Understanding Purpose Trusts: Advantages and Disadvantages

A *Community Conversations* webinar recorded on June 15, 2023.

NATIONAL CENTER FOR
FAMILY PHILANTHROPY

Featuring:

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Transcript of the *Community Conversations* webinar, Understanding Purpose Trusts: Advantages and Disadvantages. Recorded on June 15, 2023.

Jen Crino:

Welcome everybody. Thanks so much for joining the call today. My name is Jen Crino and I'm the Senior Manager of Programs at the National Center for Family Philanthropy. Thank you for joining us today for our community conversation. Our community conversations are topical webinars on issues and trends in family philanthropy and they're available to the field at large. So welcome. If you are not an NCFP member, we're so glad to see you here today with us. These events lift up experts in the field, challenge philanthropists in their thinking and practices, and share timely stories and strategies in the family philanthropy community. Before we get started, I just want to share quickly about our webinar technology. We want this webinar to be interactive, so please submit questions for the panelists either in the chat or in the Q and A button that's at the bottom of your screen.

To ask a question, you can use this question box as indicated on the current slide that you see and when sending in a question if you wish to be anonymous, you can do so by clicking the anonymous box there too. As a reminder, this webinar is being recorded and a replay will be made available to all the attendees that are listening in today and all the registrants as well. If you experience any technical issues, first, try and reconnect to the technology and if you have further problems, feel free to email me at jen.crino@ncfp.org to help troubleshoot some more with the Zoom tech.

As always, you're also welcome to chat with us on Twitter using the hashtag NCFPWeb if you would like to share quotes or other thoughts and feelings about the webinar today. So now let me briefly introduce this topic and our panel before we move into the discussion. Today's program is called Understanding Purpose Trusts: Advantages and Disadvantages, and this webinar will provide a primer on non-charitable trusts, including a review of their unique features and attributes and how they can be utilized by operating companies and family offices, along with other impact focused firms. Today we're joined by Susan Mac Cormac, Corporate Partner of Morrison Foerster and Zoe Schlag, Co-founder and Managing Partner of the Common Trust. Thank you so much Zoe and Susan for joining us. I will turn it over to you.

Susan Mac Cormac:

Thanks for having us. Pausing for just a second, I'll actually start sharing my screen in a minute. Thought I'd give you a little bit of background. I'm really pleased today to be joined by Zoe and I'm going to let her introduce herself, but I am a partner at MoFo and until 2001, I was a normal corporate lawyer, not a nonprofit lawyer, and I was facilitating the movement of money primarily in late stage private capital markets. And what happened to me is through my husband, I saw climate, I then realized early on that philanthropy was not going to be able to provide the full solution because philanthropy is between a quarter and a half of 1%. This is actually from when I was working with Steve McCormick and the Nature

Conservancy and so we really needed to come up with tools in the mainstream capital markets to address some of the biggest issues today like climate, inequality, health.

And so that's what I've been doing for the last 25 years. A Purpose Trust is one of the vehicles to use and what I really like is what we're going to be talking about today with Zoe, is how you can use some of these tools which are more viewed as part of the for-profit, but you can infuse philanthropy in them and essentially have a multiplier effect. So take a little bit of philanthropy and unlock some of the mainstream capital markets or some funding from different parts of your endowment or your family office to really accelerate impact and I'm excited to be here. Zoe.

Zoe Schlag:

Thanks Suz, and thanks everyone for being here today. I'm Zoe. I'm a Co-Founder and Managing Partner at Common Trust. We are a financing platform that supports small businesses to exit to employees and shared ownership using purpose trusts. We also have a fund groundwork that provides direct capital for these buyouts. I've been in the impact investing world for over a decade at this point and my journey to this space, actually I was with Suz about a month ago and joked about this, but my journey to this space really came through an existential dilemma. I think I've had a long evolution in theory of change, but back in 2017 I was running an early stage impact VC fund. We had some PRIs in that fund and were really threading the needle with high impact products and real return potential.

And as the fund evolved, I just couldn't help but thinking when these companies scale and grow and succeed, when they exit, given who sits on the cap table net, are we making wealth and equality better or worse, even for the highest impact products out there? So that really turned me towards ownership and the role that ownership plays and the legal tools that are available to really code in purpose and mission. And so that's what brought me to the world of purpose trusts, which we're going to get into today.

Susan Mac Cormac:

Great. Perfect segue, Zoe. So today we're going to start with a little background and then we're going to do a deeper dive on purpose trusts. And just for all of you who have joined us by Zoom, you are welcome to ask questions in the Q and A, Zoe and I will both be monitoring. We'll probably plan to provide talk for the first 25 to 30 minutes to give you a background understanding. But if there are relevant questions that come during that time, we'll certainly turn to them but if not, please get your questions in while we're speaking and we'll get to them in the latter half of the program. So first of all, I'm going to see if I can actually advance this. Hold on.

