWORK FOR IMPACT FINANCE TRANSACTIONS

Impact investing encompasses a broad spectrum of potential investment opportunities. Accordingly, consideration of impact investment transactions for pro bono representation requires a unique and flexible analytic framework. As defined in Section 1 on page 19 above, impact investing uses positive screens to identify socially responsible and environmentally sustainable investments, including those where the ultimate use of proceeds would benefit low-income and disadvantaged communities. APBCo members should weigh the following factors when determining whether an impact investment transaction qualifies for pro bono legal services:

1. The total amount of the investment;
2. Whether the expected rate of return is below market or market rate;
3. Whether the investment is made in an emerging market or a developed market;
4. Whether the investor(s) is a non-profit organization or a for-profit organization, or both;
5. Whether the investment is made into an early-stage or a mature venture;
6. Whether other parties to the transaction are receiving pro bono legal services;
7. Whether, and to what extent, commercial financial institutions are involved in the transaction;
8. Whether the transaction involves an innovative public-private partnership; and
9. Whether the investment will result in increasing access to capital for persons of limited means.

A. Total Investment Amount: In general, as the total investment amount increases, so too does the transaction's ability to support transaction costs such as legal fees. Thus, the greater the total investment amount, the less likely the transaction is to qualify for pro bono legal services. Common sense dictates that there is an obvious difference between the pro bono eligibility of an investment of, for example, less than \$250,000 versus one greater than \$5,000,000, with the former likely allowing for pro bono representation, and the latter not qualifying for pro bono representation with all other factors being equal

¹⁹ Dividend Payout Ratio = [Yearly Dividend per Share] / [Earnings per Share].

and a clear social and/or environmental impact being shown. However, this factor does not prescribe a specific amount above which a transaction would be disqualified from receiving pro bono legal services. Rather, APBCo members are encouraged to use their professional judgment in weighing this factor on a case-by-case basis.

B. Expected Rate of Return: Impact investments may be made with the expectation of below-market or market-rate returns. Where the expected returns are below-market, this factor weighs in favor of pro bono legal representation. Where the investors expect a market-rate of return, this factor weighs against pro bono legal representation. Expected rates of return vary across economic sectors, and thus APBCo members should use their professional judgment in determining how to characterize the expected rate of returns, depending on the circumstances.

C. Market Type: Impact investments can benefit individuals in both emerging and developed markets. However, where an impact investment is made in an emerging market, there is a greater likelihood that the investment will benefit individuals living in poverty and under-resourced communities.²⁰ Thus, impact investments made in emerging markets are more likely to qualify for pro bono legal services than investments made in developed markets. APBCo members acknowledge that market classifications are subject to change, and should refer to the most recent version of the World Bank's Country and Lending Group Classifications to determine appropriate market classification.²¹

D. Investor Type: Impact investors may be non-profit organizations (*e.g.*, private foundations) or for-profit organizations (*e.g.*, a for-profit impact investment fund or even a traditional, commercial bank). In general, for-profit investors are better able to support transaction costs such as legal fees, and thus transactions involving for-profit investors are less likely to qualify for pro bono legal services than those involving non-profit investors. In matters involving a non-profit investor whereby the transaction is a program-related investment, the proper analysis is Mission, Matter, Means. Please refer to Part I, APBCo Statement on the Eligibility of Non-Profit Entities for Pro Bono Legal Services.²²

E. Organization Type: Impact investments can be made at all stages of organizational development. In general, impact investments made into early-stage ventures are smaller than those made into more mature ventures. Because investments in early-stage ventures generally take on greater risk and involve smaller investment amounts, particularly as they relate to investments designed to achieve a social and/or environmental purpose, they are less likely to support transaction costs such as legal fees. Accordingly, impact investments made into early-stage ventures are more likely to qualify for pro bono legal services than investments made into more mature organizations. This factor does not prescribe a bright-line rule for determining when an organization has reached a "mature" stage, and APBCo members should use their professional judgment to determine an organization's stage of development.

F. Legal Representation of Other Parties: Impact investment transactions may involve multiple parties, such as investors, investees, guarantors, underwriters, independent evaluators and the like. In determining whether a party to an impact investment transaction qualifies for pro bono legal

²⁰ This does not suggest, however, that impact investing in emerging markets is deemed more compelling or worthy than impact investing in emerged markets. APBCo recognizes that funding into community initiatives in poor communities in, for example, the United States or United Kingdom, is no less valuable, important, or eligibility deserving – than funding initiatives in poor communities in emerging markets.

²¹ The World Bank, *Country and Lending Groups*, <http://data.worldbank.org/about/country-and-lending-groups>.

