

# The Legal Models Working Group Final Report

Executive Summary

Introduction : The Legal Models Working Group

Section A. Social enterprise – commercial activity with a social purpose

Section B. Why is legal form important?

Section C. Available legal forms in Australia

Section D. The Legal Models Working Group survey

Section E. Issues for Australian social enterprises

Section F. Issues and solutions – other jurisdictions

Section G. What change may be needed?

Appendix

## Executive Summary

Ownership and control are seen as essential questions in social enterprise and ideally social enterprise should be owned and controlled in the interest of its social or environmental mission.

The Legal Models Working Group sees the defining features of social enterprise as containing three essential elements:

1. Trading for social purpose,
2. Achieving financial sustainability, and
3. Re-investing profit into the social mission of the enterprise.

Successful trading is therefore a necessary factor for success as a social enterprise and an enterprise's social mission can be achieved only if the enterprise continues to be a viable, profit-making business venture. In that sense, social enterprises are part of the market economy in that they earn revenue from the production and sale of goods and services. This also means that the enterprise's decision makers need to continually balance the needs of the business with the enterprise's commitment to producing social benefits.

There is an argument that the only way of preserving "for social benefit" in a business in the long term may be through creating a new legal structure specific to the needs of social enterprise. If legislated for, such a legal structure could enable growth in the social enterprise "market" through strong "brand" identification via the legal form. Such a "brand" could enable better promotion of social enterprise to the community, while providing sound commercial recognition to investors.

Many other countries, including the US, UK and Canada are moving to legislate for such a social enterprise "identity". An important example is the "community interest company" (CIC), which was legislated for in the UK in 2005, with 7,700 such businesses now operating there. These countries are also showing a growing diversity of ownership and management structures in the social enterprise sector. There are also fewer restrictions being adopted by social enterprise "funders" based on prescribing a "one right" governance model for social enterprise operations.

The Legal Models Working Group devised a survey to test the views of the social enterprise sector regarding the importance of legal form in the broader context of their business strategy, goals and history. Responses to the survey highlighted a low level of sophistication in the social enterprise sector about the choice of formal legal structure. Responses seem to indicate a shortfall in understanding the importance of developing business models that are consistent with the objective of combining commercial activity with a continuing commitment to social purposes. They also indicate a lack of access to expert advice that might help enterprises to make informed choices about legal form. The widely accepted business management approach that structure should follow strategy did not seem to apply, and legal form did not seem to be a priority for most SE organisations. The lack of knowledge and often inadequate advice provided to SEs has resulted in enterprises choosing "what is easiest" rather than what is the best "fit for purpose". As a result, legal form is seen as simply a 'technicality' rather than a strategic issue that can have important consequences for the enterprise over time.

Arguably, what Australian social enterprises need is a legal form that fully reflects their character as a social enterprise, and could be adopted by them without significant legal complexity and cost.

In the Legal Models Working Group's view, such a form would ideally offer the following key elements:

- a. mechanisms to ensure that enterprise resources and assets are permanently committed to achieving social objectives (including if the enterprise is wound up);
- b. some means of third party validation to ensure the enterprise's continuing commitment in practice to its social objectives;
- c. a governance structure that provides key stakeholders with the right to participate in decisions about the overall management and direction of the enterprise;
- d. legal certainty about the enterprise's ability to pursue a broader interest than financial return to shareholders or owners;

In broad terms, the kind of social enterprise structure described above could be achieved by either:

- creating a new legal form with these characteristics, as has been done in the UK and some Provinces in Canada; or
- adapting existing legal forms – for example, by creating a hybrid legal structure with characteristics of both the not-for-profit and the for-profit corporate forms.

The Group considers that the introduction of new legal forms which are specifically tailored to the needs of social enterprises would significantly ease two main problems:

- a. It may not be possible to *entrench* social enterprise characteristics within the legal forms available. In particular, the current legal forms cannot protect against conversion into a for-profit, or against the distribution of assets to owners, and
- b. The ease of access to finance and brand which, while they are more generic issues, are significant barriers.

In relation to the available legal structures currently in Australia, the Group has noted that forming a company limited by shares (proprietary or public) may not satisfy the needs of social enterprises without the addition of complex arrangements such as special constitutions and trusts. Further, these entities may still be at risk if they seek to favour stakeholders over shareholders or may be converted to another corporate type. Alternatively, forming a company limited by guarantee may preclude the ability to raise needed capital.

The Group also noted the lack of understanding of co-operatives and their financial structure in the market and the greater complexity involved in forming such an entity compared with a company. However, the report identifies the common problem in the sector that the choice of a

legal structure is not well considered by social enterprises, and that as a result, the company structure is selected almost as the easy default position.

Also, in examining overseas developments in social enterprises it emerges that there have been legislative developments to better entrench social enterprise objectives in existing legal corporations via certification procedures as well as the creation of new legal forms that encompass the four key elements as identified by the working group.

The Legal Models Working Group therefore presents a report, which includes

- a literature review of legal models in other jurisdictions, particularly the UK, Canada and the USA,
- examines the existing range of legal models available to social enterprises in Australia,
- the results of a survey of social enterprises, focusing upon the choice of a legal structure.

At the conclusion of the Report, the Legal Models Working Group broadly recommends:

- that further work be undertaken to develop legal models for social enterprises,
- that further study be carried out in respect of overseas legal models to determine whether it is possible to incorporate these developments into existing legal models in Australian legislation, or to develop new legislation,
- that resources to assist social enterprises in selecting appropriate legal structures be developed, and guidance be provided in the development of the necessary documentation and policies to incorporate entities that best suits their enterprise.

## **Introduction : The Legal Models Working Group**

The Legal Models Working Group (LMWG) is a subgroup of the Social Innovation, Enterprise and Entrepreneurship Alliance (SIEE).

The SIEE is an alliance of fifteen organisations working in the social enterprise and innovation sector to support and improve the growth and impact of the social economy in Australia since its inception in 2010.<sup>1</sup>

The core group of the SIEE Alliance is comprised of organisations established to promote and support the development of social innovation, entrepreneurship and social enterprise throughout Australia.

The LMWG is one of the several “working groups” established by the SIEE to address specific strategic issues, informed by the social enterprise strategic review that was undertaken in the UK a decade ago and reported in the key Government document “Social Enterprise: A Strategy for Success”.<sup>2</sup> It was chartered to research, review and initiate the development of legal structures for use by social enterprises in Australia.

The LMWG was convened by SIEE Member, the Centre for Social Impact. An independent Chair – Malcolm Rodgers, PSM, former ASIC senior executive – agreed to head up the working group. The group has been coordinated by Alan Greig, representing the SIEE member Employee Ownership Australia Ltd.

The group has evolved over time and now includes:

- Stephen Bennett - Centre for Social Impact
- Les Hems – Tomorrow’s Agenda Research Institute
- Robert Pekin - Food Connect
- Assoc. Prof. Fiona Martin - Australian School of Business, Uni NSW , Australia
- Joanne MacNeill – former Parramatta City Council Social Enterprise Officer and former SIEE member
- Paul Steele – Donkeywheel
- Andrew Perry - LegalConsult
- Catherine Grayling - Sparke Helmore
- Mele-Ane Havea – Small Giants

---

<sup>1</sup> For the full list of supporters, see the Social Enterprise web-site at [socialenterprise.org.au/supporters/](http://socialenterprise.org.au/supporters/)

<sup>2</sup> Department of Trade and Industry, UK, 2002.

- Prof Bronwen Morgan – Faculty of Law, UNSW, Australia
- Robyn Donnelly – former legal counsel to the NSW Registry of Cooperatives

The Faculty of Law, University of NSW also provided an intern to assist the LMWG in analysing the survey and developing a matrix on legal forms in selected jurisdictions operating around the world. The intern was Bel Chen, a student at the Faculty.

The LMWG met approximately every two months from early 2012.

The objectives of the LMWG are:

- To identify key issues with choice of legal structures by social enterprise (SE)
- To analyse, document and propose better use of available legal forms in Australia by SEs
- To consider and recommend law reforms to enact new legal structures.
- To ensure recommendations are grounded in research

Some of the historical background to the work of the LMWG includes:

- Overseas approaches and initiatives, especially those in the UK and the US (eg: Community Interest Companies (CICs), L3Cs and Benefit corporations)
- The 2002 UK Report of the Department of Trade and Industry “Private Action, Public Benefit: Organisational Forms for Social Enterprise”, DTI, 2002
- Long standing indications from existing SEs in Australia that sourcing capital is their main priority.

At the commencement, it was indicated that the legal needs of different groups of SEs vary, and that three separate need groups could be identified as requiring different legal structure outcomes:

- Social entrepreneurs – individual social innovators and start-up initiators
- Group enterprises – broad stakeholder-owned community businesses
- Not-for-profits/charities – where operating income is generated through trading enterprises, often in hybrid structures comprising not-for-profit and for profit companies.

Early discussions on the work of the LMWG established that most SEs face capital raising questions relating to:

- how they generate the resources and income for economic self-sufficiency;

- how they raise capital while preserving their social mission in the long term (eg: 'asset lock');
- differences in capital needs at different stages of development, eg: start-up and growth and risk based and bridging capital.

The work program the LMWG therefore set itself was to:

- Review research material, reports and key issues raised in the literature and by informants;
- Prepare a research program;
- Develop a survey instrument;
- Select a group of existing SEs to participate in the survey (approximately 30);
- Finalise recommendations based on the discussions, literature reviews and the survey; and
- Compile a report.

The specific objectives of the research program were to:

- Investigate the issues facing SE in their choice of legal form
  - identify those features of SE to be captured in a legal form
- Explore decision-making which leads to the choice of legal models
  - document why particular legal forms were chosen
- Identify anecdotal evidence about what has driven choice of legal model
  - document barriers encountered
- Capture post formation experience
  - document practical problems
- Analyse data and comments
  - generate conclusions
- Develop proposals for reform, including
  - better use of available legal forms
  - appropriate new legal forms

Outside of the survey, the work done by the LMWG included locating and circulating key legal documents, articles and case studies from around the world, providing information to enquirers from the broader social enterprise sector and developing and servicing a network of key informants interested in the topic. The latter activity generated some extensive “community education” about an issue that is largely neglected in community development.

Discussion topics regularly on the LMWG meeting agenda – most of which were being developed in parallel - included director liabilities, director training, B-corp promotion and certification, the national cooperatives law legislative program, the social and economic impacts of employee owned and cooperatively-owned SEs, supporters trusts for football clubs, SE structures for environment activists, public service mutuals, indigenous enterprise and the Federal government’s review into crowd sourced equity funding.

Consideration was also given to the use of “golden share” arrangements in private and public company constitutions to act as a mechanism to provide an “asset lock” to ensure continuity in pursuit of social mission.

The key project was the survey, which despite its small scale and limited response, provided useful insights into the structural and legal issues facing social enterprise. Evidence from the survey indicated that legal form is not being investigated at the commencement of SEs and that the choices made have often been uninformed or representative of poor advice. In some cases, the legal form chosen does not now reflect the aspirations of the SEs. Better choice of legal form can also gain the “brand recognition” that SEs have indicated is a key issue in their development. Legal form may therefore be important for generating increasing community and funder confidence in the SE brand.