First of all, we really like to level set and understand what we're talking about here in terms of what are we shooting for in terms of impact in ESG. And one of the things I like to do for all kinds of audiences from hedge funds to family offices to foundations to corporations, is really level set about what we mean because the terms ESG and impact are used interchangeably and quite frankly, the purpose trust can be a tool to advance both ESG and impact. ESG as a term has been around, it is not new, it has been around since a UN report. It was first used in a UN report from 2004 where a bunch of institutional investors said, "Hey, there's this stuff related to environmental, social and governance that is material to the value of the company." So this idea that I'll get to in a second how ESG was disconnected from shareholder value, but it is, and it really has to do with underlying operations, risk management, ERM and compliance.

After it came out, it was morphed into CSR, corporate social responsibility. So it's become much broader and it's different and distinct from impact. And I know one of the key purposes of the purpose trust is to preserve impact, and Zoe and I are going to go through some specific use cases. And impact is really looking at the company and its goods and services, and reviewing the impact that it has on stakeholders, the community, its employees, as Zoe is going to be talking about, the natural environment. But I like to level set. It also explains, if any of you have questions, why we have all of this anti ESG sentiment. I mean, it's really two reasons. Number one, ESG was taken and broadened, so there is a lot in ESG that may not be material to operations. But second, it's conflated with impact, and third, we have climate, climate, climate, but that's not the topic for today.

So just Zoe, do you want to ... Actually, I'll talk for a second. I'm often asked by family offices and foundations, okay, so we're doing good, and my question is, does that good actually have any impact? In other words, we started the Rise of the Modern Foundation, it's been about 25 years old. Considerable amounts of funding has gone into it. Many of you know me, I'm not a fan of the 1% just tithing because it's not making any difference. And arguably on every measure, everything that the foundations and NGO world has tackled, is much, much worse today, whether it's oceans, whether it's homelessness, whether it's inequality. There are a lot of reasons for that. Number one is certainly not anybody's fault, you're trying to solve these huge issues with a tiny flow of funds.

But number two is people are evaluating the good that they're doing and not benchmarking it and really trying to accelerate the impact viewing, okay, what is the most impactful thing we can do in a certain space? I'm in New York right now, I happen to live in San Francisco. It's a screen I would love for our city to use. What is the most impactful thing we can do for homelessness? We're doing a whole bunch of things, it's getting worse, maybe we should revisit. And so just thinking about that, using partnerships, looking more long-term, using objectives, using innovative legal tools. And that's one of the reasons, we're going to talk about it in the purpose trust, and different mechanisms that folks can use to really accelerate impact. And Zoe, talk to us about how evolution from your perspective has shifted in 10, 15 years in this space.

Zoe Schlag:

So I think this is an interesting question and of course, people will interpret impact differently. It'll mean different things to different people. But over my time in this space, I think I've seen an evolution which in part reference based off of my existential dilemma. But initially, I've seen folks using philanthropy and impact investing around specific impact products or services. An example of this is a company called Find Help. They're a platform to support people to access social services. They've also thought about business models and how to build innovative business models for impact like microfinance, social enterprises. Folks have talked about hiring practices, making sure that they're bringing in folks who might otherwise not have an opportunity to access quality jobs like returning citizens. Back when I was in the realm of this existential dilemma, I was really interested in the role of finance and impact financing tools.

I think Susan will talk about this a little bit in the next couple slides, but I was really interested in how we leverage and design finance to meet specific goals and really protect those impact goals. And then in doing so, really came to ownership as a key tool for impact. I think this can be leveraged in a couple ways. One is really codifying the mission into the operating asset itself, but the other side of this is shared ownership of assets. This would be things like employee ownership of small businesses, community ownership of real estate, all of these tools or all of these approaches of using ownership itself as the theory of change can address things like wealth inequality, accessing quality jobs.

So that I think is an interesting entry point that I feel like was less of a conversation five years ago, and particularly with news like Patagonia has come to the fore for folks about wondering how can we actually leverage ownership itself as a theory of change. And I think the key shift here for folks to think about is that there is an opportunity to have impact at the exit or at the point of exit, in addition to after exit. I think 10 years ago folks were thinking about a moment of liquidity to then finance future impact in their communities or through their foundations and family offices. But there's also a really big opportunity to look at the exit itself as a moment to codify and lock in impact.

Susan Mac Cormac:

And it's one of the reasons I'm so excited about Zoe and their work, there are a couple of reasons, Zoe doesn't even know that I stalk her. So one is from my perspective, I think from everybody's perspective, you have a couple of really, really huge issues that overshadow everything else because they're really not solvable with our current tools and those are climate and inequality. I'll get to climate a little bit later, which is my true true north. But inequality, as Zoe said, in our low income communities in the United States and actually around the world, the only way to break the cycle of poverty is to provide some opportunity for folks, and that is typically a job and in those communities it's not ... While I love Google and Apple and work with them, they're not hiring in those communities.

