transform finance

ALTERNATIVE OWNERSHIP ENTERPRISES:

An Introduction for Mission-Oriented Investors

Andrea Armeni, Curt Lyon, and Julie Menter
With Preface by Kate Raworth

NOVEMBER 2023

ABOUT TRANSFORM FINANCE

Transform Finance is a nonprofit research, education, and implementation partner that supports all stakeholders to challenge legacy investment approaches, seed transformative investment models, and build movement power. In doing so, we work to ensure that capital aligns with the three Transformative Finance Principles:

1) it meaningfully engages communities in the design and governance of investment processes;
2) it adds more value than it extracts; and
3) it fairly balances risk and return between investors and non-investors.

We inform and create awareness through written materials, webinars, and other communications that shape dialogue and create narratives. We educate toward action through technical materials, collaborative spaces, and trainings that prepare our community for action. Lastly, we advise and support advanced investors, philanthropic actors, and other critical organizations to help them deploy capital towards best practices in the field.

www.transformfinance.org

This report may be cited as: Andrea Armeni, Curt Lyon, and Julie Menter, *Alternative Ownership Enterprises: An Introduction for Mission-Oriented Investors*, Transform Finance, November 2023.

Acknowledgments

The authors have many individuals to thank for their contributions, time, and expertise that made this report possible.

- Jason Spicer, Assistant Professor at the Marxe School of Public and International Affairs at Baruch College at CUNY and his team at the University of Toronto, Tash Cheong and Suzanne Merchant, for their dedicated research that led to the enterprise model briefs and the underlying basis for analysis.
- Expert reviewers who reviewed specific enterprise model briefs: David Hunter, Greg Brodsky, Jon Shell, and Zoe Schlag.
- The 60+ asset allocators, fund managers, field builders, and businesses, as well as technical assistance providers, lawyers, and academics who shared their time and expertise during stakeholder interviews. (See Annex 2 for a full list.)

We give a special thanks to the individuals who joined us for our Investor Convening on Alternative Ownership Enterprises in March 2023: Adam Connaker (Surdna Foundation), Amy Brakeman (Unlock Ownership Fund), Aner Ben-Ami (Candide Group), Charles Coustan (MacArthur Foundation), Daan Besamusca (Open Society Foundations), David Lynn (Mission Driven Finance), Felipe Fernandez (CO_), Humaira Faiz (W.K. Kellogg Foundation), Jason Spicer (CUNY), Jasper van Brakel (RSF Social Finance), Jon Shell (Social Capital Partners), Margot Kane (Spring Point Partners), Michael Grossman (Social Finance), Smitha Das (World Education Services), and Zoe Schlag (Common Trust).

We give a most special thank you to Erinch Sahan of the Doughnut Economics Action Lab (DEAL), who served as a primary thought partner and supporter throughout the underlying research project. For more information about DEAL's work, see doughnuteconomics.org.

DOUGHNUT ECONOMICS ACTION LAB

This report builds on several years of explorations by Transform Finance around the topic of democratizing ownership and control of the enterprise. We wish to thank the funders who have supported this work over the years, including the Roy and Patricia Disney Family Foundation, the Libra Foundation, the Surdna Foundation, and Open Society Foundations. We are grateful to the Sorenson Impact Foundation for its generous support of this project.

All inaccuracies remain the sole responsibility of the authors.

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Preface

Economic transformation on the scale that today's crises demand cannot be achieved without a transformation of business itself. From last century's growth-addicted economic paradigm we have inherited businesses that—while generating vast profits for their owners—have fuelled the destruction and degradation of the living world and exacerbated extreme inequalities by systematically capturing value, opportunity, and power in the hands of a few.

This century calls for a different paradigm altogether: one focused on the goal of meeting the needs of all people within the means of the living planet. Pursuing that goal requires an economic system—along with companies, businesses, and enterprises of all kinds—focused on bringing about utterly different economic dynamics.

Instead of degenerating the living world, economies and enterprises must become regenerative by design, so that they help restore and then work within the cycles of the living world. At the same time we need economies and enterprises that are distributive by design, sharing value, power, and opportunity far more equitably with all involved—throughout their supply chains—in creating that value.

Is it really possible for business to be part of such an ambitious regenerative and distributive economic revolution? Absolutely—indeed, it is essential—but the key to making this happen does not lie in tweaking the design of their products and services. What's key is to transform the deep design of business itself, through remaking its purpose, its networks of relationship, and through transforming how business is governed, how it is owned, and ultimately how it is financed.

Ready to meet this ambitious agenda is an ongoing renaissance in exploring alternative enterprise designs. From Multi-Stakeholder Cooperatives and employee buyouts to mission-lock governance and Steward Ownership, an innovative alternative enterprise ecosystem is fast emerging. And it is giving rise to companies that are intentionally purposed, networked, governed, and owned so that they can contribute to realizing a regenerative and distributive future. This renaissance is a crucial step in aligning business with the goal of thriving people on a thriving planet, and its seeds of success urgently need to spread and scale.

Until now, what has so often been missing—and hence holding back that wider spread and scale—is finance that is aligned with these enterprises' designs and goals. The role of such a financial ecosystem is, of course, critical—from enabling employee-ownership conversions to funding purpose-driven start-ups in ways that support, rather than undermine, their very purpose for starting up.

And that is precisely what makes this report so important. Progressive, innovative investors are going to play an invaluable role in turning the idea of investing in alternative enterprises into proof of practice, and then together building an ecosystem of investors who can enable such enterprises to spread and scale to become significant actors in an economy in service to people and planet. It's high time to change the deep design of finance, so that it too is ultimately in service to life.

I look forward to seeing the innovations that flow from this work, and to the emergence of the financial ecosystem that it kindles and that the future so deserves.

Kate Raworth
Author of Doughnut Economics
Co-founder, Doughnut Economics Action Lab

Executive Summary

Executive Summary

The conventional enterprise ownership model–and the investments that are designed for it–are creating an economy that works for the few, not the many. Fortunately, there is a rich body of work which is building new possibilities: **Alternative Ownership Enterprises (AOE)**. AOEs are firms that significantly shift economic value and decision-making power toward the non-investor stakeholders they impact, such as workers, producers, consumers, community members, or even a non-financial purpose.

This report gives an overview of the different AOE models, makes the case for their importance in solving today's crises, and provides a critical understanding of the contexts in which different models can achieve wealth building, power shifting, and other forms of social impact.

AOEs differ from conventional enterprise models primarily by changing the economic and governance rights that are tied to company ownership, and by changing who has access to that ownership. They can do this in one or more ways: shifting ownership to non-investor stakeholders, such as workers; splitting economic and governance rights into different share classes held by different groups; providing economic or governance rights to stakeholders regardless of their ownership stake; or choosing legal forms that limit the rights traditionally granted to outside investors. These strategies shift incentives and the way surplus is used such that AOEs operate very differently from conventional enterprises, where outside investors provide capital for a high growth, profit maximizing enterprise with the goal of ultimately selling their ownership stake to another buyer.

There is plenty of data demonstrating that AOEs are very impactful for the stakeholders they seek to support. They address wealth gaps, build real assets for workers, shift the balance of power at the enterprise level and within the economy as a whole, and even perform better on many standard measures of business success such as resiliency to external shocks, employee turnover, profitability, and productivity. However, much of the data on AOEs is centered on Employee Ownership models, particularly Employee Stock Ownership Plans, or ESOPs, and Worker Cooperatives, due to their longer histories and associated research infrastructure. We argue that many of these findings should be applicable to other other emergent models, such as purpose-centric models, multi-stakeholder models, and innovative Employee Ownership variations like Cooperative Holding Companies. Indicative research provides reason to believe that shifting economic and governance rights in creative ways better aligns incentives and more fairly distributes value across stakeholders, but more studies must be conducted to back this thesis.

While AOEs are impactful as a whole, some are more effective at achieving their goals than others. Since the field is now receiving attention from policymakers and conventional investors like Private Equity, there is now an imperative to distinguish deep, transformative change potential false solutions. This newfound interest may help scale the field and open the door to new sources of capital, but if that capital goes towards models that shift only meager percentages of ownership, or stakeholder governance is not prioritized, or there is pressure for rapid growth over sustainability, the overall impact of AOEs may get diluted. Mission-oriented investors can play a key role in ensuring that workers and communities of color benefit as the industry scales: by supporting the intermediaries and deal finders that are developing best practices for deep shifts in ownership, by providing blended or concessionary capital, and by supporting the development of new financial products and vehicles that allow AOE funds to compete in competitive buyout markets.

In the second section of the report ("The Alternative Ownership Enterprise Models"), we dive deeper into the structure and goals of the models themselves. We highlight the core features, examples, and financing considerations for models centering purpose (Benefit Corporations, Community Interest Companies in the UK, Foundation-Owned Companies, Golden Shares, Low-Profit Limited Liability Companies, and Perpetual Purpose Trusts), models centering workers (Employee Stock Ownership Plans, ESOPeratives, Employee Ownership Trusts, and Worker Cooperatives), and models centering other stakeholders (Consumer, Producer, Shared Services, and Multi-Stakeholder Cooperatives, and Multi-Stakeholder Perpetual Purpose Trusts). More in-depth overviews can be found in Annex 4.

When comparing the impacts of AOE models, it is critical to note that while the model dictates a baseline of economic and governance rights, each model is flexible. The impact depends greatly on the context of the enterprise, how it is financed, and the goals of the founders, retiring owners, and/or key stakeholders.

There are several important factors for investors to consider in building wealth for workers and other stakeholders of AOEs. Some models, such as Employee Ownership Trusts and Cooperatives, distribute surplus economic value to stakeholders periodically (though, for example, an annual profit share or dividend), whereas others create an asset for its stakeholders that is liquidated upon the sale of the company or upon leaving the company. Investors in AOEs must consider the direct tradeoff between the terms of their financial return and the surplus available for profit distribution to stakeholders. Even the strongest wealth building models, like ESOPs, must be implemented in the context of a company with strong financial health; an AOE model that has the potential to build assets for its stakeholders cannot do so if the company is not financially viable.

For governance, too, the model does not dictate or guarantee the highest level of shared decision making power. Many models are flexible, and elements of democratic governance and co-leadership can be developed, as with the ESOPerative (an ESOP with cooperative governance implemented). Some workplace democracies are direct, whereas some are representative, even within well-known democratic models like Worker Cooperatives. Furthermore, sharing governance with more than one stakeholder adds a layer of complexity, but perhaps a more holistic view of what democracy looks like. In any case, developing an "ownership culture" is critical for the success of newly converted AOEs that value stakeholder participation. Meanwhile, some models are designed for different goals than empowering specific stakeholder group(s), as with AOE models that center purpose; while workers and other stakeholders may participate in governance, these companies have decision-making structures that prioritize societal outcomes instead.

Whether a company has protections for its mission, via an "asset lock" or other mechanism, is also critical for determining the impact of the enterprise. Companies that seek to hold its structure in perpetuity, as with Perpetual Purpose Trust-owned companies, shift governance rights to Purpose Stewards in order to protect from internal or external changes that might jeopardize the original mission of the company. This idea fulfills the Steward Ownership principle of self-determination. Models without such an asset lock, including the ESOP, may be at risk of having the AOE structure dissolved upon the sale of a company or new ownership.

Education on the structure and impact of AOEs, as in this report, is just one of the many needs of the field if it is to scale and compete with conventional enterprises. We develop a call for a broad, field-wide campaign that delivers further education, develops financial infrastructure, and coordinates and funds the broad range of technical assistance providers and support organizations. Such a campaign would form a strong political base that unites different fields under the AOE umbrella and enables structural change. We call for this campaign to intentionally connect to other movements for justice, worker power, and those that represent communities of color in order to build real movement power. Otherwise, transformative system-level change will be impossible and AOE work will continue to rely on unsustainable philanthropic support.

For Transform Finance, this report is just the beginning of a broader project to resource the field of AOEs and mobilize capital through several different strategies. We call on the reader to join us and our peers in helping to build this campaign.

Introduction

Introduction

Our economy is not creating a livable society for most people. It is fueling climate change, worsening wealth inequality, seeding the conditions for emerging threats to democracy, and disempowering working class communities and communities of color.

Those focused on solving these issues are increasingly questioning the way the economy itself is structured. The neoliberal model that took off in the 1980s is no longer taken for granted, even in more conservative spaces. Phrases such as "late-stage capitalism" have become popular in online circles to describe the extreme nature of our hyper-commodified, highly unequal system. Young people are becoming more favorable to socialism and hostile to capitalism.[1]

Many argue compellingly for changing our economic system completely, while others lobby for reform from within. Regardless of one's perspective on system change, there is an important underlying economic feature that is often overlooked: the structure and ownership of the enterprise. Who owns an enterprise, and what rights are associated with that ownership, determines who controls and benefits from the economy.

> **"Regardless of one's perspective on system change, there is an important underlying economic feature that is often overlooked: the structure and ownership of the enterprise.**

Conventional enterprises typically have a single class of ownership, delineated by shares. That share ownership comes with two core bundles of rights for shareholders: economic rights, which provide monetary value, and governance rights, which grant decision-making and control over the enterprise. Our legal system protects the interests of these shareholders—typically outside investors distant from the company itself—above other stakeholders in the company, including its workers, the communities it affects, and the planet. Investors,

1 Jason Lemon, "Majority of Gen Z Americans Hold Negative Views of Capitalism: Poll," Newsweek, June 25, 2021

controlling the enterprise and wanting to increase the value of their investment, seek increasingly extractive avenues to amass capital, often at the expense of all other stakeholders. This has come to be known as shareholder primacy.[2]

Shareholder primacy may seem like common sense. Investors risk their own capital, so why shouldn't they be rewarded? For one thing, others also risk or bear the consequences of enterprise activity. Moreover, share ownership is concentrated in the hands of few individuals and investment institutions, so the accumulation of returns by investors contributes to inequality of wealth and power. As a result, workers and other stakeholders can't easily improve their conditions or participate in the wealth built by the enterprises they are helping succeed. Meanwhile, even mission-oriented enterprises struggle to achieve net positive impacts since the logic of shareholder primacy always encourages them to maximize profit at the expense of everything and everyone else.

"Alternative Ownership Enterprises (AOE) are firms that significantly shift economic value and decision-making power toward the non-investor stakeholders they impact, such as workers, producers, consumers, community members, or even a non-financial purpose.

We need models that limit the profit-maximizing drive of outside investors and afford other stakeholders the opportunity to influence and financially benefit from the companies that affect their lives. There is a rich body of work which does just that: we refer to it as Alternative Ownership Enterprises.

Alternative Ownership Enterprises (AOE) are firms that significantly shift economic value and decision-making power toward the non-investor stakeholders they impact, such as workers, producers, consumers, community members, or even a non-financial purpose.

There is a special moment now to embrace AOEs. Not only are cracks in the economic system causing a variety of economic actors to consider alternative models, a clear case for AOEs' ability to address our mounting crises is emerging.

And yet, even for many sophisticated investors and entrepreneurs, enterprise models that shift who owns, benefits, and makes decisions are seen as too complicated to work at scale. This is because their relative novelty and investors' persistent preconceived notions make AOEs seem riskier than they actually are.

We aim to show that AOEs represent one of the greatest opportunities for mission-oriented investors to create long-lasting, transformative impact.

2 "Shareholder Primacy," Corporate Finance Institute, last updated October 5, 2023.

ABOUT THIS REPORT

We initially set out to compile information for investors to help them make direct deals into AOEs. After over 60 practitioner interviews and an investor convening, it became clear that understanding the core ideas behind each model, their relative differences, and their impacts is a critical first step for investors, and many others, to engage in this space. We created this report as a general primer, geared towards any type of supporter—investor, entrepreneur, funder, policymaker, researcher, or otherwise—who cares about the vision that Alternative Ownership Enterprises represent.

In this report, we make the case for Alternative Ownership Enterprises, explain and compare different models and their impact, and call on the field to develop the most transformative approaches within the AOE universe. The focus is on the United States context, but there are some references and learnings from other countries, in particular the United Kingdom (UK).

This report is part of Transform Finance's campaign to educate investors and other stakeholders about Alternative Ownership Enterprise models, support investors to move capital into this space, and work with other practitioners to address the constraints that are currently preventing investors from doing so.

We especially focus on the role of mission-oriented investors because investors have a unique role in fostering the field of AOEs, and AOEs have a unique potential to maximize the impact of mission-oriented capital.

That said, the contents of this report are also relevant for a wide range of parties:

- Entrepreneurs starting businesses;
- Business owners seeking succession plans for their business or ways to shift their corporate structure to more align with their values;
- Commercial investors who are evaluating opportunities in Alternative Ownership Enterprises;
- Philanthropic actors working to advance racial, environmental, and economic justice through new funding avenues; and
- Policymakers and policy influencers looking to understand the relative strengths and challenges of Alternative Ownership Enterprise models.

In the context of the broader campaign, this report is the foundation for later work for Transform Finance and its partners. In particular, we intend to release more finance-specific materials that build on the definitions laid out here, including an analysis of the major pain points for investors interested in moving capital into Alternative Ownership Enterprises and recommendations for addressing them. In addition to sharing educational materials, we will hold conversations and build community among mission-oriented investors who are working on best practices.

We hope this campaign adds momentum for a true movement within mission-driven investment to prioritize Alternative Ownership Enterprises as part of impact considerations.

Stay in touch with this work here.

BUILDING ON OTHER EFFORTS

This work draws on existing leadership, research, and infrastructure around AOE. In particular, this work builds on the significant contributions of the worker cooperative movement. Organizations within this umbrella have developed rich infrastructure for providing capital (e.g., Seed Commons, P6 Capital), formed regional approaches that blend technical assistance and financing (e.g., Coop Cincy, Project Equity), and built the field through research and policy initiatives (e.g., US Federation of Worker Cooperatives, Democracy at Work Institute). This project seeks to increase visibility into this space for mission-oriented investors and to support capital allocations to deals, funds, and platforms investing in cooperatives.

The broader Employee Ownership movement, which historically consists of worker cooperative practitioners and advocates for Employee Stock Ownership Plans, also represents an important segment we draw from and seek to support. Organizations doing research (e.g., National Center for Employee Ownership, Rutgers Institute for the Study of Employee Ownership and Profit Sharing), policy work (e.g, Ownership America, now part of Lafayette Square Foundation), and the many intermediaries financing Employee Stock Ownership Plan (ESOP) conversions have modeled what rich AOE infrastructure can look like. In particular, this project aims to facilitate more capital into innovative ESOP models seeking high impact for workers of color and those with more shared governance (e.g., Apis & Heritage).

This project also builds on Steward Ownership efforts in Europe and the US, "a corporate ownership structure that presents an alternative to shareholder value primacy… [and] ensures that companies prioritize their long-term purpose over short-term profits."[3] In particular, the work of Purpose US and the Purpose Foundation in Europe has been meaningfully influential on this work and the space as a whole, and a budding universe of technical assistance providers (e.g., Purpose Owned, Lumo Group) are supporting businesses to convert.

> **This project seeks to increase visibility into this space for mission-oriented investors and to support capital allocations to deals, funds, and platforms investing in cooperatives.**

We also recognize the contributions of thinkers outside of the enterprise space who bring an ethos of community control and power building to their finance work: place-based investment projects such as democratic community capital funds (e.g., Ujima Fund, REAL People's Fund), and decommodified real estate projects like Community Land Trusts and Neighborhood Trusts.

3 "Steward-ownership," Purpose, accessed October 11, 2023.

Most importantly, we acknowledge that Alternative Ownership Enterprises are embedded in broader struggles for justice. Many Alternative Ownership Enterprise leaders who create better structures for workers draw from the labor movement, which helps define what quality jobs look like and builds power vis-à-vis investors, the conventional owners of capital. Other Alternative Ownership Enterprise advocates, particularly those building Worker Cooperatives, explicitly identify with political and cultural movements for a Solidarity Economy, "an organizing framework for those who wish to create a systemic commitment to and practice of interdependence and collective liberation in the economic activities that meet our material need."[4] Solidarity Economy practitioners developing cooperatives are purposeful in making strong connections with other cooperatives, networks, and associations, which builds political power.

4 "What Do We Mean By Solidarity Economy?" Solidarity Economy Principles Project, accessed October 11, 2023.

What are Alternative Ownership Enterprises?

What Are Alternative Ownership Enterprises?

Alternative Ownership Enterprises (AOEs) are firms that significantly shift economic value and decision-making power toward the non-investor stakeholders they impact, such as workers, producers, consumers, community members, or even a non-financial purpose.

To understand Alternative Ownership Enterprises, it is first necessary to understand how conventional enterprises are structured. In non-AOE enterprises, owners (holders of shares or membership interests in conventional enterprises) have two core sets of rights: 1) economic rights, which provide monetary value; and 2) governance rights, which give control over the enterprise.

> "Alternative Ownership Enterprises distribute economic rights in different ways to 1) financially reward different stakeholders for their contributions to the success of the company, 2) create incentives for the long-term success of the enterprise, and 3) build wealth for under-represented stakeholders as a part of their mission.

ECONOMIC RIGHTS

Economic rights are the rights to receive financial benefits from an enterprise. For owners, economic rights typically include rights to dividend payouts, capital appreciation, and transfer rights (i.e., the right to give or sell an ownership stake). In some cases, those rights also include preemptive rights (i.e., the right of first refusal on new shares issued) and liquidation preference (i.e., getting paid back earlier than others in case of a sale or bankruptcy).

Ownership in companies is highly unequal. Typically, owners are either 1) outside investors, 2) founders, or 3) senior management. But most people do not fall under any of these categories. The wealthiest 10 percent of US adults hold 88.6 percent of stocks, which have a value of $28 trillion.[5] Almost half of all US adults own no stocks, whether directly or as part of a retirement account. Because the unequal distribution of ownership rights is a primary driver of economic inequality, this report focuses on the economic rights that owners typically hold and considers how those might be shared across a broader set of stakeholders.

Alternative Ownership Enterprises distribute economic rights in different ways to 1) financially reward different stakeholders for their contributions to the success of the company, 2) create incentives for the long-term success of the enterprise, and 3) build wealth for under-represented stakeholders as a part of their mission.

GOVERNANCE RIGHTS

Governance rights are the rights to control a company, from small to existential decisions. For owners, these rights generally include voting on key corporate decisions and electing the board of directors, which in turn oversees the company's management, proposing and voting on shareholder resolutions and major corporate decisions, with rights to information about the company and to sue the company for wrongdoing. While day-to-day decisions are typically made by management, that management is hired by the board, which is ultimately beholden to the company's owners. Alternative Ownership Enterprises shift governance rights in order to balance the distribution of power over the firm—and the economy as a whole—from investors to other stakeholders who already contribute to or rely on the enterprise.

"Alternative Ownership Enterprises shift governance rights in order to balance the distribution of power over the firm—and the economy as a whole—from investors to other stakeholders who already contribute to or rely on the enterprise.

Governance is critical because it determines what an enterprise will do and how it will do it. Under a conventional enterprise, where those in control of the company also have economic rights, shareholders and their managers will decide to generate profits at the expense of the well-being of other stakeholders. Shifting governance rights to stakeholders with other incentives changes this equation. Workers with governance rights typically choose not to exploit themselves, while customer or supplier input helps factor in broader impacts on the enterprise's community, and appointed stewards can ensure that missions like racial equity or environmental justice are centered in decision-making. The transformative potential of shifting governance rights is often overlooked by mission-oriented investors and the impact space writ large.

5 Jack Caporal, "How Many Americans Own Stock?" Motley Fool, last updated August 15, 2023.

RETHINKING RIGHTS FOR AN ENTERPRISE

Understanding economic and governance rights shows how important they are in a system where 1) the rights of shareholders are designed to take precedence over any other stakeholder, 2) economic and governance rights are given to shareholders vis-à-vis their ownership stakes, and 3) ownership is concentrated under a small group of wealthy individuals and institutions. It's easy to see how this system is contributing to the crises of our time.

Alternative Ownership Enterprises are fundamentally different, packaging economic and governance rights differently such that non-investor stakeholders benefit from and can guide the company's activities.

They do this in one or more of a few different, and complementary, ways:

1. **Shifting who owns the enterprise:** Distributing ownership and its traditional claim to economic and governance rights away from outside investors. Cooperatives, such as Worker Cooperatives, are a core example, where outside investors cannot own voting shares, and the member-owners collectively govern the firm and share the profits.
2. **Splitting economic and governance rights into different share classes:** Separating the two types of rights means that those who govern the enterprise—or specific decisions within—are not clouded by personal financial gain. This is the core idea behind Steward Ownership models like Perpetual Purpose Trusts, where the trust owns the voting rights to hold the company to a mission and disallow a sale, while investors, workers, or even charities can receive whatever financial surplus the company creates.
3. **Providing rights to non-owners:** Stakeholders might access rights even if they don't directly have ownership of an enterprise. For example, a trust might own the shares of a company but formally delegate governance rights to employees, as with many Employee Ownership Trusts. Enterprises of various forms may also provide a percentage of board seats of a company for workers or establish a profit sharing mechanism that is not based on stock ownership (e.g., a percentage of annual profits are distributed as cash to employees).
4. **Choosing a legal form that limits rights for outside investors:** In the US, forms of Alternative Ownership Enterprise incorporation such as Low-Profit Limited Liability Corporations and Public Benefit Corporations provide a legal framework for companies that seek to pursue a purpose in addition to profits. A stronger incorporation model can be found in the UK's Community Interest Company, which has a strong asset lock and limits returns for investors.

CORE MODELS INCLUDED IN THIS REPORT

- **Benefit Corporation:** A distinct form of incorporation that allows directors and managers to pursue a public benefit in addition to shareholder value.
  Examples: Lemonade, Dr. Bronner's
- **Community Interest Company (CIC):** A corporate form specific to the UK that ensures that an enterprise pursues its mission in perpetuity by mandating a stated community purpose, enshrining protection against a sale, and limiting the financial returns to owners and lenders.
  Examples: City to Sea, Mydex
- **Employee Ownership Trust (EOT):**[6] A type of Perpetual Purpose Trust (see below) in the US that typically holds a majority of the voting shares of a company on behalf of employees and includes a profit sharing mechanism, elements of worker governance, and a charter protecting the company from a potential sale.
  Examples: Codeweavers, Mētis Construction
- **Employee Stock Ownership Plan (ESOP):** A benefit account trust structure that holds all or part of a company's stock on behalf of employees. Shares are vested to a broad base of employees individually, at no cost, over time, and employees are cashed out upon leaving the firm.
  Examples: Publix, Amsted, King Arthur Baking Company
- **ESOPerative:** Also known as Democratic ESOPs, these are ESOP-owned companies that are run democratically, where each employee is part of the company's governance.
  Examples: Once Again Nut Butter, Carris Reels
- **Foundation-Owned Company:** A business owned by a foundation, partly or entirely, typically after a transfer of ownership by the company's founder.
  Examples: Newman's Own, Novo Nordisk
- **Golden Share:** A structure that ensures that a mission-driven enterprise can pursue that mission in perpetuity by providing a special share to an individual or entity (e.g., a foundation) that confers veto power over decisions that would jeopardize the company's mission, such as a sale.
  Examples: Tony's Chocolonely, Sharetribe
- **Low-Profit Limited Liability Company (L3C)**: A US state-level corporate form established in the late 2000s in order to meet IRS stipulations for program-related investments (PRI) by foundations, which are legally mandated to prioritize charitable mission and social impact over profits.
  Example: Verde
- **Producer, Consumer, Shared Services, or Multi-Stakeholder Cooperative**: An enterprise owned and democratically controlled by its members on a one member, one vote basis. Members may be individuals (e.g., a consumer cooperative), or entities (e.g., farms, businesses, or nonprofits).
  Examples: Organic Valley, Blackstar Coop
- **Perpetual Purpose Trust (PPT)**: A trust that owns a majority of the voting shares in a company to benefit a specified mission. In a PPT, governance of corporate activities is entirely flexible, but stewards of the trust ensure that all corporate activity is achieving the stated purpose in perpetuity.
  Examples: Patagonia, Organically Grown Company, Zingerman's
- **Worker Cooperative:** A type of cooperative enterprise where the membership consists of the workers of the company who own and govern the enterprise on a one worker, one vote principle.
  Examples: Cooperative Home Care Associates, Drivers Cooperative, Equal Exchange

6 EOTs use the same structure as a PPT in the United States. When referring to PPTs, we refer to the non-EOT usage of the structure, unless otherwise specified. There is a distinct form in the UK.

The variety of models, and the flexibility in how to tailor some of them, allows any business owner, stakeholder, or investor to find one that best matches their needs, from building wealth to protecting a company's purpose.

For the purposes of this report, we focus on enterprise *models* that feature structural change(s) to the ownership of the enterprise. Such models typically are stronger in shifting economic and governance rights than what we call enterprise *features*, add-ons that may not shift the underlying structure of the enterprise yet nonetheless provide increased wealth or power to other stakeholders. This report focuses on the use of AOE models in the context of a pro-social mission, even though some models featured in the report can be used for purposes that do not relate to a mission.

In Annex 3, we define models not featured in this report because they are not widespread, including State-Owned Enterprises, Louis Kelso's other proposed Stock Ownership Plans, and Decentralized Autonomous Organizations. We also discuss a variety of enterprise features, such as co-determination, which provides formal worker input in the governance of companies, and stock options, which are a mechanism for sharing wealth with employees.

The Impact of Alternative Ownership Enterprises

The Impact of Alternative Ownership Enterprises

Alternative Ownership Enterprises move investors from the driver's seat to a co-pilot position, so that a broader set of stakeholders can also influence and financially benefit from the companies that affect their lives. This allows enterprises to share wealth more equitably, in particular with workers, to help shift political power, to create a more resilient economy, and to strengthen other impact goals.

SHARING WEALTH MORE EQUITABLY, IN PARTICULAR WITH WORKERS

Inequality has been steadily growing in the United States; by 2016, upper income households held close to 80% of the country's wealth.[7] The pay of CEOs has grown by 940 percent since 1978 while typical worker wages have only grown by 12 percent.[8] Employee-centric AOE models can reduce this wealth gap, as demonstrated in a meta study on the impact of Worker Cooperatives and ESOPs compiled by Project Equity.[9] Various studies show that ESOP participants have access to 2 to 12 times more retirement savings than their peers in companies without an ESOP. A 2017 study found that employee owners have higher levels of income, wealth, and benefits than non-employee owners.[10] One study found that ESOP accounts of low- and moderate-income workers had a median value of $165,000, close to 10 times the typical savings of American households of $17,000.[11] Worker Cooperatives also

7 "Trends in Income and Wealth Inequality," Pew Research Center, January 6, 2020.

8 Lawrence Mishel and Julia Wolfe, "CEO compensation has grown 940% since 1978," Economic Policy Institute, August 14, 2019.

9 Hilary Abell, "The Case for Employee Ownership," Project Equity, May 2020.

10 Nancy Wiefek, "Employee Ownership & Economic Well-Being," National Center for Employee Ownership, 2017.

11 "Study: Employee Ownership Narrows Gender and Racial Wealth Gaps," Rutgers School of Management and Labor Relations, April 30, 2019.

benefit workers financially. They receive a median wage boost of $2/hour and a median annual patronage payout of $2,300.[12]

The wealth sharing mechanisms of Alternative Ownership Enterprises can help address gender and racial wealth gaps as well. ESOPs were found to reduce this wealth gap, though they did not eliminate it.[13] Worker Cooperatives specifically are often structured to provide employment opportunities to populations that may be excluded, such as formerly incarcerated people or others who experience barriers to employment. Formerly incarcerated ESOP employees earn approximately 25 percent more in annual income and work roughly 8.8 percent more hours per week than formerly incarcerated workers who are employed by a non-ESOP firm.[14] Overall, given their wealth-building potential, AOEs can be used to mitigate the wealth gap when they are focused on firms and industries with high representation of marginalized people.

Most of the data evaluating the impact of AOEs has focused on two main models of employee ownership—Worker Cooperatives and ESOPs—because most of the other models and variations are new and still gathering a base of experience. There is evidence that other AOE models can increase pay and wealth for workers and other stakeholders. A report by Oxfam shows that farmer cooperatives, where an entity is owned by small farmers, are better at distributing wealth across supply chains.[15] Studies have shown that Foundation Ownership, a Steward Ownership model popular in Northern Europe, results in many positive effects for workers.[16]

Some companies include non-worker stakeholders, like suppliers and community members, in the economic upside of the company, which we expect to have similar wealth-building effects. Importantly, all strong AOE models limit the unchecked right for outside shareholders to speculate on companies as assets to buy and sell, meaning that overall an AOE-based economy works to reduce the dynamics that result in wealth concentration.

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12 Laura Hanson Schlachter and Olga Prushinskaya, "How Economic Democracy Impacts Workers, Firms, and Communities," Democracy at Work Institute, 2021.

13 "Study: Employee Ownership Narrows Gender and Racial Wealth Gaps," Rutgers School of Management and Labor Relations, April 30, 2019.

14 Robynn Cox,"The Role of Broad-Based Employee Ownership Opportunities in Prisoner Reentry." AEA Papers and Proceedings, 2020.

15 Steve Jennings, Erinch Sahan, and Alex Maitland, "Fair Value: Case studies of business structures for a more equitable distribution of value in food supply chains," Oxfam Discussion Papers, April 2018.

16 "Effects of steward-ownership as a corporate ownership structure: evidence from Denmark," Purpose White Paper, 2022.

HELPING TO SHIFT POLITICAL POWER

While the issue is not yet sufficiently studied, there is evidence that Employee Ownership can increase civic engagement. Worker Cooperative owners had more than 50 percent higher rates of volunteerism, and ESOP participants showed a higher rate of voting turnout.[17] At a more macro level, we can expect pro-democracy impacts from AOEs based on the fact that traditional corporations often leverage political power in anti-democratic ways, such as by lobbying for policies that boost their profits. The economic gains that Alternative Ownership Enterprises are able to divert to non-investors and non-traditional owners may help counter this cycle.

Importantly, workplaces can be a setting for building political power. This is obvious to labor organizers and to many Solidarity Economy organizers developing Worker Cooperatives, but mission-oriented investors are not always thinking about this as an impact thesis. By educating workers and other stakeholders about the broader movements AOEs sit within—and forging intentional connections between other AOEs, networks, and grassroots organizations—the movements they are a part of will be better able to advocate for themselves in social and political spheres. We see examples of successful power building in places like New York City, where networks of cooperatives and partner organizations successfully established a program at the city level that has distributed millions of dollars towards Worker Cooperatives annually for the past eight years.[18] This kind of power doesn't just result from changing the legal structure of an enterprise, it is built by the intentional work by AOE developers and technical assistance providers.

CREATING A MORE RESILIENT ECONOMY

An economy based on Alternative Ownership Enterprises would be more resilient and sustainable, as the primary goal of businesses shift from investor returns to a fair distribution of value and the creation of sustainable, impactful jobs.

Alternative Ownership Enterprises perform better. In one study, ESOP company sales, employment, and productivity grew more than 2 percent faster per year than would have been expected before the ESOP was introduced. In addition, ESOPs experience layoffs six times less often and three times lower turnover rates relative to traditional firms.[19] Another study found that Worker Cooperatives reported over 8% higher profit margins, on average across industries, than private firms.[20]

17 Hilary Abell, "The Case for Employee Ownership," Project Equity, May 2020.

18 "Working Together: A report on the eighth year of the Worker Cooperative Business Development Initiative (WCBDI)," New York City, 2022.

19 "A Guide to ESOPs," Fifth Third Bank, accessed October 11, 2023.

20 Hilary Abell, "The Case for Employee Ownership," Project Equity, May 2020.

AOEs foster resiliency. During the height of the COVID-19 pandemic, majority ESOP firms retained staff and maintained their pay at significantly higher rates than other companies. Those companies were also more likely to implement work from home and provide personal protection equipment, contributing to reduced health risks for workers and society as a whole.[21] Similarly, Worker Cooperatives may have experienced a smaller drop in revenues and were more likely to preserve jobs during the pandemic.[22] On an individual level, one study found that formerly incarcerated individuals with ESOP employment are significantly less likely to be arrested, convicted, and incarcerated.[23]

In addition, a few Alternative Ownership Enterprise models have asset locks that prevent a sale of the company for financial benefit. In an economy where consolidation for pure financial gain is the norm, these asset locks can prevent corporate consolidation that has often led to anti-competitive results and the degradation of working conditions for employees. Such an outcome could also curb monopoly power, as it becomes more difficult for companies to purchase competitors, and create more freedom for small- and medium-sized enterprises to serve their communities.

STRENGTHENING OTHER IMPACT GOALS

AOEs are more effective than traditional companies at meeting impact goals. Many impact-focused businesses still follow business models and investment strategies that promote rapid growth and possible sale or public offering, which can conflict with their core mission and lead to mission drift. Embedding mission into the structure of the company, such as through Steward Ownership models that fundamentally repurpose profits for impact, protects against such conflicts.

Research has shown that even outside of the context of Steward Ownership, distributing ownership to non-investor stakeholders can help prevent mission drift.[24] This is presumably because these stakeholders are closer to the problems that the company seeks to solve and have more of a stake in that mission's success. Non-Steward Ownership AOE models can similarly restrict the ability for a sale or limit the upside for outside equity investors, such as the CIC in the UK or Worker Cooperatives that mandate that all sale proceeds must go to a third party charity. Such measures disincentivize the profit-maximizing behavior seen in the traditional venture capital-style start-up ecosystem.

21 "Employee-Owned Firms in the COVID-19 Pandemic," Employee Ownership Foundation, 2020.

22 "2021 Worker Cooperative State of the Sector Report," US Federation of Worker Cooperatives, 2022.

23 Robynn Cox,"The Role of Broad-Based Employee Ownership Opportunities in Prisoner Reentry." AEA Papers and Proceedings, 2020.

24 Jason S. Spicer and Christa R. Lee-Chuvala, "Alternative Enterprises, Mission Drift, and Ownership: The Case of Values-Based Banking," Research in the Sociology of Organizations, 2021.

It's Time to Support Alternative Ownership Enterprises

It's Time to Support Alternative Ownership Enterprises

The Alternative Ownership Enterprise space is at a critical juncture in its evolution. The seeds planted over decades are now maturing, demonstrating the viability of these models and inspiring investors, funders, and entrepreneurs to find ways to grow the field. It is also attracting interest from newcomers to the space.

A "SILVER TSUNAMI" OF OPPORTUNITY

A major focus of Alternative Ownership Enterprise practitioners is the massive need to identify succession plans for the millions of businesses owned by baby boomers reaching retirement age. This phenomenon has been dubbed the "Silver Tsunami" and represents a massive shift in wealth estimated to be over $10 trillion in assets.[25] It is estimated that 2.34 million businesses are owned by baby boomers, which represents 24.7 million employees.[26] And as of 2020, 83 percent of businesses do not have a succession plan or view it as a difficult topic to approach.[27]

The most common options for these owners are shutting down or selling to another business or a private equity firm. Instead, converting these businesses to AOEs creates a twofold impact: avoiding the harm to workers and communities of a sale to extractive investors and creating new, long-lasting stakeholder ownership. The "Silver Tsunami" creates a once-in-a-generation opportunity to support business conversions.

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25 "The Lending Opportunity of a Generation: FAQs and Case Studies for Investing in Businesses Converting to Worker Ownership," Cooperative Fund of New England, Project Equity, and Democracy at Work Institute, 2016.

26 Steve Dubb, "Retiring Boomer Business Owners Turn to Worker Co-ops to Preserve Legacy," Nonprofit Quarterly, February 5, 2020.

27 "Economic Recovery and Employee Ownership," National League of Cities, 2021.

NEW, POWERFUL ENTRANTS

Since the COVID-19 pandemic, AOEs have captured interest and attention from a surprising range of major actors. Patagonia's Yvon Chouinard forfeited his billionaire status by donating his shares to a Perpetual Purpose Trust and a sister nonprofit, which has catapulted conversations around alternatives to family successions, initial public offerings, and sales to an outsider. As of this writing, Michael Bloomberg is exploring a similar option for his company.

Large, mainstream financial institutions are also interested in the demonstrated benefits of Employee Ownership models, in particular with private equity firms dipping their toes into sharing ownership with employees. The new Ownership Works initiative, piloted by private equity giant KKR, is creating programs within dozens of private equity firms to share a small portion of equity with workers and generate meaningful wealth for them when the company is sold.[28]

NEWFOUND BIPARTISAN SUPPORT

Alternative Ownership Enterprise, particularly Employee Ownership, is seeing momentum in the political sphere as well. In Congress, Democrats and Republicans have come together in a rare showing of bipartisan support for legislation around Employee Ownership. Congresspeople on both sides of the aisle are backing the Employee Equity Investment Act, which seeks to leverage the Small Business Administration's (SBA) existing Small Business Investment Company (SBIC) program to provide loan guarantees for funds that convert businesses to ESOPs or Worker Cooperatives.[29] The narrative propelling this success is not one that challenges shareholder primacy explicitly, but rather one that highlights Employee Ownership as a means of achieving widespread business ownership, demonstrating the ability for AOEs to satisfy a wide breadth of impact goals.

> **"AOEs may not be the flashiest form of impact, but they represent the greatest potential for a massive and much-needed shift in the economy.**

28 "Deal spotlight: Employee ownership as a competitive advantage," Impact Alpha, August 18, 2023. The Ownership Works initiative has been met with both praise and apprehension from the Employee Ownership community. For a discussion on different perspectives, see: Marjorie Kelly and Karen Kahn, "Is Private Equity about to Co-opt Employee Ownership?" *Fifty by Fifty*, May 18, 2022.

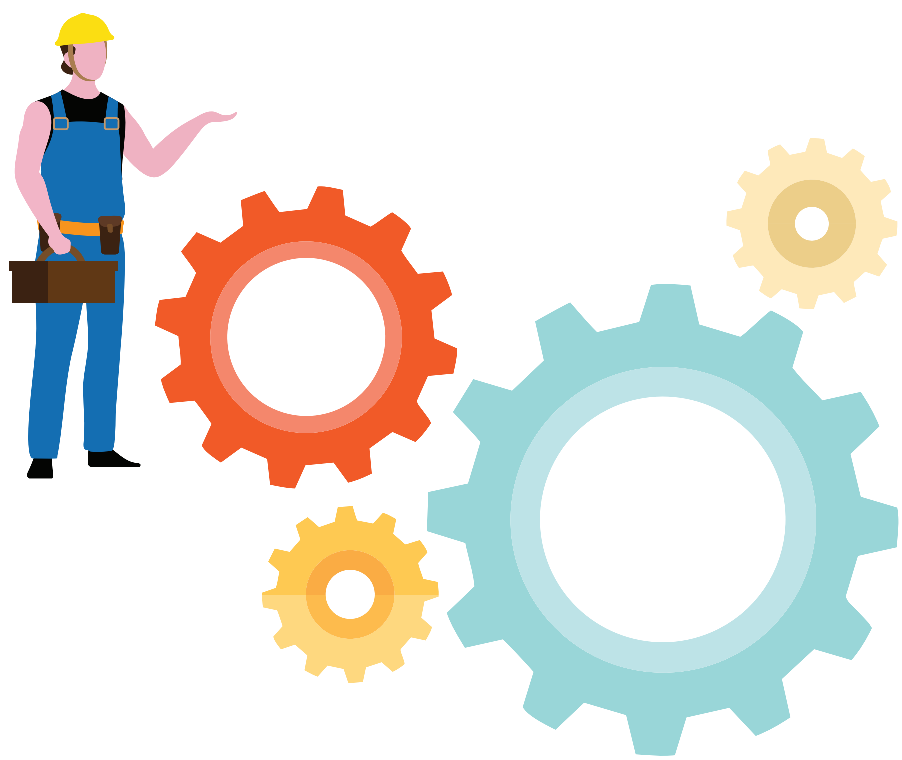
29 Corey Rosen, "Employee Equity Investment Act Introduced in Both Houses with Bipartisan Support," NCEO Employee Ownership Blog, May 17, 2023; "EMPLOYEE EQUITY INVESTMENT ACT (EEIA) Fact Sheet," Senators Chris Van Hollen and Marco Rubio, accessed October 15, 2023.

THE CRITICAL ROLE OF MISSION-ORIENTED INVESTORS

We stand at a point of inflection for the field, with a major opportunity to convert businesses from retiring baby boomers and newfound interest in ownership from conventional finance and policymakers. While this period holds promise, traditional private equity and other mainstream investors might possess an advantage compared to mission-oriented investors who are focused on creating lasting positive change. These conventional, profit-driven entities often have stronger incentives to adopt half measures. For example, they might introduce limited employee ownership without granting genuine governance rights. Moreover, these influential investors could potentially advocate for policy alterations tailored to their interests, sidelining the more potent, transformative models.

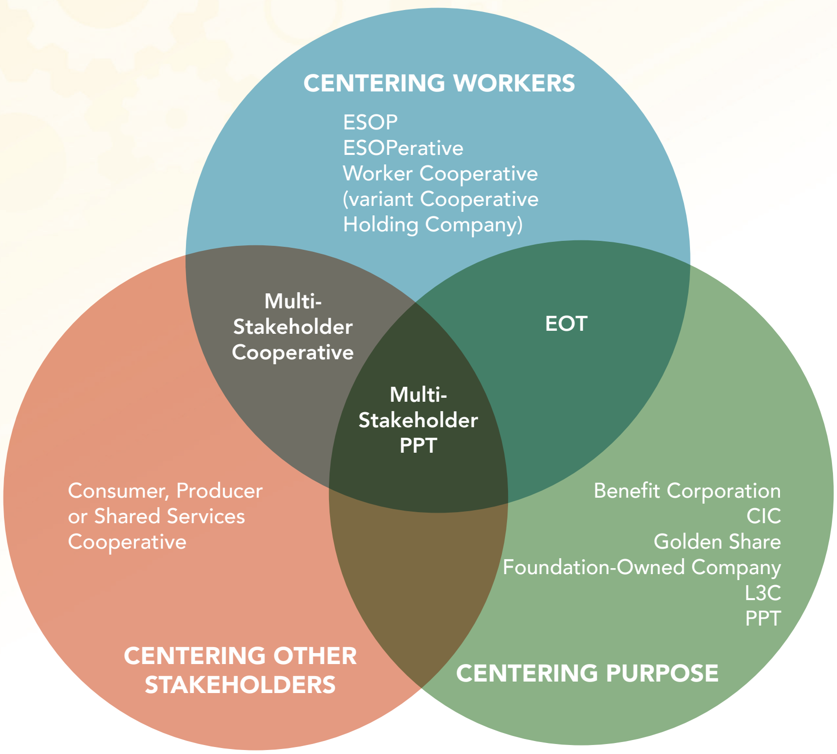
Mission-oriented investors are crucial in delivering on the transformative potential of AOEs. Direct investments in companies creates a pipeline of future success stories. Capitalizing new funds will demonstrate the viability of new investment hypotheses and highlight the skill of emerging fund managers. Providing blended, or even concessionary, capital will help improve the economics for investors who are tied to market-rate returns. Overall, mission-oriented investors can help lower the perceived risk of the space and help attract a much broader pool of capital to AOEs.

