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Social Enterprise Governance Post-SOX

By Alina Ball*

Social enterprises—nonprofit and for-profit businesses that use market-based strategies to achieve social change for marginalized populations—demonstrate a new paradigm for doing business in the United States. The Sarbanes-Oxley Act of 2002 (“SOX”), which transformed financial reporting and heightened internal controls for public companies, has, perhaps unintentionally, also had an outsized influence on the development of social enterprise governance. The primary impact of SOX is found in the state-level auditing and reporting reforms imposed on large nonprofits. Moreover, “benefit reports,” the lynchpin of social enterprise state legislation, also mirror the SOX emphasis on transparency through third-party assessment. This article outlines those reformist and legislative SOX-inspired efforts targeting the mission-driven sector, within which nonprofit and for-profit social enterprises reside. This article also explores how social enterprise governance could further develop by learning from twenty years of SOX successes, criticism, and legislative modifications.

INTRODUCTION

The twentieth anniversary of the Sarbanes-Oxley Act of 2002 (“SOX”)¹ is an opportunity to examine the ripple effects of SOX beyond the context of public companies. This article provides a descriptive summary of the impact of SOX on the social enterprise sector. Depending on which vantage point one takes, SOX can be said to have made a significant impact on the emergence and development of social enterprise governance. Indeed, SOX and its heightened emphasis on improved financial reporting has altered auditing practices for many nonprofit social enterprises and inspired key features of social enterprise legislation. However, twenty years later, it remains unclear if these SOX-inspired reforms have improved social enterprise governance or whether SOX is the right benchmark for the future of social enterprise governance reform.

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1. Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11, 15, 18, 28 & 29 U.S.C.).

Social enterprises² are businesses organized as for-profit or nonprofit firms that utilize market-based strategies to advance social and environmental goals. Social enterprises promote social change and equity by addressing structural barriers that marginalize and exclude various populations, such as refugees and asylum seekers,³ individuals with criminal records,⁴ and individuals experiencing homelessness.⁵ While for-profit, mission-driven companies are often touted as the archetypal social enterprise,⁶ it is well accepted that numerically more social enterprises are nonprofit corporations,⁷ though the empirical data here is not well developed. As I have written previously,⁸ imagine a Venn diagram of for-profit companies and nonprofits, where the overlap is companies that could arguably organize as either a tax-exempt nonprofit because of their clearly articulated charitable purpose or a for-profit entity because of their potential to generate financial returns for owners. This overlap in the diagram is an accurate description of how this article uses the term “social enterprise.”

The passage of SOX came in the wake of a series of corporate scandals.⁹ The fallout from the WorldCom inflated earnings scandal, the Enron accounting scandal involving Arthur Andersen, other dot.com related scandals,¹⁰ and

2. Hugh Whalan, *When Will the First Social Enterprise Have a Huge IPO?*, FAST CO. (Aug. 13, 2019), <https://www.fastcompany.com/90388464/when-will-the-first-social-enterprise-have-a-huge-ipo> (“Social enterprise is the use of business to solve social problems.”); *What Is a Social Enterprise?*, ANNIE E. CASEY FOUND. (Dec. 10, 2020), <https://www.aecf.org/blog/what-is-a-social-enterprise> (“Social enterprises are revenue-generating businesses with a mission. Whether it’s providing clean water, expanding health care services, strengthening renewable energy options or—similar to those the Annie E. Casey Foundation invests in—helping individuals entering or returning to the workforce, social enterprises use their profits and business practices to address a societal need.”).

3. See, e.g., 1951 COFFEE CO., <https://www.1951coffee.com> (last visited Apr. 28, 2023) (“By purchasing a cup of coffee at 1951 Coffee you are providing a life altering opportunity for a refugee living in your community.”).

4. See, e.g., *Our Mission*, HOMEBOY INDUS., <https://homeboyindustries.org/our-story/our-mission/> (last visited Apr. 28, 2023) (“Homeboy Industries provides hope, training, and support for formerly gang-involved and previously incarcerated people, allowing them to redirect their lives and become contributing members of our community.”).

5. See, e.g., *URBAN ALCHEMY*, <https://urban-alchemy.us> (last visited Apr. 28, 2023) (“We’re a social enterprise that engages with situations where extreme poverty meets homelessness, mental illness and addiction.”).

6. See Prayag Narula, *The For Profit Social Enterprise Is the Impact Model of the Future*, FORBES (Dec. 22, 2017), <https://www.forbes.com/sites/forbestechcouncil/2017/12/22/the-forprofit-social-enterprise-is-the-impact-model-of-the-future/?sh=504e05a25571> (“Today, many companies that follow the social impact model are technology companies. There are dozens of examples in Silicon Valley and beyond of companies that have the potential to create positive change on a large scale.”).

7. See Ben Thomley, *The Facts of U.S. Social Enterprise*, HUFFINGTON POST (Jan. 8, 2013), https://www.huffpost.com/entry/social-enterprise_b_2090144 (“35 percent of U.S. social enterprises are non-profit organizations; 31 percent are regular C corporations or LLCs.”).

8. See Alina Ball, *Social Enterprise Governance*, 18 U. PA. J. BUS. L. 919, 929 (2016).

9. Statement by President George W. Bush regarding H.R. 3763, 38 W.KLY. COMP. PRES. DOC. 1286 (July 30, 2002) (describing SOX as “tough new provisions to deter and punish corporate and accounting fraud and corruption, ensure justice for wrongdoers, and protect the interests of workers and shareholder”).

10. See, e.g., *The Securities and Exchange Commission, NASD and the New York Stock Exchange Permanently Bar Henry Blodget from the Securities Industry and Require \$4 Million Payment*, U.S. SEC. & EXCHANGE COMMISSION (Apr. 28, 2003), <https://www.sec.gov/news/press/2003-56.htm> (explaining charges against Henry Blodget for fraudulent research on technology companies).

accounting scandals¹¹ in the early 2000s was not just limited to those investing in public companies or high-tech industries. These major corporate scandals involving mismanagement, investment banking fraud, and accounting malpractice not only stunned their industries, but also disrupted the larger economy,¹² causing high levels of market volatility. SOX emphasized the need for internal controls of financial reporting¹³ and the imperative that boards are both aware of and accountable for the acts of the corporation. SOX was and continues to be a unique legislative process¹⁴ in the degree of wide bipartisan support for the bill.¹⁵ Major accomplishments of SOX were to create the Public Company Accounting Oversight Board¹⁶ and to establish requirements for independent audit committees,¹⁷ executive attestations of financial report accuracy, and, through Section 404, corporate governance requirements including internal controls for oversight of financial statements.

SOX governs social enterprises in a variety of ways. First, social enterprises are subject to SOX both because of their activities and because of the breadth of the legislation's reach.¹⁸ Some social enterprises are subject to SOX based on their activities as publicly traded companies. Laureate Education, Inc., for example, the first publicly traded public benefit corporation,¹⁹ raised nearly \$500 million

11. See, e.g., Gretchen Morgenson, *KPMG Settle with S.E.C. on Xerox Audits*, N.Y. TIMES (Apr. 20, 2005), <https://www.nytimes.com/2005/04/20/business/kpmg-settles-with-sec-on-xerox-audits.html> ("KPMG, the accounting firm, was censured yesterday by the Securities and Exchange Commission, which said the firm helped executives at the Xerox Corporation manipulate and distort financial statements from 1997 through 2000 by issuing audits stating that Xerox's reports were consistent with accounting rules when they were not.")

12. Carol Graham, Robert E. Litan & Sandip Sukhtankar, *Cooking the Books: The Cost of the Economy*, BROOKINGS INST. (Aug. 1, 2002), <https://www.brookings.edu/research/cooking-the-books-the-cost-to-the-economy/> (estimating the first-year costs to the economy from the corporate scandals at "approximately \$35 billion, or .34 percent, off of Gross Domestic Product (GDP)").

13. Sarbanes-Oxley Act § 404, 15 U.S.C. § 7262 (2018) (issuer management acknowledging their responsibility "for establishing and maintaining an adequate internal control structure and procedures for financial reporting" and assessing, "as of the end of the issuer's most recent fiscal year, the effectiveness of the issuers' internal controls for financial reporting").

14. Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1523 (2005) ("The Sarbanes-Oxley (SOX) Act of 2002, in which Congress introduced a series of corporate governance initiatives into the federal securities laws, is not just a considerable change in law, but also a departure in the mode of regulation.")

15. Roberta Romano, *Does the Sarbanes-Oxley Act Have a Future?*, 26 YALE J. ON REG. 229, 238 (2009) ("The confluence of spectacular financial scandals, a declining stock market, waning public confidence in business, and a media frenzy in an election year resulted in a restricted legislative debate and progressively more lopsided votes in support of greater regulation. . . . [W]hen the bill that emerged from the conference committee was the Democratic Senate's version, all but three House Republicans voted for it. The Senate votes on the bill were unanimous. In short, there was overwhelming, bipartisan support for the [SOX] legislation.")

16. Sarbanes-Oxley Act § 101(a), 15 U.S.C. § 7211(a) (2018).

17. Sarbanes-Oxley Act § 301, 15 U.S.C. § 78j-1(m)(2), (3)(B)(i)-(ii) (2018).

18. Elisabeth Bumiller, *Bush Signs Bill Aimed at Fraud in Corporations*, N.Y. TIMES (July 31, 2002), <https://www.nytimes.com/2002/07/31/business/corporate-conduct-the-president-bush-signs-bill-aimed-at-fraud-in-corporations.html> (President Bush "called the legislation 'the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt.'")

19. John Montgomery, *Why Laureate Education's IPO Matters to Silicon Valley*, B THE CHANGE (Feb. 10, 2017), <https://bthechange.com/why-laureate-education-ipo-matters-to-silicon-valley-656338f86e93> ("Laureate Education went public on February 1, 2017 as the first publicly listed benefit corporation.")

during its initial public offering. Still other social enterprises have demonstrated that an impact-driven company can attract the major investors²⁰ necessary to achieve an exit through IPO or acquisition. Moreover, several publicly traded companies have social enterprise subsidiaries.²¹

There are also SOX provisions that apply broadly to social enterprises because they apply to all businesses and are not limited to public companies, notably the document retention and whistleblower protection provisions.²² The document retention provisions make it a crime to knowingly alter, conceal, or falsify any document or object with intent to impede or influence a federal investigation of any federal matter.²³ Consequently, many social enterprises have adopted document retention policies post-SOX²⁴ that are either included in the bylaws or in a separate board policy. Similarly, whistleblower protection provisions make it a felony to retaliate against any employee who suspects fraudulent financial activities who then provides law enforcement authorities with truthful information relating to the alleged offenses.²⁵ Although SOX does not require a written policy, some social enterprises now have a written whistleblower protection policy as a matter of best practice.

While acknowledging the aforementioned implications of SOX on social enterprises, this article focuses on those reformist and legislative SOX-inspired efforts targeted at the mission-driven sector, impacting the development of social enterprise governance. Most social enterprises are small companies²⁶ that are not accessing capital markets. Thus, much of Section 404 is not formally applicable to most of the social enterprise sector.²⁷ SOX was an effort to curb mismanagement

20. *Id.* (“Laureate’s lead investor, a consortium of private equity firms, including Kohlberg Kravis Roberts & Co. L.P., Point 72 Asset Management, Bregal Investments, StepStone Group, Sterling Partners, and Snow Phipps Group, signal other private equity and venture capital investors that the benefit corporation is a legitimate and safe investment vehicle.”).