It is the small local business. So if you provide mechanisms to support, there's a stream of work that I love in working with CDFIs or as Zoe's going to talk about, with a mechanism to spread the wealth so when those companies are sold or moved on, it's not just a private equity fund or the one or two founders who benefit, but it's everyone. That is a key catalyst to addressing this inequality. That and the fact that we need to change carry for every fund that is out there but again, I'm just putting teasers out there for other conversations we can have. So Zoe mentioned, and I like to, especially when I'm talking to family offices, it used to be grant making was the preferred mechanism. We work with people like Gates and Rockefeller and others and a lot of the newer family offices and philanthropists, and they're really exploring all kinds of ways legally that you are permitted to and in fact that will give you an ability to accelerate the impact.

So making PRIs or MRIs in for-profit entities, providing support for proceeds based bonds or sustainability linked bonds, I particularly like these. There are two ways that these work. You may have heard of social impact bonds which are an extension of a grant. Here, you're buying a security but you are encouraging good behavior. And nonprofits can issue these, for-profits can, and you can say, "Hey, we get a market rate return on this debt." Well this is an MRI, it's out of our endowment if you proceed as business as usual, but let's just say you are providing the proceeds to a large real estate developer. And one of my huge issues that I just keep staring at is something like 87% of low income housing is not climate resilient. If you say to that developer in connection with those bonds, "Hey if you actually do some retrofitting to make them less subject to floods, if you include renewable energy, if you do these other things to make them climate resilient and or reduce emissions, we're going to have that." You actually pay a lot less in terms of the proceeds.

That's one mechanism. Another mechanism with philanthropy plays is actually coming in as first loss capital, marrying the money with the development funds to say, "Okay, we'll provide this capital too," in my example, do the climate resiliency. Grants, obviously recoverable grants, guarantees, are another version of the first loss and we're going to talk about purpose trusts. So Zoe, you want to start us off on the business side from your perspective?

Zoe Schlag:

Yeah.

Susan Mac Cormac:

Purpose trusts can be used for a variety of different things, but I thought it would help with a concrete example about how you're seeing them used and particularly the role of philanthropy.

Zoe Schlag:

And this is particularly for selling business owners here. Purpose trusts can be used for all types of assets, so I'm sure Susie will touch on that as well. But I wanted to give a specific example of both the business and impact lens or entry point into this. So we use purpose trusts at Common Trust as an exit vehicle for small business owners who are seeking to retire typically and looking for a way to exit and pass on their business. So historically they've had private buyers, they've had private equity, recently there's been the rise of search funds, of course there's a huge amount of M and A and corporate concentration happening. But purpose trusts provide an alternative to that, and one of the things that we hear from business owners, and these are small businesses all across America, it doesn't have to be large corporates like Patagonia, it could be your local auto shop, which we actually did a deal like that that I'll talk about later in this presentation.

But for these selling business owners, what purpose trusts offer is a way for them to sell their business and get their hard-earned liquidity out and to be able to retire while also ensuring that their people, their purpose and their mission are protected through the sale. So it's actually a really incredible value prop to these selling business owners where they can lock in impact into the business even after they're gone. For the business, it actually has really important benefits over the long term. One is in selling good governance to protect both mission and the long-term health of the business for instance. At Common Trust we have borrowed a lot of the governance structures used in Europe under foundation industrial ownership. But under that particular governance structure, what we found is that over a 40-year period, businesses using this governance structure have a 6 times higher survival rate over the long term.

So when you think about protecting quality jobs in rural communities or smaller towns across America, this is actually one of the really important ways to be able to provide opportunities for working families. And then third, the benefits to the workers. Of course, through an employee ownership exit using a purpose trust, workers have access to shared economic upside. With purpose trusts, we typically do that through profit sharing, which is protected itself in the purpose trust and Suz will get into some of the details about designing the purpose trust, but in doing so, these workers know that their job is going to be around for the long term. They're not going to necessarily get acquired by a private equity firm who might lay off a quarter of the workforce. And what we've also seen under employee ownership structures is that workers have greater access to benefits. So just to put some numbers to these, workers under employee ownership structures have 33% higher wages, 92% higher average family wealth, and four times higher access to childcare.

So if you can imagine rolling out that structure and at the companies that already exist in the economy, there's a tremendous opportunity to benefit our workers while we're presenting also a very clear value prop to these selling business owners who are ready to retire in many cases. We'll get into how it works in depth, but just briefly, I wanted to cover this from the financing perspective because that's part of what we focus on on Common Trust. Essentially how this works is a selling business owner will design a customized purpose trust as their exit vehicle.

