Senate Committee on Banking and Financial Institutions

Juan Vargas, Chair

Informational Hearing

Flexible Purpose Corporations, Benefit Corporations, and the Nonprofit Sector: Opportunities for Collaboration

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Stanford University

SENATOR JUAN VARGAS: I'd like to welcome everyone here today. If we could go ahead and get started; let's first start with the formalities here. I want to welcome everyone to the Senate Committee on Banking and Financial Institutions' informational hearing. For the record, I'd like to state that Juan Vargas, the Chair, is present. The other members will, in fact, get the opportunity to hear this hearing via the electronics provided here by the sergeant-at-arms.

I also would like to make one correction in the Senate Daily File. It states here that we are meeting at Stanford University, Room 120, Gunn Building, Palo Alto. Let the record reflect that it's Room 130, Gunn Building here at Stanford in Palo Alto.

So I want to thank each and every one of you for being here and coming. I particularly want to thank the Stanford Institute for Economic Policy Research for its hospitality and allowing us to hold this hearing today. In particular, my good friend, Joe Nation, who, of course, we have heard very much from recently at the Capitol. Someone told me today, that I'm coming to the epicenter of the pension reform issues in California, so, of course, it's a pleasure to be here in the inner sanctum of the pension reform discussion in California.

I also think it's always a good thing when the Legislature holds hearings outside of Sacramento, because it allows us to draw on the experience that we don't often find in the Capitol, so I'm very pleased to be here today with all of you.

Last year, we enacted two bills to create new corporate forms; AB 361 (Huffman), created the benefit corporations, and SB 201 (DeSaulnier), created the flexible purpose corporations. Both of these new types of corporations allow companies to pursue a double bottom line to do well while doing good. But one thing we always need to be aware of in Sacramento and that is the unintended consequences. That's why we're here today.

Last year, when the bills were being considered by the Legislature, the nonprofit community testified in opposition to them. The nonprofits were concerned that these new corporate forms could siphon money away from the nonprofit sector and dilute the nonprofits' ability to achieve their missions. The Legislature didn't want to harm the nonprofit sector when we created these new corporate forms; we wanted to give these for-profit corporations more flexibility to do the right thing in society.

So today, we're here in the heart of social entrepreneurship, notwithstanding my former comments about this institute in particular, at one of the most esteemed academic institutions in the country, to look into the potential impacts that these new corporate forms have on the nonprofit sector.

Our goal today is to see if there are ways that the new types of corporations can work collaboratively with the nonprofit sector for the benefit of both. And also, I'd be remiss if I didn't note for the record that the *New York Times* recently had a couple of articles in it. One was an opinion piece by Greg Smith titled, "Why I am Leaving Goldman Sachs." The first paragraph reads:

Today is my last day at Goldman Sachs after almost twelve years at the firm—first as a summer intern while at Stanford, then in New York for ten years, and now in London. I believe I have worked here long enough to understand the trajectory of its culture, its people, and its identity. And I can honestly say that the environment now is as toxic and destructive as I've ever seen.

It goes on to add: *It wasn't just about making money (*speaking of the corporate culture there) and … "*this alone will not sustain a firm for so long … I truly believe that this decline in the firm's moral fiber* (he goes on to describe what he believes it is) *represents a single most serious threat to its long-run of survival.*

How did we get there? The firm changed the way it thought about leadership. Leadership used to be about ideas, setting an example and doing the right thing. Today, if you make enough money for the firm (and are not currently an ax murderer) you will be promoted into a position of influence.

So with that as a backdrop, I think it's very important that we do have discussions about these new corporate forms and where we want to see our society go as a communal experience of our own values.

I will now shut-up. I want to welcome again, former Assemblymember Joe Nation. He's a professor of Practice at Public Policy here at the Stanford Institute for Economic Policy Research. And, say thank you once again for allowing us to be here. If you could please come forward I'd appreciate it. Thank you.

MR. JOE NATION: First, I want to thank you for reaching out to us and giving us the opportunity to host this. I very much appreciate that. I want to recognize the staff here because I did very little in terms of arranging this. It's the SIEPR staff who really deserve the credit for the logistics and so forth, so much appreciation to them, and, also, to Eileen, with whom I've exchanged more than a couple of emails along the way.

I'm hopeful that we can make this a tradition. We are increasingly doing work on state issues here at SIEPR; as you mentioned, a little bit of work on public employee pensions in the last couple of years. And we would really appreciate the opportunity to be able to interact more with you, the other 39 members of the Senate, and the 80 members of the Assembly, and other constitutional officers on a variety of issues. So wherever your trails take you, I hope that you'll always remember that you can come back here to Stanford and conduct hearings like this. I appreciate that.

And then the last thing; I just want to make a quick comment on my relationship with Juan Vargas. We served six years together. I have different memories about different individuals there. But I will tell you, that the time I spent with you was … I look back and the one thing that strikes me is your integrity. I mean, this is a gentleman who made commitments, kept commitments, stood up for the right things consistently in your six years there; that's not the norm as those of you who deal with Sacramento know. And I very much appreciate the chance to work with you again. I wish you a successful hearing.

Unfortunately, I have to disappear to work with students. This is our last week of classes. But I appreciate the chance to be here. And again, good luck to you. It's great to be here.

SENATOR VARGAS: Thank you very much. Appreciate it. Thank you for the kind words, in particular. Thank you.

We have three different panels here today. Normally, when we hold these hearings what we do is we wait until the very end for public comment and public input. I think that in the more informal setting here, I think it would be appropriate, if you don't all mind, that after every panel, we give the opportunity to ask some questions to the panel. I think that that might make it a little more interactive. I think it might be a little more fruitful for all of us.

Again, we're here to listen. I know my colleagues are anxious to hear from me on what was said here today and they'll get the transcript but they'll also get the information from me. So if you don't mind, that's the way we'll proceed, if that's okay. Seeing that no one stands up violently and says, "No, no, no," that's what we're going to do.

Okay, so the first panel: An Introduction to Philanthropy and Civil Society, Development of the Nonprofit Sector and the Opportunities and Challenges Posed by the Blurring of Boundaries Among the Public, Private, and Philanthropic Sectors. We have with us Kim Meredith, Executive Director of the Stanford Center for Philanthropy and Civil Society; and Bruce Sievers, the visiting scholar and lecturer at Stanford Center for Philanthropy and Civil Society. Please come forward. We welcome you and thank you.

MS. KIM MEREDITH: Thank you. It's great to be here today. Thank you so much, Mr. Vargas—Honorable Vargas. And thank you to Joe Nation—I think he's already left—for setting this up.

Hello. I'm Kim Meredith. I'm the executive director of the Stanford Center on Philanthropy and Civil Society. We are a research center. We're scholars, practitioners, and leaders coming together to explore ideas for social change. We are also the publisher of the Stanford Social Innovation Review. So we are in the business of knowledge creation, knowledge sharing, and community building. This is a perfect venue for us to be in today. So again, thank you very much.

We work with five schools, 20 departments, and thus have 100 faculty affiliations, and as a result of that, I think we feel that these issues related to philanthropy and the future of issues such as the flexible purpose corporations or the benefit corporations fits in squarely with our very interdisciplinary lens.

Today, governments are stretched, corporations have a trust deficit, and thus philanthropy has a very special role that it can play as we look to leverage social change. With that in mind, let's take a look at the exploring of these lines and some of the blurring between nonprofits, independent sector, philanthropy, business, and government. Let's take a look at a few key terms.

Philanthropy: human good; love of human kind. We typically think of philanthropy as charity today. There are tax incentives that actually try to inspire some of that charity. It can come in the form of financial capital or human capital. We also think about civil society and what does that mean?

Civil society, for those of you in the room who may or may not be as familiar with that term, it's really that space between government and business, the independent sector, the nonprofit sector, freely associated organizations and associations coming together.

Let's also think about some of the terms related to social innovation. And certainly, that comes to mind for those of us with the Stanford Social Innovation Review. It's about putting out new ideas and strategies. We hear terminology around social entrepreneurs and what does that mean? Individuals who are thinking good but trying to be entrepreneurial about that, but still potentially in the nonprofit space. So it certainly raises a lot of questions today about, can those social entrepreneurs actually be a part of this flexible purpose corporation, or this benefit corporation? And not only will we see a blurring of the lines in terms of some of the corporate possibilities, but also of the human capital and the people who work in those very areas. And social innovation can actually take place in all three categories; government, business, or in the independent sector. And in fact, research that we have is focusing on is innovation actually good; at what point is innovation appropriate; or can innovation actually be harmful if it's not done in the appropriate timing in the appropriate way? And thus, I think that is an underpinning for today's conversation; about whether or not flexible purpose corporations or B corporations actually would be good for California and how would they affect the nonprofit sector?

So some of the questions that were in the briefing, that all of us had the opportunity to see in advance really, are looking at will new corporate forms actually reduce demands on capacity for nonprofits? Will they be reducing demands on the service demands? In fact, are they going to participate in some form of service delivery? Are they going to, in fact, affect the capacity because they will be diverting funds from nonprofits over to flexible corporations or B corporations? So there's quite a bit of interplay for us to explore because potentially it could reduce or dilute the pool of funds, and so, we can take a look at what some of that might look like. Will these new corporate forms be self-sustaining or will they actually attract new capital? And will these forms in fact result in more innovation, more effective use of the dollars that are going for social good?

So let's take a look at how philanthropy has been benchmarked and tracked since 1956. I have some data starting in the 1970s, and I would actually contend that we have a unique situation here. The law that was just passed in 2011, going into effect now, we can actually start to think about tracking the investment capital that's coming into flexible purpose and B corporations and see what that might look like over time and then see not only where the dollars are coming from, but where the dollars are going to, and what that impact might be in terms of business growth or social good through these new corporations or nonprofits.

So total giving, as you can see, has grown since the 1970s. We've been tracking it since 1956 through Giving USA. So since 1970, you've seen it go up and that would actually be a result of … some people would think that, one, our economy has grown and thus philanthropy has grown with that, but that was also similar to some of the timing when tax incentives went into play, and so, we've seen philanthropy grow potentially as a result of that.

Between 2005 and 2007, philanthropic dollars were about in the $300 billion range. In 2010, with these exact numbers, it was $290 billion, about 1.8 percent of GDP. So in 2005 through 2007, it was hovering around 2 percent of GDP—did spike up to about 2.3 percent of GDP. But consistently over these 40 year, it has certainly grown from 1.5 percent, and more recently since 2000 been in the 1.8 to 2.3 percent of GDP.

Nonprofits who are receiving these dollars employ about 10 percent of the labor force, so you can think about that relationship and that could make for another interesting research project. If it's 2 percent of the GDP and it's employing 10 percent of the labor force, what might that imply?

Nonprofits also receive on aggregate 30 percent of their dollars from government. So in my opening comment that governments are stretched, that's an important number for you to be aware of. Because as government dollars shrink, then nonprofits can potentially be very seriously affected. Some nonprofits receive 90 percent of their dollars through government fee-for-service or reimbursements. Other nonprofits receive none, or 10 percent. So there is certainly a spectrum in terms of who could be affected because of the government money coming in and then what that might mean in terms of the need for philanthropic dollars to fund the nonprofit sector, as we continue with this very slow economy.

Additionally, only in 1987 and in 2009 did philanthropic dollars actually decrease, so again, a reflection of a difficult economy. So the timing of this new legislation and the implications of that in terms of the implementation, are actually important since the economy in California has been particularly disadvantaged compared to other states nationally.

So where do those dollars, those philanthropic dollars, that $300 billion that you saw before, where do they come from? And I always love asking this question in a classroom because usually before I put up this slide I say, "Alright, what do you think corporate dollars?" and consistently students will raise their hands and say, "Oh, I bet corporate philanthropy is 20, 30 percent. Some folks will say 50, 70 percent." Well, the reality is corporate dollars were 5 percent in 2010, and, in fact, that was the highest it has been in absolute years. It's usually between 3 and 4 percent. When you look at foundations, foundations accounted for 14 percent in 2010. Consistently, between 1970 and 2010, they were between 11 and 14 percent.

So who gives? It's people like you and me. Everyday families give, and on average it's about $2,000 per family. So people who are living and making gifts account for 73 percent of philanthropy in 2010, and 8 percent were from individuals who were passing on. And if you look at any given year over the past 40 years, it's pretty consistent—about 83 to 85 percent of philanthropy comes from individuals. So as you're thinking about what does that mean in terms of the potential investment that might go into these flexible purpose or benefit corporations, will they come from these individuals; will they come from corporate foundation support; will they come from foundations; or will it be a totally new pool of investors from the venture community—private, equity, or banking community? So these are some of the questions to ask.

You can also see where the dollars are going: 35 percent to religion, which has declined over the past 20 years from 50 percent down to about 35 percent. And I think for many people the reality was that only about 10 percent of philanthropic dollars ever left the walls of that particular church, temple, synagogue and moved out. So I think as that information became known, as certainly there were more nonprofits to support in communities, people have broadened out their philanthropic dollars. So you can see what that looks like. And those dollars, whether it's individuals or foundations, it's all pretty close in terms of what they fund; a few differences on the foundation side, but very minor.

Here you go. As I've said, it hasn't changed that much. So again, it's this unique opportunity to track the dollars that come in to these new corporate organizations and see what it might look like as we move ahead.

So emerging trends. Globalization. Since 2000, late 90s early 2000, here we are living in Silicon Valley and working here at Stanford. So we are the beneficiaries of seeing new ideas and new social innovation. And I would say philanthropy and the new models of philanthropy that we have seen come out in the late 90s and early 2000, certainly, this neighborhood has been a leader in that area.

Globalization (let me give you a quick example on each one of these): *kiva.org* started in 2005 by two Stanford business school students during their second year—$500,000 the first year; last year they passed through $200 million. Microfinance, micro lending, thinking about the World Bank; what that has meant in terms of opening up globally, whether it's private or public through organizations, such as the World Bank, funding microloans.

Funder collaboration: when organizations like the Hewlett Foundation, the Packard Foundation, the Moore Foundation come together to actually do some work on environmental issues and actually make a difference together. Pushing out terminology. For example, 10 years ago we hardly even talked about *carbon footprint*; today we all know what that means.

Collective impact: Groups coming together. It can be groups of nonprofits, nonprofits and private business, or government joining in. A great example, check out the SSIR article on collective impact about the Strive example in Cincinnati where a group of people came together to lift up achievement for education in that community.

Technology: Online giving. You'll hear some different ways of fundraising from a future speaker.

New donor behavior: Coming together, and, actually, donor giving circles as an example. Being a little bit more sophisticated about your approach to grant making as an individual.

Venture philanthropy: My goodness. That started here with our own board chair, Laura Arrillaga-Andreessen, in the late 90s with the Silicon Valley Social

Venture Fund. And now there are funds of that sort in 28 communities, and Social Venture Partners International, as an example.

Public-private partnerships: Again, collective impact type of style of work but coming together. For example: the gift from Marc Benioff in December to the government in San Francisco to find shelter for homeless families during the holidays; a beautiful example of a public-private partnership.

Shared value: a term that we have also put out through SSIR. Trying to bring a corporate lens into how they give their philanthropy. And we'll talk a little bit more about that corporate social responsibility.

Hybrids (nonprofit/for-profit): That's what we're here to talk about today with flexible purpose and benefit corporations.

Impact investing: foundations do impact investing into nonprofits. But individuals can do impact investing into nonprofits or potentially these types of organizations.

Social entrepreneurs: we talk about social entrepreneurs, but many of them are small organizations that they're leading and have no scale. So in fact, what's their impact?