Accordingly, this report aims to provide some recommendations on the way forward in this respect.

## **Acknowledgements**

Les Hems, Joanne McNeil and Stephen Bennett for assistance with the survey instrument

Malcolm Rodgers, Bronwen Morgan, Fiona Martin, Alan Greig, Robyn Donnelly, Joanne McNeil, Andrew Perry and Stephen Bennett for assistance with writing the report

## Section A: Social enterprise – commercial activity with a social purpose

1. There has been much discussion about what social enterprise is. There is no established definition of SE in law. The landscape is changing rapidly, with many new “business models” emerging under the social enterprise banner, and a rigid definition may restrict innovation. On the other hand it is important to identify the key characteristics that make an enterprise a SE, and the important values that social enterprise stands for.
2. This section of the report draws on definitions and descriptions of social enterprise developed by a number of sources, both overseas and Australian. The LMWG has focused its work on enterprises that have all or most of the features that are common to these definitions and descriptions.
3. The key characteristics of a SE have been described by Social Enterprise UK (SEUK) in “What makes A Social Enterprise A Social Enterprise”<sup>3</sup>. According to SEUK:
4. “[S]ocial enterprises should:
  - Have a clear social and/or environmental mission set out in their governing documents
  - Generate the majority of their income through trade
  - Reinvest the majority of their profits
  - Be autonomous of the state
  - Be majority controlled in the interests of the social mission
  - Be accountable and transparent.”
5. These characteristics make SEs clearly different from ordinary businesses – but they also differ from charities and many not-for-profits.
6. The majority of SEs view themselves primarily as businesses in that they emphasise the importance of trading in order to build long-term sustainability. In that sense, they are part of the market economy in that they earn revenue from the production and sale of goods and services. However, while traditional businesses trade for the purpose of creating profit, SEs operate for a social purpose – profit (or surplus) is only a means to that end. SEs also see themselves as distinct from charities, which have traditionally relied on donations and grants for their operations. However, as charities become more commercial and entrepreneurial, many now consider themselves to be part of the social enterprise sector.
7. Social enterprise is also seen from different perspectives by the stakeholder groups involved in their development and operation. For example, users and consumers of their goods and services value the fact that meeting investor needs is not the main priority of the business model, and that they aim to re-invest profits in the social mission of the enterprise. Social enterprises are also gaining recognition as a result of the developing focus on ethical business practices in the broader community. Many social entrepreneurs and philanthropists see social enterprises as a new way of “doing good” outside of the

---

<sup>3</sup> Available at:

[http://www.socialenterprise.org.uk/uploads/files/2012/04/what\\_makes\\_a\\_social\\_enterprise\\_a\\_social\\_enterprise\\_april\\_2012.pdf](http://www.socialenterprise.org.uk/uploads/files/2012/04/what_makes_a_social_enterprise_a_social_enterprise_april_2012.pdf)

constraints of charitable status. Governments see social enterprise as a new way of tackling “wicked problems”, building social capital, creating community wealth and outsourcing public services. Community groups and staff of the enterprises see social enterprise as a new way of becoming involved in the governance of business enterprises. Indeed, ownership and control are seen as essential questions in social enterprise, and ideally the SE should be owned and controlled in the interest of its social or environmental mission.

8. With these perspectives in mind, there are several definitions and descriptions that are being used to guide social enterprise development in Australia.
9. The original definition developed by one of the first social enterprises developers in the UK (Social Enterprise London) some fifteen years ago was similar, but also attempted to address ownership and governance:

“Social enterprises are businesses that trade in the market in order to fulfil social aims. They bring people together in order to fulfil social gain. Social enterprises have three common characteristics:

- a) **Enterprise Oriented:** They are directly involved in the production of goods and the provision of services to the market. They seek to be viable trading concerns, making a surplus from trading.
- b) **Social Aims:** They have explicit social aims such as job creation, training and provision of local services. They have ethical values including a commitment to local capacity building. They are accountable to their members and the wider community for their social, environmental and economic impact.
- c) **Social Ownership:** They are autonomous organisations with a governance and ownership structure based on participation by stakeholder groups (users or clients, local community groups, etc.) or by trustees. Profits are distributed as profit sharing to stakeholders or used for the benefit of the community.”

10. Social Enterprise London also identified a variety of forms/types of social enterprise:

“The following is a selective list of the different types of enterprise:

- Community businesses: social enterprises that have a strong geographical definition and focus on local markets and local services.
- Social firms: provide employment and training to people with disabilities and other disadvantaged groups.
- Intermediate labour market companies: provide training and work for the long-term unemployed.
- Development trusts: key actors in community based regeneration.
- Credit unions: provide access to finance.

- Co-operatives: associations of persons united to meet common economic and social needs through jointly owned enterprises.
- Employee owned businesses: create and rescue jobs as part of economic development strategies.
- Charities' trading arms: enable charities to meet their objectives in innovative ways, such as Fair Trade companies."

11. More recently, the European Commission<sup>4</sup> described social enterprises in the following broad terms, and emphasised that they have both an economic and a social dimension:

"Social enterprises are positioned between the traditional private and public sectors.

Although there is no universally accepted definition of a social enterprise, their key distinguishing characteristics are the social and societal purpose combined with an entrepreneurial spirit of the private sector.

Social enterprises devote their activities and reinvest their surpluses to achieving a wider social or community objective either in their members' or a wider interest.

*Economic and entrepreneurial nature of initiatives*

- Continuous activity of producing and selling goods or services
- High degree of autonomy
- Significant level of economic risk
- Minimum amount of paid work

*Social dimension of the initiative*

- An initiative launched by a group of citizens
- A decision-making power not based on capital ownership
- A participatory nature, which involves the persons affected by the activity
- Limited profit distribution
- An explicit aim to benefit the community."

---

<sup>4</sup> [http://ec.europa.eu/enterprise/policies/sme/promoting-entrepreneurship/social-economy/social-enterprises/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sme/promoting-entrepreneurship/social-economy/social-enterprises/index_en.htm)

12. In the United States of America, there has been some attempt to define social enterprise for the purposes of legislation. For example, the US State of Connecticut report<sup>5</sup> describes “social enterprise” as encompassing “a range of business operations and strategies that aim to promote a social goal through profit-making business “. The report points to a tension between the social goal and profit-making goal of social enterprise which it calls the “dual mission dilemma”. It identifies three challenges that the dual mission creates for SEs under US law:

- a. Protecting Directors so they can pursue social goals and shareholders so they can receive value for their investment
- b. Creating a trusted brand.
- c. Accessing capital.

13. The guiding definition adopted in Australia resulted from the “Finding Australia’s Social Enterprises” project in 2009<sup>6</sup> as follows:

“Social enterprises are organisations that:

- a. Are led by an economic, social, cultural, or environmental mission consistent with a public or community benefit;
- b. Trade to fulfil their mission<sup>7</sup>;
- c. Derive a substantial portion of their income from trade<sup>8</sup>; and
- d. Reinvest the majority of their profit/surplus in the fulfilment of their mission.”

14. The “Social Enterprise Manifesto” released by the SIEE at the beginning of 2014 provides considerable background to social enterprise development in Australia; to quote from the Introduction:

“Social enterprise activity can be found in small communities and large institutions; amongst cooperatives, public sector, community service organisations, large banking

---

<sup>5</sup> See <http://www.cga.ct.gov/2013/rpt/2013-R-0260.htm>

<sup>6</sup> See: <http://www.socialtraders.com.au/finding-australias-social-enterprise-sector-fases>,

<sup>7</sup> Where trade is defined as the organised exchange of goods and services, including:

- monetary, non-monetary and alternative currency transactions, where these are sustained activities of an enterprise; contractual sales to governments, where there has been an open tender process ; and

- trade within member-based organisations, where membership is open and voluntary or where membership serves a traditionally marginalised social group.

<sup>8</sup> Operationalised as 50% or more for ventures that are more than five years from start-up, 25% or more for ventures that are three to five years from start-up, and demonstrable intention to trade for ventures that are less than two years from start-up.

institutions and more. Each sector of the Australian economy has led initiatives that have laid foundations for what is an important and emerging sector.

Across the diverse approaches in the movement, the common thread of agreement is that we need to move beyond a 'business as usual' approach to tackling Australia's economic and social challenges. Australia's future requires new approaches to doing business, and social enterprise presents a vehicle for achieving this.

Social enterprises operate for more than profit alone; foster social and environmental innovation; and are accountable to their employees, consumers and communities. Social enterprise offers a business model where people can be given a direct voice in running their organisation; and where people can positively change their lives and the lives of those around them.

There are many opportunities in the broader Australian economy where social enterprise can have a significant beneficial impact. These include community investment in the green economy, the creation of jobs for people excluded from work, and local communities designing innovative solutions to challenges they face.

This manifesto does not advocate a one-size-fits-all approach to social enterprise. It is a plurality of models and approaches that makes an economy prosperous, sustainable and inclusive. The value of social enterprise can be seen beyond its economic contribution. It embraces the principles of mutualism, participation and community ownership, while being driven by competitiveness, productivity and sustainability.

Social enterprise is an approach that brings together the best of business and community development.”

15. In summary, the Legal Models Working Group sees the defining features of social enterprise as containing three essential elements:

1. Trading for social purpose,
2. Achieving financial sustainability, and
2. Re-investing profit into the social mission of the enterprise.

16. Successful trading is a necessary factor for success as a SE and an enterprise's social mission can be achieved only if the enterprise continues to be a viable, profit-making, business venture. Furthermore, this means that the enterprise's decision makers need continually to balance the needs of the business with the enterprise's commitment to producing social benefits.