They can define specific purposes, so we typically see employee ownership, but some folks like to add in other purposes as well related to their operating principles or particular values of the company. You'll then finance the transaction, which can be through a combination external capital and seller financing to move the company shares into the purpose trust, and then once the corporate assets are in the trust, they're owned by the trust and governed on behalf of the purposes for the long term. So at that point you have moved the business into a trust that is layered in good governance principles and ensures economic benefit for instance under employee ownership or for employees.

Susan Mac Cormac:

Thanks Zoe and I'm just going to level set on now, we've said how you can use it and why it's valuable and obviously hopefully made at least some argument for use of some of these alternatives to enhance impact. But what is a purpose trust? So purpose trusts exists in several states. Delaware is the one that I use most often, Wyoming is another, and it is an alternative to what people are much more familiar with, which is a charitable trust and they're often referred to as PPP in terms of referring to their perpetual nature in addition to there being a purpose. Like many things in this space, and forgive me, I do teach at Berkeley so I really like to understand history, they are not new. In fact in the UK and under common law, perpetual purpose trusts are centuries old.

There is conflicting case law in the UK if you ever care about the [inaudible 00:21:31] ability given the rule against perpetuities, for those of you who trust lawyers, I am not one. But most people are much more familiar with the charitable trust. The key distinction between a charitable trust and a purpose trust is A, you identify the purpose. B, you have good governing documents, that's all the same. C you have trustees, but the key is there are no set beneficiaries. You establish a clear purpose, a clear saving the climate or assuaging inequality or mitigating inequality, and then they can exist forever, and that's really why they're being used. I don't use Wyoming as much, a lot of people do. I use Delaware just because on the corporate side of my practice I practice in Delaware but I don't want to give short shrift. I think there are a couple other states that have them as well, there are other states.

But as I said, they're established for the benefit of a purpose, not any identified beneficiaries. In places like Delaware, they are allowed in perpetuity. So one of the reasons that we're seeing is they're great for succession planning to avoid just things passing to kids. They are great for expansion of ownership and decision making because you can have any different bundle of rights in terms of equity in a company or otherwise that are held by the purpose trust. They have really flexible governance. So you've got to have, I'll get into a little bit more of the nuts and bolts, but you've got to have a statutory trustee. But then many of the ones we've established have different grouping of trustees that have oversight over different functions, whether it's a charitable function, giving money away or an operational function. All of that is put together in a trust document.

And the key, for those of you who are lawyers or in the family offices, the key is really picking a purpose that is broad and that is not impossible of attainment. In other words, the way that you maintain the perpetual nature is you don't pick something which could go away after a period of time. And so that's why they're increasingly being used in Zoe's world, for long-term employee holds for closely held companies, in other worlds, long-term holds over equity over for example decision making. There's a purpose trust that is being used to arbitrate decisions at Meta. We'll get into Patagonia and Change.org, but they're being used for a variety of purposes. This is just going through what is actually in the trust agreement in terms of really describing the mission and the purpose, identifying the stakeholders who are in control and making sure you have somebody who is there to enforce the mission.

I refer to this as the sentinel role. We often put purpose trusts in, for example, for those of you who don't know, there are new corporate forms, including a public benefit corporation, a B Corp justice certification, a public benefit corporation under Delaware law allows you to have the dual fiduciary duties. Now there are 23 of these in the public market, so who makes sure that people are adhering to those duties and that somebody doesn't just flip that company out of Vitel Farms or Planet Labs? If you have a purpose trust holding some shares, that trust can serve as a sentinel to make sure that there's mission alignment. That's just one example. Fiduciary duties of the trustees in terms of decision making and acting very similar to a charitable trust or a public charity or foundation because they have a duty to the mission and as I mentioned, you have very flexible governance. You have to have a corporate trustee, but you can also have a stewardship committee, you can have different groupings of decision makers within the trust agreement that take on different roles, whether it's a sentinel role, whether it is, like in Patagonia's case, management of operating assets, whether it is an enforcer like in the Meta, there are a lot of different roles that you can draft into the trust agreement.

So, not only am I not a nonprofit lawyer, I'm not a tax lawyer, so my tax lawyers did draft this up for me just to highlight that. I will say at the beginning, there is often, if not usually a trade-off between tax and impact. So those family offices and wealthy individuals that I work with who are willing to pay some tax, Patagonia was willing to pay some tax, typically have a lot more options. That being said, really making sure that you understand the tax implications, particularly if you're transferring in. The good news and why we use them a lot on the for-profit side, and this is where I see a role for family offices and foundations if they invest, let's say as a PRI, they're holding equity together with everybody else in a for-profit company. If that for-profit company has equity that has been issued out to or held by or the nonprofit decides to transfer some of their equity to a purpose trust, typically that transaction is tax-free.