²² APBCo recognizes that some firms believe it is appropriate to establish a bright-line rule that would preclude pro bono eligibility for any party that is involved in a transaction involving a commercial entity that because of its size and resources may be able to cover the legal fees for the entire transaction. However, APBCo does not believe it should and will not issue such a bright-line rule on this issue because we believe that firms will and should decide this issue consistent with their professional judgment required for these eligibility determinations.

representation, ABPCo members should determine whether the other parties to the transaction are receiving pro bono legal services or are paying legal fees. Where one or more parties to an impact investment transaction receive pro bono legal services, the likelihood that the party in question qualifies for pro bono legal services increases. Conversely, where one or more parties to an impact investment transaction are paying for legal services, the likelihood that the party in question qualifies for pro bono legal services decreases.

G. Commercial Financial Institutions: There are perhaps no organizations that are more capable of paying for legal services than commercial financial institutions, such as large investment banks. Such institutions possess sufficient funds to pay for legal services and are accustomed to building in legal fees to transaction costs. Accordingly, where an impact investment involves one or more commercial financial institutions, this factor weighs heavily against pro bono legal representation of other participating entities. If the commercial financial institution will cover the legal costs of the entire transaction, it is not eligible for pro bono services.

H. Public-Private Partnerships: Certain impact investments, such as Pay-For-Success/Social Impact Bond transactions, involve unique and innovative public-private partnerships aimed at producing more efficient social services to low-income and disadvantaged populations. In an effort to foster the growth of these types of partnerships, which remain in the early stages of development, and to reduce the transaction costs associated with these innovative financial structures, the presence of a public-private partnership weighs in favor of pro bono legal representation, particularly for the service providers involved in these transactions. Commercial financial institutions would not be eligible for pro bono representation in these transactions.

I. Increased Access to Capital: Microfinance transactions, by definition, involve the provision of banking services to low-income individuals or groups that are traditionally “unbanked” and would not otherwise have access to the financial services industry. Accordingly, where an impact investment is a microfinance transaction, it will be designed to increase access to capital for low-income or disadvantaged individuals, and therefore will be more likely to qualify for pro bono legal services.

4. EXAMPLES ILLUSTRATING ANALYTICAL FRAMEWORKS FOR SOCIAL ENTERPRISE AND IMPACT FINANCE MATTERS

These hypothetical examples are intended to illustrate the application of both the Modified Principle 7 framework and the impact finance transaction factors described above.

A. A non-profit organization is dedicated to creating stability in regions afflicted by long-term conflict and inadequate access to economic opportunity. To achieve this mission, the non-profit serves low-income women in conflict zones by providing them with job training, education and employment skills. The organization experiences great success in training and employing Afghan women to make jewelry from locally and sustainably sourced gemstones. It decides to create a wholly owned, for-profit social enterprise subsidiary that will exclusively employ these women to make jewelry, and the proceeds from sales are either donated to the non-profit parent organization or reinvested in the social enterprise subsidiary. The non-profit organization seeks corporate formation and structuring advice.

Commentary: Even though the proposed entity is a for-profit social enterprise, it will be wholly owned and controlled by a non-profit organization. Accordingly, its eligibility for pro bono legal representation should be determined pursuant to the Mission-Matter-Means test as set forth in Part I. Here, the social enterprise satisfies the Mission test – it trains and employs indigent women, and the revenues of the

organization are either donated to the parent charity or reinvested in the organization. No further inquiry is necessary.

B. A for-profit start-up coffee company registered as a benefit corporation has just completed its first year of operations with revenues of \$250,000. The benefit corporation has, as its stated specific public benefits, the promotion of economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business and preserving or improving the environment. It achieves these missions by sourcing all of its coffee beans directly from Ethiopian coffee growers, thereby allowing it to bring Ethiopian coffee to new markets and provide higher margins to the coffee growers. It also provides educational resources to the farmers and conducts on-site monitoring to ensure that the coffee beans are grown organically and harvested sustainably, thereby improving the local environment. The benefit corporation has begun to entertain interested investors and seeks counsel in connection with raising its first round of financing.

Commentary: The benefit corporation qualifies for pro bono legal services. This example requires the application of the Modified Principle 7 framework. Assuming the founders of the benefit corporation do not qualify for pro bono legal services themselves, the question is whether the benefit corporation satisfies Modified Principle 7's four criteria for entity eligibility. Here, the specific public benefit purposes of the corporation satisfy the first criterion. Although the business has recently begun to generate revenue, the majority of the revenues will be reinvested back into the business to allow it to continue to scale and expand its mission. This satisfies the second criterion. Moreover, because revenues will be reinvested and not retained by the benefit corporation, it is unlikely that it has sufficient funds to pay for legal services, which satisfies the third criterion. Lastly, if the engagement is time-bound, terminating when the benefit corporation successfully completes its first round of financing, the engagement satisfies the fourth criterion. Under these circumstances, the benefit corporation qualifies for pro bono legal services.