21. See Stephanie Rosenbloom, *Gap Acquires Athleta for \$150 Million*, N.Y. TIMES (Sept. 22, 2008), <https://www.nytimes.com/2008/09/23/business/23gap.html>; Judith Evans, *Ben & Jerry’s vs Unilever: How a Star Acquisition Became a Legal Nightmare*, FIN. TIMES (Oct. 11, 2022), <https://www.ft.com/content/30efd993-8c23-4f1b-9385-132bbba3d863>; *Sun-Maid Growers of California Acquires Plum Organics from Campbell Soup Company*, CAMPBELL’S (Mar. 31, 2021), <https://www.campbellsoupcompany.com/newsroom/press-releases/sun-maid-growers-of-california-acquires-plum-organics-from-campbell-soup-company-2/>.

22. See also Sarbanes-Oxley Act § 1102, 18 U.S.C. § 1512 (2018) (making it a crime to obstruct, influence, or impede any official proceeding).

23. Sarbanes-Oxley Act § 802, 18 U.S.C. §§ 1519, 1520 (2018).

24. Amy Blackwood, Nathan Dietz & Tom Pollak, *The State of Nonprofit Governance*, URBAN INST. 6 (2014), <https://www.urban.org/sites/default/files/publication/22951/413229-the-state-of-nonprofit-governance.pdf> (noting “a big jump in the percentage of organizations that had a written document-retention and-destruction policy: 30 percent in 2005 to 49 percent in 2010”).

25. Sarbanes-Oxley Act § 1107, 18 U.S.C. § 1513(e) (2018).

26. See Jonathan Soros, *A New Way to Scale Social Enterprise*, HARV. BUS. REV. (Apr. 15, 2012), <https://hbr.org/2021/04/a-new-way-to-scale-social-enterprise> (noting that social enterprises “do exist, but they remain a niche minority in the growing impact investing landscape, small in scale and targeted at specific social problems or geographic areas”).

27. See Jennifer S. Fan, *Regulating Unicorns: Disclosure and the New Private Economy*, 57 B.C. L. REV. 583, 598–605 (2016) (explaining societal and financial harms caused by unicorn companies not subject to a robust disclosure regime).

that presents systemic risks²⁸ to capital markets. The purpose of SOX is to deter fraud in publicly traded corporations by improving the accuracy and reliability of financial reporting,²⁹ not to advance social mission or other non-shareholder concerns.³⁰ Thus, it may seem unnecessary to examine what, if any, impact or influence SOX had on social enterprises. But ignoring the inquiry would be fool hearted.

The social enterprise sector provides businesses and services that are desperately needed in the market and society.³¹ If SOX governance measures have proven effective, then it is useful to understand if importing similar provisions could improve performance and reduce mismanagement for social enterprises as well. Corporate law helps minimize agency costs by allowing shareholders to monitor the effectiveness of boards and officers and to sue if director and officer decisions are not made in the best interest of the corporation.³² However, for-profit social enterprises differ even from other small businesses because traditional metrics of shareholder oversight, which rely heavily on profit maximization, are not the default metrics of social enterprise success. For-profit social enterprises also attempt to define their business success as social change impacts, which can be difficult, if not impossible, to measure.³³ As a result, below market

28. See Barnali Choudhury, *Climate Change as Systemic Risk*, 18 BERKELEY BUS. L.J. 52, 57 (2021) (“Systemic risk thus involves a shock, either exogenous or endogenous, to the economic system that impairs the flow of capital and threatens the stability of the economy.”).

29. See Margaret M. Blair, *Reforming Corporate Governance: What History Can Teach Us*, 1 BERKELEY BUS. L.J. 1, 40 (2004) (explaining that SOX provisions “are intended to improve the quality and reliability of information that shareholders have about the corporations in which they are investing”); Bridget Neill, Shauna Steele & Steven Jacobs, *Twenty Years Later, SOX Continues to Drive Trust in the Capital Markets*, ERNST & YOUNG (July 27, 2022), https://www.ey.com/en_us/public-policy/sox-continues-to-drive-confidence-and-trust-in-the-capital-markets.

30. Lisa M. Fairfax, *The Impact of the Sarbanes-Oxley Act on Non-Shareholder Constituents: A Silver Lining, but Will It Endure?*, 3 J. BUS. & TECH. L. 417, 421 (2008) (“[T]he idea was that the [SOX] Act and the surrounding regulatory environment would discourage corporate actors from using their discretion to engage in acts beneficial to non-shareholders.”).

31. See, e.g., Nirmal Kumar Madal & Rabi N. Subudhi, *Emerging Role of Social Enterprises During COVID-19 Pandemic*, in FUTURE OF WORK AND BUSINESS IN COVID-19 ERA 217, 217 (Rabi N. Subudhi, Sumita Mishra, Abu Saleh & Dariush Khezimotlagh eds., 2022) (finding “increased level of activities by social entrepreneurs to fight against challenges emerged out of the global pandemic”).

32. See Lisa M. Fairfax, *Doing Well While Doing Good: Reassessing the Scope of Directors’ Fiduciary Obligations in For-Profit Corporations with Non-Shareholder Beneficiaries*, 59 WASH. & LEE L. REV. 409, 433 (2002) (“Under the shareholder primacy model, to the extent that a director’s decision is not beneficial to shareholders, shareholders have the right to sue the director, and this right operates as a check against self-interested behavior.”); but see Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013, 2015 (2019) (explaining that exculpatory provisions eliminating personal liability of directors means “that absent fraud, bad faith, or self-dealing, [directors] would rarely, if ever, pay out of pocket for harming the corporation, even if their service has been far less than perfect”); Justin Fox & Jay W. Lorsch, *What Good Are Shareholders?*, HARV. BUS. REV. (July/Aug. 2012), <https://hbr.org/2012/07/what-good-are-shareholders> (questioning the value of shareholders in corporate governance).

33. See Rodolphe Durand, *There Are Seven Problems with Measuring Social Impact. Here’s How to Solve Them*, REUTERS EVENTS (Apr. 17, 2019), <https://www.reuterevents.com/sustainability/there-are-seven-problems-measuring-social-impact-heres-how-solve-them> (identifying “seven major methodological challenges to social impact measurement . . . as confusion, inconsistency, causal validity errors, hidden factor correlation, oversimplification, partiality and over-assumption”); Bert Bakker, *The Challenges and Rewards that Social Enterprises Encounter*, B THE CHANGE (May 26, 2020), <https://>

indicators are less likely to raise the same level of shareholder scrutiny into the governance or finance practices of for-profit social enterprises. Relatedly, nonprofit social enterprises do not have shareholders.³⁴ Nonprofit social enterprises often raise funds directly from the public through donations but lack, among other governance controls, the possibility of shareholder litigation to help maintain officer and director accountability.³⁵ Thus, most social enterprises lack the regulatory and private ordering mechanisms³⁶ that help deter mismanagement and opportunism. As social enterprises utilize direct public offerings³⁷ and increasingly engage with investors and donors,³⁸ the financial stability of the sector is more important even if donors and investors do not anticipate traditional returns on their investments in social enterprises. As a result, the social enterprise sector has a specific need for robust standards and information production to encourage good governance practices.

In Part I, this article examines public responses to corporate scandals that sparked national conversations on corporate governance and financial reporting within the nascent social enterprise sector. For example, across the country state legislatures considered, and influential states enacted,³⁹ SOX-inspired changes to nonprofit governance requirements. Additionally, the rise of the for-profit social enterprise sector has been traced to the fallout from the corporate scandals of the early 2000s, as a growing number of investors, entrepreneurs,

bthechange.com/the-challenges-and-rewards-that-social-enterprises-encounter-3abf9a3b6f70 (“Some impact measurement methods are too complex and academic for an average social enterprise to use correctly. Institutions like investors and governments generally prefer reports that are easily understandable.”).

34. REV. MODEL NONPROFIT CORP. ACT §§ 13.01–.02 (AM. B. ASS’N 1987) (prohibiting nonprofit corporations from making distributions).

35. Peter Molk & D. Daniel Sokol, *The Challenges of Nonprofit Governance*, 62 B.C. L. REV. 1498, 1515–33 (2021) (explaining that nonprofit firms lack many of the internal and external governance control mechanisms of for-profit firms).

36. For example, under SEC Rule 14a-8, shareholders of public companies may put forth proposals, often in the form of recommendations, regarding requests for information or strategic plans for future action. See 17 C.F.R. § 240.14a-8(a) (2022); Roberto Tallarita, *Stockholder Politics*, 73 HASTINGS L.J. 1697, 1700 (2022) (“In the last few years, for example, shareholders have asked Exxon Mobil to reduce its greenhouse gas emissions, Facebook to address its gender pay gap, and Bristol-Myers Squibb to stop its experiments on animals.”).

37. See Anne Field, *Social Enterprises Raise Money Through Direct Public Offerings*, FORBES (Aug. 6, 2014), <https://www.forbes.com/sites/annefield/2014/08/06/social-enterprises-raise-money-through-direct-public-offerings/?sh=6ad7e7467c55> (“Through [direct public offerings], companies sell securities directly to a lot of unaccredited investors. It’s a way to raise capital without all the regulations, underwriting and expense required for a regular IPO. In some cases, there’s a cap of \$1 million; in others, there’s no cap.”); Alix Wall, *Why West Oakland’s Only Full-Service Grocery Store Closed After Less Than 3 Years*, NOSH (Feb. 28, 2022), <https://oaklandside.org/2022/02/28/community-foods-west-oakland-closure/> (“Through Community Foods’ direct public offering, [Brahm Ahmadi] made people—many of whom might never have thought much about food access [in West Oakland]—care about it enough to invest their own money in the cause, too.”).

38. See Paul Sullivan, *Philanthropy Rises in Pandemic as Donors Heed the Call for Help*, N.Y. TIMES (June 15, 2021), <https://www.nytimes.com/2020/06/26/your-money/philanthropy-pandemic-coronavirus.html> (“Giving has surged during the coronavirus crisis, eclipsing donations during the 2008 recession and after the Sept. 11 terrorist attacks, two reports show.”).

39. See *infra* Part I.A.

and customers were interested in businesses committed to doing good. Social enterprise legislation incorporates reporting and internal control requirements that mirror SOX provisions. Thus, post-SOX, governance standards and reformist legislation attempted to curb opportunism within, and encourage the transparent mission-aligned growth of, both nonprofit and for-profit social enterprises. As a result, the language and norms of social enterprise governance have the distinct influence of SOX. While not merely rhetorical, as Part II summarizes, there is little evidence that these SOX-inspired standards have led to meaningful improvements in corporate governance and financial transparency within the social enterprise sector. Given this, Part III outlines initiatives that could further strengthen social enterprise governance with the benefit of the lessons learned, criticism, and legislative modifications in the twenty years post-SOX implementation. The article argues the Internal Revenue Service (“IRS”) and private investors could better incentivize good governance by increasing access to capital for social enterprises that voluntarily adhere to enhanced internal controls and reporting standards.

