FOOD SCARCITY AND INEQUALITY OF ACCESS: A STRATEGIC LEGAL APPROACH TO COMMUNITY-FACING SERVICES ADDRESSING THE FOOD DESERT PHENOMENON

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EXECUTIVE SUMMARY

Recent studies estimate that 25-30 million Americans live in communities that lack basic access to healthy food retailers, such as supermarkets or grocery stores. The majority of these communities are in urban environments. Within these communities, the cost of the food that is available is typically 3%-37% more than comparable food available in a suburban supermarket. Food scarcity and lack of access is more likely to affect minority communities, even when accounting for differences in income, household wealth, and housing discrimination.

Long-term constrained access to healthy foods is one of the main reasons that minority and low-income populations suffer from greater incidence of diet related health conditions like type 2 diabetes, cardiovascular disease, and obesity. For many of these conditions and related health problems, a simple change in diet is the most effective remedy. However, the solution is not so simple as making healthy foods available and affordable in places where they are not. Studies show that factors like education and cultural preferences have more to do with community eating behaviors than simple availability or price. To affect real change, education must be coupled with access.

Taken as a whole, the supermarket industry in America does a pretty good job of feeding people for an affordable price. The industry in this country is mature, and highly competitive, typically operating on very slim margins. Establishing a new supermarket is also very capital intensive, often requiring millions of dollars in investment before becoming profitable. As a result, retailers tend to prefer larger stores, which lend themselves to suburban locations. Urban communities are often overlooked because of the unavailability of space, cost of real estate, higher cost of labor, and higher operational costs associated with increased security.

On the other side, community food scarcity and education initiatives often suffer from a chronic lack of resources, and are dependent either on government or private philanthropy to fund programs. This can make it difficult to implement long-term programs that may only pay social dividends 20 years out. Increasingly nonprofit funding is being tied to performance metrics, and the effectiveness of an organization in fighting a long-term chronic disease and promoting public health may only be measurable longitudinally. Often even well funded nonprofits lack the business expertise and back-end resources necessary to effectively and efficiently run a business.

Currently these two types of organizations only interact on a grant making and receiving basis. Grocery retailers may, and often do fund anti-hunger campaigns. However, I propose a deeper integration between the two— a hard wiring of sorts, combining the strengths of a national grocery retailer with the experience of an established regional nonprofit dedicated to fighting hunger in local communities. The vehicle for this integration is a joint venture LLC, owned and controlled 51% by the nonprofit, and 49% by the for-profit partner. The LLC is ideal because it permits flow-through taxation (each member of the LLC is taxed only once on their share of proceeds) and so long as the venture is majority controlled by the nonprofit partner, the LLC will function effectively as an extension of the nonprofit's tax-exempt activities. At the same time, the for-profit partner will be permitted to realize a profit on the venture. Because of majority control by the nonprofit, the community-facing mission of the venture will never be overshadowed by the compulsion to make a profit. The federal tax exemption would allow the LLC to offer products at very competitive prices and remain eligible for various public and private funding mechanisms available only to tax exempt organizations. Ideally, the joint venture would be self-funding in the long term, and duplicable between markets assuming that both members of the joint venture are committed.

I believe that this proposal represents an innovative new arrangement for addressing a persistent need in our urban communities and presents a compelling business opportunity in an underserved market. Properly planned, such an unconventional hybrid partnership can have a significant long-term impact on structural inequality within the community it serves.

In the latter part of the 19th and early 20th century, industrialization brought Americans into cities across the country en-masse. Industry wanted to be where the people were- people who would buy goods and work in the factories that produced them. Green grocers, restaurants, and department stores followed the industrial base into the city, catering to the needs of a newly urbanized America. The United States post-war boom brought prosperity to the American people through high paying manufacturing jobs, further swelling the ranks of city dwellers as everyone sought to get their piece of the pie. However, post-war America was still a country of local markets, and still lacked a comprehensive interstate system to bind the commercial fabric of the country together. Only in 1913 was the first coast-to-coast highway completed, and President Eisenhower didn't sign the Federal-Aid Highway Act into law until 1956. Coupled with the rise of air conditioning and the home mortgage interest deduction,[1] the enhanced transportation network enabled the rise of the American suburb.[2]

Considering all this it's not surprising that beginning in the 1960s and 70s, things began to change. White middle class and working class families began to leave the city for the suburbs in search of home ownership and respite from the racial turmoil of the period. During that same time, both industrial and white-collar employers began to relocate outside of the city center, seeking cheaper real estate with the recognition that they were