## Section B - Why is legal form important?

1. The legal form that a business adopts has important consequences for how the business is viewed externally (for example by its customers, suppliers, social procurement-minded contractors, providers of finance and the broader community), for the legal character of its activities, and for the position of those responsible for its establishment and operation. The choice of form is therefore a factor that needs to be considered a critical part of the business start-up phase.
2. The use of a corporate form (see further under Section C) separates a business from the individuals who own and manage it, and creates some basic features and protections, notably:
  - Limited liability – the liability of owners is limited to the amount they pay on their shares (unless they give personal guarantees to providers of finance);
  - Ability to enter into contracts – the business can enter into contracts in its own name; and
  - Continuity of the business beyond the individual.
3. In practical terms for organising a business, the main reasons why a legal form is needed are:
  - To bring together and protect the group of individuals who are pursuing the mission.
  - To ensure accountability to stakeholders.
  - To mobilise resources and manage assets.
4. In the case of SEs, each of these areas presents distinct challenges:
  - Their mission falls between the charitable and the commercial, a middle ground which is poorly recognised in law;
  - Lines of accountability are less clear cut than for the private or public sectors and often involve a wide range of stakeholders;
  - Financing options can be limited, depending on the legal form that is chosen.
5. As a result of these challenges, SEs suffer from poor community and institutional recognition and low levels of support from funders.
6. To help SEs address these challenges, the UK Cabinet Office Strategy Unit in 2002 identified a menu of desirable characteristics to enable a SE to map how well its legal form meets its needs as a social enterprise:

### **“Social enterprise – a menu of options for social enterprise legal forms.**

Social enterprises are likely to look for a legal form which has most (and sometimes all) of the following characteristics:

1. Ability to trade, generate surplus and create wealth for social aims
2. Entrenchment of a non-profit-distributing nature (eg: limits on forms of financing that involve profit distribution)
3. Assets to be devoted in perpetuity to public benefit objectives (protection against conversion to private profit)
4. Regulation which does not stifle innovative and entrepreneurial activity, but prevents abuse
5. Flexibility to implement a variety of governance structures, often with active stakeholder participation
6. Strong “public benefit” brand
7. Ability to access a range of forms of finance
8. Limited liability for members of shareholders
9. Ability to merge or be taken over
10. Capability for transition between forms.”<sup>9</sup>

The last point is considerably important for the maturation of the social enterprise, along with changing or emerging strategic directions

7. These characteristics would equally apply in an Australian context. To see them apply here would require a SE to design:
  - a. A legal structure to embed the social objective and ensure it is preserved over time:
    - A legal framework highlighting the social mission of the organisation and consolidating it in the constitution of that organisation.
  - b. A regulatory or constitutional mechanism such as an “asset lock” to operate as the primary mechanism to ensure that the SE is not open to being wound up, taken over or sold for individual gain:
    - A mechanism is installed to provide re-assurance to stakeholders, including social procurement-minded contractors and finance providers of the ongoing commitment to the social mission.
  - c. Ownership, governance and control features that reflect the openness of the operation and its ability to meet community expectations:
    - Involvement by stakeholders in the ownership of the enterprise.
    - Transparent governance and control in relation to the management of the business.

---

<sup>9</sup> Source: UK Cabinet Office Strategy Unit, *Private Action, Public Benefit: Organisational forms for social enterprise* (September 2002), p 12.

- A framework for enterprise decision-making with regard to who should be participating in what decisions.
  - Regular reporting to stakeholders on success in achieving both business objectives and social mission.
8. It is important for SEs to apply a legal structure that allows them, as closely as possible, to fulfil these requirements. To do this, in management parlance, it necessarily involves “structure following strategy” and “form following function” - organisational form and legal structure become a product of business planning and the business model that arises from it, with particular reference to both financing and governance.
9. There are four fundamental strategic issues that affect - and are shaped by - the legal structure of SEs.<sup>10</sup> These are:

**Motivation** – what is the organisation aiming to accomplish and why? How will “success” be defined? Central to this is that social mission and profitability, while not being mutually exclusive, may come into conflict. Given the need for financial sustainability (the venture cannot operate at a loss for long), profit can be fundamental to achieving this, but may also lead to “mission drift”.

**Control/governance** – how and by whom is control over the venture to be held? This is central to decision-making on structure. Ownership and control may need to be shared with outside investors, community stakeholders and/or service users. This will drive the need for transparency and accountability.

**Market** – the size of the market, the intensity of competition and the potential for profit influence both scale and financial sustainability. If it is expected that the venture will be difficult to make sustainable in the absence of grants or donations, then a not-for-profit structure is the likely choice.

**Capital** – the fundamental determinant as to whether a social enterprise will be structured as a for-profit or not-for-profit will be the capital requirement.

10. In making a choice on legal form, social enterprises will need to consider important distinctions under the current law between not-for-profit (NFP), cooperative and for-profit structures, these being:

**Social purpose** – with some NFPs (for example those incorporated as companies limited by guarantee), and for cooperatives, social purpose is legislatively embedded in the organisation’s objectives, whereas social purpose in for-profit companies needs to be ‘designed’ into their constitutions, usually with specialist legal guidance.

**Investment** – NFPs typically cannot issue shares and so cannot raise equity finance and pay dividends on such finance and may also experience difficulty in gaining affordable loans, whereas for-profits are more likely to attract investment because they can pay dividends on equity finance and are better known and understood by lenders. Co-operatives do not

---

<sup>10</sup> See <http://www.marsdd.com/news-insights/mars-reports/social-enterprise-in-canada-structural-options/>

readily fall into the not-for-profit or for-profit definition binary. Co-operatives can issue shares and debt instruments whilst being either distributing or non-distributing on share capital or surplus.

**Grants/donations** – philanthropic donations and public grants are usually targeted at NFPs, whereas they are usually not made available to for-profits.

**Branding** – NFPs find it easier to be recognised as operating for a social purpose, unlike for-profits. Co-operatives have developed, since the International Year of Co-operatives (2012), a potentially strong brand as entities suited for social enterprise because they are not restricted by dividend seeking shareholders.

**Taxation** – if granted charitable status, NFPs can apply for an income tax exemption and may be eligible for tax deductions on gifts made available to them, whereas for-profits are not eligible for charitable status (although in certain situations they may be part of a corporate group with a charity.) NFPs or co-operatives that invest their surpluses in their social purpose will find themselves in a non- or low taxable position. DGR status may or may not be available depending upon the ongoing federal review of tax concessions for charities.

11. In conclusion, a well-contemplated legal form can enhance both social mission and commercial success.
12. However, if the business is highly successful, there may be incentives to capitalise on this success for personal benefit rather than community benefit. This needs to be guarded against. On the other hand, if the business fails, then the social mission would not be achieved.
13. There is an argument that a way of preserving “for social benefit” in a business in the long term may be through the creation of a new legal structure specific to the needs of social enterprise. If legislated for, such a legal structure could enable growth in the social enterprise market through strong “brand” identification via the legal form. Such a “brand” could enable better promotion of social enterprise to the community, while providing sound commercial recognition to investors.
14. Many other countries, including the US, UK and Canada, are moving to legislate for such a social enterprise “identity”. An important example is the “community interest company” (CIC), which was legislated for in the UK in 2005, with 7,700 now operating there. These countries are also showing a growing diversity of ownership and management structures in the social enterprise sector. There are fewer restrictions being adopted by social enterprise “funders”, prescribing a “one right” governance model for social enterprise operations.
15. Addressing the important issue of legal structure will increase funder and public confidence that a SE is both socially focussed and commercially sound in operation. While it may not appear as pressing an issue as providing assistance to the commercial aspects of the business, it is important to select the correct legal structure at the outset. The importance of legal form in social enterprise has not received the attention in Australia that it deserves.

## Section C: Available Legal Forms in Australia

### Legal forms

1. A new SE, or an existing enterprise wanting to convert to a SE, currently has a range of options for the legal form in which enterprise activity takes place. A number of factors need to be considered in deciding on the legal form.
2. Some factors are common to all enterprises planning to conduct profitable commercial activity. These include:
  - a. the form that will enable the enterprise to act flexibly, and take advantage of commercial opportunities as they arise;
  - b. whether it is desirable to adopt a form that legally separates the business from those who own and manage it. This means the business has a separate legal personality so the enterprise itself, rather than the individuals behind it, can own property, enter into contracts, and sue and be sued in its own name, and that the business continues to exist even when its original founders move on;
  - c. who will be liable for the debts of the enterprise, especially if it fails to meet all of its obligations;
  - d. how the enterprise is to be governed and managed, and who is to take part in the decision-making process;
  - e. how finance is to be raised; and
  - f. taxation issues, such as considerations of business income tax, fringe benefits tax and GST.
3. Because SEs have social purposes in addition to commercial objectives, some additional factors need to be considered, including how the legal form will:
  - a. reflect the enterprise's commitment to social objectives;
  - b. ensure that the enterprise remains committed to its social purpose(s), and that profits and assets will remain available to achieve these purposes, especially if the business is successful and creates incentives for its owners or controllers to convert its success into purely private profit;
  - c. ensure that how decisions about the enterprise are made takes into account both commercial and social objectives, and has a clear mechanism of holding decision makers accountable for both objectives;
  - d. signal clearly its character as a social enterprise - its social enterprise "brand" - to external parties, such as customers, providers of finance or the broader community .

## Available legal forms

4. Many small businesses start as a result of an initiative by an individual or a small group such as a family. Often this is done with minimal legal formality. Many are “sole traders”, perhaps with only a business name registered. Others – for a variety of reasons such as liability management or taxation – form a private company, with a small number of shareholders and often only a single director.
5. SEs are different from these types of business start-ups because, although they may rely in the early stages on the initiative of a single or small groups of individuals, their objectives involve a broader set of considerations than the typical small business.
6. It is possible for a SE to commence in a relatively informal way through an “unincorporated association” bound by a set of rules or a constitution agreed upon by the founding members. An association of this kind is not an entity legally separate from its members. The association cannot hold property or enter into contracts, and individual members, or a group of them such as committee, are legally responsible for all aspects of the business.
7. This part of the report concentrates largely on legal form options that involve “incorporation” – forming a legal entity that is separate from the people who own and manage it. There are a range of options for incorporating, the most common of which are:
  - a. private (proprietary limited) company limited by shares
  - b. public company limited by shares
  - c. public company limited by guarantee
  - d. co-operative
  - e. incorporated association
  - f. Indigenous corporation
  - g. trading or other trust with a corporate trustee
8. All these options create limited liability for members (owners), and the incorporated body can own property and contract in its own name. In broad terms, the forms of incorporation fall into two classes:
  - a. those designed as a vehicle for commercial activity; and
  - b. those designed as a vehicle for carrying on activities that have a community or social benefit purpose.
9. Companies limited by shares are ordinarily commercial entities that aim to provide investment returns for their owners (shareholders). The usual way in which these companies are structured – their articles of association (constitution) – makes profit for shareholders the central objective. As a matter of law, it may be possible to structure a company limited by shares so that it has more than one objective including a social benefit objective. This, however, may be a complicated process requiring specially drafted articles,

and the use of additional mechanisms such as shareholder agreements and trust arrangements. The extent to which these will be fully effective has not been established by court decisions. In particular, it is not clear if the social benefit objective (and related mechanisms such as limits on dividends or the preservation of assets) can be kept if shareholders change their mind and want to convert back to a standard company.