AOEs may not be the flashiest form of impact, but they represent the greatest potential for a massive and much-needed shift in the economy. Now is the time for mission-oriented investors to be bold and use their capital and influence to help shape the trajectory of the coming decades in a positive way.



The Alternative Ownership Enterprise Models

The Alternative Ownership Enterprise Models



We have identified over 10 core models of Alternative Ownership Enterprises, as well as several variants. While their goals can vary tremendously, a helpful way to categorize each model is by looking at the beneficiaries they center.

1) **Purpose:** In Alternative Ownership Enterprises, the beneficiary can be a cause or other other non-financial mission.
2) **Workers:** People employed at the enterprise. These models are often categorized as Employee Ownership models.
3) **Other stakeholders:** Suppliers, customers, community members, or other people and organizations who don't directly work at the enterprise, but do have a direct relationship with the enterprise or are directly impacted by its decisions.

Some Alternative Ownership Enterprise models primarily center one type of stakeholder while others fall under more than one of these categories.

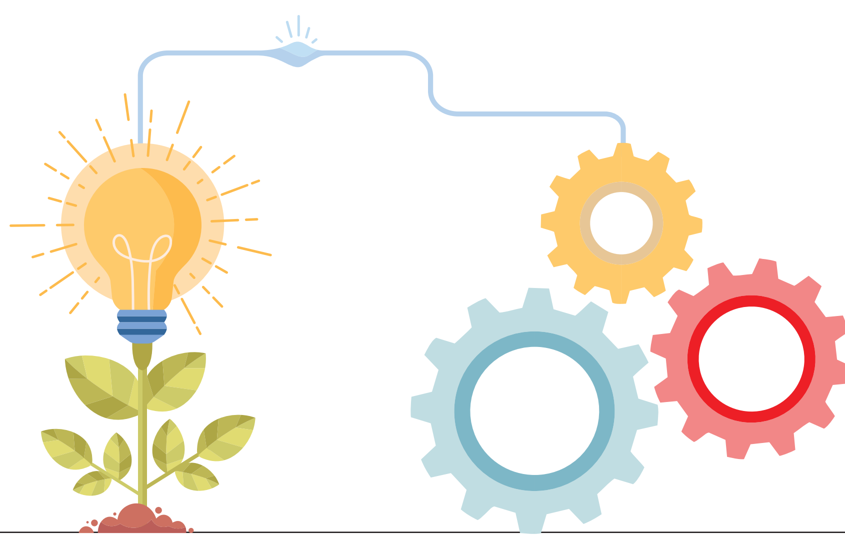
The section below provides an introduction to the key features of each of the Alternative Ownership Enterprise models. It also outlines how the models can evolve over time. **For in-depth information about each model, please see the full briefs in Annex 4.**

MODELS CENTERING PURPOSE

Several AOE models are designed not for the benefit of a specific stakeholder group, but to allow the company to achieve a specific mission. These include models called Steward Ownership, which legally enshrines two principles: self-determination, which means the company is not to be bought or sold and is controlled by stewards of the purpose, and purpose-orientation, which means that "profits are means to a purpose, not a goal in itself."[30]

The purpose-centric models presented below include Steward Ownership and related models that grant a company's purpose more importance than in typical corporations. These models include (in alphabetical order):

- Benefit Corporation
- Community Interest Company (CIC)
- Foundation-Owned Company
- Golden Share
- Low-Profit Limited Liability Company (L3C)
- Perpetual Purpose Trust (PPT)



30 "Steward-ownership," Purpose, accessed August 8, 2023.

BENEFIT CORPORATION

Definition	A Benefit Corporation, or Public Benefit Corporation (PBC), is a distinct form of incorporation that allows directors and managers to pursue a public benefit in addition to shareholder value. Benefit Corporations were devised to overcome the legal requirement for the directors and managers of a corporation to solely maximize shareholder value. Benefit Corporations are different from "Certified B Corporations" (B Corp). B Corp status is not a form of incorporation; it is granted via a certification process by the nonprofit B Lab and available to businesses of any legal form that meet certain social and environmental standards.[31]
Example	The insurance company Lemonade, with 2022 revenues of over $250 million, was founded in 2015.[32] The company donates a portion of its unclaimed premiums to charities chosen by its customers every year, and has donated over $8 million since launching.[33] It became a Benefit Corporation in December 2016 and went public in July 2020, becoming one of the few publicly traded Benefit Corporations in the US at the time.
Size of Sector	Benefit Corporations exist in ~40 US states and in Argentina, Australia, Canada, Chile, Colombia, and Italy.[34] Thousands of companies are currently believed to use the Benefit Corporation model in the United States.[35]
Financing	Benefit Corporations can use the full range of debt and equity instruments as traditional stock corporations. They have received investment from a wide number of traditional private equity and venture capital (VC) funds.[36] Convertible debt and preferred stock classes are being promoted by lawyers as more mission-aligned and desirable financing tools for Benefit Corporations.[37]

31 "Benefit Corporations," B Lab, accessed August 8, 2023.

32 "Lemonade," Yahoo Finance, accessed October 11, 2023; Daniel Schreiber, "How Lemonade Became a Precocious 5-Year-Old," Lemonade, accessed October 11, 2023.

33 "The Lemonade Giveback," Lemonade, accessed October 11, 2023.

34 Michael McGinley, "Benefit Corporations & Employee Ownership," Prairie Capital Advisors, August 1, 2022; Mara Del Baldo, "Acting as a benefit corporation and a B Corp to responsibly pursue private and public benefits. The case of Paradisi Srl (Italy)," International Journal of Corporate Social Responsibility, 2019.

35 Amy L. Simmerman, Ryan J. Greecher, and Brian Currie, Wilson Sonsini Goodrich & Rosati, "Converting to a Delaware Public Benefit Corporation: Lessons from Experience," Harvard Law School Forum on Corporate Governance, February 18, 2022.

36 "Just Good Business: An Investor's Guide to B Corps," The Yale Center for Business and the Environment, Patagonia, Inc., and Caprock, 2018.

37 Dana Brakman Reiser and Steven Dean, "Financing the Benefit Corporation," Seattle University Law Review, 2017.

Economic Rights and Ownership Structure	The most widespread form of the Benefit Corporation has the same range of ownership share class options as traditional for-profit stock corporations, with comparable ownership rights for shareholders.[38] Some states, such as Connecticut, offer a legacy preservation provision (LPP) following a waiting period of two years and unanimous vote by all shareholders. The LPP allows the Benefit Corporation to lock in a social mission as a fundamental facet of its legal operating structure. The status is irrevocable regardless of future changes in ownership or management.[39]
Governance rights	Shareholders have traditional corporate mechanisms to protect their interests (e.g., voting on major decisions or suing for breach of duty) and can hold officers and directors accountable for decisions. Directors do not have an explicit fiduciary responsibility to maximize profit, nor can shareholders seek legal action to achieve that end. The board is granted broader discretion to consider non-shareholders stakeholders in decisions.

Economic and Governance Rights in a Benefit Corporation

38 "Which Legal Structure Is Right For My Social Enterprise? A Guide To Establishing A Social Enterprise In The United States," Thomson Reuters Foundation and Morrison & Foerster LLP, September 2019.

39 Marcel J. Bernier et al., "Benefit Corporations Have Arrived in Connecticut," Murtha Cullina Attorneys via Archive.org, May 2014.

COMMUNITY INTEREST COMPANY (CIC)

Definition	A Community Interest Company (CIC) is a corporate form specific to the UK that ensures an enterprise pursues its mission in perpetuity by mandating a stated community purpose, enshrining protection against a sale, and limiting the financial returns to owners and lenders.
Example	City to Sea is an environmental organization working to stop plastic pollution, founded in 2015 by environmental campaigner Natalie Fee. It includes a charity as well as a Community Interest Company. The CIC earned over £1 million in 2020. City to Sea runs many campaigns to reduce the single-use plastic including Plastic-Free Periods and World Refill Day on June 16th.[40]
Size of sector	As of March 2022, over 26,000 CICs existed in the UK. The number of CICs has grown by over 9 percent each year since 2015, with a peak of 26% growth between 2020 and 2021, perhaps due to the COVID-19 pandemic that spurred people to help their community.[41] CICs are set up with limited liability by either guarantee or shares. The limited by guarantee form is typically used by "not for profits" and is the most common (approximately three-fourths).[42]
Financing	A CIC limited by shares can deploy the same debt and equity instruments as most limited companies, but with purpose-related limits on interest rates and profit distributions.[43] A CIC limited by guarantee, rather than shares, can only issue debt or equity-like debt instruments, as long as this does not circumvent the asset lock and the limits on financial returns.
Economic rights and ownership structure	CICs limited by guarantee typically fully reinvest any potential surplus in the business or in the community to further their social objective. If limited by shares, the company is set up such that the proportional value of shares owned by each shareholder dictates their percentage of control and ownership; the owners are thus traditional investor shareholders.[44] Returns to shareholders and debtholders are capped. Ownership is preserved via a mandatory asset lock, which prevents asset payouts to private individuals or their transfer at less than market value. If a CIC is dissolved, the locked assets can only be transferred to a nominated asset-locked body (e.g., another CIC or charity).
Governance rights	The ultimate control and responsibility for major policy and decision-making lies with shareholders, if limited by shares, or subscribing guarantors or others admitted to membership, if limited by guarantee. Members/shareholders typically appoint directors, delegate powers to the directors, declare dividends, approve major transactions, and change the constitution of the company.

40 "Connecting Our Actions to Our Oceans" and "About City to Sea," City to Sea, accessed October 11, 2023.

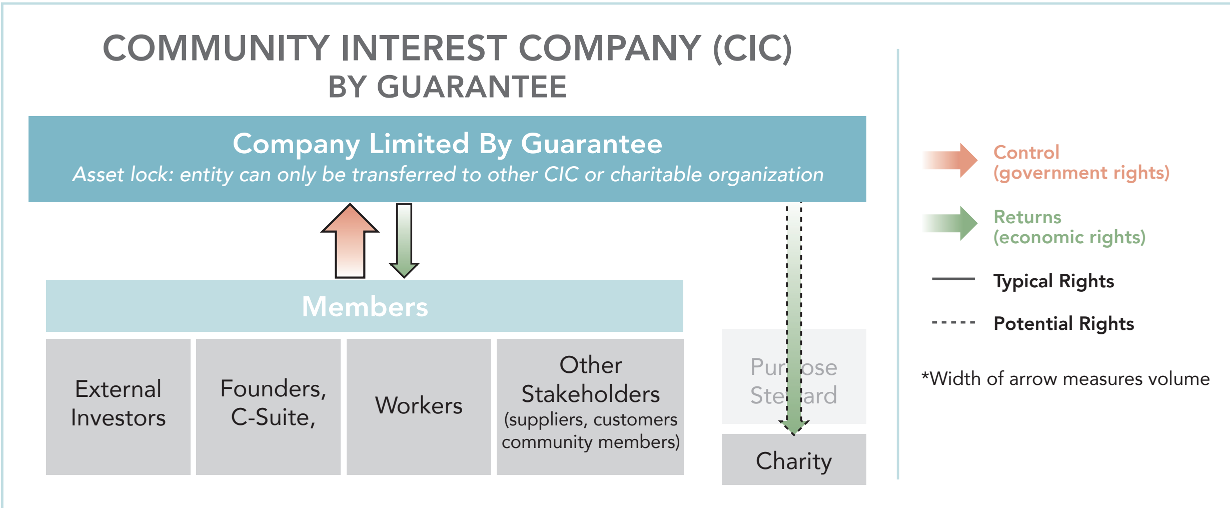
41 Department for Business Energy and Industrial Strategy, Office of the Regulator of Community Interest Companies, "Community Interest Companies Annual Report 2021/22," 2022; Anna Patton, "Record number of community interest companies amid rise of grant funds," Pioneers Post, August 25, 2021.

42 Department for Business Energy and Industrial Strategy, Office of the Regulator of Community Interest Companies, Information and Guidance Notes, "Frequently asked questions for funding organisations," May 2016.

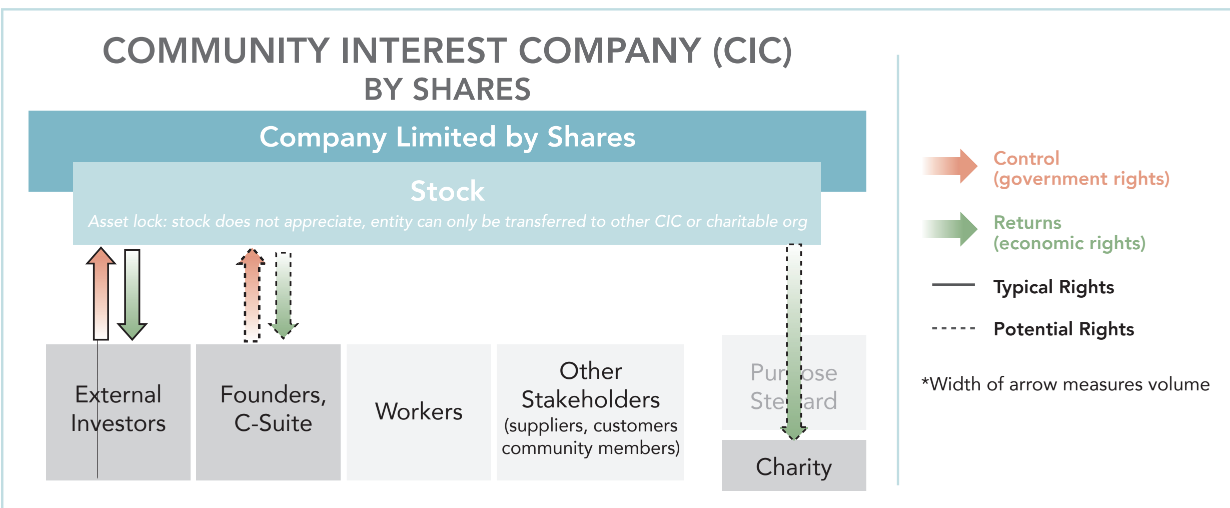
43 Department for Business Energy and Industrial Strategy, Office of the Regulator of Community Interest Companies, Information and Guidance Notes, "Chapter 7: Financing Community Interest Companies," May 2016.

44 Department for Business Energy and Industrial Strategy, Office of the Regulator of Community Interest Companies, Information and Guidance Notes, "Chapter 3: Limited Companies," May 2016.

Economic and Governance Rights in a CIC, Limited by Guarantee



Economic and Governance Rights in a CIC, Limited by Shares



FOUNDATION-OWNED COMPANY

Definition	A Foundation-Owned Company is a business owned by a foundation, partly or entirely, typically after a transfer of ownership by the company's founder.[45] In the US, the foundation must own 100 percent of the stock, but in Europe, which has many more Foundation-Owned Companies, partial foundation ownership is possible.
Example	The food company Newman's Own, founded in 1982 by actor Paul Newman and author A. E. Hotchner, donates all of its after-tax profits to charity to support children, their families and their communities in the US and around the world.[46] At Newman's death in 2008, ownership of the company was bequeathed to the Newman's Own charitable foundation, which now oversees the donations. This bequest would previously have triggered a 200 percent excise tax on a private foundation's "excess business holdings" that limited foundation ownership in the US, but a new law passed in 2018 has allowed the foundation to retain full ownership of the company.[47]
Size of Sector	Foundation ownership represents a significant portion of economic activity in Northern Europe.[48] In Denmark, the roughly 1,300 Foundation-Owned Companies account for approximately 70% of total stock market capitalization. There are nearly 1,000 Foundation-Owned Companies in Germany, 1,000 in Sweden, and 120 in Switzerland. There are at least 3 examples in the US: Newman's Own, Impact Makers, and the Hershey Company.
Financing	In the US, where the foundation is now required to own 100 percent of the company's stock, the conversion to foundation ownership is funded through a gift by a company founder. In other countries, where partial foundation ownership is possible, the operating company can act like any other joint stock company and access equity markets, subject to limits on voting stock.
Economic Rights and Ownership Structure	A Foundation-Owned Company's shares are owned, partially or entirely, by a foundation. The shares generate rights to economic value created by the company, which the foundation puts to charitable purpose. In the US, as of new 2018 regulations, 100 percent of the shares must be owned by the foundation and 100 percent of profits must be donated, meaning that purpose technically has the claim to all economic rights. Some other countries mandate a specific percentage of profits to be donated to charity.

45 Steen Thomsen, "Corporate Ownership by Industrial Foundations," European Journal of Law and Economics, 1999.

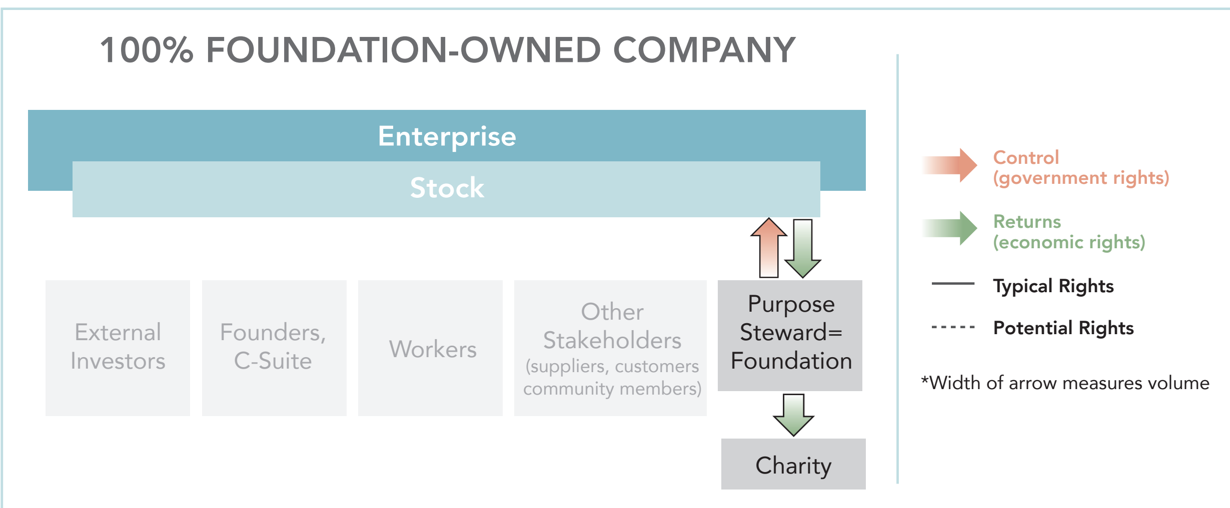
46 "About Us," Newman's Own, accessed October 12, 2023.

47 Diara M. Holmes, "Newman's Own Foundation Pushes Through Exception to Private Foundation Excess Business Holding Rules," Loeb & Loeb LLP, February 16, 2018.

48 Steen Thomsen, The Danish Industrial Foundations, 2017; Søren Bo Nielsen, "Industrial Foundations in the Tax System," Paper presented at 70th Annual Congress of the International Institute of Public Finance, 2014; Delphine Bottge, "The Foundation-Owned Company Model," Philanthropy Impact Magazine, 2021.

Governance Rights	In the US, since the 2018 changes in tax regulations, the foundation must own 100 percent of voting shares to receive full tax benefits. In addition, the governance of the foundation must be completely separate from the governance of the company in order to avoid US foundation tax penalties above a threshold of ownership.[49] In Europe, Foundation-Owned Companies can use an A/B share structure to separate economic and voting rights. In such cases, the foundation may have two separate boards: one to exercise control rights over the company and one to exercise the rights to distribute dividends as charitable activity, though this is not possible in all jurisdictions. Some companies create separate entities, such as a trust, holding company, or another foundation, to hold the voting shares and ensure commitment to its mission or charitable purpose. The board of directors or trustees that governs the foundation is responsible for ensuring the company operations align with the foundation's charter.

Economic and Governance Rights in a Foundation-Owned Company



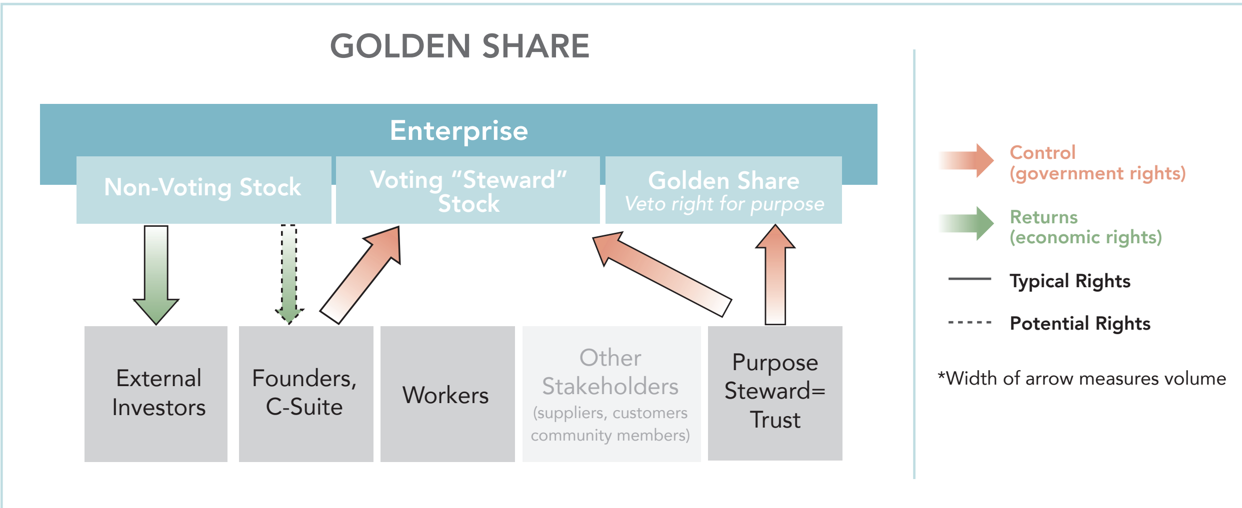
49 "Bipartisan Budget Act adopts two exempt organization provisions excluded from final Tax Cuts and Jobs Act legislation," Tax News Update, EY, February 16, 2018.

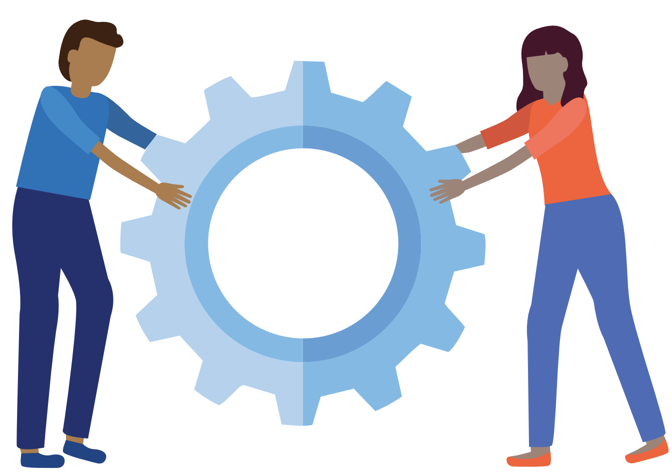
GOLDEN SHARE

Definition	A golden share enshrines a voting right on specific issues that cannot be countered by other voters. The Golden Share model ensures that a mission-driven enterprise can pursue that mission in perpetuity by providing a special share to an individual or entity (e.g.,s a foundation) that confers veto power over decisions that would jeopardize the company's mission, such as a sale. "Insiders" such as founders, key personnel, and other stakeholders make the bulk of the other corporate governance decisions, and outside investors are limited to non-voting equity shares.
Examples	Tony's Chocolonely is a Dutch chocolate company with over €100 million in revenues. It was founded in 2005 by a group of journalists who were investigating exploitation in the cocoa industry, after learning about the child labor occurring on cocoa plantations in West Africa. The company is committed to eliminating child and illegal labor in the chocolate industry. In June 2023, the company implemented a Golden Share structure. Tony's mission, the 5 Sourcing Principles, and the company's core values now cannot be amended without approval of the newly appointed "Mission Guardians," who are external experts in the field and hold the golden share.[50]
Size of Sector	There are at least 25-30 companies with a mission-oriented Golden Share model in Europe, mostly in Germany. At least two US companies use this variant of the Golden Share.
Financing	The Golden Share model can deploy a wide range of debt and equity instruments, subject to the fact that all voting equity is held by the stewards and the golden share designee. External equity investment typically occurs via the non-voting economic share classes. The model's veto power is meant to deter investment by financial return-maximizing and exit-oriented venture capital; it requires structured exits for external equity.
Economic Rights and Ownership Structure	There are no economic rights assigned to any particular stakeholder; the company may issue non-voting equity accessible to anyone. The other share classes—"steward shares" held by company insiders and the golden share held by a special designee—have no economic rights attached, thereby ensuring that no one with decision-making ability has the ability to accrue financial value from share ownership.
Governance Rights	The corporate direction is decided by "stewards," typically insiders (e.g., founders) who control the voting shares. Outside investors typically do not have governance rights. The golden shares, held by a special designee such as a foundation, are non-economic and relate to vetoing mission-jeopardizing corporate financial events.

50 "Net revenue of Tony's Chocolonely from 2011 to 2022," Statista, accessed October 12, 2023; Jane Alice Liu and Paul Schoenmakers, "Tony's Chocolonely: More Than Just Chocolate," Food Unfolded, February 12, 2021; "Tony's Chocolonely introduces 'Tony's Mission Lock' - a new legal mechanism to secure its mission indefinitely, regardless of shareholder structure," PR Newswire, May 31, 2023.

Economic and Governance Rights in a Golden Share Model





LOW-PROFIT LIMITED LIABILITY COMPANY (L3C)

Definition	L3C stands for Low-Profit Limited Liability Company, a US State-designated entity established in the late 2000s in order to meet IRS stipulations for program-related investments (PRI) by foundations, which are legally mandated to prioritize charitable mission and social impact over profits.[51] An L3C is structured akin to a Limited Liability Company (LLC), with some restrictions, and is not meant to maximize profits.
Example	The Paradigm Project, founded in 2008, develops, funds, and grows social ventures that reduce poverty and improve quality of life for low-income families in the developing world.[52] For example, they sell efficient stoves to reduce people's reliance on open fires for cooking, reducing deforestation and indoor air pollution. They are incorporated as an L3C and use donations, grant funding, social investment, and low-interest debt as sources of funding.[53] They also generate revenue by selling carbon offsets.
Size of Sector	Over 1700 L3Cs exist as of June 2020. Seven states, three tribes, and Puerto Rico have active L3C statutes, with Rhode Island as the most recent state to add an L3C statute in 2012.[54] Their development appears stalled due to regulatory and legal concerns, and L3Cs have largely been supplanted by Benefit Corporations.
Financing	While designed to receive funding from foundations through PRIs, L3Cs typically deploy a multi-tiered capital structure allowing for risk and returns to vary across members, which may include traditional profit-focused members receiving higher rates of return than foundations.[55]
Economic Rights and Ownership Structure	There is no mandated sharing of economic rights with any given stakeholder with the L3C model. L3Cs are based on a traditional LLC structure with individuals and/or business entities as members owning unit interests. As with LLCs, there is a high degree of flexibility in ownership structure and rules. An owner's liability is capped at their capital contribution.[56]

51 Nancy Artz, Jeffrey Gramlich, and Terry Porter, "Low-profit Limited Liability Companies (L3Cs)," *Journal of Public Affairs*, 2012.

52 "The Paradigm Project," The Paradigm Project, accessed October 12, 2023.

53 Stephanie Geller, "Low-profit limited liability companies," The Next System Project, March 16, 2020.

54 J. Haskell Murray, "The History and Hope of Social Enterprise Forms," *Tennessee Journal of Business Law*, 2021; Stephanie Geller, "Low-profit limited liability companies," The Next System Project, March 16, 2020.

55 Nancy Artz and John Sutherland, "Low-Profit Limited Liability Companies (L3Cs): Competitiveness Implications," Competition Forum, 2010; J. Haskell Murray and Edward I. Hwang, "Purpose with profit: governance, enforcement, capital-raising and capital-locking in low-profit limited liability companies," University of Miami Law Review, 2011; Sue Woodrow and Steve Davis, "The L3C: A New Business Model for Socially Responsible Investing," Federal Reserve Bank of St. Louis, January 1, 2010.

56 Sandra Feldman, "What Is an L3C (Low-Profit Limited Liability Company): An Entity for Entrepreneurs Who Value Purpose and Profits," Wolters Kluwer, March 3, 2020; "L3C," Northwest Registered Agent, accessed July 28, 2023.

Governance Rights	Governance rules are purposely flexible. There is no explicit democratic governance mandate, but L3Cs can implement democratic bylaws via articles of organization or an operating agreement. Foundations may retain decision-making authority to ensure compliance as a PRI.

Economic and Governance Rights in a L3C

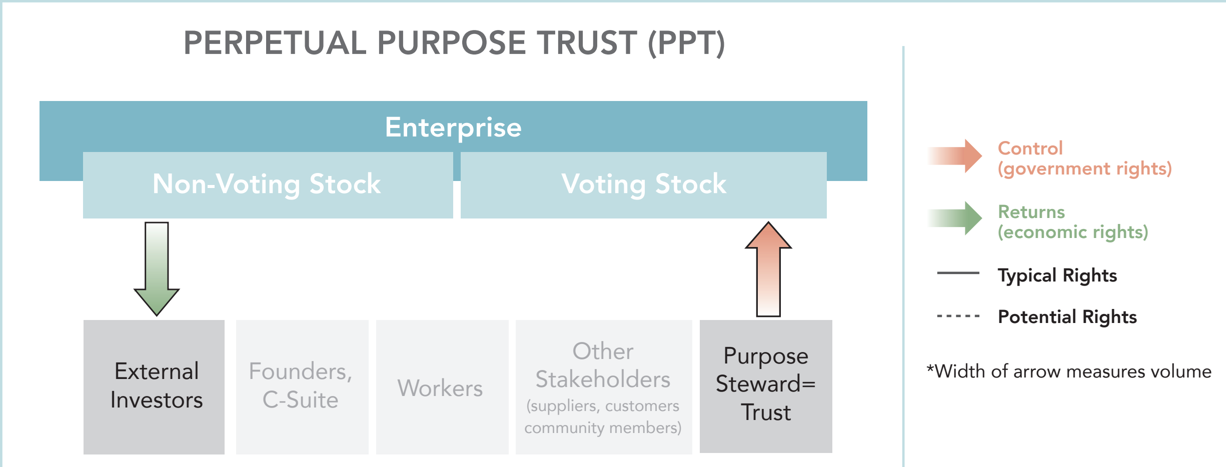
PERPETUAL PURPOSE TRUST (PPT)

Definition	A Perpetual Purpose Trust (PPT) is a form of Steward Ownership. A trust owns a majority of the voting shares in a company to benefit a specified mission. Governance of corporate activities is entirely flexible, but stewards of the trust ensure that all corporate activity is achieving the stated purpose in perpetuity.
Example	Zingerman started as a traditional Jewish deli in Ann Arbor, MI in 1982. It has grown to a network of ten different businesses in addition to the deli, with roughly $60 million in annual sales.[57] In 2023, the company established a Perpetual Purpose Trust that will own and control Zingerman's brand, preventing it from being sold to another business—although the ownership of the businesses in its network won't change as part of this deal. Over time, the profit from the brand will be shared with community share owners (e.g., staff who own a share of the intellectual property).[58]
Size of Sector	There are over 40 Perpetual Purpose Trusts used in an enterprise ownership context in the US. This includes Employee Ownership Trusts, am employee-centered PPT that is often considered alongside Employee Ownership models
Financing	The trust controls a majority, typically all, of the voting stock. In the typical case where the trust owns all of the voting stock, investors can make equity-like investment, such as non-voting redeemable equity or equity-like debt, such as revenue or royalty share loans. PPT conversions—which account for most US instances to date—rely on a mix of donated shares, seller financing, and mission-driven debt, equity, and equity-like instruments to finance the sale.
Economic Rights and Ownership Structure	A PPT's trust documents can include sharing economic rights with a specific group or groups of individuals as a means of achieving the company's purpose (see the Multi-Stakeholder PPT variation below), but there is no requirement to do so. Economic rights may be shared through non-voting equity shares or profit sharing mechanisms. The trust structure decouples control (which sits with the trust) from the financial returns on the equity (which sit with the operating company).
Governance Rights	PPT governance is flexible and can be used for varying levels of control by stakeholder groups as described in the trust documents. The PPT holds enough voting stock to secure the company's long-term mission and to prevent a sale of the company or its assets. The trust stewardship committee and trust enforcer exist to ensure that corporate activity is following the stated purpose and to prevent major corporate changes that may affect the mission, such as a sale.

57 "About Us," Zingerman's, accessed October 12, 2023.

58 Ari Weinzweig, "Sharing the Next Big Step in Zingerman's History—A Perpetual Purpose Trust," Zingerman's, February 2, 2023.

Economic and Governance Rights in a PPT



Note: Non-voting stock is an optional mechanism, as many PPT deals are instead financed by a combination of debt and seller financing.

Note: The example depicted is a PPT with governance rights for no other stakeholders besides the purpose steward(s). Multi-stakeholder PPT is described below.

MODELS CENTERING WORKERS

Models that center workers are often referred to as Employee Ownership models. These models provide a significant degree of ownership and/or decision-making power to employees. Models that fall under the category, in alphabetical order, include:

- Employee Stock Ownership Plan (ESOP)
- ESOPerative (combination of the words ESOP and cooperative)
- Employee Ownership Trust (EOT)
- Worker Cooperative, and its variant the Worker Cooperative Holding Company

EMPLOYEE STOCK OWNERSHIP PLAN (ESOP)

Definition	An ESOP is an ownership model, rather than a distinct corporate form. It is structured as a retirement benefit plan that holds all or part of a company's stock on behalf of employees. Shares are vested to a broad base of employees individually over time, at no cost, and employees are cashed out upon leaving the firm.
Example	King Arthur Baking Company was founded in 1790. In 1996, the company's owners Frank and Brinna Sands decided to set up an ESOP to gradually transfer shares of the company to their employees, as part of a long-planned exit.[59] In 2004, the company became 100 percent employee owned. Employees are granted shares in the company after their first year of work, and that amount increases over time. The company also chose to become a Benefit Corporation in 2007.
Size of sector	More than 6,000 ESOPs are in place with $1.6 trillion held in total plan assets across 13.9 million participants.[60] ESOPs are rare outside of the United States, where they are the most widespread form of employee ownership.
Financing	ESOPs are always established and financed in a conversion process (i.e., are established in ongoing revenue-generating businesses). The ESOP trust typically purchases the company stock with money borrowed from a bank and/or selling shareholder(s) (i.e., leveraged ESOP). Conversion to an ESOP may also be self-financed by the company's cash and shares (i.e., non-leveraged ESOP).[61] There are highly efficient tax benefits for the leveraged ESOP model, making it an attractive way of financing a sale for both the company and a selling owner. The ESOP trust typically purchases the company stock with money borrowed from a bank and/or selling shareholder(s) (i.e., leveraged ESOP). Conversion to an ESOP may also be self-financed by the company's cash and shares (i.e., non-leveraged ESOP).[62] There are highly efficient tax benefits for the leveraged ESOP model, making it an attractive way of financing a sale for both the company and a selling owner. The underlying company owned by an ESOP can access traditional forms of corporate finance, though if the company is 100 percent owned by an ESOP it generally cannot access traditional equity investments (since all of the equity is owned by the ESOP).

59 Christian Kreznar,"How King Arthur Flour's Unusual Leadership Structure Is Key To Its Success," Forbes, January 30, 2019.

60 "Employee Ownership by the Numbers," National Center for Employee Ownership (NCEO), February 2023; "The Economic Power of ESOPs" and "Infographic: ESOPs by the Numbers," NCEO, accessed August 8, 2023.

61 Regina Carls, Leveraged ESOPs and Employee Buyouts, 2020; Adam Hayes, "Leveraged Employee Stock Ownership Plan (LESOP)," Investopedia, last updated January 4, 2023; Aaron Juckett, "How Does a Leveraged ESOP Work? Here's All You Need to Know," ESOP Partners, September 14, 2021.

62 Regina Carls, Leveraged ESOPs and Employee Buyouts, 2020; Adam Hayes, "Leveraged Employee Stock Ownership Plan (LESOP)," Investopedia, last updated January 4, 2023; Aaron Juckett, "How Does a Leveraged ESOP Work? Here's All You Need to Know," ESOP Partners, September 14, 2021.

Economic Rights And Ownership Structure	Employees are not direct owners of the shares. The ESOP itself is the legal shareholder.[63] Where not all shares are owned by the ESOP, outside investors can own shares of the company not held in the ESOP.[64] A "broad base" of employees must participate in an ESOP, but each employee's ownership stake can vary significantly based on tenure and pay. Employee ownership must include at least 70 percent of non-highly compensated employees who are over 21 and who have completed a year of employment.[65] When an employee leaves the company, their vested shares are typically sold by the employee back to the ESOP. In 2020, ESOPs paid out over $149 billion to participants.[66] While the main benefit for employees is on cash-out value at retirement, ongoing wealth can be generated through pass-through dividends, which can be distributed to employees on an on-going basis.[67]
Governance Rights	ESOPs have no requirement for democratic governance. Employees typically do not have direct voting rights on ordinary votes and have limited legal authority with ongoing firm governance, though the degree of employee governance can vary widely.[68] The voting rights (e.g., voting for the board of directors) of participating employees are generally exercised by an ESOP trustee, who operates similarly to conventional shareholders but is held to a high fiduciary standard by regulatory agencies. However, the employees have pass-through voting rights for major corporate events such as merger, liquidation, dissolution, or sale of substantially all the assets of the company.

Economic and Governance Rights in an ESOP-Owned Company

Note: The example depicted is a Partial ESOP; 100% ESOP-Owned Companies do not include rights for outside investors.

63 "What is an ESOP? How an Employee Stock Ownership Plan Works," ESOP Partners, accessed August 8, 2023.

64 Richard May et al., "Fiduciary Responsibilities Regarding External Investors in ESOP Companies," August 2019.

65 Aaron Juckett, "Your Ultimate Guide to ESOP Eligibility: Who's In & Who's Out?" ESOP Partners, May 17, 2022.

66 NCEO, "Employee Ownership by the Numbers," February 2023.

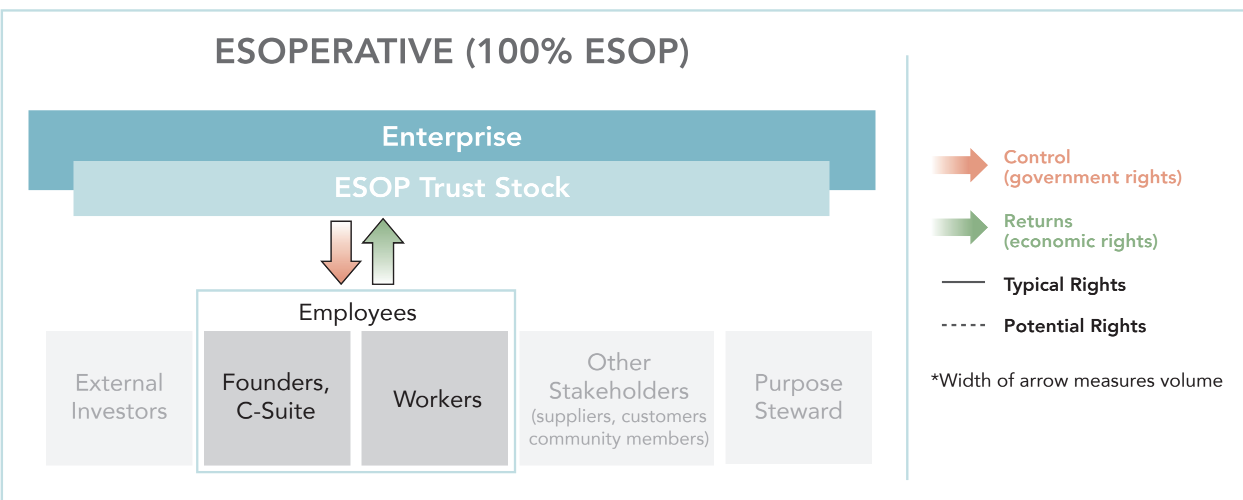
67 "A Detailed Overview of Employee Ownership Plan Alternatives," NCEO, May 14, 2021.

68 Deborah Groban Olson, "Distinguishing Employee Ownership, Workplace Democracy & Workplace Participation," ESOPlaw.com, accessed August 8, 2023; Aaron Juckett, "ESOP Corporate Governance," ESOP Partners, November 19, 2019.

ESOPERATIVE

Definition	ESOPeratives, also known as democratic ESOPs, are ESOP-owned companies that are run democratically, where each employee is part of the company's governance
Example	Once Again Nut Butter was founded in 1976 as a Worker Cooperative and became 100% ESOP-Owned in 2006. It has approximately 80 employee-owners and annual revenue of $50 million. The company is run as a cooperative with a participatory style of management where each person gets one vote on 75 different types of management decisions, including electing the board of directors. Employees receive an equal share of each year's profits in addition to the value of their vested shares when they leave the company.[69]
Size Of Sector	ESOPeratives are not well documented—and the exact number is unknown—but best estimates suggest that fewer than 100 ESOPeratives are operating today in the United States.
Financing	The financing considerations for ESOPs apply to ESOPeratives too. The ESOPerative model can be appealing because it benefits from the ESOP capital gains and distribution tax advantages and avoids the capital availability constraints of worker cooperatives.
Economic Rights And Ownership Structure	As with a typical ESOP, the trust is an indirect vehicle that holds the company's stock on behalf of the employees. Shares vest to employees over time and are cashed out upon exiting the company. While relative ownership in an ESOP is typically tied to wages and seniority, ESOPeratives tend to allocate ownership to employees in a way that limits disparities.
Governance Rights	ESOPeratives provide democratic "one person, one vote" governance, enshrined in the bylaws. Governance rights extend to choosing ESOP trustees, casting shareholder votes, and electing the board of directors.[70] Governance in ESOPeratives varies across companies; there are not standardized practices.

Economic and Governance Rights in an ESOPerative



Note: The example depicted is a 100% ESOP-Owned Company, operated as an ESOPerative.

69 "About Us" and "Employee Ownership," Once Again Nut Butter, accessed October 12, 2023; Deborah Groban Olson, "Case Study: Once Again Nut Butter Collective, Inc. (OANB)," ESOPlaw.com, accessed October 12, 2023.

70 Julie Lynn Kaufman, "Democratic ESOPs: Can Workers Control Their Future?" The Labor Lawyer, 1989; David Ellerman, The democratic worker-owned firm: A new model for the East and West, 1990.

EMPLOYEE OWNERSHIP TRUSTS (EOT)

Definition	EOTs provide indirect employee ownership through a legal trust that typically holds a majority of the voting shares of a company on behalf of employees. In the US, they are a specific form of Perpetual Purpose Trust (PPT) with employees as the main beneficiaries. The EOT typically includes a profit sharing mechanism, elements of worker governance, and a charter protecting the company from a potential sale.
Example	CodeWeavers, an open-source software development company, was founded in 1996 by Jeremy White. In 2023, the founder started to transition ownership of the company to an Employee Ownership Trust. The trust will become the company's sole shareholder after 7 years.[71] The trust locks in CodeWeavers' open source mission and values, while also giving the staff a financial stake in the company and a strong voice in the company's direction through the trust's stewardship committee.
Size Of Sector	The EOT model has been adopted by more than 20 US companies so far.[72] As of June 2021, there were 576 EOTs in the UK.[73]
Financing	Most EOTs are established as a conversion to employee ownership during a sale event. The selling owner establishes the trust, transfers their interest in the company to the trust, and receives a promissory note for a portion of the sale price. The remaining portion is provided by upfront debt from banks or alternative lenders, secured by the company's assets.[74] The promissory note is paid back through company profits. Because common stock is only held in the trust, 100 percent EOTs can only raise equity-like capital by offering preferred non-voting equity shares. This instrument requires a structured exit (e.g., revenue-based loans, redeemable shares, etc.) to provide liquidity to investors, and generally has a cap on returns. Because a large portion of profits is distributed to employees, the repayment period for investors is often longer term than comparable investments. In the UK, companies that are not 100 percent EOT-owned can offer common stock.
Economic Rights And Ownership Structure	US EOTs typically direct the company to retain some portion of profit for reinvestment to employees and to pay out the remaining profits to workers either as cash or as a contribution to a diversified 401(k) plan, or a combination of both. EOTs typically hold the majority (or all) of the equity of the underlying firm. There is no allocation of shares to individual employees.

71 "CodeWeavers Transitions to Employee Ownership Trust," CodeWeavers Press Release, May 17, 2023.

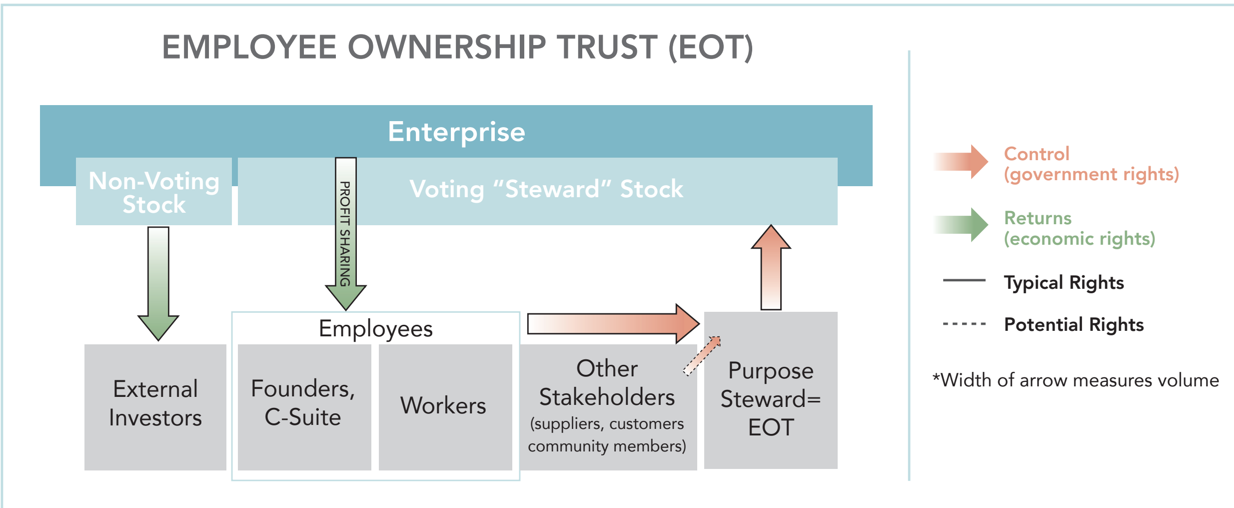
72 Anne-Claire Broughton et al., "Employee Ownership Trusts, Perpetual Purpose Trusts, and Stewardship Trusts in the United States," Harvard Dataverse, 2022.