Which leads to the next question around strategic philanthropy measurements, outcomes; do you have a strategic plan; do you have a course in mind; are you doing evaluation and assessment? Those are the issues that are the emerging trends in philanthropy. But what do we see? Almost in every example that I brought up we were in that space, in the middle, and the blurring of the lines is very much a reality of today.

So if you're a nonprofit and you're running an organization, you are thinking with one lens. If you are a corporation, you've got a different side—different language, different purposes.

Mission: corporations want a mission today. Nonprofits want revenue. But the reality is, this chart actually picks up sort of where the work actually falls. Nonprofits have a social mission. Corporations have a profit mission. You have a board of volunteers, a board who is paid. Financial tools in the nonprofit community are quite limited. You can fundraise; you can apply for government funds; you can try to have benefits; you might start a small business or have a shop to raise some earned revenue, but it's pretty limited. When you're thinking about financial tools for business, they have full access to banks; they have full access to private equity, to venture capital. And that doesn't mean that funds aren't opening up and financial tools aren't opening up for nonprofits, but it is challenging compared to what corporations have in terms of their full tool kit; I know this, having led a nonprofit during some very difficult times.

Funding: donations, government, revenue, product services, filling a service gap, competitive advantage. And certainly, many nonprofits are looking to see what their niche is and how they might partner and collaborate and fill that gap. But do we actually talk about our competitive advantage? Sometimes, but in a limited way for most nonprofits.

Sustainability, financial performance, leadership and staffing, an issue for all. But what do you pay people in the nonprofit community as compared to the for-profit community? These are issues as you try to create longer term relationships with your staff and be a leader.

And then of course, reporting, transparency and accountability. Everybody has those issues.

Looking at what a corporation might think about in terms of bridging that gap. They are coming at their philanthropy looking at, hopefully, the nonprofit as a partner in the work they're doing. And I think a really great example is what Bobbi Silten has done with the Gap Foundation. She looked at their core competencies, kind of the right hand side. Like if you have core competencies, how do you use those core competencies to actually align your philanthropy? They have manufacturing plants where 90 percent of the employees are women overseas; training women in leadership, development, health, being a partner in that community, and promoting from within. Locally, in their stores, using their employees to actually do training with high school students, actually helping students learn how to have their first job. What does that mean? And then hiring some of those students or creating a network for those young people to get a job. So those are the kinds of things to be looking at from a corporate lens.

And then, nonprofits, they're actually trying to ask themselves some questions that are very strategic in nature that the independent sector … and some of you may be aware that there's a large organization that most nonprofits are affiliated and associated with called "Independent Sector" out of Washington, DC. It is the advocacy arm that is used to advocate whether it be tax related issues, staffing related issues for nonprofits. So asking yourself some strategic questions about where your organization is going and what you're doing.

And then finally, creating shared value. As we said, whether you're that corporation, you're that nonprofit, or you're government, how do we actually do that and how do we address these issues together? And I think John Hennessy actually has this marvelous quote about "*the scope and complexity of social and scientific challenges has grown immensely in recent decades*." And so with these complexities, coming at these problems, to come up with new ideas and solutions is critical and it has more complexity and it will take scholars, practitioners, and leaders to solve these problems and to think about these issues.

So we welcome you here at Stanford today to be looking at these issues and this new flexible purpose corporation and benefit corporation.

Thank you. I'll hand it off to Bruce.

SENATOR VARGAS: Thank you very much. Professor. I will have a question for you afterwards, one that kind of struck me, it may have struck other people, the pie charts, but I'll wait. It was pretty shocking. I would have flunked your class because I think I would have been 40 or 50 percent corporations.

MS. MEREDITH: Great! We don't want you to flunk. Let's ask that question.

MR. BRUCE SIEVERS: Thanks. I'm Bruce Sievers. First of all, Senator Vargas, thank you very much for doing this. I particularly appreciated your quote from Greg Smith, because I think it gets at some of the fundamental value questions that I want to address briefly.

First, just a note on my own background. I was an undergraduate/graduate student here at Stanford ending with a doctorate in Political Science. When I finally couldn't find any further justification for hanging around here, I left to become an executive in the philanthropic world, where I was for 30 years, the last 20 of which as CEO of a private foundation in San Francisco, the Walter and Elise Haas Fund. And since retiring from that, I've been, for about 10 years, writing and teaching in the area of civil society and philanthropy. And I'm actually now teaching a course here at Stanford called Theories of Civil Society: Philanthropy in the Nonprofit Sector.

First, just a word on terminology, just building on what Kim had said. I'm going to use the term mostly "civil society" which is growing in international acceptance as the preferred term to describe this arena we're discussing. Now there are plenty of other terms, and the "nonprofit sector" is clearly the popular one in the U.S. and there are plenty of others: "voluntary sector," "third sector," "independent sector," "philanthropic sector," and so on, "NGO sector" if you're talking internationally. But all of these tend either to be negative, that is nonprofit or non-governmental, or to capture only some partial aspect of what this field is about. Civil society by contrast, offers the most comprehensive scope, and more important, captures both the value set and the institutional members that populate this sector. And I'll say a little bit more about the values in a minute.

So let me just give a quick historical snapshot kind of how we got to where we are today in this world. Rest assured, I'm not going to try to capsulize 2,000 years of history of the development of civil society in my 10 minutes but I did want to make a couple of key points about the background of where this comes from.

First of all, the practices of civil society are really ancient. Actually, a good argument could be made, and some anthropologists have made it, that civil society institutions and civil society forms predate institutions of government and institutions of commerce. We looked simply at ancient religious groups, fraternal groups, clans, and so forth that were an integral part of primitive societies. And certainly, there are several key elements we now think of as civil society that were present in almost all traditional cultures: private associations, some forms of giving or philanthropy, legal norms—that is the rule of law, and a commitment to the good of the community.

To jump forward a couple of thousand years, it was not until about the 17th century in Europe when civil society began to appear in its truly modern form. And this actually first appeared, at least I've argued it in some writing, in this little country in the northeast corner of Europe, the Dutch Republic, the famous golden age of the Dutch Republic. That society had state-of-the-art orphanages, hospitals, old folks homes, philanthropy quite complexly administered, freely practicing religious organizations, communal and fraternal groups of all sorts, and the free flow of information about public matters -- all of these complements that we think of as part of civil society today. That Dutch experience actually had a very strong influence upon England, most notably through the invasion of England by the Dutch, that some people probably don't know about. And that is in 1688, the Glorious Revolution in England was actually accomplished by William and Mary sailing across the channel and occupying England for several years and leaving a very important impact on it, particularly in this realm. And that imprint actually got transferred via England into the early American experience—the American colonies, of course. So what we have today is, to some degree, an era of this phenomenon that occurred beginning, maybe, in the Dutch Republic but other places as well in Europe in the 17th century. What was being created here was this area outside the state, and importantly also, outside the for-profit sector where people could pursue their mutual benefit and public benefit activities and freely express their beliefs and values. This was the essence of the early forms of civil society.

Alexis de Tocqueville … and you can't do a presentation like this without mentioning Tocqueville at least once. Tocqueville's famous writing in the 1830s describes how such vibrant, voluntary associations were fundamental to the creation of American democracy.

So the next two centuries in the U.S. witnessed a complicated dance among the three sectors as they sought to draw lines and clarify purposes punctuated by at least three very significant legal cases. One was the Dartmouth College case of 1819 where a clear dividing line was set between government and private institutions. The case was argued by Daniel Webster and the Chief Justice was Marshall, so a very significant case in establishing some of these boundaries. Then 100 years later in 1919, Dodge versus Ford, a nice contrast of car companies, where the Supreme Court ruled that a corporation could not legally divert profits in order to vote them to purposes unrelated to the business. This actually held clear up until the fifties, when it finally began to change … and I say this with some trepidation knowing that there are some legal scholars in the audience here so I hope what I'm saying is correct … actually by a New Jersey supreme court but it became a precedent for the U.S. in 1952, that finally ruled that corporations were allowed to broaden their social interests. So this is a fairly recent phenomenon.

All this is to say that there has been a long history of negotiation about the proper spheres and boundaries for these three sectors. But what has also been clear is that there's been a distillation of core and distinctive purposes of civil society and that is that they are public benefit oriented, not self-interest oriented. That's incorporated and symbolized by the non-distribution constraint that's contained in federal tax regulations about the nonprofit sector; they're voluntary; they're philanthropic; they're free from government and market constraints; and an arena for the individual expression of values.

And I just want to illustrate a little bit about the differences among the three sectors. (*Electronic presentation set up)*

So I just want to say that if you use these categories along the left to describe some fundamental principles upon which these three sectors operate, you'll see some fairly fundamental differences.

So the mission, if you divide it by mission, public benefit is certainly a fundamental mission of government that in a universal sense applies broadly and in the interest of justice, has to be uniformly administered. For the for-profit, essentially, interest maximizing is the primary mission. And civil society, also public benefit but differentiated, it's allowed to differentiate among its targets.

Operating principles: The government is universal and mandatory in its laws. The market can be particularistic but market driven. So society can be mission driven. Organizational forms clearly, democratic institutions, governmental institutions, enterprise and nonprofit organizations. And these last two are fairly critical. That is, the government responds to, fundamentally, the median voter. That is, 51 percent of the electorate essentially determines where government is going and what its priorities are. In the market we know it's the consumer. Very different in civil society; it's the individual or group vision of the public good.

(Portable Microphone handed to witness)

So responding to the median voter, the consumer in civil society, individual or some group vision in the public good.

And finally, legitimacy is established in these three different arenas in quite different ways. Government fundamentally by elections; the for-profit sector by the market; and in the absence of some overriding and overarching accountability mechanism, the nonprofit world relies essentially on public trust as its source of legitimacy, and this is important.

Considering this matrix, my concern is that when boundaries get blurred in the name of social benefit, the very basis on which civil society rests gets eroded. The entire legitimacy of civil society rests, as I've suggested here, on public trust. Again, for the reason in part of the non-distribution constraint; that is, profits can't be distributed to shareholders, or they're not supposed to be even distributed back into the salaries of the people operating the organizations, although there's a lot of fuzziness there. Simply illustrated by one question; would you donate to Microsoft or Google? The answer is, probably not. The reason is, because it's simply going to go into profit margin of those corporations; whereas, we would donate to other entities where we have trust that it's going to be spent. The trust is not always fulfilled. We know of cases where it's not. But the concept is, that we have trust that it's going to be spent well.

When market organizations move aggressively into the civil society space there is a real danger of creaming, crowding out, and leaving out the least well off, and most importantly from my perspective, implicitly embracing the market as the most effective and efficient way to solve social problems with the corollary that all or most social benefit can be quantified and metrically compared. Some have called this the "marketization of everything." And I love the little line by Gail Collins in the *New York Times* today. She always has great lines. She says, *People, when you see Republicans and Democrats together talking about holding hands and unlocking the magic of the marketplace, hold onto your wallets.*

So just let me conclude with one additional little matrix that compares economic profit versus social benefit. Now clearly, I'm making sort of large scale arguments here, but I think the point is clear and that is … if you look up at the left hand corner; you see things like solar panels conceivably, well, maybe not Solyndra, but in most cases, has the potential at least to be very high profit and high social benefit. MRI technologies, lots of things like that.

If you go to the right corner; very low social benefit I would argue; very high profit: casinos, cigarettes, and lots of things like that.

You go down to the lower left hand corner; these are the things that generally we find in the civil society arena. That is: homeless shelters, human rights advocacy organizations, saving endangered species, lots and lots of things that are never going to make a profit. Always they're going to need to be subsidized, but fill a very valuable social purpose.

And finally, if you go the right hand corner; things that probably don't exist much anymore, like buggy whips, salad shooters, I don't know. I haven't seen an ad for a salad shooter in a long time so I presume they're gone. But one thing that is, I think, crucial in this diagram is that these kinds of entities that are in between here, the micro, finance, educational technology and addiction programs, are the kind that can go either way. They can go toward the higher profit or toward greater social benefit. They clearly are … generally tend to be not high profit but can be. But I also … I won't go into it, but you can look at examples of where these issues have arisen directly in each of these spheres these days—microfinance, there's a lot of controversy over those that are going to for-profit arena. Addiction programs, clearly the Betty Ford Clinic, the cream off the top, and all the others are left to the nonprofits. Educational technology I think is a really interesting example, and I'll finish with that, and that is the famous Khan Academy that I'm sure all of you know about. Khan's decision to keep this hugely successful nonprofit as a nonprofit because he said himself he wants to keep it free to all participants and free of advertising. And I think this probably, this example, illustrates in the most direct possible way, what it is that's special about civil society.

SENATOR VARGAS: Thank you very much. As I said between each one of these presenters, a group of presenters, I want to give the opportunity to ask some questions from the public. I do have some questions and one in particular. You might be able to answer this. Both bills went through the Judiciary Committee, the Appropriations Committee because it's a fiscal committee and all bills go through there—and then they came to our committee, the Banking and Financial Institutions Committee, and I did have some concerns. I'd heard from … I received letters from many civil society nonprofits, now. But one of the concerns that they had was the issue of tax advantage and that might create, you know, that maybe it was just a shell game to create some opportunities there and I kind of discarded that one fairly easily. The second one was that they would in a fact be doing some of the work that nonprofits were doing and siphoning off the money. But I guess I looked at it a little bit differently. I think it was illustrated a little bit on the pie chart that you had here. It was surprising to me that you showed that 73 percent of the money was given by individuals into philanthropy and only, I think it was, 5 percent corporate philanthropy coming from corporations. But for me it was an issue, then, of maybe timing; is it the case, then, that most of those individuals, they give later on in life because the corporation has already produced their wealth, then they decide to give? So for example, you gave the Microsoft; would we give money to Microsoft? No. But Microsoft certainly is giving a lot of money away in the sense of Bill Gates now giving his money away. So is it … for me, the thought of, well, maybe if he gave it earlier in his life, or the corporation was giving it early in their life, that's a positive thing to get that money into our civil society programs. Is that possibly some of the things that are going on here? Because again, you showed that very little comes from the corporation and a lot comes from the individuals, but is that just an issue of timing?

MS. MEREDITH: I would say that it's not just an issue of timing. I think that it's been very consistent, when I put up that chart, from 1970 to 2010 about what corporate giving has been and it certainly has grown but in very small increments. Corporations have had to ask themselves, as I think there's been more interest in philanthropy, as to what is their role in philanthropy. And as they have leaders who are thinking about that and also as there's more and more … there are watchdog organizations that actually give ratings to corporations that score them on whether they actually have a corporate social responsibility program, a CSR program. So I think there's greater awareness today.

I think as Bruce talked about, there's more and more conversation about civil society and whatever the language is that we use that corporations need to be participating in social good. And so, I would say it's not timing at all, I would say, in fact, in terms of age, but rather it might be timing in terms of where we are historically and where organizations are in terms of trying to be better community partners. Because that whole concept of shared value that I put out there … and we have a very interesting article in our most recent SSIR called "Roundtable" and there's a shared article discussion … that it's actually in the corporation's benefit to become a community partner; to find ways to lift, whether it's the neighborhoods or the community, whether it's local or international, and so they also are looking at whether it fits in with their market. So some of the questions that I raised there around using your core competency in order to make that contribution. So I think those are issues in a bigger ecosystem.

SENATOR VARGAS: But I think you were describing the corporation in a much more strict way than I looked at it. For me, it was more the issue of the corporation exists, obviously, but also their shareholders and those principles that created the corporation. I suspect that a lot of the money that's being given away, the 73 percent, comes from people like them. In other words, a Bill Gates, sure. Microsoft hasn't given away much money; it has some corporate philanthropy but Bill Gates certainly has and is one of the largest shareholders. Isn't it just an issue of timing there, that he could have given that money earlier through the corporation as opposed to waiting, earning it himself, then giving it away, looking at it then as an individual contribution, although the corporation really was the one that produced the wealth?