Other assets could be subject to tax. And moving assets, I'm often asked about moving assets from a foundation to a trust. It's possible, provided that the trust is going to use it for the charitable purpose and that the foundation continues to exercise expenditure responsibility. Moving from a foundation to a trust is difficult if the plan is just for the trust to hold them as it usually is. So typically we structured, if a family office is going to invest say in a PRI in a company, the company then issues equity out to a purpose trust as opposed to having it tied or having the foundation transfer those shares in. So this is just a summary of two or three of the tax issues. Just note that you need to consult with your tax lawyer. So Zoe, I'm going to stop for a second and I can on the legal side, but why don't you highlight generally some of the advantages and disadvantages, and then we'll go into a couple of the specific use cases.

Zoe Schlag:

Yeah, so very quickly on the business side, I think what we hear from owners choosing to pursue this path is one of the key advantages is the customizability of purpose trusts. So a lot of these businesses that have been operating for the last 30 plus years have core values that they have been operating with, ways of doing business, ways of giving back to their communities, giving back to their employees. And purpose trusts allow them to really codify and protect those values as the original founder owner who is playing a protective role of those values, as they transition out. One of the things that I particularly like about purpose trusts in the world of impact is again, because it's so customizable, it allows you to bridge two different worlds of impact that I see, one of which is shared ownership. That's things like employee ownership or including other stakeholders.

I'll give you guys a specific example there. We're working with a organic wholesaling company right now that is in the process of designing their purpose trust. They want to do an employee ownership exit, but they came to us and said, "Hey, we've been working with these grower families in our supply chain for the last 30 years. They've been critical to our business's success. So it's really important to us that they're a part of this process too." And so with them, we're working with them to include both the employees and the growers as stakeholders in this purpose trust. So there's an ability to include other stakeholders beyond just employees from the shared ownership component. The other side of that is the ability to protect mission-driven operating principles. I see that as one of the things that a lot of folks in the B corp world have really been trying to do with that particular approach to either the certification or public benefit corporations, but within the same legal vehicle, you can protect aspects of both shared ownership and mission driven operating principles.

So some of those are the advantages. I would say on the disadvantage side of things, the considerations that selling business owners are having to contend with are a couple. One is while Sue said, it's not a new legal vehicle, people are using it recently for the first time for these specific approaches like employee ownership. So it's just a less developed landscape of financing for these businesses. Not all investors are familiar with purpose trusts and investing in these types of transactions. So I think that's actually an important role for philanthropy to play to catalyze the capital ecosystem for these types of businesses.

Susan Mac Cormac:

I think it's a good point. I mean it was interesting, there was a good Forbes article on the Patagonia Purpose Trust where some legal scholars are like, "These are going to be challenged." I mean similar, it's one of the reasons why the case law in the UK is actually interesting and could be relevant because it's perpetual and you have a rule against perpetuities and it has no beneficiaries. So you do have some oversight, but really it's set up with the trustees. I think my view is you've got a good statute and if you set up a good governance structure and you really set up some people who are always in charge, I think one of the risks is that, Zoe and I set up a purpose trust and we love each other and we bring our friends in and then by the next generation, everybody's died out and this is with our heirs and there's infighting and it's not doing anything.

I think that could lead to issues. I think one of the things that is good about how Zoe sets it up is you have perpetual employee ownership so that you have people who are really vested in the ... Sorry, not employee ownership, employee representation within the trust. Another thing that I've used a lot is just having people who have real authority sitting as trustees by designation. For example, I've set up purpose trusts where always a trustee is the head of TNC, always the trustee is the head of the environmental law department at Stanford. And you're trusting other people who know, and my primary area is climate, who know your area, who have been vetted by some other process, who always have seats and may have control and view their role very seriously. They have the fiduciary duties. So I think there are ways to ensure that the structure we set up is used for the intended purpose and as I said, it can save a lot of headache, especially in connection with succession planning, and also it provides a lot more flexibility than a traditional foundation in terms of how it can operate again with the tax qualification.

The other downside and the reason that I often pair purpose trusts with C4s is confidentiality. It is not as good to maintain the confidentiality of its operations as a C4 that has to really disclose nothing to no one. And so we often have, the trust may make decisions related to, and we're going to go into Zoe running a company, make decisions related to its rights as a shareholder of a company to maintain mission, but then it may delegate to, for example, a C4 in terms of the actual outside investment, charitable giving, other opportunities. So we're going to take two use cases, I think, one is Zoe's on employees and small business, which as I mentioned I think is one of the key means of addressing inequality, in addition to change and carry, and second, I'm going to go into use of purpose trusts together with investment to hold equity in companies. This is public companies and private companies. Zoe.