73 "What The Evidence Tells Us," Employee Ownership Association, accessed August 8, 2023.

74 Chris Budd, "How using external debt can help turn an EOT wish into reality," Thincats, September 3, 2021; "Employee-ownership trusts: issues with lending to employee-owned companies," Birketts, November 2, 2021; "Where does the money for an EOT come from?" Postlethwaite Solicitors Limited, March 15, 2022.

Governance Rights	The governance rights for employees within EOTs is flexible. Employees may be given rights to direct the trustee—essentially the power to elect board members and make other high-level decisions—or may establish elements of democratic day-to-day management. Employees may have additional voice via company board and EOT trustee seats, but these are not required.

Economic and Governance Rights in an EOT



WORKER COOPERATIVE

Definition	A Worker Cooperative is a type of cooperative enterprise where the membership consists of the workers of the company. These members own and govern the enterprise on a one worker, one vote principle. Workers are often referred to as "worker-owners."
Example	Cooperative Home Care Associates (CHCA) is a worker-owned homecare agency that provides care for elderly and disabled clients. It was established by Rick Surpin in 1985. In 2018, it also became a certified Benefit Corporation. It's one of the largest Worker Cooperatives in the United States, employing 2200 homecare workers in the South Bronx and generating an annual income of over $40m.[75] Workers can become members by purchasing a share for $1000, and just under half of CHCA's workers are members. Members receive dividend payments in years when the co-op is profitable. CHCA's formation was partially funded by foundation grants to support business operations as well as a training program for workers. Given the size of the company, democratic control has been implemented through representative rather than direct channels. For example, worker representatives hold 8 of 13 seats on CHCA's board of directors, and all members are eligible to vote for these representatives. CHCA workers are also unionized which provides additional pathways for worker influence in decision-making.[76]
Size of Sector	Worker Cooperatives in the United States are few and tend to be small. A non-exhaustive 2021 census identifies roughly 600 US worker cooperatives employing 6,000 workers in total, with a median size of 6 workers and aggregate annual revenues of roughly $300 million.[77] Twelve percent of worker cooperatives began as conventional enterprises and converted, while 88 percent were worker co-ops as start-ups, which includes the 18 percent that were assisted by a cooperative developer during the start-up phase.[78]
Financing	Worker Cooperatives struggle to secure outside financing due to the lack of equity shares for anyone besides workers and difficulties in receiving debt from unfamiliar lenders (e.g., navigating a personal guarantee requirement for businesses with no single owner). Most start-up and growth capital is received via loans from mission-aligned debt providers (e.g., Community Development Financial Institutions, mission investors, community banks, credit unions, or cooperative incubator funds) or philanthropic capital. To raise equity or equity-like capital, Worker Cooperatives may issue preferred/Class B equity shares or offer various forms of revenue-based financing.

75 "Cooperative Home Care Associates (CHCA), New York City," International Labor Organization, last updated June 5, 2015.

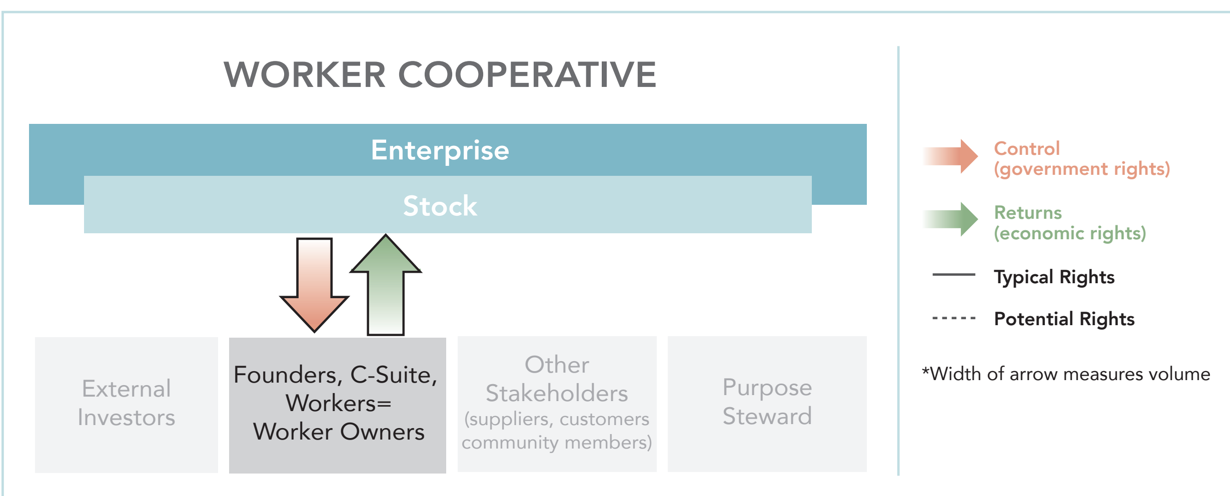
76 Sanjay Pinto, "Case Studies of Worker Cooperatives in Health: Cooperative Home Care Associates," Rutgers School of Managament and Labor Relations, December 2022.

77 "The 2021 State of the Sector Report is now available," United States Federation of Worker Cooperatives (USFWC), April 18, 2022.

78 USFWC, "The 2021 State of the Sector Report." Examples of cooperative developers include Cooperative Development Institute, Sustainable Economies Law Center, and ICA Group.

Economic Rights and Ownership Structure	Members typically become owners by purchasing a membership share to "buy-in."[79] Membership eligibility must be available to all workers. Eligibility for membership may require a minimum work tenure length. Surplus is allocated to individual owners on the basis of their economic contribution. This surplus is called patronage and is either allocated to a worker's individual capital account (which is retained and then cashed out upon leaving the company) and/or shared directly to the workers in the form of cash. A member's patronage distribution amount is typically based on total hours worked but can also be adjusted to include seniority and other considerations.
Governance Rights	The governance of a worker cooperative is democratic, with each worker-owner holding equal full voting rights: "one worker, one vote." Most Worker Cooperatives have participatory processes in day-to-day management and board elections. The nature and degree of worker-owner voting rights varies depending on firm bylaws and state law. At a minimum, the worker-members have majority voting rights to elect the board of directors, often majority or entirely drawn from among the member-owners themselves. At a maximum (and in smaller cooperatives), the board may comprise all members, and members may make all decisions. A cooperative's members may unionize and exert worker voice through the union, in addition to worker control of the board.[80] Management functions are distinct from governance, though most worker cooperatives use participatory, consultative, and open book management practices. The Worker Cooperative model is designed to be a permanent ownership structure. A worker cooperative can only be sold or dissolved by a vote of the worker-members, usually requiring a supermajority.

Economic and Governance Rights in a Worker Cooperative



79 "Setting a Membership Share Price," ICA Group, September 2020; "Financing a Cooperative," Co-opLaw.org Resources; "Worker Cooperative FAQ," USFWC Democracy at Work Institute, accessed August 7, 2023; "Sample Bylaws Project: Volume I Overview of Cooperative Articles of Incorporation," National Council of Farmer Cooperatives, 2017.

80 Laura H. Schlachter, "Stronger together? The USW-Mondragon union co-op model," *Labor Studies Journal*, 2017.

VARIANT: WORKER COOPERATIVE HOLDING COMPANY

Definition	A Worker Cooperative Holding Company is a blend of a Worker Cooperative and a corporate holding company. This is an emerging cooperative structure in which subsidiary companies are owned by a central entity, and are owned and democratically managed by workers of the subsidiary companies at the Cooperative Holding Company level and/or at the subsidiary level. The Cooperative Holding Company structure theoretically could scale quickly by enabling and incentivizing acquisitions.
Size of Sector	There are a very small number (fewer than 5) in existence in the US, incorporated and structured in various ways including Evergreen Cooperatives, Obran Cooperative, and Spokane Workers Cooperative.
Financing	Financing for acquisitions is being sourced from a variety of philanthropic[81] and government sources, where possible, and may be channeled through entity-specific capital conversion/acquisition funds.
Economic Rights and Ownership Structure	A central Cooperative Holding Company entity owns a minority (e.g., Evergreen) or majority (e.g., Obran Cooperative) of the subsidiary entities' equity. Employee members of Cooperative Holding Companies are granted equity ownership at the Cooperative Holding Company level, granting dividends in the form of patronage.
Governance Rights	There is no standard for governance rights, either at the Cooperative Holding Company level or the portfolio company level. In the Obran version, workers ultimately own and control 51+ percent of the holding company, with workers transitioning to ownership roles over a specified post-closing period.[82] The subsidiary companies are not necessarily managed cooperatively. At Evergreen, the Cooperative Holding Company's board is led by local "anchor institutions" who are often clients of the subsidiaries. It has an outsized role in subsidiary governance until profitability is achieved.[83] Workers run the businesses cooperatively, but the Cooperative Holding Company does maintain a minority (20 percent) ownership in the subsidiaries to weigh in on major corporate decisions.[84]

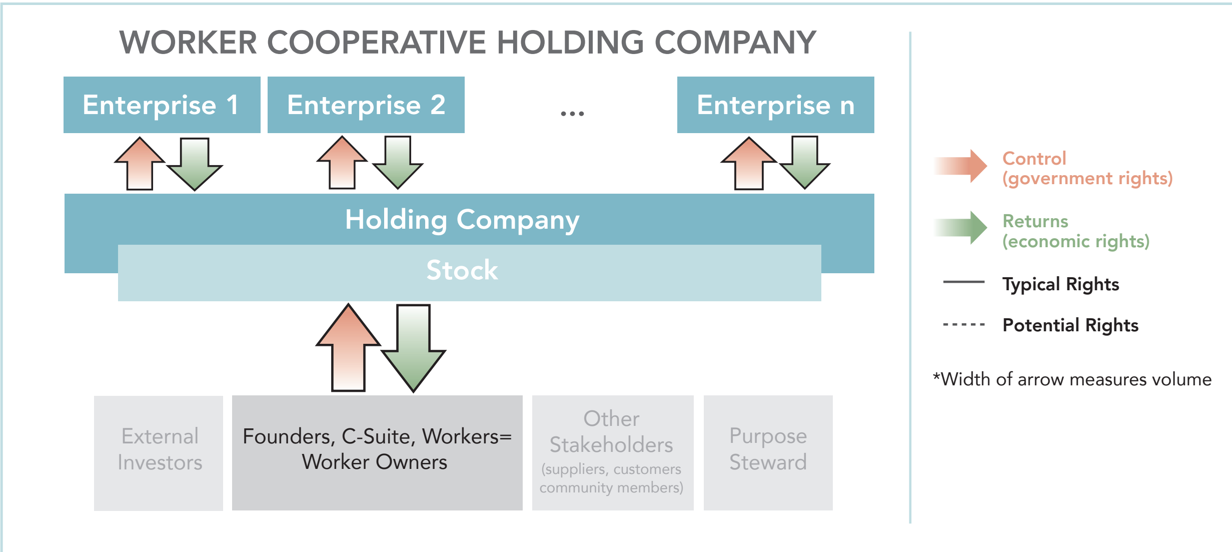
81 Diane Ives, "Building Community Wealth That Lasts," The Kendeda Fund, August 25, 2019.

82 "What is Obran Cooperative? A Member's Guide." Obran, accessed July 24, 2023; Karen Kahn, "Obran: A Cooperative Conglomerate," *Fifty by Fifty*, August 12, 2020.

83 "The Evergreen Cooperatives Story Continues," The Field Guide to a Regenerative Economy, April 2014; Karen Kahn, "Evergreen Cooperatives Adapt and Grow," *Fifty by Fifty*, March 31, 2021.

84 "Evergreen Cooperatives Case Study," REDF's Impact to Last: Lessons from the Front Lines of Social Enterprise, 2015.

Economic and Governance Rights in a Worker Cooperative Holding Company



MODELS CENTERING OTHER STAKEHOLDERS

Some Alternative Ownership Enterprises center the needs and priorities of stakeholders who are not workers or outside investors, but instead could be customers, producers, volunteers, or members of the community (either individuals or as organizations) who are connected to that enterprise's activities.

These models include:

- Consumer, Producer, Shared Services, or Multi-Stakeholder Cooperative
- Multi-Stakeholder PPT (a variant of the PPT)

CONSUMER, PRODUCER, SHARED SERVICES, OR MULTI-STAKEHOLDER COOPERATIVE

Definition	An enterprise owned and democratically controlled by its members on a one member, one vote basis; members may be individuals, farms, businesses, nonprofits or a combination of different types of members. In addition to Worker Cooperatives (discussed previously), types of cooperative enterprises include: • Consumer Cooperatives owned by individual members who use the cooperative to purchase goods and services. • Producer Cooperatives that bring together members who produce similar types of goods and services. • Shared Services (or Purchasing) Cooperatives, which are similar to consumer cooperatives but their members are businesses or organizations, instead of individuals. • Multi-Stakeholder Cooperatives that are owned and controlled by members with different roles and interests.
Examples	Producer: Organic Valley, founded in 1988 by seven farmers in Wisconsin, is the US's largest farmer-owned organic cooperative, with an estimated \$1.2B in revenue and represents nearly 1,700 organic farmers in 34 US states. It produces organic food products such as milk, cheese, butter, produce and snacks.[85] Consumer: REI Co-op is a Consumer Cooperative which sells outdoor recreation gear, sporting goods, and clothes, with \$3.1B in revenue in 2019. Anyone who shops at REI becomes a member of the cooperative and can vote for the board of directors who are responsible for overseeing the management of the cooperative. The board of directors hires the CEO and other senior executives who are responsible for running day-to-day operations.[86] Multi-stakeholder: The Fifth Season Cooperative is a sustainable regional food system hub which provides the infrastructure and coordination needed to connect producers and buyers in the 7 Rivers Region of Wisconsin. It was established in 2010. The cooperative includes different classes of membership—producer, producer groups, buyer, processor, distributor, and worker—who own Class A shares, which provide rights to elect the board of directors and access to patronage when available. The board of directors must include a producer, a worker, and a buyer representative. The cooperative also issues Class B shares to community members who wish to support the cooperative. Those shares have no economic rights and more limited governance rights.[87]
Size of Sector	Consumer, Producer, Shared Services, and Multi-Stakeholder Cooperatives are widespread and can be quite large. There are approximately 40,000 such cooperatives in the US.[88] Some, such as Land O'Lakes, Ace Hardware, and REI are well known brands with billions in annual revenue.[89] There are approximately 15 examples of Multi-Stakeholder Cooperatives by one estimate.90 There has been some growth in Multi-Stakeholder "Platform Cooperatives" for sharing economy activities, such as vacation home rentals (e.g., Fairbnb).
Financing	The financing varies based on the cooperative. The initial source of funding for a cooperative is often capital contributions provided by the members. If additional funding is needed, cooperatives can work to secure loans or issue non-voting preferred shares to outside investors. Producer and purchasing cooperatives tend to be well-capitalized, as their members are often businesses or organizations with sufficient capital to support the cooperative's start-up and growth capital requirements.

85 "About Us," Organic Valley, accessed October 12, 2023; "WORKING AT ORGANIC VALLEY," Zippia, accessed October 12, 2023; Pamela Accetta-Smith, "Stable and sustainable: Organic Valley embraces its family farm origin," Dairy Processing, July 21, 2022.

86 "Board Election Process" and "REI Governance" and "Financial Information," REI Co-op, accessed October 12, 2023.

87 "Fifth Season Cooperative" and "Fifth Season Cooperative Bylaws," Fifth Season, accessed October 12, 2023.

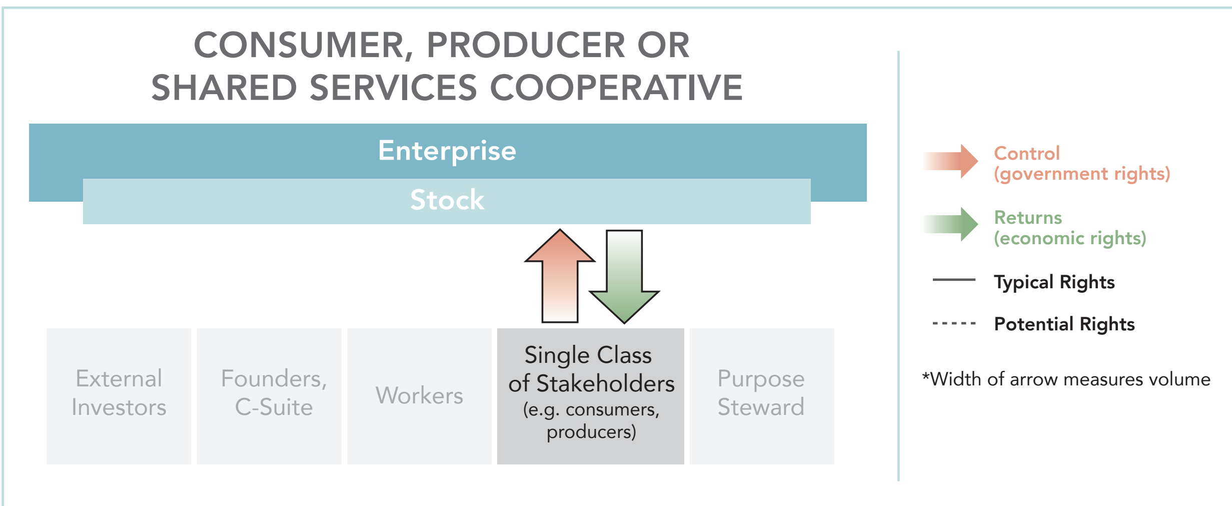
88 "Co-op Sectors," National Cooperative Business Association (NCBA), accessed August 7, 2023.

89 "Build Back for Impact," National Cooperative Bank, accessed August 7, 2023.

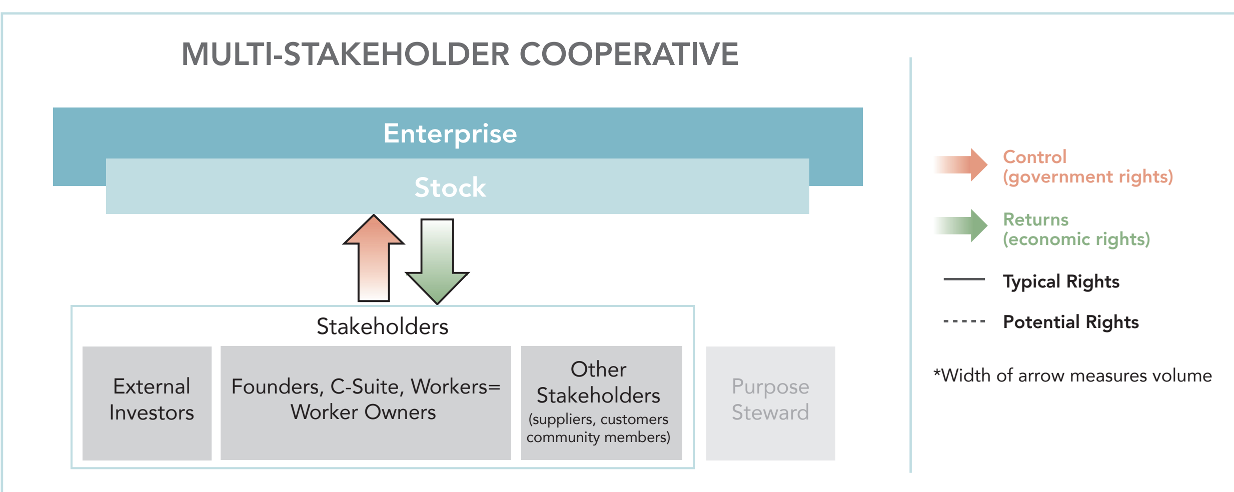
90 Email exchange with University of Wisconsin-Madison Center for Cooperatives, July 26 2023.

Economic Rights And Ownership Structure	The economic rights of cooperatives are shared between members. While the financial surplus can be distributed via patronage or rebates, the core economic benefit of the cooperative to its members is that it provides them with access to, and lower cost on, goods and services. By aggregating different "classes" of members (e.g., producers, consumers, workers, or community members), Multi-Stakeholder Cooperatives have the potential to benefit whole communities, not just certain stakeholders.
Governance Rights	As with any cooperative, members of the cooperative each have an equal voice in decision-making. Where the members are not the workers of the cooperative, there is no explicit mechanism for employee governance rights. In practice, the decision-making power of members at large cooperatives can be limited to the election of the board of directors, who are often pre-vetted.

Economic and Governance Rights in a Consumer, Producer, or Shared Services Cooperative

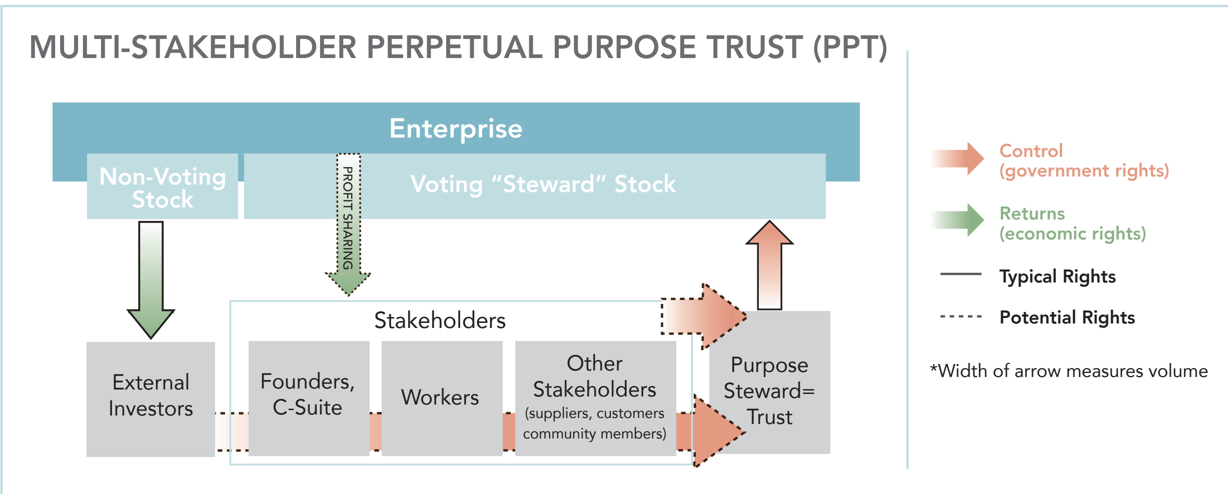


Economic and Governance Rights in a Multi-Stakeholder Cooperative



PPT VARIANT: MULTI-STAKEHOLDER PPT

The simplest form of PPT only provides voting rights for the purpose steward(s). The EOT includes employees as stakeholders with governance and economic rights, in addition to purpose steward(s). That said, PPTs are flexible structures that can also include various stakeholders in their governance (e.g., customers, workers, suppliers, and investors), each with specifically defined rights. A Multi-Stakeholder PPT can be set-up to financially benefit multiple stakeholders in different ways. For example, investors may be paid back before other stakeholders and/or the allocation of profits can change over time as certain milestones are reached. As of mid-2023, there was one known example in the United States, the Organically Grown Company.



CREATING, CONVERTING, AND CHANGING AOE MODELS

Some models are established as start-ups while others are converted from conventional enterprises

Some Alternative Ownership Enterprise models can be established as start-ups while others start as conventional enterprises that are converted to an AOE at a later date, often as a result of the owner retiring and needing a succession plan, or as part of a fundraising round. Several models, especially ESOPs, EOTs, and PPTs, are extremely rare in a start-up context due to the legal fees required to establish them; these are almost entirely formed through conversions from traditional businesses.

TABLE 1: MODE OF CREATION BY MODEL

Model	Created by start-up and/or conversion?
Benefit Corporation	Start-up and conversion
CIC	Start-up and conversion
EOT	Conversion (start-up possible but rare)
ESOP	Conversion
ESOPerative	Conversion
Foundation-Owned Company	Conversion (gift from owner to foundation)
Golden Share	Start-up and conversion
L3C	Start-up and conversion
PPT	Conversion (start-up possible but rare)
Worker Cooperative	Start-up and conversion
Consumer, Producer, Shared Services, and Multi-Stakeholder Cooperative	Start-up and conversion

Models can be combined

Different models can be combined to better meet the goals of the company. For example, Berrett-Koehler, a publishing company, has a unique model that splits shares among both an ESOP and a Perpetual Purpose Trust. Cooperatives may even maintain a Golden Share or ownership by a Perpetual Purpose Trust, enshrining the mission of the company in perpetuity. Benefit Corporations have the ability to take on various ownership models and can be run as Worker Cooperatives.

PATAGONIA: CHARITABLE OWNERSHIP AND A PPT AS A SUCCESSION PLAN

In 2022, Patagonia made waves when founder Yvon Chouinard announced that he would be donating 100 percent of the company's stock he held to two newly established entities: a nonprofit organization called the Holdfast Collective and a Patagonia Purpose Trust. The goal of this transfer was to ensure that Patagonia's activity was geared not towards enriching any shareholders, but towards protecting the planet.

The combination of ownership between two entities was novel for PPTs but was the best structure to fit the founder's goals. The Holdfast Collective holds essentially all of the economic rights, and the Purpose Trust holds the voting rights. The split of rights allows for stewardship by the trust, which governs the company and ensures that it is acting in the best interest of the mission, while profits go to the nonprofit to do charitable and political work.[91]

91 This report includes Foundation Ownership as a core model and does not discuss nonprofit ownership. Both have a structure beholden by law to a charitable purpose, own rights to an enterprise, and operate similarly, although regulations are different for nonprofit ownership.

Enterprises can switch their model over time

Depending on the needs of a company, its structure can evolve over time. In some cases, Alternative Ownership Enterprises return to a more conventional model after a sale, for example when an ESOP is sold to a non-ESOP.

ORGANICALLY GROWN COMPANY: A 40 YEAR JOURNEY TO BECOME A MULTI-STAKEHOLDER PPT

The Organically Grown Company (OGC), a distributor of organic produce based in Oregon, became one of the most widely known examples of a Perpetual Purpose Trust-owned company in 2018. What's lesser known is the journey in enterprise structure OGC has taken over its 40+ year history. OGC started as a nonprofit educating farmers about organic growing methods, then it became a producer marketing cooperative in order to help farmers sell their goods. Later on, it became an S-Corporation to include employees in ownership.

When the team grew, OGC implemented an ESOP so that all employees, not just founders, could benefit from an ownership stake in the company. Because of heavy ESOP share repurchase obligations that came with the oncoming retirement of early employees, OGC wanted to end the ESOP model, cash out employees, and set up a structure that locked in its mission while providing economic and governance rights to the wide set of stakeholders that helped build the company. The Sustainable Food and Agriculture Perpetual Purpose Trust was the solution, and the company became 100 percent owned by the trust in 2018.[92]

92 "Organically Grown Company Transitions from ESOP to Perpetual Trust," *Fifty by Fifty*: Employee Ownership News, August 8, 2018.

Comparing the Alternative Ownership Enterprise Models

Comparing the Alternative Ownership Enterprise Models

While there is a clear impact case for Alternative Ownership Enterprises overall, each model differs in the impact goals it pursues. This section compares the impact goals of the main Alternative Ownership Enterprise models along key dimensions of economic rights, governance rights, worker power, and fit for mission, so that investors, business owners, and others can identify the models that most align with their needs.

Below, we evaluate the models' standard iterations, but it is important to note that every model can be adjusted and combined with others to meet many different impact goals.

COMPARISON OF ECONOMIC RIGHTS

Some Alternative Enterprise Ownership models concentrate economic rights into the hands of a single type of stakeholder (e.g., employees in a 100% ESOP-Owned Company or workers in a Worker Cooperative) while others distribute them across a broad array of stakeholders (e.g., in Multi-Stakeholder Cooperatives).[93]

This analysis compares the split of economic rights across the main types of stakeholders:

1) Workers
2) Non-financial purpose (e.g., a mission that guides a company's decisions)
3) Other stakeholders (e.g., customers, suppliers, community members, or others)
4) Outside investors

93 Outside investors are still able to access economic value in AOEs. The investment instruments in these models take the form of debt, preferred equity, revenue-based financing, or other non-voting investment terms.

TABLE 2: SPLIT OF ECONOMIC RIGHTS BY TYPE OF STAKEHOLDER

SHARE OF RIGHTS	WORKERS	PURPOSE	OTHER STAKEHOLDERS	OUTSIDE INVESTORS
HIGH	• 100% ESOP • ESOPerative • Worker Cooperative	• Foundation-Owned Company	• Consumer, Producer, and Shared Services Cooperative	• Benefit Corporation • Partial ESOP
MEDIUM	• EOT	• CIC	• Multi-stakeholder Cooperative	• L3C • Golden Share
LOW	• Multi-stakeholder Cooperative • Partial ESOP	• L3C		• CIC • EOT • Multi-stakeholder Cooperative
FLEXIBLE	• PPT (typically low)	• PPT	• PPT (typically low) • EOT (typically low)	• PPT
MINIMAL	• **All others**	• **All others**	• **All others**	• **All others**

Note 1: The information in the chart is approximate and meant to help compare across models. Since many models can be tailored to suit stakeholder needs, the exact split of economic rights of a particular enterprise can differ from those shown in the chart.

Note 2: When considering the share of economic rights, we only consider the financial benefit distributed beyond what is required by markets or by law and that can be allocated in various ways depending on corporate priorities (i.e., we do not consider worker wages, supplier payments, taxes, etc.).

As one might expect, Employee Ownership models (e.g., ESOP, EOTs, Worker Cooperatives) concentrate the bulk of the economic rights into the hands of workers. ESOPs are known for their strong wealth building components, in particular when 100% ESOP-Owned Companies are sold. Worker Cooperatives have also been shown to generally pay workers higher wages than conventional companies in similar industries and give workers a share of annual profits, helping to build wealth over time (see Table 3 below). EOTs provide profit sharing mechanisms for employees that can range from nominal to as substantial as patronage dividends in Worker Cooperatives.

Within purpose-centric models, there is a range of economic rights delivered to non-investors. Other than Foundation-Owned Companies, which by definition dedicate surplus to their purpose, other purpose-centric models are not mandated to distribute profits to charity or any non-investor stakeholder. Golden Shares and PPTs are the most flexible because rights for investors are limited, creating greater freedom to use funds internally for their mission. For example, both models can easily create a share class for workers, other stakeholders, or purpose—as the PPT-owned Patagonia did with 98 percent of economic stock held by a 501(c)(4) nonprofit—or set up profit sharing mechanisms for one or more stakeholders (e.g., the Organically Grown Company). At the other end of the spectrum, Benefit Corporations have a similar distribution of economic rights to traditional corporations with the financial benefits accruing primarily to investors and founders of a company, but cash reinvested into the company does go towards the charitable mission and can be voluntarily donated to charities.

Producer, Consumer, Shared Services, or Multi-Stakeholder Cooperative models are adept at sharing profits with different stakeholders. Consumer, Producer, or Shared Services Cooperatives help smaller, disaggregated actors compete in a consolidated economy, and the economic benefits are shared among the cooperative's members. Multi-Stakeholder models elect to share economic rights with a broader array of stakeholders, which can be particularly effective for knitting together producers, distributors, consumers, and workers in a supply chain.

Additional observations about economic rights

- The size and profitability of the enterprise will affect the amount of money available to distribute; for example, ESOPs are typically created from mature, profitable companies, which by definition generate more wealth for workers than start-up enterprises, but unprofitable ESOPs would not generate any wealth for workers. The model itself does not guarantee wealth building—other contextual factors are critical.
- Debt repayment from financing the conversion of the company to an AOE can be at odds with the distributions to other stakeholders until the debt is repaid; investors participating in the capital stack for a conversion should be aware of this tension with wealth building goals.
- Similarly, models that share economic value across multiple stakeholders (including investors) should be aware that the more groups that participate means the less available for each individual group.
- The split of economic value can change over time. For example, a Multi-Stakeholder Cooperative may wait to add a dividend for a particular membership group until it is profitable enough to do so, or Multi-Stakeholder PPTs may have to pay back loan providers and previous owners before they can distribute funds to workers and others.

TABLE 3: WEALTH SHARING MECHANISMS IN KEY MODELS

	WORKER COOPERATIVE	ESOP	EMPLOYEE OWNERSHIP TRUST	PPT	MULTI-STAKEHOLDER COOPERATIVE
Payment Over Time	Annual or quarterly patronage dividends for workers	Deferred. Accounts held for each employee paid out when they leave the company	Typically an annual or quarterly profit sharing mechanism	Profit sharing possible with any stakeholder	Annual or quarterly patronage dividends for members, sometimes different classes
Upon Sale of the Company	Very rare. Divided among workers per formula or given to charity (depending on charter)	Employees receive one-time payment based on ESOP account value	Cannot be sold	Cannot be sold	Very rare. Value divided among members based on formula

COMPARISON OF GOVERNANCE RIGHTS

The other critical dimension of Alternative Ownership Enterprises is governance rights. These rights determine which stakeholder group—and their corresponding priorities—set the company's practices. As with economic rights, some models share such rights with a single stakeholder group, or multiple stakeholders at a time. What they all have in common, however, is that outside investors are typically not the primary decision makers, a major deviation from conventional enterprises.

This analysis compares the split of governance rights across the main types of stakeholders:

1. Workers
2. Non-financial purpose (e.g., a mission that guides a company's decisions)
3. Other stakeholders (e.g., customers, suppliers, community members, or others)
4. Outside investors

TABLE 4: SPLIT OF GOVERNANCE RIGHTS BY TYPE OF STAKEHOLDER

SHARE OF RIGHTS	WORKERS	PURPOSE	OTHER STAKEHOLDERS	OUTSIDE INVESTORS
HIGH	• ESOPerative • Worker Cooperative	• Foundation-Owned Company • PPT	• Consumer, Producer, and Shared Services Cooperative	
MEDIUM		• CIC • Golden Share • L3C	• Multi-Stakeholder Cooperative	• Benefit Corp • CIC • ESOP • L3C
LOW	• 100% ESOP	• Benefit Corp		
FLEXIBLE	• PPT • Multi-Stakeholder Cooperative (typically high) • EOT (typically med-high)	• EOT (typically low)	• PPT • EOT (typically low)	• Multi-Stakeholder Cooperative (typically low)
MINIMAL	• All others	• All others	• All others	• All others

As one might expect, workers have a strong governing role in worker-centric models. In Worker Cooperatives and ESOPeratives, workers are the only governing body and therefore have the most decision-making power of any model. In EOTs, the worker responsibilities are flexible and depend on the trust documents—they can similarly operate cooperatively or can play more of a role of accountability for the board. The role for employee decision-making is limited in standard ESOPs, where trustees make decisions on behalf of employees who only have some pass-through voting rights in major decisions.

In purpose-centric models, the purpose is protected by a dedicated steward responsible for protecting the mission of the company. A fully PPT-owned company is completely governed by stewards, whose mandate is determined by the trust documents. The flexibility of the trust documents opens up opportunities for input from other stakeholders in the stewardship of that mission, such as board elections. In the Golden Share model, the golden share owner has veto power over major corporate events such as a sale or changes to the company's incorporation status, but senior leadership (often the founders) typically hold the rest of the decision-making shares. In a Foundation-Owned Company, the founder and their family play the role of steward and retain control over the company's major decisions.

Benefit Corporations, L3Cs, and CICs operate in the same way as traditional companies with shareholders selecting a board of directors and exercising their other rights. In addition, with Benefit Corporations, the board must consider designated non-shareholder stakeholders in decisions. When there is a conflict between social/environmental and financial concerns, stakeholders have little recourse to enforce purpose except in some states where shareholders or directors may engage in "benefit enforcement proceedings" for failing to pursue the social or environmental mission.[94] In L3Cs, the purpose is enshrined by adding program-related investment provisions to LLC statutes.[95] CICs have stronger requirements and are required to demonstrate their impact to a regulatory agency to incorporate and to keep operating. The community interest test effectively guarantees that CICs are attempting to meet some type of environmental and/or social goal.

Producer, Consumer, Shared Services, or Multi-Stakeholder Cooperatives are very effective at sharing governance power with the set of stakeholders identified as members of the cooperative.

Additional observations about governance rights

- Economic rights and governance rights can be split. For example, in the Golden Share model, investors can reap returns for their investments but are excluded from key decisions such as whether to sell the company.
- Stakeholders can be granted direct governing power (e.g., members in a cooperative directly control it) or indirect power (e.g., in EOTs, the trust controls the company, and the employees elect the board of the trust but don't directly control the underlying company).
- Concentrated control of a company's governance can lead to lack of accountability, while sharing governance with a broad set of stakeholders introduces helpful checks and balances. Some Foundation-Owned Companies, PPTs, and Golden Share structures can concentrate control into the hands of a few insiders who can direct the company as they wish. A case in point is Hobby Lobby, which has faced criticism, notably on anti-LGBTQ grounds. The company is now owned and controlled by a trust with the mission to "honor God, reward employees with meaningful work and compensation, and contribute to global hope and healing."[96] Multi-Stakeholder PPTs or Cooperatives are less likely to fall short in this way.
- Good governance also requires transparency so that all stakeholders can readily access relevant company data, establishing trust and mitigating the risks of unethical decisions. Although many AOEs aren't publicly held, certain structures like Benefit Corporations, CICs, and ESOPs have specific disclosure obligations while others are able to keep their operations completely private from the public.

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94 Tiffany Burba, "To 'B' or Not to 'B': Duties of Directors and Rights of Stakeholders in Benefit Corporations," Vanderbilt Law Review En Banc, 2017.

95 J. Haskell Murray and Edward I. Hwang, "Purpose with profit: governance, enforcement, capital-raising and capital-locking in low-profit limited liability companies," University of Miami Law Review, 2011

96 David Green, "My decision to give away ownership of Hobby Lobby: I chose God," Fox News, October 21, 2022.

TABLE 5: GOVERNANCE SHARING MECHANISMS IN KEY MODELS

	WORKER COOPERATIVE	ESOP	EMPLOYEE OWNERSHIP TRUST	PPT	MULTI-STAKEHOLDER COOPERATIVE
Who has governance rights?	Worker-owners	Managers, board	Managers, board, sometimes employees	Can range widely from purpose guardian to broad range of stakeholders	Member-owners (e.g., workers, consumers, producers)
How and over what?	One worker, one vote, can be day to day and/or electing board	Some pass-through voting for workers for major company decisions	Very flexible. Employees can elect trustees or board or make day-to-day decisions	Very flexible. Typically identified stakeholders elect board/ trustees	One member one vote, can be day to do and/or electing board

WORKER POWER VARIES ACROSS MODELS, EVEN WITH 100 PERCENT WORKER OWNERSHIP

Ownership grants important, but limited, rights. As such, 100 percent worker ownership of an enterprise does not guarantee that all workers will have an equal voice in the governance of the enterprise. Most ESOPs for example are managed in a top-down way, and a trustee represents the collective interest of the workers. The workers only weigh in directly on major decisions of the company, such as a sale. The ESOPerative variation involves workers more directly in day-to-day management decisions under the same ownership structure. Similarly, EOTs can be managed democratically or not, depending on the decisions of the owners, investors and workers at the time of conversion. Even Worker Cooperatives, which are directly owned by workers, can limit the influence of workers to electing the board of directors, can be fully democratic in management, or even can unionize.

Even when they are granted more power, workers will require information and training around an "ownership culture" to be prepared to manage firms, which is why some companies use open book management practices and include employee education in their onboarding process.

MISSION AND ASSET LOCK

A critical issue tackled by many Alternative Ownership Enterprise models is how easily a company's fundamental structure can be altered, such as selling the company to an outside buyer or changing the corporate structure. Steward Ownership models—PPTs, Golden Shares, and Foundation Ownership—are designed to prevent that based on the belief that such sales lead to the distortion of its impactful mission. Some AOE models can easily be changed through a decision of the board, while others models are "locked," making it difficult to sell the company or change its purpose.

TABLE 6: STRENGTH AND MECHANISM OF MISSION-PRESERVATION "LOCK" BY MODEL

MISSION PRESERVATION "LOCK"	MODEL	MECHANISM
HIGH	CIC	Community interest test and asset lock required for incorporation.
	EOT	Asset locked by trust structure. Mission enforced by trust steward(s).
	Foundation-Owned Company	Transfer of ownership stake in the company to the foundation is generally irrevocable and in perpetuity.
	Golden Share	Golden shares are established and held by a designee that exists to veto decisions that would jeopardize the company's mission, such as a sale.
	PPT	Asset locked by trust structure. Mission enforced by trust steward(s).
MEDIUM	Consumer, Producer, and Shared Services Cooperative	Dissolution requires unanimous vote by members. Bylaws may force sale proceeds to be donated.
	Multi-Stakeholder Cooperative	Dissolution requires unanimous vote by members. Bylaws may force sale proceeds to be donated.
	Worker Cooperative	Dissolution requires unanimous vote by members. Bylaws may force sale proceeds to be donated.
	L3C	Legally mandated to prioritize charitable mission and social impact over profits.
LOW	Benefit Corp	Conversion done by corporate charter amendment by a vote of existing shareholders. Can be overturned unless locked with legacy preservation provision (LPP) available in some states.
	ESOPerative	Workers elect ESOP trustees and decide on major corporate decisions, including sale offers.
	ESOP (100%)	Pass-through vote to workers in event of sale, but the trustee has fiduciary duty to consider the offer.
Minimal	ESOP (Partial)	In most cases, trust owns only a minority of the company's shares.

IMPACT MAKERS: HOW ALTERNATIVE OWNERSHIP CAN PROTECT A COMPANY'S MISSION

Impact Makers, an IT consulting company in Richmond, VA, was founded by Michael Pirron as a mission-oriented company that donates 100 percent of profits to charitable purposes in the Richmond community. It became a test case for the need for a strong asset lock mechanism for social enterprises.

Impact Makers's current structure was developed in 2015, after substantial growth led to a desire for equity investment that did not jeopardize the company's mission. The company changed its legal structure to a stock Benefit Corporation and established a holding company, which held all voting-only Class A shares (akin to the steward shares of a Golden Share). The holding company board consisted of the same volunteer board members as the company's board and was led by a Permanent Director, a position held by Pirron. The Permanent Director had veto power over critical decisions such as amending governing documents, paying dividends, issuing shares, or granting equity to employees. Pirron has stated that the structure was designed to prevent excessive pay to board members and senior management. Impact Makers also created a foundation, which held all of the non-voting equity Class B shares and used the proceeds for impact investing and charitable purposes. Finally, an additional set of non-voting equity Class C shares were issued to outside investors in order to raise equity capital.

The structure was put to the test in 2019, after the company had grown to $23m in revenue and already given away nearly $5m in charitable activity. Despite the existence of the Permanent Director, there was no clause in the holding company bylaws that prevented the sale of the non-voting Class A shares, even though they held no economic value. The holding company board, in an attempt to wrest control of the company from Pirron and the mission-first purpose he established, fired Pirron and moved to sell the company to a newly established entity for a mere $1,000. Pirron then sued the company on grounds that such a sale violated the company's benefit statute—the first ever lawsuit surrounding benefit enforcement. The company settled, returning Impact Makers to Pirron. After the legal battle concluded, Pirron amended the Permanent Director position on the holding company board to include an explicit right to veto the sale of the company to an outside party, adding an extra layer of protection. Impact Makers continues to operate under this structure.

The Impact Makers case indicates that the Benefit Corporation model can potentially be used to prevent a sale that jeopardizes a company's mission, but it is also unclear how much the other provisions in Impact Makers's complex structure contributed to the settlement. It is unknown how the benefit enforcement proceeding would have been ruled, had it not been settled.

A fundamental difference between Impact Makers and more familiar Steward Ownership models is the overlap between the Permanent Director and corporate management, whereas Steward Ownership models appoint third parties to make fundamental corporate decisions. Impact Makers also forgoes perpetuity, as the Permanent Director can (after the post-legal case amendments) approve a sale, in which case all proceeds would go to charity. In conversation with the authors, however, Pirron acknowledged that the growing use of Perpetual Purpose Trusts for enshrining a mission would likely be stronger and simpler—it just wasn't in use when Impact Makers's structure was developed in 2015.

Sources:
Dan Brown et al., "The State of Social Enterprise and the Law: 2019-2020," The Grunin Center for Law and Social Entrepreneurship, NYU Law, accessed July 28, 2023.
Elena Loutskina, Gerry Yemen, and Jenny Mead, "Impact Makers (A): The Newman's Own of Management Consulting," University of Virginia Darden Business Publishing, 2017.
Michael Pirron, Personal Communications, 2022-2023.

SOME MODELS ARE NASCENT WHILE OTHERS ARE WELL ESTABLISHED

While cooperatives have existed for centuries, we have seen a large growth in the number of other Alternative Ownership Enterprise models in recent years. In the United States, the most widespread model is the ESOP, which was established by the Employee Retirement Income Security Act of 1974 (ERISA). At the other end of the spectrum, there are only a handful of Foundation-Owned Companies since legislation allowing private foundations to hold 100 percent of a company's voting stock passed only in 2018. Similarly, as of mid-2023, there are slightly over 30 Perpetual Purpose Trusts and their variant Employee Ownership Trusts in the US[97] because this structure was not allowed until the emergence of model legislation for statutory trusts in state law in the early 2000s.

The legal and regulatory environment is critical to enabling or hindering different models. While Benefit Corporation and ESOPs have clear and supportive legislation and case law, other models do not. For example, only a handful of states allow for the creation of trusts in perpetuity, which are critical to establishing Perpetual Purpose Trusts. Some legal scholars are concerned that certain models, like the Golden Share, have yet to be tested legally and may not stand up to court scrutiny. These are risks for investors and entrepreneurs to be aware of.