MR. SIEVERS: A couple of points. Clearly, I think a huge amount of this wealth does end up being given away by individuals rather than corporations. Actually to the point of this hearing, I think there is a question about how much of a sense of restriction corporate bodies feel in terms of being able to directly donate to charities or philanthropy as opposed to … and having to justify that to shareholders. So this old issue is still there a bit; about we still have to make the case to our shareholders why we're doing this although legally they can do it these days.

But the other thing is, I would say there's a little bit of murkiness here in the sense of there's a lot of corporate activity that goes into the nonprofit sector that probably doesn't show up here. That is things like, certainly, all the volunteer time that's given by corporations, but also they can take it out of different budgets. They can take it out of their advertising budget and it typically would not show up as a contribution. Then also, a fair amount of their money gets channeled into corporate foundations and I believe that would show up in your chart in the foundation category as opposed to the direct corporate giving category. So I think it's a little clear.

(Members of the public may not be identified and are off mic)

MR. SIEVERS: Well, I know in some recounting of corporate giving, if it's given through a foundation and the foundation is the much smaller part of what they give, but it actually shows up as a nonissue because it is a private foundation.

MS. MEREDITH: The two charts. That I think is correct. You know, your question is really an interesting question. There was a recent report out about a year ago from a group called Hope Consulting and I could certainly send it to you. But it's not the 80/20 rule and it's not the one in 99 in this case. In fact, when you look at where the philanthropic dollars are coming from, it's a much broader base of people who support philanthropy. So it may only be that it's just a different ratio and I can get that information and I don't have it right with me but I would say it's not exactly that issue.

SENATOR VARGAS: Okay. Well, thank you. Any questions? Yes.

MR. ________: I believe there's been some studies that have been done ________ Americans spend 2 percent of their income on nonprofit giving and that the lower the income that tends to be of higher proportions. And then I also think a lot of the higher wealth individuals, they tend to form these foundations to give away that wealth.

SENATOR VARGAS: Yes.

MR. ________: I'm just curious about the pie chart of the "individual giving" category. Is there any kind of analysis of what the stat looks like in terms of how much of that 70 percent, how much of the total dollars, is coming from? You said the mean or the average is $2,000. I would guess the median is probably far lower than that. And the numbers, you know, the difference between the mean and the median is probably large gifts by the one percent. Have you looked at that kind of data? Because I'm guessing the one percent, to Chairman Vargas' point, are people who receive substantial wealth from corporate investing or corporate leadership and donate it.

MS. MEREDITH: Yes. There is information like that and you can really dig in. Giving USA tracks a lot of that and really looks at it both geographically, and my income. I think somebody did mention that, you know, high income individuals give, I think it's around 4 percent of their income, middle income give around 3.9, and low income give around 4.1 percent, so kind of the …

MR. ________: It's a U.

MS. MEREDITH: It's a U, exactly. So it's interesting in that way, sort of, to go back and track the dollars. But again, I don't think it's a full 20/80 percent rule, where 20 percent of the people are giving 80 percent of the dollars when you look into that $300 billion, so it's a little bit broader than that.

MR. ________: My question really went to the fact that there's 70 percent that comes from individuals. Sort of tagging onto Chairman Vargas's question, if you looked at how much of that 70 percent was coming from high net worth individuals who either had excess from stock or had stock in corporation, would that account for 80 percent of that giving?

MS. MEREDITH: No. It would not. And that's what I'm trying to say is, it is not that way when it comes to these larger dollars. And we could certainly get some of that data and it's available. But it is not, as I say, the 20/80 rule that you see in a lot of other applications. It is not in this particular case.

SENATOR VARGAS: Yes.

MR. ________: I know that there is a difference between different income groups and where they give and so ______ low income groups tend to give _________ I've seen pie charts of this, the arts tend to be funded at a higher percentage by higher income people so it would be interesting to do an analysis next year, five years from now, however many years from now you're doing this to sort of not only break out the total, but also by income groups because that has other ramifications in tax policy as well.

MS. MEREDITH: And there actually is quite a bit of data and different groups track it, so I think that's absolutely something to be looking at. And I don't know, is there anything you would add to that?

SENATOR VARGAS: We have another question here—this young man over here.

MS. MEREDITH: And corporate giving … I think corporate giving also falls into areas that would be community building, nonpolitical, probably historically in the arts and culture, and then also in education, so there's definitely a correlation in that way.

SENATOR VARGAS: Thank you. Yes, sir.

MR. ________: My question relates to the presentation by Professor Sievers and may be more theoretical than not based on the data. I think the argument was made that there might be crowding out of nonprofits and my question is; isn't that in terms of dollars or is that in terms of the vision and mission of the nonprofit? The argument is interesting, I think, because you can also see a relation between the question posed by the Honorable Vargas about corporate dollars being one way for a corporation to participate in some of the vision-based missions. And my question is -- are we saying that corporations can also participate by not changing the number of dollars at play but instead having a different mission as part of its vision and its mission? That was complex.

MR. SIEVERS: If I understand your question correctly, I would suggest that it is more in the mission and vision side of things than it is in the dollars because if we're talking about not so much corporate contributions, because those simply go into the nonprofit accounting and become part whatever nonprofit mission is being funded, but I'm thinking about these new entities that are using market-based strategies to work in what is traditionally been the nonprofit sector or was partly in the nonprofit sector. And the crowding out potential is related to the creaming point I was making.

That is, you can take part of the kind of business, if you will, that operates now in the nonprofit sector and cream off the top the part that actually will generate a profit and leave all the rest to, as usual, government and the nonprofit world, and that's the concern I have. So it's partly taking potentially this kind of vehicle, taking money away, although it's also generating—I think, some of the speakers today are going to be talking about it—it will be generating new sources of income for quasi nonprofit kind of activity as well. So it gets very murky. But my concern is the vision and the mission.

SENATOR VARGAS: Okay. I think that's all the questions. That was excellent by the way. It's one of the things that's too bad about the way we do legislation. That would have been nice to have these presentations before we actually pass the laws. But it's unfortunate the way the operation works. That was excellent. Thank you very much for being here. I appreciate it. Thank you for that presentation. It really was excellent.

Okay, we're going to go now to the next section: The New Corporate Forms: Flexible Purpose Corporations and Benefit Corporations. We're very lucky to have a number of people here to speak on that. We have Todd Johnson, partner at Jones Day; we have Robert Wexler, attorney at Adler & Colvin and a lecturer on nonprofit law here at Stanford; we also have Donald Simon, at Wendel Rosen Black & Dean, LLP, and I believe they're going to speak about the flexible purpose corporation; and Mal Warwick, founder and chairman of Mal Warwick Associates; and Sara Olsen, founder and CEO of the SVT Group; then we're very thankful to have Professor Klausner here, who will, I believe, sum it up somewhat. So thank you and welcome.

MR. TODD JOHNSON: Thank you very much. I'm Todd Johnson. I'm a partner at the law firm of Jones Day where I head up our renewable energy and sustainability practice. But I think it's quickly becoming obvious that my greatest claim to fame is that I've had the opportunity over the last nine-plus years, to work with Stanford's extreme affordability class. It's called Entrepreneurial Design for Extreme Affordability. It was started by Jim Batal and Paul Polak and David Kelley of IDEO.

And really, it's fun to be at Stanford because this is where my social entrepreneurship education began. It was from a couple of students out of that class who came to me seeking some advice about their project that is a bottom of the pyramid developing world design of a solar powered LED flashlight with a cell phone charger. Actually, I brought one with me.

This is a third generation of the light. At the original time it looked a little clunkier as a prototype but it's now embodied in a company called DElight, which is a social enterprise. And their focus is taking these to the bottom of the pyramid to replace a finite resource of kerosene, which is used in most of the developing world, or wood, but when that's used to light a house, in a hut, it emits a lot of carbon and other noxious toxic fumes; it hurts people and ultimately kills them. And they're paying about $7 a month for the kerosene, whereas they can pay $25 or $40, depending on the version of this that they want to get, and they can, with the solar power, they can charge their neighbor's cell phones for a small fee and create a microenterprise.

Anyway, these entrepreneurs came to me and they asked me a very simple question; should we be a for-profit or should we be a not-for-profit? And it seemed to me such an obvious question and I thought, "Well, the answer must be obvious as well but no one's ever posed that to me before so let's go find out." And I figured I'd go to people a lot smarter than me and we would find out the answer. And convened a meeting down at __________ El Camino, a dinner meeting with some of the real, I've come to learn, giants in the field: Tim Freundlich who was at the Calvert Foundation at the time; Jett Emerson posted briefly; we had John Sage from Pura Vida Coffee; people that have long since become my friends in the social enterprise space. And at the end of the evening the obvious answer was "we don't know."

And what I've come to learn is it's a false dichotomy that we present to entrepreneurs who are adamant about creating good through a business. And it's a shame that it's a dichotomy that we live with. And actually, I appreciated the setup of the two prior speakers because I think in a lot of ways they set up that dichotomy incredibly well from a historical perspective of how we've lived in terms of organizational forms.

And if I had known, I would have brought my own PowerPoints and we could have done this by charts. But if just think of an X and Y axis and the Y axis is making money and the X axis all the way to the left or the right, depending which side of that you're on, is doing good, we've managed to optimize a corporate form or organizational form for each. The fascinating thing is over hundreds of years of using those forms, both are trying to migrate to a place of integration. And I would say that we need to get past the point of talking about it as a blurring of the lines because a blurring insinuates that we're creating a distortion. Actually, the movement that's happening, irrespective of any kind of legislative initiative, the movement that was already occurring a long time before, is a movement to the place of integrity; a place of integration, where you can combine both the making of money and the doing of good. And it doesn't seem to me such a hard thing to grasp that that would be where organizational forms would try to move. Now the challenge, of course, is that the forms we've created are neither one well suited to do that. Our tax subsidies for nonprofits and the tax deductions that go along with donations there, place restrictions on how much they can do in terms of earned income strategies. And I'll leave it to Rob Wexler, who … I flatter myself all the time by saying I'm the for-profit version of Rob Wexler. But the challenge, of course, is that nonprofits are heavily restricted in terms of what they can do around earned income strategies.

And I'm old enough to remember the late Honorable Claude Pepper who used to convene meetings every year as part of the Appropriations Committee in Washington, DC on unrelated business income tax. And every year the war would break out with the Sisters of Charity from somewhere who have their little hospital going, and learned that they could also more cheaply clean the sheets and, "Hey, while we're cleaning our own sheets, why don't we charge to clean other people's sheets?" And then Joe's Dry Cleaner from down the street would come in and say, "How come the tax subsidized money is competing against me?" So I get that that's a complicated issue and I'm not trying to address that here today. In fact, it's one of the reasons why I think both groups who are drafting legislation specifically stayed away from tax deduction or tax incentives around these kinds of corporate forms. It's a very thorny issue.

But what we were trying to do is was to remove some of the obstacles. And what I would say to you is, first of all, be leery of the sky-is-falling testimony. I think there is a tendency in this space to suggest that the sky is falling if we try to blur or blend value. And rather, go back to Jett Emerson's piece before Harvard ever coined the phrase "shared value" and look at the 1999 piece that he wrote on blended value. And the point that he made was so poignant. We have this idea that Wal-Mart is all about making money. But Wal-Mart employs 1.5 million people around the world who make paychecks and who give to philanthropies and who provide a lot of social value in the civil society. Similarly, we tend to think of the Girl Scouts of America as a really good organization that's out there doing good, but they sell 150 million dollars of cookies every year. And both of them are having value across the lines that we use to traditionally think about those organizations. And it's really how do we measure and think about the blended value that every organization brings to bear.

Now my challenge in looking at this for social entrepreneurs, was that there are real obstacles for them. For example, Rob and I worked on a deal with the Omidyar Network. They wanted to spinout some technology into a for-profit company with the idea that they could really affect the issue of child obesity by attracting investor dollars around a product that they had built inside the foundation and that product could have a real impact on a serious social issue. We tried to file the Articles of Incorporation for that company with the social mission embedded in the articles. We didn't want to leave it to chance of other things that we could construct around the various vehicles. And lawyers are smart enough to do that but we end up creating Frankensteins and investors get afraid of Frankensteins. So how could we very elegantly place it straight in the articles? And when we filed those articles, the Secretary of State bumped them and said, "That's not in the statute. You can't add a social purpose like that to your company." So we ended up creating a Frankenstein. We had to think about mission anchor in other ways because it was critically important to the Omidyars that this company have a mission that was anchored in reducing child obesity, especially around the issue of low-income families.

There are other impediments. And I mentioned the Frankenstein issue. I mean, when you start creating things like super voting classes of stock to anchor the mission, or you use other vehicles, like creating negative controls in the hands of the founders or other guardians of the mission, you end up creating friction around the attraction of capital.

And again, I appreciated the T-up because Kim and I have had some great interactions here at Stanford and I love the work they do. But I have this dream that we won't be talking about $300 billion of philanthropy but rather, we'd be talking about how do we access for civil society and the social good the $3 trillion that moves around the markets every single day instead of $300 billion annually? I mean, the challenge, of course is that the kinds of structures that we would create to anchor missions, create friction for capital and they reduce the opportunity of accessing capital because they increase the due diligence costs for that kind of capital.

And if you'll take a moment with me and step back 50 years and look at where we're sitting today and what this valley looked like 50 years ago, you would hear people like Frederick Terman talking about how could Stanford let loose its technology from nonprofit and have other people monetize it in businesses. Well, that was a radical idea at the time and it is still in other parts of the country. When I travel around and speak at colleges and universities, they're trying to hold on tight and say, "Well we want to control the monetization," and they're not doing it like happened in the Silicon Valley. Or think about the Fairchild 11, this Fairchild semiconductor 11 who left and started in a brand new industry, a venture capital, to try to help take those things to scale. And look at where it is today. Today, compared to the 7 percent of GDP of philanthropy, venture capital produces 11 percent of all the private sector income and 21 percent of all the GDP in the United States—venture backed companies.

What a vision it would be to see social entrepreneurs be able to access those kinds of opportunities? And I think the fear is, of course, you're going to hear, you may hear some people say, "Well, companies can't do it because fiduciary duties restrict it." Well, I think that is an overblown adage. I think Steven Bainbridge at UCLA has written a wonderful law review article from the nineties on how corporations really can push the edge of the envelope and quite frankly, lots of them have. The Dayton Corporation gives away 5 percent every year in a very unsung way. We have companies that have even written into their articles in other states that their purpose is to honor God and to do all kinds of things that we would consider radically pushing the edge of the envelope. Just across the Bay, we have Give Something Back, which is a not product that's cool and sexy as a solar powered LED flashlight, it's the staples. But the staples run by social entrepreneurs, who every year, give away a large percentage of their profit by empowering the stakeholders; their vendors, their customers, their employees to decide how that money is going to be given away. And those people need vehicles, need corporate vehicles that can attract capital easily without the friction points that we put in place and the kinds of structures we have to create. Can we do it without that? Yes, and we have. We have venture backed social entrepreneurs. Good Guide is a classic example. We have DElight. We have my favorite … I had to bring some props.

SENATOR VARGAS: Yeah, I can see it. It's great! Although, you better be careful because my daughter is almost sixteen and she decided to go to Latin America. She's going out to the wilds of Nicaragua to work in a small village and I may steal that LED powered flashlight… she's going to be in one of those kerosene lighted huts, I suspect.