C. Assume the same facts as above, except that the benefit corporation has been in operation for three years, has annual revenues of \$5,000,000, and is seeking counsel in connection with a \$15,000,000 Series C round of financing.

Commentary: The benefit corporation does not qualify for pro bono legal services. The mission of the organization still satisfies the first criterion, but the change in financial circumstances likely precludes it from satisfying the second and third criteria. After successfully raising two rounds of financing, it is likely that early investors have received some portion of the revenues, and it is highly unlikely that the benefit corporation does not possess sufficient funds to pay for legal services.

D. A for-profit impact investment fund, with assets under management of approximately \$100 million, intends to invest \$2,000,000 in a promising new California start-up that is a certified B Corp. The social enterprise has retained a large law firm as pro bono legal counsel. The for-profit impact investment fund seeks outside counsel to represent the fund in the transaction.

Commentary: The investment fund is not eligible for pro bono legal services. Because the potential client is an investor, and not a social enterprise, the example requires the application of the impact finance factors. In this example, the total investment amount (\$2,000,000), the expected rate of return (market-rate), the market type (developed market), the investor type (for-profit), and the legal representation of the other parties to the transaction all weigh against pro bono representation. Moreover, the transaction does not involve a unique public-private partnership and is not a microfinance transaction, which also weigh against pro bono legal representation. The remaining two factors, organization type (early-stage B Corp) and the absence of a commercial financial institution, weigh in

favor of pro bono representation. In this case, the factors against pro bono representation outweigh those in favor of pro bono representation.

E. A non-profit impact investment fund with assets under management of approximately \$100 million invests in organizations, both not-for-profit and for-profit, which serve the poor by developing affordable housing, providing health care, creating jobs, protecting the environment and working in numerous other ways for the social good. The fund intends to invest \$100,000 in a promising Kenyan social enterprise whose mission is to increase access to basic health needs of the country's rural population. The fund expects a 3% return on its investment, well below market rate. The social enterprise is receiving pro bono legal counsel in connection with the transaction. A private foundation, which has a large law firm on retainer, is also making a program-related investment of \$100,000 in the social enterprise. The non-profit impact investment fund seeks outside counsel in connection with the transaction.

Commentary: The non-profit impact investment fund is eligible for pro bono legal services. This example requires the application of the impact finance factors to determine the non-profit investment fund's eligibility for pro bono legal services. Here, the total investment amount (\$200,000), the expected rate of return (below market), the market type (developing market), the investor type (non-profit fund), the organization type (early-stage social enterprise), and the absence of a commercial financial institution all weigh in favor of pro bono legal representation. While the private foundation is paying for legal services, the social enterprise is not, and thus the legal representation factor is neutral. The transaction does not involve a unique public-private partnership and is not a microfinance transaction, and thus both of these factors weigh against pro bono legal representation. Regarding the assets held under management by the non-profit fund, while the amount is significant, the non-profit is directly funding positive outcomes for poor individuals through its investment activities, and thus it is more akin to a well-resourced, traditional non-profit that is engaged in delivering services to the poor where total assets are not considered in the analysis. In this case, the factors in favor of pro bono legal representation outweigh those against pro bono legal representation. Determination of the non-profit eligibility from Mission, Matter, Means, as set forth in Part I, supra, is not strictly applied because of the profit return to which the impact investment fund is entitled.

F. A microfinance institution with assets totaling \$150 million intends to enter into an agreement with several other parties to form a new entity in Myanmar that will extend \$20,000,000 in microloans with below-market interest rates to rural farmers. All other parties to the agreement, none of whom are commercial financial institutions, are paying for legal services. The microfinance institution seeks counsel in connection with the agreement and formation of the new Myanmar entity.

Commentary: The microfinance institution is eligible for pro bono legal services. In this case, the total investment amount (\$20,000,000) and the fact that all other parties to the agreement are paying for legal services weigh against pro bono legal representation. However, the expected rate of return (below market), the market type (developing market), the investor type (microfinance institution), the organization type (early-stage), and the absence of commercial financial institutions all weigh in favor of pro bono legal representation. Moreover, the ultimate goal of the venture is to increase access to capital to rural farmers in one of Southeast Asia's poorest countries, which also weighs heavily in favor of pro bono legal representation. Regarding the assets held under management by the microfinance institution, while the amount is significant, the non-profit is directly funding positive outcomes for poor individuals through its investment activities, and thus it is more akin to a well-resourced, traditional non-profit that is engaged in delivering services to the poor where total assets are not considered in the analysis. In this example, the factors in favor of pro bono legal representation outweigh those against pro bono legal representation.