TABLE 7: NUMBER OF AOES BY MODEL, WITH ASSOCIATED LEGISLATIVE AND REGULATORY ENVIRONMENT IN THE UNITED STATES

MODEL	APPROXIMATE NUMBER OF STRUCTURES IN THE US	LEGISLATIVE AND REGULATORY ENVIRONMENT
Benefit Corporation	3,000	Supportive
Consumer, Producer, and Shared Services Cooperative	40,000	Supportive
EOT	23	Varies by state
ESOP	6,250	Supportive
ESOPerative	100	Supportive
Foundation-Owned Company	<5	Supportive
Golden Share	<5	Some restrictions
L3C	1,700	Some limitations
Multi-Stakeholder Cooperative	15+	Varies by state
PPT (including Multi-Stakeholder PPT)	8	Varies by state
Worker Cooperative	600	Varies by state

Note 1: There are approximately 26,000 CICs in the UK, thanks to supportive legislation but none in the United States.
Note 2: More information on the associated legislative and regulatory environment can be found in the "What are legal, regulatory, and tax considerations?" sections of the model briefs below (see Annex 4).

97 Anne-Claire Broughton et al., "Stewardship Trusts in the United States," Harvard Dataverse, accessed August 16, 2023.

WHAT IS EACH MODEL BEST SUITED FOR?

Benefit Corporations are an easy step for traditional corporations to take, as it is the most similar to conventional corporate structures. As such, they are helping to reframe the narrative around the role and power outside investors should have in corporations. That said, on their own they fall short in terms of providing employees or other stakeholders with wealth or power to influence their working conditions.

ESOPs are very well suited for building wealth for employees due to their provision of real, appreciating assets. Additionally, the favorable tax treatment makes financing ESOPs possible at scales that compete with private equity firms. Because ESOPs are usually created out of mature, cash-positive businesses, they typically generate meaningful amounts of wealth for their workers. The model is not without its downsides, though. The working capital requirements to pay out employees as they retire or leave the company can add challenges to a company's cash flow. Additionally, the lack of asset lock and potential responsibility for the ESOP trustee to consider sale offers means that ESOPs are not always durable structures. ESOPs are also not democratically managed, unless structured as an ESOPerative, and therefore the gains for workers are constrained to the economic realm.

Worker Cooperatives have historically built less wealth for workers than ESOPs due to their relatively small sizes, but they still provide real wealth building through patronage dividends, and any excess profit goes back into the cooperative or to workers. What they are best structured for is to create deeply democratic workplaces and good, higher paid jobs for many, including people who are often excluded, such as returning citizens or others who experience barriers to employment. Worker cooperatives are designed to be permanent ownership structures and are rarely sold.

Employee Ownership Trusts, similar to Worker Cooperatives, share their economic surplus with employees. EOTs are also designed to benefit both current and future workers and to limit decisions that could be detrimental to future workers. However, the wealth created is through a profit sharing mechanism, rather than ownership of the company value itself, which some critics argue will create less wealth for workers than through an ESOP. But EOTs are appealing because they can be tailored to the needs of the stakeholders involved and can include other purposes in the trust documents.

Perpetual Purpose Trusts are flexible vehicles that protect an enterprise's purpose, whatever that may be. Their flexibility is their greatest strength: they can be used to protect any mission a typical social enterprise would have, mandate profit sharing to one or more stakeholders, and implement complex governance structures across stakeholders. The form is very nascent in the United States, which can make transactions complex and resource intensive at this time, but that is likely to shift as the field grows.

Foundation-Owned Companies, while few exist in the US, are legal structures that allow all profits to go to charity. They also are governed by the charitable entity, meaning that the entire business is by and for its purpose, rather than for its investors (or any other stakeholder, for that matter). They can be a great way for founders to cement their legacy, but it requires them to forgo any financial benefit from selling their ownership stakes.

Golden Share models can be a more lightweight way to enshrine an enterprise's purpose and keep control of the company in the hands of founders and key "stewards," without necessarily changing how the company operates on a day-to-day basis. The Golden Share model is not typically used to share economic rights with other stakeholders. Golden Shares can achieve similar mission protection as a PPT but are much cheaper to establish, making them potentially attractive for start-up enterprises (although at this time, there are still only a handful of Golden Share companies in the US).

Low-Profit Limited Liability Companies were promising initially as a tool to harness foundation program-related investments, but they haven't achieved much traction in the US.

Community Interest Corporations, the UK counterpart of the L3C, continues to show great promise as a model that focuses an enterprise on its purpose.

Consumer, Producer, and Shared Services Cooperatives are the most-widespread form of Alternative Ownership Enterprise. They are all around us—from credit unions to rural electric cooperatives—and we often don't realize it. They allow individuals or small businesses to work together to access products and services more cheaply or effectively than they otherwise would separately.

Multi-Stakeholder Cooperatives can enable cooperation across a value chain to the greater benefit of all stakeholders, but they can be complex to set up and administer.

SUMMARY COMPARISON OF ALL MODELS

HIGH MEDIUM LOW FLEXIBLE MINIMAL

	BEST TO:	WORKERS ECON. RIGHTS	WORKERS GOV. RIGHTS	PURPOSE ECON. RIGHTS	PURPOSE GOV. RIGHTS	OTHER STAKEHOLDERS ECON. RIGHTS	OTHER STAKEHOLDERS GOV. RIGHTS	OUTSIDE INVESTORS ECON. RIGHTS	OUTSIDE INVESTORS GOV. RIGHTS	MISSION PRESERVATION "LOCK"
Benefit Corporation	Demonstrate commitment to impact in lower effort way	Minimal	Minimal	Minimal	Low	Minimal	Minimal	High	Medium	Low
CIC	Embed impact permanently	Minimal	Minimal	Medium	Medium	Minimal	Minimal	Low	Medium	High
Consumer, Producer, and Shared Services Cooperative	Help smaller, disaggregated actors compete in a consolidated economy	Minimal	Minimal	Minimal	Minimal	High	High	Minimal	Minimal	Medium
EOT	Balance benefits to workers and lasting commitment to impact	Medium	Flexible (typically med-high)	Minimal	Flexible (typically low)	Flexible (typically low)	Flexible (typically low)	Low	Medium	High
ESOP (Partial)	Build assets for employees	Low	Minimal	Minimal	Minimal	Minimal	Minimal	High	Medium	Minimal
ESOP (100%)	Build assets for employees	High	Low	Minimal	Minimal	Minimal	Minimal	Minimal	Medium	Low
ESOPerative	Build assets and democratic governance for employees	High	High	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal	Low
Foundation-Owned Company	Generate funds for impact permanently	Minimal	Minimal	High	High	Minimal	Minimal	Minimal	Minimal	High
Golden Share	Limit risk of company sale	Minimal	Minimal	Minimal	Medium	Minimal	Minimal	Medium	Minimal	High
L3C	Receive foundation PRI investment	Minimal	Minimal	Low	Medium	Minimal	Minimal	Medium	Medium	Medium
Multi-Stakeholder Cooperative	Build supply chains that benefit all stakeholders	Low	Flexible (typically high)	Minimal	Minimal	Medium	Medium	Low	Flexible (typically low)	Medium
PPT	Embed impact permanently	Flexible (typically Low)	Flexible	Flexible	High	Flexible (typically Low)	Flexible	Flexible	Minimal	High
Worker Cooperative	Build worker power and broaden pathways to employment for marginalized people	High	High	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal	Medium

Building a Campaign for Transformative Impact

Building a Campaign for Transformative Impact

Transform Finance uses the term Alternative Ownership Enterprises to connect several related fields of work that displace shareholder primacy for two reasons.

First, many investors that are interested in wealth building, economic democracy, and strong mission-oriented enterprises as viable impact strategies remain confused about what models are best for what purpose. We believe the umbrella term Alternative Ownership Enterprise—and comparing across a variety of structures contained within it—can help investors more effectively make sense of this body of work and mobilize capital toward it.

Second, if we are to achieve the shift in public awareness and the public policy wins needed to grow this field, the campaign to push for Alternative Ownership Enterprises must be broad and include as many different players as possible. We envision this campaign to consist of coordinated movements, from campaigns that generate strong forms of Employee Ownership within the private equity industry, to those that develop models that enshrine purpose as the operating mission of enterprises, to worker-led efforts to build cooperatives for immigrant communities.

> **"If we are to achieve the shift in public awareness and the public policy wins needed to grow this field, the campaign to push for Alternative Ownership Enterprises must be broad and include as many different players as possible.**

Such a campaign will require collaboration across AOE practitioners who sometimes have different priorities in terms of impact and returns. Take Employee Ownership models as an example. Advocates for ESOPs position their model as one that creates meaningful wealth for workers, even if it doesn't fundamentally shift the balance of power in the economy, whereas many Worker Cooperative developers seek to build grassroots power via political and economic alliances. These different strategies have at times made the Employee Ownership movement a tentative alliance.

Other founders and supporters aim to tackle a broader set of impact goals. They sometimes ask: “why stop at workers?” Why not invite consumers, suppliers, or community members to the table? Even Louis Kelso, the inventor of the ESOP, had sought to expand ownership rights beyond workers; he imagined Consumer Stock Ownership Plans for consumer ownership of companies, General Stock Ownership Plans for community ownership of public works, and more.[98] Advocates for Steward Ownership, rather than providing benefits for one or more stakeholder groups, center purposes like environmental protection or user privacy instead.

While advocates for specific AOE models may have their own reasons for doing so, all are challenging shareholder primacy to different degrees and in different ways. Their goals should not be conflated, but looking at a range of models does reflect a vision of what an economy that decenters outside investors could look like nonetheless. The Alternative Ownership Enterprise framework is designed not to upend, replace, or even attempt to unify these existing movements, but to help investors, the business community, policymakers, and others understand each model’s respective needs and drive a shared narrative of displacing shareholder primacy.

A campaign to further Alternative Ownership Enterprises should center around the following areas of work:

1. **Financial infrastructure and investor education**. The space of Alternative Ownership Enterprise is as financial as it is entrepreneurial. An ecosystem of funds, lenders, and other financial intermediaries to capitalize deals and conversions to AOEs does exist, but it needs major support in order to scale. Unfortunately, the capitalization needs of AOEs are often perceived to be too risky, the wrong size, or too complex, even by mission-driven asset allocators, let alone more conventional players like banks and pension funds. Developing a pathway to scale for existing and new AOE intermediaries is necessary.

2. **Education for policymakers, field building organizations, the business community, and financial practitioners on the spectrum of Alternative Ownership Enterprise impact**. While there is no single perfect AOE model, there is a spectrum of impact and variations on each model that can provide differing levels of economic and governance rights to stakeholders. Those in charge of making Alternative Ownership Enterprises happen need to be informed of these distinctions and pushed to strengthen their outputs. For example, ESOP conversion funds can and should operate with a strong racial equity lens and implement worker governance components, as demonstrated by Apis & Heritage’s Legacy Fund. Employee Ownership policy should include components for more worker autonomy, such as the proposed Employee Equity Investment Act’s

98 Nathan Schneider, “Digital Kelsoism: Employee Stock Ownership as a Pattern for the Online Economy,” 2020.

(EEIA) inclusion of a one participant, one vote decision-making for workers upon a proposed sale of an ESOP.

3. **Funding for support organizations**. Alternative Ownership Enterprises cannot flourish without business support organizations, workplace and community organizers, narrative builders, policy advocates, educators, and other field builders. Philanthropy is in a critical position of ensuring that these organizations are able to do their work and that their efforts are coordinated.

4. **A strong political base that is able to advocate for different Alternative Ownership Enterprise models effectively**. As described in this report, Alternative Ownership Enterprises encompass several movements—Cooperatives, Employee Ownership, and Steward Ownership—and intersect with many others, including labor, Solidarity Economy, and social enterprise. Without usurping the goals of those individual movements, there is a need for a strong political base that provides each a seat at the table and develops a set of goals that are mutually viable and beneficial. Only a strong, movement-led base will be able to ensure that narrow corporate interests do not dominate the political discussion. Better yet, it can help existing movements for specific AOE models develop strategic partnerships to strengthen the impact of their work.

5. **Commitment to serving movements, workers, and communities of color**. These new entrants into the Alternative Ownership Enterprise space are not the first to seek solutions to shareholder primacy, nor are they often those who bear the brunt of it. Because of the historical power imbalances between grassroots movements and corporate-backed movements, the needs of working and marginalized people must be central to this conversation in order for efforts to be most impactful. AOE supporters should coordinate with labor movements, Solidarity Economy organizers, and other movements for racial and economic justice in developing strategies that align with them.

JOIN TRANSFORM FINANCE IN THIS WORK

At their core, Alternative Ownership Enterprises center the needs of the stakeholders they impact, reducing how much outside investors are able to shape businesses and society as a whole. They make a dent in shareholder primacy and deliver transformative material impacts for workers, working class communities, communities of color, and other groups who have historically not made major decisions about capital and ownership.

The seeds sown by practitioners point to a new kind of economy. This economy is interconnected, creating solidarity among producers, suppliers, workers, and customers; is mission-oriented; protects businesses from the outside influence of profit-seeking capital; and centers marginalized groups in its operation. Getting to this vision will take time, but it is well worth the effort. There is already a very healthy body of activity in the Alternative Ownership Enterprise space, with experiments continually improving on models, making more feasible versions for different contexts, and making transactions easier. It just needs more support to flourish.

The capital component to Alternative Ownership Enterprises is still a major gap in the field's success. While the impact case still needs to be made to a broad swath of investors, even the mission-oriented investors who are aligned with the impact goals of AOEs have difficulty moving capital into the space. A dependence on traditional capital tools, unwillingness to work with more complex financing structures, and challenges moving new strategies past gatekeepers (like advisors) holds up many asset allocators. At the fund level, many intermediaries focusing on AOEs are handicapped in fundraising by their lack of a track record, making it a slow process to launch and create that track record.

“The Alternative Ownership Enterprise framework is designed not to upend, replace, or even attempt to unify these existing movements, but to help investors, the business community, policymakers, and others understand each model's respective needs and drive a shared narrative of displacing shareholder primacy.

Clarifying the role for investors in this space and recommending a clear agenda for them is the focus of Transform Finance's future work. We are building interest for broader participation from investors in a movement to finance the Alternative Ownership Enterprise ecosystem. If you are a financial practitioner with experience in this area, or are inspired to add AOEs to your impact agenda, join us!

Annexes

Annex 1: Key Resources

REPORTS

- Investing in Employee Ownership: Financing Conversions Through a Private Equity Fund Model: A report by Transform Finance detailing a model for worker-centric ESOP conversions using a private equity fund model, including a review of different financing methods and funds for ESOPs and Worker Cooperatives.
- Opportunity Knocking: A report by the Democracy Collaborative detailing different models for Employee Ownership financing and making the case for impact investment into the space.
- Steward Ownership: Rethinking Ownership in the 21st Century: A booklet from Purpose providing an overview of Steward Ownership models, capital needs, and various perspectives on impact.
- Exiting to Employees Through Employee Ownership Trusts: A report from Purpose and Common Trust that compares Employee Ownership models, proposes the need for EOTs, and details strategic, legal, financial, and other facets of the EOT model.
- Employee Ownership: A Pathway to Economic Resilience: A report by Asset Funders Network, authored by Democracy at Work Institute's Melissa Hoover, which outlines the impact case of Employee Ownership models for philanthropy and details recommendations for funders.
- The Case for Employee Ownership: A report by Project Equity that provides an overview of research on the impact case for Employee Ownership models, particularly Worker Cooperatives and ESOPs.
- Exit to Community: A Community Primer: A booklet by the Media Economies Design Lab at the University of Colorado Boulder that provides an overview of the need for and real community-owned alternatives to the traditional exit strategy for start-ups, many of which are Alternative Ownership Enterprise models.
- State of Alternative Ownership in the US: A report by Purpose and RSF Social Finance on the key learnings and financing needs of many core Alternative Enterprise forms.
- Creating Shared Value: A forthcoming report commissioned by MSI Integrity that details the core Employee Ownership models and provides an overview of their financing strategies in direct deals and through funds.

WEBSITES

- Fifty by Fifty: Employee Ownership news.
- Democracy at Work Institute: Resource Guide: A national organization dedicated to worker cooperative development.
- Ownership Matters: A publishing platform and community of practice bringing driven by economic democracy.
- The Innovative Finance Playbook: A playbook of alternative capital products and investment strategies.
- Purpose: Open Content: Knowledge, information and experiences on steward-ownership.
- National Center for Employee Ownership: Resources on ESOPs and Employee Ownership.
- Harvard Dataverse: A list of Employee Ownership Trusts, Perpetual Purpose Trusts, and Stewardship Trusts in the United States.
- Impact Terms: A library of innovations in impact investing terms and investment structures.
- Rutgers Institute for the Study of Employee Ownership and Profit Sharing: A research center for Employee Ownership, with a variety of resources and initiatives."

Annex 2: Interviewees

NAME	ORGANIZATION/AFFILIATION AT TIME OF INTERVIEW
Virgilio Barco	Acumen
Laura Haverkamp	ALV Foundation
Laura Viegener	ALV Foundation
Philip Reeves	Apis & Heritage
Bruce Campbell	Blue Dot Advocates
Aner Ben-Ami	Candide Group
Janice Shade	Capital Innovation Lab
Derek Razo	Common Trust
Zoe Schlag	Common Trust
Esme Verity	Considered Capital
Katherine Chen	CUNY
Kusi Hornberger	Dalberg
Hays Witt	Driver's Seat Cooperative
Rana Zincir Celal	Equality Impact Investing
Jenny Everett	Everett Interests
Felipe Witchger	Francesco Collaborative
Elizabeth Garlow	Francesco Collaborative
Francesca Esquenazi	Future Club
Santhosh Ramdoss	Gary Community Partners
Julia Stone	Gary Community Partners
Catherine Toner	Gary Community Partners
Michael Pirron	Impact Makers
Aunnie Patton Power	Intelligent Impact
Jason Wiener	Jason Wiener|p.c.
Blake Jones	Kachuwa Impact Fund
John Balbach	MacArthur Foundation
Lauren Grattan	Mission Driven Finance
David Lynn	Mission Driven Finance
Amelia Evans	MSI Integrity
Milap Patel	MSI Integrity

NAME	ORGANIZATION/AFFILIATION AT TIME OF INTERVIEW
Melanie Riebeck	Nonprofit Ventures
Joseph Cureton	Obran Cooperative
Evan Steiner	One Project
Jack Moriarty	Ownership America
Elias Crim	Ownership Matters
Catherine Burnett	Phillips Foundation
Alison Lingane	Project Equity
Maike Kauffmann	Purpose
Adrian Hensen	Purpose
Natalie Reitman-White	Purpose Owned
Jasper van Brakel	RSF Social Finance
Jon Shell	Social Capital Partners
Taylor Sekhon	Social Capital Partners
Michael Grossman	Social Finance
Margot Kane	Spring Point Partners
Greg Brodsky	Start.coop
Jonny Gordon-Farleigh	Stir to Action
Adam Connaker	Surdna Foundation
Mark Hand	The University of Texas
Jeshua John	The Workers Lab
Dario Parziale	Toniic
Malini Moraghan	Torana Group
Dan Fireside	Uncommon Capital Solutions
Nathan Schneider	University of Colorado Boulder
Amy Brakeman	Unlock Ownership Fund
Esteban Kelly	US Federation of Worker Cooperatives
Humaira Faiz	W.K. Kellogg Foundation
Andre le Prince	WLP GmBH
Smitha Das	World Education Services
Daniel Nowack	Yunus Social Business School
Alissa Orlando	Zebras Unite Cooperative
Astrid Scholz	Zebras Unite Cooperative

Annex 3: Alternative Ownership Enterprise Models and Features

MODELS NOT INCLUDED IN THE REPORT

- **State-Owned Enterprises:** State ownership over corporations is a way of ensuring that they act in a public interest, especially in cases where the services provided are critical to the infrastructure and well-being of the country. In the US, however, the few State-Owned Enterprises are largely quasi-public services, such as Amtrak and the critical lenders Fannie Mae and Freddie Mac, or companies that are acquired by the state as a temporary bailout, as seen in the auto and banking industry during the financial crisis of 2008. As such, there is not a robust process for the creation of state-owned enterprises in the US to warrant much discussion from an investor perspective, but there may be avenues through policy.
- **Louis Kelso's other Stock Ownership Plans:** Louis Kelso, the inventor of the ESOP, also envisioned Consumer Stock Ownership Plans (CSOP), to allow full or part consumer ownership of companies, and Ownership Plans, to allow for public ownership of public works and others to source community investment more broadly.[99] There has only been one CSOP in history, California's Valley Nitrogen, which closed in 1963, and no examples of Kelso's other ownership structures exist.[100]
- **Decentralized Autonomous Organizations (DAO):** DAOs are networked, blockchain-based autonomous entities which only use "smart contracts" (i.e., automated rules) to make decisions, eliminating the divide between ownership and management. While most DAOs seem to be used to fractionalize ownership of digital assets like NFTs, some proponents believe they can be used to distribute ownership across different stakeholders, creatively and fairly, by issuing tokens based on different contributions to the success of the DAO. A democratic, one person, one vote version of the DAO that uses the cooperative principles, the Distributed Cooperative Organization (DisCO), has been proposed as an alternative to the one token, one vote structure of typical DAOs.[101] As this space is emerging, there are few examples of impact-oriented DAOs or DisCOs that are enabled by the structure itself.

99 Nathan Schneider, "Digital Kelsoism:Employee Stock Ownership as a Pattern for theOnline Economy," 2020.

100 Nathan Schneider, "User Trusts: Broad-Based Ownership for Online Platforms," 2020.

101 "DisCO.coop," accessed October 13, 2023.

ALTERNATIVE OWNERSHIP ENTERPRISE FEATURES

While we have focused on full fledged alternative models so far, there are also lighter weight "features" that can provide more economic and/or governing rights to stakeholders without significantly changing the underlying incorporation or ownership structure of a company. Many of these features can also be combined with "models" to further increase their impact.

Sharing Wealth

Companies can share the wealth they generate with employees via profit sharing or by issuing them some of the company's stock (either for free or at a discount, often over time following a vesting schedule). These features can motivate employees to help the company perform better financially and retain staff (in particular in the case of stock grants with vesting schedules). That said, these features do not necessarily address wealth inequality since these benefits tend to be awarded to senior or highly compensated employees.

Profit sharing is a form of compensation in which a company shares a portion of its profits with its employees. Under profit sharing programs, a percentage of the company's profits is distributed among eligible employees. The allocation of profits can be based on various factors, such as individual performance, team performance, or another formula. Profit sharing can motivate employees to work towards the company's success and be a way to align the interests of employees with the company's financial performance. It provides employees with the opportunity to directly benefit from the company's profitability beyond their regular salaries or wages. Since the compensation is based directly on profits, it's not dependent on the company's share price that can vary widely. It can be structured to compensate all workers equally or to disproportionately benefit those who are already highly compensated.

Stock-based compensation and incentives can be awarded to employees. These grants can be provided free of charge or at a favorable price and are often subject to a vesting schedule that releases the shares to employees gradually over time. By distributing company stock to employees, organizations share their success and the wealth they create, potentially encouraging longer-term commitment as employees wait for their shares to vest. Furthermore, such grants can motivate employees to work towards increasing the value of the company's stock. However, stock-based compensation does not necessarily address wealth inequality since it tends to be awarded to senior or highly compensated employees. This is different from an ESOP or EOT, in which each employee accesses a share of the company's stock (though not always equitably either). Specific stock grant mechanisms include:

- Employee Stock Purchase Plans (ESPP): ESPPs allow employees to purchase company shares at a discounted price, typically through payroll deductions. Employees contribute a portion of their salary into the plan and, at specified intervals, the accumulated funds are used to buy shares at a discounted price.

- Phantom Stock: Phantom stock awards provide employees with a notional or virtual share in the company's value. Although employees do not actually own company stock, they receive cash or stock-based payouts based on the appreciation of the company's value over a specific period.
- Stock Appreciation Rights (SAR): SARs are similar to stock options but do not require the employee to purchase shares. Instead, employees receive the appreciation in the stock price in cash or additional company shares, depending on the terms of the plan.

Sharing Governing Power

Some features are focused on sharing governing power with stakeholders, in particular with employees. In part of Europe, co-determination is mandated in larger companies and allows employees to participate in the company's decision-making. In addition, collective bargaining agreements driven by a company's union are another way for employees to influence the terms and conditions of their employment. More informally, some companies might choose to create advisory councils composed of external stakeholders to gather input that can shape the direction of the company.

Co-determination, also referred to as copartnership or worker participation, is a practice of involving employees in the decision-making processes of a corporation. It allows employees to elect or appoint representatives who participate in the company's decision-making bodies alongside shareholder representatives. The purpose of co-determination is to ensure that employees have a voice and influence in shaping the policies and direction of the company they work for. Co-determination is widespread in Europe, where co-determination is mandatory as soon as companies reach a certain size. In the United States, it can be achieved in some collective bargaining agreements.[102]

Collective Bargaining Agreements (CBA) are legally binding contracts negotiated between an employer and a labor union on behalf of a group of employees. These agreements establish the terms and conditions of employment, such as wages, working hours, benefits, and grievance procedures. CBAs are the outcome of collective bargaining, which involves negotiations between the parties to address the interests of both labor and management. Once agreed upon, the CBA ensures that employees have a voice in determining their terms and conditions of employment.

Asset Lock

Finally, some features are focused on enshrining a company's mission and making it harder for the company to be sold via an "asset lock." This includes voluntary certification standards, such as a B-Corp certification. Ben & Jerry's put in place a second, independent board of directors to preserve the company's mission when it sold the company to Unilever, as a more formal way of preserving the company's mission. Another type of feature is using a dual- or triple-class share

102 "Worker representation on corporate boards of directors," Wikipedia, accessed October 13, 2023.

structure to give some shares significantly more voting power than others. The holders of shares with more voting power, often the company's founders, initial employees, or early investors, are able to control the company even if they no longer retain a majority of the economic rights. Some companies use "poison pill" provisions as a way to prevent hostile takeovers. These approaches can prevent corporate consolidation by blocking hostile acquisitions, but since they simply give the company's board or a small number of people more power, they are generally undemocratic and offer no guarantee that the company will advance progressive values.

Poison pills, also known as shareholder rights plans, are a defensive tactic employed by a corporation to deter hostile takeovers or acquisitions. It is a provision added to a company's bylaws or charter that triggers certain unfavorable consequences if an acquiring party surpasses a specified ownership threshold. This strategy could theoretically be used to preserve the mission of a company and prevent corporate consolidation. A steward-owned company uses a similar approach but the control is held by a third party "steward" and not by the company's board.

Dual-class share structures provide a company a "separate class of stock that offers its holders superior voting rights compared to common shareholders."[103] Founders, early investors, or other specific people are granted multiple-voting shares to maintain greater control and influence over corporate decisions, even if they own a smaller economic stake in the company. Advocates argue this allows a company to protect the company's vision, mission, and long-term goals from short-term pressures for financial returns, but critics argue it's undemocratic and can potentially lead to a lack of accountability, reduced shareholder rights, and limited checks and balances on management decisions. The New York Times implemented a dual-class share structure to preserve its editorial independence and mission of delivering quality journalism, it argued.[104] Class A shares, available to the public, hold one vote per share, while Class B shares, primarily owned by the Ochs-Sulzberger family, carry 10 votes per share, ensuring the family's continued control over the company's direction. This structure is fairly common in technology companies, from Facebook to Meta to Snap.

Secondary boards of directors can provide a layer of protection against certain decisions, similar to Steward Ownership models. The ice cream company Ben & Jerry's is an example of a company that has two boards of directors. The board of the parent company Unilever is responsible for financial and operational decisions, while its independent board is "empowered to protect and defend Ben & Jerry's brand equity and integrity." This structure was put in place to protect the company's mission when it was acquired by Unilever. Previously, Ben & Jerry's had a dual-class share structure allowing the founders to control close to the majority of voting rights of the company.

103 Kosmas Papadopoulos, "Dual-Class Shares: Governance Risks and Company Performance," Harvard Law School Forum on Corporate Governance, June 28, 2019.

104 Matt Orsagh, "Dual-Class Shares: From Google to Alibaba, Is It a Troubling Trend for Investors?"CFA Institute Market Integrity Insights, April 1, 2014.

CASE STUDY: BEN & JERRY'S

Ben & Jerry's is renowned for being an early advocate of combining financial success with social and environmental responsibility. The company prioritized employee well-being and environmental sustainability, and it contributed a portion of its profits to the Ben & Jerry's Foundation.

To protect itself from hostile takeovers and preserve the company's mission, Ben & Jerry's put in place several of the Alternative Ownership Enterprise features.

1. **Dual-share structure:** Ben & Jerry's share structure consisted of two classes of common stock. Class A shares adhered to the one share, one vote principle, while Class B shares had ten votes per share. Founders Ben Cohen and Jerry Greenfield, along with director Jeff Furman, held a significant majority of the super-voting Class B shares, which granted them effective control over the company's board and direction. Additionally, the Ben & Jerry's Foundation, controlled by Ben and Jerry themselves, held a separate class of preferred stock with veto rights over mergers and tender offers. This is similar to a Golden Share model.
2. **Poison pill:** This made any potential acquisition extremely costly and required an acquirer to find a friendly board or secure one through elections. The staggered election process ensured that at least two elections had to be scheduled a year apart for the acquirer to gain control. Since Ben Cohen, Jerry Greenfield, and Jeff Furman controlled a majority of the voting shares, they effectively controlled board elections, and therefore no acquisition could go through without their approval.

In 2000, the board of directors of Ben & Jerry's decided to accept an acquisition offer from Unilever. The poison pill was not triggered by the board. The sale was likely driven by the company's lackluster financial performance—the company was struggling and Unilever could expand its sales dramatically.[105]

Even with strong purchase protection provisions, the decision to sell was still in the hands of the founders and their close allies. This is why stronger asset lock models, such as Perpetual Purpose Trusts and Golden Share models, place this decision to sell into the hands of a third party with the sole purpose of vetoing major events.

105 Paula Caligiuri, "When Unilever Bought Ben & Jerry's: A Story Of CEO Adaptability," Fast Company, August 14, 2012.

That said, a condition for Ben & Jerry's acquisition by Unilever was the creation of an **independent board.** This board "empowered to protect and defend Ben & Jerry's brand equity and integrity" and has the power to initiate litigation against Unilever at the expense of the acquiring company.[106]

In July 2022, Ben & Jerry's independent board filed a lawsuit against its parent company Unilever to block the sale of its Israeli business to a local licensee, Avi Zinger. The ice cream maker said the sale violated a 2000 merger agreement that gave its board independence to protect its brand and social mission. Other allegations against Unilever from Ben and Jerry's include "refusing to disburse revenue from the ice cream maker to charities, eliminating jobs affecting product mission and marketing products without its approval."[107] This lawsuit was resolved in the fall of 2022 but details about the outcome were not available.[108]

Notably, the sale of Ben and Jerry's happened before the advent of legal forms such as the L3C, Benefit Corporation, and US-based experimentations with Perpetual Purpose Trusts. In fact, proponents of these models often cite Ben and Jerry's as a motivator for their creation.[109] The independent board is a novel feature of a subsidiary of a large corporation to maintain independence, but as the 2022 lawsuit shows, it might not be enough to maintain independence. When it comes to mission protection, this example demonstrates that hybrid features have a role and can make a difference in how corporations are governed, but they are not perfect.

106 "How We're Structured," Ben & Jerry's, accessed October 13, 2023.

107 Jessica DiNapoli, "Ben & Jerry's says parent co Unilever 'covertly' took trademarks," Reuters, October 3, 2022.

108 Richa Naidu and Jessica DiNapoli, "Unilever says litigation with Ben & Jerry's board has 'been resolved'," Reuters, December 15, 2022.

109 Antony Page and Robert A. Katz, "The Truth About Ben and Jerry's," Stanford Social Innovation Review, Fall 2012

Annex 4: Overviews of Alternative Ownership Enterprise Models

What are Benefit Corporations?

DEFINITION

- A Benefit Corporation is a distinct form of incorporation that differs from the legal framework of the traditional for-profit stock corporation by allowing directors and managers to pursue a public benefit in addition to shareholder value. Benefit Corporations were devised to overcome the legal requirement for directors and managers of a corporation to solely maximize shareholder value.
- The public purpose, or benefit, can be defined broadly or narrowly. Benefit Corporations can be combined with other mechanisms to enhance stakeholder benefit and lock in ownership or assets (e.g., Employee Stock Ownership Plan [ESOP] or Perpetual Purpose Trust).
- Benefit Corporations, sometimes referred to as Public Benefit Corporations (PBC), should not to be confused with public benefit nonprofit corporations, which are long-standing entities more akin to traditional nonprofits (e.g., in California) or quasi-governmental entities (e.g., in New York).
- They are also different from "Certified B Corporations" (B Corp). B Corp status is not a form of incorporation; it is granted via a certification process by the nonprofit B Lab, available to businesses of any legal form that meet certain social and environmental standards.[1]
    - There is often overlap between the Benefit Corporations and Certified B Corps, with some states and countries requiring Benefit Corporations to receive the Certified B Corp designation, or vice-versa.[2]
    - B Lab, which developed the certification, was also instrumental in promoting model Benefit Corporation laws.

1 "Benefit Corporations," B Lab, accessed August 8, 2023.

2 "The Need and Rationale for the Benefit Corporation: Why it is a legal Form that Best Addresses the Needs of Social Entrepreneurs, Investors and Ultimately, the Public," B Lab White Paper, 2013.

CONTEXT AND EMPIRICS

- Benefit Corporations were first introduced in Maryland in 2010 to allow companies to pursue social and environmental benefits and protect the companies from claims that doing so would breach the rules around shareholder value maximization.[3]
    - For mission-aligned investors, Benefit Corporations offer an alternative to the Low-Profit Limited Liability Company (L3C)—a similar legal designation based on a traditional LLC that is designed to meet the program-related investment stipulations of foundations—which has not received as much traction.
- Benefit Corporations exist in ~40 US states and in Argentina, Australia, Canada, Chile, Colombia, and Italy.[4]
- Thousands of firms are currently believed to use the Benefit Corporation model in the United States.[5] They range from small businesses and start-ups to global brands across a variety of industries, with well-known examples like Kickstarter, Method, Allbirds, and Warby Parker.[6]
- As of 2021, there are at least 10 Benefit Corporations that are publicly traded or subject to SEC reporting obligations, all incorporated in Delaware.[7]
- At least 16 publicly traded companies received shareholder proposals to convert to a Benefit Corporation in 2020-2021.
- Reliable data on the share of Benefit Corporations that convert compared to how many are incorporated as start-ups are unavailable.

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3 John Montgomery, "Mastering the Benefit Corporation," Business Law Today, American Bar Association, July 2016; Gene Takagi, "Maryland's Benefit Corporation," Nonprofit Law Blog, May 26, 2010.

4 Michael McGinley, "Benefit Corporations & Employee Ownership," Prairie Capital Advisors, August 1, 2022; Mara Del Baldo, "Acting as a benefit corporation and a B Corp to responsibly pursue private and public benefits. The case of Paradisi Srl (Italy)," International Journal of Corporate Social Responsibility, 2019.

5 Amy L. Simmerman, Ryan J. Greecher, and Brian Currie, Wilson Sonsini Goodrich & Rosati, "Converting to a Delaware Public Benefit Corporation: Lessons from Experience," Harvard Law School Forum on Corporate Governance, February 18, 2022.

6 "Understanding Delaware's Benefit Corporation Governance Model," Morris, Nichols, Arsht & Tunnell LLP, May 2016; "The Rise Of Investable Public Benefit Corporations," Seeking Alpha, June 27, 2022; "Public Benefit Corporation: Everything You Need to Know," UPCounsel, July 13, 2020; Mark Henricks, "What Is a Public Benefit Corporation?" Yahoo Finance, September 14, 2020.

7 "Shareholder Proposals Requesting Conversion to Public Benefit Corporations: A Fleeting Trend or the Future?" Faegre Drinker Biddle & Reath LLP via JD Supra, August 6, 2021; Christopher Marquis, "Public Benefit Corporations Flourish In The Public Markets," Forbes, June 14, 2021.

WHAT ARE THE BENEFITS AND LIMITATIONS OF BENEFIT CORPORATIONS?

Benefits

- Benefit Corporations can fill a gap between traditional corporations and nonprofits by providing entrepreneurs flexibility to achieve dual objectives: shareholder profit and social benefit.[8]
- In Benefit Corporations, the social or environmental mission is embedded in the corporate charter and bylaws, and is thus less likely to be diluted or abandoned than in traditional corporations that seek to pursue a mission goal. The requirement of an annual Benefit Report further ensures that mission is preserved.[9]
- The directors of the company are not subject to fiduciary obligations to maximize profit and cannot be held liable for not maximizing "shareholder value," a long-standing legal issue for corporations.[10]
    - Some argue that the likelihood of being held liable for a fiduciary breach in this way is very limited, and the primary value of the legal model may be in signaling the commitment.[11]

Limitations

- In part due to the newness of the model, there are no reliable studies or data confirming whether or how much Benefit Corporation status might benefit workers or other social beneficiaries. Most empirical data on the population of Benefit Corporations comes from advocates, with few independent comprehensive studies.
- When there is no legacy preservation provision (LPP, see more below) in place, a PBC could amend its articles of incorporation or charter to remove its social or environmental benefit and convert to a traditional corporation. The model also does not require any democratic governance or ownership. The combination of these two factors has led some PBCs to jointly deploy other models (e.g., ESOP, trust, or foundation).

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8 Mark A. Underberg, "Benefit Corporations vs. 'Regular' Corporations: A Harmful Dichotomy," Harvard Law School Forum on Corporate Governance, May 13, 2012.

9 Lauren A. Cooper and Jill Weber, "Does Benefit Corporation Status Matter to Investors? An Exploratory Study of Investor Perceptions and Decisions," Business & Society, 2020.

10 Marc S. Gerber, Edward B. Micheletti, and Peter A. Atkins, "Social Responsibility and Enlightened ShareholderPrimacy: Views From the Courtroom and Boardroom," Skadden, Arps, Slate, Meagher & Flom LLP, February 4, 2019; William H. Clark, Jr. and Elizabeth K. Babson, "How Benefit Corporations Are Redefining the Purpose of Business Corporations," William Mitchell Law Review, 2012; Janine S. Hiller, "The Benefit Corporation and Corporate Social Responsibility," Journal of Business Ethics, 2013.

11 Mohsen Manesh, "Introducing the totally unnecessary benefit LLC," North Carolina Law Review, 2018.

HOW ARE BENEFIT CORPORATIONS FINANCED?

General Financing

- Benefit Corporations can use the full range of debt and equity instruments as traditional stock corporations. They have received investment from a wide number of traditional private equity and venture capital (VC) funds.[12]
- Convertible debt and preferred stock classes are being promoted by lawyers as more mission-aligned and desirable financing tools for Benefit Corporations.[13]
- It is still unclear whether Benefit Corporations face reduced or increased access to capital compared to traditional corporations:
  - Standardization, consistency, accountability, and transparency may mean greater capital availability from socially responsible or impact investment sources.
  - Given compliance costs and the fact that some profit may be sacrificed to achieve social or environmental goals, the model may not be as popular with mainstream investors.[14]
- The model may create additional marketing or commercial advantages from the Benefit Corporation label, which may in turn attract mainstream capital providers.
- Benefit Corporations can go public. In 2017, Laureate Education became the first publicly traded Benefit Corporation by listing its shares on the Nasdaq stock exchange. Lemonade and Vital Farms followed suit in 2020.[15] A small but growing number are currently publicly traded.

Conversion Financing

- The conversion to PBC status is an amendment in charter by a vote of existing shareholders, not a change in ownership (as with an ESOP conversion, for example). As such, there is no requirement to purchase shares and no explicit financing component.
- A traditional company can convert to a PBC while privately held, as part of a going-public transaction, or even once it is already publicly traded.
  - In 2021, Veeva Systems, a Delaware based corporation providing cloud-based life science industry software became the first publicly traded company to convert into a public Benefit Corporation.[16]

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12 "Just Good Business: An Investor's Guide to B Corps," The Yale Center for Business and the Environment, Patagonia, Inc., and Caprock, 2018.

13 Dana Brakman Reiser and Steven Dean, "Financing the Benefit Corporation," Seattle University Law Review, 2017.

14 Nancy B. Kurland, "Accountability and the Public Benefit Corporation," Business Horizons, 2017; Jane Haskins, "What is a Benefit Corporation?" Legal Zoom, May 11, 2023.

15 Lauren Debter, "The World's Biggest For-Profit College Company, Laureate Education, Raises $490 Million In Public Debut," Forbes, February 1, 2017; David M. Waizer, "Impact Investing: Renewed Interest in 'Benefit Corporations'," Day Pitney, June 23, 2021.

16 "Veeva Becomes First Public Company to Convert to a Public Benefit Corporation," Veeva Systems Press Release, January 13, 2021.

Start-up financing

- There do not appear to be distinct start-up financing considerations for PBCs versus traditional corporations.
- Benefit Corporations have significant track record in attracting traditional VC:[17]
    - Between 2013-2018, nearly 300 Benefit Corporations raised over $2.5 billion from VC.
    - Almost every major Silicon Valley VC house has invested in Benefit Corporations.
    - Benefit Corporations such as Ripple Foods—which obtained Series C funding in 2018—have raised more than $100MM in VC funding.
- Additionally, accelerator/incubator investors (e.g., Y Combinator and Techstars), angel investors, and hedge funds have invested in Benefit Corporations.

HOW ARE OWNERSHIP AND ECONOMIC RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

Share Ownership

- The most widespread form of the Benefit Corporation has the same range of ownership share class options as traditional for-profit stock corporations, with comparable ownership rights for shareholders.[18]
- Non-stock versions also exist:[19]
    - A benefit LLC, created at the same time as the Benefit Corporation in Maryland in 2010, offers an LLC non-stock version, not widely adopted but available in five states, including Delaware as of 2018.
    - A limited partnership (LP) non-stock version, via the Statutory Public Benefit Limited Partnership (SPBLP), created in Delaware in 2019, also exists.
    - Colorado also offers a public benefit cooperative as an incorporation option.
- There are no explicit features or limitations on share ownership (e.g., no limits on multi-class/large shareholders or voting concentration); the model is compatible with distributed share ownership and ownership by external entities.

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17 Michael B. Dorff, James Hicks, and Steven Davidoff Solomon, "The Future or Fancy? An Empirical Study of Public Benefit Corporations," European Corporate Governance Institute Working Paper, 2019; "Investors in Benefit Corporations," B Lab Dataset via Data.World, accessed August 8, 2023; The Shareholder Commons, "How Investors Really Feel About B Corps," published in B The Change, May 24, 2017; "After $65M Funding Splash, Plant-Based Start-Up Hopes for Ripple Effect," The Shareholder Commons, accessed August 8, 2023.

18 "Which Legal Structure Is Right For My Social Enterprise? A Guide To Establishing A Social Enterprise In The United States," Thomson Reuters Foundation and Morrison & Foerster LLP, September 2019.

19 See the Social Enterprise Law Tracker, hosted by the Grunin Center for Law and Social Entrepreneurship at New York University (NYU) School of Law, accessed August 8, 2023.

- Democratic ownership in a public benefit context can be achieved through other forms, such as Colorado's public benefit cooperative. Public benefit LLCs, available in some states, can be deployed with equal and democratic member owner interests (e.g., Worker Cooperative bylaws).
- Some ESOP-owned companies are adopting Benefit Corporation status, and some Benefit Corporations are becoming ESOP-owned.[20]

Asset Preservation

- In most states' Benefit Corporation statutes, there is no legal lock to restrict owners from redirecting assets or the company from pursuing its benefit-related mission.
    - Upon sale, liquidation, or bankruptcy, shareholders are paid out in the same order and fashion as with a traditional corporation.
    - In some US states, legislation may provide directors with greater discretion to consider factors other than the highest purchase price in capital events (e.g., during potential acquisitions).
- Some states, such as Connecticut, offer a legacy preservation provision (LPP) following a waiting period of two years and unanimous vote by all shareholders. The LPP allows the Benefit Corporation to lock in a social mission as a fundamental facet of its legal operating structure. The status is irrevocable regardless of future changes in ownership or management.[21]
    - Benefit Corporations with an LPP may only enter a merger, share exchange, lease, sale, or other disposition of its assets (including liquidation upon dissolution) with Benefit Corporations who have adopted their own LPP.
    - Assets may, however, be transferred or distributed to a charitable organization.
- Steward Ownership models, such as the Golden Share and Perpetual Purpose Trust ownership, are compatible with Public Benefit Corporations (e.g., Patagonia). Asset lock can be accomplished by moving all voting shares into Steward Ownership models that prevent or restrict major corporate changes.
    - In the case of Impact Makers, after an attempted hostile takeover by the board, provisions were created for a special position at the governing holding company to prevent such a sale in the future.[22]

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20 Nancy Kurland, "ESOP Plus Benefit Corporation: Ownership Culture with Benefit Accountability," California Management Review, 2018.

21 Marcel J. Bernier et al., "Benefit Corporations Have Arrived in Connecticut," Murtha Cullina Attorneys via Archive.org, May 2014.

22 Dan Brown et al., "The State of Social Enterprise and the Law: 2019-2020," The Grunin Center for Law and Social Entrepreneurship, NYU Law, accessed July 28, 2023.

HOW ARE GOVERNANCE RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- Shareholders have traditional corporate mechanisms to protect their interests (e.g., voting on major decisions or suing for breach of duty) and can hold officers and directors accountable for decisions.
- Directors do not have an explicit fiduciary responsibility to maximize profit, nor can shareholders seek legal action to achieve that end.
- The board is granted broader discretion to consider non-shareholders stakeholders in decisions.
    - Benefit Corporations typically adopt a "stakeholder or benefit governance" model, whereby the business must consider the impact of its decisions on shareholders in addition to other stakeholders.
    - Stakeholders may include, but are not limited to, employees, suppliers, society, and the environment.
    - Stakeholder governance commitments can be embedded with varying specificity within company constitutions, charters, articles of incorporation, and other formation documents.
- The lack of specific guidance for directors on how to achieve benefit or consider the impact of their decisions is a known issue. There is no clear standard for management to operationalize consideration of competing interests. When there is a conflict between social/environmental and financial concerns, stakeholders have little recourse to enforce benefit.[23]
- If established in state regulations (e.g., Connecticut), shareholders or directors may engage in "benefit enforcement proceedings" for failing to pursue the social or environmental mission.[24]
    - This varies by state, but in addition to shareholders or directors, bylaws can specify others, such as beneficiaries, who have the legal standing to pursue enforcement proceedings.
    - Very few benefit enforcement proceedings have been brought. The first was Impact Makers in Virginia in 2019, which was settled in favor of the founder. The founder had originally filed the case after a hostile takeover by the board sought to subvert the mission-orientation of the company.
- The model may be combined with elements of democratic governance, including cooperative governance. The Kachuwa Investment Cooperative, for example, is incorporated as a Colorado PBC.