MR. JOHNSON: My favorite is a company that started here a few years ago, a company called Embrace Technologies. And they're trying to tackle the issue that 20 million infants die every year in the first 28 days of life. Most of them, a total of 4 million of them, die from nothing short of hypothermia; they simply are too cold and can't be kept warm. Now why would that be happening? Well, first of all, it's not happening very much here in the United States. It's happening in the developing world. And why is it happening in the developing world? Well, because the cheapest infant incubator costs $20,000 and in the developing world, that's a lot of money, which means, if you have incubators, they're in cities, and 80 percent of the population that lives in extreme poverty is living in the rural areas. So this team sought to tackle that issue by creating a $200 infant warmer. They created a wax and water material that can be heated up just by dropping it in boiling water, or putting it into this warmer, if you have electricity, and then a pouch that the infant fits into all suited out with Velcro and the back of the pouch where you simply slip the pad, once it's warmed and it keeps the infant's body temperature at the right body temperature for four to five hours for $200.

Now unfortunately, when these folks started four years ago, they really felt that their only choice was to create a nonprofit and so they did. And they raised money and they managed to cover the soft costs of doing all the research and prototyping and market study and education necessary to be able to get this up and going in India but then they realized they hit a wall. A nonprofit vehicle wasn't going to provide the kind of capital they needed to scale this to millions and millions and millions of babies who needed it. And so, working with their nonprofit board, the founders licensed out the technology on an arms-length fair market deal and created a great revenue stream for the nonprofit but took the technology and got investment dollars from the __________ Social Impact Fund and from Capricorn Management, $5 million to take their business to scale. And what I would say to you is, that's not money that would have been donated anywhere. And I think the other fear that you often hear is the creaming fear, that fear that dollars are going to be diverted.

This is a business. It's a business that was being run inside a nonprofit, but it's a business that had a viable opportunity to be run as a business with investment dollars. And so, when they decided to run it as a business, they found investment dollars. It wasn't money that was being taken out of the philanthropy pocket of _____________ or Jeff Skull(?). It was money that was set aside for investment purposes that was used. And I would say it freed up money for philanthropy.

And quite frankly, I was hoping for a much bigger opportunity to express all the impact that we've had since these two bills passed. But truthfully, there's a lot of thinking, looking, deciding—is this the best way to go? Should we be a benefit corp? Should we be a flexible purpose corp? But far-and-away the most calls I'm getting right now are from nonprofits who are saying, "You know, we've been running a business inside our nonprofit and we think we can attract investment dollars. Let's talk about a flexible purpose corporation or a benefit corporation."

So what I would say to you is, what does the world look like if we could unleash the power of investment dollars with missions that are anchored in for-profit and attract it to create a real social good of attacking some of the world's hardest problems in some of the world's hardest places through business entrepreneurship? That's the vision I have.

And I'd like to think … I just spoke at Harvard two weeks ago … I'm really quick to claim, we're not done. That in some respects the Legislature showed the leadership to put California on the map as being one of those who's going to be thinking innovatively about how to do this. But just last week or the week before, Washington passed the Social Purpose Corporation statute and we're going to see other models emerge. And at some point, we'll have enough data about how these things are working and what's working well and what's not, that we'll actually be able to know how to optimize for that integrated organizational form that wants to blend the value of doing good and making money.

Thanks.

SENATOR VARGAS: Thank you. The only thing I would remind you is that this law actually only went into effect January 1st, so I wouldn't suspect that there'd be a whole lot of corporations yet—a lot of data. Thank you again. I appreciate it.

Go ahead.

MR. ROBERT WEXLER: So I'm Rob Wexler and I always get stuck following Todd Johnson. But I do have a Stanford pin just like you. I am a shareholder with Adler and Colvin in San Francisco. We're a firm that represents nonprofit organizations almost exclusively and now some social enterprises. And Todd and I often find ourselves on the opposite sides of the same deal, including this one and the obesity thing he mentioned, so I've enjoyed working with Todd quite a bit. I also teach nonprofit law here as an instructor in law. I'm the vice chair of the ABA's committee on Exempt Organizations. And I've been writing articles on this topic since 2006. I just got a third article out in January on hybrids. And as much as I love this topic intellectually, I mean, I've had a chance last year, to attend and speak in sessions on this, frankly taking away from my billable hours, at Georgetown, Loyola, the Aspen Institute, the independent sector, NYU, and even the White House was interested in this; they convened a session on this, so this is really interesting stuff. Everyone's talking about it. A lot of people think it doesn't make sense. A lot of people think it does make sense. But the thing is, we have it. And so what I want to address today is a more concrete topic which is how does this affect, or how may this impact the nonprofit sector? That's really what we're here for.

And I have to say, being a lawyer who makes my livelihood from the nonprofit sector, including representing at times CAN (California Association of Nonprofits). And Jan and Ken are here from that today. They objected to the bill during the hearings, and, of course, that broke my heart. I'm looking at Ken. But you know, we agreed to disagree on some things and that's fine.

But what I'd like to talk about now is what I think may be the negative impacts that we need to think about going forward are in the nonprofit sector and some of the positive impacts. I always start with the negative because that's my personality. So I've been thinking deeply, because I really respect Ken, about what could the negative impact in the nonprofit sector be from these organizations? You know, during the hearings, what did we have? Three hearings in the Senate and three in the Assembly, I testified a few times and said that I did not think intuitively that there would be a negative impact on the nonprofit sector and I still believe that. But now that we have these laws I've tried to think even more deeply about this and I came up with three possible negative impacts—very concrete.

One is what if these new entities cause us to have less new nonprofit organizations? Now some of you may think, "Boy, that's not a bad thing." But you know, for organizations in the nonprofit sector and especially those representing them, it may be a bad thing.

I think Todd and I would agree—I'm putting words in your mouth—that when clients come to our offices to talk about the option between a nonprofit or a for-profit and describe their new business venture, it's not a question of do I want to be a nonprofit or a flexible purpose/benefit corporation, the question is, is my business model best suited for a nonprofit or a for-profit? And once we make that decision, then we decide if it's a for-profit, maybe a flexible purpose or a benefit is a better way to go; if it's a nonprofit, great. But it's not like in my practice, in my experience, that people are going to be forming flexible purposes or benefits in lieu of nonprofits. If the money is coming from grants and foundations, they're going to form nonprofits.

Second thing I thought about was; is there going to be less money because of these organizations? I mean, that's the bottom line issue, I think, for most people. And then I thought about, "Well, how do we divide this issue up?" I mean, nonprofits get money, as we saw on the pie charts, from a lot of individual donors primarily. They also get grants. And then, there's government funding and some nonprofits are heavily dependent on government funding. And I thought about, are these new entities going to change the amount of money available for nonprofits? And then I thought, "I hate speculating." You know, I love baseball and I love statistics and I love analysis, I love the moneyball concept, and I don't like reaching judgments about things without numbers and data. And so at this point, I think we're just speculating. We don't know if money is going to be siphoned off from the nonprofit sector to these new entities. We just don't know. We'll know in five years, ten years. You know, Stanford Social Innovation Law Review will do some studies. We'll have some great new pie charts and we'll be able to discuss this more intelligently. But for now, we just don't know with any certainty whether money is going to be taken out of the nonprofit sector.

And I thought Kim's comments were great and I think she set us up for the types of things we need to study in the future, but her material did not say we know right now that there's going to be a problem or not going to be a problem.

So I really look forward to that evidence-based data moving forward, if we can get it.

My intuitive sense is that donors, individual donors, are not going to make the choice not to give to charity and rather to invest in a flexible purpose or benefit corporation. I mean, I said that during the hearings; I'll say that now. I don't think that's going to happen. Donors give to charity for a number of reasons, including the tax deduction; they're not going to get that in the flexible purpose or the benefit corporation. But again, the bottom line is we don't know for sure. I can't say that with any certainty and neither can CAN or any other nonprofit organization.

I would also say that … let's say that my worst fears come true and CAN's worst fears come true and hundreds of millions of dollars are no longer going into the nonprofit sector because they're going into flexible purpose or benefit corporations. I have to step back and say even though I make my livelihood from nonprofits, well, maybe something is going on here in the market that makes that a good thing. I mean, you know, maybe there's a reason for that and maybe we need to step back and look at that reason. It can't be that this new corporate form itself … a legal form doesn't cause money to go from one thing to another; there must be something else going on. So I'd be interested in following up on that. But intuitively, I do not think that money, less money is going to come in from individual donors.

Now what about the government? I'm a little bit more concerned in that regard because I've seen … for example, just recently the San Francisco Board of Supervisors is considering a measure right now that would give procurement preferences to benefit corporations—not flexible purpose corporations -- benefit corporations—and sort of put them in the same sort of vein as, let's say, minority owned businesses, women owned businesses, and nonprofits. I don't think that that's a preference vis-à-vis versus nonprofits, but I don't know. I haven't studied the language. I can see other … you know, the federal government … when I was in Washington, the federal government's talking about this as a possibility. Nobody's talking about tax breaks, but people are talking about procurement benefits. You know, "Should we give contract benefits to these new entities?" I don't have an opinion yet on that. I'm thinking about it. I guess I would be disturbed if time shows that money is going away from, you know, let's say, low-income housing nonprofit organizations and moving into for-profit benefit organizations that are operating low-income housing. That would bother me. But I have no evidence, no data to show me. But I do think that when new laws come up … and if the state of California starts considering laws like that, I would hope that the Senate and the Assembly would think about that and the financial impact. It's one thing to say there's a new corporate form; it's another thing to say, "and now we're going to give you financial benefits." So that's that point.

I would also like to, then, say though, with all the negative comments, I'd like to say that I also have no evidence-based data or statistics on the positive impact. But what I do have, what I do have is lots and lots of client situations that are in front of me. I have at least seven matters on my desk right now where nonprofit organizations are looking at setting up for-profit affiliate subsidiaries, and they were doing this before and they're doing it now. This isn't new. This isn't because we have the flexible purpose or the benefit. But they see this new form, a lot of them, as a great way to focus their mission … if they're going to set up a subsidiary anyway or an affiliate, they love the idea of having one where they can build in a social mission, they can build in the idea that money can be spent on multi-purposes, and, maybe the ability to track the new breed of investors.

I also think … you know, the question was asked earlier, and again, I don't know, and Bruce and Kim commented on this, but I would hope that these new entities, despite still having the same 10 percent limit on tax deductible charitable contributions—you know, corporations can only make contributions that are no more than 10 percent of their net income—but I would hope that these new entities do put more money into the charitable sector because they can do that freely without the boards being concerned about shareholders complaining.

And I would hope that—in answer to the Senator's question—I would hope that the Bill Gates's of the world would say, "You know, let's put that money in now; let's not wait until I'm out of there." And I mean, I know you thought deeply about that during the hearings. And I would hope that that's one of the effects of this.

I do want to say that … and so, Todd brought some examples. I don't need to go into more examples. There are dozens and dozens of these examples of nonprofits that will be able to use these forms.

The other thing that I do want to say, though, is also on the negative side. I was intrigued, and have to think more about this crowding out idea. I think Bruce or others mentioned the idea that maybe these for-profits are going to come in and skim off the top the most lucrative parts of the nonprofit and I find that an intriguing concept that I had not thought about before. I'd be interested in talking more about that.

So in conclusion, I just want to say that we don't know. This is a cutting edge movement. It's not going away. California is now part of that movement, which makes me proud as a resident here. You know, I know that I argued and others argued during the committee hearings before the bills were passed, that we didn't know exactly how these would impact nonprofits but we sure thought that this would be a positive rather than a negative impact. I still believe that. But I also would say that we need the data. We need to see how this shakes out. And we're not going to know for five years or even ten years. So I'll just conclude with that.

SENATOR VARGAS: Thank you. Appreciate it. Now we have Donald Simon.

MR. DONALD SIMON: Thank you, Senator Vargas. So my name is Donald Simon. I'm a partner at the Oakland law firm of Wendel Rosen Black & Dean. I was a co-chair of the Legal Working Group that was behind the drafting and promotion of AB 361, the Benefit Corporation bill. And it's an honor to be back before this committee. We were in front of this committee in June of last year. And I didn't think we'd be right back right away but here we are. So hopefully some thinking has progressed since then over concerns around this. I certainly have some information and data to share that I think supports very strongly our belief that we all strongly held that this is a wonderful thing for the nonprofit sector.

And on that note, there's been a lot of talk about the nonprofit sector. And I come here not just as a lawyer, as a partner in a law firm that started our green business practice group, but as a nonprofit practitioner. I personally founded three nonprofits that have had a pretty substantial impact in California—mostly around green building. I started the U.S. Green Building Council's chapter for Northern California. It's the biggest in the United States. I started Build It Green, which wrote the standards for green building in the state of California; and I also started a nonprofit that put together the largest urban sustainability summit that the United Nations has ever conducted in its years.

I have been dedicated to the nonprofit sector. I have put my lifeblood into it. And I have seen its limitations. And the reason I put my time and energy into this legislation, much for the same reason that these gentlemen did for the flex purpose corporation, is that we have seen that there needs to be another way—an additional way. We need to get the power of capital working in ways that people want to see it happen and that is what I believe we have all jointly accomplished here.

The problem that I've seen in the nonprofit sector and have actually now tried at certain points to kill some of the groups that I created, is that invariably over time, it becomes a commitment to the organization that takes primacy over the commitment to the mission. The nonprofit sector does not have a right to exist unto itself; it exists to promote public benefit. And anytime I think that we can achieve the public benefit, we shouldn't care about the vehicle that gets us there. That is a limiting belief and it is a limiting factor that will prevent us from ever achieving the goals for which we create the nonprofit sector in the first place. And so, I start from that general notion.

What is our objective? Our objective, I believe, is to achieve public good and there are many ways of getting there and we can't have just one arrow in our quiver. And so, there will always be a need for the nonprofit sector because it is uniquely able to do certain things that the for-profit sector, even with these new entities, never will be able to accomplish. But we need to have more people with their oars in the water paddling the boat.

We've seen what's happened as traditional capitalism has driven the world to near bankruptcy over the last four years as we've tried to climb out of this recession. We've seen the article that Senator Vargas quoted from, talking about how these massive capital investment banks still have not changed their behavior much since they brought the world buckling down. We need to get business being part of the solution. These examples of these companies that Todd was talking about earlier are but one example among thousands and we in California live in the hotbed of that type of innovation.

So I don't want to speak today about the particulars of the benefit corporation bill, I believe Eileen did an excellent job with the report and providing a summary of those details. And given that we were before this committee just last June, I'm sure you're all pretty familiar with those things. What I do want to talk about is the results. And, yes, it's only been three-and-a-half months since these laws came on the books. January 3, 2012 was the first day that any company could choose to organize as a flex purpose corporation or a benefit corporation. But I will say that the response has gone far beyond even the rosiest expectations.

On January 3rd, we showed up, sixteen companies filed their paperwork at the Secretary of State's office to become benefit corporations. Included among them were a mix of startups, social entrepreneurs, and established companies that have been around for 20, 30 years that have found, finally, that this provided a vehicle for them to incorporate into their corporation the values that they've put their blood, sweat, and tears in developing. So sixteen lined up on that first day.