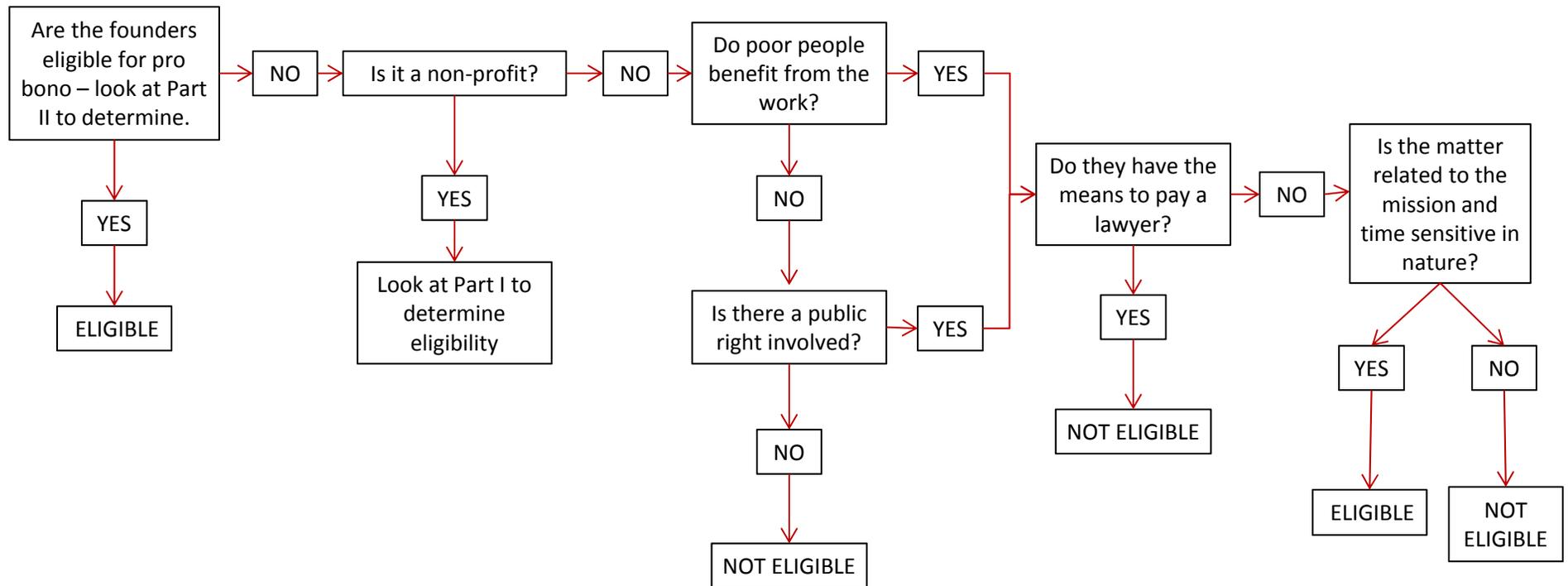
G. A private foundation, with an endowment of \$1 billion, and one that does not overtly have a charitable or other pro bono eligible mission, seeks to make a program-related investment in the amount of \$150,000 in a newly formed Vermont L3C (see Appendix A for a description of the L3C). The private foundation expects a 2% return on its investment. The L3C's mission is to empower women who live in distressed areas to start businesses producing candles, which are then sold at below-market prices to the local community and helps establish local markets for female entrepreneurs. The L3C is paying for legal services. The private foundation seeks counsel in connection with the PRI transaction.

Commentary: The private foundation is ineligible for pro bono legal services. In this example, the total investment amount (\$150,000), the expected rate of return (2%), the investor type (non-profit), the organization type (early-stage L3C), and the absence of a commercial financial institution all weigh in favor of pro bono legal representation. Factors weighing against pro bono legal representation include the market type (developed market), the fact that the L3C is paying for legal services, the absence of a unique public-private partnership, and the fact that the transaction will not result directly result in an increased access to capital. In addition, the private foundation's endowment weighs heavily against pro bono representation. Here, the factors against pro bono legal representation outweigh those for pro bono legal representation.

H. A state government seeks to establish the first pay-for-success/social impact bond (SIB) project in its jurisdiction, which will invest \$25,000,000 in an intervention program that aims to reduce incidences of teen pregnancy in low-income communities across the state. The other parties to the SIB transaction include: both non-profit and for-profit investors (including commercial financial institutions), a non-profit intermediary, a non-profit service provider and a for-profit independent evaluator. The investors' returns are capped at 15%. All for-profit investors and the state are represented by paid legal counsel. All other parties to the SIB transaction are receiving pro bono legal services. The non-profit intermediary seeks counsel in connection with the SIB transaction.