Zoe Schlag:

Yeah. So I want to talk about the opportunity for using purpose trusts for shared ownership and employee ownership because I think it is a much bigger opportunity than I realized two years ago, and I think it's really relevant for communities all across America. It's not just the large corporations, this is relevant and important for every small business across America. Just briefly to ground us in some numbers here, over the next decade, it's projected that three in five small businesses are going to seek a sale. This is in large part driven by the fact that 40% of them are owned by boomers who naturally are ready to retire and go sit on a beach somewhere. But the thing that really blew my mind as I was exploring this landscape is if you look at the current buyers for these small businesses I mentioned earlier, private equity, private buyers working with a broker for instance, the deal volume that they're doing, the businesses that they're buying each year is just going to absorb 5% of that market turning over.

So of the three in five small businesses who are going to seek a sale over the next decade, 95% of them have no buyer. One of the things that's really interesting about employee ownership is you basically have an inbuilt buyer because you're promoting someone from within into the CEO role and additionally, there's typically a lot of seller financing to support these transactions to transact. And so it is actually one of the more scalable mechanisms to address these 95% that have no buyer. Purpose trusts, relative to other forms of employee ownership, folks on this call may be familiar with ESOPs or co-ops, purpose trusts offer an affordable mission aligned way to sell a business, they offer an opportunity for the selling business owners to access their liquidity and they can really customize that. That's like I mentioned before, that's one of the aspects that folks really like about purpose trusts.

So we are typically working with folks who want some version of employee ownership. In fact, I think one of our interesting experiences is folks will typically come to us through the lens of employee ownership and once we walk them through the customizability and the opportunity set with how much they can customize their purpose trust, they'll end up with something that actually protects values or types of impact above and beyond that. As an example, we worked with a bakery in Oakland called Firebrand Artisan Breads. They include aspects of employee ownership, but they also have a longstanding practice of hiring returning citizens to provide access to quality work for them. So they actually embedded that directly into their purpose trust. Other groups are interested in protecting aspects of climate and sustainability. As an example, we're working with a solar developer installer right now, which is interested in pursuing both employee ownership and also making sure that their green transition mission is embedded in their purpose trust.

So that's one of the aspects that's really interesting and why this particular legal vehicle is so exciting to folks. I think I mentioned before the opportunity from an impact side about how much wealth this has the opportunity to bring to workers across America. In terms of the role of philanthropy to catalyze this impact, like we said on the previous slide, purpose trusts, they're not new but they're relatively new for these particular use cases. So MRIs and PRIs to help finance purpose trust transactions. For those of you who might have a place-based approach to your investing, this is a really important role to go out into your community and find businesses that have been community institutions providing quality jobs in your local business, ensuring that they actually have a succession strategy and that those workers can participate in the future economic growth of that business. Loan guarantees is another way to incentivize and accelerate capital participation into this market. To my knowledge, we haven't seen that with purpose trusts, but I think it's a particularly compelling place for philanthropy to consider playing. But those are a couple examples of both the opportunity set with this and then also the role that philanthropy can play.

Susan Mac Cormac:

And I was thinking Zoe, particularly what, and one of the reasons I featured some of the ways family offices and foundations could invest with PRIs or MRIs or debt instruments that are linked to performance, I mean that's something where it can be a really viable means of ensuring that there is the financing long-term in the form of debt and or receivables financing, but it can be tied to certain impact outcomes. And it's interesting to me also, we work with, like many others in the space, I would learn about something and get very excited, like ESOPs with employee ownership and like King Arthur Flour, what I really like is the ESOPs are fabulous in San Francisco here, Recology is one, there are many large, they have a lot of restrictions on how they're managed from an employee's perspective and have had a lot of difficulty raising the capital that they need from a debt perspective. And the beauty of having the purpose trust is A, you can marry it with equity and B, it has a lot more flexibility. Do you want to say anything about that?

Zoe Schlag:

Yeah, briefly to the first point. So the opportunity for, we typically use a combination of debt and seller financing for our buyouts. Equity is also a role, I'm actually particularly interested in the role of permanent capital vehicles in this space. It's something that I hope we will be contributing to the space over the long term, but right now we have a fund, Groundwork, that is specifically focused on supporting these buyouts. But to the impact piece, Groundwork is specifically focused on businesses that have at least 50% low to moderate income workers to ensure that we're bringing this model to the workers that will benefit the most. Again, to Susan's point, I think there's actually tremendous amount of opportunity for innovation in capital products married to this particular legal structure.

But I think we're really in the early stages of development of the capital landscape for this space, which I think is a place that philanthropy can play a really important role because at the nascent stages, that's when we're really going to build the template deals, the template structures, the analogs that people look to in terms of learning about how do we finance these in an equitable way, in a way that doesn't undo our impact, which I feel like I saw a lot of in the VC world. So I think that's also a big opportunity.