10. Companies limited by guarantee and incorporated associations (and the special form of indigenous corporation) commonly have social benefit objectives and do not allow profits to be used to pay dividends to investors. They generally have a constitution that requires their funds and assets to be used only to further their social benefit objective, and preventing assets from being distributed to members, including if the body ceases to operate (an “asset lock”). Incorporated associations are usually not permitted to engage in commercial activity for the purpose of producing pecuniary gain for their members. Generally, “not-for-profit” is used to describe companies limited by guarantee and incorporated associations that operate in this manner.
11. Co-operatives are a special form of incorporation and generally fall into two types: distributing co-operatives and non-distributing co-operatives.<sup>11</sup> Distributing co-operatives have a share capital and the business is generally conducted as a mutual business activity between the entity and its members. Members agree to rules, which require them to perform activities that support the primary purpose of the co-operative. Surpluses can be distributed in a variety of ways, such as rebates based upon business done, which may in fact be a refund in the context of a conditionally-priced contract. Co-operatives can distribute dividends on shares held by members but they are limited to ten percent of the share value. Non-distributing co-operatives may or may not have a share capital. As a non-distributing co-op, there can be no dividends on shares and no distribution of the cooperative's assets upon winding up. Surpluses at winding up must be transferred to an entity with a similar purpose. These provisions are similar to an asset lock, although they do not preserve an asset in specie in the same way that a trust over a particular asset may do. Non-distributing co-operatives can and do give rebates to members based upon business done, but the capital of the co-operative remains intact. Non-distributing co-operatives can fit within the standard (tax) definition of a NFP.
12. Co-operatives legislation imposes a social and community benefit role upon all co-operatives by incorporating the principles established by the International Co-operative Alliance. Recent changes to directors' duties under the CNL permit directors of co-operatives to incorporate cooperative principles into their business decisions, making them able to act in furtherance of the entity's social or community purpose, rather than confining them to acting in the interests of share holding members.
13. All co-operatives under the CNL have the power to issue Co-operative Capital Units (CCUs) as a device to assist with access to capital funding. CCUs can be issued to the public or in house to members. They are broadly equivalent to redeemable preference shares, and, if they are issued to members they may be convertible to shares. They are still unknown as

---

<sup>11</sup> The new national co-operatives legislation was commenced on 3 March 2014 in NSW and Victoria, with other states to follow. The legislation replaces the terms “trading co-operative” and “non-trading co-operative” with “distributing co-operative” and “non-distributing co-operative”, respectively.

financial instruments, but they have significant potential to encourage social investment. CCUs are limited in that they can be offered to the public within the co-operative's state of incorporation, but once they are offered interstate, they will be subject to additional regulatory processes under the Corporations Act, making them expensive to issue. CCUs can be traded on a stock exchange.

14. Co-operatives are also in a position to utilise crowdfunding platforms for raising equity, where the equity raising exercise is within the co-op's state of incorporation. Pending the outcome of the CAMAC inquiry into crowdfunding, it is not possible to state whether limits on interstate equity crowdfunding for co-ops would be relaxed, although there is a strong argument for permitting this because of the unique nature of co-operative shares. Like CICs there is no capital gain on co-op shares, they are only ever repurchased by the co-operative at the issue price and thus do not require the same level of investor protection mandated for company shares under the Corporations Act.
15. All forms of incorporation are governed by legislation. Companies are governed by Commonwealth legislation administered by the Australian Securities and Investment Commission. Incorporated associations and co-operatives are governed by State legislation, administered by separate authorities in each State or Territory.<sup>12</sup> Co-operatives under the CNL will soon enjoy national operation arising from the new provisions for mutual recognition of co-operatives carrying on business in other States. Indigenous corporations are governed by Commonwealth legislation, which is administered by a specialist Commonwealth regulator.
16. A SE may also be conducted through a trust structure. Broadly, a trust is established when assets are provided to a person for use only for a particular purpose, such as the benefit of a designated group of people. As SEs are designed to be “for purpose”, a trust deed can help the SE clearly set out the purposes of that trust, and can create an ‘asset lock’ on both the initial contributions to that trust and all income generated by the trust. While a company can often resolve to change its ‘purpose’ through a meeting of its members, it may be necessary to apply to a Court to change the purpose of a trust. This can provide confidence to those dealing with the SE that the assets of the enterprise will be applied toward the stated purpose, beyond the involvement of current management or other stakeholders. Such trust structures may also be used for employee share ownership plans (ESOPs) where employees do not hold shares directly in the business but indirectly through an ESOP trust, which holds the shares on their behalf as the defined beneficiaries of the trust.

---

<sup>12</sup> The new national co-operatives legislation is designed to make the legislation uniform across all participating States, but administration remains at the State level.

## Charities and not-for-profits

17. The description above relates to the legal form – the type of incorporation – an organisation can adopt. But the legal system also gives a legal character to organisations for the purposes of other laws, especially taxation laws, and for other government purposes (such as the making of grants). The most common of these are not-for-profits (NFPs), charities and community service providers. These three characterisations do not describe a kind of incorporation, and many of them use one of the general forms of incorporation described above.

### *Not-for-profits*

18. In modern communities, many functions are performed by government and business. However there is another sector that provides and consumes products and services. This is commonly referred to as the NFP sector, the third sector, the non-profit sector, the civil sector, the civil society or the philanthropic sector.<sup>13</sup> Within this sector are also found charitable organisations.<sup>14</sup>
19. The NFP sector consists of private organisations that are formed and sustained by groups of people (usually their members) acting voluntarily. They provide benefits to themselves and others, most commonly the community or a designated section of it.<sup>15</sup> They range from local neighbourhood watch groups, tennis clubs and other community organisations to religious organisations, medical research organisations and international agencies that assist developing countries. The government may fund NFP sector organisations either through grants or contracted services (or a combination of the two) and they can provide public services such as education or medical services; however they are not part of the government. Nor are they part of the business sector as, although they may charge for their services, the generation of profit for their owners is generally not an aim. In most cases profits are returned to the organisation to be used in the furtherance of its purposes.<sup>16</sup> These organisations therefore occupy a unique space within the community in that they are private in nature but they exist for a public or community purpose.<sup>17</sup>
20. Some NFPs are subject to tax concessions, such as the exemption from income tax, but not all. Examples of those that are income tax exempt are trade unions and societies established for the encouragement of art, a particular sport, literature or music.

---

<sup>13</sup> Mark Lyons and Susan Hocking, 'Dimensions of Australia's Third Sector' (Centre for Australian Community Organisations and Management, University of Technology, Sydney 2000) 1.

<sup>14</sup> Gino Dal Pont, *Law of Charity* (LexisNexis Butterworths, 2010) [1.15].

<sup>15</sup> Mark Lyons and Susan Hocking, 'Dimensions of Australia's Third Sector' (Centre for Australian Community Organisations and Management, University of Technology, Sydney 2000) 1.

<sup>16</sup> *Ibid*, chapter 1.

<sup>17</sup> Lester M Salamon, S Wojciech Sokolowski and Regina List, 'Global Civil Society: An Overview' (Centre for Civil Society Studies The Johns Hopkins University, 2003), 1; Susan D Phillips and Steven Rathgeb Smith, 'Between Governance and Regulation: Evolving Government-Third Sector Relationships' in Susan D Phillips and Steven Rathgeb Smith (eds), *Governance and Regulation in the Third Sector* (Routledge, 2011) 1-29.

## **Charities**

17. At common law a ‘charity’ must be a NFP.<sup>18</sup> No payment can be made to a charity’s members other than for wages or allowances to employees, reimbursement of expenses, or payment for services.<sup>19</sup> This requirement also requires that, on winding up, any excess funds must be transferred to an entity with similar purposes.<sup>20</sup>
18. Charity law is a creature of the common law in Australia and has its antecedents in English law that dates back several hundred years. In 2013, the Australian Federal Government enacted the *Charities Act 2013* (Cth), confirming the common law but also extending the categories of charitable purposes. This Act commenced operation on the first of January 2014 (although there is ongoing uncertainty about its longevity, given the governmental commitment to close the ACNC).
19. Under Australian law, the words “charity” and “charitable” have a technical meaning, with “charity” referring to four categories of activity:
  - a. The relief of poverty;
  - b. The advancement of education;
  - c. The advancement of religion; and
  - d. Other purposes beneficial to the community.
20. For tax purposes, to qualify as a “charitable” purpose, a purpose must be beneficial to the community, or deemed to be for the public benefit by legislation applying to that purpose. Section 12 of the *Charities Act* defines charitable purpose and adds a number of areas to the common law, including the purpose of advancing culture and the purpose of promoting or protecting human rights.
21. Taxation law also requires that, for an entity to be charitable, all of its purposes must be charitable.<sup>21</sup> This is, however, subject to the proviso that non-charitable supporting or ancillary purposes will not cause the forfeiture of the entity’s charitable status.<sup>22</sup>

---

<sup>18</sup> *Re Smith’s Wills Trusts; Barclays’ Bank Ltd v Mercantile Bank Ltd* [1962] 2 All ER 563; Ann O’Connell, ‘The Tax Position of Charities in Australia - Why Does It Have To Be So Complicated?’ (2008) 37 *Australian Tax Review* 17, 24.

<sup>19</sup> Ann O’Connell, ‘The Tax Position of Charities in Australia - Why Does It Have To Be So Complicated?’ (2008) 37 *Australian Tax Review* 17, 24; Gino Dal Pont, *Law of Charity* (LexisNexis, Butterworths, 2010) [3.24]-[3.25].

<sup>20</sup> Australian Taxation Office, *Income Tax and Fringe Benefits Tax: Charities*, TR 2011/4, 2011 [235].

<sup>21</sup> *Word Investments* [2008] HCA 55 [17]; *Stratton v Simpson* (1970) 125 CLR 138, 159; *Royal National Agricultural and Industrial Association v Chester* [1974] 3 ALR 486, 489.

<sup>22</sup> *Maclean Shire Council v Nungera Co-operative Society Ltd* (1994) 84 LGERA 139.

22. Some of the significant advantages of charitable status include the exemption of a charity's income from taxation and a charity's longevity. The income of charitable institutions or funds is exempt from income tax in Australia. In some situations charities are also exempt from certain state and local government taxes. Charities may also be eligible for deductible gift recipient status, meaning that received donations of over two dollars or more are tax deductible.
23. Even though the charity's purposes are charitable there are potential difficulties if there is engagement in business activities. In the 2011 Federal Budget, the then Government announced that there would be reforms to the charities and NFP sector to ensure that any income tax exemption did not apply to unrelated business income. The former Government stated that it would ensure that the income tax exemption was targeted only at those activities that directly further an NFP's altruistic purposes. Under this measure, the income tax concessions will only apply to profits generated by unrelated commercial activities that are directed back to an NFP entity to carry out altruistic work. This means NFP entities will pay income tax on profits from their unrelated commercial activities that are not directed back to their altruistic purpose (that is, the earnings retained in their commercial undertaking).
24. It is also possible for a SE established as a for-profit corporation to establish a charitable trust that can obtain the types of tax benefits otherwise available only to charities. Rather than the restrictions on charities described above constraining the SE as a whole, the restrictions will largely apply only to the assets of the charitable trust. A SE may therefore create a hybrid structure where certain elements of the enterprise are charitable and obtain taxation benefits subject to particular constraints, while the balance of the enterprise is free to enter into a broad range of commercial arrangements with investors, employees, customers and other stakeholders.
25. The Australian Charities and Not-for-Profit Commission (ACNC) was established in December 2012. Charities (and in the future, NFPs) are required to register with the ACNC and lodge annual financial statements. Prior to its election in September 2013 the Coalition Federal Government announced that it would disband the ACNC and establish a Centre of Philanthropic Excellence. At the time of writing this Report, this has not occurred.

### **Community service providers**

26. The taxation legislation also provides for the establishment of Community Service Providers (CSPs). These entities must be NFP and established for community service purposes.<sup>23</sup> The ATO states that the rationale for this category of organisation was to grant an income tax exemption to community bodies whose activities are not accepted as being charitable but which still conduct activities of benefit to the community.<sup>24</sup> The CSPs must be altruistic.<sup>25</sup> In other words, the aims are motivated by an unselfish concern for the benefit of others.

---

<sup>23</sup> Tax Act s 50-70.

<sup>24</sup> Australian Taxation Office, *Income Tax: what is the Scope of the Exemption from Income Tax provided by Subparagraph 23(g)(v) of the Income Tax Assessment Act 1936?* TD 93/190, 30 September 1993. Section 23(g)(v) is the predecessor to Tax Act s 50-10 [2].