We told you during those hearings that if California would display the leadership in being one of the first states to adopt this corporate form, that "if you build it; they will come," and come they have. I personally can only speak of the corporations that I'm working on. I have five other benefit corporations that I'm working on currently. They'll be filing their paperwork in the next couple of weeks. We told you that we thought that this would draw companies away from being incorporated in other states, to come to California because we provided this unique opportunity that is not available there. Thus far, I have transitioned two Delaware corporations to California. Earlier this week, on Tuesday, I transitioned a Florida corporation. I have two more Delaware corporations that I'm working on currently. They're leaving Delaware; they're coming to California because finally, this state where they have been doing business provides the vehicle for them to actually incorporate in a way that conducts their values throughout the corporation that can't just be dispelled by other shareholders that may come onboard. We also told you at the hearing that if we did this, it would solidify further California's reputation as a hotbed of innovation and it has. It has garnered us incredible attention.

The benefit corporation bill has been the subject of the *CBS Nightly News*. It has been in the *Wall Street Journal*; the *New York Times*; and featured in the *Economist* magazine. It has been on *PBS News Hour* in the last two weeks. People are paying attention. They come to Silicon Valley. They look at us in California because we show people new ways of doing things that go beyond their sacred cows; that go beyond their limiting beliefs to provide a new idea to see what that might bring and everybody has been paying attention. There are two law review articles being printed right now; one in Ohio I'm aware of and another one in California where students are exploring these two new corporate forms. And just this morning, I got an email from someone that's a Ph.D. student in Paris, France that is coming to California with three of her protégés that are coming out to try to study these ideas to take them back to their business management school in Paris. We are leading; others are wanting to follow, and that is the opportunity that we bring here in California.

So how are companies using this? Granted it's been three-and-a-half months, but I want to share some of those ways that companies have been using at least the Benefit Corporation Law (I have not had the opportunity yet, to setup a flex purpose but I'm hoping for that to come) and I think that those ways that companies are using the law, really shows how this is a wonderful thing for the nonprofit sector.

The first thing that it does is that it changes the fiduciary duty of corporations and I think that might have something to do with the reason why only 5 percent of corporate giving is coming from corporations. A corporation does not typically give a large amount of money away to charity because that is not consistent with the legal duties around a corporation. Can a corporation give money to charity? Yes. As the professor mentioned, they can do that. Can they get away with donating 10 percent on a regular basis or could a shareholder who disagrees with that action raise a stink? You bet they can. Because the fiduciary duty of a corporation in California and of the people that run that corporation is to maximize profit. And so, any time a corporation brings in new investors, new shareholders who maybe are not as mission aligned, they have that risk that the corporation could say they're not following their legal duties under California law. Now one would think that if a corporation was founded by entrepreneurs, that it had the mission of promoting social benefit as well as making a profit, that any other new investors that come in, knew what they were getting into and they couldn't complain about that, but that is not so. That is not what the law for traditional corporations provides.

So what the Benefit Corporation Law provided was new duties where a corporation now can have, in addition to earning a profit, it can have a purpose of promoting environmental and social benefits. And, if it so chooses, it can also adopt what's called "specific public benefit purposes," where they can bake into the corporation's governing principles, certain actions. And what might those actions be? Well, of the fourteen benefit corporations that I personally formed or have in process in right now, four of them are writing into their Articles of Incorporation a requirement that the corporation give a certain range or a specified percentage of its profits to charity. One of those companies each year does about a half-billion dollars in revenues. And it has put in its articles—we're working on it right now—that it will be donating one percent of its gross sales to 501(c)(3) organizations. Now they've been doing charitable giving for quite a while, but they were terrified. Why? Because the owners of that corporation are getting up in their years. They know that when they die, some of that ownership of the corporation will go to other outsiders and those outsiders could raise a stink about that: "Why are you giving away the equivalent of $4 million a year to charity? How does that follow the duty to maximize profits?" It doesn't. And so, they could make a bit of waves and they could cause that number to come down. But now that they're a benefit corporation and the way we're writing that into their Articles of Incorporation, that is going to be the governing law for the corporation unless new shareholders can muster about a 75 percent vote to change that. Prior to the Benefit Corporation Law that was not possible. As soon as somebody came onboard and especially if they got majority control (51%), they could do whatever they wanted. So this is a way for these corporations to earmark profits so that their conduction of their business becomes a way to actually generate revenues for the nonprofit sector.

What else are they doing? Well, another specific benefit purpose that they're incorporating is a requirement that the corporation allow all of its employees at least once a year to take paid time off to volunteer for 501(c)(3) organizations of their choosing. That's not something you see in a traditional corporation; that's not something that would typically survive a court challenge if a disgruntled shareholder said, "Wait a minute; this is not advancing the bottom line."

Additional things they're doing is putting in purposes that say we have come up with some really interesting proprietary way to make our products less damaging to the environment. That gives us a market advantage for consumers that like that kind of thing but you know what? We actually want to be able to share that information with our competitors. Now normally that would be a breach of fiduciary duty. You're giving away corporate knowledge to competitors to use to compete against you to gain a competitive advantage. But they're baking that into their Articles of Incorporation by adopting one of these specific benefit purposes, so that becomes the default rather than the exception.

So these are just a handful of the ways that these corporations are actually promoting public benefit and actually advancing the purposes for which the nonprofit sector exists.

Now we heard a couple of concerns, some of which have been touched upon today, about what the risks are. And the number one risk that I think—I would be concerned about this too—is that somehow people are going to stop giving money to charities and give instead to these benefit corporations. Well, as Rob was saying, are there any facts to support that? And there aren't. And one would not expect there to be. And it's only been three and a half months. Give some data some time to flow. But what we can tell you is that of corporations that are of this socially mindful mindset, one subset being B corporations, certified B corporations, they actually report out what they do. And what we do know is that 29 percent of the certified B corporations give 10 percent or more of their profits to charity.

Now if you look at traditional corporations across the board, less than one percent of corporations do that. So the little bit of evidence, the facts that we do have, actually support a contrary interpretation as to whether or not this could reduce corporate giving. And again, we have these companies, three of which I mentioned are giving one percent or more. Give Something Back is another one where they actually donate 80 percent of their profits to charity, leaving 20 percent for reinvestment.

Then one last issue that was raised was that somehow there was not sufficient oversight of these new corporate forms. And the point was raised, that at least in the nonprofit sector they have oversight by the Attorney General and that is appropriate. Nonprofits don't pay taxes to the state or federal government; that is a special benefit that is conferred upon them that is not conferred upon any of these corporate forms. It was never suggested and is not being proposed now. So what they do have in terms of oversight, any corporation does, is the ability of its shareholders to sue the corporation if it steps out of line. There is no such right for members of a nonprofit or for the general public to sue a nonprofit if it somehow deviates from its stated mission. The Attorney General has that ability. And in addition, now at least under the benefit corporation, we've given a specific right of action that the shareholders can sue the corporation, the benefit corporation, if it fails to abide by the public benefit purposes that it voluntarily took on itself. A traditional corporation, a shareholder would have no such ability. So we believe we actually have increased accountability and increased transparency beyond what you have in a traditional corporation because of the disclosure requirements that are associated with being a flex purpose corporation or a benefit corporation. That they now actually have to report out how they do on promoting the triple bottom line rather than just reporting out how they do on the financial bottom line. And in this era where corporations have driven the economy to the brink of death, I think we can all agree that getting business out there paddling, helping achieve some of the social ends that the nonprofit sector has been fighting for for so long, is a good thing and should be applauded.

Thank you.

SENATOR VARGAS: Thank you. I appreciate each and every one of you. There's obviously a lot of enthusiasm here too. I think that's one the things that probably many of us found attractive when we voted on this.

I am conscious of the time. I know that a lot of people need to leave about six, so we're going to speed it up just a little bit if we could.

Are there any questions? Yes, Professor.

MR. SIEVERS: *(No Mic, difficult to hear)* Quickly. I guess I'd ask all three of you. What happens when push comes to shove, when profit and social mission _______________ you've seen cases like this that say _____________ … I found out everything the banks did and I did the opposite. And that's why it's critical of what's going on in some of the ________________ .

I guess the second question _________ how to determine the public benefit without getting into ridiculous methods ___________ .

And third, would any of you eliminate the non-distribution _________ the nonprofit sector because it seems to me the same philosophy that you are suggesting; that is, distributing economic benefits from socially beneficial enterprises is a good thing?

SENATOR VARGAS: Go ahead. Who would like to …

MR. JOHNSON: I'll take a stab at it. I'm not sure I'm going to remember all three questions but I certainly remember the last one. And I'm not sure I know—Rob's probably better suited to deal with something that restricts the distributions on nonprofits—but I think in your discussion, you know, you made the point very artfully that nonprofits have a special public trust. And I think the challenge, of course, is when we start using subsidized dollars to support and build an organization that's founded on a public trust, the challenge of wealth inurement to individuals, as a possibility, serves to undermine that.

I think to a point that Don made about for-profits, you know, I think jumping straight to the litigation strategy is not the smartest thing. I actually think there's a lot of governance levers that shareholders pull in for-profit organizations that provides great oversight. And so, when it comes to the issue of the tensions and mixing of money and mission, so-to-speak, I think shareholders are already flexing those muscles. And in my world of renewable energy and sustainability, I see the pension funds doing that rather forcefully and to great effect in their ES&G standards on public companies. They own 73 percent of all the public companies in the United States today and they're making their voice well known that they think that a public company that's not taking sustainability seriously or the environment seriously, are not applying good governance standards is hurting their own pensioners in the long-run and so they want to see different behavior types. And I think that does provide an oversight model and they're flexing that muscle by throwing the bums out where the directors don't get it and aren't working. They're really working to exercise the vote on director slates.

And I think when I've talked to the guys who were behind the benefit corp legislation, while we had some disagreements, in a lot of places we were in violent agreement with one another. And one place was that the governance mechanisms of getting rid of bad directors because they're not fulfilling one or the other, or they're not working well to navigate the tensions that exist between money and mission, is part of what the oversight that this bill, this legislative form, has given to shareholders to exercise.

MR. WEXLER: I'll just add quickly; I would not want to see a non-distribution requirement in these. These are for-profits. These are invested dollars and these are not charitable purposes, you know, as that's been defined going back to the …

MR. _______: I think Bruce was asking …

MR. _______: ____________

MR. WEXLER: Oh, no.

MR. ________: … distribution nonprofits.

MR. WEXLER: No, not at all. I mean, that's sacred to the nonprofit world the non-distribution requirements, I think. I mean, no, I wouldn't do that at all. I'd love to see even a more hybrid model, like the Kick that they have in U.K., where you can actually put money in and have an asset lock but get dividends out. It's a little bit more—taking this one step further. I know you're familiar with that.

You know, in terms of the … both these forms leave it to the board of directors to make the decision about line blurring and, you know, that's their job; and the shareholders make the decision if they like the job the board's doing.

And then on the purpose question, you know, I can speak at least to the flexible purpose corporation; we deliberately set it up so that their … you articulate your alternative purpose or purposes in the articles. So whatever you decide you're going to do, that's all you have to do alternatively and then the board has to report every year as to how they've met it. So it's not a social return on investment metric or anything like that, which I know trouble you; it's a question of here's what we did. Shareholders, are you satisfied with that? And the shareholders vote.

Did you want to add anything?

MR. SIMON: I'd be happy to add. Do you feel like you've got enough? I'm sensitive to the time as well.

SENATOR VARGAS: Okay. Alright. Any other questions? Thank you. Thank you very much. Appreciate it. Thank you for letting us know about that nifty little invention too. I keep thinking of my poor 16-year-old out there in the wilds of Nicaragua.

MR. JOHNSON: *(no mic)* … hundreds of inventions like that ______ promoting them around the world.

SENATOR VARGAS: Oh, that's great. Alright. Now we have Mal Warwick here and also Sara Olsen. And we welcome them.

MR. MAL WARWICK: Chairman Vargas, thank you very much for this opportunity to speak. My name is Mal Warwick. And since 1979, I've been involved in advising nonprofit organizations on how to raise money. The clients my colleagues and I have served over the past three decades have included many hundreds of institutions, charities, and advocacy organizations, including some of the nation's largest and most prestigious nonprofits, as well as numerous local and regional charities in California. We've raised close to one billion dollars to help them fulfill their missions.

In addition, I've written or edited a total of 17 books on fundraising, including two of the major texts in the field. I've also taught fundraising techniques to tens of thousands of nonprofit executives on six continents, representing more than 100 countries. Throughout our 33 years in business, Mal Warwick Associates has sought to fulfill its multiple responsibilities to society as well as to our clients. I've been personally involved in the movement to promote socially responsible business for more than two decades. I joined Social Venture Network, or SVN, in 1990; cofounded Business for Social Responsibility two years later; and recently served as chair of SVN for four years. My company was a founding B corporation, and once we've made the necessary preparations, we're going to register as a California benefit corporation. So now that I have thoroughly bored you with my credentials, I'd like to move onto the heart of the matter as I was asked to address today.

First, to tell you about some of the many ways in which my company relates to the nonprofit sector. Second, to address some of the concerns raised before the passage of legislation enabling benefit corporations and flexible purpose corporations. And third, to explain a few of the realities of fundraising with which you may not be familiar.

First, about my company: Mal Warwick Associates is a small business. We employ about 45 people, principally in our headquarters in Berkeley and our Washington, DC office. Our relationship with the nonprofit sector, or civil society as Bruce would have it, is multi-dimensional. At any given time, we advise some three dozen nonprofits, primarily nationwide advocacy organizations, on their efforts to raise money online and by mail. Our role as consultants typically includes hands-on work to create, produce, and dispatch the messages that they approve and to analyze the results. Our work as consultants places us in a teaching role, sometimes explicit; always informal. Over the years, we've trained dozens of our clients in fundraising techniques, enabling some of them to dispense with our services and others to advance to more demanding jobs, including in more than a few cases, working with our competitors or setting up their own companies to compete directly with us. We actively share our skills and insights with nonprofits.

My colleagues and I have donated countless hours to speaking without compensation at conferences on fundraising and nonprofit management, presenting workshops online and by teleconference as well as face-to-face. We've reached as many as 3,000 nonprofit leaders at a single event. We've also shared our knowledge, including many techniques and insights regarded as proprietary by our competitors, not just through the books I've written, but also by publishing a monthly fundraising newsletter for 25 years that reached 3,000 subscribers.

As philanthropy professionals, our employees are encouraged to exercise their own generosity by the company's two-to-one match of philanthropic gifts to the causes and charities of their choice. Since we instituted our philanthropic fund in 1996, our aggregate giving, including my personal gifts, has risen to approximately one million dollars. Corporate matching funds are common in large companies, as you know, but they're rare in small business, though much less rare in B corporations.

In addition, we freely provide pro bono advice to small local nonprofits in the communities where we work, and many of us serve on volunteer nonprofit boards as well.

Now clearly, my company is unusual in that we're professionally engaged in the nonprofit sector. However, we do not stand out so clearly among the more than 550 B corporations nationally in our generosity to nonprofit organizations. On average, American companies contribute approximately 2 percent of their net income to charity. Among B corporations, the average is close to 10 percent. A few, such as Give Something Back of Oakland, which has already been mentioned, donate essentially all of their available profits, except those required for reinvestment. Not at all incidentally and unlike nearly all our clients, we pay a living wage, have a diverse workforce and a diverse board, actively engage in our communities where we work and are environmental leaders in our industry. A great many other B corporations can tell similar stories; that's how we become certified as B corporations.

Now about the objections raised in testimony to the enabling legislation for the two new corporate forms. As I read the background paper for this hearing there were essentially two arguments posed; the benefit corporation and flexible purpose corporation would compete for financial resources with nonprofits and public agencies and that we would not be externally accountable. Neither of these arguments holds water in my opinion. In fact, it's difficult to see either argument as anything more than a sign of hostility to the notion that business should give back to society. Will the newly authorized corporate forms compete for funds with nonprofits and public agencies? I can't understand for the life of me how private companies might compete with the public sector for funds. We, after all, haven't been given the power to levy taxes. And as I will demonstrate a little later, the concern that we might in any way compete for funds with nonprofit organizations is based on what I believe is a gross misunderstanding of the nature of the philanthropic and capital markets.