I. SOX CHANGED EVERYTHING

Although SOX provisions expressly govern publicly traded corporations, SOX governance reforms have influenced the national conversations⁴⁰ on and led to state-enacted reforms and the adoption of new industry best practices⁴¹ for nonprofit and for-profit social enterprise governance.

A. NONPROFIT GOVERNANCE REFORMS

Following several nonprofit scandals in the early-2000s that undermined confidence in the nonprofit sector,⁴² politicians discussed and state legislatures enacted SOX-inspired reforms patterned after securities regulation as a means of deterring fraud and opportunism in the nonprofit sector.⁴³ In 2016, U.S. nonprofits generated more than \$2.5 trillion in revenue and held nearly \$6

40. James Cox, *SOX's Impact on the Quality of Financial Reporting*, 78 BUS. LAW. 685, 686 (2023) (“The ensuing financial crisis introduced to the public the meaning and significance of an accounting restatement.”).

41. See generally ABA COORDINATING COMM. ON NONPROFIT GOVERNANCE, *GUIDE TO NONPROFIT CORPORATE GOVERNANCE IN THE WAKE OF SARBANES-OXLEY* (2005).

42. See, e.g., Todd Wallack, *PipeVine Scandal Deters Giving Fallout Comes at a Bad Time for Nonprofits*, SF GATE (June 10, 2023), <https://www.sfgate.com/bayarea/article/PipeVine-scandal-deters-giving-Fallout-comes-at-2611011.php> (explaining donations to regional United Ways dropped by 18 percent after PipeVine, a San Francisco nonprofit which “processed more than \$100 million a year in charitable donations for several United Way organizations and Fortune 500 companies, abruptly shut down” due to financial mismanagement).

43. Dana Brakman Reiser, *Enron.org: Why Sarbanes-Oxley Will Not Ensure Comprehensive Nonprofit Accountability*, 38 U.C. DAVIS L. REV. 205, 224 (2004) (“The staggering press accounts of scandals in nonprofits of all types and sizes demonstrate that financial abuse in nonprofit entities is not merely hypothetical.”).

trillion in assets.⁴⁴ While significantly less than the \$12 trillion in revenue generated by Fortune 500 companies alone in 2016,⁴⁵ nonprofit assets are a noteworthy⁴⁶ and growing portion of the U.S. economy.⁴⁷ Historically, approximately 80 percent of U.S. households—some demographics giving at staggering rates—donate to nonprofits.⁴⁸ This is substantially more than the percentage of U.S. households directly invested in the stock market.⁴⁹ Thus, mismanagement in the nonprofit sector⁵⁰ understandably can hold the public's attention as well as initiate pressure from elected representatives.

In the wake of dot.com bubble busting, there were also several nonprofit scandals⁵¹ that demanded the attention of Congress. In 2001, the outpouring of

44. NCCS Project Team, *The Nonprofit Sector in Brief 2019*, URBAN INST. (June 2020), <https://nccs.urban.org/publication/nonprofit-sector-brief-2019#the-nonprofit-sector-in-brief-2019>.

45. See Sam Dangremond, *This Year's Fortune 500 List Was Just Released*, TOWN & COUNTRY (June 10, 2016), <https://www.townandcountrymag.com/society/money-and-power/news/a6518/fortune-500-list-2016/> (“With a combined total of \$12 trillion in revenues and \$840 billion in profits, Fortune 500 companies represent two-thirds of the U.S. GDP.”); see also Cox, *supra* note 40, at 690 (“Firms making up the S&P 500 have a collective market capitalization on January 31, 2023, of \$35.9 trillion, or 80 percent of all publicly held firms traded in the United States.”).

46. Molk & Sokol, *supra* note 35, at 1498 (“The size and scope of the nonprofit enterprise is staggering.”).

47. Anna Bernasek, *For Nonprofits, A Bigger Share of the Economy*, N.Y. TIMES (Mar. 8, 2014), <https://www.nytimes.com/2014/03/09/business/for-nonprofits-a-bigger-share-of-the-economy.html> (“The overall economy has been expanding slowly, but at least one sector is vibrant: nonprofits, which have been growing at a breakneck pace. From 2001 to 2011, the number of nonprofits in the United States grew 25 percent while the number of for-profit businesses rose by half of 1 percent, according to the most recent figures compiled by the Urban Institute.”).

48. See Jeffrey M. Jones, *Percentage of Americans Donating to Charity at New Low*, GALLUP (May 14, 2020), <https://news.gallup.com/poll/310880/percentage-americans-donating-charity-new-low.aspx> (“In prior years’ polling, Gallup usually found more than 80% of U.S. adults saying they donated money to a religious or other type of charity in the past year—except for 2009, during the worst economy since the Great Depression, when it dipped to 79%.”); see also Michelle Singletary, *Black Americans Donate a Higher Share of Their Wealth than Whites*, WASH. POST (Dec. 11, 2020), <https://www.washingtonpost.com/business/2020/12/11/blacks-prioritize-philanthropy/> (“Black households on average give away 25 percent more of their income per year than Whites. . . . Despite structural racism and discriminatory practices that have blocked asset-building and wealth creation, Black people have always prioritized philanthropy . . .”).

49. Lydia Saad & Jeffrey M. Jones, *What Percentage of Americans Own Stock?*, GALLUP (May 12, 2022), <https://news.gallup.com/poll/266807/percentage-americans-owns-stock.aspx> (“Gallup finds 58% of Americans reporting that they own stock, based on its April Economy and Personal Finance survey. This is slightly higher than the 56% measured in 2021 and 55% measured in 2020 but is not a statistically meaningful increase.”); Kim Parker & Richard Fry, *More than Half of U.S. Households Have Some Investment in the Stock Market*, PEW RES. CTR. (Mar. 25, 2020), <https://www.pewresearch.org/fact-tank/2020/03/25/more-than-half-of-u-s-households-have-some-investment-in-the-stock-market/> (“While a relatively small share of American families (14%) are directly invested in individual stocks, a majority (52%) have some level of investment in the market. Most of this comes in the form of retirement accounts such as 401(k)s.”).

50. Avner Ben-Ner, *Who Benefits from the Nonprofit Sector? Reforming Law and Public Policy Towards Nonprofit Organizations*, 104 YALE L.J. 731, 734 (1994) (“There is no question that reform of the nonprofit sector is in order; as the studies in *Who Benefits?* demonstrate, the gap between our perception and the reality of nonprofit organizations is widening.”).

51. See, e.g., Monte Morin, *Goodwill Scam Is Alleged*, L.A. TIMES (May 29, 2003), <https://www.latimes.com/archives/la-xpm-2003-may-29-me-goodwill29-story.html> (“The onetime president of Goodwill Industries in Santa Clara County masterminded an embezzlement scheme that siphoned off millions of dollars in donations meant for job training for disabled people, according to a federal indictment unsealed this week.”).

donations to the American Red Cross⁵² and other nonprofits⁵³ following the September 11 attacks, where donations were funneled into general operations or were otherwise unaccounted for, sparked public outcry.⁵⁴ Given how many people donated to charities to support September 11 victims,⁵⁵ it is not surprising that Americans were reportedly following the Red Cross scandal⁵⁶ closer than the Enron bankruptcy.⁵⁷ Not long before, the United Way of America scandal,⁵⁸ where the CEO used over \$1.2 million of the charity's corporate funds for personal reasons, highlighted the lack of board oversight.⁵⁹ In the aftermath of the scandal, donations to the United Way went down "from \$45 million to \$18 million."⁶⁰ In California, from 1995 to 2002, a nearly \$1.3 billion loss was

52. Diana B. Henriques & David Barstow, *A Nation Challenged: The Red Cross; Red Cross Pledges Entire Terror Fund to Sept. 11 Victims*, N.Y. TIMES (Nov. 15, 2001), <https://www.nytimes.com/2001/11/15/nyregion/nation-challenged-red-cross-red-cross-pledges-entire-terror-fund-sept-11-victims.html> ("The American Red Cross, humbled by weeks of scathing criticism, announced today that it would use its \$543 million Liberty Disaster Fund only to assist the people affected by the terrorist attacks of Sept. 11 The announcement is a sharp departure from the organization's original plan to steer more than \$200 million of the Liberty fund donations into a reserve fund for potential future terrorist attacks and to use millions more for programs aimed at improving its own readiness for such attacks.")

53. The Associated Press, *Where'd the Money Go? Shady Dealings, Unaccountability Rife Among 9/11 Charities*, NBC NEWS (Aug. 25, 2011), <https://www.nbcnews.com/id/wbna44271766> ("[I]n virtually every category of 9/11 nonprofit, an AP analysis of tax documents and other official records uncovered schemes beset with shady dealings, questionable expenses and dubious intentions.")

54. See Nick Cater, *Why 9/11 Was a Disaster for Charities*, GUARDIAN (Sept. 6, 2002), <https://www.theguardian.com/society/2002/sep/06/charities.september112001> ("The image of charities in America has been damaged. In a poll for the Chronicle of Philanthropy, 42% of Americans said they had less confidence in charities because of how they handled 9/11 . . . and 29% said they would be less likely to contribute to any charity because of how disaster donations were handled")

55. See Linda Kamas, Sandy Baum & Anne Preston, *Altruistic Responses to the September 11 Terrorist Attacks: Some Evidence from Dictator Games*, 31 E. ECON. J. 551, 551 (2005) ("After the September 11 terrorist attacks, Americans responded with an unprecedented outpouring of contributions to charitable organizations dedicated to helping the victims of the attacks.")

56. *Grassley Seeks Answers on Red Cross' 9-11 Relief*, U.S. SENATE COMM. FIN. (June 14, 2002), <https://www.finance.senate.gov/ranking-members-news/grassley-seeks-answers-on-red-cross-9-11-relief> ("Grassley's inquiry came after many of his constituents expressed concern over the Red Cross' delay in distributing their donations for victims' relief.")

57. Paul C. Light, *The Red Cross Is No Enron*, BROOKINGS INST. (Mar. 6, 2002), <https://www.brookings.edu/opinions/the-red-cross-is-no-enron/> ("According to a Brookings Institution survey conducted in December 2001, 60 percent of Americans said they were following the Red Cross story very or fairly closely, placing it ahead of the death of former Beatle George Harrison or the Enron bankruptcy.")

58. Karen W. Arenson, *Ex-United Way Leader Gets 7 Years for Embezzlement*, N.Y. TIMES (June 23, 1995), <https://www.nytimes.com/1995/06/23/us/ex-united-way-leader-gets-7-years-for-embezzlement.html> ("The former president of United Way of America, William Aramony, was sentenced today to seven years in prison for fraudulently diverting \$1.2 million of the charity's money to pay for a romance with a teen-age girlfriend and other benefits for himself and friends.")