[1] *See e.g.* Dennis J. Ventry, *The Accidental Deduction: A History and Critique of the Tax Subsidy for Mortgage Interest,* 73 LAW & CONTEMP. PROBS. 233 (2009) *available at* http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1561&context=lcp.
[2] *See* EDWARD GLAESER, TRIUMPH OF THE CITY: HOW OUR GREATEST INVENTION MAKES US RICHER, SMARTER, GREENER, HEALTHIER, AND HAPPIER (2012).

no longer tied to large cities.[3] When the jobs moved, so did the businesses providing goods and services to those salarymen, and over time, so many formerly thriving downtown districts became ghost towns. Not everyone moved however. The great mid-century urban exodus left many of those too poor to move out to the suburbs or buy a home. Race-based redlining during the midcentury period- both explicit and implicit- also hindered the mobility of minority groups. Disproportionately represented among those remaining in the American city were African Americans, many who had recently moved up from the south in search of a better life, a decent wage, and freedom from Jim Crow.

Given this recent history of American migration, the current state of our urban places is unsurprising. Even though we've recently seen a generational shift back towards the urban center, this return has been uneven, and still many former urban manufacturing centers remain places of deep poverty. Synonymous with urban poverty is a lack of options- both economically and on the dinner plate. With urban flight went the supermarkets and grocery retailers, leaving many inner-city communities with scarce options for healthy food. Many of the urban centers left without a full service food retailer are also "oversaturated with fast-food restaurants, liquor stores, and other sources of inexpensive, processed food with little to no nutritional value."[4]

Recent studies estimate that 25-30 million Americans are living in communities that lack basic access to healthy food retailers, such as supermarkets or grocery stores.[5] In these same communities, car ownership is likely to be much lower than the national average, with 2.1 million households living more than a mile away from a grocery store without

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[3] *Id.*
[4] JUDITH BELL ET. AL., ACCESS TO HEALTHY FOOD AND WHY IT MATTERS: A REVIEW OF THE RESEARCH 6 (2013).
[5] *Id*. at 9, n. 4.

owning a car.[6] While scarcity of healthy food options is most often a problem of the city, it is not exclusively a city phenomenon, and some rural areas also suffer from the same deficiency. However, rural food scarcity is less likely to affect predominantly poor communities, with almost eight percent of the total rural population lacking healthy food access, but only little more than a third classified as low income.[7] Those living with rural food scarcity often have other food sources available to them as well, whether through hunting, farming, or a simple family garden. Many of these forms of scarcity mitigation are unavailable or impractical for urban residents.

Urban food scarcity affects not only the availability of food, but also the price of food and quality of food that is available. Food purchased at small neighborhood stores is typically 3%-37% more expensive than the same products purchased at a suburban supermarket.[8] As a general rule, healthy food is more expensive than unhealthy food. This generality has only become more pronounced in recent decades, with the price of fruits and vegetables in the United States increasing by 75 percent between 1989 and 2005, and the price of unhealthy processed and fatty foods dropping by 26 percent during that same time period.[9]

Food scarcity and lack of access is also more likely to affect minority communities, even when accounting for differences in income, household wealth, and housing market discrimination. Not only are African-Americans disproportionately likely to earn less than

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[6] *Id*. at 11.
[7] *Id.*
[8] *Food Deserts*, FOOD EMPOWERMENT PROJECT, http://www.foodispower.org/food-deserts/
[9] http://www.foodispower.org/food-deserts/ (last visited Aug. 10, 2015).

other racial groups,[10] but the typical middle income black family more likely to live in a community with lower average income than a statistically similar white or Asian family.[11] The difference is striking, as "[b]lack middle-class households (with incomes of roughly $55-60,000), [] are typically located in neighborhoods with median incomes similar to those of very poor white households (those with incomes of roughly $12,000)."[12] The poorest communities are most often found in the inner city.[13] Thus, while food scarcity and the food desert phenomenon is a fact of life for anyone living in these communities, African-Americans are statistically more likely than other populations to live in food deserts.[14]

"While unhealthy eating may be economically cheaper in the short-term, the consequences of long term constrained access to healthy foods is one of the main reasons that ethnic minority and low income populations suffer from statistically higher rates of obesity, type 2 diabetes, cardiovascular disease, and other diet-related conditions than the general population."[15] Obesity, cardiovascular disease, and diabetes often require costly medical treatment. Considering that under the Affordable Care Act low-income Americans are eligible for Medicaid,[16] and all older Americas are eligible for Medicare,[17] it's likely that