Commentary: The non-profit intermediary is eligible for pro bono legal services. Here, the total investment amount (\$25,000,000) weighs against pro bono legal representation. The expected rate of return is, at most, 15%, and thus this factor weighs in favor of pro bono legal representation. While the investment is made into a developed market, it is specifically targeted at low-income communities, and thus the market -type factor weighs in favor of pro bono legal representation. There are both non-profit and for-profit investors in the transaction, and thus this factor is neutral in the analysis. The service provider, a non-profit organization, is the recipient of the investment, and thus this factor also weighs in favor of pro bono legal representation. The state and for-profit investors are represented by paid legal counsel, while all other parties to the transaction are receiving pro bono legal services, and thus this factor also remains neutral. The presence of commercial financial institutions as for-profit investors in this example weighs against pro bono legal representation. However, in this case, the transaction is the first of its kind in the state involving an innovative public-private partnership, which weighs heavily in favor of pro bono legal representation. While this example illustrates a close call, the factors in favor of pro bono legal representation outweigh those against pro bono legal representation.

Chart of the Social Enterprise Analysis





EXECUTIVE SUMMARY OF IMPACT INVESTING:

There must be an element of social or environmental mission in the transaction for it to qualify as an impact investment for the purposes of this analysis. If there is no such mission, the matter is not appropriate for pro bono. Although, unlike in Part I, the mission alone is not dispositive.

There are several factors that would make such an impact matter be appropriate for pro bono representation. It is not necessary for each of the factors to be present for the matter to be an appropriate pro bono matter (and the existence or lack of any one factor is not dispositive), but there should be a preponderance of them.

Factors in favor of pro bono eligibility:

- Total amount of the investment is less than \$5 million;
- The rate of return is below market;
- The investment is being made in an emerging market or for the benefit of the poor (such as will result in increasing access to capital for persons of limited means);
- Your client is a non-profit;
- It is an early stage investment;
- No other parties involved are paying for their legal services;
- No commercial financial institutions are involved in the transaction; and
- The transaction involves an innovative public-private partnership.

Appendix A

LEGAL STRUCTURES FOR SOCIAL ENTERPRISE

A. Non-profit/For-Profit Tandem Structures

Increasingly, non-profit organizations are seeking alternative sources of funding by establishing revenue-generating businesses that pursue missions aligned with their charitable purpose(s). These business ventures may operate within an existing non-profit organization, or they may be structured as a subsidiary or corporate affiliate of a non-profit organization. Where a non-profit organization owns, controls and/or operates a for-profit social enterprise, determinations on whether the for-profit organization qualifies for pro bono legal services should be made in accordance with the analysis set forth in Part I.

B. Benefit Corporations²³

As of January 1, 2015, 26 states and the District of Columbia have adopted benefit corporation legislation.²⁴ The benefit corporation form is available to newly formed corporations as well as to pre-existing corporations that wish to convert. Benefit corporation legislation varies from state-to-state, but is generally based on one of two models: (i) the Model Benefit Corporation Legislation (the “Model Act”),²⁵ or (ii) the Delaware model.²⁶ Benefit corporations are for-profit organizations that are a subcategory of a state’s traditional business corporation, and accordingly, are subject to a state’s corporate code. In addition, benefit corporations are subject to special rules and fiduciary duties that are designed to lock in the organization’s stated public benefit purpose.

Corporate Purpose

Unlike traditional corporations, which serve “any lawful business” purpose, benefit corporations combine the traditional for-profit purpose with broader social or environmental purposes. Specifically, a benefit corporation *must* state in its articles of incorporation that it is organized for a “general public benefit,” which is defined as “a material positive impact on society and the environment, taken as a whole, assessed against third-party standards, from the business and operations of a benefit corporation.”²⁷ In addition, a benefit corporation may elect to identify one or more “specific public benefit” purposes in its articles of incorporation, which include the following:

²³ This section applies equally to benefit limited liability companies (BLLCs), which are authorized in Maryland, and track the language of the Model Benefit Corporation Act. MD. CODE ANN., CORPS. & ASS’NS §§ 11-4A-1201 to 11-4A-1208; 11-1-502; 5-6C-03 (2015).

²⁴ B Lab, *State by State Legislative Status*, <http://benefitcorp.net/state-by-state-legislative-status>; see also Social Enterprise Law Tracker, *Status Tool*, <http://socentlawtracker.org/#/map>.

²⁵ B Lab, *Model Benefit Corporation Legislation*, <http://benefitcorp.net/attorneys/model-legislation> (hereinafter, the “Model Act”).

²⁶ DEL. CODE ANN. tit. 8, §§ 361-68. The Delaware version has only been adopted by Delaware and Colorado, and uses the term “public benefit corporation” instead of “benefit corporation.” See COLO. REV. STAT. § 7-101-503. For purposes of this Statement, the term “benefit corporation” is used to refer to both versions of the legislation.