27. Service clubs such as Apex, Rotary, Lions, Zonta, Quota and community service organisations such as the Country Women’s Associations are considered community service providers. Other examples include age pensioner or senior citizens associations, play group associations and associations of Justices of the Peace.
28. The Tax Act grants community service providers an exemption from income tax as long as they are not established for political or lobbying purposes.<sup>26</sup>
29. The *Income Tax Assessment Act 1936* (Cth) defines the concept of a co-operative company in sections 117 and 118. A co-operative company is one that conducts 90% of its transactions with its members and is incorporated for a variety of purposes, with the provision identifying transactions that give rise to mutual income, which is not taxable.

---

<sup>25</sup> Ibid [4].

<sup>26</sup> Tax Act s 50-10.

## **SECTION D – The Legal Models Working Group Survey**

### **Survey design**

#### ***Project Scope***

1. There were two key questions:
  - Whether the existing legal framework and its regulation in Australia make it harder than it should be to start and operate successful social enterprises?
  - Whether changes are needed to take account of the special features of this type of organisation?

#### ***Methodology***

##### *Project aims and data*

2. The survey was regarded as an exploratory study only to provide a foundation for further review of legal forms in Australia.
3. The project aimed to explore the current legal structures, governance models and reporting requirements of operating social enterprises in Australia and to better understand the decision making process to select an appropriate legal structure.

##### *Perspectives from social enterprise*

4. The social enterprise perspective was captured through an online survey conducted of operating enterprises across Australia, with the support of the Centre for Social Impact (CSI). Due to the limited information on social enterprises in Australia, a panel study was selected as an appropriate method to incorporate a range of different legal and governance structures within the survey, and to ensure a range of enterprises across Australia are analysed. A panel of 38 organisations was developed.
5. Furthermore, researchers collated and reviewed secondary data sources on the organisations identified within the panel to provide a deeper understanding of the products and services, the intended beneficiaries, the social purpose and the existing governance structures. CEOs and senior managers were invited to participate in the study.
6. The survey included questions covering: organisation characteristics, governance structure and legal form, funding model and the leadership decision-making process. The structure of the survey was based on previous studies conducted in the United Kingdom. The survey questions are included in the appendix attached to this report.

##### *Comparative structures*

7. To identify and understand gaps in the current legal and regulatory framework in Australia, a review and comparative analysis of four comparable jurisdictions was conducted.

## 8. Researchers:

- Conducted a review of the current legal and regulatory frameworks in four comparable jurisdictions: the United Kingdom, US, Canada and New Zealand. The review was limited to these four countries due to the similarity of their political, economic, social and legal contexts to Australia.
- Identified innovations in legislation and/or innovative legal structures within existing frameworks
- Carried out a literature review within each jurisdiction.

### *Limitations*

9. As this was an exploratory study, limited resources and capacity created some constraints in the data collection process.
10. Firstly, as there is presently no up-to-date, publicly available dataset of social enterprises (the Social Traders developed “Find A Social Enterprise” list was used to some extent, but it does not include contact information required for a survey), the sample frame was created by the Working Group and does not claim to be representative of the social enterprise sector in Australia. Judgements also had to be made to ensure spread across States, industries, target groups and known ownership structures.
11. Secondly, due to the challenges in recruiting participants into the study and ensuring survey completion, the resulting response rate was too low to conclude generalisations. The findings from the survey are therefore suggestive only. The return sample at about 40% of those survey forms forwarded (including the part-completed survey forms), though limited in number, did provide an indication that some projects have a problem with identifying with the term “social enterprise”.
12. Finally, the anonymity required under the ethics approval precluded the kind of post survey discussions that were undertaken in the UK example, which greatly contributed to the analysis and the quality of the report produced there, which included about twenty brief but excellent case studies.

### *Project ethics*

13. This project sought and received ethics approval from the University of New South Wales, ASB Research Ethics Advisory Panel.<sup>27</sup>

### **Survey responses**

14. The survey was forwarded online to 38 social enterprises (SEs), with an introductory letter from the LMWG”.<sup>28</sup>

---

<sup>27</sup> The relevant approval number is 126049.

<sup>28</sup> Please find the appendix attached at the end of this report for the survey form and letter.

15. During the survey period eighteen responses were received and not all not all surveys were completed. We attribute the low response rate to challenges in connecting and engaging with regional and remote organisations, time limitations of senior staff to complete a lengthy survey and difficulties in understanding the issues/novelty of the topic in the sector. Online inputting of survey responses was managed through the Centre for Social Impact at the University of NSW (the convenor of the LMWG).
16. The SEs were chosen by the Working Group to ensure that there was a wide cross section of SE 'types' (in terms of business form), target groups being served and industries being operated in, with as even a spread across States as could be achieved .
17. There were seven proprietary limited companies that fully participated in the survey. All of them were locally based and all wanted to bring positive impacts to the community through building a local enterprise, increasing local employment, improving financial returns to the community, combined with creating an innovative and collaborative community environment.
18. Other respondents who finished the survey included three public companies limited by guarantee, one public company limited by shares, two incorporated associations and one aboriginal corporation. No cooperatives completed the survey (with some indicating that they did not identify with social enterprise).

## **Analysis**

19. Generally speaking, the analysis of the survey showed that social enterprises (SEs) are seeking a legal form that:
  - a. encourages the growth of their businesses and promotes better governance within their organizations.
  - b. increases the recognition of the business and of its contribution to the community.
  - c. promotes their business as a sound commercial proposition and a good "community brand".
  - d. highlights the connection between healthy financial performance of the business and benefits that will flow to the community over time.
18. Responses to the survey highlighted a low level of sophistication in the social enterprise sector about the choice of formal legal structure. Responses seem to indicate a shortfall in understanding the importance of developing business models that are consistent with the objective of combining commercial activity with a continuing commitment to social purposes. They also indicate a lack of access to expert advice that might otherwise help enterprises to make informed choices about legal form. The widely accepted business management approach that structure should follow strategy did not seem to be applied, and legal form did not seem to be a priority for most SE organisations. The lack of knowledge and often inadequate advice provided to SEs has resulted in enterprises choosing 'what is easiest' rather than what is the best 'fit for purpose'. As a result, legal form is seen as simply a 'technicality' rather than a strategic issue that can have important consequences for an enterprise over time.

19. From the survey, however, it was apparent that two of the respondents did state that they wished for changes in future to their legal forms which would allow for easier access to business finance, though most of those who responded also received some form of grant funding from government or elsewhere.
20. Overall, the analysis of the survey highlighted some of the dissatisfaction, concerns and needs of SEs in relation to their business operations and financial sustainability.
21. The survey indicated that the most prominent need is for social recognition of the contributions of SEs to their respective communities. This is because it is believed that increased recognition from the community will help SEs to secure a more sustainable level of business in future, primarily through increased turnover. If this is achieved, it would then better assist the “community benefit” aspect of their operation and their “social impact”.

## Section E: Issues for Australian social enterprise

1. This section combines the overview of legal options (Section C) with the analysis of the survey (Section D) to draw some conclusions on what the main issues for Australian social enterprises are in going forward.
2. There are four key issues of particular importance to Australian social enterprise when making choices amongst the range of legal forms and legal character currently available:
  - a. the status of social purpose in the overall mission – how social purpose is reflected in and preserved by the legal form;
  - b. the treatment of profits or surplus;
  - c. the ability of the enterprise to raise finance; and
  - d. the impact of enterprise activity on tax advantages for charity and NFP forms.
3. We also identify the importance of the legal model itself as a separate issue, although this is not typically understood at present as a *separate* issue of importance by many in the sector, as indicated by the survey.
4. All four of these issues tend to be dealt with in sharply contrasting ways by the current legal forms, although the cooperative structure offers some ability to bridge these contrasts. In this section we focus on a succinct description of the way in which the two broad classes of legal models described in Section C deal with each issue, as well as the evidence that has emerged from our survey on the issue.
5. **Social purpose:** Social enterprises by definition seek to blend or pursue in parallel both the generation of surplus and some kind of social or community purpose. The two main ways in which legal form can directly affect the centrality of social purpose are:
  - by legally entrenching that purpose as a central objective of the company, and
  - by legally protecting the continuity of the central objective over time, including upon wind-up.
6. Legal structures created as a vehicle for commercial activity are not designed to give any priority to objectives other than to create a profit for shareholders. Although creative article drafting could alter this for specific companies, it is not currently clear how much courts will support a different approach via creative drafting of articles (nor is the cost to individual social enterprises to do this being taken into account, including their ability to access the specialist legal expertise required). In stark contrast, legal structures for carrying on community or social benefit clearly place social purpose front and centre in their legal structure. There is potential for external vetting of these purposes. For example, in 2012, Australia introduced the ACNC which has oversight of charities and NFPs. However, the future of the ACNC is uncertain (see further discussion in C).
7. The survey possibly suggests that these latter structures *de-emphasise* the commercial aspects of social enterprise: the survey sample divided roughly in half along the two broad classes of legal models, with only a third *self-identifying* as social enterprises (two-thirds of

which were proprietary limited companies). Cooperative structures in fact provide an opportunity to blend social and commercial objectives in their governance structure, but none were represented in the survey.

8. The survey evidence suggested that *visibility* of the social purpose was perhaps currently more central to companies than legal entrenchment into the governance structure. A desire for greater recognition of their social contribution was one of two principal themes to emerge, especially for companies that use the traditional for-profit company structure. Such recognition can be achieved not only by embodying it in the legal form; private certification schemes could serve a similar purpose. Overseas schemes (see Section F) such as B-Lab certification have become recently available in Australia and one survey respondent explicitly signalled a desire for a B-Lab type certification scheme.
9. **Restrictions on profit/surplus distribution:** A legal constraint on distributing profit or surplus helps to give continuity to the social purpose of an organisation and to reassure financial backers and social procurement-minded contractors that this purpose will remain central over time. Building such restrictions into the core of an internal governance structure is a notable feature of the UK, and to a lesser extent Canada. The US, by contrast, appears to avoid internal governance mandates and prefers arms-length regulatory assessment of the social purpose (see Section F).
10. Legal structures designed as a vehicle for commercial activity in Australia typically give priority to the objective of making profit for shareholders, and do not ordinarily restrict distribution. By contrast, legal structures used for carrying on community or social benefit purposes commonly do so, by either or both prohibition on the use of funds for anything other than the social purpose, or asset locks that prevent assets from being distributed to members, including through winding-up. Cooperatives provide a variety of opportunities to introduce hybrid structures that partially restrict the distribution surplus through dividend caps or asset locks.
11. The survey provided very little evidence of consideration provided to this aspect. Cooperatives were not represented, and the issues were not mentioned by other respondents, although some of the responses on finance (see below) may have implicitly included similar concerns.
12. **Raising finance:** Reflecting the common findings of business surveys, raising finance is an important issue for many respondents in our survey. Again, the specifics diverge along the familiar dichotomous lines of the two classes of structures. While those with structures designed to deliver commercial objectives worried about lack of social recognition, those with more central community or social benefit purposes were frustrated by difficulties in raising funds. Most of those referred to funding in terms of grants and received government funding, and these same respondents also expressed concern about the inflexibility associated with grant funding. A minority focused explicitly on the need for more social *investment*.
13. **Tax advantages:** While tax advantages do not attach specifically to particular legal forms, legislative restrictions can effectively mandate commonly adopted structures that are a prerequisite for benefits such as exemption from income tax, or the ability for a donor to

deduct gifts from their personal taxable income. The details of such eligibility are described in Section C

14. Oddly, however, given the significant financial ramifications of such tax advantages, the survey respondents seemed to attach little importance to tax considerations in explaining the rationale of their choice of legal form/This is a further reflection of the low level of awareness and understanding of the implications of legal form decisions).
15. This issue is of particular relevance to existing charities and NFPs that currently have income tax exemption status, if they move more towards commercial activity (rather than donations or grants) to support their social purpose activities.