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23 Tiffany Burba, "To 'B' or Not to 'B': Duties of Directors and Rights of Stakeholders in Benefit Corporations," Vanderbilt Law Review En Banc, 2017.

24 J. Haskell Murray, "Enforcing Benefit Corporation Reporting," The *Tennessee Journal of Business Law*, 2022; Jaime Lee, "Benefit Corporations: A Proposal for Assessing Liability in Benefit Enforcement Proceedings,"Cornell Law Review, 2018.

WHAT ARE LEGAL, REGULATORY, AND TAX CONSIDERATIONS?

Legal

- Benefit Corporations generally must have a social or environmental purpose stated in their formal, state-filed articles of incorporation. Incorporation laws limit shareholder primacy and profit maximization by requiring the Board to consider the stated social, environmental, or public purpose.
- The PBC form is available in US states and countries that have passed Benefit Corporation legislation. Companies operating in states without a Benefit Corporation law can domicile in one that does or form a new corporation therein. Delaware is the most common state for PBC incorporation.
- Five states have created laws for flexible/social purpose corporations (FPC/SPC), which are almost identical to the Benefit Corporation.

Tax

- There is no separate US tax status.
- A PBC can elect to be taxed as either an S corporation or a C corporation provided it otherwise meets requirements on types and numbers of shareholders.[25]

Regulatory

- Traditional corporations can elect to become Benefit Corporations, typically by obtaining two-thirds shareholder approval (originally 90 percent in Delaware, since amended) and amending their incorporation and governing documents in states where Benefit Corporations are recognized.[26]
- Rules vary by state but almost all specify or require a statement of purpose and reporting of benefits:
  - Though purpose statement requirements are generally flexible (e.g., create a material positive impact on society and the environment), some states are more specific.
  - All require reporting (e.g., Benefit Report) of overall social and environmental performance as assessed against a comprehensive, credible, independent, and transparent third-party standard (e.g., the B-Lab certification).

25 "Benefit Corporations: What You Need to Know," Cultivating Capital, accessed August 8, 2023.

26 Amy L. Simmerman, Ryan J. Greecher, and Brian Currie, "Converting to a Delaware Public Benefit Corporation: Lessons from Experience," Harvard Law School Forum on Corporate Governance, 2022.

- Whether the Benefit Report is certified or audited by a third party may vary among states; some laws may also require it to be filed with the state.
- The report may be publicly available, and released annually, biannually, or biennially.

- Most states require an independent "benefit director" responsible for ensuring the company is consistently meeting its stated purpose. They also prepare and secure auditing for the Benefit Report and deliver an opinion as to whether the company is meeting its stated purpose.[27]

27 "Examining the 'Independent' Benefits Director requirement for New Jersey and Vermont Benefit Corporations? Could it be a Deterrent?" Apex Law Group, accessed August 8, 2023.

What are CICs?

DEFINITION

- A Community Interest Company (CIC) is a corporate form specific to the UK that ensures a traditional limited company structure—either by guarantee or by shares—and pursues its mission in perpetuity by mandating a stated community purpose, enshrining protection against a sale, and limiting the financial returns to owners and lenders.
- CICs can engage in profit-seeking activity—subject to dividend and performance-related interest limits—and can deploy equity capital shares, distinguishing them from charities and most nonprofit regulated entities.

CONTEXT AND EMPIRICS

- CICs were first established in 2005 by a UK Government legislative act in response to a lack of legal mechanism for "non-charitable" social-purpose enterprises that lock in a community benefit.1
- As of March 2022, over 26,000 CICs existed in the UK, 84 percent were limited by guarantee and 16 percent by shares. The number of CICs has grown by over 9 percent each year since 2015, with a peak of 26 percent growth between 2020 and 2021, perhaps due to the COVID-19 pandemic, which spurred people to help their community.2
- CICs vary in size (measured by revenue, assets, employee numbers) and can be found across different industry sectors and organizations from health care, social services, and education to private sector activities such as property, finance, and other professional

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1 Michelle Cho, "Benefit Corporations in the United States and Community Interest Companies in the United Kingdom: Does Social Enterprise Actually Work?" Northwestern Journal of International Law & Business, 2017; Alex Nicholls, "Institutionalizing Social Entrepreneurship in Regulatory Space: Reporting and Disclosure by Community Interest Companies," Accounting, Organizations and Society, 2010.

2 Department for Business Energy and Industrial Strategy, Office of the Regulator of Community Interest Companies, "Community Interest Companies Annual Report 2021/22," 2022; Anna Patton, "Record number of community interest companies amid rise of grant funds," Pioneers Post, August 25, 2021.

services. Well-known examples include efforts to create full-time employment opportunities for ex-offenders.3

- CIC legal forms are also being used within corporate groups as the "social impact"-focused vehicle within a wider corporate group structure.

WHAT ARE THE BENEFITS AND LIMITATIONS OF CICS?

Benefits

- The social impact of a CIC is defined by the "community interest test."[4] **The community interest test, required for incorporation and reviewed annually, effectively guarantees that CICs are attempting to meet some type of environmental and/or social goal**, rather than merely maximize profit for investors or wages for employees, board directors, and/or additional members.
- **The limited company structural flexibility and the flexibility of the regulatory environment accommodates a diversity in social and environmental purposes.**[5]
- A CIC may deliver the provision of a specific service, such as a welfare service to vulnerable communities.
- A CIC may directly generate profit through a community service and distribute the profits directly to the community they serve, through any mechanism specified in their articles of incorporation and related documents.
- CICs can address a wide range of social and environmental issues. Examples include supporting community-based wind energy systems by providing technical capacity, employing formerly incarcerated people and long-term unemployed people, or offering complementary therapy to underserved populations in a local community.
- Any assets owned by the company are held in **an asset lock to ensure they are used for the designated social or environmental purpose**.[6]

Limitations

- Though investors are eligible for limited tax relief, CICs are not provided the same donor tax benefits as charities, limiting their ability to raise philanthropic contributions.7 The current tax relief is slated to end in 2023.

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3 "About," Bristol Together, accessed August 8, 2023.

4 Department for Business Energy and Industrial Strategy, Office of the Regulator of Community Interest Companies, Information and Guidance Notes, "Chapter 2: Preliminary Considerations," May 2016.

5 Johnathan Korchak, "Advantages and disadvantages of a community interest company (CIC)," Inform Direct, May 30, 2018; Department for Business Energy and Industrial Strategy, Office of the Regulator of Community Interest Companies, Information and Guidance Notes, "Chapter 1: Introduction," May 2016.

6 Celine Chew, "Strategic Positioning And Organizational Adaptation In Social Enterprise Subsidiaries Of Voluntary Organizations," Public Management Review, 2010.

7 Nicholls, "Institutionalizing social entrepreneurship."

- To date there have been few empirical studies examining the profitability, distributions, employee/board compensation, or frequency of de-registration of CICs.
- Despite the diversity in size and range of activities, CICs are perceived as being mostly small and locally-focused, which is a positive for community accountability.8

HOW ARE CICS FINANCED?

General Financing

- A CIC can deploy the same debt and equity instruments as most limited companies, but with purpose-related limits on interest rates and profit distributions.[9]
- Companies limited by shares can issue debt and equity, while those limited by guarantee can only issue debt or equity-like debt instruments, as long as this does not circumvent the asset lock and the limits on financial returns.
- Returns on performance-related debt (i.e., debt with equity-like characteristics, hybrid/mezz/preferred equity, or sustainability-linked debt, where interest is linked to the CIC's financial or other performance indicators) are currently capped at 20 percent.[10]
- If established as a company limited by shares, CICs can raise capital through traditional equity shares, including multiple share classes (e.g., preferred equity ["preference shares"], common stock, etc.). They may pay dividends up to the "dividend cap," which acts to limit profit distribution:
  - The amount of profits paid to shareholders is capped by law at a maximum of 35 percent of annual total profit;[11] the remaining 65 percent of distributable profits must be reinvested back into CIC or the community it serves.[12] However, profit distributions are not capped if a CIC's shareholders are all asset-locked bodies.[13]
  - While profit is technically unlimited, these distribution restrictions effectively serve to cap profit.
- CICs limited by shares are eligible to receive grants, and several have been financed through grants. Charities seem to be favored over CICs as recipients of socially oriented funding.
- Shares are not subject to any special resale restrictions as to the nature of the purchaser or the price.

8 Cho, "Benefit corporations."

9 Department for Business Energy and Industrial Strategy, Office of the Regulator of Community Interest Companies, Information and Guidance Notes, "Chapter 7: Financing Community Interest Companies," May 2016.

10 "Community Interest Companies (CICs)," Dixon Wilson Chartered Accountants, October 24, 2019.

11 Regulator of Community Interest Companies, "Chapter 7: Financing Community Interest Companies."

12 Department for Business Energy and Industrial Strategy, Office of the Regulator of Community Interest Companies, Information and Guidance Notes, "Chapter 6: The Asset Lock," May 2016.

13 "Deciding between a CIC limited by guarantee and limited by shares," KG Accountants Blog, May 28, 2019.

Conversion and start-up financing

- Most CICs are created as start-ups or are very early stage conversions. Over the last two years, there have been over a thousand conversions from limited company to CIC. Anecdotally, many conversions are from existing entities in distress; this suggests that the price for acquiring equity for a conversion would be limited.
- Beyond community investors and crowdfunding campaigns, equity sources for companies limited by share do not appear to be well-developed.
- The UK government has been providing significant subsidies for CICs. It currently has a ~£150 million Community Ownership Fund that can support some CIC conversion costs.[14]

HOW ARE OWNERSHIP AND ECONOMIC RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

Share Ownership

- CICs are set up with limited liability by either guarantee or shares:
  - The limited by guarantee form is typically used by "not for profits" and is the most common (approximately three-fourths).[15]
  - If limited by shares, the company is set up such that the proportional value of shares owned by each shareholder dictates their percentage of control and ownership; the owners are thus traditional investor shareholders.[16] On a winding-up, a CIC shareholder is only entitled to receive back the amount contributed as share capital, with no appreciation.
- CICs limited by guarantee are usually nonprofit. As they are the most prominent CIC form, many CICs fully reinvest any potential surplus in the business or in the community to further the social objective.
- Companies limited by guarantee technically do not have shareholders or owners, only members. The guarantors, also called subscribers, are the members of the company, comparable to the board of directors of a nonprofit corporation.
- There is no legal requirement that shareholders or guarantors be community members, employees, customers, suppliers, or have any other non-financial relationship with the enterprise.

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14 Her Majesty's Government, "Community Ownership Fund Prospectus," January 20, 2023.

15 Department for Business Energy and Industrial Strategy, Office of the Regulator of Community Interest Companies, Information and Guidance Notes, "Frequently asked questions for funding organisations," May 2016.

16 Department for Business Energy and Industrial Strategy, Office of the Regulator of Community Interest Companies, Information and Guidance Notes, "Chapter 3: Limited Companies," May 2016.

Stakeholder Financial Benefit

- The financial surplus, if any, is chiefly distributed to benefit the community, in line with the CIC's stated mission. Returns to shareholders and debtholders are capped.

Asset Preservation

- Ownership is preserved via a mandatory asset lock, which prevents asset payouts to private individuals or their transfer at less than market value.
    - If a CIC is dissolved, the locked assets can only be transferred to a nominated asset-locked body (e.g., another CIC or charity).
    - The asset lock appeals to impact investors and grant funders because it ensures the permanent, mission-oriented use of funds.

HOW ARE GOVERNANCE RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- CICs are governed similarly to traditional limited companies.[17] Directors are responsible for ensuring the CIC meets its statutory requirements and satisfies the community interest test by preparing and filing the mandatory annual CIC Report.[18]
    - CICs must appoint company directors, which typically include shareholders or members, to provide oversight of day-to-day business activities.
    - The board may consist entirely of shareholders/insiders.
- The ultimate control and responsibility for major policy and decision-making lies with shareholders, if limited by shares, or subscribing guarantors or others admitted to membership, if limited by guarantee.
- Members typically appoint/dismiss directors, and they may delegate powers to the directors, declare dividends, approve major transactions, and change the constitution of the company.
- Board remuneration is permitted—unlike with charities, which generally prohibits remuneration to trustees for acting in such capacity—but is subject to "reasonableness" to ensure sufficient community profit and to limit the ability to use board payouts as a way to get around profit distribution restrictions.
- The board has a limited ability to reduce the community purpose in the CIC's range of operating activities.

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17 Department for Business Energy and Industrial Strategy, Office of the Regulator of Community Interest Companies, Information and Guidance Notes, "Chapter 9: Corporate Governance," May 2016.

18 Department for Business Energy and Industrial Strategy, Office of the Regulator of Community Interest Companies, Information and Guidance Notes, "Chapter 8: Statutory Obligations," May 2016.

WHAT ARE LEGAL, TAX, AND REGULATORY CONSIDERATIONS?

CICs are incorporated as a special-purpose limited company, with similar tax treatment to a typical limited company, though historically special tax relief has been available.

- CICs are required by law to have provisions in governing documents setting out the social purpose, which defines its range of corporate activities and must meet a community interest test.19 Incorporation as a CIC is not as of right, but contingent on regulatory approval.
- They are legally required to have an asset lock, which restricts the transfer of assets out of the company and ensures the continuity of community benefit.
- Once legally registered, they cannot be converted into a traditional company; if dissolved, their assets must be transferred to a similar restricted-purpose entity or converted into a charity.
- CICs are taxed in the same way as traditional companies and are subject to corporate income tax, with few exceptions.20
- CICs do not grant a funder the same donor tax relief as charitable entities (i.e., UK "gift aid"). A charitable funder wishing to support a CIC needs to be satisfied that in doing so, what they are funding is charitable and for public, not private, benefit. This is not as obvious with a CIC as a charity. Because of these two factors, CICs, as compared to charities, receive less socially-motivated funding.
- Historically, UK investors/lenders could access Social Investment Tax Relief (SITR), which spurred adoption of CICs. This is coming to an end in 2023.21
- No exact US peer to a CIC exists, but Benefit Corporations, Public Benefit Corporations, Low-Profit LLCs, and Perpetual Purpose Trusts have some similarities, in that they combine traditional corporate forms with some restrictions.
- CICs are subject to ongoing regulation; they must submit an annual explanatory report detailing the company's activities and the community benefit, along with director remuneration and dividend payments.
- There is a higher duty of transparency than in traditional private companies in order to satisfy the regulatory community interest test and asset lock.22 However, CICs are more lightly regulated than charities.23
    - The community interest test reviews the company's activities and how it will benefit the community, which is fairly broadly defined. It can be a population as a whole or a definable group of individuals through the provision of specific services or profit-sharing (e.g., welfare service to vulnerable people or the generation of profits used directly to benefit a community).

19 Regulator of Community Interest Companies, "Chapter 4: Creating a Community Interest Company."

20 Graham Batty, "Not-for-profit, not for tax?" Tax Adviser Magazine, August 1, 2015.

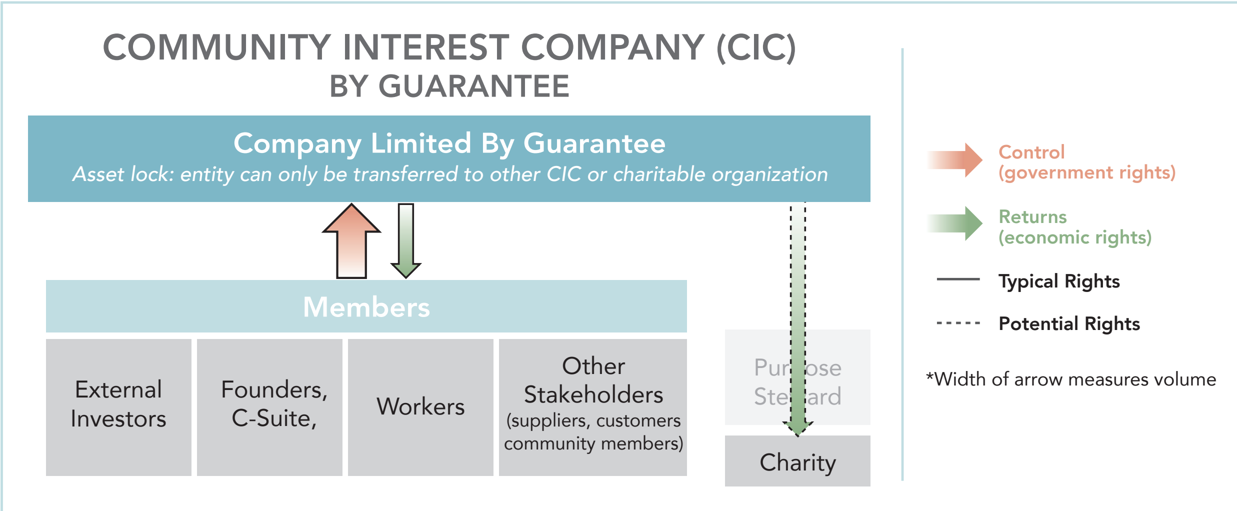
21 Her Majesty's Government, "Use SITR to raise money for your social enterprise," June 16, 2017.

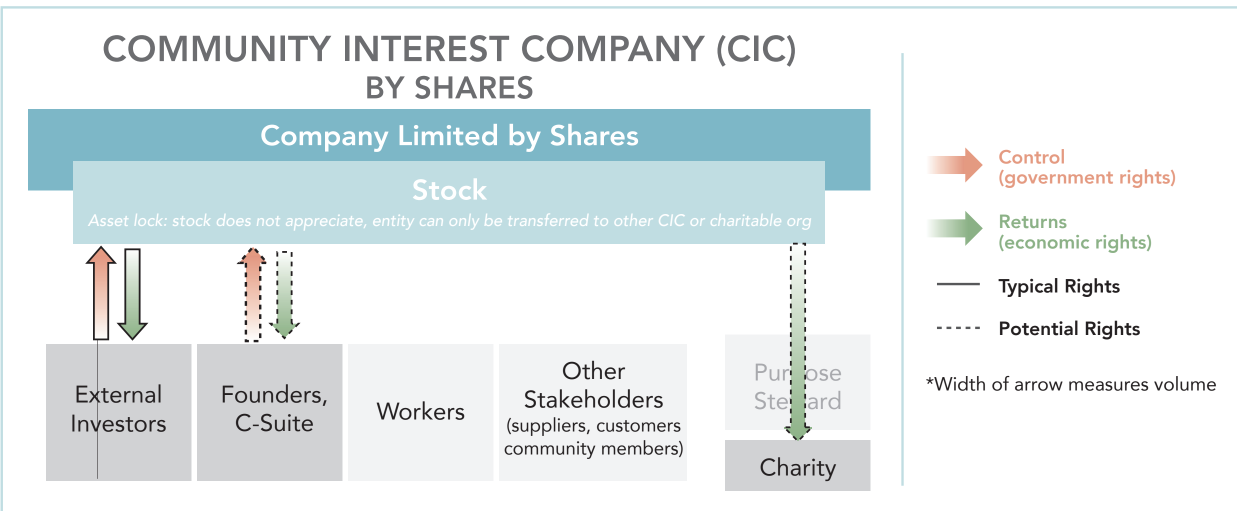
22 Regulator of Community Interest Companies, "Chapter 8: Statutory Obligations."

23 "Community Interest Companies," Community Companies, accessed August 8, 2023.

  - Both the community activities and the group being defined as a community must be considered "reasonable."
- Conversion to or from the form:24
  - Charities and community benefit societies may convert to a CIC, and a CIC may convert to a charity and community benefit society.
  - A CIC cannot be converted into a traditional company, but existing traditional companies can readily be converted to CIC structure if they meet regulatory requirements.
  - The impossibility to convert out of a CIC can be a limitation for founders concerned about potential changes in circumstances.
- Regulatory relationship to charities:
  - A single organization cannot be both a registered charity and CIC.
  - Charities may use CIC as a "charity shop" to operate trading activity where profits are passed on to finance its charitable activities, though CICs are not the exclusive way of achieving this.
  - It is unclear how frequently CICs are deemed to fall short of compliance with regulation or how often they are forcibly delisted/unregistered as a result.
- Community right to bid (2011) and a proposed community right to buy (2023 expected) could further enhance the use of CICs by community entities seeking to acquire "assets of community value." These mechanisms give communities the right to buy social purpose assets and provide some funding mechanisms and support, including through a Community Ownership Fund.

24 "Social Enterprise – Community Interest Companies (CIC)," Community Southwark, August 4, 2022; Regulator of Community Interest Companies, "Chapter 2: Preliminary Considerations."


COMMUNITY INTEREST COMPANY (CIC)
BY GUARANTEE
Company Limited By Guarantee
Asset lock: entity can only be transferred to other CIC or charitable organization
Members
External Investors
Founders, C-Suite,
Workers
Other Stakeholders (suppliers, customers community members)
Purpose Steward
Charity
Control (government rights)
Returns (economic rights)
Typical Rights
Potential Rights
*Width of arrow measures volume


COMMUNITY INTEREST COMPANY (CIC)
BY SHARES
Company Limited by Shares
Stock
Asset lock: stock does not appreciate, entity can only be transferred to other CIC or charitable org
External Investors
Founders, C-Suite
Workers
Other Stakeholders (suppliers, customers community members)
Purpose Steward
Charity
Control (government rights)
Returns (economic rights)
Typical Rights
Potential Rights
*Width of arrow measures volume

What are Consumer, Producer, Shared Services, or Multi-Stakeholder Cooperatives?

DEFINITION

- Cooperative enterprises bring together members (people or companies) with common interests in pursuit of commercial activity.[1]
  - **Consumer Cooperatives** owned by individual members who use the cooperative to purchase goods and services.
  - **Producer Cooperatives** that bring together members who produce similar types of goods and services.
  - **Shared Services (or Purchasing) Cooperatives,** which are similar to consumer cooperatives, but their members are businesses or organizations, instead of individuals.
  - **Multi-Stakeholder Cooperatives** that are owned by members with different roles and interests.
- As with Worker Cooperatives, these cooperatives are governed based on *one member, one vote*, with the financial benefit being shared between members. And they subscribe to the cooperative principles: (1) voluntary and open membership; (2) democratic member control; (3) member economic participation; (4) autonomy and independence; (5) education, training, and information; (6) cooperation among cooperatives; and (7) concern for the community.

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1 "Types of Co-ops," University of Wisconsin Center for Cooperatives, accessed August 7, 2023.

CONTEXT AND EMPIRICS

- Consumer, Producer, Shared Services, and Multi-Stakeholder Cooperatives are widespread and can be quite large. There are approximately 40,000 such cooperatives in the US.[2] Some, such as Land O'Lakes, Ace Hardware, and REI are well known brands with billions in annual revenue.[3]
- Consumer Cooperatives include credit unions, grocery co-ops, housing, childcare, and telephone and electrical distribution. There are over 130 million credit union members, which means that nearly one-third of all Americans use a cooperative credit union for financial services.[4] Electric cooperatives provide electricity to 12 percent of Americans and own 42 percent of the country's electric distribution lines.[5]
- Producer Cooperatives, by pooling member products, can negotiate better prices and access larger markets. These cooperatives can also operate shared facilities for processing or distribution. Producer Cooperatives are often used by artisans and are very common in agriculture. The majority of America's 2 million farmers and ranchers belong to one or more farmer cooperatives.[6] That said, the number of agricultural cooperatives has been declining for years (from 2,595 in 2007, down to 1,699 in 2021).[7]
- Shared Services Cooperatives are used by hospitals, independent retail stores, farm supply cooperatives, and educational institutions for cost-effective wholesale purchases. With over $10 billion in revenue, one of the largest Shared Services Cooperatives in the US appears to be Associated Wholesale Grocers, Inc., a cooperative food wholesaler for independently owned supermarkets.[8]
- Multi-Stakeholder Cooperatives, by aggregating different "classes" of members (e.g., producers, consumers, workers, or community members), have the potential to benefit whole communities, not just certain stakeholders. That said, there are currently only 15 examples of such cooperatives by one estimate.[9] There has been some growth in Multi-Stakeholder "Platform Cooperatives" for sharing economy activities, such as vacation home rentals (e.g., Fairbnb).

2 "Co-op Sectors," National Cooperative Business Association (NCBA), accessed August 7, 2023.

3 "Build Back for Impact," National Cooperative Bank, accessed August 7, 2023.

4 "Financial Services," University of Wisconsin Center for Cooperatives, accessed August 7, 2023.

5 "Rural electric cooperatives," Solar United Neighbors, accessed August 7, 2023.

6 "About NCFC," National Council of Farmer Cooperatives, accessed August 7, 2023.

7 "Agricultural Cooperative Statistics 2016," United States Department of Agriculture (USDA), December 2017; "Agricultural Cooperative Statistical Summary Results for 2021," USDA Rural Development, November 2, 2022.

8 "About us," Associated Wholesale Grocers, accessed August 7, 2023.

9 Email exchange with University of Wisconsin-Madison Center for Cooperatives, July 26 2023.

WHAT ARE THE BENEFITS AND LIMITATIONS OF THESE COOPERATIVES?

Benefits

- The main goal of these cooperatives is to help smaller, disaggregated actors compete in a consolidated economy. For example, the ACE Hardware cooperative allows independent, generally family-owned businesses, to compete against large, publicly traded home improvement retailers such as Home Depot and Lowe's.
- Cooperatives can also provide services where there is market failure or gaps in government provided services. For example, electric cooperatives provide important services to their members but are less profitable than typical utilities.[10] Similarly, water cooperatives thrive in suburban and rural areas that are located too far from municipal water companies to receive service.[11]
- Some cooperatives can catalyze additional positive impacts. For example, agricultural cooperatives can be a tool to support farmers of color.[12] Housing cooperatives can help provide more affordable and higher quality housing for vulnerable people.[13] Cooperatives, when owned by members of the same physical community, are shown to support local economies. Some estimate that $1 spent at a food cooperative is reinvested into its local community at an average rate of 160 percent.[14]

Limitations

- Consumer, Producer, and Shared Services Cooperatives are structured to benefit members and might choose to sacrifice the well-being of others to further their own interest. For example, REI has been engaged in many labor disputes with its employees (who are not members of the co-op) and has been accused of trying to block employee unionization efforts.

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10 Cooperatives serve an average of 8 consumers per mile of electric line and collect annual revenue of $19,000 per mile of electric line, whereas other utilities average 32 customers and $79,000 of revenue per mile, see: "America's Electric Cooperatives," National Rural Electric Cooperative Association, accessed August 7, 2023.

11 "Utility Cooperatives," University of Wisconsin Center for Cooperatives, accessed August 7, 2023.

12 Dara Cooper, "Reframing Food Hubs: Food Hubs, Racial Equity, and Self-Determination in the South," Race Forward and Center for Social Inclusion, February 2018.

13 See, for example: "What's a ROC (resident-owned community)?" ROC USA, accessed August 7, 2023.

14 NCBA, "Co-op Sectors."

HOW ARE THESE COOPERATIVES FINANCED?

- The financing varies based on the cooperative. The initial source of funding for a cooperative is often capital contributions provided by the members. If additional funding is needed, cooperatives can work to secure loans or issue non-voting preferred shares to outside investors.
- Producer and Shared Services Cooperatives tend to be well-capitalized, as their members are often businesses or organizations with sufficient capital to support the cooperative's start-up and growth capital requirements.

HOW ARE OWNERSHIP AND ECONOMIC RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- The economic rights of cooperatives are shared between members. While the financial surplus can be distributed via patronage or rebates, the core economic benefit of the cooperative to its members is that it provides them with access to, and lower cost on, goods and services.

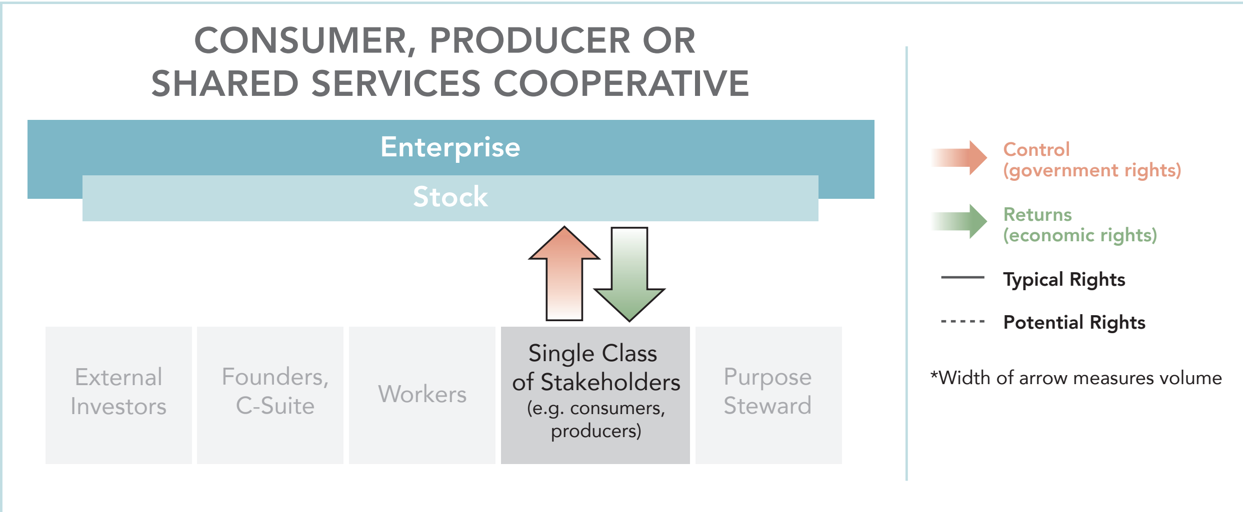
HOW ARE GOVERNANCE RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- As with any cooperative, members of the cooperative each have an equal voice in decision-making. Where the members are not the workers of the cooperative, there is no explicit mechanism for employee governance rights.
- In practice, the decision-making power of members at large cooperatives can be limited. For example, at REI, members can only approve or reject board members that have been approved by the existing board and pre-selected and vetted by its Nominating and Governance Committee.[15]

WHAT ARE LEGAL, TAX, AND REGULATORY CONSIDERATIONS?

- The US has some specific federal programs for specific cooperative subtypes with funding attached (e.g., model federal act for state rural electric cooperatives, federally chartered credit unions, etc.).
- Most legal, tax, and regulatory guidelines that apply to Worker Cooperatives apply here.

15 "Board Election Process," REI Co-op, accessed August 7, 2023.


CONSUMER, PRODUCER OR
SHARED SERVICES COOPERATIVE
Enterprise
Stock
External Investors
Founders, C-Suite
Workers
Single Class of Stakeholders (e.g. consumers, producers)
Purpose Steward
Control (government rights)
Returns (economic rights)
Typical Rights
Potential Rights
*Width of arrow measures volume

What are Platform Cooperatives?

DEFINITION

- Platform Cooperative is a term applied to digital platforms (i.e., two-sided market-matching platform on a website or mobile app to facilitate the exchange of goods and services) that embrace cooperative principles.[1] Platform Cooperatives lack specific legal or regulatory status, as well as clear model bounds or definitional limits.

CONTEXT AND EMPIRICS

- Platform Cooperatives emerged as a more equitable alternative to large-scale "gig economy" profit-maximizing platform companies, such as Airbnb. They embrace ethical commitments to promote enhanced labor conditions, equity, and transparency within the digital sharing economy.
- The conceptual framework was developed in 2014 with the first Platform Cooperatives emerging during that time. Despite the lack of a universally accepted definition or census, 500 Platform Cooperatives are said to exist worldwide across sectors including asset sharing, financial services, online marketplaces, local and remote gig work, agroindustry, and data and software services.[2]
- Notable examples are the online marketplace Fairmondo, an eBay alternative, and Eva and Green Taxi Driver, driver-owned alternatives to Uber.[3]

1 Mai Sutton, "A Shareable Explainer: What is a Platform Co-op?" Shareable, August 16, 2016.

2 Morshed Mannan, "Towards a Legal Framework for Platform Cooperatives: Potential and Obstacles," Submission to the United Nations Department of Economic and Social Affairs, June 1, 2021.

3 Jiang Zhu and Olivera Marjanovic, "A Different Kind of Sharing Economy: A Literature Review of Platform Cooperatives," Proceedings of the 54th Hawaii International Conference on System Sciences, 2021.

WHAT ARE THE BENEFITS AND LIMITATIONS OF PLATFORM COOPERATIVES?

Benefits

- The focus is to benefit specific members or an identified community, such as the providers or purchasers of a service that is transacted online. The majority of Platform Cooperatives aim to improve precarious labor conditions and economic dependence of gig workers. Members are provided regular incomes and have the agency to directly choose, for example, commission rates and mechanisms for surplus allocation.[4]

Limitations

- The lack of a universally accepted definition or framework is a constraint to their growth.
- Some practitioners have identified a challenge in applying cooperative principles in a distributed, online context, particularly where multiple stakeholders are involved.

HOW ARE PLATFORM COOPERATIVES FINANCED?

- The financing varies depending on whether the platform is a stand-alone start-up or the extension of an existing analog cooperative or entity. Extensions of an existing entity are likely to tap all relevant traditional institutional capital sources available to it to build a platform and may already have the required financial infrastructure. For start-ups, which are more likely to be self- or member-financed, different funding schemes such as crowdfunding may be deployed. The comparatively lower emphasis on profit creation makes Platform Cooperatives less attractive to investors that are not mission-driven.

HOW ARE OWNERSHIP AND ECONOMIC RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- Platform Cooperatives have democratically distributed economic rights among members and participants who work for, supply to, or buy from the platform. In theory, Platform Cooperatives may have various membership shares and different membership types for different stakeholders (i.e., a mix of worker, producer, and consumers may own platform co-ops, though one owner type is likely typically dominant). Ownership may also come with dividend rights.

4 Trebor Scholz, "PLATFORM COOPERATIVISM: Challenging the Corporate Sharing Economy," Rosa Luxemburg Stiftung, New York Office, January 2016; Damion Jonathan Bunders et al., "The feasibility of platform cooperatives in the gig economy," Journal of Co-Operative Organization and Management, 2002.

HOW ARE GOVERNANCE RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- In theory, Platform Cooperatives engage in democratic, transparent shared governance across stakeholders with broadly shared, board-style voting rights. Members may elect a board of directors using *one member, one vote* rules that provide equal representation in voting regardless of a member's stake in the company. In reality, decision-making may vary depending on internal company structure or by-laws adopted.[5]

WHAT ARE LEGAL, TAX, AND REGULATORY CONSIDERATIONS?

- There are currently no platform-specific legal, tax, or regulatory frameworks. If applicable in the relevant jurisdiction, Platform Cooperatives may be created under cooperative specific statutes. However, they may also incorporate as a Limited Liability Corporation (LLC in the US) with cooperative bylaws, private limited company by guarantee (UK), or nonprofit (France/Brazil). They are thus subject to appropriate tax mechanisms and tax benefits, depending on the chosen legal structure.
- Similarly, Platform Cooperatives are subject to regulatory frameworks associated with specified corporate forms (e.g., cooperative corporation, LLC, etc.). The lack of definitions and regulations means that the term has been stretched to apply to investor-owned platforms that may merely offer some membership or social benefit. The term is also being loosely applied to any digital enterprise, even if not technically a platform, further muddying the definition.

5 For examples, see "Co-op Rules," Stocksy, and "Welcome to Fairmondo", Farimondo, accessed August 7, 2023.

What are EOTs?

DEFINITION

- Employee Ownership Trusts (EOT) provide **indirect employee ownership through a legal trust that purchases (typically a majority of the) shares of a company and holds them on behalf of employees**.
  - In the US, they are a specific form of Perpetual Purpose Trust (PPT) with employees as the main beneficiaries. EOTs do not allocate share ownership directly to employees and there is typically no up-front cost for employees as beneficiaries of the trusts.
- The fundamental purpose of an EOT is twofold:
  - 1) to provide financial benefit to employees through profit sharing mechanisms or other pathways; and
  - 2) to retain long-term or permanent ownership of the company by the trust.
- EOTs often have elements of democratic participation by employees, although the legal forms being used to create EOTs do not require it.

CONTEXT AND EMPIRICS

- In contrast to Employee Stock Ownership Plans (ESOP), EOTs are not a qualified retirement plan.
- EOTs in the US are structured using the Purpose Trust (PT) or Perpetual Purpose Trust (PPT) model—depending on whether perpetuity is possible—in which the purpose has stipulations for employee governance and economic participation.
- An EOT is often used by owners as part of exit or succession planning.
  - In the UK, any owner selling directly to an employee benefit trust can reap tax benefits.[1]

1 "Employee-ownership trusts: UK tax considerations," Clyde & Co Market Insight, May 11, 2022.

- EOTs are garnering interest among owners looking for an Employee Ownership alternative to ESOPs and are further enabled in the US by ongoing statutory legal changes in trust law. (Most of these legal changes, however, concern PPTs in general, not specifically EOTs.)
- Start-up EOTs, while possible, remain uncommon.

United States

- Most US EOTs use existing statutory trust structures (e.g., non-charitable purpose trusts, directed trusts, grantor trusts, etc.), and there are currently few standardized features across EOTs in the US.
- The EOT model has been adopted by more than 20 US companies so far.2
- Most EOTs are conversions, ranging from small (<50 employees) to mid-sized (<500 employees) businesses.
- Patagonia's sale to a family-controlled Perpetual Purpose Trust and 501(c)(4) in 2022 may be a game changer for trust ownership structures in the US, including EOTs.

United Kingdom

- In the UK, EOTs have grown considerably since a 2014 law incentivized the adoption of the century-old "John Lewis" model,[3] so-called because of the UK's largest employee-owned company, with 80k employees and US$12B revenue.
- The number of employee-owned businesses in the UK—and EOTs specifically—are growing rapidly:
  - As of June 2023, there are more than 1,400 UK employee-owned businesses of any kind.4
  - As of June 2021, there were 576 EOTs in the UK.5 The model has experienced strong growth with 500 new EOTs created in the twelve months ending September 2022. This was up from 235 in the previous year and 56 in the year before that.6
  - Figures from 2021 show 1 in 20 sales of companies/firms in the UK were to EOTs.7

2 Anne-Claire Broughton et al., "Employee Ownership Trusts, Perpetual Purpose Trusts, and Stewardship Trusts in the United States," Harvard Dataverse, 2022.

3 Bernard Paranque and Hugh Willmott, "Cooperatives — Saviours or Gravediggers of Capitalism? Critical Performativity and the John Lewis Partnership," Organization, 2014; Marcus Leroux, "Ownership brings staff added bonus at John Lewis," The Sunday Times, August 25, 2014; Abby Cathcart, "Directing Democracy: Competing Interests and Contested Terrain in the John Lewis Partnership," Journal of Industrial Relations, 2013.

4 "What The Evidence Tells Us," Employee Ownership Association, accessed August 8, 2023.

5 "What The Evidence Tells Us," Employee Ownership Association, accessed August 8, 2023.

6 Mary McDougall, "UK businesses turn to employee-ownership at record rates," Financial Times, December 8, 2022.

7 Employee Ownership Association, "What The Evidence Tells Us."

WHAT ARE THE BENEFITS AND LIMITATIONS OF EOTS?

Benefits

- The EOT principally serves to ensure the company's permanent commitment to its mission and to commit it to benefit employees by creating high quality jobs, sharing in the economic benefit and other benefits, and allowing employees to participate in governance.
- EOTs embed benefits of employee voice and wealth building; asset lock among Employee Ownership models ensures that the company will be operated by and for the employees in perpetuity.
- Advocates claim it can be cheaper and simpler to administer than either an ESOP or Worker Cooperative, and that it provides a greater degree of Employee Ownership and control than an ESOP and more operating flexibility than a Worker Cooperative.[8]
    - In its simple form, the model can serve smaller-sized companies that want to avoid the complexity and ongoing costs of an ESOP transaction, but the model can also be made to fit much larger entities.
    - In addition, EOTs don't have the same need for ongoing cash flow and capital planning that ESOPs require to meet their share repurchasing obligations, since shares are allocated to the trust and not to individual employee accounts.
- As with worker cooperatives, the financial benefit to EOT employees is ongoing, unlike with ESOPs, where employees wait until retirement or resignation for the payout.
    - Most EOTs specify the process by which annual profits are distributed to employees.
- Because of the flexibility of the PPT structure in the US, EOTs have the option to provide benefits to other stakeholders (e.g., suppliers or contractors) in addition to full-time employees and to list additional purposes in their trust documents. If they provide such benefits, they may claim to be both an EOT and a PPT.
- The use of the more flexible Purpose Trust model to create EOTs in the US makes it possible to embed other beneficiaries (e.g., the "environment" or firm stakeholders) alongside employees in whose benefit the trust is held.
- EOTs have economic benefits to employees that are similar to Worker Cooperatives (and different from ESOPs):
    - Employees receive an annual cash benefit (and do not have to wait until they depart from the company or it is sold). Those benefits can start flowing immediately if the company has the available cash flow.
    - The EOT is exempt from the share repurchase obligations that can create a cash flow burden for ESOPs.
    - EOTs are designed to benefit employees—both current and future—by preventing the sale of the company and ensuring employee ownership over the long term. This contrasts to ESOPs, which are designed solely to benefit current employee-owners as

8 As suggested, for example, by advisory services such as Common Trust and EOT Advisors (EOT FAQs), accessed August 8, 2023.

beneficiary shareholders and have no explicit requirement or mechanism to consider the welfare of future employees at the company.

  - However, there is a lack of capital value accrual (i.e., employees are not “owners” and therefore never get to cash out). This makes the advantage of the EOT more like a Worker Cooperative’s financial benefit through ongoing patronage dividends. In an ESOP, employees potentially enjoy a greater (delayed) upside if the stock value appreciates.

- EOTs contribute to maintaining control of the company against a potential takeover. Because the company cannot be sold, EOTs (like other Steward Ownership models) may act against increased corporate consolidation and its associated negative effect on worker wages and community wealth.[9]
- While not mandated, the levels of employee control at EOTs are typically much higher than in a traditional company. This may lead to a range of benefits to workers that have been found for Worker Cooperatives.

Limitations

- Due to the bespoke nature of transactions to date, legal fees and transaction costs to structure EOTs have been high, but they are declining as lawyers and investors conduct repeat transactions. Many corporate lawyers remain unfamiliar with PPT law. The set of available best practices is limited.
- The asset lock, which prevents a sale of the company, might limit the financial upside for current employees, though it likely allows the company to benefit more workers over time.
- Trusts are governed by private documents, which makes it impossible to independently verify the actual economic and governing power granted to employees in EOTs.

HOW ARE EOTS FINANCED?

General Financing

- Common stock equity financing is hard to obtain for EOTs, as voting and governance rights are largely reserved to the trust.
- Because the economic benefits are meant to accrue to employees, there is less cash available for returns to investors. Moreover, in the US, EOTs typically have a clause that the company should retain some portion of profit for reinvestment, with the surplus to be paid out either as cash or as a contribution to a diversified 401(k) plan (and not made available to investors).
- Traditional debt remains an option for financing.

9 Elena Prager and Matt Schmitt, “Employer consolidation and wages: Evidence from hospitals,” American Economic Review, 2021.

- Because common stock is only held in the trust, 100% EOTs can only raise equity-like capital by offering preferred non-voting equity shares. This instrument requires a structured exit (e.g., revenue-based loans, redeemable shares, etc.) to provide liquidity to investors, and generally it has a cap on returns.
- In the UK, companies that are not 100% EOT-owned can offer common stock; as long as majority control remains with trust, disqualifying events are not triggered.
- In the UK, the trust cannot act as a financial guarantor of the company's debt. This means that when lenders evaluate the creditworthiness of the company, they take into consideration what the company owes for the conversion financing without considering the value of the shares held by the trust, thereby weakening their balance sheet picture. This may undermine the ability of the company to access favorable ongoing financing from some banks.[10]

Start-up Financing

- There is very little record of EOT start-ups in either the US or UK. The one known example of a start-up EOT in the US—Equity Atlas, a mortgage and financial services company—appears to be now defunct.

Conversion Financing

- Most EOTs are established as a conversion to employee ownership during a sale event.
- The mechanics of financing a conversion to EOT ownership are as follows:
    - The selling owner establishes a trust.
    - The selling owner transfers their interest in the company to the trust, either whole or partial and at once or over time.
    - The sale is generally seller-financed via "deferred consideration," where the seller receives a promissory note that will be repaid out of company profits.
    - The remaining portion is provided by upfront debt from banks or alternative lenders, secured by the company's assets.[11] The presence of seller financing is effectively a prerequisite to bring in additional capital providers.
    - Repayment of the purchase debt to the seller is a company expense. Typically, the promissory note will be repaid over a period of years.
    - A seller concerned with having seller financing outstanding while the employees fully control the company can have a provision to grant employee governance rights once the seller financing is repaid.

10 Mike Dinnell, "Why we want to raise awareness around the benefits of accessing finance to fund an EOT transition," Employee Ownership Association, October 20, 2022.

11 Chris Budd, "How using external debt can help turn an EOT wish into reality," Thincats, September 3, 2021; "Employee-ownership trusts: issues with lending to employee-owned companies," Birketts, November 2, 2021; "Where does the money for an EOT come from?" Postlethwaite Solicitors Limited, March 15, 2022.

- A successful EOT conversion relies on the steady and profitable growth of the enterprise and the right balance of risk from the debt load with fair compensation for the selling owner.
    - Using cash flow to repay the seller and investors can hamper the distribution of profits to employees.
    - Debt providers for conversions in the US tend to be mission-driven lenders (e.g., RSF Social Finance) and emerging Purpose Trust lenders (e.g., Common Trust).
- Typically, all common stock is held by the trust, at least in the Oregon model. Companies can, however, issue preferred equity shares outside of the trust for a minority stake.
    - It is possible to issue non-voting preferred equity shares as part of the conversion financing, as demonstrated by Firebrand Artisan Breads.
    - It is also possible for voting shares to sit outside of the trust, which can help raise growth equity. However, majority voting needs to remain within the trust to ensure that the purpose is not jeopardized.12
- A sale to a US EOT is a private transaction, there is no valuation requirement.
- In the UK, the majority-stake share sale is based on an independent business valuation and cannot be more than market value, but it can be contributed below market value. A selling owner may choose to gift their shares or sell at below market value.
    - Sellers may elect an initial 51 percent sale to enable a phase-out period and to reduce the debt burden of a 100 percent sale; this may also improve the company's financial position to attract conversion debt financing.

HOW ARE OWNERSHIP AND ECONOMIC RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- EOTs are not a distinct corporate form. They are a holding structure where generally the EOT holds the majority (51+ percent) of a firm's share ownership, voting rights, and income/capital rights, collectively owned in trust for all employees. Employees do not individually hold or receive shares or associated capital value, but they do have some governance rights.