²⁷ Model Act, *supra* note 5, at § 102. In contrast, the Delaware statute defines “public benefit” as “a positive effect (or reduction of negative effects) on one 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.” DEL. CODE ANN. tit. 8, § 362(b).

providing low income or underserved individuals or communities with beneficial products or services;
promoting economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business;
preserving or improving the environment;
improving human health;
promoting the arts or sciences or the advancement of knowledge;
increasing the flow of capital to entities with a public benefit purpose;
and
conferring any other particular benefit on society or the environment.²⁸

If a special public benefit is selected, any change to such corporate purpose requires the approval of a two-thirds majority (or a greater amount if required by the articles of incorporation) of the outstanding shares of the benefit corporation.²⁹

Fiduciary Duties

Directors of traditional corporations are charged with two duties: (i) the duty of loyalty (to act in the “best interests” of the corporation); and (ii) the duty of care (to act with the care an “ordinarily prudent person” would exercise in similar circumstances). Courts have interpreted these duties to require directors to maximize the long-term pecuniary interests of the corporation’s shareholders. Under constituency statutes, directors may, but are not required to, consider nonshareholder interests when making business decisions. However, courts have held that directors who run afoul of the shareholder wealth maximization norm and adopt an “avowed purpose ... to sacrifice the [financial] interests of the shareholders”³⁰ have breached their fiduciary duties.

In response, benefit corporation legislation imposes a duty on directors to “consider”³¹ the impact of any proposed action on nonshareholder groups, including:

The employees and workforce of the benefit corporation and its subsidiaries and suppliers;
The interests of customers as beneficiaries of the general or specific public benefit purposes of the benefit corporation;
Community and societal considerations, including those of any community in which offices or facilities of the benefit corporation or its subsidiaries or suppliers are located;
The local and global environment;
The short-term and long-term interests of the benefit corporation; and
The ability of the benefit corporation to accomplish its general, and any specific, public benefit purpose.³²

²⁸ *Id.* The selection of a specific public benefit is required by the Delaware statute. DEL. CODE ANN. tit. 8, § 362(a)(1).

²⁹ *Id.* at § 201(d).

³⁰ *Dodge v. Ford*, 170 NW 668 (Mich. 1919). *See also eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1 (Del. Ch. 2010).

³¹ The Delaware statute requires directors to manage the benefit corporation in a manner that “balances the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation’s conduct, and the specific public benefit or public benefits identified in its certificate of incorporation.”³¹ DEL. CODE ANN. tit. 8, § 365(a) (emphasis added).

³² Model Act, at § 301(a)(1)(i)-(vii).

The additional “duty to consider” imposes a decision-making framework, but does not require any particular outcome. Indeed, in performing their fiduciary duties, directors of a benefit corporation are not required to give priority to the interests of any particular person or group listed above, unless the articles of incorporation provides otherwise. Moreover, benefit corporation statutes make clear that directors owe no duty to nonshareholder groups that are beneficiaries of the benefit corporation’s general or specific public benefit purpose. In addition, directors are shielded from monetary liability in the event the benefit corporation fails to accomplish a general or specific public benefit.³³

Right of Action

Most benefit corporation statutes provide for a special right of action – a benefit enforcement proceeding (“BEP”) – designed to ensure that directors of a benefit corporation take nonshareholder interests into account when making business decisions. Standing to bring a BEP is generally conferred upon the following: (i) directors; (ii) any person or group of persons that own at least 2% of the total number of outstanding shares of the benefit corporation; (iii) any person or group of persons that own 5% or more of outstanding shares of a benefit corporation’s parent company; and (iv) any other persons granted standing in the articles of incorporation.³⁴ A BEP may be brought for an alleged failure to pursue a general or specific public benefit, or violation of any special duty or standard of conduct imposed by statute, such as the requirement to produce and disclose an annual benefit report.³⁵

Reporting Requirements

All benefit corporation statutes require the production of a benefit report, which assesses the benefit corporation’s social and environmental performance against a comprehensive, independent third-party standard. In most jurisdictions, the benefit report must be published annually,³⁶ delivered to the shareholders, and made publicly available on the benefit corporation’s website. The report must include a narrative description of the following: (i) the ways in which the benefit corporation pursued both its general and any specific public benefits during the preceding year; (ii) any circumstances that have hindered the creation of general or specific public benefits; and (iii) an assessment of the social and environmental performance of the benefit corporation.³⁷

C. Social Purpose Corporations

As of January 1, 2015, social purpose corporations (“SPC’s”) have been authorized in California,³⁸ Florida³⁹ and Washington.⁴⁰ The SPC form is available to newly formed corporations as well as to pre-existing corporations who wish to convert to a SPC. There are several substantive distinctions between SPC’s and benefit corporations, which are highlighted below.

³³ *Id.* at § 301(a), (d); 303(c)(2).

³⁴ Model Act, at § 305(c)(2)(i)-(iv).

³⁵ *Id.* at § 305(a).