[10] *African American Income,* http://blackdemographics.com/households/african-american-income/ (last visited Aug. 10, 2015).
[11] David Leonhardt, *Middle-Class Black Families, In Low Income Neighborhoods*, N.Y. TIMES, June 24, 2015, at A3.
[12] SEAN REARDON ET. AL., NEIGHBORHOOD INCOME COMPOSITION BY RACE AND INCOME, 1990-2009 19 (March 2015).
[13] *In America's War on Poverty, Inner Cities Remain the Front Line*, INITIATIVE FOR A COMPETITIVE INNER CITY (Feb. 3, 2014), http://www.icic.org/connection/blog-entry/blog-in-americas-war-on-poverty-inner-cities-remain-the-front-line.
[14] *Food Deserts, Supra* note 8.
[15] *Id.*
[16] *Medicaid and CHIP Coverage*, HEALTHCARE.GOV, https://www.healthcare.gov/medicaid-chip/ (last visited Aug 10, 2015).
[17] Patricia Barry, *Do You Qualify for Medicare?*, AARP (Jul. 29, 2015), http://www.aarp.org/health/medicare-insurance/info-04-2011/medicare-eligibility.html.

federal and state governments will bear the bulk of the cost for medical treatment. On a personal level, individuals suffering from these diet-related health conditions will see a lower quality of life, and decreased ability to work and earn a paycheck.

If food scarcity is such a problem in the urban community, and the resulting costs so concrete, why haven't they been addressed? After all, everyone must eat and so logic would dictate that in a market oriented society where there is a dollar to be made, an entrepreneur will build a business to make that dollar. Conversely, why haven't government and private charitable efforts to address food security had an appreciable affect on the diets of these at-risk populations?

In the for-profit world, several factors explain supermarkets absence from the inner city. Foremost among these is the perception that the increased operational costs cannot be justified by profit opportunity. The grocery industry is a low margin business, with strong and weak performers differentiated by as little as 1% net margins in some cases.[18] Food costs and inflation can have a big impact on profitability, although overall labor costs constitute the largest single operating expense as the grocery industry is highly labor intensive and grocery chains tend to be unionized.[19] As a result, the grocery industry relies on volume sales to turn a profit. This simple fact has led to larger stores in less-dense areas, which promote efficiencies of scale. Compared to suburban locations, commercial real estate prices cities are appreciably higher than in more rural areas, and due to existing development it can be difficult to arrange the space necessary for a full service supermarket. Traditional full service supermarkets are usually between 17,000 and 65,000

[18] THE REINVESTMENT FUND, UNDERSTANDING THE GROCERY INDUSTRY 10 (Sept. 30, 2011).
[19] *Id.*

square feet[20] while commercial supermarket spaces in inner cities are typically much smaller.[21] Lower income urban areas can also come with higher operational costs associated with additional security.[22] However, many of the problems associated with operating in a lower income inner city environment can be overcome with careful business planning, technological innovation, and community engagement. Additionally, federal and state tax incentive and financing programs are available for groceries that locate in areas of need.[23]

Apart from the challenges of physically attracting grocery retailers to food desert areas, encouraging residents to adopt healthier lifestyles is an additional challenge. Even when healthier food options are physically available and economically within reach, many community residents simply choose not to buy them.[24] Simply adding a supermarket to a neighborhood alone doesn't influence community-eating behavior, and the only change is the out-of-pocket price of consumption. Cost, education level, and existing community eating habits have all been found to be much more powerful predictors of consumption behavior than simple convenience.[25] The everyday realities of poverty can also explain some of the variation in shopping behavior. Not only is healthier food more expensive to purchase, but it also requires more labor and knowledge to prepare, and does not keep for

[20] *Id*. at 2.
[21] Kathleen Pierce, *Supermarkets Shrink to Fit City Spaces*, THE BOSTON GLOBE (Dec. 28, 2011) http://www.boston.com/business/articles/2011/12/28/supermarkets_shrink_to_fit_city_spaces/.
[22] Jeremy Bowman, *Food Deserts: Where Have All the Inner-City Grocery Stores Gone?*, DAILY FINANCE (Apr. 4, 2012), http://www.dailyfinance.com/2012/04/04/food-deserts-where-have-all-the-inner-city-grocery-stores-gone/.
[23] *Funding: Incentives*, HEALTHY FOOD ACCESS PORTAL, http://www.healthyfoodaccess.org/funding/incentives (last visited Aug. 10, 2015).
[24] Margot Sanger-Katz, *Giving the Poor Easy Access to Healthy Food Doesn't Mean They'll Buy It*, N.Y. TIMES, May 8, 2015.
[25] *Id.*

as long.[26] Real change in community eating habits needs to link affordability, physical proximity and convenience with outreach and education- both services that do not generate a profit and are not self-sustaining.