Susan Mac Cormac:

That's great. And somebody had a question, we can't toggle to you to unmute you and have you answer it, but if you could put it in the Q and A, I promise we'll get to it, unless it's in the chat. Yep. No, put it in the Q and A. Okay. So next, another use, as I mentioned this as a sentinel, and this is where we're seeing a lot in the larger scale, the larger corporates. I think a Patagonia type structure is a little unusual. It is more usual in our world to have a Delaware purpose trust holding equity. And the type of equity tends to be, and again, this can be a transfer of equity from an existing shareholder or by the company itself. We're actually seeing this just as an aside, as an alternative to the Zuckerberg super voting stock.

So instead of having a super voting stock in the public markets, you have a dual class or the private markets, you just have a different either class of common or preferred, usually common. And it really has just certain rights, it's issued to or held by the purpose trust, and it holds a class of equity that gives the sentinel or the purpose trust the right to approve things that would deviate from that mission. So it's everything from if the company is a PBC or has a stated mission by its board changing that mission. This is something that was born at the wake of JULE, which was funded by impact investors. If you change your mission and you start selling cigarettes to children, you have a sentinel unit of ability to stop it because you have a shareholder with real approval rights and enforcement rights. Can have the right to elect board, can have a right at the other end to approve a sale if the buyer, this is as Zoe mentioned, through the sale, if the buyer is not going to maintain the mission orientation.

So it's a series of consent and control rights that are given to a class of equity that is either issued to or transferred to a purpose trust for purposes of the public purpose of holding and then voting that. And Zoe, I haven't seen it yet, but I know that people are playing with the idea that this is a good way for a corporation, a large corporation to have employee ownership at the governance level. So you could have, again, you have your corporate trustee, but you could have a group of trustees and one or two of those trustees could be employees on a rolling basis that weigh in on certain issues related to the business. And again, you can, like Patagonia, expand out the use of that purpose trust to a much broader range of operational and charitable decisions, but this is how we're seeing it most often.

And I'm sorry, I'm having trouble, before we get to the case studies, Zoe, did you see if we had the question? Okay, no. Let us know. So just a few case studies and then we will pause for questions. One is Patagonia, where obviously the clothier and they restructured to ensure that the majority of the company, the economics of the company, were held by C4s and some C3s for charitable purposes. But the voting shares were transferred to a voting trust. And the purpose trust then has governance that allows it to oversee the business and operations of the company. They used a Wyoming purpose trust. Zoe, I'm just not allowed to say a lot more and all that's public. So why don't you talk a little bit more about Clegg Auto?

Zoe Schlag:

Yeah, so Clegg Auto is a deal that we did last year. It is a set of four family-owned businesses, auto shops in Utah. Basically it was owned by two brothers who came to us back in, I guess it was 2022 or 2021. I'm forgetting my years at this point, but they came to us because-

Susan Mac Cormac:

I lose whole decades, Zoe.

Zoe Schlag:

Yeah, thank you. They came to us because one of the brothers who had basically been a silent partner in the businesses for years, he was ready to get his liquidity out, whereas the other brother, Kevin, was a CEO and wanted to stay on. They decided to look at this because they wanted to incorporate some aspect of employee ownership, but they really needed to figure out a way to get some liquidity for one of the brothers who was ready to get out. So what we did with them is we designed a customized purpose trust. For them, the employee ownership aspect was most important for what they were bringing into the fold here. So in terms of from a technical perspective, what that looked like is we designed a purpose trust where they have a protected employee seat at the level of the trust.

We also have protected that they'll share profits with employees, that they have development programs for their employees. All of these things are spelled out in the trust itself to protect these aspects into perpetuity over the long term for the business. We ended up doing a hundred percent buyout of the deal. So that was financed in part by us, Common Trust, and in part through seller financing, which was basically converting a portion of their equity into a seller note paid out over the long term. One of the things that we really like doing from a financing perspective, married to the setup of a purpose trust, is designing a customized cashflow waterfall that basically reinforces the purposes as defined. So what that looks like in practice is if we're designing a trust that is to support employee benefit and wellbeing, we'll make sure in different tranches in the cashflow waterfall that money is being reinvested in the business to protect its long-term health, but also that employees are getting profit sharing alongside other distributions that may be happening.

So in terms of what this means for the business today, they have 50 workers across these four auto shops. They're all participating in profit sharing right now. So this business was founded in 1998, they had their best quarter in company history in Q1. They had 100K in profit sharing after all allocations in terms of company reinvestment and operating reserve at the company. And the auto industry is a place where folks are, I think the starting salary is about 28K. So being able to share this 100K with the workers at these auto shops is incredibly impactful from an economic perspective. So that's one of the examples that I'll share in terms of the work that we're doing.