As for the concern that we would not be externally accountable, SB 201, which governs the operation of flexible purpose corporations, requires annual public reports to its shareholders and on the internet of detailed information about the company's operations and about its efforts to pursue its stated purpose or purposes.

AB 361, which enabled the creation of benefit corporations, goes further in that it requires a benefit corporation assess its environmental and social performance against exacting third party standards each year and to report the results publicly on its website as part of an annual benefits report that also describes the ways in which the benefit corporation pursued general public benefit.

I believe these requirements make us far more accountable than the overwhelming majority of America's 29 million businesses. In fact, unless a company stock is publicly listed, it has no responsibility to report to the public unless it's a benefit corporation or a flexible purpose corporation.

Now for a few brief comments about fundraising: Individual Americans, as we've learned from Kim, account for more than 80 percent of the nearly $300 billion contributed each year to the nonprofit sector. All other sources, including foundations and corporations together, account for only 19 percent. Broadly speaking, nonprofits are supported by large numbers of small donors who contribute gifts of less than $100, and by small numbers of major donors who typically give $1,000 or more at a time. Donors who fall into the mid-range are far less common. Small donors in general rarely invest in individual companies of any sort. To the extent that small donors do make such investments, they're almost invariably in the stock market. If any benefit corporations have listed shares, I'm not aware of them. I don't think that's likely to happen.

Now, some major donors, these people who give $1,000 or more at a time, do invest in mission driven companies. In fact, there's a growing number of investors who specifically seek out B corporations and similar businesses because they want their investments to reflect their personal values. I've been one of those investors for more than a decade-and-a-half, and I'm personally acquainted with many others. But every single one of these so-called impact investors, everyone I know, including myself, is also a donor to nonprofit causes and institutions. In fact, some of us donate 10 percent, 20 percent, or more, of our income to what is broadly called "charity" every year.

Now, are there some impact investors who don't contribute philanthropically? Doubtless there are. After all, only three out of four American households annually donate to the nonprofit sector. But I would give strong odds that impact investors, generally speaking, wealthy individual families who try to make the world a better place through their dollars, are far more likely than investors in general to be generous philanthropic donors.

Now, are there foundations that invest in B corporations or similar businesses but don't make grants to nonprofits? This, I think is unlikely in the extreme. So-called program related investments, or PRIs, the only way a foundation can invest in a for-profit company, as I understand it, are available at a few hundred of the nearly 100,000 charitable foundations in the United States. Every PRI must pass a rigorous test of its relevance to the individual foundation's program priorities.

In short, I fail to see any credible way in which benefit corporations would receive funds that would otherwise be given to nonprofit organizations as charitable contributions.

Chairman Vargas, Senators, friends, thank you.

SENATOR VARGAS: Thank you. Appreciate it. Now we have Sara Olsen. Welcome.

MS. SARA OLSEN: Thank you so much. And I'm really very glad to see this happening. It's kind of amazing that the California State Senate is having this hearing and learning so much about this sector. I think that is a very good thing, so I'm grateful to you for having called this hearing.

I speak to you as the founder the SVT group, which is a new kind of firm called an "impact accounting" firm. It was not too long ago that we finally arrived at that branding after working in this space for eleven years on the issue of how can businesses and nonprofits in a practical way, understand, measure, and manage their social and environmental value analogous to the way a financial accounting firm might help them account for their financial value creation. And over the course of our eleven years of work in this space, we've had the opportunity to serve a number of institutional investor clients, including CalPERS here in California, the largest public pension fund in the United States, by virtue of work with the environmental investment advisors to CalPERS. One, Pacific Coast Bank, which just slightly predates the advent of this corporate form and is an innovative model in that it is a foundation that owns all the economic interests in a bank. Their purpose is to establish the concept of beneficial banking by contrast with extractive banking that predominates, unfortunately, in the economy today, as well as startups in both the social enterprise and nonprofit space, such as ____________ global social venture competition, which I co-founded, and the YMCA, another very large nonprofit organization. So in total, we've influenced about $2 billion worth of private equity investment assets in terms of helping shed light on what their social and environmental impact is. We have also had an influence on about $500 million worth of nonprofit assets in the same way. And I am a co-chair of the International Social Return on Investments ___________ Methodology Committee and the co-founder of the USSRY Network __________ forgive me for that.

So all of this builds, though, on an experience I had prior to any of this when I was in Mississippi. After college, I lived in the Mississippi Delta and I think that that thread is relevant to my remarks which have to do with why it's imperative, it's not just an opportunity, but it's also imperative, that the for-profit sectors and the nonprofit sectors collaborates in order to address the scale of some of the problems we face. And in light of the economy and the direction that our resources are going and that there is actually evidence, in my experience, that this corporate form and some of the work that surrounds it, and the ecosystem that surrounds it, is in fact helping to make it possible to enable that collaboration by raising the bar on how both sides of that equation talks about their impact—their social impacts as well as how that relates financial impacts. And then I'll also talk briefly about some concerns that have been raised and _________ haven't heard yet but I do have.

So many who work in the nonprofit sector are driven into the social enterprise sector, as I was, and then ultimately into this kind of work, as I was, by the realization that there's a disconnect between how philanthropic funding is allocated and the actual creation of social value. And my little anecdote about that is that when I was a social work master's degree student in Chicago, I worked for South Shore Banks, a new development corporation, on a little social enterprise called "Studio Air," which was founded by a woman who just this last year, I'm happy to say, became one of CNN's heroes for her more recent work in South Africa, Amy Stokes. She started this thing. And with a team of about two-and-a-half people, we were working with teenagers from the inner city of Chicago on bringing them into an art studio but it turns out that it was actually a business. And we were helping them to learn how to run a business and why you would need to go to math and English class, because if you're going to really sell business to clients where you are the product, literally in this case they were creating artwork that was then mass produced as a t-shirt and things like that—it gives you a reason to understand the relationship between the skill and success. So that was the premise of this social enterprise. It was entirely grant funded _______ capital—there really was no such thing as an impact investor—and that money came from foundations and from the government.

So after a few years of realizing that most of the foundations would not even give money for a second year in a row because it was against the way they did it, and that the city of Chicago, as a criterion of giving money for a third year in a row, wanted us to double the number of kids we were working with just because that was a way they could see that we were growing our impact. What we found was that in fact by doing that we were in fact reducing the impact on all of the kids we were working with, potentially to zero, because we had told them that their efforts actually contributed to this organization becoming self-sufficient. And in fact, it turned out that by making this change you would never reach that target of self-sufficiency. So that was very upsetting from the human developmental standpoint, from the social mission standpoint, but it was also troubling from a sort of financial capitalization standpoint, because at the rate we were going we would have broken even and begun to cover all of our costs after five years. And with this change, we would become pretty much forever dependent on grant money. It wasn't going to be from one source every single year, but it was collectively a waste of philanthropic resources.

And the problem that I think underpins that is that we did not have good language or good skills either as an organization ourselves or in our conversations with our philanthropists who were supporting us, about what was the social value that we were creating and how was what we were doing creating it.

So fast forward. I then decided I was not going to get anywhere in that setting. And I think a lot of nonprofit practitioners feel that same sense of frustration. That's really tragic.

So what we see is that we've got one-and-a-half or two million nonprofits in this country. I just read an article yesterday that HUD is working to create 70,000 new affordable housing units in the country in the face of the need for affordable housing now that the recession has really increased it. A couple of years ago, HUD itself estimated that there's a need of affordable housing units that numbers 12 million and other estimates would put it much higher than that. So even HUD's efforts and all of what's already going on in the nonprofit affordable housing space, less than, because they work harder than anybody, is going to cover 170th of the need. That's not enough.

It's also not enough that … I just heard Steve Rothschild from Minnesota, he's got a new organization that he's calling "Human Capital Bond" with the state of Minnesota, which is quite fascinating. But his premise is that if you look at government expenditures, the rate of growth of health care costs over the foreseeable future is 8.5 percent. If you peg the rate of educational spending growth to inflation, it's 2 percent. As you extrapolate 25 years, everything else the government spends money on will have to go to zero. Unless we completely change the tax structure I don't think that's going to happen. So if nothing changes, the amount of money going to the nonprofit sector from government is going to go down in every area except those two. Something needs to be done.

And the point I think wasn't made, I was sort of surprised, maybe I missed it, that while there's two million nonprofits, most foundations generally are required to give 5 percent of their assets to program related grants and so forth. The other 95 percent is still invested in the stock market and in bonds and in real estate doing regular stuff that may or may not be consistent with their stated public missions for which they're getting a tax deduction. So there's a lot of money out there that can be deployed and can be more effectively and more beneficially deployed.

So it wouldn't just be nice if there were collaboration, it's imperative. It's urgent. And how can that happen? I believe that a way is emerging through a shared language, a set of principles around how to measure social value, and some measures that we all agree on, and sort of processes around that, as well as opening a door to really restore the corporations, the for-profit corporations, to the original intent of for-profit corporations. I mean, not only are nonprofits supposed to benefit the public, so are corporations supposed to benefit the public, yet somehow that has been lost and that's, I think, what is being fixed at last.

The way that I think this is happening and that my particular work speaks most to, is that the for-profit sector is really entering the conversation finally about how do we measure our social value and our mental value as a regular management practice and how do we report that? And the way that they are thinking about this is going to dramatically accelerate and decrease the power of the work the nonprofit sector has done on that for so long, because the for-profit sector is thinking about not only how do we measure that, but how do we get paid to create that value? And by finding somebody who will pay you to create social value, you really accelerate the benefits from bothering to measure that you are having social value and thus bothering to have social value. So I think that there's going to be a huge and wonderful benefit to some of the innovation that has just happened with these new corporate forms.

And specifically, you know, as you get a lot of conferences, I've probably addressed 3,000 people directly in workshops that we've done with them on these topics. And the increase in the interest in the last couple of years on the non-profit practitioners, the conferences that I go to, in learning some skills around how to measure their impact as a regular course of action, has dramatically increased since B corporation and B lab started to make noise about, "Oh, we should have a certification; we should have some sort of Good Housekeeping seal; we should have a corporate form," even though none of those had anything to do with the nonprofit sector directly. So there is a sort of raising up of attention and, I think, competency in this area as a benefit of what's going on.

This brings me to the issue of is the benefit corporation or would a third party standard that's been done well that exists right now adequate? And I think that there is actually a risk factor which is that if the business or the nonprofit, it doesn't matter which, that was being rated for its social and environmental responsibility was just filling out a checklist and wasn't really learning how … what does that have to do with what we're actually trying to do as a business, there is a risk, I think, that you could have a rating that though it may be somewhat audited in 10 percent of the cases you could still have sort of gaming of that just like you have in the for-profit sector. And so, ostensibly there could be some sort of scandal that might ensue from having sort of gotten a brand out there that says, "We're part of this benefit corporation thing and we got a high score," and then if there's some bad thing that happens in the news, then everyone might pull back and say, "Wait a minute. What's really happening and are we just being snookered?" and that would not help.

But that reminded me of when a real role model of mine early on in the SVT, Penelope Douglas, who was the founder of Community Ventures, mentioned to me something … ten years ago we had done an analysis of someone's social return on investments, a venture capital fund, and we priced carbon waste, and she saw that and she was concerned, I think, about that. And she said, "Well, Sara, if you mess up the social return on investment thing and you kind of sell me the image of it, it could really set back the whole movement." And now today, at least SORI, is an international movement which was … I was just at a conference in Berlin with hundreds of attendees convened by the European Union and there's members all around the world now. So I think that though that would be a bad thing if that happened and we should work hard to prevent that from happening, it would not be the end of this movement by any means.

And I'll just leave it at that. Thank you very much.

SENATOR VARGAS: Thank you very much. I have to say, as a car guy, when I saw SVT Group, it's a special vehicle team from Ford, so I'm glad that you explained that that wasn't the case.

Professor, thank you very much for being here. Appreciate it.

MR. MICHAEL KLAUSNER: My goal is to see if there's any more to say and I'm not sure there really is.

My take on what this is about starts from the premise that people produce social value, people produce profits, and they do so by some people providing money, some people providing labor. I think that's how things work. The vehicles don't provide anything. The vehicles are in effect contracts between the people who provide the money and the people who provide the labor, and by labor I mean management as well. So why could a vehicle matter at all? Well, it could facilitate the money and the labor coming together to produce social benefits, profits, or produce both. So when I first heard about these vehicles I thought, "Well, gosh, why do we need those? We've got a corporation; we've got an LLC, which has certain advantages from a tax point of view. Just write into a corporate charter what you want to do." And I teach corporations; that's what I would tell my students. I do that at Delaware. I don't think this issue comes up in Delaware at all but then Rob Wexler told me, "Wait a minute, in California you can't do that." Okay, so now I get it. I now understand why we need it. We need it because we can't write our own contracts to produce a mixed benefit—a flexible purpose or benefit corporation. So that's the role of these things. All they are, are standards for contracts.

Then I thought to myself, "The other area that I'm somewhat known for in corporate law is the value of standardization." And this, therefore, fits right into that. And Rob continued to explain it to me; you get legal certainty, you get shared precedent—if someone is unfortunate enough to have to litigate an issue, everyone else gets the benefit because you're working on the same contract terms; in this case, statutory terms and conditionsSo that's what this is. It's fairly simple. It's a standardized contract. You can provide money. You can provide labor to do either, to one degree or another, a mix of social benefit and profits. What could be wrong with that? I still don't see anything really wrong with that. I don't think any of the people here today have suggested there could be anything wrong with that. It seems kind of like an unequivocally safe harbor. It provides standardization. And it's apparently an efficient vehicle by which people can bring money and labor together to do something that is good.

So then I wondered, "Okay, so where is the issue?" and I hear, "crowding out." Well, that seemed kind of unlikely. I still think it's unlikely. And I wondered what this mechanism of crowding is going to be because in the nonprofit sector they have a very powerful voice behind them which is the tax rules. And so, you get deductible donations, you get foundation grants, you get non-taxability of profits. That's a big advantage. So where would this crowding out be when this advantage exists? And then Bruce says, "Cream skimming." Okay, so now I get it. In particular markets, maybe, there's a level where you can make some money and a level where can't. And because of the unfortunate frictions in the world, I think you've got to take that cream and give it to the people that are serving the people below, because of frictions in the world whereby the nonprofit sector, for whatever reason, isn't going to only serve the people below. That strikes me as a deeply factual, very localized, and probably unlikely that if you're seeking donations, if these entities are funded by donations, it ought to be the non-cream that generates the donation more than the cream. Nonetheless, it is conceivable, I guess, that this would happen. But the nature of that argument, then, if it is an argument is "Hey listen. We do not want you to provide an efficient vehicle for serving a set of social purposes that I think is cream. We want to throw sand in their gears so they can't get to this space, so they leave it to us the nonprofit sector to take care of. That just seems like, as they say, highly de factual, highly localized, highly particularized scenario that I certainly would not say should govern whether this vehicle should be available or not; available to anyone who happens to want to use it—again, people with money on the one side, people with labor on the other—finding that this is the best way to conduct their mixed purposes. So that is I think where it all shakes out. It's quite straightforward to me. I'm an academic which may have simplified things but that's my view.