Urban environments are complex and so it's unsurprising that a number of factors combine to make the food desert phenomenon and resulting health issues both pernicious and resistant to a simple fix. The need within the largely minority urban community is undisputed, but wherever there is need there is also opportunity. Traditional methods of addressing this problem have proven to be insufficient in one way or another. Charity funded efforts like community pantries are often susceptible to government budget cuts and the health of the larger economy. Similarly, community outreach and educational efforts often suffer from problems related to inconsistency or lack of funding. Traditional for-profit retailers- to the extent that they do operate within the inner city- don't have an incentive to conduct the outreach necessary to affect health in the community, even though a full service supermarket would be a logical organizing hub for such efforts. A combination of these traditionally separate functionalities can address these shortfalls. By combining characteristic of both of these worlds, we can incentivize for-profit retailers to go into these communities in a financially sensible way while protecting a potentially vulnerable population through state level public charity oversight and federal level IRS filing requirements. Through this kind of innovative organizational thinking, a neighborhood supermarket can become more than a mere source of groceries, but a self-funding community center that improves the lives and diets of community members.

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[26] *Id.*

What follows is a discussion of business planning considerations for any nonprofit or mission driven enterprise targeting public health and food scarcity. I first discuss the so-called 'hybrid' corporate entities, and examine some of the currently existing 'off-the-shelf' options that are available for socially minded entrepreneurs. Next I provide a brief overview the characteristics of tax-exempt nonprofit entities. Finally, I discuss an innovative application of nonprofit company law to address food scarcity in one community, and make suggestions for further development in this area.

HYBRID ENTITY CHOICES

Hybrid entities are the newest entrants in the field of company law, and have been introduced for the purpose of protecting the social or environmental missions of for-profit enterprises. Under the traditional corporate law doctrine of shareholder primacy, the highest priority of a corporation is to create value for its owners, the shareholders. First stated in 1919 by the Michigan Supreme Court in the canonical *Dodge v. Ford Motor Company* case,[27] and with more contemporary reiteration by influential economist Milton Friedman, the shareholder primacy theory has taken ahold of corporate lawyers imaginations like few others. While corporate directors are generally given wide deference in day-to-day decision making matters, once a challenge for control of the corporation is initiated, and/or defensive measures taken by corporate directors, courts will apply a much stricter level of decision making scrutiny. Thus, despite the presence of various state-based constituency statutes, the directors of socially conscious for-profit business' often feel pressured into selling when they are under threat of acquisition due to fear of a long and

[27] 170 NW 668 (Mich. 1919).

expensive legal battle, and a potential for individual liability. In response, new hybrid entity forms like the Beneficial Corporation, or B-Corp., have been statutorily enacted in states around the country. Naturally these statutes vary in exact content and protections, but all function to promote facilitation of socially conscious capital and protect the corporate ability to pursue social or environmental causes by explicitly allowing for stakeholder preemption of shareholder financial interests. The three most discussed hybrid forms are the B-Corp., the L3C, and the British CIC.

The B-Corp. is the most well known and discussed of all three forms in the United States. As generally conceived, B-Corp. has two components, and two ways for a corporation to signify its commitment to both profits and the public interest. The first element is an independent, third party certification. Any traditionally formed corporation in any jurisdiction can gain recognition as a B-Corp. through third party certification by B Lab, a 501(c)(3) nonprofit.[28] This involves submitting documentation and evidence supporting the corporation's social consciousness or purpose, in addition to traditional profit motive.[29] A company seeking certification by B Lab must meet the performance requirements as set forth in the B Impact Assessment, which addresses corporate accountability, transparency, compensation and wages for employees, corporate giving, and environmental impact.[30] If the corporation satisfies the requirements set to be certified as a B-Corp, B Lab will issue certification that can then be used in marketing and packaging to socially conscious investors and consumers. The certification process operates on the

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[28] *See, Performance Requirements*, B LAB, http://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/performance-requirements (last visited Aug. 10, 2015).
[29] *Id.*
[30] *How to Become a B Corp*, B LAB, https://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp (last visited Aug. 10, 2015).

same level that a Fair Trade Certification, or LEED Green Building Certification might. In a marketplace where consumers are increasingly conscious of the provenance and practices involved in producing the products they use, recognizable independent certification can be a valuable signifier and differentiating force.

Apart from independent B-Corp. Certification, for which an entity incorporated in any state can apply; twenty-seven states have enacted legislation allowing the creation of a B-Corporation as an entity distinguishable from a traditional corporation.[31] A statutorily based B-Corp. functions as a for-profit corporation might, but goes beyond the third-party B-Corp. certification process, and allows a company devoted to the creation of a "multiple bottom line" to bake social mission into its DNA as part of its corporate purpose.[32] Individual state statutes vary in their requirements and protections for directors, but all are based on the model statute promulgated by B-Lab.[33] The statutes allow a company organized as a B-Corp. to pursue a broad-based definition of value creation- serving both shareholders and stakeholders.