59. T. Rees Shapiro, *United Way Leader's Fraud Scandal Marred Charitable Legacy*, WASH. POST (Nov. 14, 2011), https://www.washingtonpost.com/local/obituaries/united-way-leaders-fraud-scandal-marred-charitable-legacy/2011/11/14/gIQAInwbMN_story.html

60. Joseph Mead, *Confidence in the Nonprofit Sector Through Sarbanes-Oxley Style Reforms*, 106 MICH. L. REV 881, 884 (2008).

reported due to nonprofit scandals.⁶¹ Diminished public confidence was seen as a real crisis impacting the entire nonprofit sector.⁶²

Like the public outrage regarding the untrustworthiness of well-established publicly traded companies,⁶³ constituents expressed concern about nonprofit financial integrity. As IRS Commissioner Mark Everson noted:

We need go no further than our daily newspapers to learn that some charities and private foundations have their own governance problems. Specifically, we have seen business contracts with related parties, unreasonably high executive compensation, and loans to executives. We at the IRS also have seen an apparent increase in the use of tax-exempt organizations as parties to abusive transactions. All these reflect potential issues of ethics, internal oversight, and conflicts of interest.⁶⁴

Thus, politicians and think tanks publicly contemplated nonprofit reforms that borrowed heavily from SOX to improve nonprofit governance and management of nonprofit finances. Although no federal legislation was enacted for nonprofits,⁶⁵ the Senate Committee on Finance created a draft paper on possible legislation. The Senate proposal would have required nonprofit CEOs to certify the accuracy of their nonprofit's processes and procedures for financial reporting, and that CEOs certify the material completeness of all tax returns.⁶⁶ The Panel on the Nonprofit Sector, a nonprofit sector coalition formed with the encouragement of the U.S. Senate Finance Committee,⁶⁷ also supported the

61. *Id.* at 885.

62. Kelsey L. Fisher, *Swings for Dreams: Public Perceptions of the Nonprofit Sector and Effects on Donating Behavior*, MASTER'S PROJECT 506 (2005); Paul C. Light, *Confidence in Charitable Organizations*, BROOKINGS INST. (Dec. 15, 2003), <https://www.brookings.edu/on-the-record/confidence-in-charitable-organizations/> ("A new study from The Brookings Institution concludes that, especially since September 11th, Americans generally believe charities waste a lot of their money before getting it to the intended recipients.")

63. Cox, *supra* note 40.

64. *Written Statement of Mark W. Everson, Commissioner Internal Revenue, Before the Comm. on Fin., U.S. Senate: Hearing on Charitable Giving Problems & Best Practices*, INTERNAL REV. SERV. 3 (June 22, 2004), <https://www.irs.gov/pub/irs-news/ir-04-081.pdf>.

65. CARE Act of 2003, S. 476, 108th Cong., <https://www.congress.gov/bill/108th-congress/senate-bill/476> (draft bill eventually died in committee); NEW YORK STATE BAR ASSOCIATION TAX SECTION SUMMARY REPORT ON THE PROVISIONS OF RECENT SENATE BILLS THAT WOULD CODIFY THE ECONOMIC SUBSTANCE DOCTRINE (May 21, 2003), <https://nysba.org/NYSBA/Sections/Tax/Tax%20Section%20Reports/Tax%20Reports%202003/1032%20Report.pdf>.

66. *Staff Discussion Draft*, SENATE FIN. COMM. 1 (2004), <https://www.finance.senate.gov/imo/media/doc/062204stfdis.pdf>.

67. *See Panel on the Nonprofit Sector*, INDEP. SECTOR, https://www.amacad.org/sites/default/files/academy/multimedia/pdfs/Philanthropy/IndependentSector_PanelontheNonprofitSector.pdf (last visited May 5, 2023) ("The Panel on the Nonprofit Sector was an independent effort by charities and foundations to ensure that the nonprofit community remains a vibrant and healthy part of American society. Formed by Independent Sector in October 2004, at the encouragement of the U.S. Senate Finance Committee, the Panel prepared a series of recommendations for Congress to improve the oversight and governance of charitable organizations and for individual nonprofit organizations to ensure high standards of ethics and accountability.")

recommendation.⁶⁸ The panel's proposal recommended that Congress require nonprofits with annual revenues of at least \$250,000 to hire an independent accountant to review their financial statements and nonprofits above \$1 million revenue threshold to submit audited financial statements.⁶⁹ With a stated goal of enhancing transparency and promoting good governance, the IRS incorporated several of the recommendations generated in revised versions of the Form 1023,⁷⁰ the initial tax filing for charitable tax-exemption, and the Form 990,⁷¹ annual return for tax-exempt nonprofits.

Similar legislative discussions also took place at the state level. Several states considered or adopted⁷² their own SOX-inspired reforms for nonprofits. In New York, legislation was proposed to require the CEO or CFO of large nonprofits to attest to the accuracy of the nonprofit's financial statements.⁷³ Ultimately, New York passed legislation clarifying that it would breach fiduciary duties if nonprofits filed reports that are not "complete and accurate."⁷⁴ Of the state legislative proposals that were enacted, California's is the most substantial reform to nonprofit governance. Aimed at improving governance by incorporating modified versions of SOX provisions, the California Nonprofit Integrity Act of 2004 (the "Integrity Act")⁷⁵ requires that any charity receiving annual gross revenues of \$2 million or more maintain an independent audit committee.⁷⁶ Although the Integrity Act does not include a requirement for a financial expert on the audit committee, in practice that is often the goal. If the nonprofit has a finance committee, the Integrity Act mandates that members

68. PANEL ON THE NONPROFIT SECTOR, INDEP. SECTOR, STRENGTHENING TRANSPARENCY, GOVERNANCE, ACCOUNTABILITY OF CHARITABLE ORGANIZATIONS: A FINAL REPORT TO CONGRESS AND THE NONPROFIT SECTOR 26 (June 2005), http://philanthropy.org/documents/Panel_Final_Report.pdf.

69. *Id.* at 5.

70. See Jane Wilton, *IRS Efforts to Improve Nonprofit Governance*, N.Y. CMTY. TRUST (June 7, 2014), <https://www.nycommunitytrust.org/newsroom/professional-notes/irs-efforts-to-improve-nonprofit-governance-june-2014-download-as-pdf/> ("The IRS's foray into governance started in earnest in 2004, with the issuance of a substantially revised version of the IRS Form 1023.")

71. See Julius Green & Seth Moskowitz, *Revised Form 990: The Evolution of Governance and the Nonprofit World*, TAX ADVISER (Aug. 1, 2009), <https://www.thetaxadviser.com/issues/2009/aug/revised-form990theevolutionofgovernanceandthenonprofitworld.html> ("The revised Form 990, *Return of Organization Exempt from Income Tax*, incorporates many of the same governance principles and transparency best practices introduced to the for-profit world through the Sarbanes-Oxley Act, Pub. L. No. 107-204, in the aftermath of the Enron scandal. This is the latest attempt by the federal government to restore public confidence in the governance of the exempt organization sector, particularly charities.")

72. See, e.g., S.B. 153, 125th Gen. Assemb., Reg. Sess. (2003); N.H. REV. STAT. ANN. § 7:28(III-a) to (III-b) (2022); CONN. GEN. STAT. §§ 21a-190b, 21a-190c (2022).

73. Mead, *supra* note 60, at 887 ("In 2003, Eliot Spitzer, then attorney general of New York, proposed legislation that adopted the Sarbanes-Oxley officer-certification requirements for large nonprofits.")

74. Assemb. B. 7825, 228th Assemb., Reg. Sess. (N.Y. 2005) (referred to Senate Committee on Rules on June 19, 2006).

75. California Nonprofit Integrity Act, 2004 CAL. STAT. 7158 (codified as amended in scattered sections of CAL. BUS. & PROF'L CODE & CAL. GOV'T CODE).

76. CAL. GOV'T CODE § 12586(e)(2) (2022) ("The audit committee may include persons who are not members of the board of directors, but the member or members of the audit committee shall not include any members of the staff, including the president or chief executive officer and the treasurer or chief financial officer.")

of the finance committee may not comprise 50 percent or more of the audit committee.⁷⁷ Like SOX, the objective behind requiring independence between the audit and finance committee is a heightened oversight of nonprofit financials. California nonprofits with revenues of \$2 million or more must also conduct independent audits of annual financial statements.⁷⁸ The Integrity Act also requires directors to review and approve executive compensation to ensure they are “just and reasonable.”⁷⁹

Regardless of the state of incorporation, high-revenue nonprofits have invested in their governance practices post-SOX to be competitive for private foundation dollars.⁸⁰ Outside of state mandates, many large nonprofits⁸¹ have voluntarily adopted SOX-inspired practices into their governance: “Overall, the nonprofit sector has collectively devoted considerable resources to implementing SOX-related policies and reforms since the passage of [SOX] in 2002.”⁸² However, nonprofit “adherence to [SOX] varies considerably for different provisions.”⁸³ Research shows that many nonprofit organizations have an annual (or biannual) external audit,⁸⁴ audit committee of the board,⁸⁵ dual leadership (defined as the positions of board chair and CEO held by different persons), independent directors, CEO certification of the accuracy of financial statements,⁸⁶ and open public access to audit reports among other SOX measures. Large nonprofits are choosing to opt into these SOX provisions to improve their reputations through transparent and accountable financial reporting that is widely acknowledged as governance best practices. There is also empirical evidence that adoption of SOX governance controls reduces risks of accounting fraud and enhances the effectiveness of nonprofit boards.⁸⁷

77. *Id.*

78. *Id.* § 12586(e)(1).

79. *Id.* § 12586(g).

80. Ted Bilich, *A Call for Nonprofit Risk Management*, STAN. SOC. INNOVATION REV. (July 13, 2016), https://ssir.org/articles/entry/a_call_for_nonprofit_risk_management (explaining that nonprofits “undergo regular independent audits to attract and retain high-quality donors”).

81. However, in 2016, nonprofits with gross receipts of \$10 million or more made up just 5.4 percent (or 17,063 nonprofits) of the total number of public charities. See NCCS Project Team, *supra* note 44.

82. Gregory D. Saxton & Daniel G. Neely, *The Relationship Between Sarbanes-Oxley Policies and Donor Advisories in Nonprofit Organizations*, 158 J. BUS. ETHICS 333, 333 (2019).

83. Francie Ostrower & Marla J. Bobowick, *Nonprofit Governance and the Sarbanes-Oxley Act*, URBAN INST. 1 (2006), <https://www.urban.org/sites/default/files/publication/50636/311363-Nonprofit-Governance-and-the-Sarbanes-Oxley-Act.PDF>.

84. *Id.* at 3 (“Sixty-seven percent of nonprofits in the study have an external audit within the previous two years. That figure jumps to 91 percent for nonprofits with expenses of over \$500,000, and over 96 percent among nonprofits with expenses greater than \$2 million.”).

85. *Id.* at 2 (“A separate audit committee was the least commonly adopted practice related to Sarbanes-Oxley issues in all size groups. . . . It was only among nonprofits with over \$40 million that a majority of the organizations had an audit committee.”).

86. *Id.* at 3 (“The CEO of 51 percent of all nonprofits studied signed the organization’s IRS Form 990.”).