Share Ownership

- Trusts are flexible legal US or UK structures that can hold assets on behalf of others.
    - In the US, the underlying firm can assume most corporate forms, although this may vary by jurisdiction.
    - UK EOTs are deployed with corporate ownership forms limited by share.[13]

12 "Exiting to Employees Through Employee Ownership Trusts," Common Trust and Purpose Foundation, 2021.

13 William Franklin, "Employment ownership trusts," *Tax Adviser Magazine,* April 1, 2016.

- EOTs typically hold the majority (or all) of the equity of the underlying firm. There is no allocation of shares to individual employees.
    - In the US context, EOT refers to a type of Perpetual Purpose Trust that owns a majority (or all) of the equity of the underlying firm, in perpetuity, for the benefit of the employees. However, there is no standard definition in law or in practice.
    - In the UK, a specific type of statutory trust must be used to be eligible for tax benefits.[14] Ownership of a majority of the shares is required to receive tax benefits in the UK.
- While there have been some start-up EOT in the US, all current ones are conversions. Most UK EOTs are full 100 percent ownership conversions.
    - Many UK EOTs start with 51 percent ownership sale with intention to reach 100 percent over a transition period, during which the trust buys the remaining shares from the non-trust owner on a schedule.
    - A small number opt or intend to remain less than 100% EOT-owned (i.e., a hybrid EOT model). This is typically to retain some shares to sell to key management employees (using other tax incentive plans) or to sell to an outside investor (provided the EOT retains majority control of ownership shares and majority voting rights).

Stakeholder Financial Benefit

- The EOT is effectively a way to (1) share ongoing financial benefit with a broad base of employees as an employee benefit via an annual bonus, and (2) help assure the business is governed for the employees' benefit in perpetuity.
    - US EOTs typically direct the company to retain some portion of profit for reinvestment, and to pay out the remaining profits to workers either as cash or as a contribution to a diversified 401(k) plan, or a combination of both.
        - Some practitioners (e.g., Common Trust) recommend including provisions in the trust agreement to ensure that the company will be operated to protect the long-term financial health of the business; this is not, however, a legal requirement.
    - Bonuses to employees may initially be modest after the initial trust creation, when profits are used to pay back the EOT's acquisition cost.
    - Because EOT employees do not buy shares, accumulate allocated ownership stakes, or accrue capital balance in deferred accounts, they do not receive additional when leaving the company. In other words, there is no deferred dividend or appreciation in the shares' face value.
    - Norms and practices are still emergent (e.g., around the employee probationary period before becoming a beneficiary).
- In the UK, employees holding 5 percent of any class of shares—or rights to acquire 5 percent of any class of shares—in the company pre-conversion cannot become beneficiaries of the EOT.

14 "Guide to Structuring Employee Ownership," Employee Ownership Association, 2015.

HOW ARE GOVERNANCE RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- The governance of EOTs is flexible. In general, EOTs provide a mechanism for workers to exert more voice and vote in the company. In the UK, tax benefits are conditional on the EOT having majority control of economic and voting rights. Employees may have additional voice via board and EOT trustee seats, but these are not required. US examples include some employee governance rights over the EOT itself, if not always over the company's governance.
- Corporate governance of the company itself is generally not affected by the existence of an EOT, as the EOT only pertains to holding shares in the company. However, certain restrictions and provisions allow for the trust to supersede corporate board decisions (e.g., to prevent a sale).
- Governance of the trust itself is derived from trust law, absent specific provisions.

United States

- The US EOT models' trust governance structure is purposely flexible and can be customized. For example, governance can include non-employee stakeholders.
- EOTs interested in ensuring perpetuity will include share sale provisions or restrictions in the trust agreement, but the trust structures being deployed to create EOTs do not necessarily require this.
- The optimal governance structure to protect purpose varies and can be based on factors such as industry and company size. Since trusts are generally governed by private documents, it is difficult to access detailed information about existing EOTs.
- EOTs provide governance rights to the employees via specific trust mechanisms: trust agreement, trust stewardship committee, trust enforcer, and trustee. The actual governance rights are flexible.
    - The trust agreement defines the roles and responsibilities of stakeholders (e.g., decision-making practices, employee-trustee relations, trustee selection, etc.).
        - The trust agreement need not have an explicit democratic governance mandate, though most US EOTs have such a mandate along with a company sale restriction. It can also adopt cooperative principles, as at least one EOT has.[15]
        - Employees may be given rights to direct the trustee—essentially the power to elect board members and make other high-level decisions—while maintaining the trustee's discretion over the sale of the company.[16]

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15 "Workers to Owners: The Story of Metis Construction," US Federation of Worker Cooperatives, June 17, 2018; "Employee Ownership through Perpetual Trusts: A Case Study," National Center for Employee Ownership Newsletter, October 2020.

16 "Steward-ownership: Ownership and finance solutions for mission-driven businesses," The Purpose Foundation et al., Expo West, 2019.

- The trust may choose to specify other rights for employees to amend the trust or corporate documents in order to assure that the trust's stated purpose is achieved.
- The trust agreement may specify how to remove leaders not honoring the values of the corporation,[17] perhaps via the stewardship council or the protector.
- EOTs interested in ensuring perpetuity can include share sale restrictions in the trust agreement.

  - The trust stewardship council/committee and trust protector/enforcer (separate from trustee) both have a legal obligation to ensure that the trust's stated benefit/purpose related to stewarding the firm, as per the trust agreement, is met.
    - The trust council and trust enforcer are both usually free from direct company management responsibilities.
    - The trust enforcer arbitrates beneficiary grievances over trust agreement violations. Beneficiaries (which in the case of EOTs are employees) also have a legal right to raise violations to them.
    - Rules regarding eligibility and selection for the stewardship council and enforcer roles (e.g., stakeholder election or appointment by some other specified means) are specified in trust agreement.
  - The trustee carries out administrative functions, with no substantive governance role.

United Kingdom

- UK EOTs "best practice" may choose to include an employee council, a body elected from employees, which may be empowered to appoint or remove trustees and have consultations rights prior to the trustees exercising their voting rights. The council may also hold company or trust seats.[18]
  - The majority of voting rights must remain with the trust's majority shares, but it does not seem that employees must formally have seats on or in the trust's governance. Most EOTs have at least one employee trustee, and employees account for 30-40 percent of trustee seats in the typical EOT.
  - Regardless, the EOT must be run for the benefit of employees, and it may formally include direct employee representation and control in the trust without necessarily having a majority of the trustee positions.
- The trust may also specify that employees have a seat on the company board, separate from the trust, but again this does not seem to be required. John Lewis, for example, operates with a variation of both types of corporate and trust control by employees.

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17 Karen Kahn, "New Employee Ownership Trusts Demonstrate Viability in U.S.," *Fifty by Fifty,* March 30, 2021.

18 "Model Documentation for a Company with Employee Ownership," Pett, Franklin and Co. LLP. for the Government of the UK, Department for Business, Innovation and Skills, accessed August 8, 2023.

WHAT ARE LEGAL, TAX, AND REGULATORY CONSIDERATIONS?

United States

- US EOTs are legally available as a specific type of statutory trust in some states and under the recent Uniform Trust Code (UTC), adopted by a majority of states.[19] While laws are now changing to allow perpetuity, most states still do not allow it.[20]
  - Oregon introduced the "stewardship trust" into state law in 2019 as a statutory trust with specific rules to assure stewardship of the firm.[21]
  - As of 2022, Delaware, South Dakota, Wyoming, and New Hampshire also allow business/non-charitable purpose trusts in perpetuity, but these are not specific to Steward Ownership or social/environmental purpose.
  - Most US EOTs are organized under the Delaware or South Dakota statutes.
- In other states, existing statutory trust structures (e.g., non-charitable purpose trusts, directed trusts, grantor trusts, etc.) are applied with specific governance features to create EOTs.
  - US EOTs frequently use types of non-charitable purpose trusts to incorporate; they are by definition a subset of Perpetual Purpose Trusts (PPT) or Purpose Trusts (PT).
  - There is no statutory meaning or definition to the term EOT in US law.
  - Statutory and common law recognize PTs of various kinds—the two major varieties being charitable purpose trusts and non-charitable purpose trusts—which under specific circumstances can continue in perpetuity (PPT).[22]
  - Oregon's stewardship trust is a sub-type of non-charitable purpose trust.
  - Most, if not all, US EOTs are being structured "in perpetuity."
- US EOTs do not receive federal or state tax benefit, either for company sale to the trust or for employee distributions, but there are bills proposed in Maryland, Wisconsin, and drafted for New York States that would provide some tax benefits.[23]
  - However, the portion of cash that is paid out to employees as a bonus—which would otherwise be taxable income for the trust—is a deductible expense to the company.
- There is minimal regulatory oversight, which is a perhaps reason why some view EOTs as more simple and affordable to set up and administer.

19 Christina Bogdanski, "The Uniform Trust Code and the Common Law: An Analysis of Three Sections of the Code That Deviate from the Common Law and Why the Drafters Changed the Law," Cardozo Law Review, 2015.

20 "Where Should Your Trust Call Home?" Alternative Ownership Advisors, accessed August 8, 2023.

21 Susan N. Gary, "The Oregon Stewardship Trust: A New Type of Purpose Trust that Enables Steward-Ownership of a Business," University of Cincinnati Law Review, 2020.

22 Thomas E. Simmons and Brad Myers, "Purpose Trusts as a Planning Tool for the 21st Century," University of South Dakota School of Law, September 8, 2019.

23 Christopher Michael, "The British Are Coming: ESOPs and Perpetual Trusts," EOT Advisors, accessed August 8, 2023.

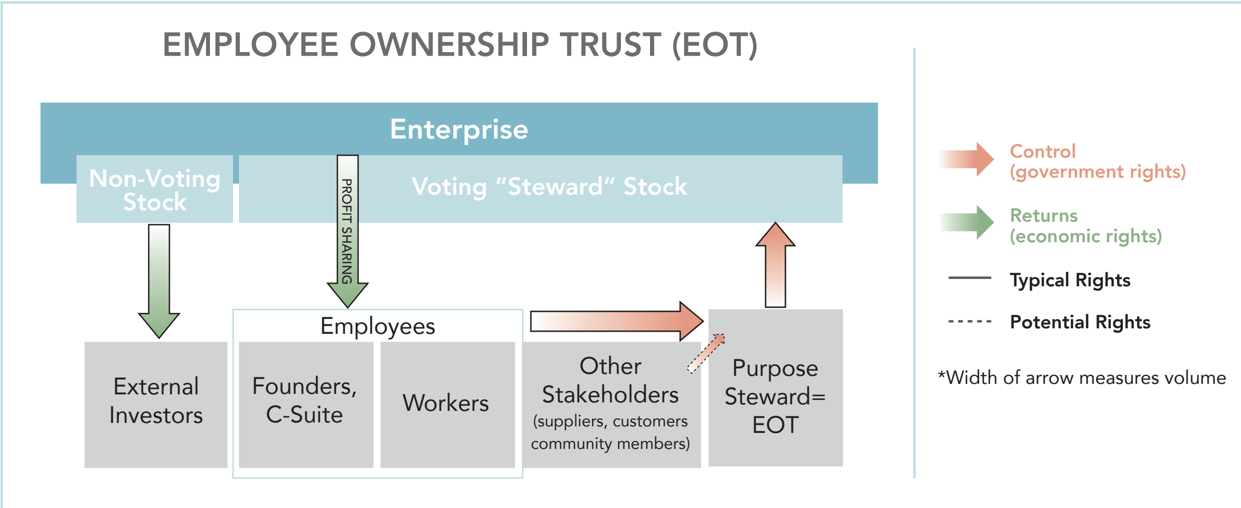
- Because there is no standard model or uniform regulation, there is no guarantee that US EOTs distribute a majority of dividends to a broad base of employees, or that they give employees broad governance rights with respect to corporate events. In practice, most do appear to do the latter.

United Kingdom

- EOTs are regulated in the UK under Finance Act 2014 Schedule 37. The legal existence of EOTs in the UK as distinct from other trusts is based on tax considerations:
  - EOT refers to a particular sub-type of employee benefit trust (EBT), which is a previously existing type of UK trust that can be used to hold funds for various types of employee benefits. EBTs have previously been used for employee share purchase plans, share options, and other employee benefits.[24]
  - EOTs are also referred to as Sch 37 trusts, based on Schedule 37 of the 2014 law that created the EOT defined tax benefits for EBTs that serve a certain purpose and meet certain conditions.
    - Before the 2014 law, companies were free to use existing trusts to own a majority of a company's shares, without tax benefits.
    - The law established legal requirements related to ownership level, governance, and nature of distributions to qualify for EOT tax benefits.
- Tax advantages exist for capital sale proceeds and ongoing employee income and corporate income:
  - *Capital Sale Proceeds:* Sale of shares from owners to the EOT is entirely free from capital gains tax if it meets the "all-employee benefit requirement" and "equality requirement" tests. For a hybrid EOT, capital gains tax is avoided on the portion of the value conveyed to the EOT.
  - *Employee Income*: The annual bonus compensation to employees, which is not technically a dividend, is tax deductible to both the employee and the company, up to a limit.
- For the tax benefits to apply, the trust must hold more than 50 percent of the shares, voting, and capital rights. And all financial benefits from the trust must be available to all employees—subject to considerations such as tenure and waiting periods—on equal terms (e.g., payouts to specific employees are not allowed, but payouts may differ based on considerations such as salary).[25]
- Except for the advantages above, an EOT is taxed like any other holder of company shares.

24 Guy Mulley, "The Shifting Sands of UK Tax Law," *The Cambridge Law Journal*, 2017.

25 "EIM03054 - Employee Ownership Trusts – qualifying bonus payments: The equality requirement," HM Revenue & Customs, published May 22, 2014 and last updated July 6, 2023.


EMPLOYEE OWNERSHIP TRUST (EOT)
Enterprise
Non-Voting Stock
Voting "Steward" Stock
PROFIT SHARING
Employees
External Investors
Founders, C-Suite
Workers
Other Stakeholders
(suppliers, customers community members)
Purpose Steward= EOT
Control
(government rights)
Returns
(economic rights)
Typical Rights
Potential Rights
*Width of arrow measures volume

What are ESOPs?

DEFINITION

- An ESOP (Employee Stock Ownership Plan) is an ownership model, rather than a distinct corporate form. It is structured as a retirement benefit plan that provides a broad base of employees with indirect financial ownership of their place of work.
- The company's stock is partly or wholly held in a trust on behalf of employees. Shares are vested to employees over time, at no cost, and are cashed out upon exiting the company. In a 100% ESOP, a company's stock is wholly held by the ESOP (and thus by the workers).

CONTEXT AND EMPIRICS

- In 1956, Louis Kelso piloted an employee stock ownership plan (ESOP) to enable the employees of a closely held newspaper chain to buy out its retiring owners. Kelso and his co-author, the philosopher Mortimer J. Adler, later expanded on the economic theory on which the ESOP is based in a best-selling book, *The Capitalist Manifesto*.[1]
- ESOPs were formally established in the United States by the Employee Retirement Income Security Act of 1974 (ERISA) as an employer retirement plan.[2]
- More than 6,000 ESOPs are in place with $1.6 trillion held in total plan assets across 13.9 million participants.[3] **ESOPs are rare outside of the United States, where they are the most widespread form of employee ownership.**
- ESOPs are most prevalent in mature, privately held companies but can be used in both private and public companies. While publicly traded companies represent only 8 percent

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1 Louis O. Kelso and Mortimer J. Adler, The Capitalist Manifesto, 1958.

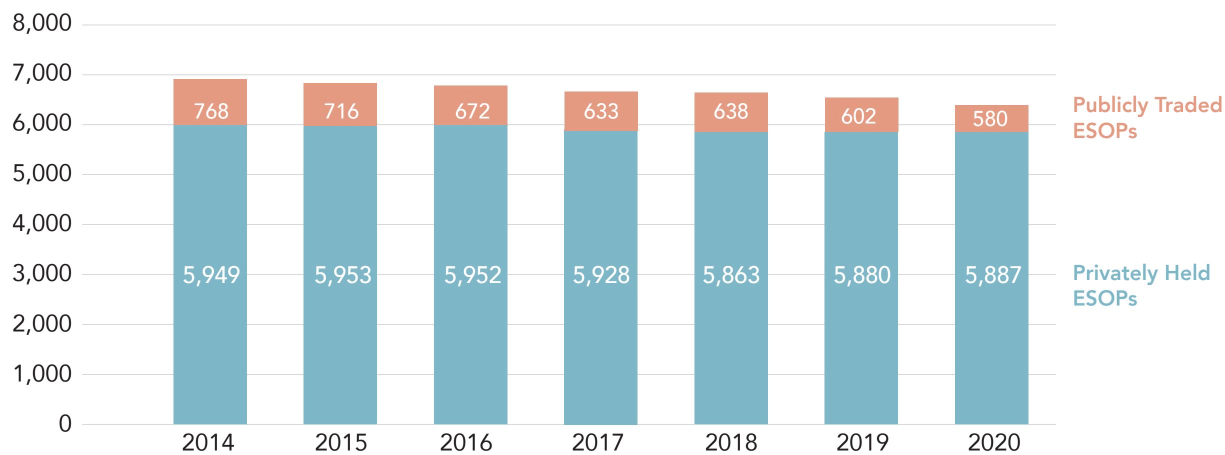
2 "The Origin and History of the ESOP and Its Future Role as a Business Succession Tool," The Menke Group, accessed August 8, 2023; Saeyoung Chang, "Employee Stock Ownership Plans and Shareholder Wealth: An Empirical Investigation," Financial Management, 1990.

3 "Employee Ownership by the Numbers," National Center for Employee Ownership (NCEO), February 2023; "The Economic Power of ESOPs" and "Infographic: ESOPs by the Numbers," NCEO, accessed August 8, 2023.

of total ESOPs, they employ ~85 percent of ESOP beneficiaries. Some 250 new ESOPs are formed each year, and their number remains fairly steady.[4]

- ESOPs are represented across a wide variety of industries and are most prevalent in professional/tech services and manufacturing, followed by construction, and finance/insurance/real estate and wholesale trade (for privately held companies).[5] Notable ESOPs include privately-held Publix (80 percent employee-owned, over 230,000 employees) and Davey Tree Expert (100 percent employee-owned, over 11,000 employees).

ESOPS IN THE UNITED STATES BY YEAR



WHAT ARE THE BENEFITS AND LIMITATIONS OF ESOPS?

Benefits

- **ESOPs provide wealth building opportunities for employees.** In 2020, ESOPs paid out over $149 billion to participants.[6]
- **Employees are generally granted the shares** with no up-front costs.[7]
- ESOPs are enabled by federal legislation as a retirement contribution plan with associated tax advantages.

4 "A Statistical Snapshot of ESOPs: Company and Participant Numbers, and Industry Distribution," NCEO, accessed August 8, 2013; NCEO, "ESOPs by the Numbers."

5 NCEO, "ESOPs by the Numbers."

6 NCEO, "Employee Ownership by the Numbers."

7 Akhilsh Ganti, "Employee Stock Ownership Plan (ESOP): What It Is, How It Works, Advantages," Investopedia, last updated March 15, 2023.

- An ESOP, when applied to a company with majority lower- and middle-income employees and people of color can help to build significant wealth for employees that have historically been excluded from asset-building opportunities. ESOPs may be used to reduce wealth concentration within firms and provide retirement security.[8]
- An ESOP per se is no guarantee of job quality or other employee benefits. However, ESOPs tend to stabilize employment and significantly increase employee retention.[9]
- There is some evidence that ESOPs may increase corporate environmental engagement and ESG ratings.[10] They also tend to have a better chance of maintaining its mission.[11]
- Department of Labor (DOL) oversight ensures ESOPs deliver on wealth building for employees and aren't used as an extractive financial engineering move, which was a historical criticism of ESOPs.

Limitations

- While ESOPs have the potential to build wealth for under-represented and marginalized people, men tend to be over-represented in ESOPs.[12]
- ESOPs have no requirement for democratic governance and ESOP employees generally have limited legal rights over the company's decisions.[13]
- The purchase of an ESOP by another company might threaten job security, create mission drift, end wealth benefits for future employees, or lead to further corporate consolidation, though it can also result in a financial windfall for employees.
- Strict regulation under ERISA constrains adoption of the model, as it generates high costs for initiation and ongoing management. ESOPs generally cost between $100,000 and $300,000 to set up, with ongoing costs of about $20,000 to $30,000 for most ESOPs.[14]
- Paying out employee accounts on departure creates significant ongoing cash-flow management demands for the company.

8 Karen Kahn, "Race, Equity and the Transformative Power of Employee Ownership: A conversation with Todd Leverette," *Fifty by Fifty*, July 21, 2020.

9 Douglas Kruse, "Does employee ownership improve performance?" IZA World of Labor, 2022; "Employee-Owned Firms in the COVID-19 Pandemic," Employee Ownership Foundation, accessed August 8, 2023.

10 Dongmin Kong and Yanan Wang, "Employee Stock Ownership Plans and Corporate Environmental Engagement," Available at SSRN, September 1, 2021.

11 Sarah Stranahan and Marjorie Kelly, "Mission-led employee-owned firms: The best of the best," *Fifty by Fifty*, 2019.

12 Melissa Hoover, "Employee Ownership: A Pathway to Economic Resilience," Asset Funders Network, 2023.

13 Michael Murphy, "The ESOP at Thirty: A Democratic Perspective," *Willamette Law Review,* 2005.

14 "Employee Ownership for Closely Held (Private) Companies: ESOPs, Equity Grants, Trusts, and Worker Cooperatives," NCEO, September 3, 2021.

HOW ARE ESOPS FINANCED?

General financing

- The underlying company owned by an ESOP can access traditional forms of corporate finance, though if the company is 100 percent owned by an ESOP it generally cannot access equity investments (since all of the equity is owned by the ESOP).
- ESOPs are always established and financed in a conversion process (i.e., are established in ongoing, revenue-generating businesses). Company shares may be sold to the ESOP trust to generate funds for expansion, to withdraw cash for other business or operating activities, or to provide an exit for a company owner(s).
    - ESOPs are often used to enable succession planning as an alternative to selling the company to a private equity firm or a competitor.
    - Non-succession ESOPs are used either as a supplemental employee benefit plan or a way to borrow tax-efficient funds; because the proceeds from a loan can be used by the company for any purpose, an ESOP transaction can act as a source of ongoing financing.[15]

Conversion Financing

- The purchase of shares by an ESOP is typically debt financed as part of the sale of a mature company's shares by the owner(s) to its employees (i.e., leveraged ESOP). Conversion to an ESOP may also be self-financed by the company's cash and shares (i.e., non-leveraged ESOP).[16]
- Where debt financing is used, the company stock is purchased by the ESOP with money borrowed from a bank and/or selling shareholder(s). Approximately half of privately held ESOPs are currently leveraged and become non-leveraged over time as the loan is paid down.[17]
    - The tax benefits of a leveraged ESOP make it an attractive way of financing a sale for both the company and a selling owner.
    - When borrowing externally, the company sets up a trust, which borrows money to acquire the shares; the company effectively repays the loan by contributing cash to the trust, which is used to repay the lender. As the loan is repaid, the shares are released to employee accounts. In practice, the company takes out the loan, which it then reloans to the ESOP trust.
    - In a seller-financing context, the owner(s) transfer the stock to the ESOP in exchange for a seller note, which is subordinated to other financing.

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15 "A Detailed Overview of Employee Ownership Plan Alternatives," NCEO, May 14, 2021.

16 Regina Carls, Leveraged ESOPs and Employee Buyouts, 2020; Adam Hayes, "Leveraged Employee Stock Ownership Plan (LESOP)," Investopedia, last updated January 4, 2023; Aaron Juckett, "How Does a Leveraged ESOP Work? Here's All You Need to Know," ESOP Partners, September 14, 2021.

17 NCEO, "Employee Ownership by the Numbers."

- Who provides outside financing for conversions?
  - Smaller companies that are—or seek to become—majority ESOP-owned can borrow from the Small Business Administration (SBA). They can do so directly or indirectly (e.g., through SBA preferred lenders) for ongoing finance or conversion, via the 7(a) and Small Business Investment Company programs.[18]
  - Many traditional banks have ESOP lending practices to provide loans to establish new ESOPs.
  - Currently, some impact funds specialize in investing to convert businesses held by retiring owners to ESOPs. And recently, ESOP conversion funds have emerged that focus explicitly on workers of color (e.g., Apis & Heritage Capital and the Business Legacy Fund).[19]

Start-Up Financing

- ESOPs are not established at a firm's start-up phase (i.e., before there is recurring revenue), due largely to the fact that younger companies are not leverageable and there is generally not a seller.

HOW ARE OWNERSHIP AND ECONOMIC RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- ESOPs can hold 100 percent of a company's ownership shares (100% ESOP), or a fractional stake (Partial ESOP).[20]
  - Employees are not direct owners of the shares. The ESOP itself is the legal shareholder and owner of record for the company shares that are held in trust for the participant employees.[21]
  - Where not all shares are owned by the ESOP, external investors can own shares of the company not held in the ESOP.[22]
  - The ownership percentage is usually negotiated at the formation of the ESOP by management, investors, and existing shareholders.

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18 "New Law Eases SBA Financing Rules for ESOPs," BDO United States, April 5, 2019; "SBA Loans for Employee Stock Ownership Plans," US Small Business Administration (SBA) Fact Sheet, accessed August 8, 2023; Aaron Juckett, "How to Find and Work With a Lender to Secure ESOP Financing," ESOP Partners, August 3, 2021; "New 2018 Law Makes SBA ESOP Financing Easier," NCEO, August 29, 2018.

19 "(Press Release) Apis & Heritage Capital Partners Announces Initial Close of $30 Million to Turn Businesses with Workforces of Color into Employee-Owned Firms," The Rockefeller Foundation, June 23, 2021; "Business Legacy Fund Seeks Applications," Become Worker Owned, accessed August 8, 2023.

20 "What Is Employee Ownership?" NCEO, accessed August 8, 2023.

21 "What is an ESOP? How an Employee Stock Ownership Plan Works," ESOP Partners, accessed August 8, 2023.

22 Richard May et al., "Fiduciary Responsibilities Regarding External Investors in ESOP Companies," August 2019.

- Both public and private stock corporations can have ESOPs.[23]
    - Even LLCs, which have no shareholders or stock, can technically issue ESOPs, if they are taxed as an S-Corp. In this case, members' unit interests are treated as shares.[24]
- A "broad base" of employees must participate in an ESOP, but each employee's ownership stake can vary significantly based on tenure and pay.
    - Employee ownership must include at least 70 percent of non-highly compensated employees who are over 21 and who have completed a year of employment.[25]
    - Ownership typically increases with an employee's length of tenure and their relative pay, and it can vary substantially.
    - When an employee leaves the company, their vested shares are typically sold by the employee back to the ESOP. The unvested portion of shares is returned to the unallocated ESOP pool for redistribution or gets taken out of circulation by the company.[26]
- Employees gain assigned shares through vesting measures over time (ranging between three and six years).[27] In addition to vesting, shares may also be offered as a bonus or gifted to employees through a reward structure.
- An ESOP can be dissolved through a company acquisition, even when a company is 100% ESOP-Owned. The new owner can be an ESOP but does not have to be. When an ESOP is terminated, all ESOP participants are paid out.
    - Shares may be rolled over into purchasing company ESOP (if applicable) or transferred into an alternative 401(k) plan. Participants may also have the choice to receive fair market value in a lump sum cash payment; however, that subjects them to capital gains tax (and a 10 percent excise tax if under retirement age).[28]
- While the main benefit for employees is on cash-out value at retirement, ongoing wealth can be generated through pass-through dividends, which can be distributed to employees on an on-going basis.[29]

23 "How an Employee Stock Ownership Plan (ESOP) Works," NCEO, August 24, 2020.

24 "Start Here: Limited Liability Companies (LLCs) and Employee Ownership," NCEO, January 18, 2019.

25 Aaron Juckett, "Your Ultimate Guide to ESOP Eligibility: Who's In & Who's Out?" ESOP Partners, May 17, 2022.

26 Judith L. Kornfeld, "Redeeming vs. Recirculating ESOP Shares," NCEO, August 1998.

27 NCEO, "How an ESOP Works."

28 Zach Molner, "What Happens to ESOP Benefits When a Company Closes or is Sold?" ESOP Partners, November 9, 2021.

29 NCEO, "A Detailed Overview."

HOW ARE GOVERNANCE RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- ESOPs have no requirement for democratic governance. Employees typically do not have direct voting rights on ordinary votes and have limited legal authority with ongoing firm governance.[30]
  - The degree of employee governance is established upon creation of the plan document and can vary widely. Typically, decision-making power is constrained and delegated to the board of directors, trust stewardship committee, or a single trustee to hold voting power for all participants. Some ESOPs adopt a democratic governance system that distributes decision-making power equally amongst employees. This form takes the name of democratic ESOP or ESOPerative.31
- The interests of participating employees are generally represented by an ESOP trustee, who has the same types of voting rights as other shareholders but is held to a high fiduciary standard by regulatory agencies.
  - There are no legal requirements on how a trustee is selected: the board may choose one of their own members, or an external institution or individual, or allow employees to choose.[32]
  - While the trustee exercises the participants' voting rights (e.g., voting for the board of directors and buying or selling stock), the employees have pass-through voting rights for major corporate events such as merger, liquidation, dissolution, or sale of substantially all the assets of the company. In practice, there appears to be no documented case where the trustee's vote and the employees' pass-through vote diverged.
  - An individual employee's voting power, to the extent it is present, depends on the number of shares allocated to them. For example, senior employees might have more voting power than newly hired employees with fewer shares.
  - In an ESOP that holds more than 50 percent of the voting stock of the company, ESOP trustees control the vote for the company board, but typically the board appoints the ESOP trustee in a "circular" arrangement.[33]

30 Deborah Groban Olson, "Distinguishing Employee Ownership, Workplace Democracy & Workplace Participation," ESOPlaw.com, accessed August 8, 2023; Aaron Juckett, "ESOP Corporate Governance," ESOP Partners, November 19, 2019.

31 Julie Lynn Kaufman, "Democratic ESOPs: Can Workers Control Their Future?" The Labor Lawyer, 1989; Martin Staubus, "The ESOP-erative: A new design: worker cooperative governance with ESOP tax benefits," *Fifty by Fifty*: Employee Ownership News via Medium, August 17, 2017.

32 John Case, "Employee Ownership: Building a Better American Economy," NCEO, 2017.

33 Anne Bushman, "Who controls an ESOP-owned company? An ESOP's effect on corporate governance," RSM, updated July 2018.

WHAT ARE LEGAL, TAX, AND REGULATORY CONSIDERATIONS?

- ESOPs are enabled by federal legislation as a retirement contribution plan with associated tax advantages. ESOPs are highly regulated under US federal tax and employee benefits laws and are subject to rules and oversight by the DOL and the Internal Revenue Service (IRS). Legal and fiduciary compliance requires significant advance planning and ongoing costs.
- As a legal entity, the ESOP exists at the federal level, recognized as a 401(a) retirement contribution plan that may be adopted by corporate entities taxed under Subchapter S (S-Corp) and Subchapter C (C-Corp) of the Internal Revenue Code (IRC).[34]
- There are tax incentives for both the sponsoring company and for participating employees:[35]
    - The loan made by the sponsor company to the ESOP is deducted from the sponsor's corporate income tax (both interest and principal).
    - A non-leveraged ESOP sponsor (i.e., the company) may deduct contributions of stock to the ESOP for up to 25 percent of covered payroll in each tax year. For a leveraged ESOP, the sponsor can make tax-deductible contributions to repay principal similarly up to 25 percent of covered payroll limit.
    - Dividends paid to the ESOP are deductible expenses at the corporate level. As the ESOP uses those dividends to repay the loan, essentially the earnings of the company help pay for the acquisition of the stock.
    - In C-Corps, once the ESOP owns 30 percent or more of the shares, the sponsoring company has the option to defer, or even avoid, capital gains tax on stock sold to the ESOP (e.g., by a retiring owner) by reinvesting proceeds in other securities, under a "Section 1024" rollover.
    - In S-Corps, the percentage of ESOP ownership is not subject to federal corporate income tax (but may be taxed at state level); a 100% ESOP-Owned Company pays no federal corporate income tax and is exempt from most state income tax.[36]
    - While many states pass through the federal tax treatment, some have implemented additional tax and legal benefits, such as state-level capital gains exemptions, laws removing restrictions that prohibit certain professions from using the model, state funding for transition studies, and loans for the actual implementation of a transition.[37]
    - Employees pay no income tax on shares or contributions until they access the distributions, and then usually do so usually at favorable rates. Employees also may roll over distributions into other individual retirement plans or pay current tax on the distribution, with any gains subject to capital gains tax. A 10 percent penalty occurs if distributions are taken before normal retirement age.

34 "Federal Legislation on ESOPs," NCEO, September 2022; "Employee Stock Ownership Plans (ESOPs)," Internal Revenue Service (IRS), last updated August 30, 2022.

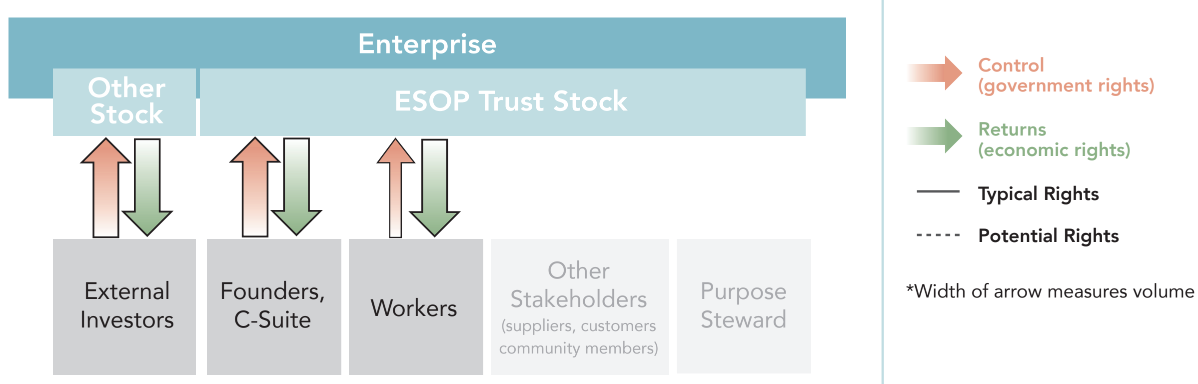
35 "ESOP Tax Incentives and Contribution Limits," NCEO, February 7, 2018; "Tax Advantages of ESOPs for Business Planning," Employee Ownership Foundation, accessed August 8, 2023.

36 NCEO, "How an ESOP Works."

37 "State Legislation on Employee Ownership," NCEO, September 2022.

- Regulatory requirements create significant costs to structure and maintain an ESOP, such as third-party annual valuations and the ongoing repurchasing obligations of shares from employees.[38]
    - ERISA rules are meant to protect the beneficiaries of the plan from fraud and malfeasance. ESOP fiduciaries remain subject to ERISA's fiduciary duties and prohibited transaction rules.
    - Internal Revenue Code (IRC) section 401(a) requires all ESOPs to have a trustee and administrator.
    - IRS and DOL share jurisdiction over enforcing some various ESOP features; DOL is authorized to bring litigation against ESOP fiduciaries to enforce fiduciary and prohibited transaction requirements.

PARTIAL EMPLOYEE STOCK OWNERSHIP PLAN (ESOP)



38 Deborah Groban Olson, "Employee Ownership Trusts (EOT): Less Expensive & Less Complex Than an ESOP, More Flexible and Permanent," ESOPlaw.com, accessed August 8, 2023; Pete Stavros, "Private Equity and ESOPs," *The Journal of Private Equity*, 2002.

What are democratic ESOPs / ESOPeratives?

DEFINITION

- Democratic Employee Stock Ownership Plans (ESOP), now known as ESOPeratives, are ESOPs that are run democratically, where each employee is part of the company's governance. To learn more about ESOPs, see this brief.

CONTEXT AND EMPIRICS

- ESOPeratives are not well documented—and the exact number is unknown—but best estimates suggest that fewer than 100 ESOPeratives are operating today in the United States. They vary in size and profile and include some mid-sized firms.
- The model originated in the late 1970s and early 1980s, with high-profile examples of distressed industrial firm sales that were often brokered with union assistance.[1]
- In the last decade, as interest in worker cooperatives and democratic ownership revived, the model was rebranded as an ESOPerative. And organizations such as Project Equity offer ESOPerative conversion support.[2]

1 Joyce Rothschild-Whitt, "Who Will Benefit from ESOPs?" *Labor Research Review,* 1985; Joyce Rothschild and Raymond Russell, "Alternatives To Bureaucracy: Democratic Participation In The Economy," Annual Review of Sociology, 1986.

2 Jason S. Spicer, "Worker and Community Ownership as an Economic Development Strategy: Innovative Rebirth or Tired Retread of a Failed Idea?," *Economic Development Quarterly,* 2020; "Employee ownership options" and "How we can help," Project Equity, accessed August 8, 2023.

WHAT ARE THE BENEFITS AND LIMITATIONS OF ESOPERATIVES?

Benefits

- As with Worker Cooperatives, workplace democracy can:
    - create better working conditions for employees;
    - lead to higher satisfaction and retention; and
    - address race and class inequities within the firm.
- ESOPeratives combine the democratic aspect of Worker Cooperatives with the scale and financing advantages of ESOPs.

Limitations

- Some of the limitations of the ESOP model still apply (e.g., no asset lock, cash flow demands for the company, and trustee fiduciary responsibility potentially at odds with long-term interests of employees).
- The model is not widely known or implemented.

HOW ARE ESOPERATIVES FINANCED?

- The financing considerations for ESOPs apply to ESOPeratives too.
- The ESOPerative model can be appealing because it benefits from the ESOP capital gains and distribution tax advantages and avoids the capital availability constraints of worker cooperatives. This makes it a viable model for larger companies.
- ESOPeratives can have a dual share structure,[3] which should allow for preferred equity infusions without diluting worker governance. However, dual share models are typically used to enable unequal distributions among employees based on seniority and pay.

HOW ARE OWNERSHIP AND ECONOMIC RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- As with a typical ESOP, the trust is an indirect vehicle that holds the company's stock on behalf of the employees. Shares vest to employees over time and are cashed out upon exiting the company.
- While relative ownership in an ESOP is typically tied to wages and seniority, ESOPeratives tend to allocate ownership to employees in a way that limits disparities. For example, Sun Light & Power distributed shares to the employees according to a split: 50 percent divided

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3 Julie Lynn Kaufman, "Democratic ESOPs: Can Workers Control Their Future?" *The Labor Lawyer,* 1989.

equally among all employees; 25 percent allocated based on seniority; and 25 percent allocated based on pay level.[4]

HOW ARE GOVERNANCE RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- ESOPeratives provide democratic "one worker, one vote" governance, enshrined in the bylaws. Governance rights extend to choosing ESOP trustees, casting shareholder votes, and electing the board of directors.[5] This is different from "standard" ESOPs where employees vote based on the number of shares they hold and on a limited number of issues. Governance in ESOPeratives varies across companies; there are not standardized practices. Features may include:
    - Democratic rules for the selection committee in nominating and electing trustees and board of directors.
    - Two-tiered voting where employees democratically vote to instruct ESOP trustees how to vote on shareholder fiduciary decisions, including sale offers for the company.
    - Rules for maximum pay ratios or the delegation of many management decisions from the board to employees. For example, Once Again Nut Butter Collective has a 4:1 pay ration and delegates 75 types of company decisions democratically to employees.[6]
    - All employees (not just ESOP stock eligible members) vote in company-related governance and board elections.

WHAT ARE LEGAL, TAX, AND REGULATORY CONSIDERATIONS?

- ESOPeratives can be incorporated using the same range of legal corporate forms (e.g., traditional incorporation with shares) and tax statuses (e.g., S-corp and C-corp) available to majority ESOP-owned firms. They are accordingly eligible for all the same tax benefits of an ESOP.
- ESOPeratives are likewise subject to the same regulations as an ESOP. They are not technically incorporated as a cooperative. Therefore, they are not subject to any legal restrictions associated with cooperatives, nor are they required to maintain cooperative financial and governance features.

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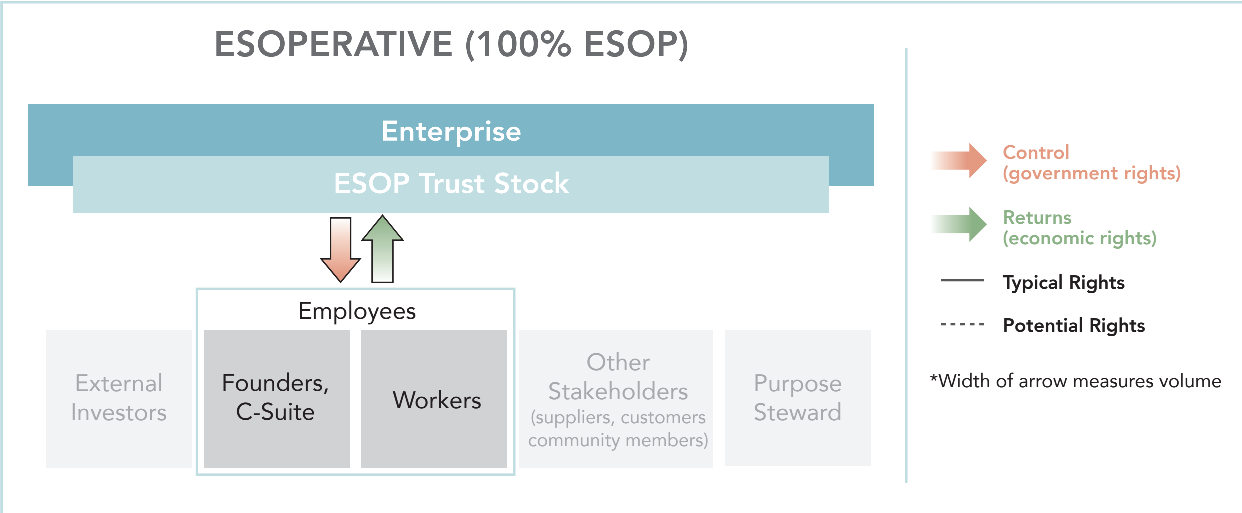
4 Martin Staubus, "The ESOP-erative: A new design: worker cooperative governance with ESOP tax benefits," *Fifty by Fifty: Employee Ownership News via Medium,* August 17, 2017; Peter Walsh, Michael Peck, and Ibon Zugasti, "Why the US needs more worker-owned companies," *Harvard Business Review,* August 8, 2018.

5 Kaufman, "Democratic ESOPs"; David Ellerman, The democratic worker-owned firm: A new model for the East and West, 1990.

6 Deborah Groban Olson, "Case Study: Once Again Nut Butter Collective, Inc. (OANB)," ESOPlaw.com, accessed August 8, 2023; Marjorie Kelly and Thomas Hanna, "Democratic ownership in the USA: A quiet revolution," *International Journal of Public Policy,* 2019.


ESOPERATIVE (100% ESOP)
Enterprise
ESOP Trust Stock
Employees
External Investors
Founders, C-Suite
Workers
Other Stakeholders
(suppliers, customers community members)
Purpose Steward
Control
(government rights)
Returns
(economic rights)
Typical Rights
Potential Rights
*Width of arrow measures volume

What are Foundation-Owned Companies?

DEFINITION

- A Foundation-Owned Company is a business owned by a foundation, partly or entirely, typically after a transfer of ownership by the company's founder.[1]
- Foundation Ownership of a company may be combined with partial control by another entity, such as a trust, where the foundation has ownership of all economic shares and the trust holds the voting shares.[2] The primary goals of the separation of economic rights from governance rights are to allow founders to maintain a degree of control over the company and to set and preserve the company's purpose in perpetuity.
- Many foundation owners use corporate activity primarily to generate philanthropic dollars, rather than maximizing profits for the benefit of shareholders or other stakeholders.
    - This goal is enshrined most strongly in foundation models that split economic and control rights among two separate boards or two separate entities.
    - Some countries mandate a specific percentage of profits to be donated to charity. In the US, as of new 2018 regulations, 100 percent of profits must be donated.
- There is no consistent international regulatory framework. Governance structures and allowed charitable purposes vary dramatically, depending on cultural and political environments.
- Throughout this document, we are not reviewing Foundation Ownership as a tax shelter or similar mechanism. We focus on Foundation Ownership as a form of Steward Ownership, "a corporate ownership structure that presents an alternative to shareholder value primacy… [and] ensures that companies prioritize their long-term purpose over short-term profits."[3]

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1 Steen Thomsen, "Corporate Ownership by Industrial Foundations," *European Journal of Law and Economics,* 1999.

2 "Steward-ownership: A short guidebook to legal frameworks," NYU Law and The Purpose Foundation, 2020.

3 "Steward-ownership," Purpose, accessed August 8, 2023.

CONTEXT AND EMPIRICS

- Foundation-Owned Companies (e.g., Ford) were prevalent in the US prior to the 1969 Tax Reform Act, which limited ownership of a company's shares by a foundation to 20 percent. The 1969 tax reform—which may have been motivated by the Ford Foundation's abuse of the existing law to retain family control of the Ford Corporation—sought to remedy the use of philanthropic institutions to avoid inheritance taxes.[4]
  - Changes in US legislation from 2018 now entitle private foundations to hold 100 percent of a company's voting stock, subject to certain requirements.[5]
  - This enabled well-known companies, such as Newman's Own company, to become 100 percent owned by their private foundation.
- Foundation Ownership is found around the world[6] in companies like Bosch and Bertelsmann (Germany), Hershey (US), Tata (India), Rolex (Switzerland), and Ikea (Sweden). It is most common in Northern Europe, particularly in Denmark (e.g., Maersk and Carlsberg).
- Foundation-Owned Companies do not appear to be concentrated in any particular sector.
- While Foundation-Owned Companies could be expected to underperform, given the lack of profit incentive and the comparatively higher cost of capital, the evidence for large Foundation-Owned Companies suggests that they do as well as conventional enterprises.[7]
- Foundation Ownership represents a significant portion of economic activity in Northern Europe:[8]
  - In Denmark, the roughly 1,300 Foundation-Owned Companies account for approximately 70 percent of total stock market capitalization. They account for 5 percent of all jobs, 8-10 percent of private sector employment, and 20 percent of Danish GDP.
  - There are nearly 1,000 Foundation-Owned Companies in Germany, 1,000 in Sweden, and 120 in Switzerland.
  - 5 of the 100 largest German companies are majority-owned by foundations.
- The Milton Hershey School Trust is the oldest and most prominent US example. It still holds more (29 percent) voting shares of the Hershey Company than any other shareholder.[9]

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4 Francis X. Sutton, "The Ford Foundation: The Early Years," Daedalus, 1987; Benjamin Soskis, "Newman's Own Shaky Foundation," *Town & Country Magazine,* October 27, 2022.