A Low-Profit Limited Liability Company, commonly referred to as an L3C, is fundamentally an LLC that has been customized to ease the regulatory burden of receiving program related investments, or PRIs from private foundations. A PRI usually takes the form of an equity investment or loan that a private foundation makes to further the charitable mission or purpose of an organization and only incidentally to realize a profit.[34]

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[31] *State by State Legislative Status*, B LAB, http://www.benefitcorp.net/state-by-state-legislative-status (last visited Aug. 10, 2015).
[32] *How to Become a B Corp, supra* note 30.
[33] *See, Model Legislation*, BENEFIT CORP INFORMATION CENTER, *available at* http://benefitcorp.net/attorneys/model-legislation (last visited Aug. 10, 2015).
[34] Lloyd Hitoshi Mayer & Joseph R. Ganahl, *Taxing Social Enterprise*, 66 STAN. L. REV. 387, 396 (February 2014).

L3C statutes "are specially worded to track the regulatory language pertaining to PRIs. This PRI language is intended to ease private foundations' investment in L3Cs by creating an entity custom tailored to the federal tax law requirements for PRIs.[35] Unfortunately, to date the IRS has refused requests to issue rulings that would automatically deem an equity investment or loan to an L3C as a PRI,[36] and the L3C statutory authorization has even been rolled back in North Carolina.[37] The legislation is only active in eight states, and in light of federal tax related uncertainty the L3C does not currently look like a useful organizational form.

On the other hand, the British Community Interest Company, or CIC, has been somewhat successful in stimulating private investment in community facing companies.[38] Similar to an American-style nonprofit corporation, the assets of a CIC are held in lock, and cannot be distributed at will upon winding up or sale by the CIC enterprise. This secures the assets to applications for the good of the community. Unlike an American nonprofit, there is no prohibition against private inurement or benefit, and earnings are not tax exempt. However, limitations are imposed on the level of dividend and interest payments allowed to shareholders and financiers, such that a profit can be made, but the primary focus of the CIC is on achieving benefit for the community. The authorizing statute also includes a devoted regulator, and the regulator continues to make adjustment to the

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[35] *Id*. at 397.
[36] *Id*. at 397-8.
[37] *North Carolina Becomes the First State to Drop L3Cs*, LLC LAW MONITOR (July 9, 2013) http://www.llclawmonitor.com/2013/07/articles/low-profit-llcs/north-carolina-becomes-the-first-state-to-drop-l3cs/.
[38] *Community Interest Companies: Case Studies*, UK.GOV (Aug. 2, 2013) https://www.gov.uk/government/collections/community-interest-companies-case-studies.

investment and interest payment limits to appropriately balance stakeholder protections with the private investor's need to make a risk justified profit.

All of the hybrid forms have specific advantages, largely centering on protection of a social or public oriented mission in a for-profit context. All must necessarily balance the sometimes-contradictory goals of creating a public benefit with the capitalist necessity of creating a profit for investors. Individually they do not provide an answer on a larger scale and are likely to remain relatively bespoke corporate offerings, as they impose restraints on an investor's ability to profit while providing little in terms of competitive advantage aside from product marketing differentiation.

TAX-EXEMPT NONPROFIT ENTITIES

Currently tax-exempt status is only open to entities that fulfill the requirements set out in IRC Section 501(c). "An organization's tax-exempt status is based on two independent but related characteristics: its incorporation status, which is determined on the state level; and its federal tax status, which is determined by the Internal Revenue Service."[39] So long as an organization conforms to the requirements of the code, it may be eligible for federal tax exemption, which encompasses both exemption from federal income tax and allows individuals and companies making qualifying donations to a deduction on their federal taxes, typically between thirty and fifty percent, depending on how exactly the organization is classified. Further, the nonprofit corporation form is valuable above and beyond the federal tax exemption because it serves as a signaling mechanism to the public

[39] LYNN PITMAN, COMPARATIVE NONPROFIT AND COOPERATIVE STRUCTURES (Feb. 2015) *available at* http://www.uwcc.wisc.edu/issues/Legal-Tax/coops_nonprofits_2015.pdf.