### **Legal form as a separate issue**

16. The survey provided curiously mixed evidence on the perceived importance of legal form as a separate issue. It seemed fairly clear that few respondents had thought separately about the legal model and most had adopted either a pre-existing structure or a structure suggested by expert advice at the time of start-up with little reflection.
17. The notion that legal structure is not considered separately or even consciously is consistent with the striking answers to a direct question regarding how influential four factors (mission, tax, finance, funding) were for respondents in shaping their choice of legal form. The response patterns here were inconclusive: most either indicated that all four were very salient, or (a majority) that none were. There was also no divergence in answers here across classes of legal structure, unlike the other issues discussed above.
18. Some respondents have wanted to change (or had done so) their legal structure since setting up their enterprise. The reasons were not always clear, but in the few survey responses that did highlight a specific factor as shaping their choice of legal form, that factor was finance. Changing legal structure is therefore more likely to be linked to difficulties in raising finance and a concomitant desire for growth than any other reason.
19. These aspects of the survey arguably suggest that legal form is not well understood, and/or that legal support services are thin. Further discussion of this point outside the confines of the survey analysis supports the conclusion that most SEs have not thought through the relationship between their overall approach and the choice of legal format at the commencement of the business. Many are not aware of why their enterprise is currently operating with the legal form it has as an established business. Many of those involved in initial discussions indicated that they did not know why their current legal form was chosen (or even when). Some also indicated that it was simply a case of “this is what we were advised to do” (in terms of incorporation). As a result, the choice of legal form was often uninformed.
20. More broadly, the conclusions that could be drawn on the key issues for Australian social enterprise are:
  - a. The legal form of some SEs does not seem to reflect the ‘aspirations’ of the enterprise as highlighted in their promotional material, including accountability to stakeholders and ‘inclusiveness’ in how decisions are made.

- b. There does not appear to be a strong understanding of the taxation consequences of the choice of a particular legal form.
  - c. The survey responses suggest that options currently available for legal form for social enterprises make it difficult for them to achieve recognition as a new form of activity, combining social purpose with commercial activity. They are faced with the choice between the company limited by guarantee (NFP company) and the private or public company limited by shares. The NFP structure provides access to funding (largely grant funding and donations) but not to equity finance, while the company limited by shares structure offers the reverse. Companies limited by shares typically lack an “asset lock” which does not entrench the social mission and could allow for the company to be wound up or sold for personal gain. This increases the risk profile for potential donors and social procurement-minded contractors. On the other hand, the company limited by guarantee lacks the equity base for those social investors looking to hold patient capital in the enterprise.
  - d. A significant gain in both recognition and credibility could be had from a more considered approach to legal form. There is likely to be a link between legal form and the “brand” that is being presented as an operating SE, especially with regard to being accountable for the public statements that the SE makes about its social mission.
24. There is a further conclusion that could be drawn. The apparent lack of understanding of the importance of legal form may reflect the relative rigidity of a dichotomous ‘either-or’ effect in terms of how the four major issues for social enterprises play out. The menu of choices of legal form is quite diverse, yet on these four issues, there is little scope for blended missions to be embodied in hybrid governance forms. Cooperatives provide an exception but are not represented in this survey (though evidence elsewhere is supportive of their salience to social enterprise). But on the whole, legal form may well matter to initiatives yet be masked by the lack of genuinely hybrid alternatives. Other jurisdictions now provide such alternatives. The next section addresses what they offer.

## **Section F: Issues and Solutions – Other Countries**

1. A number of English-speaking countries have responded to issues that social enterprises face in the choice of legal form by introducing new corporate forms designed to reflect the special nature of social enterprises. These forms have a number of features in common, but they also differ because of the different context of the countries involved, including different legal traditions, taxation rules and so on.
2. Common to these new legal forms is explicit recognition that social enterprise combines profit making commercial activity with commitment to some form of social benefit. This character means that social enterprise differs from both:
  - a. traditional charities or NFPs which do not normally rely on profit-making commercial activity to provide most of the financial resources needed for their activities; and
  - b. standard commercial activity, the main objective of which is to provide profit for the owners of the business.
3. In many countries, most available legal forms are based on an either-or approach to legal form – either a charity/NFP or a standard for-profit business - and available legal forms do not readily cater to activity that combines features of both types.

### **United Kingdom**

4. In 2004, the UK changed its company law system to create a new type of company, the community interest company (CIC). A CIC can be a public company limited by shares, a private company limited by shares or a company limited by guarantee (and has the same benefits and obligations as other companies of its type), but has special features that explicitly recognise its character as a social enterprise. The legislation also established a specialist regulator for CICs.
5. Every CIC must:
  - a. meet a Community Interest Test;
  - b. file an annual CIC report with its accounts;
  - c. keep the community in touch with its activities;
  - d. only use its assets and profits for the community specified or pass them to another body with similar features,(the “asset lock”);
  - e. be registered at Companies House (the registry body for all companies) in the same way as a normal company with the same incorporation documents but supplemented by a Community Interest Statement.

### ***Community interest test***

6. All companies applying to be registered as CICs must provide the regulator with evidence that they will satisfy the community interest test. To enable the regulator to decide whether they will satisfy the test, applicants are required to deliver a community interest statement.
7. When the regulator considers whether a company will satisfy the community test, she is taking a view about the likely course of its future activities, and what reasonable people might think of them. Once a company has been registered as a CIC, it must continue to satisfy the test for as long as it remains a CIC. The regulator may take enforcement action against a CIC if she forms the view that it no longer satisfies the test.
8. A CIC must issue a public report annually on how it has achieved its community interest objectives.

### ***The asset lock***

9. The 'Asset Lock' is a fundamental feature of CICs. Asset Lock is a general term used to cover all the provisions designed to ensure that the assets of the CIC (including any profits or other surpluses generated by its activities) are used for the benefit of the community.
10. This means that, subject to the CIC meeting its obligations, its assets must either be retained within the CIC to be used for the community purposes for which it was formed or, if they are transferred out of the CIC, the transfer must satisfy one of the following requirements:
  - a. It is made for full consideration (i.e. at market value), so that the CIC retains the value of the assets transferred;
  - b. It is made to another asset-locked body (a CIC or charity, a permitted industrial and provident society or non-UK based equivalent) which is specified in the CIC's articles of association;
  - c. It is made to another asset locked body with the consent of the regulator; or
  - d. It is otherwise made for the benefit of the community.

### ***The dividend cap***

11. The dividend cap has three elements:
  - a. the maximum dividend per share limits the amount of dividend that can be paid on any given share. From April 2010 the limit for shares issued is 20% of the paid-up value of a share.
  - b. the maximum aggregate dividend limits the total dividend declared in terms of the profits available for distribution. Currently, the limit is 35% of the distributable profits.
  - c. the ability to carry forward unused dividend capacity from year to year is limited. Currently the limit is 5 years.

## **United States**

12. A number of States in the US have enacted legislation that recognises social enterprise but for more limited purposes than the UK CIC model.

### ***Low profit limited liability companies (L3C)***

13. Nine States in the US have enacted legislation that creates L3Cs as a special form of limited liability company (LLC). An LLC is a legal form commonly used for smaller scale business activity and combines features of the corporation and, for taxation purposes, the partnership. The main aim of the L3C legislation is to allow private charitable foundations to make investments in L3Cs and retain the tax advantages associated with the investment (their character as “program related investments”).
14. To qualify as an L3C, a company:
  - a. must significantly further the accomplishment of one or more charitable or educational purposes (as defined by the taxation legislation) and be formed solely to achieve those purposes;
  - b. cannot have the production of income or the appreciation of property as a significant purpose (although in practice it may make a profit);
  - c. cannot have a purpose to influence any legislation or political campaign.
15. In other respects, an L3C is treated as an ordinary LLC. It is not a non-profit for taxation purposes and is subject to the same taxation rules as other LLCs.
16. L3Cs are not required to have an asset lock, and can have investor members who can receive unlimited distributions during the L3C’s existence or upon winding up. If the L3C ceases to pursue its educational and charitable purposes it transforms into an ordinary LLC.<sup>29</sup>
17. As of 11 November 2013, there are 934 active LLCs in the US.<sup>30</sup>

### ***Benefit corporations***

18. Nineteen US States (and the District of Columbia) have enacted legislation to give effect to a new form of corporation, the benefit corporation.<sup>31</sup> One reason for creating this new form was to overcome the position that had become entrenched in American corporate law that directors of a for-profit corporation must act solely in the interest of the corporation’s

---

<sup>29</sup> See Reiser, Benefit Corporations—A Sustainable Form of organization?, Vol 46 Wake Forest Law Review 2011, p593

<sup>30</sup> See [http://www.intersectorl3c.com/l3c\\_tally.html](http://www.intersectorl3c.com/l3c_tally.html)

<sup>31</sup> As of August 2013. Not all jurisdictions use the term benefit corporation but legislation is reasonably standard regardless of the name.

owners (shareholders). The benefit corporation laws do this by requiring these entities to pursue purposes other than profit-making.

19. Benefit corporations are subject to the same rules that govern traditional corporations except in three areas - corporate purpose, accountability, and transparency – and in the related issues (right of action and change of control, purpose, or corporate structure) that arise from these three areas.
20. A benefit corporation must be formed for a “general public benefit,” defined as a “material, positive impact on society and the environment.” General public benefit is defined by measurement against a “third-party standard.”<sup>32</sup> As well as a general public benefit, a benefit corporation can pursue more specific public benefits (for example, providing low income individuals or a low income community with beneficial products or services).
21. Directors and officers have expanded fiduciary duties that require them to consider non-financial interests, and to consider the effect of decisions on shareholders, employees, suppliers, customers, community, and the environment (the corporation’s stakeholders). They can give priority to particular stakeholders consistent with general and any specific public benefit purposes.
22. A benefit corporation must publish an annual benefit report that assesses its overall corporate social and environmental performance against a third party standard. The annual benefit report must be made available to all shareholders and to the public (proprietary information can be excluded). A third party standard is defined as "a standard for defining, reporting, and assessing overall corporate social and environmental performance". The legislation does not specify a particular standard, but legislative guidelines generally provide that standards should be comprehensive, credible, transparent, and developed by an independent entity that has no material or financial interest in the use of the standard. Government has no role in determining whether a selected third party standard is acceptable or whether the benefit corporation has met its benefit corporation purpose to create a material positive impact. Benefit corporation legislation does not require benefit corporations to adopt any particular third party standard in preparing its annual benefit report and does not require the annual benefit report to be audited or certified by any third party standards organization.
23. Some States require a benefit corporation to have an independent benefit director accountable for preparing a statement in the annual benefit report as to whether the board acted consistent with its obligation to create general and any named specific public benefit purposes, and considered effects of its decisions on stakeholders
24. A benefit corporation does not have to have an asset lock and can change its control, purpose or structure. A protection against a move away from benefit corporation status is that a two-thirds super-majority vote is required. A decision by the directors to move in this direction may also be challenged by a shareholder.