³⁶ The Delaware statute requires that the report be provided “no less than biennially [.]” DEL. CODE ANN. tit. 8, § 365

³⁷ Model Act, at § 401(a).

³⁸ CAL. CORP. CODE § 2500 *et seq.* California originally passed legislation in 2011 authorizing the Flexible Purpose Corporation (“FPC”). The FPC statute was amended in 2014 to rename FPCs as social purpose corporations.

³⁹ FLA. REV. STAT. § 607.501 *et seq.*

⁴⁰ REV. CODE WASH. §§ 23B.25.005 to .150. In addition, Texas has passed legislation that permits a corporation to adopt a “social purpose,” but does not authorize the creation of a new corporate form. TX. BUS. ORG. CODE §§ 23.001 to .110.

Corporate Purpose

Unlike a benefit corporation, which must be organized for a “general public benefit,” an SPC’s purpose is limited to one or more social purposes set forth in its articles of incorporation. A social purpose includes promoting positive effects and minimizing negative effects on one or more of the following:

the SPC’s employees, supplier, or customers;
the local, state, national or global community; and/or
the environment.⁴¹

In Washington and Florida, an SPC may elect a special social purpose, which must be stated in the articles of incorporation.⁴² Any change to an SPC’s social purpose must be approved by a two-thirds majority of all outstanding shares.⁴³

One notable feature that is unique to the Washington statute and designed to protect the social purpose of the SPC, is the requirement that an SPC include the following mission statement in its articles of incorporation: “The mission of this social purpose corporation is not necessarily compatible with and may be contrary to maximizing profits and earnings for shareholders, or maximizing shareholder value in any sale, merger, acquisition, or other similar action of the corporation.”⁴⁴ In theory, such a mission statement is designed to avoid the so-called *Revlon* duty to maximize shareholder value in the context of change-of-control situations, thus ensuring that the directors of the SPC can consider nonshareholder interests when the SPC is for sale.⁴⁵

Fiduciary Duties

Like directors of traditional business corporations, directors of SPC’s are subject to the duties of loyalty and care.⁴⁶ In addition, directors of SPC’s are required to consider the social purposes of the SPC in discharging his or her duties.⁴⁷ The statutes make clear that directors and officers do not owe any duty to third party beneficiaries of the SPC’s social purpose(s).⁴⁸ Moreover, any action, or failure to act, that a director or officer reasonably believes is intended to promote one or more of the social purposes of the corporation, is deemed to be in the best interests of the corporation.⁴⁹

Right of Action

Rights of action against SPC’s vary from state-to-state. The Florida statute adopts the benefit corporation’s BEP provisions,⁵⁰ and confers standing to bring a BEP on: (i) shareholders; (ii) directors; (iii) any person or group of persons that own 5% of more of the outstanding shares of an SPC’s parent company; and (iv) any other person specified in the articles of incorporation.⁵¹ In contrast, under the

⁴¹ REV. CODE WASH. § 23B.25.020; FLA. REV. STAT. § 607.506(2).

⁴² REV. CODE WASH. § 23B.25.030.

⁴³ *Id.* at § 23B.25.090.

⁴⁴ *Id.* at § 23B.25.040(1)(e).

⁴⁵ *See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

⁴⁶ *See, e.g.*, CAL. CORP. CODE § 2700(a); REV. CODE WASH. § 23B.25.050(1).

⁴⁷ CAL. CORP. CODE § 2700(c); REV. CODE WASH. § 23B.25.050(2); FLA. REV. STAT. § 607.507(1).

⁴⁸ CAL. CORP. CODE § 2700(f); REV. CODE WASH. § 23B.25.050(5); FLA. REV. STAT. § 607.507(3).

⁴⁹ REV. CODE WASH. §§ 23B.25.050(3); 23B.25.060(3).

⁵⁰ FLA. REV. STAT. § 607.511(1)(a).

⁵¹ *Id.* at § 607.511(2).

Washington and California statutes, only shareholders have standing to bring a derivative action against an SPC.⁵²

Reporting Requirements

Annual reporting requirements also vary from state to state. The Florida statute adopts the benefit corporation reporting requirements.⁵³ The Washington statute requires SPC's to produce a "social purpose report" annually, furnish the report to shareholders, and make the report publicly available on the corporation's website.⁵⁴ However, unlike benefit corporation reports, there is no requirement that the social purpose report be assessed against an independent, third-party standard. Where a Washington SPC fails to furnish a social purpose report for two consecutive years, shareholders have a statutory right to seek a court order requiring the SPC to produce a report.⁵⁵

In California, SPC's are required to furnish annual special purpose reports to shareholders, to make the reports publicly available on the SPC's website, and, in certain circumstances, make a "special purpose current report" available to shareholders.⁵⁶