SENATOR VARGAS: Well, excellent. I do have some questions for you since you are the academic. When these two bills were coming before the Legislature on the senate side, the policy committee … there's two of them, really, that shared responsibility. The Judiciary Committee to make sure all the, really, "i's" were dotted and the "t's" were crossed, and then more the policy of whether this is a good thing or a bad thing in my committee. And to be frank, I mean, we have a lot of respect and even love for the nonprofits and they were against this bill and usually a bill like this doesn't not go forward because of that. But I thought long and hard about this and I had to reach back to an old professor that I had (he wasn't old at the time), Roberto Unger. He was my professor. I took a number of classes from Roberto. And one of the things that I do recall is that he was trying to come up with different ways to look at capital and one of them was sort of radicalizing capital in the sense that instead of giving large chunks to large groups you would give smaller chunks to smaller groups and they would go out there and become more capitalistic, and, in fact, they would produce more wealth. I thought, "Well, maybe this is an opportunity to do that." It doesn't sound like that's what you're saying. It sounds like what you're saying is, "No, really what this is, is a contract. It's not really the opportunity; it's just kind of standardizing it." It seems to me when I was thinking about it, two things. I said the thing earlier that the timing, maybe that generous people, however you want to look at the people go into these businesses, will put their capital or their wealth to work much more quickly instead of waiting for the company to produce it and then take it and then ultimately towards the end of their life, give it away. That they give it away a little more quickly.

And then secondly, there might be these opportunities but it doesn't sound that's what you think.

MR. KLAUSNER: Yeah, I don't think so. I think that if there are people that wanted to do what you're describing, they would set themselves up in a vehicle that exists already or with no vehicle at all and set themselves up for going into business. But if they want limited liability they would probably set themselves up in one sort of vehicle or another, a corporation, LLC and whatever size they are, they can do what they want to do. I don't think that this entity subsidizes this or promotes this in any way. Actually it would be the tax deduction that would promote this through an entity that would work with tax deductible dollars, I would think.

I don't really see any sort of democratization of capitalism happening simply as a result of putting this vehicle on the shelf and making it available.

SENATOR VARGAS: What about the timing issue? What about the timing issue? Because I do think as you took a look, I mean, the corporations seem to give very little compared to the larger donations by individuals. But I think, at least in my thoughts, I thought, "Well, maybe it's the timing issue because these people could have invested much more quickly and maybe more effectively earlier in their lives and maybe that's a benefit that, you know, let a thousand flowers bloom. Let's figure that out." But I thought maybe that would be an opportunity.

MR. KAUSNER: Well, I think that if you take timing literally, you could imagine someone, let's say you and I start a company; we're making a lot of profits and every year we take our profit, take dividends out and we go put it into the social sector to promote social good in some way. No timing issue there.

What you're describing could be the purpose of these vehicles, which is within the corporate entity do it. Don't take the dividends out and spend them separately. So to the extent that the existing corporate form creates risks for having the corporate entity promote social good, then these vehicles would accomplish that and that is their purpose. So it's not so much timing, but whether it's done within the entity or outside the entity, either individually or given to a separate nonprofit entity or having a for-profit entity associated with a nonprofit entity. So I think that's really it. And it does do that. I was surprised to hear you couldn't simply write that into a charter. You could do it in Delaware. I mean a company here could go get a Delaware charter and write whatever they want and accomplish it. But as a number of people here have said, and you've now created a standard form in California, it certainly does no harm and it sounds like it's doing a lot of good.

SENATOR VARGAS: Okay. Thank you. Any other questions? Okay. Well, thank you very much. I appreciate it. Thank you.

We do have some people here to testify that may think that it does some mal, so let's see. We have thankfully here, Jan Masaoka; and we also, of course, have Jim Anderson. Please come forward. Thank you again. I appreciate it. And thank you very much. We'd love to hear from you.

MS. JAN MASAOKA: Thank you very much, Senator Vargas. I just have to say on the subject of crowding out, it is sort of ironic to be called to speak and testify at 6:02 for a session was supposed to end at 6:00 and I appreciate the fact that you're willing to stay a little bit longer and in fact you still appear to be very alert.

SENATOR VARGAS: I am. It was a big issue. Just from my perspective, it was a big issue. It's one of those ones where it looks small to others but when it was coming through, I have to tell you, I think this is a big deal, and so, that's why I'm actually very enthusiastic about this.

MS. MASAOKA: So my name is Jan Masaoka. I'm the new CEO of the California Association of Nonprofits, which is a 501(c)(3) corporation founded in California in 1984. And although we have some ways, as a trade association representing nonprofits, we also have a higher purpose of strengthening California by bringing the full of power of California's nonprofits to benefiting California's communities.

And I also want to say that we are ourself something of a hybrid organization. In 1985, we formed a for-profit corporation, which is a wholly owned subsidiary of the California Association, so we're kind of one of the longer standing ones that have for-profit and the nonprofit incorporation.

And just a word about myself; I was, until very recently, on the advisory board of Stanford Social Innovation Review (SSIR) and so I was in this building many times in that role. And I also am a publisher of *Blue Avocado Magazine*, which is a nonprofit magazine with 63,000 subscribers. And prior to Blue Avocado and the California

Association of Nonprofits, I used to be the executive director of CompassPoint Nonprofit Services, which is the national consulting firm to nonprofit organizations based in San Francisco.

And I have to say, I feel a little bit like I have a lot of straw coming out of my sleeves because I feel like a lot of the characterizations of the objections to these things of setting up straw men that I don't think are actually here so I want to try to pull all that straw out if I can.

Along those lines, I just wanted to mention that one of the things I think the slides didn't point out earlier is that although … the pie chart represented the components of donated income to the nonprofit sector, but if you look at total income to the nonprofit sector, actually 45 percent of it, approximately, is earned income. So the nonprofit sector actually has a … sometimes we stated these different pies for one or the other aspects.

So I joined the California Association of Nonprofits just about two months ago. And since then, I and the board of directors have had a chance to revisit and explore further the issues related to flexible purpose and benefit corporations and to think more deeply about them and perhaps with something of a different framework. And I think it might help, certainly, that these corporations will in fact result in attracting significant new capital to doing help and good. That would be awesome.

And we see these corporations not as something that are inherently wrong, but as additional elements in an already very complex ecosystem. And that ecosystem, as we know, comprises of many different kinds of corporations. For example, in California and across the country, there are many types of preschools. There are nonprofit preschools. There are church preschools. There are preschools owned by sole proprietors. There are preschools owned by publicly held corporations. There are preschools run by government. There are many different kinds of preschools, and I think that we all would have our own opinions about which preschool we would want our children to go to, but I think that we're glad that all these different kinds of corporate forms exist in the environment of preschools.

But just as we want to be concerned with an ecosystem as opposed to one particular species, I just want to caution us on some other things that have happened in California related to ecosystems. And the one that comes to mind in particular is that of the eucalyptus tree. Probably some of you know that eucalyptus trees … why are you smiling? Do you already about eucalyptus trees?

MS. MASAOKA: Alright, good. So eucalyptus trees are not native to California. They were introduced by some very ambitious entrepreneurs who brought in our eucalyptus trees and hired thousands of workers to plant thousands of acres of eucalyptus trees. And the goal there was that there would be a wonderful … they were fast growing and they would fuel California's furniture making industry because they would use them for furniture. Well, one thing … and a lot of people, including the California state government, supported the introduction of eucalyptus to California. Well, now we know more about eucalyptus trees. The first thing that California learned very quickly is that it makes terrible furniture …

SENATOR VARGAS: And also railroad ties. They were also going to make them for the hardwood railroad ties but they were very brittle and they fall apart.

MS. MASAOKA: Right.

SENATOR VARGAS: I worked in a nursery for about six years.

MS. MASAOKA: I come from a nursery family, actually. Yes, this table, as you may realize, is not made of eucalyptus; it may not even be made of wood, I'm not sure, now that I take a better look at it.

So I would say that we all enjoy, I enjoy, eucalyptus. They make wonderful landscape trees. We want to keep eucalyptus in California. We also know that eucalyptus has destroyed many important ecosystems in California; that it has created high fire danger zones that did not previously exist in particular habitats for deer.

So I think that, you know, just as these new corporate forms are entering the ecosystem, we don't yet know what they're going to produce. And undoubtedly, I suspect that like eucalyptus trees, they will produce some good things and some bad things and that we need to be on the lookout in the future to make sure that there are appropriate controls and regulations.

As nonprofit corporations, we are very familiar with regulation. I know everybody is probably familiar with regulations, but we're especially familiar with nonprofit corporate regulation. And one of the concerns that we do have in a continuing way is what we see as the lack of oversight and monitoring of some of these new types of corporations. And I know some people earlier had mentioned shareholder flexibility and shareholder oversight. Let me say that I think in recent years we have seen, to a huge degree, the failure of shareholder oversight in many important cases.

But we are concerned, for example, that flexible purpose and benefit corporations are allowed to choose both the standards to which they will be held, and the third party vendor that they pay to assess them about those standards. There has been a lot of talk here about setting goals and reporting on actually most of the financial information would not be necessarily disclosed, of course, it could be disclosed but it need not be. And in fact, the California legislation specifically absolves both directors and corporations of flexible purpose and benefit corporations of any liability if they fail to create any public benefit. So as it's clear to the careful reader, and I have to say probably only to careful readers, flexible purpose corporations and benefit corporations are for-profit corporations. They are not a new type of corporation, they are a for-profit corporation. They might look a little bit different, just like an eastern sparrow looks different from a western sparrow, but they both actually have the same DNA, and these corporations promise to do good but they are not held to that standard by anyone other than their shareholders. So we would like to suggest three things to the committee to take into account.

First of all, the flexible purpose and private corporations should continue to be overseen as they are now by the Department of Corporations in California so that they continue to be subject to all the same rules and regulations as other for-profit corporations.

Second, along these same lines, these corporations should not be eligible for state grants, contracting, or procurement preferences, set asides, tax advantages, or any other privilege based solely on their designation as a flexible purpose or benefit corporations. Of course, if they qualify for a procurement or contracting privilege for some other reason; for example, by being small business or a minority owned business or something like that, they should get those, but they should not get those kinds of privileges solely based on being a flexible purpose or a benefit corporation.

And third, because there is such a high greenwashing potential for these corporations to mislead the public intentionally or unintentionally, we also suggest that the Department of Corporations play an oversight role with them as it does with other corporations, protecting both investors and consumers by establishing disclosure standards and enforcement decisions.

And finally, I wanted to let you know something about what we at the California Association of Nonprofits see as our own goal in working with these new corporate forms, and there are three components to that.

First, we see our most important role as educating nonprofit organizations about whether and how to form such subsidiaries and for affiliate organizations as either flexible purpose or benefit corporations, to help them understand whether these are forms that would be useful for them to take advantage of and how they could do so in a proper way. They need to understand whether these vehicles would in fact, for example, help them attract investment capital to be able to further their own issues.

Our second role is to educate benefit corporations, flexible purpose corporations, and the people that are thinking about forming them, about the various corporate forms that already exist within the nonprofit structure and help them also make informed choices about what kind of corporate forms that they might want choose.

Rob and I were recently on a national panel, for example, on this topic, of which about 120 people or so were in the room, and when somebody asked a question; how many people here are considering forming a flexible purpose corporation? And to, I think, both of our surprises, nobody, not a single person, raised their hand. But so clearly, there's kind of a role on educating both the people who are interested, informing them about nonprofit forms as well as educating nonprofit organizations about these new forms.

And then finally, our third role is simply to watch and see how these corporations grow, like watching eucalyptuses spread through California, we want to see what happens, both the positive and the negative impacts on them, and we want to, importantly, ensure that they do not, as a result of greenwashing, obtain nonprofit like benefits without nonprofit like oversight and regulation.

Thank you.

SENATOR VARGAS: Thank you. Appreciate it. Jim.

MR. JIM ANDERSON: Chairman Vargas, thank you for holding this hearing, first of all. I very much appreciate that. My name is Jim Anderson. I'm the president and CEO for the California Society of Association Executives. We have over 1,200 members of California based associations here in California representing over 400 different associations.

Now one of the things about associations is that we can't explain them to our families. They still don't understand. But virtually everybody in this room is probably represented by an association of some sort. They span the gamut of virtually every trade and profession that exists today, and so, within that we have some levels of expertise that I think have so far been untapped. In addition to that, really their mission is to advance their particular profession through education, shared knowledge, advocacy, and developing and promoting professional relationships. So they're really tapped in to each one of their industries that they're helping support.

Now I believe, and we believe that AB 361 and SB 201 were well intentioned bills designed to modify for-profit corporate behavior to generate greater public good and societal benefits; that's a great goal. I appreciate all of the prior arguments that were made on our behalf by other witnesses (laughter).

But I think what we need to think about boils down to two things. Number one is we felt shutout with the process. That was very substantial. This is not a small piece of legislation. I've been doing this job for eight years and I don't testify hardly ever. So there's a real impact that's going on here. And so, in some ways it feels like there's a tectonic shift and to sort of be excluded from that, most of the time what you want to do is slow things down and have a more measured approach and really think about what's happening or could happen. And I think there's going to be a lot of things that we can't possibly anticipate.

The second thing is that this is really merging what I would consider capitalism and altruism and that's not really been done before. And those are two major forces in our society and what happens when you blend those two forces?

I very much appreciate the vigor and support the proponents of this legislation have. By the way, it did pass. But at the same time, I would be hard pressed to say that there wouldn't be any unanticipated negative consequences. Money is going to shift, we talked about greenwashing, there's all kinds of things that go on, particularly when you talk about a for-profit motive. I don't think I need to go and go talk about, you know, all the things that could go on wrong with capitalism; I think we're all very well aware of that, but it's also the basis of our country so obviously there's great good in that as well. But there's still a lot of power in that and mixing it with a society, the nonprofit sector, you know, just causes some concern.

The other thing that I was asked to do today was really talk a little bit about collaboration and how nonprofits could be more involved in this process so I'd like to spend a little time speaking about that. And I do believe there is significant collaboration, and in fact, there may be some associations that want to pursue this new corporate form. I mean, it's very common for a lot of associations to have four, five, six foundations themselves to help support what they do.

And the first thing I would say is nonprofits should be used as an informational resource. I think when we can set up processes and make decisions without tapping into what nonprofits already know, that I would have to consider that a flawed process. There are a lot of … for example, I mentioned associations and their expertise within each of these professions.

Another thing I wanted to mention is, for example, AB 361 allows for what we call third party standards for corporations. Well, creating third party standards without including nonprofit associations is not a good approach. I think they should really tap into that knowledge that nonprofit associations have.

Second, nonprofits have a vast knowledge about the complexity of service systems, environmental issues, and the delivery systems that are in place by this public benefit into society at large and the populations they serve. So all these examples can be shared by nonprofits, but I've haven't heard anything about that yet, so I'm hoping that could be something that becomes more of the dialogue.

Now the second area that I wanted to mention is I think this has been alluded to and frankly if this comes to be true, I believe you will see the nonprofits being a great cheering section for you, which is, if you really do find that profit from these type of corporations starts finding its way into the nonprofit community, this is what we're looking for. This is great. There's lots of other ways besides just handing them money to be able to do that. But again, if a company starts trying to be good, absolute the other good ecosystems that Jan was mentioning, then it's not maximizing contributions as well. So in other words, it's just a single player and decides it's going to have its own contribution process, for example. That's adding layers to bureaucracy that's already out there. So if every company becomes _________ distributing money, it has a lot of drivers. And we should be able to tap into the nonprofit system. The system is already there to help determine where that money should be best spent. So from my perspective here, this is new information that we're trying to take in. I would really look for a three or five year window, as the Chair mentioned, because we really do want to see what some of the impacts are over time. Again, I think there's a lot of good happening here. I'm positive and optimistic about it. But at the same time, if we ignore what potential consequences there could be, I think we're not doing ourselves full service in that.