87. Tamara G. Nezhina & Jeffrey L. Brudney, *Unintended? The Effects of Adoption of the Sarbanes-Oxley Act on Nonprofit Organizations*, 22 NONPROFIT MGMT. & LEADERSHIP 321, 332–33 (2012) (“According to the survey respondents, the perceived benefits that accrued to nonprofit organizations most often as a result of SOX adoption were improvements in financial management and governance

Even though national discussions on nonprofit governance did not result in federal legislation or universal state reforms, the passage of SOX initiated conversations that changed reporting requirements and best practices for nonprofit governance.⁸⁸ Nonprofit governance became an earnest topic of inquiry and influenced a culture shift impacting nonprofit social enterprises.

B. QUASI-REGULATORY SOCIAL ENTERPRISE LEGISLATION

In the aftermath of the dot.com scandals, there was substantial public and political support for more for-profit businesses doing good while doing business. While there was an initial increase in corporate altruism following the corporate scandals,⁸⁹ research has found that corporate rhetoric did not necessarily result in sustained corporate commitment to social responsibility.⁹⁰ Although for-profit companies have broad discretion to engage in socially beneficial activities,⁹¹ they consistently resist placing societal or environmental benefits above short-term profit maximization.⁹² Thus, public skepticism about how corporations use rhetoric to market themselves as socially and environmentally responsible remained high in the late 2000s because corporate actions routinely did not match the stated corporate commitment.⁹³ “[C]orporations feel some pressure to project an image of other regarding or socially responsible behavior, even when there

(Table 4). About one-quarter of the organizations indicated ‘better financial controls’ (27.3 percent), ‘reduced risk of accounting fraud’ (24.3 percent), and ‘enhanced effectiveness of the board’ (21.1 percent) as positive effects of SOX.”

88. See, e.g., *Principles of the Law of Nonprofit Organizations*, AM. L. INST. (2007).

89. Lisa M. Fairfax, *The Impact of Stakeholder Rhetoric on Corporate Norms*, 31 J. CORP. L. 675, 677 (2006).

90. Fairfax, *supra* note 30, at 424.

91. Business Roundtable, *Principles of Corporate Governance*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 8, 2016), <https://corpgov.law.harvard.edu/2016/09/08/principles-of-corporate-governance>.

92. See, e.g., Daniel Gilbert, *Moderna’s Billionaire CEO Reaped Nearly \$400 Million Last Year. He Also Got a Raise*, WASH. POST (Apr. 29, 2023) (“Moderna emerged from the pandemic as a standout corporate winner The firm’s windfall profits have drawn criticism, particularly because it used \$1.7 billion in taxpayer funding and assistance from the National Institutes of Health to develop its vaccine.”); Douglas MacMillan, Peter Whoriskey & Jonathan O’Connell, *America’s Biggest Companies Are Flourishing During the Pandemic and Putting Thousands of People Out of Work*, WASH. POST (Dec. 16, 2020), <https://www.washingtonpost.com/graphics/2020/business/50-biggest-companies-coronavirus-layoffs/> (“Between April and September, one of the most tumultuous economic stretches in modern history, 45 of the 50 most valuable publicly traded U.S. companies turned a profit Despite their success, at least 27 of the 50 largest firms held layoffs this year, collectively cutting more than 100,000 workers [M]any [corporate] firms have put Americans out of work and used their profits to increase the wealth of shareholders.”); Jeanne Sahadi, *When Good Executives Go Bad*, CNN (May 2, 2019), <https://edition.cnn.com/2019/05/02/success/executives-behaving-badly/index.html> (“It isn’t shocking that some business leaders lie, cheat, steal or neglect critical problems. . . . But it never fails to amaze when those who play a key role in the scandals are otherwise highly successful executives with good reputations.”); Art Markman, *Why People Aren’t Motivated to Address Climate Change*, HARV. BUS. REV. (Oct. 11, 2018), <https://hbr.org/2018/10/why-people-arent-motivated-to-address-climate-change> (“Companies can keep manufacturing cheaper if they don’t have to develop new processes to limit carbon emissions.”).

93. See, e.g., Fairfax, *supra* note 30, at 418 n.12 (describing the aggressive marketing strategy by British Petroleum (BP) to present the corporation as socially and environmentally responsible in commercials, annual reports, and on its website when investigations into the oil spill in Texas revealed BP had been “ignoring significant safety problems”).

is no corresponding desire to engage in such practices.⁹⁴ Public frustration with corporate rhetoric on social justice issues proving inconsistent with corporate actions is an enduring widely held sentiment.⁹⁵

Moreover, politicians, the media, and the public blamed the “tunnel-vision focus on profit and wealth maximization for the corporate scandals,”⁹⁶ which necessitated congressional intervention.⁹⁷ SOX does not require a fundamental change in the values of directors and officers making the decisions about corporate expenditures or actions.⁹⁸ The corporate scandals of the early 2000s primed the stage for for-profit social enterprises, which provide a different kind of business model altogether that values social impact and change through its pursuit of profits. For-profit social enterprises demonstrate their commitment, not as rhetoric but through actions deeply baked into their business practices. Thus, the emergence of for-profit social enterprises in mass during the early 2010s had a ready audience of consumers,⁹⁹ employees, and impact investors.¹⁰⁰

The public’s enthusiasm about for-profit social enterprises facilitated an explosion of social enterprise law. Within less than a decade, legislation across the country provided for the benefit corporation,¹⁰¹ social purpose corporation (“SPC”),¹⁰² or public benefit corporation (“PBC”)¹⁰³ in Delaware, the public

94. *Id.* at 424.

95. See Jessica Camille Aguirre, “People Are Fed Up with This Level of Virtue Signaling”: Corporate America Is in A.P.R. Meltdown Over the Black Lives Matter Movement, *VANITY FAIR* (July 22, 2020), <https://www.vanityfair.com/news/2020/07/corporate-america-in-pr-meltdown-over-black-lives-matter-movement> (“In public, major brands have issued statements proclaiming solidarity with Black Lives Matter, to questionable effect.”); see also Laura Morgan Roberts & Megan Grayson, *Businesses Must Be Accountable for Their Promises on Racial Justice*, *HARV. BUS. REV.* (June 1, 2021), <https://hbr.org/2021/06/businesses-must-be-accountable-for-their-promises-on-racial-justice>; Igor Derysh, *Big Corporate Donors Claim to Support Racial Justice—but Fund Republicans Pushing Voting Limits*, *SALON* (Apr. 17, 2021), <https://www.salon.com/2021/04/17/big-corporate-donors-claim-to-support-racial-justice-but-fund-republicans-pushing-voting-limits>.

96. Fairfax, *supra* note 30, at 419.

97. Thuy Vo, *Lifting the Curse of the SOX Through Employee Assessments of the Internal Control Environment*, 56 *KAN. L. REV.* 1, 12 (2007) (“Among the costs of SOX 404 compliance have been the loss of senior management’s time and strategic decision-making to maximize shareholder value.”).

98. Blair, *supra* note 29, at 40 (“But better information does not affect the degree of control that corporate directors have over the corporate decisions or allocations of corporate assets.”).

99. See Paul Drury-Bradey, *Businesses Must Get Serious About Purpose Beyond Profit, or Risk Losing Market Share*, *UNLTD* (Feb. 6, 2018), <https://www.unltd.org.uk/blog/news/businesses-must-get-serious-about-purpose-beyond-profit-or-risk-losing-mark> (reporting “that almost three quarters (73%) of consumers are more likely to buy from brands that [put purpose before profit]. Amongst millennials, this figure is even higher, with 81% more likely to buy from purpose-driven brands, demonstrating the importance of corporate purpose among 18–34 year olds.”).

100. David Gelles, *How Environmentally Conscious Investing Became a Target of Conservatives*, *N.Y. TIMES* (Feb. 28, 2023), <https://www.nytimes.com/2023/02/28/climate/esg-climate-backlash.html> (“More than \$18 trillion is held in investment funds that follow the investing principles known as E.S.G.—shorthand for prioritizing environmental, social and governance factors—a strategy that has been adopted by major corporations around the globe.”).

101. *Proposed Changes to the Model Business Corporation Act—New Chapter 17 on Benefit Corporations*, 74 *BUS. LAW.* 819 (2019) (providing modifications to the Model Business Corporations Act to include the benefit corporation).

102. See, e.g., *CAL. CORP. CODE* §§ 2500–3503 (2022) (requiring the SPC to, among other things, pursue one or more explicitly adopted social purposes).

103. See *DEL. CODE ANN.* tit. 8, §§ 361–368 (2022).

benefit limited liability company (“PBLLC”),¹⁰⁴ and the low-profit limited liability company (“L3C”)¹⁰⁵—all for-profit entities that require the firm to adhere to either a general public benefit or its stated specific social purpose. They are collectively referred to as “hybrid entities” because each is a for-profit entity mandated to consider social purpose or mission, much like a tax-exempt nonprofit must have a charitable or educational purpose. Hybrid entities were enacted to provide off-the-shelf for-profit entity options for social enterprises and to signal to social entrepreneurs the state legislature’s interest in making the state economy social enterprise friendly.

Hybrid entity statutes have quasi-regulatory reporting provisions requiring the social enterprise to transparently assess its advancement of its social mission and report on its financial expenditures. These annual or regular reports are referred to herein as “benefit reports.” The quasi-regulatory characteristics of the benefit reports make hybrid entities unique among the corpus of company law, applying to all hybrid entities regardless of revenue thresholds or number of owners. The benefit report has been referred to as the lynchpin of social enterprise law because it is seen as indispensable to ensuring the social enterprise’s adherence to its social purpose.

For example, in California,¹⁰⁶ all SPCs must prepare and provide shareholders with annual reports including a management discussion and analysis (a “special purpose MD&A”) summarizing the corporation’s material actions taken with respect to its stated purposes.¹⁰⁷ The SPC benefit reports require a discussion of financial, operational, and managerial performance. Directors, officers, and agents of the SPC are jointly and severally liable for materially false information they knowingly include the benefit report.¹⁰⁸

The hybrid entity reporting and governance requirements mimic key SOX provisions to increase accountability and mission alignment of social enterprises. It is difficult to imagine that social enterprise legislation would have included these SOX-inspired features but for the passage of SOX, given that no other entity up to that point had.

II. SOX CHANGED NOTHING

However, in practice, it is not clear how effective these post-SOX social enterprise governance reforms have been in reducing financial fraud and increasing transparent reporting within the social enterprise sector. As Professor Bainbridge

104. See, e.g., DEL. CODE ANN. tit. 6, §§ 18-1201 to -1205 (2022) (providing variations to the Delaware LLC that track the distinctions of the Delaware public benefit corporation).

105. The L3C retains the flexibility and standard characteristics of the LLC while requiring the company accomplish one or more “charitable” and “educational” purposes within the Internal Revenue Code definitions. See, e.g., VT. STAT. ANN. tit. 11, § 4001(14) (2022).

106. See Elizabeth MacBride, *Boston Leads the Top 21 Cities for Social Entrepreneurs*, FORBES (Aug. 24, 2017), <https://www.forbes.com/sites/elizabethmacbride/2017/08/24/the-top-cities-for-social-entrepreneurs/?sh=433ec937371d> (reporting three California cities in the top twenty U.S. cities for social entrepreneurship).

107. CAL. CORP. CODE § 3500(b) (2022).

108. *Id.* § 3503.

points out, summarizing the extent to which SOX and SOX-inspired reforms “generated significant improvements in accounting quality is complicated, however, because there are confounding factors.”¹⁰⁹ The development of business practices and governance norms over the last two decades has been a “dynamic environment in which there are many unknowns and unknowables.”¹¹⁰ Moreover, the contours of social enterprise governance are still evolving.