---

<sup>32</sup> New Jersey law does not require this; Reiser p597.

### ***California flexible purpose corporation (FPC)***<sup>33</sup>

25. California, through a law commencing in October 2012, created the FPC as a new corporate form. All FPCs must specify at least one “special purpose” in its charter, such as promoting environmental sustainability or minimizing adverse effects on its employees. In exchange, an FPC is given a new “safe harbor” (in addition to the business judgment rule) so boards and management are protected from shareholder liability when they weigh their special purpose(s) against shareholder value – both in the ordinary course of business and in change of control situations. The FPC is distinguished from the L3C and Benefit Corporation in that it is primarily intended for use by for-profit companies seeking traditional capital market investment.
26. The FPC differs from the traditional corporate form in the following primary ways:
- a. **Qualifying Special Purpose.** The FPC has one or more social and/or environmental purpose(s) agreed upon between management and shareholders, and included in the charter. The FPC is not permitted to change its purpose without a two-thirds vote of each class of voting shares.
  - b. **Protection from Liability.** The FPC provides protection from liability for directors and management who make decisions on the basis of the agreed special purpose(s).
  - c. **Conversion of Other Forms.** An existing public or private corporation (LLC, partnership, or other entity) can convert into an FPC with two-thirds vote of each class of voting shares, with dissenter’s rights.
  - d. **Reporting.** The FPC is required to publish regular reports with objectives, goals, measurement, and reporting on the impact or “returns” of social/environmental actions.
  - e. **Enforcement.** As fiduciary duties include the special purpose(s), shareholders have traditional enforcement rights with respect to the special purpose(s) (removal of directors and/or legal action); other “stakeholders” will not have enforcement rights.
27. Benefit Corporations differ from Flexible Purpose Corporations in three main ways:
- a. Benefit Corporations are *required* to pursue a General Public Benefit – a “material positive impact on society *and* the environment, taken as a whole”. Flexible Purpose Corporations, on the other hand, need only pursue a specific purpose that has a positive effect on *any* of the following: its employees, suppliers, customers, creditors; the community and society; *or* the environment.
  - b. Benefit Corporations are *required* to gauge their success based on an independent third party standard (which can be costly and time-consuming). No such standard is required for Flexible Purpose Corporations.
  - c. Benefit Corporations are *required* to provide to its shareholders every year (and to the public via its website) a comprehensive assessment of its activities in support of its

---

<sup>33</sup> Information from [http://www.law.berkeley.edu/files/bclbe/Berkeley\\_Handout\\_1182011\\_-\\_1.pdf](http://www.law.berkeley.edu/files/bclbe/Berkeley_Handout_1182011_-_1.pdf) [accessed 20-11-13]

purpose, as measured against the above-mentioned third party standard. Flexible Purpose Corporations, on the other hand, may waive the shareholder reporting requirements under certain circumstances, and where reporting is required, the annual report is far less onerous on company resources.<sup>34</sup>

### ***B Lab certification***

28. In addition to initiatives by various States to create new legal forms that recognise social enterprises, there is also a process in the US (and now internationally, including Australia) by which corporations of any kind can become “certified” as meeting B Corps. These are standards of social and environmental performance, accountability, and transparency.
29. B Lab, a non-profit organization, functions as an impartial third party that certifies and rates B corporations on how well they meet a list of social and environmental standards. A corporation must score 80 points out of 200 to become a B-certified corporation.
30. To be certified by B-Lab, corporations must:
  - a. insert values in bylaws, including their social commitments in their corporate governing documents;
  - b. commit themselves to a governance structure that reflects a broad set of stakeholders so that a B corporation aims not only to maximize profits for shareholders but also to pursue the interests of its employees and, more broadly, of the communities and environments in which it operates;
  - c. commit to meeting a set of un-audited social and environmental performance standards;
  - d. pay a portion of net profit to B lab.
31. There are more than 963 Certified B Corps in 32 countries and 60 industries. There are 17 certified B-Corps in Australia at the time of writing.

### **Canada**

#### **British Columbia community contribution companies (CCCs)<sup>35</sup>**

32. In May 2012, the Canadian province of British Columbia amended its company law to create a new form of company, the CCC. CCCs are modelled on CICs in the UK and are similar. CCCs must have a purpose that is beneficial to society at large or “a segment of society that is broader than the group of persons who are related to the community interest company”. They have the following features which distinguish them from other forms of incorporation.

---

<sup>34</sup> Information on differences between benefit corporations and FPC from <http://www.hansonbridgett.com/Publications/articles/2012-09-flexible-purpose.aspx> [accessed 20-11-13]

<sup>35</sup> See <http://www.socialenterprisebuzz.com/2013/04/01/community-contribution-companies-or-canadian-benefit-corporation-coming-to-bc/> [accessed 19-11-13]; [www.centreforsocialenterprise.com/C3\\_BC.html](http://www.centreforsocialenterprise.com/C3_BC.html) [accessed 21-11-13]

33. *Asset lock and dissolution*: If a CCC dissolves, it is subject to an asset lock that limits the distribution of assets to shareholders to a maximum of 40 percent. This means at least 60 percent of its assets must go to an entity subject to a similar asset lock, such as another CCC, or to a registered charity or NFP.
34. Private investment and dividends: CCCs can accept equity investment, issue shares, and pay shareholder dividends. However, the amount of dividends that a CCC can pay is limited to no more than 40 percent of annual profit, unless shareholders are registered charities and other “qualified donees” under the relevant taxation law.
35. *Community contribution report*: CCCs must produce and publish an annual “community contribution report”. This report provides details of the CCC’s activities, transfer of assets, amount of dividends that were declared, the identities of shareholders receiving dividends, and a list of persons who are remunerated more than \$75,000.
36. CCCs receive no preferential tax treatment.

***Nova Scotia community interest companies (CICs)***<sup>36</sup>

37. In December 2012, Nova Scotia enacted legislation to create a new form of company, the CIC. The CIC created by the legislation is very similar to British Columbia’s CCC. The legislation requires:
  - a. a CIC to have a community purpose;
  - b. a limit on dividends payable on investments;
  - c. an asset lock
  - d. an annual community interest report for shareholders and the Registrar of Community Interest Companies.

---

<sup>36</sup> See for example, [http://www.martindale.com/corporate-law/article\\_Miller-Thomson-LLP\\_1653606.htm](http://www.martindale.com/corporate-law/article_Miller-Thomson-LLP_1653606.htm) [accessed 21-11-13]; <http://www.theglobeandmail.com/partners/advnationalphilanthropyday1113/new-corporate-vehicles-for-social-enterprises-in-canada/article15309829/> [accessed 21-11-13]

## Section G – The way forward?

### Some conclusions

1. Based on the work completed to date as described in this report, the LMWG has drawn a number of tentative conclusions. The most important of these are:
  - a. Australian SEs are at a relatively early stage of development. This is especially true for new-start SEs. Some charities and traditional NFPs appear to be moving more to trading and other commercial activity to support their social objectives, but not all identify themselves as “social enterprises”, as the term is used in this report and charities remain heavily dependent on donations and grants.
  - b. Based on the evidence of the survey, existing SEs have not paid particular attention to the choice of legal form and have not seen it as an important strategic issue. This is understandable as social entrepreneurs focus on the demanding tasks associated with starting and operating a new business. Nonetheless, not addressing how the legal form reflects and protects the values underlying the decision to commence a SE may lead to problems down the track. This is especially true if the business is successful and there are clear incentives to capture that success for individual gain, thus undermining the social objectives that were the primary rationale for the formation of the business.
  - c. New SEs struggle for “recognition” of their blended social and commercial aims. There is no clear brand that allows third parties including the broad community, purchasers and contractors and providers of finance, to identify easily the differences between SE, other forms of business and the traditional not-for-profit sector. Among other things, this means that providers of finance may not be comfortable in dealing with SEs.
  - d. Currently available legal forms do not readily offer a legal structure that captures the special characteristics of SEs. Typically, they offer an either-or choice between a not-for-profit model and a purely-for-profit model. NFP structures (such as the company limited by guarantee, the incorporated association and the community benefit co-operative) provide a means of enshrining and preserving the social benefit component of social enterprise, but they make it difficult to raise finance from commercial sources. The for-profit company structure facilitates financing (for example through the issue of shares) and is readily understood by the finance community, but does not provide a ready means of reflecting and maintaining an enterprise’s commitment to social purposes.
  - e. A number of comparable overseas jurisdictions have recognised the need for a special legal form designed for the needs of SEs. The most comprehensive is the UK community interest company, which has comprehensive rules on key issues such as an asset lock, limits on the uses to which trading profits may be put, and a separate specialist regulator to oversee the sector. This has resulted in the creation of a clear brand for SE, as well as a number of SEs which are significant providers of mainstream goods and services in the market economy. It has also enabled access to significant sources of equity financing.

## **The need for a social enterprise structure**

1. The Canadian report “Social Enterprise in Canada: Structural Options”<sup>37</sup> concluded that there are four essential questions that arise at the outset for every SE venture. These are:

- What is the fundamental purpose of the venture: to make money for individuals or investors, or to promote a social purpose?
- How much control do the enterprise proponents want to maintain, and with whom are they willing to share the control of the enterprise?
- How will the enterprise be positioned and branded in the market?
- How will the enterprise be financed, both at start-up and on an ongoing basis?

As is evident in this report, these questions remain key points for consideration for social enterprise legal structure reform in Australia.

2. Arguably, what Australian SEs need is a legal form that fully reflects their character as a social enterprise, and could be easily adopted by them without significant legal complexity and cost.

3. In the LMWG’s view, such a form would ideally offer the following key elements:

- a. an asset lock to ensure enterprise assets were permanently committed to achieving social objectives (including if the enterprise is wound up);
- b. a limit on the amount of profit which can be distributed as dividends to investors;
- c. some means of third party validation to ensure the enterprise’s continuing commitment in practice to its social objectives;
- d. a governance structure that provides key stakeholders with the right to participate in decisions about the overall management and direction of the enterprise;
- e. legal certainty about the enterprise’s ability to pursue a broader interest than financial return to shareholders or owners;

4. At the same time, such a form would need to facilitate viable commercial activity and be potentially attractive to providers of both equity and debt finance.

## **How could this be achieved?**

5. In broad terms, the kind of SE structure described above could be achieved by:

- f. creating a new legal form with these characteristics, as has been done in the UK and some Canadian provinces;
- g. adapting existing legal forms; for example by creating a hybrid legal structure with characteristics of both the NFP and the for-profit corporate forms.