that the organization is not driven by a profit motive, producing what some call a "halo effect."[40] Additionally, donors are much more willing to give to nonprofits, and many more grants are open to nonprofits than are available to for-profit enterprises. The nonprofit corporation, organized under state corporate law, is by far the most common form of mission driven enterprise, and potentially the simplest to set up and operate if kept within the requirements of IRC 501(c)(3). No wonder then that it is the choice of the overwhelming majority of social entrepreneurs. The drawbacks however are that the very characteristics that make the 501(c)(3) nonprofit so attractive to donors; the prohibition against private inurement, can hinder the organization's ability to scale-up and grow. While a nonprofit can receive grants and take on debt obligations in pursuit of its publicly stated mission, many lenders are hesitant to lend to nonprofits due to the lack of other market based funding sources, dependence on giving, and often limited ability to generate income. Nonprofit corporations do not have stock and so ownership is not freely transferable. However, nonprofit corporations can own stock, and perform many of the same investment and business activities that for-profit corporations can, so long as those activities are in furtherance of the nonprofit mission as stated in the certificate of incorporation. Unlike the new hybrid forms and some for-profit forms, the tax-exempt nonprofit has a long history and a well-established body of both corporate and tax law to rely upon. As such, absent trouble with scaling and the traditional reliance on donor rather than self-generated funds, the tax-exempt nonprofit corporations are a very attractive formation choice for community facing entrepreneurs.

EXAMPLE IN ACTION: PHILABUNDANCE AND THE FARE & SQUARE GROCERY

[40] *See, e.g., Taxing Social Enterprise, supra* note 34.

In 2001, the last supermarket pulled out of Chester, a town in southeast Pennsylvania of about 34,000 residents, over half of which earn less than 200% of the poverty level.[41] In 2013, a grocery store returned to Chester in the very same location vacated twelve years prior. However, the store that located in that space was Fare & Square, the nation's first true nonprofit, full service supermarket.

Fare & Square is a venture of nonprofit hunger-relief agency Philabundance, which was established in 1984 and merged with the Philadelphia Food Bank in 2004.[42] Philabundance is classified as a public charity 501(c)(3),[43] and operates with the "belief that no man, woman, or child should go hungry."[44] As of fall 2014, Philabundance had almost 25 million in total assets.[45] Phillabundance traditionally worked through a network of local agencies, the Philabundance Community Kitchen, and the Philabundance Direct Distribution Program. As such, opening and operating a supermarket is a logical continuation of the charity's established nonprofit work and mission.

Fare & Square is organized, owned, and operated through an ecosystem of three entities; Philabundance Nonprofit, F&S Chester, RE, Inc., and Fare & Square, LLC.[46] Both F&S Chester, RE, Inc., and Fare & Square, LLC are wholly owned by Philabundance with the purpose of developing and operating the Fare & Square grocery store.[47] F&S Chester, RE,

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[41] FARE & SQUARE FACT SHEET *available at* http://www.philabundance.org/wp-content/uploads/2013/09/FS-Fact-Sheet-923.pdf.
[42] *About Us*, PHILABUNDANCE, http://www.philabundance.org/about-us/mission-history/ (last visited Aug. 10, 2015).
[43] PHILABUNDANCE, CONSOLIDATED FINANCIAL STATEMENTS: YEAR ENDED SEPTEMBER 30, 2014, 3 *available at* http://www.philabundance.org/wp-content/uploads/2010/09/FS-09.30.14.pdf.
[44] *About Us, supra* note 42.
[45] CONSOLIDATED FINANCIAL STATEMENTS, *Supra* note 43 at 3.
[46] *Id*. at 7.
[47] *Id.*

Inc. is a Pennsylvania nonprofit that holds the real estate and improvements, and Fare & Square, LLC serves as the store operator. As an LLC wholly owned by a nonprofit, Fare & Square, LLC is disregarded as a separate entity for tax purposes[48] and so Philabundance can take advantage of the flow through taxation of profits produced by the grocery while maintaining protection against liability from the venture, even though an LLC is traditionally a for-profit organizational form. F&S Chester, RE, Inc. owns the physical property and functions as a blocker entity to shield Philabundance from UBIT (Unrelated Business Income Tax) produced by rental of the property to Fare & Square LLC.[49] F&S Chester, RE, Inc. also protects Philabundance from potentially being classified as a Private Foundation instead of a Public Charity, and thus triggering much more onerous IRS regulatory obligations.[50] Important to note here that while F&S Chester, RE, Inc. is organized as a nonprofit corporation in the state of Pennsylvania, it is not a tax exempt nonprofit.[51]

As a nonprofit, Philabundance was able to take advantage of several affordable funding sources that might otherwise be unavailable to a for-profit supermarket. In addition to donation and grant support from The Reinvestment Fund, Sunoco Foundation, and Robert Wood Johnson Foundation among others, Philabundance was able to take advantage of low cost financing through the New Market Tax Credit Program (NMTC). Loans by NMTC funded CDEs to F&S Chester, RE, Inc. totaled $6,840,000, with interest

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[48] BNA, TAX MANAGEMENT: JOINT VENTURES INVOLVING TAX-EXEMPT ORGANIZATIONS 478 (2007).
[49] *See,* CASSADY V. BREWER & SEAN J. REYNOLDS, TAXATION OF EXEMPTS: BUSINESS AND TAX PLANNING WITH CONTROLLED ORGANIZATIONS 4 (Thompson RIA, 2007).
[50] *See,* BNA, TAX MANAGEMENT: PRIVATE FOUNDATIONS (2007).
[51] Obtaining tax-exempt status is not a requirement of organizing as a nonprofit.