A. ONGOING NONPROFIT SCANDALS

High-profile nonprofit failures and scandals did not stop in the early 2000s after the national conversations on nonprofit governance and the reforms enacted to decrease nonprofit financial fraud. In 2013, for example, an investigative report from *The Washington Post* found that, between 2008 and 2012, more than 1,000 major U.S. nonprofits disclosed “significant diversion” of assets from internal wrongdoing in their Form 990 federal filings.¹¹¹ Some of these were relatively small amounts, less than \$250,000, but others were between \$40–60 million in unsubstantiated spending.¹¹² Total reported diversions from the charitable mission totaled \$170 million in 2009 alone.¹¹³ “You go out of your way to trust a nonprofit. People give their money and expect integrity. And when the integrity goes out the window, it just hurts everybody. It hurts the community, it hurts the organization, everything. It’s just tragic.”¹¹⁴ In 2015, the Federation Employment and Guidance Service, Inc. (the largest social services agency in New York operating over 200 programs) announced bankruptcy due to financial mismanagement.¹¹⁵ In 2015, the Red Cross was again embroiled in scandal after the outpouring of public donations to support victims of the 2010 devastating earthquake in Haiti could not be accounted for as victim relief efforts.¹¹⁶ In 2016, the Wounded Warrior Project fired its CEO

109. Stephen M. Bainbridge, *Sarbanes-Oxley § 404 at Twenty*, 78 *BUS. LAW.* 647, 654 (2023).

110. Roberta Romano, *Regulating in the Dark and a Postscript Assessment of the Iron Law of Financial Regulation*, 26 *HOFSTRA L. REV.* 25, 27 (2014).

111. Joe Stephens & Mary Pat Flaherty, *Inside the Hidden World of Thefts, Scams and Phantom Purchases at the Nation’s Nonprofits*, *WASH. POST* (Oct. 26, 2013), https://www.washingtonpost.com/investigations/inside-the-hidden-world-of-thefts-scams-and-phantom-purchases-at-the-nations-nonprofits/2013/10/26/825a82ca-0c26-11e3-9941-6711ed662e71_story.html.

112. *Id.*

113. *Id.*

114. *Id.*

115. See Laura Nahmias, Dan Goldberg & Nidhi Prakash, *The Wrecking of a Blue-Chip New York Nonprofit*, *POLITICO* (Mar. 13, 2015, 4:20 PM EDT), <https://www.politico.com/states/new-york/city-hall/story/2015/03/the-wrecking-of-a-blue-chip-new-york-nonprofit-087679> (“A Capital review of the [Federation Employment and Guidance Service]’s financial disclosure forms and yearly tax returns reveal an agency engaged in risky long-term behavior and slowly drowning in debt, seeking capital financing from an ever-widening array of sources to expand its operations and interests even as those operations failed to produce profit.”).

116. Laura Sullivan, *In Search of the Red Cross’ \$500 Million in Haiti Relief*, *NPR* (June 3, 2015), <https://www.npr.org/2015/06/03/411524156/in-search-of-the-red-cross-500-million-in-haiti-relief> (“The [Red Cross], which in 2010 has a \$100 million deficit, out-raised other charities by hundreds of millions of dollars—and kept raising money well after it had enough for its emergency relief. But where exactly did that money go?”); Laura Sullivan & Justin Elliott, *Report: Red Cross Spent 25 Percent of Haiti Donations on Internal Expenses*, *NPR* (June 16, 2016), <https://www.npr.org/2016/06/16/>

and COO after reports of wasteful spending.¹¹⁷ In 2019, the exposure of the Key Worldwide Foundation's participation in the "Varsity Blues" scandal, where parents paid off officials and administrators to ensure admission of their children into elite universities and colleges, demonstrated pervasive integrity issues across multiple nonprofits.¹¹⁸

Despite new best practices for nonprofit governance post-SOX, nonprofits remain almost entirely self-governed because there is no agency that focuses on enforcing nonprofit governance.¹¹⁹ Most attorneys general and secretaries of state lack the bandwidth to adequately enforce nonprofit reporting requirements.¹²⁰ Although attorneys general have exerted formal oversight of nonprofits,¹²¹ they do not have the bandwidth or the budget to monitor nonprofit governance. This allows ample opportunity for continued nonprofit mismanagement.¹²² While more empirical data would be helpful to compare the numbers of nonprofit scandals before and after SOX-inspired reforms, what is clear is that nonprofit integrity issues and mismanagement endure.

482020436/senators-report-finds-fundamental-concerns-about-red-cross-finances ("The American Red Cross spent a quarter of the money people donated after the 2010 Haiti earthquake—or almost \$125 million—on its own internal expenses, far more than the charity previously had disclosed, according to a report released Thursday by Iowa Sen. Chuck Grassley. . . . It concludes 'there are substantial and fundamental concerns about [the Red Cross] as an organization.'").

117. Bill Chappell, *Wounded Warrior Project Fires Top 2 Executives After Reports of Overspending*, NPR (Mar. 11, 2016, 12:49 PM ET), <https://www.npr.org/sections/thetwo-way/2016/03/11/470081279/wounded-warrior-project-fires-top-2-executives-after-reports-of-overspending> ("CEO Steve Nardizzi and COO Al Giordano are no longer with the organization," the charity announced in a news release that also reported the results of an independent review of its finances—a review that was prompted by a series of CBS News reports that said the Wounded Warrior Project uses some 40 percent of its funds on overhead expenses and pays millions of dollars for staff conferences and meetings in luxurious settings.").

118. Martin Levine, *Hiding in Plain Sight: A Nonprofit Fraud Story*, NONPROFIT Q. (Mar. 19, 2019), <https://nonprofitquarterly.org/hiding-in-plain-sight-a-nonprofit-fraud-story/> (explaining that the Key Worldwide Foundation "presented a picture of fiscal strength, having raised more than \$7 million since its founding and more than \$2 million in assets. But we now know it was a charade, using the aura of a nonprofit organization as a cover for illegality and personal gain. Rather than help low-income students, it served as a vehicle for wealthy parents to tilt the admission process in their favor."); Marjorie Valbrun, *Does USC Need More Housecleaning?*, INSIDE HIGHER ED (May 21, 2019), <https://www.insidehighered.com/news/2019/05/21/usc-board-trustees-undergo-major-changes-wake-recent-scandals>.

119. See James J. Fishman, *Improving Charitable Accountability*, 62 MD. L. REV. 218, 268–69 (2003); Eric Franklin Amarante, *Unregulated Charity*, 94 WASH. L. REV. 1503, 1506 (2019) (explaining that charities with less than fifty thousand dollars in annual gross receipts are essentially ignored by the IRS).

120. Reiser, *supra* note 43, at 220 ("Even in the new era of [attorney general] activism, the resources allocated for oversight of the nonprofit sector remain tight and so priorities must be set."); Ellen P. Aprill, *What Critiques of Sarbanes-Oxley Can Teach About Regulations of Nonprofit Governance*, 76 FORDHAM L. REV. 765, 792 (2007) ("Given the lack of private parties monitoring the [nonprofit] sector and the limited state enforcement, we need to develop ways to achieve a more direct federal presence regarding matters of governance.").

121. CAL. DEP'T OF JUST. ATTORNEY GENERAL'S GUIDE FOR CHARITIES 82 (2020), <https://www.oag.ca.gov/system/files/media/Guide%20for%20Charities.pdf> ("The Attorney General has primary responsibility for supervising charities and charitable trusts in California.").

122. See Nicole Gilkeson, *For-Profit Scandal in Nonprofit World: Should States Force Sarbanes-Oxley Provisions Onto Nonprofit Corporations?*, 95 GEO. L.J. 831, 852–53 (2007) (expressing skepticism that under-enforcement of nonprofit regulations will change).

In some instances, the post-SOX nonprofit governance reforms may have even exaggerated the underlying issues. For example, although an objective of the Integrity Act is to ensure executive compensation is “just and reasonable,” researchers have found that California nonprofit CEO compensation was “increased by about 6.3 percent (post-regulation) when compared with a control group of comparable unaffected nonprofits.¹²³ Scholars caution that increased disclosure requirements may contribute to an upward spiral inflating instead of curtailing executive compensation.”¹²⁴

Thus, it is not clear the SOX-inspired reforms tangibly improved nonprofit governance. Scholars maintain there are still significant problems in nonprofit governance, in some cases describing nonprofit governance as “abysmal.”¹²⁵ “A remarkable number of commentators agree that boards of [nonprofits] are generally less effective than [for-profit] corporate boards.”¹²⁶ In the absence of shareholders, Professor Dent argues that nonprofit CEOs end up governing nonprofits with boards rubber-stamping the CEO decisions.¹²⁷ He argues there is limited to no accountability of nonprofit directors¹²⁸ in part because of a lack of understanding or uncertainty about roles and responsibilities of directors.¹²⁹ However, SOX-inspired reforms did not resolve an underlying cause of poor nonprofit governance, which is a lack of financial and social capital resources. The nonprofit sector remains sorely underfunded to achieve its stated goals of public service and advancing social change.

Both legal¹³⁰ and public perspective restrictions placed on nonprofits ensure they will rarely have the financing to adequately address societal issues. A key difference in nonprofit and for-profit entities is the reality that for-profit compa-

123. Sandip Dhole, Saleha Khumawala, Sagarika Mishra & Tharindra Ranasinghe, *Executive Compensation and Regulation-Imposed Governance: Evidence from the California Nonprofit Integrity Act (2004)*, 90 *ACCT. REV.* 443, 445 (2014).

124. *But see* Edward M. Iacobucci, *The Effects of Disclosure on Executive Compensation*, 48 *U. TORONTO L.J.* 489, 490 (1998) (noting that “disclosure may naturally tend to increase compensation, but that this tendency does not necessarily reveal any infirmities with the regime governing post-disclosure executive compensation”); Ella Mae Matsumura & Jae Yong Shin, *Corporate Governance Reform and CEO Compensation: Intended and Unintended Consequences*, 62 *J. BUS. ETHICS* 101 (2005).

125. *See* JOHN TROPMAN & THOMAS J. HARVEY, *NONPROFIT GOVERNANCE: THE WHY, WHAT, AND HOW OF NONPROFIT BOARDSHIP* 32 (2009).

126. George W. Dent, *Corporate Governance Without Shareholders*, 39 *DEL. J. CORP. L.* 93, 94 (2014).

127. *Id.* at 100.

128. *But see* Ben-Ner, *supra* note 50, at 735 (proposing “legal ‘member’ status to those consumers, sponsors, and donors who can be identified as having an economic demand for specifically nonprofit provision”).

129. Dent, *supra* note 126, at 100 (“Board of directors [of nonprofits] are deeply flawed. They seriously underperform and malperform virtually everywhere.”).