5 "Private foundations: Establishing a vehicle for your charitable vision," Deloitte, 2021.

6 Ann-Kristin Achleitner et al., "Foundation ownership and shareholder value: an event study," Review of Managerial Science, 2020; Joern Block and Reza Fathollahi, "Foundation ownership and firm growth," *Review of Managerial Science,* 2022.

7 Christa Børsting et al., "The Performance of Danish Foundation-Owned Companies," Unpublished Working Paper, Center for Corporate Governance, Copenhagen Business School, 2014; Steen Thomsen and Nikolaos Kavadis, "Enterprise Foundations: Law, Taxation, Governance, and Performance," *Annals of Corporate Governance,* 2022.

8 Steen Thomsen, The Danish Industrial Foundations, 2017; Søren Bo Nielsen, "Industrial Foundations in the Tax System," Paper presented at 70th Annual Congress of the International Institute of Public Finance, 2014; Delphine Bottge, "The Foundation-Owned Company Model," *Philanthropy Impact Magazine,* 2021.

9 "What Kind Of Shareholders Own The Hershey Company (NYSE:HSY)?" Simply Wall St, June 28, 2021; Jonathan Klick and Robert H. Sitkoff, "Agency Costs, Charitable Trusts, and Corporate Control: Evidence from Hershey's Kiss-Off," *Columbia Law Review,* 2008.

WHAT ARE THE BENEFITS AND LIMITATIONS OF FOUNDATION-OWNED COMPANIES?

Benefits

- A significant percentage of corporate profits go to charity (e.g., 100 percent in the US), which removes short-term shareholder value maximization.
- Foundation-Owned Companies donate to a variety of causes.
  - For example, in the US, Newman's Own addresses childhood hardship, Patagonia addresses climate issues, and the Milton Hershey School Trust is dedicated to medical services and educational enrichment for children living in poverty.
  - The causes are not exclusively progressive. For example, Tripp Lite is now owned by the right-wing 501(c)(4) Marble Freedom Trust.
- This structure prevents a company sale, which leads to long-term stability and mission preservation. In the aggregate, company sales lead to corporate consolidation, the avoidance of which is seen by some as an impact in itself.
- The separation of corporate governance and economic distribution of share value—while varying across jurisdictions and individual companies—allows for the commitment to mission and the avoidance of mission drift.
- Foundation-Owned Companies play a stabilizing role in the local economies in which they operate. They tend to be cast as "responsible employers" who compensate employees well and engage in termination less often compared to investor-owned firms.[10] Charitably oriented Foundation-Owned Companies tend to have higher ethical standards and are less likely to renege on implicit contracts with employees.
- Foundation-Owned Companies, like other Steward-Owned Companies, operate with more of a long-term lens.[11]
  - As compared to conventional enterprises, Foundation Ownership enables long-term economic performance, especially during market volatility, and increases the probability of surviving beyond 40 years. Directors and management focus more on long-run profitability, given that they are freer from short-term stock market pressures.[12]
  - Foundation-Owned firms tend to invest more in long-term assets and human capital.
- Corporate responsibility may be formalized into the governance structure (e.g., governed by charters which typically force companies to operate in a socially responsible manner).[13]

10 Christa Børsting and Steen Thomsen, "Foundation ownership, reputation, and labour," Oxford Review of Economic Policy, 2017.

11 Steen Thomsen et al., "Industrial foundations as long-term owners," Corporate Governance: An International Review, 2018.

12 Bottge, "The Foundation-Owned Company Model."

13 Steen Thomsen, "What Do We Know (and Not Know) about Industrial Foundations?" Draft Paper, Copenhagen Business School, 2012.

Limitations

- The model has been criticized in both Europe and the US for being used to entrench managerial control and family ownership, or to avoid taxes.
    - Foundation Ownership is commonly criticized for perpetuating control where the family retains control of the foundation after the transfer of shares.
    - Foundation Ownership has been marred by its abuse for tax avoidance purposes. IKEA's foundation was heavily criticized for abusing Dutch law and widely critiqued for allowing self-enrichment, as it donated very little to charity and focused on the cause of "interior design." After an exposé, the founding family amended its articles of incorporation to address this.[14]
- Philanthropic activity has in some cases been critiqued for furthering the corporate activities of the company, rather than advancing a charitable purpose. For example, the Danish pharmaceutical company Novo Nordisk funds research into pharmaceuticals at universities.[15]

HOW ARE FOUNDATION-OWNED COMPANIES FINANCED?

General Financing

- In principle, the operating company—when not 100 percent Foundation-Owned—can act like any other joint stock company and access equity markets, subject to limits on voting stock.
    - If the company is listed on the stock exchange, the foundation may retain a voting majority by only listing shares with limited voting rights or owning enough shares. For example, the Carlsberg Foundation holds 30% of the capital and 76% of the votes for the company Carlsberg.[16]
    - Impact Makers in the US issued non-voting preferred equity shares to raise growth capital.
- In some jurisdictions, foundations are allowed to reinvest most proceeds back into the company, reducing the need for outside capital infusions.
- In smaller countries, like Denmark, the inability for a buyout by out-of-country investors may help attract domestic capital, even without offering voting rights.

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14 "Flat-pack accounting," The Economist, May 11, 2006.

15 Arthur Gautier and Joel Bothello, "What Happens When a Company (Like Patagonia) Transfers Ownership to a Non-profit?" *Harvard Business Review,* October 10, 2022.

16 "Frequently Asked Questions," Investor Relations, Carlsberg Group, accessed August 8, 2023.

Conversion Financing

- In the US, where the foundation is now required to own 100 percent of the company's stock, the conversion to foundation ownership would be funded through a gift by a company founder.
- There appears to be limited financing mechanisms for conversions, in either the US or Europe. US tax rules prevent any type of financial benefit from the transfer of ownership.

Start-up Financing

- There do not appear to be instances of Foundation Ownership at the early stage of enterprises.

HOW ARE OWNERSHIP AND ECONOMIC RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

Share Ownership

- A Foundation-Owned Company's shares are owned, partially or entirely, by a foundation. This foundation has no legal owners, only trustees and/or a board, corresponding to the legal form of nonprofit entity chosen to incorporate the foundation.
- The foundation is typically set up by the company's founder, who transfers an ownership stake of the company to it, generally irrevocably and in perpetuity. The underlying company is usually a stock corporation.
    - As a shareholder of the operating company, the foundation receives dividends and can either reinvest earnings into other financial assets or redistribute part of its revenue to an applicable social purpose or charitable cause.
    - The initial founder typically retains no economic stake in the operating company; however, depending on the regulatory framework, they or their heirs may be permitted to participate on the company's or the foundation's board of directors.
    - Board members receive fixed compensation that must not exceed what is deemed standard. Regulatory bodies can address violations and remove directors where warranted.
    - Though employees can be included as financial beneficiaries of the foundation, this is not required.
    - Typically, foundation board members have no ownership interest in the company (i.e., are not awarded company stock, stock options, or other incentive pay).

HOW ARE GOVERNANCE RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- Foundation-Owned Companies can use an A/B share structure to separate economic and voting rights.
  - In such cases, the foundation may have two separate boards: one to exercise control rights over the company and one to exercise the rights to distribute dividends as charitable activity, though this is not possible in all jurisdictions.
  - Some companies create separate entities, such as a trust, holding company, or another foundation, to hold the voting shares and ensure commitment to its mission or charitable purpose.
  - Where allowed by law, the foundation may own the majority of voting stock but only a minority of the total stock.
- The foundation's charter can be used to restrict or outright preclude the ability to dilute foundation's ownership of voting stock below a majority.[17]
- In the US, since the 2018 changes in tax regulations, the foundation must own 100 percent of voting shares to receive full tax benefits.
- The board of directors or trustees that governs the foundation is responsible for ensuring the company operations align with the foundation's charter._
  - The rules for appointing the board can be determined by the foundation's founder at its outset; in some cases, the board may elect itself in self-perpetuating fashion.
  - Some foundations may have two separate boards, one to control charitable activity and another to exercise control over the company.
  - The founder-directed charter may specify how profits are distributed and the composition of its board of directors (e.g., whether it is self-appointing or if the founder's heirs are entitled to a seat).
  - The charter may be amended with foundation authority.
- Generally, the governance of the foundation and of the company are kept separate, or at least are restricted from overlap.
- In the US, the governance of the foundation must be completely separate from the governance of the company in order to avoid US foundation tax penalties above a threshold of ownership.[18]
- In Europe, generally boards of the foundation and the company can fully overlap, and employees may have a right to representation on both.
- With partial ownership (only possible in Europe), the operating company remains legally responsible to all shareholders and may adopt similar corporate governance practices to conventional enterprises (e.g., an annual general meeting to elect a board).

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17 Henry Hansmann and Steen Thomsen, "The Governance of Foundation-Owned Firms," *Journal of Legal Analysis*, 2021.

18 "Bipartisan Budget Act adopts two exempt organization provisions excluded from final Tax Cuts and Jobs Act legislation," Tax News Update, EY, February 16, 2018.

- If operating with a foundation-trust model, whereby a separate entity holds all voting shares of the company, this entity effectively governs the company and governance decisions are typically made in accordance with a guiding document. For example, in cases where the entity is a Purpose Trust, it will abide by the trust document.

WHAT ARE LEGAL, TAX, AND REGULATORY CONSIDERATIONS?

- Tax and legal treatment vary markedly by country. The acceptance of Foundation Ownership is increasing across jurisdictions.
- In the US, Foundation Ownership is subject to a particular tax status and legal incorporation choices.
  - "Private foundation" refers to an Internal Revenue Service (IRS) tax-related designation and definition (the default designation for all 501(c)(3) organizations) unless they qualify for another sub-designation.[19]
    - Private foundation tax status typically corresponds to legal incorporation as a nonprofit, non-stock corporation, or as a charitable trust.
    - The status is different from a public charity, in that the foundation can be majority-controlled by a family or other insiders on its board, while a public charity cannot and accordingly receives additional tax benefits.
  - Historically, if a private foundation owned more than 20 percent of a firm, it would be subject to an "excess business holdings" excise tax. An exception was established in 2018.
  - The transfer and long-term holding of the company ownership interest by the foundation is not subject to tax, provided three conditions are met:[20]
    - (1) "Exclusive ownership" requires that the stock is donated (not sold) and represents 100 percent of the voting stock of the company.
    - (2) "All profits to charity" requires that 100 percent of the company's net operating income is donated.
    - (3) "Independent operation" requires that the foundation and company boards are sufficiently independent from one another and from the founder and their family's influence.
  - There is no specific gift or capital gains tax treatment for the donor.
- In Europe, the foundation typically qualifies for applicable tax benefits by formalizing either a charitable or social purpose, and it may be required to donate a percentage of annual net income.

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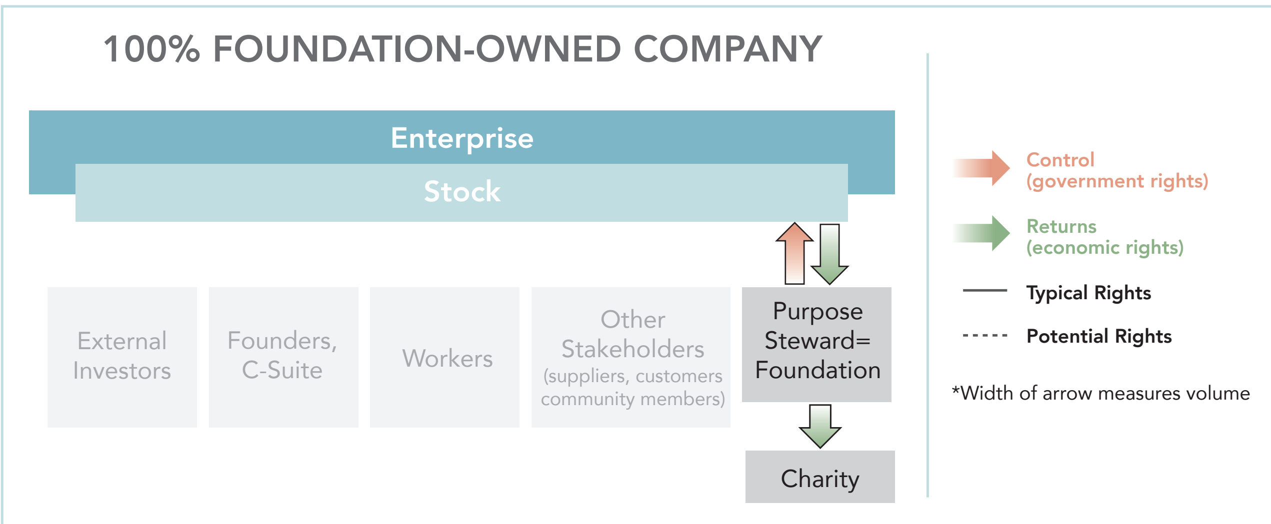
19 "Private Foundations," Internal Revenue Service, accessed August 8, 2023.

20 Louis Vlahos (Rivkin Radler LLP), "Private Foundations, Closely Held Businesses, And Distribution Requirements," JD Supra, October 12, 2022.

- Requirements for the percentage of income donated to social causes may vary. For example, in Sweden the tax exemption is conditional on the foundation donating at least 80 percent of its net income to charitable purposes.[21]
- The founder's initial donation of ownership may provide an exemption from inheritance, wealth, and capital gain taxes. This is typically seen in Nordic countries, and complete exemptions prior to 1987 in Denmark may help explain the widespread use of the model there, although tax rules have since tightened.
- Denmark's social purpose requirement is quite broad and can include the business, though most also donate substantial income to charitable causes.

- Failure to satisfy explicit tax requirements renders income taxable at the corporate tax rate, but if requirements are met, the foundation and the company may receive tax exemptions on the portion of income passed through to the foundation.



21 Magnus Henrekson, Dan Johansson, and Mikael Stenkula, "The rise and decline of industrial foundations as controlling owners of Swedish listed firms: the role of tax incentives," *Scandinavian Economic History Review*, 2020.

What is the Golden Share model?

DEFINITION

- A golden share enshrines a voting right on specific issues that cannot be countered by other voters. The Golden Share model can be used specifically to ensure that a mission-driven enterprise pursues that mission in perpetuity. Under this model, a separate golden share is established and held by a designee that confers veto power over decisions that would jeopardize the company's mission, such as a sale. "Insiders" such as founders, key personnel, and other stakeholders make the bulk of the other corporate governance decisions, and outside investors are limited to non-voting equity shares.
- The golden share model can be combined with other models to enhance stakeholder benefit and lock ownership or assets (e.g., Employee Stock Ownership Plan [ESOP] or Purpose Trust).

CONTEXT AND EMPIRICS

- The model is based on a European model of denationalized companies that wanted to maintain a degree of government control.
    - Golden shares emerged in the 1980s as a way for UK and European governments to maintain control of privatized formerly public facilities and assets or to structure public-private partnerships (e.g., UK airports, Eurostar rail, utilities, shipping lines, etc.). The model exists as "action spécifique" in France and "spezialaktie" in Germany.[1]
    - Though it helped assure continued public purpose, this approach fell out of favor in mid-2000s after the European Court of Justice questioned whether the governments' use of the practice to obtain national public control of companies' capital stock violated EU policy on freedom of capital movement across borders. As a result, most European golden shares were disposed of.

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1 Naveen Thomas, "Golden Shares and Social Enterprise," *Harvard Business Law Review,* 2022; Alice Pezard, "Commentary: The golden share of privatized companies," *Brooklyn Journal of International Law,* 1995; "One share, one vote? Golden shares in privatised companies," Oxera, 2005.

- The board controlling version is somewhat controversially used by the government of China to control companies—including US-listed firms—by holding 1% as golden share(s) endowed with a special veto/control over directors. The nation's largest pre-school company, NYSE-traded RYB Education, has a golden share in conjunction with an ESOP.[2]
- The Golden Share model has a similarly contested non-social purpose use in the US, whereby lenders or preferred equity may use a Golden Share structure to limit access to bankruptcy and influence creditor payouts.[3]

- The concept was repurposed by US, UK, and EU advocates as means for mission-oriented owners to maintain majority control of companies and secure a "social mission lock."[4]
  - This movement is led by Purpose, a German-based group that promotes the model and, through its Purpose Foundation, can act as a "veto service" steward holder of golden shares.
- The model is considered a core model of Steward Ownership, "a corporate ownership structure that presents an alternative to shareholder value primacy… [and] ensures that companies prioritize their long-term purpose over short-term profits"[5]
- There are at least 25-30 companies with a Golden Share model in Europe, mostly in Germany. At least two US companies use the mission-oriented variant of the Golden Share. Most companies are small and/or start-ups.
- The model can be combined with other structures for additional impact goals, including an ESOP, a Benefit Corporation, nonprofit corporate form, and a holding company structure, as well as substantially varying rights associated with the golden share.
- The social purpose use of the Golden Share model is traceable to the Europe-based Purpose Foundation and its affiliated operating entities.[6]
  - Purpose holds golden shares for 25-30 small, recently started German companies and nonprofits, as well as at least two non-German companies.
- At least two US firms have a purpose-related Golden Share model, with Purpose as holder of the golden share:
  - Ziel Apparel, a benefit corporation; it has completed Series A funding and has <10 employees.[7]

2 "Fretting about data security, China's government expands its use of 'golden shares'," Reuters, December 16, 2021; "Fourth Amended and Restated Memorandum and Articles of Association," RYB Education, June 20, 2017.

3 Yiming Sun, "The Golden Share: Attaching Fiduciary Duties to Bankruptcy Veto Rights," *The University of Chicago Law Review,* 2020; "The 'Golden Share': All That Glitters Is Not Gold," Proskauer, May 18, 2020.

4 "Going for Gold How golden shares can help lock in mission for social enterprises," Hogan Lovells, 2015; "Steward-ownership: A short guidebook to legal frameworks," NYU Law and Purpose Foundation, 2020.

5 "Steward-ownership," Purpose, accessed August 8, 2023.

6 "Steward-Owned Companies," Purpose, accessed August 8, 2023.

7 "How Marleen Vogelaar has successfully scaled Ziel…," The Scale Lab (Podcast), May 20, 2021; "Ziel," Cruchbase, accessed August 8, 2023.

- Creative Action Network, which works with political art creators, transitioned from nonprofit to a Benefit Corporation with a golden share.[8]

WHAT ARE THE BENEFITS AND LIMITATIONS OF THE GOLDEN SHARE MODEL?

Benefits

- The Golden Share ensures that any mission-driven enterprise can pursue that mission in perpetuity.
- By limiting the possibility of a sale, it acts against the impulse to manage the enterprise so as to maximize potential sale value.
- Golden Shares have been considered by some to be easier and cheaper to establish for companies seeking steward ownership—and a better fit for companies at the start-up phase—than Perpetual Purpose Trusts (PPT) or Foundation-Ownership.

Limitations

- The mission can be broadly defined. It need not include employees or specific stakeholders.
- The model does not require democratic governance or ownership, and it can in fact be counter-democratic by preventing a majority vote on certain issues.
- There is no requirement or standardized agreement for minimum thresholds or certifications as to "purpose." This model could be used to enshrine controversial purposes, as there are no legal or private regulatory limits on use of the term or concept of "golden share."
- Golden Shares may face legal challenges.

HOW ARE GOLDEN SHARE MODELS FINANCED?

General Financing

- The Golden Share model can deploy a wide range of debt and equity instruments, subject to the fact that all voting equity is held by the stewards and the golden share designee. The model's veto power is meant to deter investment by financial return-maximizing and exit-oriented venture capital (VC); it requires structured exits for external equity.

8 Max Slavkin, "Our Alternative Journey To Alternative Finance," Creative Action Network, July 23, 2018; Steven Heller, "Creative Action Network: Profiting From A Nonprofit," Design Observer, August 16, 2018; "Creative Action Network," Cruchbase, accessed August 8, 2023.

- Most companies using the Purpose Foundation variant of a Golden Share are still at the start-up capital phase of their development and haven't reached stages where more traditional ongoing financing sources may be relevant.
    - Sharetribe (described below) brought on growth capital at the point of conversion to a Steward Ownership model with a golden share.
- Growth capital for later stage companies would likely be structured as an offering of non-voting preferred equity shares, as well as debt financing instruments.

Conversion Financing

- Very few for-profit companies of substantial age or size (i.e., with a substantial equity value requiring take-out at conversion or sale) appear to have converted to the Golden Share model.
    - The most notable appears to be Waschbar, with ~400 employees, which had previously gone through bankruptcy. The bankruptcy likely reduced the financing requirements for the prior owner, who gave up his dividend rights in exchange for a pension.[9]
- It is possible to convert traditional legacy VC equity into redeemable, capped preferred equity shares under a Golden Share structure. This was the case with the Finnish company Sharetribe, which is targeting a 5x return for investors after 10 years.[10]
    - Notably, Sharetribe needed growth capital and used the fundraising opportunity to change its corporate structure to preserve its mission.
- It is unclear whether any purpose-driven Golden Share examples have reached redemption stage and repaid initial investors. Assuming 10-year exits, the first are unlikely to occur until 2025 or later.

Start-up Financing

- Almost all existing uses of the purpose-driven version of the Golden Share, largely in Europe, involve newer companies that are mostly still in a start-up phase.
- External equity investment typically occurs via the non-voting economic share classes.
    - Investor equity class typically structured as preferred equity entitled to a predetermined minimum share of profits until a designated return cap has been reached.
    - One of the two US instances, Creative Action Network, received VC investments from matter.vc, a Purpose affiliate, and its own artists/clients, and it uses a demand dividend to limit external investor return to 5x the initial investment.
    - The other US case, Ziel, has received Series A funding that included limits of redeemability on non-voting preferred equity for founders and specified a minimum share of free profits to be used to repay investors.

9 "Steward Ownership: Rethinking Ownership in the 21st Century," Purpose Foundation, accessed August 8, 2023.

10 "ShareTribe Case Study," Purpose Foundation, 2021.

- The Purpose Foundation has created case studies with financing details of EU-based start-up companies deploying the Golden Share.
    - One case, Wildplastic, relied on a grant from a government development bank (IFB Hamburg), a traditional loan from a Waldorf-affiliated co-operative bank (GLS), and a convertible loan (convertible to non-voting equity or debt) from an affiliate of Purpose Foundation called Purpose Ventures, which is in turn backed by mission-oriented investors in Germany.[11]
- Investors in Golden Share models include mission-driven banks and corporations with other non-traditional ownership models, such as Foundation-Owned Companies.
- Purpose Foundation, which holds the golden shares for many European companies using the model, also has a related incubator (soulincubator) and provides start-up capital from its affiliate investors (Purpose Ventures and Purpose Evergreen Capital).

HOW ARE OWNERSHIP AND ECONOMIC RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- There are no economic rights assigned to any particular stakeholder; the company may issue non-voting equity accessible to anyone. The other share classes—"steward shares" held by company insiders and the golden share held by a special designee—have no economic rights attached.
- The model can be deployed with any corporate form with divisible classes of ownership.
    - **Golden share:** Very narrow voting rights on specific issues. The holder of a golden share is typically a "veto service" entity aligned with the social purpose and not the economic success of the business—commonly a foundation, charity, or other asset locked entity driven by mission, not commercial profit.
    - **Steward shares:** Voting shares at the company, typically called a "steward" class and usually held by company insiders such as founders. Steward shares typically have little to no rights to economic benefit.
    - **Economic shares**: Non-voting shares may be offered as a form of equity for investors.
- The Golden Share model does not directly provide wealth-building opportunities for employees and other stakeholders. That said, it is possible to combine this model with other features, such as profit-sharing mechanisms and even an ESOP.

11 "Wildplastic Case Study," Purpose Foundation, 2021.

HOW ARE GOVERNANCE RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- The corporate direction is decided by "stewards," typically insiders (e.g., founders) who control the voting shares. Outside investors typically do not have governance rights. The golden shares, held by a special designee such as a foundation, are non-economic and relate to vetoing mission-jeopardizing corporate financial events. Each shareholder class has rights that are specified in the articles of incorporation or charter.
- The voting-only steward shares are typically reserved for company insiders, such as employees and founders, but can be issued to anyone the company deemed "stewards." This class holds effective majority control of the direction of the firm and the board and may be restricted from being passed on via inheritance or sold to outsiders.[12]
- Any economic, non-voting preferred equity share classes don't have substantial governance rights.
    - One class may be separated for use by external investors alone, but it is possible to include both insiders and outsiders in a single non-voting economic class. Early employees or founders may hold positions in separate voting (i.e., steward class) and non-voting economic share classes, thereby effectively giving some individuals conjoined economic and voting rights.
- The golden share only gives either majority or veto control over a small number of corporate actions which might threaten the company's stated mission, such as:
    - charter changes that undermine partitioning of economic and voting rights; or
    - issuance of new shares or liquidation of existing shares in ways which threaten the mission of the company or sale of the company.
- The golden share itself—which may be a single share or may be many shares structured as a small percentage (1%) of total shares outstanding—may face transfer and sale restrictions to protect the mission.
- Other uses of golden shares (e.g., by governments or bankruptcy-focused lenders) may have a wholly different split and set of classes.
- The day-to-day management of the firm (i.e., involvement of employees or other stakeholders) is not prescribed by the model itself.

12 "Going For Gold: How the Golden Share Model Protects Mission and Independence," Alternative Ownership Advisors, October 6, 2020.

WHAT ARE LEGAL, TAX, AND REGULATORY CONSIDERATIONS?

Legal

- There are no specific legal implications in the US.
- Notwithstanding rulings by European Court of Justice and US courts on other uses of the model, a Golden Share is neither explicitly authorized nor prohibited by incorporation or tax law and requires no new legislative status to be readily deployed with existing legal incorporation options, making it potentially easy to deploy.
- However, some jurisdictions have placed limits on the Golden Share model.
    - EU national governments now face significant limits on use of golden shares to protect public purpose and control ownership because of violations of EU policy on freedom of capital movement across borders.[13]
    - Some governments limit the ability of companies to issue shares which have only economic or voting rights, which may preclude the use of a Golden Share entirely. For example, no economic rights are prohibited in Italy, Brazil, and Chile, while no voting rights are prohibited in Austria, Switzerland, and Sweden.[14]
- There is some potential risk given legal scrutiny over the use of Golden Share models as a tool in bankruptcy.
    - US courts have scrutinized the ongoing use of Golden Shares in bankruptcy proceedings, placing some restrictions on it (i.e., golden shareholders must be "bona fide" equity holders with "genuine equity interest").[15] This risk could weigh on its long-term appeal for investors.

Tax

- There is no special tax status or tax consequence for mission-driven Golden Share models in the US. A C-corp. tax status seems to be preferred.

Regulatory

- As the term lacks any special legal status with respect to laws of incorporation or tax, there are no known public or private regulatory frameworks surrounding or limiting the use of the term "golden share" for Steward Ownership or other purposes.
- There is no third-party regulatory organization imposing any minimum private certification standard on how the Golden Share model is used. The Purpose Foundation's guidelines are most closely associated with a social purpose use of the Golden Share.

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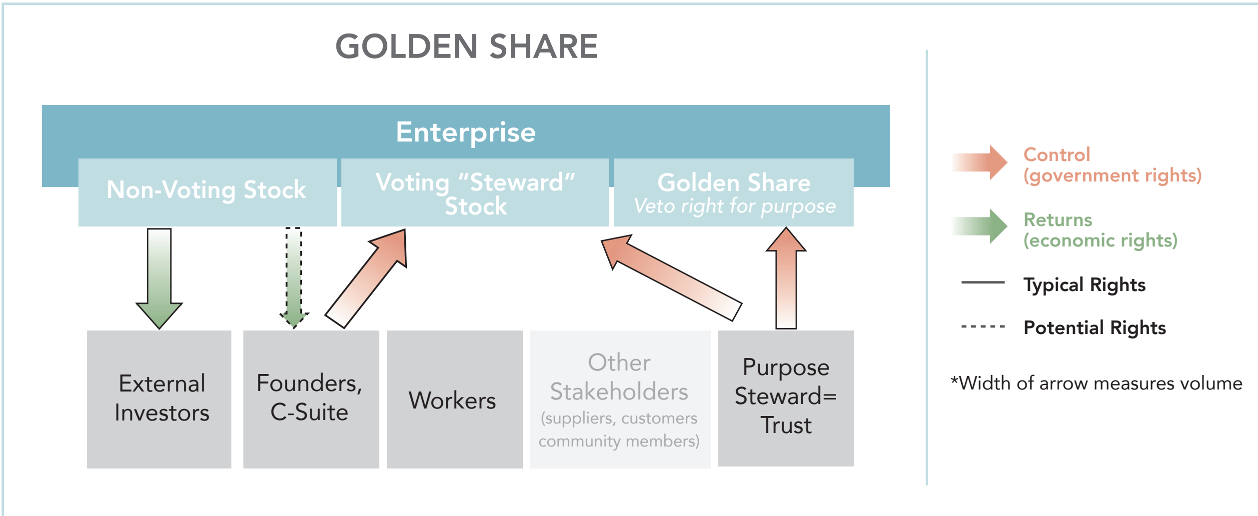
13 Christine O'Grady Putek, "Limited but not lost: A comment on the ECJ's Golden Share Decisions," *Fordham Law Review,* 2004.

14 NYU Law and Purpose, "Steward-ownership."

15 Sun, "The Golden Share."


GOLDEN SHARE
Enterprise
Non-Voting Stock
Voting "Steward" Stock
Golden Share
Veto right for purpose
External Investors
Founders, C-Suite
Workers
Other Stakeholders
(suppliers, customers community members)
Purpose Steward= Trust
Control
(government rights)
Returns
(economic rights)
Typical Rights
Potential Rights
*Width of arrow measures volume

What are L3Cs?

DEFINITION

- L3C stands for Low-Profit Limited Liability Company, a US state-level corporate form established in the late 2000s to serve as a social investment vehicle for foundations.[1]
- An L3C is structured akin to a Limited Liability Company (LLC), with restrictions to meet IRS stipulations for program-related investments (PRI), and is not meant to maximize profits.
- It closely resembles the UK's Community Interest Companies with light enforcement mechanisms.

CONTEXT AND EMPIRICS

- Foundations face Internal Revenue Service (IRS) parameters as to which of their investments count as PRIs and therefore benefit from special treatment. L3Cs were meant to provide a predetermination that an investment by foundations into such companies would indeed qualify as a PRI.
- Seven states, three tribes, and Puerto Rico have active L3C statutes, with Rhode Island as the most recent state to add an L3C statute in 2012.[2]
- Over 1700 L3Cs exist as of June 2020. Their development appears stalled due to regulatory and legal concerns, and L3Cs have largely been supplanted by Benefit Corporations.

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1 Nancy Artz, Jeffrey Gramlich, and Terry Porter, "Low-profit Limited Liability Companies (L3Cs)," *Journal of Public Affairs*, 2012.

2 J. Haskell Murray, "The History and Hope of Social Enterprise Forms," *Tennessee Journal of Business Law*, 2021; Stephanie Geller, "Low-profit limited liability companies," The Next System Project, March 16, 2020.

WHAT ARE THE BENEFITS AND LIMITATIONS OF L3CS?

Benefits

- L3Cs are legally mandated to prioritize charitable mission and social impact over profits. The specific activities and motivations vary widely within the parameters of what the IRS deems acceptable for program-related investments by foundations.

Limitations

- There is scant data on the scale and depth of their charitable effects.
- Some critics argue that the application of PRI rules (i.e., designed to assess investments) to L3Cs (i.e., evaluated at the company level) does not assure social benefit at the company level. Others argue that holding an entire business to PRI standards while expecting a profit may be challenging.

HOW ARE L3CS FINANCED?

- L3Cs, while designed to receive funding from foundations through PRIs, typically deploy a multi-tiered capital structure allowing for risk and returns to vary across members, which may include traditional profit-focused members receiving higher rates of return than foundations.[3]
- However, foundations may be decreasingly willing to invest in L3Cs due to the uncertainty surrounding their legitimate PRI status and the potential for capital loss without any tax benefit.[4]
- Profit-maximizing investments and activities are permitted but must be secondary to the pursuit of the L3C's social mission. Crowdfunding (i.e., the offering of shares to non-accredited investors) is also possible.

3 Nancy Artz and John Sutherland, "Low-Profit Limited Liability Companies (L3Cs): Competitiveness Implications," Competition Forum, 2010; J. Haskell Murray and Edward I. Hwang, "Purpose with profit: governance, enforcement, capital-raising and capital-locking in low-profit limited liability companies," *University of Miami Law Review,* 2011; Sue Woodrow and Steve Davis, "The L3C: A New Business Model for Socially Responsible Investing," Federal Reserve Bank of St. Louis, January 1, 2010.

4 "L3c: Everything You Need to Know," UpCounsel, June 26, 2020.

HOW ARE OWNERSHIP AND ECONOMIC RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- L3Cs are based on traditional limited liability company (LLC) structure with individuals and/or business entities as members owning unit interests.
- As with LLCs, there is a high degree of flexibility in ownership structure and rules. An owners' liability is capped at their capital contribution.5
- By their design, L3Cs are not meant to maximize profits.

HOW ARE GOVERNANCE RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- Much like an LLC, governance rules are purposely flexible.
- There is no explicit democratic governance mandate, but L3Cs can implement democratic bylaws via articles of organization or an operating agreement.
- Foundations may retain decision-making authority to ensure compliance as a PRI.

WHAT ARE LEGAL, TAX, AND REGULATORY CONSIDERATIONS?

Legal

- L3Cs are a distinct legal form which appends PRI provisions to LLC statutes.
- It is simple to convert to or from traditional LLCs. Conversions from other entities (e.g., conventional enterprise or non-profit), however, can be restricted and vary by state.[6]

Tax

- L3Cs are not afforded any tax exemption (unless all members are tax exempt).
- It is a flow-through tax entity which may elect to be taxed as a corporation.

Regulatory

- L3Cs are lightly regulated. Regulation varies by state, but typically requires meeting PRI eligibility at the company level via three requirements:[7]

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5 Sandra Feldman, "What Is an L3C (Low-Profit Limited Liability Company): An Entity for Entrepreneurs Who Value Purpose and Profits," Wolters Kluwer, March 3, 2020; "L3C," Northwest Registered Agent, accessed July 28, 2003.

6 "Forming an L3C," Digital Media Law Project, accessed August 8, 2003.

7 Murray, "The History and Hope of Social Enterprise Forms."

    - (1) the primary purpose is charitable and/or educational;
    - (2) a "significant purpose" is not the production of income or the appreciation of property; and
    - (3) the purpose is not to influence legislation or elections.
- The directors have a fiduciary responsibility to uphold the charitable mission.
- There is debate over whether L3Cs legitimately meet PRI rules since the IRS has never formally ruled on L3Cs as a class.
- Foundations can seek to obtain a costly and time-consuming pre-approval on a case-by-case basis. If a foundation's investment is investigated and deemed ineligible for PRI status, the foundation's capital could be ruled a "jeopardy investment" yielding penalty taxes.
- There is uncertainty and criticism by some lawyers that the statute design and enforcement are flawed, which has likely stymied growth.
- North Carolina recently repealed its L3C statute.

What are PPTs?

DEFINITION

- A Perpetual Purpose Trust (PPT) is a form of Steward Ownership whereby a company is owned by a legal trust that purchases a majority of its shares to benefit a defined purpose in perpetuity.
- PPTs can be divided among those that benefit a single purpose (i.e., with no specified stakeholders), a single set of stakeholders (e.g., workers in employee ownership trusts), or multiple stakeholders at the same time (e.g., customers, workers, and suppliers).

CONTEXT AND EMPIRICS

- A PPT is predicated on the trust law applicable to business/non-charitable purposes in the US.
    - The trust's governing documents dictate the purpose of the enterprise, and the trust governance ensures that the company operates for that purpose. The purpose can be specific to a group (i.e., benefiting a bounded set, such as employees), a cause (e.g., environmental protection), or a broad purpose (e.g., commitment to fair trade).
    - Trusts are typically established in perpetuity, where allowed by law, and trust documents prevent the possibility of a sale or dissolution of the trust.
    - A trust can also hold a specific asset of an enterprise, such as its intellectual property (IP), and not the enterprise itself. For example, Zingerman's in Michigan recently set up a PPT to protect the company's mission and enable stakeholder financial participation in the IP.[1]

1 Ari Weinzweig, "Sharing the Next Big Step in Zingerman's History—A Perpetual Purpose Trust," Zingerman's, February 2, 2023.

- The interest in PPTs in the US dates to the early 2000s, with the emergence of model legislation for statutory trusts in state law.[2] There were previously legal restrictions on PPTs in the United States.
- The model has been adopted by a small number of US firms to date, but it has risen rapidly in popularity.
- Data from 2022 shows more than 30 US Purpose Trusts (PT) used in an enterprise ownership context, of which the majority are active operating businesses.[3] Of those, more than 20 self-describe as Employee Ownership Trusts (EOT), which are PPTs with employee benefit as the primary purpose. (See the EOT brief for more information.)
- PPTs can be combined with other forms. Berrett-Koehler Publisher is transitioning to a majority-owned PPT structure with an Employee Stock Ownership Plan (ESOP).[4] The underlying enterprise is incorporated as a Benefit Corporation. The trust also includes a subsidiary previously structured as a cooperative.
- Companies that use a PPT structure sometimes identify externally via other ownership and governance features, such as Worker Cooperatives or nonprofit collectives.
- Patagonia's sale to a family-controlled PPT and a 501(c)(4) foundation entity in 2022 may prove a game changer for PPT popularity in the US.
- Purpose US, Common Trust, and Purpose Owned—a new incarnation of Alternative Ownership Advisors, itself an offshoot of a PPT-owned company—all advocate for PPT adoption in the US and act as advisors and developers.

WHAT ARE THE BENEFITS AND LIMITATIONS OF PPTS?

Benefits

- PPTs allow mission-oriented companies to put a purpose at the heart of the company, often tying it to efforts to advance a particular impact. It is the trust's responsibility to ensure that the company does not deviate from its purpose, which includes preventing the sale of the enterprise.
- The perpetuity of the model, by removing short-term equity investor pressure, better enables a PPT to deliver on its long-term (environmental, social, or economic) goals and avoid mission drift that could come from optimizing for a future sale. It also serves to counter issues of corporate consolidation.
- The model's flexibility allows for creative ways to benefit different stakeholders (e.g., the environment, employees, customers, suppliers, etc.) as named beneficiaries and as part of governance. The inclusion of multiple perspectives in a Multi-Stakeholder PPT is expected

2 Alexander A. Bove Jr., "The use of purpose trusts in the United States," Trusts & Trustees, 2004; Alexander A. Bove Jr., "The Purpose Trust Has a New Purpose," American Bar Association, July/August 2019.

3 Anne-Claire Broughton et al., "Employee Ownership Trusts, Perpetual Purpose Trusts, and Stewardship Trusts in the United States," Harvard Dataverse, 2022.

4 Matt Jorgensen, "A Mission-driven Publisher's Succession to Shared Ownership," Purpose, March 29, 2021.

to benefit the company overall, as is the deeper commitment to the company of the stakeholders that are included in the trust.

- Though few in number and all fairly recent, many of the existing PPT cases in the US appear to benefit excluded members of the population (e.g., the formerly incarcerated, undocumented workers, low-wage home health care aides, etc.) or significant environmental causes (e.g., addressing climate change, sustainable agriculture, sustainable seafood, etc.).
- PPTs can be cheaper and simpler to administer than other alternative ownership models, such as ESOPs or Worker Cooperatives.[5]

Limitations

- The purpose of a PPT can vary widely and doesn't necessarily advance social or environmental purposes.
    - It can be neutral (i.e., just go to the perpetuity of the enterprise).
    - It can also be a purpose that may be antithetical to positions taken by many impact investors. For example, Hobby Lobby's conservative CEO transferred the company's shares into a trust.[6]
- Not all PPTs are rooted in Steward Ownership of a company towards a social or environmental purpose; there are PPTs in the US that pertain to shielding assets from taxes, or to maintaining a pet, art collection, family, site, or event.[7]
- Due to the bespoke nature of transactions to date, legal fees and transaction costs to structure PPTs have been high, but costs are declining as lawyers and investors conduct repeat transactions.
- Many corporate lawyers remain unfamiliar with PPT law.
- Emerging regulatory scrutiny could quickly change the landscape.
- Trusts are governed by private documents that make it impossible to independently verify the actual economic and governing power of many PPTs.

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5 As suggested by advisory services such as Common Trust and EOT Advisors (EOT FAQs), accessed August 8, 2023.

6 Jerry Bowyer, "Restoring Trust Through Trusts: Hobby Lobby CEO Is A Steward, Not An Owner," Forbes, May 1, 2017; Bethany Biron and Heather Schlitz, "16 of the biggest controversies in Hobby Lobby's 50-year history," *Insider,* last updated October 21, 2022.

7 Dan Holbrook, "The Evolution of Purpose Trusts," Tennessee Bar Association, January 2021.

HOW ARE PPTS FINANCED?

General Financing

- The trust controls a majority (typically all) of the voting stock. Investors can own any remaining equity as well as make equity-like investment, such as non-voting redeemable equity, and equity-like debt, such as revenue or royalty share loans.
- Liquidity to investors comes from cash share buybacks or buy-outs (generally leveraged) at conversion, but also from a portion of additional equity raises, dividends, and even non-voting IPOs (i.e., while the majority of voting shares remain in the trust, non-voting shares can be issued to the public). Liquidity from a sale of the company generally comes from a sale to another Steward-Owned Company (e.g., PPT, Golden Share, etc.).

Conversion Financing

- PPT conversions—which account for most US instances to date—rely on a mix of donated shares, seller financing, and mission-driven debt, equity, and equity-like instruments to finance the sale.
- In the case of donated shares (e.g., Patagonia), there is no financing need for the conversion.
- In the case of a PPT conversion with a purchase of shares by the trust, the current majority owner establishes a trust with the intention of selling all or a majority of shares.
    - The underlying company obtains debt financing (as needed) from the seller or a bank and transfers the proceeds to the trust. The trust then uses those proceeds to buy the shares tendered in response to the offer to buy.
    - If an ESOP is in place for the underlying company (e.g., Organically Grown Company) and those shares will be bought by the trust, 100 percent of the ESOP shares must be acquired, in order to avoid a potential conflict of interest between the trust and the ESOP.
        - Note that PPT/EOT majority ownership is consistent with the presence of a Partial ESOP, which would deliver its usual tax benefits.
    - Non-ESOP shares can be bought by the trust or redeemed by the underlying company, over time.
    - An offering of new preferred stock may be made, and the proceeds may be used to buy outstanding shares.
    - It is possible for the conversion to take place simultaneously with a capital raise for other purposes, in which case part of the proceeds go to financing the conversion and part go to growth.
    - Some current shareholders may wish to reinvest the proceeds from the sale of their common stock into the newly issued preferred stock.
- The use of cash flow to repay investors for the conversion financing does impinge on beneficiary profit distributions during the transition period.

- That is, a portion of the value created by the stakeholders will be used to compensate investors, rather than accruing to the stakeholders intended to benefit.
- Conversely, the existence of a waterfall with other stakeholders with a claim to profits means that the equity investors will not be entitled to 100 percent of profit.

Examples of Different Conversion Financing Modalities

- Patagonia's owner donated 100 percent of his company voting stock to the founder's family-controlled Patagonia Purpose Trust (2 percent of total stock) and donated 100 percent of the non-voting stock (98 percent of stock) to a 501(c)(4), which will receive almost all profits not reinvested in the business.[8]
    - The donation of the voting stock to the PPT generated a $17.5M gift tax payable by the seller, not the trust; the donation of the non-voting stock generated no such tax because the recipient entity is a tax-exempt 501(c)(4).
    - Donating to a 501(c)(3) would have created a deduction for the donor; however, a (c)(3), unlike a (c)(4), could not have engaged in political spending.
    - Neither transfer generated capital gains tax.
    - The family will not financially benefit from the PPT but will control it to ensure Patagonia remains socially responsible and gives away its profits.

- Firebrand's owner donated 51 percent of the voting stock to the trust during its 2020 conversion to a PPT, when the firm also raised additional funds for expansion. The remainder of the stock is intended to transfer over time to the trust, once mission-driven investors receive their capped returns on their preferred equity and convertible notes.[9]
- Organically Grown Company's conversion to majority PPT ownership in 2018 involved a $10M loan from RSF to buy out existing ESOP shareholders, since the company had gone through multiple ownership structures over time. It also involved an additional $10M capital raise from mission-driven investors and foundations and $1M of working capital raised. Eventually, 100 percent of the common stock and all voting stock in the company (structured as a Oregon benefit C corp., held by an Oregon steward trust) will be owned by the PPT.[10]

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8 "Patagonia's tax break, explained," The Indicator From Planet Money, NPR, September 20, 2022; Craig Kennedy, "Reforming §501(c)(4) organizations," *Philanthropy Today,* September 26, 2022; Beck Groff and Susan N. Gary, "Patagonia, Purpose Trusts, and Stewardship Trusts—Business with a Purpose," Probate & Property, 2023.

9 Oscar Perry Abello, "The Bakery That's Owned by an Idea," Next City, February 16, 2021; "Case Study: Firebrand Artisan Breads," Purpose, 2020; "Firebrand Artisan Breads Case Study," ICA Fund, accessed August 8, 2023.

10 Malia Spencer, "Taking Root," Portland Business Journal, December 29, 2020; "Organically Grown Company Pioneers Groundbreaking Ownership Structure to Maintain Mission & Independence in Perpetuity," RSF Social Finance, July 9, 2018; Anne Field, "How A Restructuring Plan Helped An Organics Pioneer Maintain Its Mission," *Forbes*, July 21, 2018.

Start-Up Financing

- There have been two high-profile PPT start-ups, both of which had assistance from unions and/or state governments.[11]
- The start-up capital needs were addressed via partnerships with mission-driven cooperative entities (e.g., Seed Commons/The Working World, Funds for Jobs Worth Owning), as well as major financial roles for private equity in one case and ongoing public funding/operating contracts in the other.