D. Low-Profit Limited Liability Companies

Much like the benefit corporation and SPC are variant forms of traditional for-profit corporations, low-profit limited liability companies (L3Cs) are variants of a traditional limited liability company (LLC). Accordingly, L3Cs share the same fundamental characteristics of LLCs, such as flexibility in organization and operation, liability protection, and malleable tax treatment. L3C statutes, which have been adopted in eight states,⁵⁷ create a subcategory of LLCs designed to receive program-related investments from private foundations.⁵⁸

Corporate Purpose

The L3C is unique among social enterprise forms in that it must be formed for a charitable or educational purpose within the meaning of the Internal Revenue Code, and, but for the charitable or educational purpose, would not have been formed. In addition to these affirmative requirements, there are restrictions. The production of income or the appreciation of property must not be a significant purpose of the L3C, and it cannot have a political or legislative purpose. In the event an L3C fails to satisfy any of these requirements, it immediately ceases to be an L3C and converts to a limited liability company by operation of law.⁵⁹

⁵² CAL. CORP. CODE § 2900(c); REV. CODE WASH. § 23B.25.080.

⁵³ FLA. REV. STAT. § 607.512.

⁵⁴ REV. CODE WASH. § 23B.25.150(1).

⁵⁵ *Id.* at § 23B.25.150(5).

⁵⁶ *Id.* at § 3501.

⁵⁷ VT. STAT. tit. 11 §§ 3001(23); 3005(a); 3023(a); 805 ILL. COMP. STAT 180/1-4, 180/1-10, 180/1-26, 180/5-5; LA. REV. STAT. ANN. §§ 12:1301(a)(11.1), (12), 12:1302(C), 12:1305(B)(3), 12:1306(A)(1); 12:1309(A); ME. REV. STAT. §§ 1502(16), 1508, 1611; MICH. COMP. LAWS §§ 450.4102(m); R.I. GEN. LAWS §§ 7-16-2(27), 7-16-9, 7-16-49, 7-16-76; UTAH CODE §§ 48-2c-412, 48-2c-1411; WY. STAT. § 17-29-102(a)(ix) *et seq.*

⁵⁸ For a more comprehensive discussion and critique of L3Cs, see Daniel Kleinberger, *A Myth Deconstructed: The Emperor's New Clothes on the Low-Profit Limited Liability Company*, 35 DEL. J. CORP. L. 879 (2010).

⁵⁹ *Id.* at § 3001(27)(D).

Fiduciary Duties

L3C statutes lack clarity regarding the fiduciary duties of their managers. APBCo members should be aware that such fiduciary duties are jurisdiction-specific, and accordingly, should consult the appropriate statutory provisions before counseling L3C clients regarding the fiduciary duties of their managers.

Right of Action

No L3C statute grants standing to any group of individuals to bring a special right of action to enforce the charitable mission of the company. Accordingly, L3C members must rely on derivative suits traditionally available to LLC members to allege violations of fiduciary duties against the L3C or its managers.⁶⁰

Reporting Requirements

Unlike all other social enterprise forms, L3Cs are under no legal obligation to produce reports assessing the company's social or environmental performance.

E. Traditional For-Profit Corporation Forms

Social enterprises may also adopt traditional corporate forms, such as the C Corp or the LLC. Indeed, in the experience of APBCo member firms as of the publication of this Statement, the majority of social enterprise clients that are not not-for-profit organizations are either in a tandem structure or are a traditional corporate form (without B Corp certification, discussed below). This should not be a bar to pro bono eligibility. The analysis for a social enterprise that chooses a traditional corporate form involves application of the criteria detailed in Part III, and in addition, a determination whether the organizational documents lock in the social and/or environmental mission to the fullest extent practicable. APBCo member firms should reach this conclusion, at minimum, through interviews with the prospective pro bono client to confirm that the founders have a primary intent to further the social and/or environmental mission and are committed to this from a corporate law perspective.

It is also important to note that traditional corporate entities may seek to obtain third-party certification confirming their social enterprise status. A prominent example is the "B Corp" certification offered by B Lab, a Pennsylvania-based non-profit organization seeking to harness the power of business to solve social and environmental problems. B Corp certification is distinct from the benefit corporation form discussed above; the former is a third-party certification available to a wide range of corporate forms while the latter is a new corporate form authorized under state law. An organization seeking to be B Corp certified must first take a "B Impact Assessment" and obtain a score of 80 or higher, adopt B Lab's amendments to its articles of incorporation, sign the B Corp Declaration of Interdependence and Term Sheet, and pay the appropriate certification fee. Once this process is complete, B Lab certifies the organization as a

⁶⁰ A notable exception is the Illinois L3C statute, which grants the Attorney General regulatory authority over L3Cs pursuant to the Illinois Charitable Trust Act.

B Corp, at which point it is subject to B Lab's private regulatory regime and randomly selected on-site reviews.