Susan Mac Cormac:

And it's interesting to me from a philanthropic perspective, the financing for the buyout. At first blush, I'm sitting and I'm like, how is this a PRI? In fact, if you are structuring your PRI debt capital to ensure that there is a transfer of wealth and it's addressing inequality, particularly in lower income areas, and then even if you added on some requirements in terms of environmental sustainability related to waste or otherwise, you could have a huge impact. And again, I think we focus, and my practice just because I sit at a big firm is focused much more on the huge companies, but there's no way that all the mainstream of the capital markets can really address inequality. It really is left to the small, localized companies that hire and can actually make a difference in our low income areas.

So finally, I was just going to give you the Change.org case study because it's interesting for a lot of reasons. And I think in my practice, I could have a full-time job just advising people on how to achieve this outcome because if you take, and again, why I describe the difference between ESG and impact, is if you take an impact company, a company like Change.org that is having a disproportionate and positive impact, but then you set it up as a for-profit and you raise a lot of venture capital, but there's nowhere for it to go to continue to expand. And if it starts gouging its customers and getting higher and higher prices, think major corporation, the issue is that it's going to hurt. The gouging of the prices is going to hurt the people who are trying to affect change. There's just a fundamental tension.

And so at a time 2020 when Change.org had done quite well because there was a, you can remember what happened in 2020, a great influx and increase in public type campaigns, they decided, and it was really driven by some of the investors in the board, that they were going to reverse engineer and take this from a privately held company to a public charity held company. The key is not a foundation but a public charity, there being the two primary types of 501 C3, and then we would have some residual governance rights afforded to some of the folks at the dot com, at the for-profit and others who were focused on this space to make sure that there was really good mission control and mission lock, and ensuring financial. So you got the vestiges or the best of the for-profit capital markets expertise with a need for mission.

And I don't need to tell everybody on this webinar that it's not just the for-profit world that has to focus on losing their way and their mission. Unfortunately, given the structure of many foundations and public charities and the incentives, it tends to be that people start over time often focusing more on job security than advancing the ball. And that can really, really undercut the mission of organizations. So at any rate, there is a trustee LLC and then a purpose trust set up with oversight over the foundation board and the ability to make certain decisions from a governance and mission perspective. So it was just a really exciting way of using it. And again, I mentioned Meta. Meta has a purpose trust used for a totally different purpose, which is really overseeing policy decisions at a level above the board.

And then I can't give you, but I have five examples of large public companies in the tech space where they have used this dual class and they're in the private markets, they will be in the public, instead of super voting, they're setting it up for a purpose trust. And two of those were driven by my clients that are foundations that have said, "Okay, we're going to make a PRI, but we're investing with all of these VCs to advance impact. We need to ensure embedded in the structure. Is there something to ensure that there remains impact?" And so it's interesting in our world, I haven't seen those same entities push for more employee participation within the governance of that. But I think that there's a lot of discussion and I really think that could be a really exciting development.

Zoe Schlag:

My guess is as the space evolves and we have more landmark or lighthouse cases, we'll see more of that. But I think you're right. I agree with you.

Susan Mac Cormac:

Okay, so we've got a couple of minutes left. Jen or Britt, do you guys have a question? Do you want to just wrap up? It sounds like we don't have any Q and A because that means that we've either overwhelmed people or we've answered all of their questions. I'm not sure.

Jen Crino:

I think this was so helpful and provided so much information. If anyone does have any last minute questions, feel free to put them into the chat and Zoe and Susan can take care of them now too. But if not, we can wrap up in just a couple of minutes here. And I just want to extend our thanks from NCFP for sharing about this topic and providing such good slides and examples and case studies for people to chew on as we move through all of this content. So for anyone who is listening in still, we will share out the replay of this program with anyone who attended and all of the registrants as well. We'll share out the slides, any related resources, Zoe or Suz, that you have, to share with the attendees too. And just thanks so much for joining. We very much appreciate it. Britt, if you want, actually Suz, if you don't mind, could you could pull your slides down and then Britt will bring up just the two closing slides and we'll go through the announcements?

Susan Mac Cormac:

I was so excited that I got the screen sharing right.

Jen Crino:

It was perfect. Great. Okay, thanks. Also, just so you all are aware, NCFP has webinars that are just internal to NCFP members, but also for the full field of family philanthropy. So these are two of our community conversations that are open to the field. We have one on international grant making going over the challenges of legal and regulatory barriers for doing that work. We have another one in September coming up as well too that's really talking deeply about considering your lifespan as a philanthropy and thinking critically about if spending down is the right choice for you and your family as you move forward, and think about the purpose of your foundation or your broader philanthropy together. And again, thank you. You'll see in the chat there's a feedback survey if you would love to provide any comments or thoughts about the webinar as well too. And thanks so much again to Zoe and Susan for leading this conversation, for facilitating all these great examples and case studies, and we will see you at the next NCFP program. Thanks so much.

Susan Mac Cormac:

Thanks for having us.

Zoe Schlag:

Thanks for having us.