HOW ARE OWNERSHIP AND ECONOMIC RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

Share Ownership

- Trusts, in general, are flexible legal structures that hold ownership of assets on behalf of others. In the US, the underlying firm can assume most corporate forms, although this may vary by jurisdiction.
- The trust structure decouples control (which sits with the trust) from the financial returns on the equity (which sit with the operating company).
- The PPT holds enough voting stock to secure the company's long-term mission and to prevent a sale of the company or its assets. Economic shares without voting rights may be issued. Distribution of corporate profits may go to employees and other stakeholders, but such distributions are not based on direct ownership of shares.
- When used to steward company ownership in perpetuity, the trust will hold enough voting stock (i.e., 51+ percent) to secure the company's long-term mission.
  - Typically, trust governing documents instruct the trust to hold the voting stock in perpetuity, preventing the sale of the company to an outside buyer except for special cases, such as a sale to another Steward-Owned Company.
  - PPTs may also hold non-voting stock.
  - Due to tax law, a PPT may be structured to have little, if any, income flow to or through the trust.
  - US tax law has implications for how the financial benefits of trust ownership are distributed. Trusts can face high taxes on any retained income. While the trust's governance framework may specify some aspects of how the financial benefits of ownership will flow to benefit its purpose, those financial gains themselves may not actually pass through the trust itself. The gains may be retained by the company for distribution or reinvestment instead.

11 Oscar Perry Abello, "Bringing Pro-Worker Home Care Practices from the Bronx to the Pacific Northwest and Beyond," Next City, October 10, 2019; Tom Cassauwers, "The Workers Lab: the union-backed accelerator helping to disrupt capitalism," *Equal Times,* August 16, 2018.

Stakeholder Financial Benefit

- A PPT's trust documents can include sharing economic rights with a specific group or groups of individuals as a means of achieving the company's purpose, but there is no requirement to do so. Economic rights may be shared through non-voting equity shares or profit-sharing mechanisms.
- The trust agreement may require the company to retain a portion of profit for sharing with core stakeholders, either through cash donations, as a contribution to a diversified 401(k) plan (if beneficiaries are employees), or a combination of both.
  - In some instances, as with the case of Organically Grown Company, these may include several different stakeholders, with a clearly specified "waterfall" of who is prioritized in profit sharing.
  - As shares are allocated to the trust, not to individuals, the PPT structure avoids repurchasing obligations, eliminating future ongoing cash flow and capital planning issues.

HOW ARE GOVERNANCE RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- PPT governance is flexible and can be used for varying levels of control by the various stakeholders. The trust stewardship committee and trust enforcer exist to ensure that corporate activity is following the stated purpose and to prevent major corporate changes that may affect the mission, such as a sale.
- Corporate governance of the company itself is generally not affected by the existence of a PPT, as the PPT only pertains to holding shares in the company. However, certain restrictions and provisions may allow for the trust to supersede corporate board decisions (e.g., to prevent a sale).
- Governance of the trust itself is derived from trust law, which allows PPT governance to be purposely flexible and customizable.
  - The optimal governance structure to protect purpose depends on a number of factors, such as industry and company size. Since trusts are generally governed by private documents, it is difficult to access detailed information about existing PPT governance.
  - Governance can include any stakeholder. Therefore, it can be used as a vehicle for democratic control by workers (e.g., in Employee Ownership Trusts) and in more complex Multi-Stakeholder models (e.g., the Organically Grown Company).
- The trust mechanisms for governance include the trust agreement, trust stewardship committee, trust enforcer, and trustee. The actual governance rights are flexible.[12]
  - The trust agreement defines roles and responsibilities of stakeholders (decision-making practices, stakeholder-trustee relations, trustee selection, etc.).

12 Susan N. Gary, "The Oregon Stewardship Trust: A New Type of Purpose Trust that Enables Steward-Ownership of a Business," *University of Cincinnati Law Review,* 2020.

    - The trust agreement typically states the purpose of the trust and restricts the trust from making any decisions that undermine that purpose, such as share disposition, resale, or dilution that might eliminate control.
    - No explicit democratic governance mandate for the firm or trust is required. The agreement can be structured, however, to include employees or other relevant beneficiaries in the governance of the trust, or to mandate their democratic inclusion in the governance of the firm.[13]
    - The trust agreement may specify other rights for employees or other stakeholders to amend the trust or corporate documents to assure the trust's stated purpose is achieved.
    - The trust agreement may specify how to remove leaders not honoring the values of the corporation, perhaps via the stewardship council or the protector.[14]
    - PPTs interested in ensuring perpetuity can include share sale restrictions in the trust agreement.
- The trust stewardship council/committee and trust protector/enforcer both have a legal obligation to ensure that the trust's stated benefit/purpose are met in stewarding the firm, as per the trust agreement.
    - The trust council and trust enforcer are both usually free from direct company management responsibilities.
    - Beneficiaries can raise grievances over trust agreement violations to the trust enforcer, which arbitrates them.
    - Rules regarding eligibility and selection for the stewardship council and enforcer roles (e.g., stakeholder election or appointment by some other specified means) are specified in trust agreement.
- The trustee is administrative and has no substantive governance role.

13 "Employee Ownership through Perpetual Trusts: A Case Study," *National Center for Employee Ownership Newsletter*, October 2020.

14 Karen Kahn, "New Employee Ownership Trusts Demonstrate Viability in U.S.," *Fifty by Fifty*, March 30, 2021.

WHAT ARE LEGAL, TAX, AND REGULATORY CONSIDERATIONS?

- Trust incorporation options vary by state; there is no special/separate tax status in the US for PPTs apart from existing corporate, trust, and individual tax laws. Therefore, PPTs have had to use trust laws not specifically designed for their purpose. Oregon became the first state to design a trust law specifically for Steward Ownership in 2019.
- Historically, Purpose Trusts have not been allowed to exist in perpetuity in the US. Furthermore, trust law deemed that trusts without named individual beneficiaries were invalid.
- US trust law underwent a shift in the early 21st century as trust law was codified by a majority of states with the adoption of the Uniform Trust Code (UTC).[15] As a result, some states now allow perpetuity of trusts, although there is a degree of variability.
    - Oregon introduced "stewardship trusts" (a sub-type of non-charitable purpose trust) in 2019 as statutory trust, with specific rules designed for long-term Steward Ownership.[16] It removes time limit and reducibility by a judge, and it requires a steward council and enforcer to ensure its mission and only whose unanimous vote can modify the trust. It is the only such law tailored specifically to such a use.
    - As of 2022, Delaware, South Dakota, Wyoming, and New Hampshire also allow business/non-charitable purpose trusts in perpetuity, but these are not specific to Steward Ownership or social/environmental purpose.[17]
    - In other states where trust statutory law has developed, existing trust statutes appear to be applied with specific governance features to create PPTs; trust types being used include directed trusts, intentionally defective grantor/non-grantor trusts, and others, including foreign trusts.[18]
        - It is unclear if most US PPTs are being structured "in perpetuity" or not, or merely for ~90 years (allowed in some states), as trust agreements are often not public.
        - If not authorized in their home state, companies can create a trust in a state with more trust-friendly laws.
- At the trust and corporate levels, PPTs are broadly subject to conventional tax (i.e., income is taxed to either the trust or the company) and does not qualify for charitable deductions for the donor in the US.[19]
    - Trust tax rates can quickly rise to higher levels than corporate or individual rates, thereby incenting efforts to structure the trust to retain little income.
- There is no specific federal or state tax "benefit" for selling a company to a PPT.

15 Christina Bogdanski, "The Uniform Trust Code and the Common Law: An Analysis of Three Sections of the Code That Deviate from the Common Law and Why the Drafters Changed the Law," Cardozo Law Review, 2015; Alexander A. Bove Jr. and Melissa Langa, "The Perpetual Business Purpose Trust: The Business Planning Vehicle for the Future, Starting Now," American College of Trust and Estate Counsel, ACTEC Law Journal, 2021.

16 "Chapter 130 (Uniform Trust Code)," from Oregon Revised Statutes, Volume 3, Title 13, accessed August 8, 2023.

17 "Where Should Your Trust Call Home?" Alternative Ownership Advisors, accessed August 8, 2023.

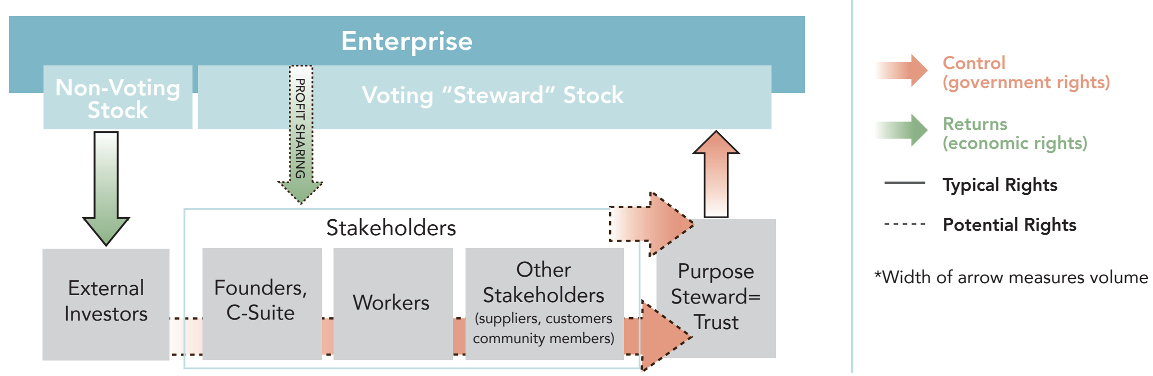
18 See, for example, Christopher Michael, "Grantor Trusts: A Path to Employee Ownership," via EOT Law, originally published in Tax Notes, October 12, 2015.

19 Alex Lyden-Horn, "Planning With Purpose: Non-Charitable Purpose Trusts," Evercore, October 19, 2021.

- Though the PPT itself is not charitable, capital gains and gift tax for seller/donator can also be significantly reduced through creative structuring (see Patagonia example), but this may change.
- Bills providing a tax benefit for company sale to a trust, as well as for beneficiary distributions, are being moved forward in Maryland, Wisconsin, and New York (for the EOT version of a PPT).[20]

- The company income is taxed to either the seller/donator of the shares, the corporation itself, or to the trust (at prevailing corporate and trust rates, respectively). This can be structured to reduce capital gains and gift taxes.
- Most US PPTs are organized under the Delaware or South Dakota statutes.
- US PPTs have minimal regulatory oversight when compared to ESOPs.
- Greater regulatory oversight, however, could be introduced through reforms of tax law, which could affect the PPTs created via a significant gift by the company founder.
- Some lawyers are raising concerns about potential litigation down the road when next-gen beneficiaries have conflicts about how to proceed with a trust. Some of these will be novel issues without clear case law, particularly around Multi-Stakeholder models.

MULTI-STAKEHOLDER PERPETUAL PURPOSE TRUST (PPT)



20 Christopher Michael, "The British Are Coming: ESOPs and Perpetual Trusts," EOT Advisors, accessed August 8, 2023.

What are Worker Cooperatives?

DEFINITION

- A Worker Cooperative is a business owned and controlled by the workers of that business. Workers are often referred to as "worker-owners."
- Cooperatives are officially defined by the International Cooperatives Alliance as "an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise."[1]
    - Seven principles guide structure, governance, and work: (1) voluntary and open membership; (2) democratic member control; (3) member economic participation; (4) autonomy and independence; (5) education, training, and information; (6) cooperation among cooperatives; and (7) concern for the community.[2]
- A Worker Cooperative is part of the broader category of cooperative enterprises, which includes Consumer Cooperatives, Producer Cooperatives, Shared Services Cooperatives, and Multi-Stakeholder Cooperatives.

CONTEXT AND EMPIRICS

- Worker Cooperatives in the United States are few and tend to be small. A 2021 census by the United States Federation of Worker Cooperatives, while not exhaustive, identifies roughly 600 US Worker Cooperatives employing 6,000 workers in total, with a median size of 6 workers and aggregate annual revenues of roughly $300 million.[3]

1 "Cooperative identity, values & principles," International Cooperative Alliance, accessed August 7, 2023.

2 International Cooperative Alliance, "Cooperative identity, values & principles."

3 "The 2021 State of the Sector Report is now available," United States Federation of Worker Cooperatives (USFWC), April 18, 2022.

- There are only two Worker Cooperatives with more than 1,000 worker-owners in the US: CHCA and the Drivers' Co-operative.
- Each worker-owner owns one share, which provides them one vote ("one worker, one vote"). This contrasts with non-cooperative businesses, where votes are in proportion to the amount of capital held.
- Worker Cooperatives operate in all industries and at various scales. However, they tend to be most frequent in the food, care, and service sectors, and infrequent in high-tech and fast-changing industries.[4]
- Twelve percent of Worker Cooperatives began as conventional enterprises and converted, while 88 percent were Worker Cooperatives as start-ups, which includes the 18 percent that were assisted by a cooperative developer during the start-up phase.[5]
- Formation appears to be highly cyclical, historically, with waves occurring periodically in the US and elsewhere, typically during periods of systemic crisis.[6]

WHAT ARE THE BENEFITS AND LIMITATIONS OF WORKER COOPERATIVES?

Benefits

- Worker Cooperatives are typically smaller entities with high social impact, including lower pay inequality ratios and higher worker satisfaction and outcomes.
- The primary impact benefits of a Worker Cooperative are:[7]
    - Control by the workers, both in terms of governance and economic participation.
    - Building pathways for marginalized workers, providing skill building, and improving job security and quality.
    - Wealth building opportunities, economic stability, and economic mobility for workers via ownership stakes.
    - Retention of the value created among workers and in the community, as opposed to wealth drain to investors.
- The democratic decision-making and wealth building for workers are integral to Worker Cooperatives. In addition, cooperatives can choose to embed significant social purpose

4 Jason Spicer, "Worker and community ownership as an economic development strategy: Innovative rebirth or tired retread of a failed idea?" *Economic Development Quarterly*, July 2020 and "Cooperative enterprise at scale: comparative capitalisms and the political economy of ownership," Socio-Economic Review, July 2022.

5 USFWC, "The 2021 State of the Sector Report." Examples of cooperative developers include Cooperative Development Institute, Sustainable Economies Law Center, and ICA Group.

6 Spicer, "Worker and community ownership."

7 For reviews of the benefits of worker cooperatives, see: Christopher Gunn and Hazel Dayton Gunn, Reclaiming Capital: Democratic Initiatives and Community Development, 1991; Ariana R. Levinson, "Founding Worker Cooperatives: Social Movement Theory and the Law," *Nevada Law Journal*, 2014; Jason Spicer and Tamara Kay, "Another Organization Is Possible: New Directions in Research on Alternative Enterprise," Sociology Compass, 2022.

considerations into governance through their ownership structure. Democratic governance helps ensure that a Worker Cooperative serves the common social, economic, and cultural needs of its members as determined by its self-elected board (e.g., generated profits are equitably distributed among members).

- Worker Cooperatives have historically shown higher rates of worker satisfaction and well-being, and lower rates of turnover and termination during downturns.
- Workers have higher workplace participation and job satisfaction, which contributes to improved productivity.[8]
- The typical pay ratio of highest to lowest paid workers is 2:1 in US Worker Cooperatives.[9] Worker-owners may place limits on the pay ratio in their bylaws; for example, Mondragon in Spain limits this ratio to 9:1 and is often quoted to have an actual ratio of 6:1.[10]
- As compared to conventional enterprises, Worker Cooperatives reduce inequality among workers and retain wealth more equitably in their host economic region.
- Worker Cooperatives are believed to be more resilient in economic downturns, as they may reduce hours for all workers rather than lay off workers, and workers may feel great investment of ownership in the company.[11]
- Conversely, a Worker Cooperative's philosophy may constrain its ability to survive during a downturn by, for example, cutting wages.[12]
- Worker Cooperatives might help to foster democratic capacity in communities, potentially with spill-over into the civic arena.[13]
- Advocates argue that Worker Cooperatives are a better model to respond to climate change, due to greater worker alignment with climate resiliency than investor alignment.

Limitations

- Setting up a Worker Cooperative can be complex. There is no agreed upon set of best practices for incorporation, and the regulatory environment can sometimes be hostile.
- Raising external capital is challenging for Worker Cooperatives. Access to loans is sometimes restricted by the need for a "personal guarantee," which cooperatives can't provide since individual worker-owners usually don't have the necessary assets. Access to investment capital is limited because workers retain majority ownership and control of the

8 Carole Pateman, "Participatory Democracy Revisited," Perspectives on Politics, 2012; Ben Craig and John Pencavel, "Participation and productivity: a comparison of worker cooperatives and conventional firms in the plywood industry," Brookings papers on economic activity, 1995; Edward S. Greenberg, "Participation in industrial decision making and work satisfaction: the case of producer cooperatives," Social Science Quarterly, 1980.

9 USFWC, "The 2021 State of the Sector Report."

10 Sharryn Kasmir, "The Mondragon Cooperatives and Global Capitalism: A Critical Analysis," New Labor Forum, 2016.

11 George Cheney et al., "Worker Cooperatives as an Organizational Alternative: Challenges, Achievements and Promise in Business Governance and Ownership," Organization, 2014.

12 Kenzie Love, "The Allium's Closure Offers Lessons for Other Worker Co-ops," Canadian Worker Co-operative Federation, June 19, 2023.

13 Laura H. Schlachter and Kristinn M. Ársælsson, "Spillover, selection, or substitution? Workplace and civic participation in democratic firms," SocArXiv, 2020.

company, though external investors can sometimes purchase non-voting/class B shares and take a few board seats.

- Worker Cooperatives have been critiqued for how they may treat non-owners. Mondragon—a worker/consumer cooperative hybrid that is believed to be the largest cooperative in the world—has been widely criticized for how it treats non-owner workers in its international subsidiaries.[14]

HOW ARE WORKER COOPERATIVES FINANCED?

General Financing

- Worker Cooperatives struggle to secure outside financing due to the lack of equity shares for anyone besides workers and difficulties in receiving debt from unfamiliar lenders.
- Worker Cooperatives are often not designed for high return investments, significant exit gains, or investments that include giving control to outside investors. By and large, Worker Cooperatives do not pursue these types of investments.
- For growth capital, Worker Cooperatives mostly rely on self-financing via members' retained equity or loans from specialized cooperative lenders, despite some innovations (e.g., revenue-based financing, exempt community investor raises preferred/Class B equity shares, and indivisible reserves if allowed by state law).
- Internal financing
    - The main source of internal financing is retained earnings, which are either kept at the cooperative level or allocated to worker-owners' internal capital accounts. While these can be used for internal financing, they must be paid out when the worker retires or leaves.
    - Another source of capital for cooperatives, though often minimal, is the purchase by a new member of their share (immediately upon joining or over time).
- Loans
    - Many Worker Cooperatives access growth capital through cooperative lenders. Worker Cooperatives often work with cooperative specialist banks and funds, generally Community Development Financial Institutions (CDFI), such as the Cooperative Fund of New England.[15]
    - US Worker Cooperatives struggle to obtain traditional small business debt capital given the long-standing "personal guarantee" requirement to obtain bank financing or participate in the US Small Business Administration's (SBA) 7(a) loan guarantee program.[16]

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14 Anjel Errasti, Ignacio Bretos, and Enekoitz Etxezarreta, "What Do Mondragon Coopitalist Multinationals Look like? The Rise and Fall of Fagor Electrodomesticos S. Coop. and Its European Subsidiaries," Annals of Public and Cooperative Economics, 2016.

15 Micha Josephy, "Are Cooperatives Really So Difficult to Finance?" *Fifty by Fifty*, November 28, 2018. Other examples include: National Cooperative Bank, Shared Capital Cooperative, Cooperative Fund of the North East, Local Economic Assistance Fund, Seed Commons/Working World, and Capital Impact Partners.

16 "Tell SBA to support co-ops through their loan guarantee programs!" USFWC, December 27, 2022.

    - P6 Capital, a new initiative hosted by Zebras Unite Cooperative, is a new fund filling a capital gap for growth-stage cooperatives, targeting cooperatives in a higher ticket size bracket than traditional lenders but still too small for commercial lenders.
    - There is also a relatively high degree of inter-cooperative lending, generally informal but occasionally formalized by cooperative developers such as the Arizmendi Association.
- Loan Guarantees
    - Personal guarantees are hard to enforce in a Worker Cooperative, given the distributed ownership. Some lenders, particularly cooperative lenders, have devised other means of guaranteeing debt.
    - In lieu of general personal guarantees, a limited guarantee can be issued by the selling owner in a cooperative conversion (i.e., limited in time and to a portion of the debt).
    - Guarantees can also come from foundations and public entities, or even other cooperatives.
- Equity
    - Worker Cooperatives can issue preferred/Class B/"community investor" shares (as modeled by Equal Exchange), where authorized by state law.[17]
        - These shares usually have capped returns, which is required in some jurisdictions. Eligibility to purchase shares is defined at the state level and the shares may be substantively restricted (i.e., not redeemable or resalable).
        - Both members and non-members can purchase non-Class A shares.
        - Terms vary. Shares may be subordinate to patronage capital or may receive priority payments and proceeds in the event of liquidation over member voting stock.
        - States with a "next gen" limited cooperative association law (and lacking a worker cooperative specific statute) allow for a majority of the surplus to be distributed to investors via dividends.
    - The lack of direct voting control for investors deters investment. Some cooperatives do, however, give investors board observer rights or a small number of board seats.
    - Multi-Stakeholder Cooperatives are emerging as a way around the limitations in capital raising for Worker Cooperatives, as investors can be included as members.
    - Returns to outside investors can come from:
        - revenue share (a percentage of revenue, up to a capped multiple of invested capital);
        - profit share (allocated based on percentage share ownership); or
        - dividend share (based on a target dividend, as in the preferred share scenario).

17 Oscar Perry Abello, "Worker Cooperatives Are Finding Investors Who Share Their Values," The Bottom Line, July 10, 2018; "Financing Cooperative Conversion," Co-opLaw.org Resources and "What is the maximum dividend rate that co-ops can offer on preferred stock?" Cooperative Development Institute, accessed August 7, 2023.

Start-up financing

- Generally, Worker Cooperatives have difficulty accessing financing at the start-up phase and are significantly undercapitalized.
- Internal Financing
    - Worker Cooperatives typically access start-up equity capital from worker-owner equity buy-in (i.e., internal capital accounts) prior to seeking external equity funding sources.[18]
        - This is often an insufficient source of capital during start-up, especially since the payment of buy-in may be deferred.
    - As initial years that incur a loss could create negative distributions, Worker Cooperatives may elect to create a start-up loss account, which spreads initial losses over several years and to subsequent members, so that founders do not disproportionately bear the burden of this loss.[19]
- External financing
    - Some start-up capital can come from mission-aligned debt providers (e.g., CDFIs, mission investors, community banks, credit unions, or cooperative incubator funds) or philanthropic capital.
    - Some Worker Cooperatives use direct public offerings and crowdfunding for start-up capital.
    - Typically, start-up capital is a stack of several of the above options.

Conversion financing

- Worker Cooperative conversions are typically financed with a combination of seller notes, senior debt, and subordinated debt.
    - Some cooperatives have offered preferred, non-voting shares as part of a conversion, to both accredited and non-accredited investors. The targeted return is subject to the financial performance of the cooperative and is subordinated to the debt. These non-voting shares tend to attract investors interested in the social impact of the worker cooperative.
- The outside debt for a conversion is often provided by a CDFI that specializes in lending to cooperative businesses.
    - The CDFI debt is typically senior. Member (or community) financing and seller financing is subordinated or unsecured. Some loan funds do provide subordinated debt for conversions.
- Conversions often also rely partially on philanthropic contributions and grants to cover the cost of technical assistance.

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18 "Financing a Cooperative," Co-opLaw.org Resources, accessed August 7, 2023.

19 "Internal Capital Accounts: An Illustrated Guide to the Internal Capital Account System for Worker Cooperatives," ICA Group, accessed August 7, 2023.

- Several organizations have started dedicated funds (e.g., the Fund for Employee Ownership and the Fund for Jobs Worth Owning) to provide more flexible investment capital for conversions that acts somewhat like debt and somewhat like equity, with risk mitigated by the technical assistance they also provide.
- In circumstances where the cooperative's collateral has been committed for the conversion loan, it is challenging for the cooperative to obtain additional working capital loans while the conversion loan is outstanding, which constrains growth.

HOW ARE OWNERSHIP AND ECONOMIC RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

Share Ownership

- Worker Cooperatives are typically structured using a stock corporation form. There are also a number of worker-owned LLCs that are structured as cooperatives by embedding cooperative terms in the LLC's operating agreement.
- A stock Worker Cooperative is majority owned by its worker-owners, with each worker owning one share.
    - Typically, the worker ownership member class comes with dividend distribution and asset liquidation rights.
    - Not all workers must be owners, though typically a majority are.
    - Some jurisdictions allow co-ownership by other types of non-worker members in the form of a Multi-Stakeholder Cooperative.[20]
    - Non-worker-owners typically have limited voting rights, if any. Some jurisdictions allow cooperatives to issue non-voting, non-member preferred equity.
- Members typically become owners by purchasing a membership share to "buy-in."[21]
    - In the worker-owner member class, all individual shares have the same financial value and, typically, each worker can hold only one share.
    - The initial buy-in requires a payment as a capital contribution. The initial share may be partly acquired through internal financing rather than cash (e.g., paycheck deduction); it may also be eventually rebated to the member.
    - The buy-in amount is typically determined by the board of directors. This amount, once set, remains fixed. There is no appreciation in share value. The buy-in amount is returnable at the worker's retirement or resignation, or upon liquidation of the cooperative.

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20 Georgeanne M. Artz and Younjun Kim, "Business Ownership by Workers: Are Worker Cooperatives a Viable Option?" Iowa State University Working Paper, November 2011.

21 "Setting a Membership Share Price," ICA Group, September 2020; "Financing a Cooperative," Co-opLaw.org Resources; "Worker Cooperative FAQ," USFWC Democracy at Work Institute, accessed August 7, 2023; "Sample Bylaws Project: Volume I Overview of Cooperative Articles of Incorporation," National Council of Farmer Cooperatives, 2017.

- The amount can vary widely, from a nominal to a substantial amount, though high share amounts are currently very rare. A high amount can act as a source of working capital.
- Membership eligibility must be available to all workers. Eligibility for membership may require a minimum work tenure length, and some cooperatives require workers to either become members or leave the cooperative once they become eligible to join.
- Worker ownership stakes can typically not be re-sold to non-workers and must be sold back to the cooperative when a worker-owner retires or resigns.

- Because the US lacks a common federal framework or a priority jurisdiction (i.e., there is no "Delaware" equivalent for Worker Cooperatives), these features vary depending on how and where the cooperative is incorporated.

Stakeholder Financial Benefit

- While voting rights are typically equal among all worker shareholders, economic rights may vary.
- Net income is allocated for the benefit of members, divided into profit and surplus.
    - Profit is the portion of net income not generated by members (i.e., generated by workers that are not members) and/or that members choose to retain in the business. It goes to a collective account and is taxed.
    - Surplus is the portion of net income attributable directly to worker-owner contributions. Surplus is allocated to individual owners on the basis of their economic contribution. This surplus is called patronage.
    - A member's patronage distribution amount is typically based on total hours worked but can also be adjusted to include seniority and other considerations. Such workers may also be eligible for bonuses, depending on board discretion, bylaws, and state laws that vary.[22]
    - The patronage amount is either allocated to a worker's individual capital account or shared directly to the workers in the form of cash, which can be shared quarterly or annually. Often there is both a cash portion and a retained portion.
    - Capital (or retained patronage) in individual member accounts is retained in the business and is available for working or growth capital, but it is owned by the individual worker and is paid out to the worker upon exiting the company.
    - Some jurisdictions set requirements on the minimum amounts of surplus that must be retained in individual capital accounts or distributed as cash.
    - Member patronage distributions are always taxed at the point they are allocated, with tax owed by the worker, not the cooperative, even if it is retained.

22 "Tax Considerations for Worker Cooperatives," Co-opLaw.org Resources, accessed August 7, 2023.

Asset Preservation

- The Worker Cooperative model, unlike the employee stock ownership plan, is designed to be a permanent ownership structure. A Worker Cooperative can only be sold or dissolved by a vote of the worker-members, usually requiring a supermajority.
- Worker Cooperatives can create additional financial disincentives to a sale, such as providing in the bylaws that some portion of the proceeds of the sale go to all previous owners or to a charitable or membership organization. The bylaws provide for how current worker-owners can undo that requirement.
- An alternative is to assign preferred stock to a third party who can exercise an independent veto on worker-owner decisions. This veto can be held by an independent trustee or Class B shareholder who would vote in accordance with the trust's intent.
- Lastly, the stock can be transferred in its entirety to a trust, with the board of trustees controlled by the worker-owners, but with an independent trustee who can veto some decisions, such as demutualization (i.e., the conversion from a cooperative to a non-cooperative form), as provided for in the trust document.

HOW ARE GOVERNANCE RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- The governance of a Worker Cooperative is democratic, with each worker-owner holding equal full voting rights: "one worker, one vote."
  - Most worker cooperatives have participatory processes in day-to-day management and board elections.
  - The nature and degree of worker-owner voting rights varies depending on firm bylaws and state law.
- At a minimum, the worker-members have majority voting rights to elect the board of directors, often majority or entirely drawn from among the member-owners themselves. At a maximum (and in smaller cooperatives), the board may comprise all members, and members may make all decisions.
- Board governance
  - The board roles and responsibilities can vary depending on the nature of the business and its bylaws, and the allocation of governance rights over major decisions to the board varies by jurisdiction.
  - Generally, the board determines allocation of surplus/loss between individual members, the cooperative, and the subsidiary classes of members, if any.
  - The board makes decisions on behalf of the membership related to the cooperative's strategic goals and overarching vision, and has voting power over major capital, and corporate events. The board may also have outsized responsibility for hiring and recruiting the executive leadership and staff.

    - Members are included in decisions on conversions to another form, as opposed to it being a board decision. For example, in Illinois a yes vote by two-thirds of members is required to convert to another form.
- Some states may also allow non-worker members to vote only on major events, such as company sale or dissolution. California, for example, requires that community investor members have at least these minimal voting rights.[23]
- Some states, conversely, disallow anyone other than worker-owners from having any voting rights of equity ownership (e.g., Oregon).[24]
    - State laws require that the firm's management committee and the board be selected through separate processes.
- A cooperative's members may unionize and exert worker voice through the union, in addition to worker control of the board.[25]
- Management functions are distinct from governance, though most Worker Cooperatives use participatory, consultative, and open book management practices.
    - Especially in medium and larger Worker Cooperatives, the members—via the board—may hire managers that are accountable to the strategic plan and the board, and are empowered to make daily business and personnel management decisions.
    - Some smaller Worker Cooperatives use collective management and/or rotating manager job roles.

WHAT ARE LEGAL, TAX, AND REGULATORY CONSIDERATIONS?

- The US regulatory framework ranges from incomplete to hostile.[26]
    - The US is alone among high-income democratic nations in lacking any type of national comprehensive cooperative incorporation statute.
        - The US does have some specific federal programs for specific cooperative subtypes with funding attached (e.g., model federal act for state rural electric cooperatives, federally chartered credit unions, etc.), but no such programs exist for Worker Cooperatives.
    - There is no federally consistent framework for financing, taxation, or labor law for Worker Cooperatives.
    - In the US, there are no regulatory restrictions for funds to remain in shared models upon dissolution, nor restrictions on demutualization, as other countries have.
    - This lack of a robust federal regulatory or enabling framework poses substantial barriers to institutionalizing support for cooperatives in federal agencies such as SBA and

23 "Capital-raising for Worker Cooperatives: Using the AB 816 Community Investor Provision," Sustainable Economies Law Center, accessed August 7, 2023.

24 "Oregon," Co-opLaw.org Resources, accessed August 7, 2023.

25 Laura H. Schlachter, "Stronger together? The USW-Mondragon union co-op model," *Labor Studies Journal*, 2017.

26 Spicer, "Cooperative enterprise at scale."

Treasury, though the Department of Agriculture does have long-standing grants and lending programs in support of rural cooperatives.

- Many US states lack Worker Cooperative-specific statutes, in which case cooperatives may incorporate using other forms. Some US states have multiple incorporation frameworks for cooperatives more broadly:
  - Cooperatives can be incorporated in non-stock and stock forms, and jurisdictions can specify different cooperative corporation types (e.g., Worker Cooperative corporation, cooperative marketing association, etc.) with limits or requirements as to ownership, capital, and governance features.
- Where they exist, Worker Cooperative statutes vary substantially across states:[27]
  - California's current law, for example, enables a greater financial threshold for securities regulation-exempt community investors to be a non-voting shareholder class, enables indivisible reserve accounts, and specifies that dividends can be based on hours worked as well as tenure and total wages paid. Other states may lack all or some of these provisions or specify variations.
  - Absent cooperative specific statutes, worker-owners may elect to form as LLCs or traditional corporations and voluntarily adopt cooperative bylaws.[28]
  - While Worker Cooperatives in states without a cooperative statute can simply choose to incorporate in other states with appropriate enabling laws, in practice small Worker Cooperatives often choose to incorporate in-state as an LLC with cooperative bylaws.
- In a non-stock cooperative model, which exists in a variety of jurisdictions, Worker Cooperatives can incorporate as an LLC, divide member interests equally, and adopt cooperative bylaws. A member-managed LLC can opt for corporate or partnership tax treatment.
- Some states also have a formal, non-stock cooperative legal form, separate from the LLC, that has been used by nonprofit, farmers' marketing, and Consumer Cooperatives, but in theory could be used by worker cooperatives.[29]
- There are legal restrictions associated with use of the term "cooperative," as well as requirements around financial and governance features.
- Despite federal law directing it to address its personal guarantee requirement, the SBA has not yet done so.
  - The SBA conducted a trial lending program in 2012 for Worker Cooperatives.[30]

27 "State-by-State Co-op Law," Co-opLaw.org Resources, accessed August 7, 2023.

28 Sara Stephens, "Forming a Worker Coop: LLC or Cooperative Corporation?" Sustainable Economies Law Center, May 18, 2016.

29 "Stock v. Nonstock Cooperatives in Wisconsin," Center for Cooperatives, University of Wisconsin-Madison, accessed August 7, 2023.

30 Spicer, "Worker and community ownership."

- Despite SBA explorations, an owner of 20 percent of the business must still pledge collateral as a personal guarantee against the loan. Given the structure of Worker Cooperatives, no single owner can satisfy this requirement.[31]
- This has been a long-standing lobbying issue that a 2018 law change was supposed to address but did not.
- The State Small Business Credit Initiative, under the ARPA legislation of 2021, includes a stated priority for shared ownership forms. Funds may be difficult to access through conventional implementation channels.

- Given the complex regulatory environment and administrative burdens required, local governments may offer support to new cooperatives and existing businesses interested in converting into a cooperative (e.g., the Cooperative Technical Assistance Program in Minneapolis or similar programs in New York).[32] There are also a number of technical assistance providers focused on developing the Worker Cooperative sector.
- All in all, the costs and regulatory and administrative barriers to incorporating as a Worker Cooperative are substantial, relative to their size.

Taxation

- Democratic ownership (e.g., one worker, one vote) is often required by legislation (e.g., IRS Subchapter T).[33]
- There are three possible tax statuses in the US. Worker Cooperatives typically file federal taxes under Subchapter T but may elect to be taxed under Subchapters S or C (S-Corp or C-Corp) instead.
  - Subchapter T avoids "double taxation," as surpluses are only taxed once, either at the cooperative or the member level (i.e., patronage distribution is deducted from gross income).
  - The IRS has repeatedly challenged Worker Cooperatives' tax status, due to questions of both definition (i.e., none of the tax laws technically define a cooperative in specific legal form or incorporation rules) and the lack of a clear divide between workers and owners. (For example, are "patronage" dividends simultaneously owners'/investors' profits?) This can create regulatory concerns with employment law or the Department of Labor.
  - There is a de facto policy that a cooperative may remain tax eligible for Subchapter T if less than half of the employees are non-owners.

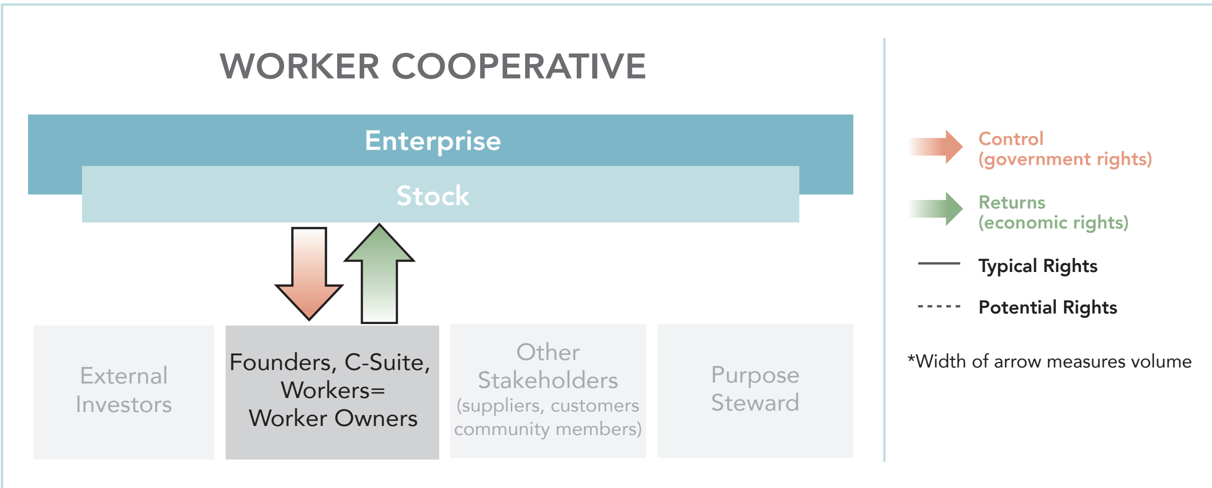
31 "Leveling the Playing Field: Access to Cooperative Business Financing in SBA 7(A) Programs," National Cooperative Business Association CLUSA International, accessed August 7, 2023.

32 Stacey A. Sutton, "Cooperative Cities: Municipal Support for Worker Cooperatives in the United States," *Journal of Urban Affairs*, 2019.

33 Michael Seto and Cheryl Chasin, "General Survey of I.R.C. 501(c)(12) Cooperatives and Examination of Current Issues," Internal Revenue Service, 2002; "Income Tax Treatment of Cooperatives," US Department of Agriculture, 2013.

- Surplus/profit paid to non-worker-owners, or paid to preferred equity via fixed dividends, is subject to IRS double taxation (i.e., both the worker/investor and the cooperative pay income tax), and is not exempt through Subchapter T.[34]

- In conversions, a seller may be eligible for a Section 1042 rollover provided at least 30 percent of the entity is worker-owned after the initial transfer.



34 Co-opLaw.org Resources, "Financing Cooperative Conversion."

What are Cooperative Holding Companies?

DEFINITION

- **Worker Cooperative Holding Companies** are a blend of a Worker Cooperative and a corporate holding company.
- This is an emerging cooperative structure in which subsidiary companies are owned by a central cooperative entity and are owned and democratically managed by workers of the subsidiary companies at the Cooperative Holding Company level and/or at the subsidiary level. There are a very small number (fewer than 5) in existence in the US, incorporated and structured in various ways.

Context and empirics

- There are at least three well-known examples in the US.[1]
  - Obran has made multiple company acquisitions and appears to currently have 2-3 operating companies.
  - Main Street Phoenix Project (MSPP) has made one confirmed acquisition in Colorado.[2] It is currently in the process of winding down.[3]
  - Evergreen began to incubate new co-ops in 2008 and began focusing on acquisitions in the last few years, completing at least four to date.
  - The Spokane Workers Cooperative is a new Cooperative Holding Company based in Spokane, Washington.
- Two other entities, newly founded, have a primary focus on acquisitions.

1 Robert Raymond, "Acquisition-conversion: the promising new strategy for scaling worker ownership," Shareable, August 19, 2021.

2 The Main Street Phoenix Project, Annual Report 2020-2021, accessed August 7, 2023 via Archive.Org.

3 Nathan Schneider, "Interview: Winding Down a Cooperative with Care," Ownership Matters, July 6, 2023.

- The Cooperative Holding Company structure theoretically could scale quickly by enabling and incentivizing acquisitions.

WHAT ARE THE BENEFITS AND LIMITATIONS OF COOPERATIVE HOLDING COMPANIES?

Benefits

- Cooperative Holding Companies can have management expertise and easier access to capital, making it easier to convert traditional companies to cooperatives.
- Cooperative Holding Companies might more effectively save at-risk jobs from business closure via an acquisition or conversion approach.
  - Like any Worker Cooperative, Cooperative Holding Companies can provide a pathway to eventual worker control and wealth building among excluded populations, including minorities and returning citizens.
- In the Obran version, workers can become owners at the Cooperative Holding Company level, rather than at the operating company level. This allows for a diversification of risk for the workers, instead of the risk being concentrated in the entity in which they work.

Limitations

- Some proponents of traditional cooperatives have questioned the "top-down" nature of the acquisitions.

HOW ARE COOPERATIVE HOLDING COMPANIES FINANCED?

- Financing for acquisitions is being sourced from a variety of philanthropic (e.g., Kendeda)[4] and government sources, where possible, and may be channeled through entity-specific capital conversion/acquisition funds (e.g., Evergreen's Fund for Employee Ownership or Obran's Acquisitions Fund I).
- Evergreen's use of a 501(c)(3) nonprofit structure[5] makes it readily able to receive some forms of public funding (e.g., Federal Reserve community development funds).
- In the Obran version, both common and preferred equity investment in the central cooperative and in the subsidiaries may be possible.[6]

4 Diane Ives, "Building Community Wealth That Lasts," The Kendeda Fund, August 25, 2019.

5 Evergreen Cooperative Corporation, IRS Form 990, 2019.

6 Joseph Cureton, Obran Cooperative Deck, 2021.

HOW ARE OWNERSHIP AND ECONOMIC RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- A central entity owns a minority (e.g., Evergreen) or majority (e.g., Obran Cooperative and Main Street Phoenix Project) of the subsidiary entities' equity.
    - This is the reverse of a typical cooperative federation (e.g., Mondragon or Arizmendi), where the central cooperative providing shared services is owned by the subsidiary cooperatives.
- The central entity may be directly and cooperatively owned and controlled by the worker-owners of the subsidiaries (Obran) or may be majority-owned by some other mission-driven entity (Evergreen).

HOW ARE GOVERNANCE RIGHTS DIVIDED BETWEEN STAKEHOLDERS?

- There is no standard for governance rights, either at the Cooperative Holding Company level or the portfolio company level.
- In the Obran version, workers ultimately own and control 51+ percent of the holding company, with workers transitioning to ownership roles over a specified post-closing period.[7]
- At Evergreen, the Cooperative Holding Company's board, led by local "anchor institutions" who are often clients of the subsidiaries, has an outsized role in subsidiary governance until profitability is achieved.[8]

WHAT ARE LEGAL, TAX, AND REGULATORY CONSIDERATIONS?

- There are no specific legal and tax structures for Cooperative Holding Companies ; they make use of existing legal frameworks for cooperatives, nonprofits, and limited liability companies (LLC).
- They may use next-generation cooperative legislation, often called a Limited Cooperative Association (LCA), which is more flexible than traditional cooperative statutes and available in many states.[9]

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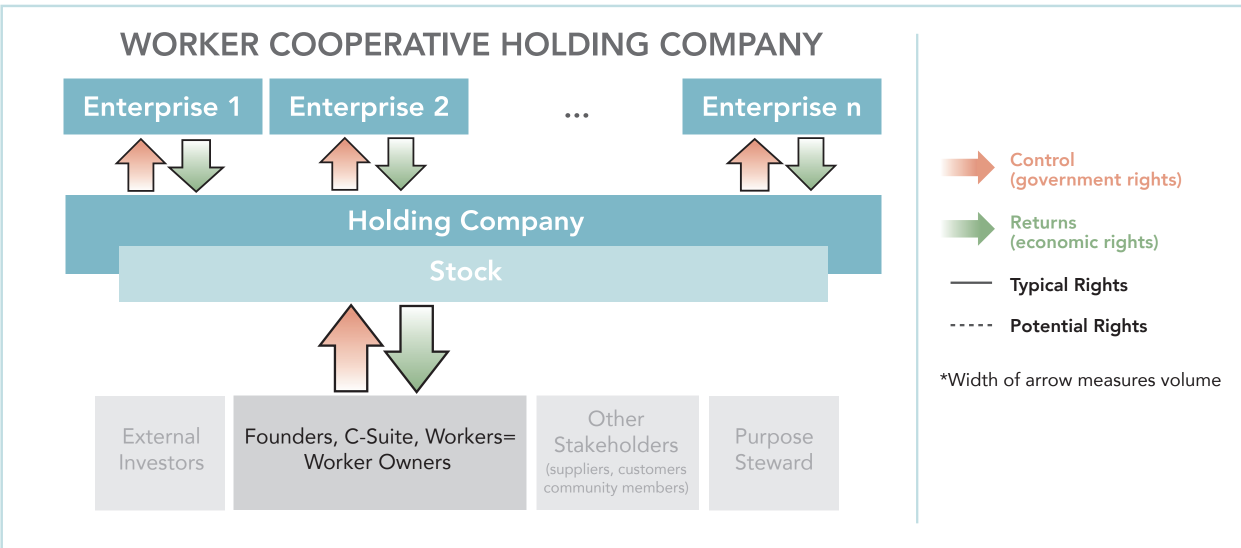
7 "What is Obran Cooperative? A Member's Guide." Obran, accessed July 24, 2023; Karen Kahn, "Obran: A Cooperative Conglomerate," *Fifty by Fifty*, August 12, 2020.

8 "The Evergreen Cooperatives Story Continues," The Field Guide to a Regenerative Economy, April 2014; Karen Kahn, "Evergreen Cooperatives Adapt and Grow," *Fifty by Fifty*, March 31, 2021; "Evergreen Cooperatives Case Study,"REDF's Impact to Last: Lessons from the Front Lines of Social Enterprise, 2015.

9 Lynn Pitman, "Limited Cooperative Association Statutes: An Update," University of Wisconsin Center for Cooperatives, April 2008.

- For example, Obran is a LCA with subsidiaries owned using a corporation or an LLC (e.g., Core Staffing is an LLC subsidiary of Obran LCA).

- A 501(c)(3) nonprofit corporation may also be the minority owner of a cooperative (e.g., Evergreen Cooperative Corporation and its recent acquisitions), which can create tax benefits for investors and facilitates the receipt of program-related investments from foundations.
- Similarly, there is no distinct regulatory treatment. Instead, Cooperative Holding Companies are subject to regulatory frameworks associated with the chosen corporate form (e.g., cooperative corporation, LLC, etc.).



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