Again, I'd like to thank you for the time today. And appreciate …

SENATOR VARGAS: Thank you. Questions from the audience? Yes, go ahead.

MR. WEXLER: So I like what you both said. I'm quite thinking about if we're going to measure potential greenwashing and effectiveness over three to five years, who does that? I mean, you know, the government, with all due respect, only gets certain information and only gets certain resources to measure and really can only measure real compliance; it can't measure … I don't think you have the tools to measure the effectiveness of whether dollar …

SENATOR VARGAS: We can't even measure it in the government, let alone somewhere else, come on. (Laughter)

MR. WEXLER: You know, in the 1990s there was a big push for nonprofit hospitals and HMOs to __________ . ___________ Department of Corporations was __________ playing the key watchdog ___________ . But I'm wondering is the Stanfoord Social Innovation Review writing articles on this? Are your two organizations writing articles on this? I'm trying to think about who the logical candidates sort of … I'm sure it will emerge but nothing sort of pops in my head.

MR. ANDERSON: That's a great question. I think that's one worth lookinh into. I know there's a lot of information that's captured through the IRS …

MS. MASAOKA: About the nonprofits.

MR. ANDERSON: Right. So there's that reporting requirement that we have. And then the other thing I think there is—this is a little bit beyond your question here, but there should be some way for ___________ and I think _______ transparency reporting, some of the things that Jan had asked about earlier. Because when you move from a for-profit … if you're a for-profit and then start trying to do social good, I think there's also a social compact that sort of makes it … greater responsibility to report what's going on because you are in some ways gathering the public trust. So there isn't that reporting mechanism on the other side but it should be there for corporations themselves or something like that in terms of ways to measure that, that can stand outside scrutiny as well. But to make it a true measure that can be accommodated, I really like this idea of ___________ so there may be some way to do that as well.

MS. MASAOKA: Well, we have already many ways in which we review the effectiveness or the impact of legislation, right. So I think that all those usual forms should be put in place, just like we look back and see what has been the impact of any other kind of legislation and that usually involves the combination of government hearings, for example, studies that are conditioned by various interested players, the ones that you mentioned, the hospital, for example, conversion, those things are sparked by employers who do these things so I would say all those things would be important players.

I don't, of course, want to rule out a gigantic donation from California Association of Nonprofits to perform a study like that.

MR. JOHNSON: If I could just add on. I mean, that's part of why we developed a standard of transparency and required public reporting.

MS. MASAOKA: I just consider that the reporting requirements are so thin and so misleading, okay. It's important, for example, for the standards to be reported but not actually whether people met those standards.

MR. JOHNSON: No, that's actually not true. The requirements that we put in place for flexible purpose corporations, we were happy to see that the benefit corporation also adopted it, were actually tailored off of the management discussion analysis requirement that the SEC requires for financial reporting. And today, the problem is the Federal Trade Commission does try to regulate greenwashing, but there's very little transparency into impact. And so, if somebody makes a claim that "my product is green," or a product that is social benefit, the Federal Trade Commission has had a very hard time in trying to actually do enforcement around whether that's greenwashing or not. Our idea was "let's bring some light to this by requiring not only goals and objectives, but actual reporting the impact that you as a company are claiming that you're having around the goals and objectives that you've set on your social purpose. And if you change any of your measuring tools or your goals or objectives during the year, you have to report that as well. And our feeling was that that kind of transparency not just to shareholders, but to the public in general, then not only would we be helping the shareholders, but we'd be helping the public at large to better shine light on the claims that companies already make around a product or a function of the corporation that's doing any kind of good. I would suggest this would be a good thing because I think they have ways to set the bar for corporations obviously have to do but I'm not sure you're dealing with standards that nonprofits need to meet …

MR. ANDERSON: But we also don't have the public trust of nonprofits of tax deductions that's given to corporations.

MR. JOHNSON: Well, that is true. However, like I said before, it's like you're entering into the public trust area now and trying to do social good. And you try to meet that but I think that would be a _______________ and how could you ensure that at least it's at least accurate reporting without creating a whole ________.

SENATOR VARGAS: Professor Klausner, you had a question, sir.

MR. KLAUSNER: I don't really understand the reason why there needs to be any reporting, except for people did write it into the statute.

So my question is a) Why, leaving aside things like consumer fraud or something like that? Consumer fraud _______________ . And then, two, what's your remedy? Would you then want to disallow corporations from providing and serving the public good? Would they be prohibited? So if we get the information …

MS. MASAOKA: Jim and I may have different points of view on this. You know, I don't want to presume to speak for you. I would say that we are not saying that they shouldn't report or they should have to report; we're saying that they should not receive any nonprofit benefits without nonprofit reporting, restrictions, and regulations. So for example … alright. So I just want to be clear that you're attacking me but not attacking the straw person, alright, that presumably is sitting next to me. For example, yesterday, the city and county of San Francisco held hearings on the issue of what procurement and contracts should be provided not to to flexible purpose, but to benefit corporations; and that was about procurement or contracting advantages but without any reporting, accountability, or transparency so that's what we're against.

MR. ________: I'm against that too.

MS. MASAOKA: So I want to just make it clear that you're making … that we're understanding each other.

MR. KLAUSNER: I'm against that too.

MS. MASAOKA: Against what?

MR. KLAUSNER: I'm against tax benefits or procurement benefits …

MS. MASAOKA: Great. Do you want to testify at the next hearing?

MR. KLAUSNER: I'd be happy to.

MS. MASAOKA: Fantastic!

SENATOR VARGAS: Okay. We have another question. It's okay. I know it's a good back and forth; very healthy. But I know that Professor Sievers, you had a question, sir.

MR. SIEVERS: It's just an observation. That is assessing social benefits. I mean, is more complex than assessing economic benefits. And I think to try to equate those two, where you find the line, you can easily find the line in economic analysis. It is really complicated to find some line in the social benefit.

MS. OLSEN: But not impossible. And there are now hundreds of people who have been trained in sort of good ways of thinking through materiality and stakeholder impacts and involving stakeholders in that process. And gradually, an ecosystem is arising not just in the United States, but worldwide that is figuring this out. And I think that a legal corporate form rating that brings together metrics and all of the certification standards that are public rating are all part of helping to enable some kind of new discipline to come into being because that's what we need—discipline that is treated with _______________ because that is what it's going to take to get …

MR. ANDERSON: Yes, I agree. It's very complex. But it's almost 20 years that we've been trying to go with the outcome based types of funding and results. And so, sure, there are some who are doing it very well and have succeeded, but it's tapping into that knowledge, I think, that would benefit everyone.

MS. MASAOKA: Can I just say that, you know, social benefit is not a neutral scientific term; it's a subjective term. And what one person thinks is social benefit, another person thinks is a deep social disaster. And so, I think the wonderful thing about American democracy is that we don't say … that we allow nonprofit organizations and corporations to do these things without sort of saying that you have to do certain things. So I think that there are many nonprofits whose entire purpose, for example, is to defeat another nonprofit's purpose. So I just want us to be careful that we're not venturing into the zone of saying that somehow or another there's an agreed upon determination of what social impact …

MS. OLSEN: I would agree with that totally. And I think it's more about the process of how you define what the effect it is and then maybe there are some objectives, you know, everyone in this society agrees on something ______ impact and then other things that are more subjective. But I think that's an evolving, is a framework within which both of those can agree.

SENATOR VARGAS: I think we have another question here. Go ahead.

MR. SIMON: Yes. First, to go to the straw man: The arguments that, the issues that we raised at the table when we were up there, those are not issues that we made up; those were all issues that were raised by your two organizations in opposing the legislation, and so, that's what felt _________ those references again.

MS. MASAOKA: I understand that. But to some degree they're _____ after this legislation as passed in any way. Okay.

MR. SIMON: Well, they are mainly the oversight and the fear that it was going to draw money away from nonprofits.

But I wanted to go back to your comments and discussion about the greenwashing and about the disclosure. So I worked on the benefit corporation bill and actually, one of the main reasons why I decided to do that was because I was seeing greenwashing be such a concern is everybody claims to be green and they love America and they and all these wonderful things and now suddenly you have … well, you could put on a Sunday news programs and you'd see that and you'd think Exxon was the greatest, most environmentally sustainable company that's ever walked the earth. Some, well, let's just say that's just not true. So we debated on the disclosure element and we toyed with the idea of first giving the reporting requirements, actually having a third … because we have a third party standard, we first toyed with the idea of having a state agency develop that standard and then we came away from that. And the reasons were as were mentioned earlier, the state really doesn't have the competency to do that and more importantly, the market is too new and there needs to be a lot more development because as you try to apply any of the standards that are out there today, one standard may work fine for a manufacturing business but it doesn't work very well, for example, for a law firm that is a service business. And so, we thought the better course was to actually do a metric of what is an acceptable standard _________ comprehensive elements of the third party standard was achieved and the disclosure that the third party standard must itself provide and the thinking was that would then create an incentive for there to become a proliferation of third party standards so that you would continually have greater expertise in the industry and we would get more and more highly relevant standards that are more particularized to particular industries. And since that time I've actually already been contacted by two different groups that are actually developing different standards.

And so, I'm curious, you said that … your third point was that you'd like to see the Department of Corporations establish this whole disclosure standard and are you suggesting that you would want the Department of Corporations to create its own transparency standard, third party standard, or what did you mean by that?

MS. MASAOKA: No, what we're saying is that we just … I mean, I understand the difficulties of trying to regulate greenwashing. I understand that it's not simple or easy. But I think that what we would like to see is the same kinds of efforts that the Department of Corporations tries to make around greenwashing of other products, for example, also be applied to these corporations in the same way. So in other words, it's not that we have a magic bullet that we're suggesting but instead that it be taken up by the Department of Corporations just like they look at oversight in other areas.

MR. SIMON: So just so we're clear; there is nothing that the Department of Corporations or any other state or federal agency can do to a traditional corporation that it cannot do to a flex purpose or benefit corporation.

MS. MASAOKA: I fully agree. And that's what we're just saying; so do that.

SENATOR VARGAS: Okay, that generated a lot of hands. Yes, sir.

MR. KEN LARSON: Ken Larson. Jim and I, we sort of are the voices in opposition. But as his remarks made clear, our opposition is not based because we presumed that these idea were problematic, just that we had to investigate that question. So this hearing is starting in that direction. I wish we'd done it two years ago.

And the other thing is there's still been no real voice for the public here about _________ we're talking about a very euphemistic, no following SEC guidelines and so on. But I get, you know, every time the ___________ operating system I get 45 pages of privacy information and consumer responsibility, and so, you know, there's a kind of level of smoke around this still that I think we somehow need to work on penetrating so that the public feels that they're really participating in the benefiting process as well.

And we've both talked to each other now for a couple of years and it's great. But I would like to see this open process ________ great, letting folks in.

When I read the comments about both of these bills being reported on in the general media, people are totally cynical about them. I want them to overcome that cynicism. And so, I'm open to some very … maybe not in the papers you read but …

MR. _________: _________ seven of pages of Google websites …

CROSSTALK

SENATOR VARGAS: I'm going to try to diminish a little bit of the back and forth because I know there are other people that have comments too. It's been very helpful. Go ahead.

MS. PAT TSEN: My name is Pat Tsen. I actually work at the Department of Corporations. So I've worked on the bill in terms of just doing analysis. And just so you know, we are treating these two entities as for-profit corporations that are under our jurisdiction, so that's not something that you need to be concerned with.

SENATOR VARGAS: Thank you. Yes, sir.

MR. WEXLER: Two comments quickly: And in fact, we had conversations with Ms. Tsen before the bill passed.

MS. TSEN: Yes.

MR. WEXLER: You were a voice on the phone but you made some good suggestions. We did include them.

And secondly, the attorney general's office, you know, has made it clear that to the extent one of these types of entities actually solicits money for a charitable purpose, or says something in their articles like, "25 percent of our assets will be dedicated to this charitable purpose," that they will treat that as though there is a charitable trust on those assets and they will grab supervision over that. So we have this back and forth …

MS. MASAOKA: No, I'm glad.

MR. WEXLER: So I'm just thinking of the ways in which these entities could infringe on the charitable sector are that and then tax. So at least the AG's office has said, "if you do that, we're stepping in."

SENATOR VARGAS: Well, I think I'm going to step in here because I do notice the time. It was a very … I think we had a very good discussion. I don't know if I erred in not putting you first. It might have generated a lot more discussion.

I do want to make sure that anyone that's here from the public has an opportunity to speak if they would like to. I normally run a much more formal ship but today I think it would be much more beneficial if we did, after each panel, have the back and forth. I just want to make sure if there's anyone from the public that wants an opportunity to speak, now is your turn. Okay. Seeing none, I think I will, before I adjourn I'd like to say this. That I thank again, each and every one of you for being here. I thank the University for allowing us to be here.

From my own perspective, you know, it was one of those bills where it had to come through the Banking Committee, and we're a fairly small committee, so usually we can stop bills there if we think there's something wrong with them or we can pass them along if we think that there's something good with them. This one did have a lot of opposition. I don't think that they were straw, sort of, men and arguments because I'd heard them from a number of people. But it is one that made me think, you know, that the nonprofits have transformed themselves in many ways and I'm glad that you mentioned that.

Weird background: But I studied to be a priest for a long time and then decided that it wasn't for me. I was a Jesuit. And then went to Harvard for law school and got into law and decided that wasn't for me either and I went into the—crazy—I don't what the hell I'd do next, but then I went into being a politician.

I was on the San Diego City Council for a long time and worked with a lot of nonprofits because I represented a very poor area. They have transformed themselves completely. At one point they almost were completely reliant on city, county and the state for money. Now they do earn, in some cases, 70, 80 percent of their own money and they rely very little on the state and on the city because of necessity. So they have transformed themselves. And I thought, "Well, they're trying to blend, transform, or whatever word you want to use, it seems like businesses are trying to do something like that too; why would that be bad?" I thought, "No, that's probably a good idea," unlike eucalyptus, where once the eucalyptus got here and you found out what it was intended for didn't work out very well, in fact, there's been a lot of damage. The law is not like that. You can stop law. You can change law. I know; I've done it quite a bit.

And you know, you can't smoke anywhere near a door or window; that's my law. I passed that. So I know that you can change law quite easily—not quite easily but you can. I thought, "Why not try this out?" and so we did.

There's not a lot of data. I think that that is going to come. And frankly, I think the market is going to determine whether this is a vehicle, a form, a standard that people want to use or not. It may not work but at least give it a chance. So that was my view.

I do think, however, you have to have oversight. I do think that the issue of taxes is a very important issue. That we at that point … society and the Legislature may change its mind; it may want to give an advantage. You know, at the moment, just so you know, no procurement advantage. We give advantage in many ways to companies that give a living wage in some cities. We say, "Well, we're going to give them an advantage because we think that if that corporation gives a living wage to their workers, that's a benefit." As opposed to another company that can glean just as well but doesn't give a living wage. So these are issues, I think, that we have to figure out as we go along. But I did think it's better to be optimistic and not pessimistic, so I didn't hold it in my committee. I let it go. And here we are today. I think it's a start to a good discussion.

I appreciate everyone that was here and your input very, very much. Any other logistics? Okay, we, then, are going to formally conclude the informational hearing of the Banking and Financial Institutions Committee here at Stanford University, Room 130, Gunn Building. We are adjourned. Thank you.