payments ranging between 2.064% and 1.275%.[52] For comparison, a loan secured through the U.S. Small Business Administration carries an absolute minimum a rate of 6.25%, exclusive of fees, with total loan amount capped at five million dollars.[53]

As a whole, the grocery industry operates on very slim margins. On the higher end, companies like Whole Foods Markets operate with a relatively generous four percent profit margin.[54] A two percent profit margin is considered to be excellent, as the average supermarket pulls in a 1.3 percent net.[55] Supermarkets are volume businesses, and so successful companies create earnings through volume- large stores in more locations equal higher total earnings, and the more purchasing power the market chain has. Fare & Square is 16,000 sq. ft. and has six departments, including produce, deli, seafood, dairy, frozen, and brand name and private label dry foods. "Traditional supermarkets vary significantly in size, but typically range between 20,000 square feet (SF) and 65,000 SF+."[56] At 16,000 sq. ft., the Fare & Square footprint compares more favorably to limited assortment supermarkets, sometimes referred to as discount supermarkets, which typically have few if any service departments and range between 13,000 sq. ft. and 25,000 sq. ft.

As a nonprofit that is exempt from federal income tax, Fare & Square has a distinct competitive advantage in a marketplace where a four percent margin is considered double the average for a successful supermarket. Fare & Square uses this advantage to provide

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[52] CONSOLIDATED FINANCIAL STATEMENTS, *supra* note 43 at 16.
[53] *7(a) Loan Amounts, Fees & Interest Rates*, U.S. SMALL BUSINESS ADMINISTRATION, https://www.sba.gov/content/7a-loan-amounts-fees-interest-rates (last visited Aug. 10, 2015).
[54] Cassie Owens, *Nation's First Non-Profit Supermarket is Picking Up Steam,* NEXT CITY (Oct. 23, 2014) https://nextcity.org/daily/entry/nonprofit-supermarket-food-desert-chester-fare-and-square.
[55] *Id.*
[56] THE REINVESTMENT FUND, UNDERSTANDING THE GROCERY INDUSTRY 2 (September 30, 2011).

quality food to the community at approximately 8-10 percent less than small urban grocers.[57] The unique nonprofit status also allows Fare & Square to provide free membership through its Carrot Club membership program. "Carrot Club members are eligible to earn rewards, including store credit given through in-store promotions, program incentives and special values."[58] This free membership system stands in contrast to the traditional co-op grocery model, which requires patrons to purchase membership to take advantage of discounts. Additionally, "members who earn 200% of the poverty line or less have an opportunity to receive Carrot Cash benefits, a 7% credit towards future purchases."[59] This can add up to be a significant benefit for low-income shoppers, as the bottom income quintile of American households spend on average thirty-five percent of their disposable income on food, when the general population spends 12 percent.[60]

While early progress has generally been encouraging, the model requires fine-tuning before the Fare & Square can be considered an unmitigated success. Management has struggled with finding the right balance between healthful options, low prices, and appealing to the tastes of the community.[61] Additionally, the inventory selection continues to require adjustment to suit the ethnic tastes of the community, like the addition of more halal options.[62] Individuals connected with Philabundance estimate that Fare & Square needs to sell double the current volume to be fully self-sustaining, however this does not necessarily indicate failure. In the traditional supermarket, investors can spend between

[57] Eileen Cunniffe, *Fare & Square: An Oasis Appears in a Food Desert*, NONPROFIT QUARTERLY (Oct. 3, 2013) https://nonprofitquarterly.org/policysocial-context/23011-fare-square-an-oasis-appears-in-a-food-desert.html.
[58] FARE & SQUARE FACT SHEET, *supra* note 24.
[59] *Id.*
[60] *Supra*, note 54.
[61] *Id.*
[62] *Id.*

eight million and twenty-five million before seeing any return on investment.[63] Fare & Square has a little ways to go yet, but it is on the right path as it enjoys permanent structural advantages in a very competitive, yet strikingly underserved marketplace.