130. Brian Galle, *Social Enterprise: Who Needs It?*, 54 *B.C. L. REV.* 2025, 2027–31 (2013) (explaining the nonprofit firm as a partial solution to contract failures); Molk & Sokol, *supra* note 35, at 1503 (“Nonprofits’ core distinctive legal feature is their prohibition on distributing earnings to private parties, but many implications flow from this deceptively simple statement, ranging from the behavior expected of management, to who has legal standing to sue for violations of that behavior, to the public and private disclosures that the non-profit is required to make.”); Ben-Ner, *supra* note 50, at 754 (“This absence of transferable ownership interests precludes reliance on an important external control mechanism available to for-profit firms: the market for takeovers.”).

nies have more access to capital, which allows them to pay their directors¹³¹ and attract director talent with corporate governance and financial reporting experience. Conversely, the nonprofit norm is to appoint volunteer directors,¹³² who are not compensated for their service.¹³³ Insufficient access to capital also prevents nonprofits from hiring experienced legal counsel, accountants, and auditors, who are key gatekeepers on for-profit officer actions and board decisions. At the same time, SOX has contributed to both decreasing the pool of available auditors and increasing the cost of audited financials for nonprofits.¹³⁴ Without independent legal counsel and auditing, nonprofits often rely on personal relationships to obtain guidance, making it less likely those resources will enforce governance best practices (intra-board, CEO to board, or board over CEO).

While SOX requires intensive and costly reporting and internal processes, SOX governs publicly traded companies that have determined that their participation in the capital markets outweighs the costs of these requirements. Nonprofits, on the other hand, do not have increased access to capital under the SOX-inspired reforms applicable to nonprofits. Thus, nonprofits understandably continue to struggle to implement post-SOX best practices and improve fundamental impediments to good nonprofit governance.

131. See 2022 S&P 500 Compensation Snapshot, SPENCER STUART (2022), https://www.spencerstuart.com/-/media/2022/september/compensation_snapshot/compensation_snapshot_final_9_07_22.pdf (“The average total compensation for S&P 500 directors is \$316,091, an increase of around 3% from \$305,808 in 2021. Stock grants represent the largest share of director compensation, at 56%—the same proportion as last year.”); Paul Ausick, *25 Companies that Pay Their Board of Directors a Shocking Amount*, USA TODAY (Dec. 14, 2018), <https://www.usatoday.com/story/money/business/2018/12/14/how-much-do-corporate-boards-pay-companies-highest-compensation/38637377/> (“Using the 250th ranked company, Applied Materials, as our example, the median cost of a [public company] board is around \$2.83 million a year.”).

132. James F. Reda, Kimberly A. Glass & James A. Rice, *Private vs. Public Director Pay: Is There a Difference?*, GALLAGER, <https://www.ajg.com/us/news-and-insights/2018/07/private-vs-public-director-pay-is-there-a-difference/> (last visited May 5, 2023) (explaining that nonprofit director “positions are largely unpaid”).

133. Even for a nonprofit that could afford to compensate experienced director talent, the IRS has previously discouraged nonprofits from compensating directors, which remains the sector norm. Thomas Silk, *The Shifting Landscape for American Not-for-Profit Organizations*, 10 INT’L J. NOT-FOR-PROFIT L. (2007), <https://www.icnl.org/resources/research/ijnl/good-governance-practices-for-501c3-organizations-should-the-irs-become-further-involved-2> (“Charities should generally not compensate persons for service on the board of directors except to reimburse direct expenses of such service. Director compensation should be allowed only when determined appropriate by a committee composed of persons who are not compensated by the charity and have no financial interest in the determination.” (internal citation omitted)).

134. MIT Sloan Office of Media Relations, *MIT Sloan Study Shows Negative Effects of Sarbanes-Oxley on Nonpublic Entities*, MIT SLOAN SCH. MGMT. (Nov. 16, 2017), <https://mitsloan.mit.edu/press/mit-sloan-study-shows-negative-effects-sarbanes-oxley-nonpublic-entities> (“After SOX, the demand for auditors by public companies increased, leaving fewer auditors available for private companies and nonprofits. As a result, audit fees for nonpublic entities increased significantly and private companies applying for bank financing decreased their use of independent auditors. . . . For nonprofits, they found that annual auditor fee increases more than doubled.”).

B. ELUSIVE BENEFIT REPORTING

While for-profit entity options for social enterprises have drastically increased in the last decade, social enterprises have been hesitant to organize under these new hybrid entity statutes. A barrier to adoption of hybrid entities by social enterprises is the hardship in the benefit reporting requirements. Although not as expensive as SOX reporting requirements,¹³⁵ benefit reports still require substantial time and financial resources to prepare. Moreover, there is little evidence that social enterprises are using benefit reports as governance tools. Few social enterprises are releasing benefit reports, with some compliance rates below ten percent.¹³⁶ Unlike the SOX regime where the Securities and Exchange Commission enforces SOX governance requirements and reviews submitted reports, secretaries of state are not enforcing benefit reporting requirements because they lack the necessary resources. With no agency enforcement of this statutory reform, single-digit benefit reporting compliance is understandable. For those benefit reports that exist, there is minimal quality control. These realities add to concerns that hybrid entities are marketing strategies that do not meaningfully advance social change or strengthen the firm's adherence to its social mission.¹³⁷

For-profit social enterprises have evaded major accounting and fraud scandals. The issues benefit reporting seeks to address are less about reeling in fraud and more about ensuring accountability to the social enterprise's social mission. Because the issues benefit reporting is primarily concerned with are fundamentally different than the early-2000s accounting scandals that gave rise to SOX, it is not clear benefit reports would substantially improve corporate governance. More data on benefit reporting is necessary. The criticism of benefit reports includes that they increase administrative costs and take funds away from their intended purpose to serve the public good. For these reasons, social enterprise governance has not been revolutionized by hybrid entities, notwithstanding the proliferation of these new business forms.

III. FUTURE SOCIAL ENTERPRISE GOVERNANCE REFORMS

There are several arguments against imposing additional SOX-inspired reforms on social enterprises. Primarily, the agency costs of poor social enterprise governance are different than the costs of mismanaged public companies. The major concerns for public company executives inflating numbers to induce investors and earn enhanced compensation are the systemic risks these actions

135. *SOX Section 404 Compliance Costs Are Still Rising Twenty Years Later*, PROFESSORBAINBRIDGE.COM (Aug. 23, 2022), <https://www.professorbainbridge.com/professorbainbridge.com/2022/08/sox-section-404-compliance-costs-are-still-rising-twenty-years-later.html>.

136. See J. Haskell Murray, *An Early Report on Benefit Reports*, 118 W. VA. L. REV. 25, 26 (2015).

137. Mohsen Manesh, *Introducing the Totally Unnecessary Benefit LLC*, 97 N.C. L. REV. 603, 607 (2019) ("[T]he advent of benefit LLCs reveals that the animating force behind benefit entity legislation has never been a desire for legal reform. Rather it is about branding: the creation of a state-sponsored designation made available to private entrepreneurs to signal the virtue of their for-profit business to consumers, investors, and the broader public.").

cause. Public company mismanagement can lead to systemic market failures. However, capital markets do not have nearly as much interdependence on the social enterprise sector because of the number, size, or often hyper-local geographic focus of most social enterprises. Stealing from a nonprofit or defrauding a limited number of private investors—the most likely results of poor social enterprise governance—while undesirable, do not pose the same potential of financial institution failures or disturbances. Fraud as a substitute for legitimate purchase hopefully occurs less frequently in the social enterprise sector. Because the systemic risks for social enterprise failures versus public company failures are not comparable, SOX-inspired reforms should not be transposed onto social enterprise governance. Moreover, there have been consistent attempts to narrow the applicability of SOX requirements,¹³⁸ which strengthens the argument SOX should not be imposed on social enterprises. Thus, future interventions on social enterprise governance should abandon SOX as a touchstone for best practices because federalized compliance is inappropriate¹³⁹ or at least unnecessary¹⁴⁰ in the context of social enterprises, which are overwhelmingly small private companies.

Notwithstanding, SOX has in many respects achieved its stated goals of tempering corporate scandals and failures through an emphasis on governance, oversight, and reporting.¹⁴¹ Most scholars and practitioners agree that a trustworthy reporting system is necessary for sustained business performance. For this reason, the U.S. securities regime depends on a balanced approach of reporting to ensure compliance and good governance.¹⁴² Section 404 has also bene-

138. See, e.g., *Accelerated Filer and Large Accelerated Filer Definitions*, U.S. SEC. & EXCHANGE COMMISSION (Apr. 27, 2020), <https://www.sec.gov/rules/final/2020/34-88365.pdf> (amending “the accelerated filer and large accelerated filer definitions to more appropriately tailor the types of issuers that are included in the categories of accelerated and large accelerated filers and promote capital formation, preserve capital, and reduce unnecessary burdens for certain smaller issuers while maintaining investor protections”).

139. See Aprill, *supra* note 120, at 768 (“SOX’s governance provisions represent a misplaced and unwarranted federalization, upsetting the proper balance between state and federal regulation by intruding into matters of corporate governance that have been and should remain the province of the states.”).

140. See Romero, *supra* note 14, at 1529 (arguing “that the corporate governance provisions of SOX should be stripped of their mandatory force and rendered optional for registrants”).

141. See Michael W. Peregrine, *Sarbanes-Oxley Changed Corporate America*, N.Y. TIMES (July 25, 2012), <https://www.nytimes.com/roomfordebate/2012/07/24/has-sarbanes-oxley-failed/sarbanes-oxley-changed-corporate-america> (reflecting on “the profound way [SOX] has reshaped attitudes toward corporate governance”); Jesse M. Fried, *Firms Gone Dark*, 76 U. CHI. L. REV. 135, 144 (2009) (“Moreover, the enactment of the Sarbanes-Oxley Act, which has raised reporting costs, appears to have increased the tendency of firms to go dark.”); Weili Ge, Allison Koester & Sarah McVay, *Benefits and Costs of Sarbanes-Oxley Section 404(b) Exemption: Evidence from Small Firms’ Internal Control Disclosures*, 63 J. ACCT. & ECON. 358, 360 (2017) (“Overall, we find that the costs of [the SOX § 404(b)] exemption due to [internal control] misreporting (\$719 and \$936 million) are larger than the benefit (\$388 million in audit fee savings).”).

142. LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 45 (3d ed. rev. 1998) (“[T]here is the recurrent theme throughout [securities laws] of disclosure, again disclosure, and still more disclosure.”); LOUIS D. BRANDEIS, OTHER PEOPLE’S MONEY AND HOW THE BANKERS USE IT 92 (1914) (“Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.”).

fited from regulatory tweaks over the last two decades that could be instructive for other governance regulation. Though SOX-inspired reforms have not presently revolutionized social enterprise performance, they have introduced governance inroads that are not likely to be abandoned by mission-driven businesses and, thus, should not be ignored. For these reasons, learning from SOX's governance regime can be insightful for the future of social enterprise governance.

Modest regulatory intervention in social enterprise governance could increase economic efficiency and would be justified under the public interest theory of regulation. Markets are not perfect and often require government intervention beyond what industry gatekeepers and self-discipline provide.¹⁴³ Moreover, history has demonstrated that without reliable information, assumptions about market discipline are often more optimistic than reality. As demand for social enterprises continues to grow,¹⁴⁴ a larger social enterprise sector is likely. A functioning social enterprise sector necessitates organizations running efficiently and adhering to their social missions,¹⁴⁵ which good governance facilitates. Given this, this Part provides pragmatic suggestions for how to encourage social enterprise governance that builds on the SOX regime and lessons learned over the last twenty years since its passage.