Future Development

The Fare & Square nonprofit grocery model is a very encouraging, and I believe it will ultimately be a successful experiment in addressing systemic market failures that have produced the urban food desert phenomenon. We need not stop here though, and through innovative structuring and cross-sector partnership, the nonprofit or hybrid nonprofit supermarket model has a lot to offer- and room to grow. The solutions currently deployed in the marketplace are all inadequate in one way or another to address the issue of food scarcity and the phenomenon of food deserts on a permanent basis. Food banks and soup kitchens rely on donated food, grants, and individual charitable donations. While the work of these organizations and the donors that support them is certainly admirable, the organizations are reliant on discretionary charity, and so in a down market when they are needed most, they often lack the resources to address the full extent of need. Traditional supermarkets are fully exposed to market conditions, and with razor thin operating margins often hesitant to take the risk of locating in a low-income urban area where ability to generate sufficient volume is more difficult with a smaller footprint. Co-op markets are an interesting option, but require a broad base of support from community members through the purchase of patron-memberships, a capital outlay that is difficult for many low-income families. Nonprofit supermarkets like Fare & Square offer a glimpse of what

[63] *Id.*

the future may hold, but despite the low cost funding available for startup, the nonprofit supermarket will encounter the same issues as other nonprofits when attempting to scale and expand to new communities of need.

The solution to this problem is multifaceted and involves a partnership that combines second and third sectors. This arrangement is specifically tailored to meet the food scarcity needs and constraints of a low-income urban community, but the general outline can be applied to other communities and even industry areas as well. That is, a for-profit/nonprofit partnership through a joint venture. Building on the example of Fare & Square, a for-profit supermarket chain or another similarly positioned partner would invest as a minority share member in an LLC which is majority owned and controlled by a tax-exempt nonprofit entity. So long as the nonprofit maintains at least majority ownership and control over managerial responsibility (so as to ensure the primacy of its charitable mission), tax exemption is not jeopardized and the nonprofit will not incur UBIT for any actions conducted within the joint venture in furtherance of its IRS approved charitable purpose.[64]

Interestingly, this "hybrid" solution would not involve any of what are thought of as hybrid organizational forms, but would be hybrid in the sense that it combines both for-profit and nonprofit qualities. Through majority ownership and management control, the nonprofit would be able to ensure the obedience of a social mission and access low cost funding and grant opportunities only open to tax-exempt entities, much as the L3C was intended to do. Any profits relating to the nonprofit's share of the joint venture would be tax exempt, so long as the joint venture is in line with the IRS approved charitable mission

[64] *See* TAXATION OF EXEMPTS, *supra* note 49.

of the nonprofit. The nonprofit would also be able to enforce equitable community hiring practices, and potentially operate ancillary community outreach programs from the supermarket, both creating a community hub and driving traffic to the profit making activities of the joint venture.

On the other side of the table, a large for-profit grocery chain operator like Wal-Mart would benefit by gaining access to an area and community that it does not currently serve well, and by doing so with a nonprofit partner, could do it in a cost effective manner. Larger grocery retailers like Wal-Mart that have traditionally adhered to the superstore model (150,000 sq. ft. or more) have increasingly been experimenting with smaller footprint, lower cost options in urban markets.[65] Partnering with a mission driven nonprofit may allow a company like Wal-Mart to access communities that might otherwise resist the location of such a retailer. Additionally, partnering with a nonprofit is a great marketing move for such a brand as it produces a "halo effect" and does not necessitate the dilution of a brand or deviation from a chain-wide macro level marketing message. In exchange for these benefits, the nonprofit and joint venture would be able to piggyback on the retailer's advantages of scale. These include various back-end support services and structural advantages that range from an established vendor and distribution network, to computerized inventory management systems, operational and analytics expertise, and bulk purchasing power.

Done correctly, the joint venture could truly harness the strengths of both parties to accomplish what would likely be very difficult or impossible to accomplish individually.

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[65] Lydia Dishman, *Why Walmart is Betting Big on Small Stores*, FORBES (Mar. 6, 2013) http://www.forbes.com/sites/lydiadishman/2013/03/06/why-walmart-is-betting-big-on-small-stores/.

While such a two party arrangement would be the backbone of the venture, there is no reason why such a joint venture could not be expanded through additional partners. So long as the nonprofit maintains financial equity and practical managerial control, tax-exempt status is protected and the potential for abuse by the for-profit partners can be checked. Such a joint venture arrangement is not without precedent. While no for-profit/nonprofit joint venture supermarket currently exists, this type of joint venture arrangement is relatively common within the healthcare industry when for-profit and nonprofit hospital systems want to merge with one another while maintaining tax advantage. There is no legal reason why an arrangement similar to this cannot be extended to other industry areas.

CONCLUSION

Community development practitioners and aspiring socially minded entrepreneurs should incorporate corporate legal formation decisions into the basic planning stage of a project or grant proposal. Properly designed corporate forms can have significant long-term benefits for founders, managers, and the communities they serve, potentially including tax exemption, social mission safeguards, and enhanced liability protection. "Line jumping" fourth sector hybridity and unconventional partnerships between for-profit and nonprofit sectors can be an important source of strength in addressing long-term structural deficiencies within a community.