A. OPT-IN REPORTING FOR INCREASED TAX DEDUCTIONS

SOX requires public companies to provide additional reporting and internal processes in exchange for access to capital markets. To date, SOX-inspired reforms have been applied to all nonprofits over a specific revenue threshold¹⁴⁶ and all hybrid entities.¹⁴⁷ However, none of these reforms address what social enterprises need most, which is increased access to capital.¹⁴⁸ With limited regulatory enforcement,¹⁴⁹ there is ample opportunity for noncompliance and no

143. See Anat R. Admati, *Financial Crises, Corporate Scandals, and Blind Spots: Who Is Responsible?*, LONDON SCH. ECON. (Jan. 25, 2018), <https://blogs.lse.ac.uk/businessreview/2018/01/25/financial-crises-corporate-scandals-and-blind-spots-who-is-responsible/> ("Corporations cause preventable distortions and harm through deception and recklessness largely because governments fail to set and enforce proper rules."); Anat R. Admati, *A Skeptical View of Financialized Corporate Governance*, 31 J. ECON. PERSP. 131 (2017).

144. See Simon Day, *Social Enterprise: The Future of Capitalism?*, THE SPINOFF (Sept. 29, 2017), <https://thespinoff.co.nz/business/29-09-2017/social-enterprise-the-future-of-the-capitalism/> ("Consumers, potential employees, and clients are starting to demand businesses think carefully about the social impact they have and the potential for the company to make a greater contribution to their ecosystem.").

145. Reiser, *supra* note 43, at 208.

146. See *supra* Part I.A.

147. See *supra* Part I.B.

148. See Emma Sheppard, "Social Enterprises Go Bust All the Time"—How the Sector Is Tackling Its Image Problem, THE GUARDIAN (Mar. 12, 2018), <https://www.theguardian.com/small-business-network/2018/mar/12/social-enterprises-go-bust-all-the-time-how-the-sector-is-tackling-its-image-problem> (quoting a social entrepreneur explaining why business is more difficult: "My commitment to ethics makes everything more expensive and much more time-consuming," she adds. "My margins are smaller . . . and a lot of routes to funding are closed to me," she says.").

149. See *supra* Parts II.A & II.B.

financial incentive for social enterprises to comply with the SOX-inspired reforms targeting mission-driven companies.

Mindful of the uncertainties of new regulation, and that market actors often are informed more than politicians on how best to correct issues, a humble innovation would allow social enterprises to opt into heightened reporting and governance practices in exchange for greater access to capital. A voluntary system would allow individual social enterprises to determine if the costs of reporting and internal controls are worth the benefits of additional capital. The IRS could, for example, allow charitable nonprofits¹⁵⁰ to opt into additional reporting and an internal controls regime¹⁵¹ in exchange for increased tax deductibility for their donors. The Tax Cuts and Jobs Act¹⁵² not only increased standard deductions,¹⁵³ it also decreased the number of individual donors who benefit from itemizing their deductions to charitable nonprofits.¹⁵⁴ Increased tax deductibility for opt-in nonprofits would improve their likelihood of receiving more individual donations.¹⁵⁵ An opt-in regime would also be preferable to the current mandatory revenue thresholds at the state level because the diversity within the nonprofit sector means that revenue is not always the most relevant factor in determining if heightened governance practices would be beneficial.

150. Most tax-exempt nonprofits are not charitable; however, nonprofit social enterprises often are charitable. This additional tax incentive could be limited to those tax-exempt nonprofits that can demonstrate the deduction would increase their charitable activities.

151. See also Aprill, *supra* note 120, at 792 (“I urge consideration of legislation establishing some federal minimum standards of nonprofit governance for the IRS to enforce, with the IRS to withdraw if state regulation is shown to be sufficient.”).

152. Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017).

153. *Id.* § 11021; *Tax Policy Center Briefing Book*, TAX POLY CTR. (2020), https://www.taxpolicycenter.org/sites/default/files/briefing-book/how_did_the_tcja_change_the_standard_deduction_and_itemized_deductions_1.pdf (“The Tax Cuts and Jobs Act (TCJA) increased the standard deduction from \$6,500 to \$12,000 for individual filers, from \$13,000 to \$24,000 for joint returns, and from \$9,550 to \$18,000 for head of household in 2018. . . . The TCJA eliminated or restricted many itemized deductions in 2018 through 2025. This, together with a higher standard deduction, will reduce the number of taxpayers who itemize deductions.”).

154. Richard Eisenberg, *How the Tax Overhaul Contributed to a Drop in Charitable Giving*, PBS (June 19, 2019), <https://www.pbs.org/newshour/economy/making-sense/how-the-tax-overhaul-contributed-to-a-drop-in-charitable-giving#:~:text=The%20chief%20reason%3A%20the%20doubling,to%20have%20been%20proven%20out> (“Charities feared that the 2017 tax law would lead to a drop in charitable giving by individuals. The chief reason: the doubling of the standard deduction (to \$24,000 for married couples filing jointly) would mean it wouldn’t pay for many to itemize on their 2018 tax returns, and without a charitable contribution deduction, they’d be less inclined to give. New data shows the fear seems to have been proven out.”).

155. *Id.* (“An incentive to give will definitely increase giving, no question about that. For many, it may not be a matter of whether to give, it’s how much to give.”); *Health of the U.S. Nonprofit Sector Quarterly Review*, INDEP. SECTOR (Jan. 10, 2023), <https://independentsector.org/resource/health-of-the-u-s-nonprofit-sector/> (“The number of donors declined 7% in the third quarter of 2022 and it is visible across all sizes of donations. This downward trend demonstrates the need to reinstate charitable giving incentives for all taxpayers.”).

The IRS, much like the SEC,¹⁵⁶ is not traditionally thought of as having a mandate to promote corporate governance.¹⁵⁷ However, since the passage of SOX, the IRS has consistently emphasized its role in advancing nonprofit governance.¹⁵⁸ Moreover, given the IRS's established regulatory framework for nonprofits,¹⁵⁹ it is unlikely another federal agency would encroach. While a system where charitable nonprofits voluntarily adhere to more robust governance practices for increased deductibility would largely be self-regulating,¹⁶⁰ the IRS could enforce compliance to minimize abuse.

Moreover, this does not have to be fast regulation in the same way SOX was. Unlike with SOX, this regulation could include sunset clauses. This would allow the IRS to gather empirical and anecdotal data, as well as a process for comments from a wide variety of nonprofit leaders and attorneys who could provide input on the exact provisions. With a substantial number of nonprofits opting in to new nonprofit governance practices, even a statutory reform with a sunset provision could be sufficient incentive to shift culture and performance.

B. BENEFIT REPORTS AS GOVERNANCE TOOLS

In recent years, there has been a dramatic increase in the number of for-profit companies disclosing environmental, social, and corporate governance (“ESG”) topics.¹⁶¹ Benefit reports provide social enterprises with a competitive advantage to streamline and perfect what is a steadily increasing trend of ESG reporting.

156. *Protecting Investors*, U.S. SEC. & EXCH. COMM'N 1, <https://www.sec.gov/about/secpar/secparsumm04.pdf> (last visited May 5, 2023) (“The mission of the Securities and Exchange Commission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.”).

157. *The Agency, Its Mission and Statutory Authority*, INTERNAL REV. SERV., <https://www.irs.gov/about-irs/the-agency-its-mission-and-statutory-authority> (last visited Apr. 28, 2023) (“The IRS Mission: Provide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.”).

158. See *Governance and Tax-Exempt Organization*, INTERNAL REV. SERV., 2 (2009), https://www.irs.gov/pub/irs-tege/governance_training_presentation.pdf (identifying that “nonprofit governance has become an area of focus by IRS”); *Governance and Related Topics—501(c)(3) Organizations*, INTERNAL REV. SERV., https://www.irs.gov/pub/irs-tege/governance_practices.pdf (last visited May 5, 2023) (“And while the tax law generally does not mandate particular management structures, operational policies, or administrative practices, it is important that each charity be thoughtful about the governance practices that are most appropriate for that charity in assuring sound operations and compliance with the tax law.”).

159. MARION R. FREMONT-SMITH, *GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION* 465 (2004) (arguing that “it is naïve to think that Congress would remove regulation of charities or other exempt entities from the [IRS]”).

160. Reiser, *supra* note 43, at 276–79 (arguing that nonprofits should self-regulate to better protect mission and organization accountability).

161. Atinuke O. Adediran, *Disclosing Corporate Diversity*, 109 VA. L. REV. (forthcoming 2023) (“Ninety percent of S&P 500 companies and many small- and medium-sized companies currently disclose ESG reports.”); Rachel Layne, *Are Companies Actually Greener—Or Are They All Talk?*, HARV. BUS. SCH. WEEKLY (Jan. 13, 2023), <https://hbswk.hbs.edu/item/are-companies-actually-greener-or-are-they-all-talk-esg-greenwashing> (“Most companies now account for social good in their financial reports in some way, but with regulation scattershot and evolving, it’s complicated for investors to assess so-called ESG reports.”).

Social enterprise lawyers¹⁶² should also counsel their social enterprise clients on the positive impact regular reporting can have on governance practices. In the same way corporate lawyers have led the paradigm shift in public company governance under SOX, the benefit report provides social enterprise lawyers a mechanism to help pioneer social enterprise governance. Social enterprise lawyers could verify the accuracy and completeness of benefit reports, identify potential legal risks raised by the information in the benefit report, and establish and implement appropriate governance practices to mitigate any risks. By annually examining the mission, finances, management, and governance of the social enterprise, the company could not only ensure mission alignment, but also improve its overall performance. For this reason, impact investors should prioritize investing in social enterprises that not only produce benefit reports, but also recognize and use them as governance tools.

CONCLUSION

In essence, this article contemplates the counterfactual question how social enterprise governance might have developed without the enactment of SOX. We will never know if social enterprise governance would have organically evolved to emphasize reporting, audit requirements, and compulsory director expertise absent the intervention of SOX. But it is hard to imagine it would have as reporting, audit requirements, and director expertise are uniquely central to SOX. Perhaps that is sufficient justification for scholars to look beyond SOX for frameworks and touchstones for the future of social enterprise governance that are grounded in mission-driven performance instead of preventing systemic risks. However, SOX has had an undeniable impact on the growth of social enterprise law and governance. Given the insights regulators, attorneys, accountants, and business professionals have gained twenty years post-SOX, it is worth continuing to learn from SOX to foster good social enterprise governance. Social enterprises have an indispensable role to play in promoting a more just society. SOX provides effective mechanisms to promote good governance that can be useful for the social enterprise sector in achieving social change goals. Social enterprises could improve their governance practices if there was increased access to capital for adhering to enhanced reporting requirements and heightened internal controls.

162. See Alina Ball, *Social Enterprise Lawyering*, 88 UMKC L. REV. 803, 803 (2020) (defining social enterprise lawyers as corporate lawyers who also intuit how the social justice objectives of their social enterprise clients impact each legal matter).