---

<sup>37</sup> Op cit, page 16

6. The creation of a new legal form would require new legislation, which in turn means the need to convince government of the need for such a form and of the priority that should be given to that legislation.
7. There is a range of views on the potential “solutions” even within the LMWG. These range from minimal intervention being required as the existing legal regime is flexible enough to be used in most situations, through to legislating for new legal models that are especially suitable to more innovative, high technology, capital intensive SEs..
8. There are also developments occurring in new areas, such as “spin outs” from the public sector (known as “public service mutuals” in the UK, where health and social services are provided by new and more entrepreneurial forms of social organisation operating with assets that are owned by the public sector), many of which will be requiring new legal structures to work under contract to Government and which serve to protect the “public interest” in their operation.
9. Adapting existing legal forms could be done independently of government, but would require access to suitable expertise to do the necessary legal work, including determining which of the key elements outlined above could be achieved in a legally effective way, and drafting the related documentation. Consideration would need to be given, for example, to the extent to which a for-profit company’s constitution (articles of association) could be adapted to enshrine an asset lock and a limit on dividends, whether additional mechanisms are needed, such as a shareholders agreement, or the creation of a “golden share” to be held by a trusted third party with a right to override the decisions of other shareholders on key issues such as amendment of the constitution.
10. It is the view of the LMWG that with sound business advice, enhanced governance training and education for SEs and improved planning, most SEs could be accommodated within the current legal regimes for the various corporate forms in Australia.
11. However, the increasing international diffusion of SEs and the associated distinctive forms that are going to be researched by the forthcoming International Comparative Social Enterprise Research project, led by EMES in Belgium, suggests that the new forms of SE will play an increasingly prominent role alongside more traditionally operated for-profit and NFP entities in future. There is a need therefore to assist innovations in how SEs are legally structured and operated.
12. New legal models that can unlock greater levels of finance and increased participation in the ownership, control, development and funding of SEs – especially by those stakeholders impacted most by the social enterprise – could be of considerable benefit to the growth and sustainability of the SE sector in Australia.

## **Recommendations**

The LMWG would like to put forward two recommendations for furthering the work that needs to be done toward improving the forms of incorporation for SEs.

The recommendations are aimed at solving the two main problems identified in this report, specifically:

- a. It is not possible to *entrench* social enterprise characteristics within the legal forms available. In particular, the current legal forms cannot protect against conversion into a for-profit, or against the distribution of assets to owners, and
- b. Ease of access to finance and brand, while more generic issues, are significant barriers.

The LMWG sees that both these problems could be significantly eased by the introduction of new legal forms which are specifically tailored to the needs of SEs.

Accordingly, it is recommended that:

1. The LMWG as chartered remain in place in the short-term to gather feedback on this report and continue its education program within the social enterprise sector on legal model choices, shared ownership arrangements and capacity building, especially in the area of improved enterprise governance.
2. The LMWG assist with the establishment of an “Experts Panel on Social Enterprise Legal Models” which will:
  - (i) advise more formally on specific social enterprise legal models, either via amendments to the Corporations Act or through a “dedicated legislative/regulatory regime” along the lines of the “Community Interest Company” legislation and regulator as instituted in the UK and being copied in other jurisdictions, most recently in some Canadian provinces.
  - (ii) draft “off the shelf” templates for social enterprise legal model documentation and develop simple social enterprise governance toolkits covering legal, tax and other regulatory considerations as guidance to the social enterprise sector, and
  - (iii) design a social enterprise “certification” system which will underpin the robustness of the social enterprise “brand”, ensure that appropriate standards are maintained in the operation of a social enterprise and enable some regulation in the use of the term and the purposes to which it is put, perhaps in association with B-lab Certification as used with the “B-Corp” mark.

The LMWG will continue to meet in its present form to consider the response to this report and to the proposals made. It will provide an update within three months and – depending on the response received and resources available - develop a “management plan” along the lines of “Recommendation 2” above for action within six months from the release of this report.

Accordingly, in order to start this process, the LMWG is seeking feedback on this report and broader input on the following key questions:

1. What might legal forms for social enterprise look like in five years time?
2. Do we need a particular legal form to help grow the SE sector?
3. Do we need particular sources of capital to grow social enterprise?
4. What support services are needed to foster diverse models of social enterprise?

# Appendix

## Survey

| Question   | Response  |
|--|---|
| <b>SECTION 1: Your Organisation</b>  |   |
| <p>Q.1.1 Which of the following categories best describes your organisation's primary activities?</p> <p>Note: even though more than one may be relevant, please choose one option only. If you require more information on these categories see the ABS classifications here.</p> | <p>Culture and recreation (culture, arts, sports, recreation)</p> <p>Education and research</p> <p>Health (hospitals, rehabilitation, nursing homes, mental health, crisis intervention and other health organisations)</p> <p>Social Services (social services, emergency relief, income support and assistance organisations)</p> <p>Environment (environment and animal protection organisations)</p> <p>Development and Housing (economic and community development, employment and training, housing organisations)</p> <p>Law, advocacy and politics (civic, advocacy, legal, law, or political organisations)</p> <p>Philanthropic intermediaries and voluntarism promotion</p> <p>International</p> <p>Religion</p> <p>Business and professional associations</p> <p>Other (please specify)</p> |
| <p>Q.1.2 Do any of these describe other activities of your organisation (i.e. in addition to its primary industry identified above)?</p> <p>Note: only tick as many as apply. If you require more information on these categories see the ABS classifications here.</p>            | <p>Culture and recreation (culture, arts, sports, recreation)</p> <p>Education and research</p> <p>Health (hospitals, rehabilitation, nursing homes, mental health, crisis intervention and other health organisations)</p> <p>Social Services (social services, emergency relief, income support and assistance organisations)</p> <p>Environment (environment and animal protection organisations)</p> <p>Development and Housing (economic and community development, employment and training, housing organisations)</p> <p>Law, advocacy and politics (civic, advocacy, legal, law, or political organisations)</p>  |

|  |  |
|--|--|
|  | Philanthropic intermediaries and voluntarism promotion   |
|  | International  |
|  | Religion   |
|  | Business and professional associations   |
| Q.1.3 What type of activities best describe the primary activities of your organisation? (Even though more than one option may be relevant, please choose one answer only) | A service provider (i.e. organisation whose central purpose is direct involvement in service provision to the community)   |
|  | An advocacy or campaign organisation (i.e. organisation or peak body with a central purpose of advocating and raising awareness of particular issues or for general or special constituencies; including health promotion) |
|  | A trust or foundation (i.e. organisation which hold money in trust for the public benefit and which make grants of money for charitable or socially useful purposes)   |
|  | An intermediary (i.e. organisations whose central purpose is to build capacity, build relationships, promote giving, fundraising and/or volunteering, rather than providing services themselves)                           |
| Q.1.4 Which is the best description of your organisation: (choose one option only) [added]   | We are a national organisation   |
|  | We are a local / neighbourhood organisation  |
|  | We are an organisation mainly based in a single state/territory  |
|  | We are an organisation mainly based in several states/territories  |
|  | We are an international organisation, with operations in Australia   |
| Q.1.5 Does your organisation's mission target specific issues for Aboriginal and Torres Strait Islander communities? (choose one option only)                              | Yes, this is a primary mission for our organisation  |
|  | Yes, for some particular programs or projects  |
|  | Not a distinct focus for our organisation  |
| <b>SECTION 2: Location</b>   |  |
| Q.2.1a Please identify where your organisation mainly operates (please select one answer only):  | Australian Capital Territory   |
|  | New South Wales  |
|  | Northern Territory   |
|  | Queensland   |
|  | South Australia  |
|  | Tasmania   |

|   |                              |      |      |      |
|---|------------------------------|------|------|------|
|   | Victoria                     |      |      |      |
|   | Western Australia            |      |      |      |
| Q.2.1b Please identify which states and territories your organisation mainly operates in (you may select more than one option): | Australian Capital Territory |      |      |      |
|   | New South Wales              |      |      |      |
|   | Northern Territory           |      |      |      |
|   | Queensland                   |      |      |      |
|   | South Australia              |      |      |      |
|   | Tasmania                     |      |      |      |
|   | Victoria                     |      |      |      |
|   | Western Australia            |      |      |      |
| Q.2.1c Please identify where your Australian operations are mainly based: (you may select more than one option):                | Australian Capital Territory |      |      |      |
|   | New South Wales              |      |      |      |
|   | Northern Territory           |      |      |      |
|   | Queensland                   |      |      |      |
|   | South Australia              |      |      |      |
|   | Tasmania                     |      |      |      |
|   | Victoria                     |      |      |      |
|   | Western Australia            |      |      |      |
| Q.2.2 Are your Australian operations in: (choose as many as apply)  | Urban Areas                  |      |      |      |
|   | Regional and Rural Areas     |      |      |      |
|   | Remote Areas                 |      |      |      |
| OPTIONAL: Would you like to make any comments on your responses above?  | [Text Entry]                 |      |      |      |
| <b>SECTION 3: Please provide an overview of your organisations mission and purpose.</b>   |                              |      |      |      |
| Q.3.1 When did you commence operation?  | 2012                         | 2003 | 1994 | 1985 |
|   | 2011                         | 2002 | 1993 | 1984 |
|   | 2010                         | 2001 | 1992 | 1983 |
|   | 2009                         | 2000 | 1991 | 1982 |

|  |   |      |      |             |
|--|---|------|------|-------------|
|  | 2008  | 1999 | 1990 | 1981        |
|  | 2007  | 1998 | 1989 | 1980        |
|  | 2006  | 1997 | 1988 | Before 1980 |
|  | 2005  | 1996 | 1987 |             |
|  | 2004  | 1995 | 1986 |             |
| Q.3.2 What is your overall purpose and your social/environmental aims? [Please include mission statement here] | [Text Entry]  |      |      |             |
| Q.3.3 Who benefits from your activities?   | [Text Entry]  |      |      |             |
| Q.3.4 What was the primary reason for establishing the organisation?   | [Text Entry]  |      |      |             |
| Q.3.5 Who or what were the main catalysts for its formation?   | [Text Entry]  |      |      |             |
| Q.3.6 Who were the founders and what were their backgrounds?   | [Text Entry]  |      |      |             |
| Q.3.7 What are your key priorities for the future in terms of activities?                                      | [Text Entry]  |      |      |             |
| <b>SECTION 4: Please identify your organisations current legal form.</b>                                       |   |      |      |             |
| Q.4.1 What is your current legal or organisational form?   | Partnership   |      |      |             |
|  | Company limited by guarantee  |      |      |             |
|  | Registered co-operative   |      |      |             |
|  | Incorporated association  |      |      |             |
|  | Company limited by shares   |      |      |             |
|  | Unincorporated body   |      |      |             |
|  | Other (Please specify)  |      |      |             |
| Q.4.2 Do you have charitable status. (Please select all that apply)  | TCC (i.e. Tax Concession Charity, as endorsed by the Australian Taxation Office)  |      |      |             |
|  | ITEF (i.e. Income Tax Exempt Fund, as endorsed by the Australian Taxation Office) |      |      |             |
|  | None of the above   |      |      |             |
| Q.4.2 Do you have Deductible Gift Recipient  | DGR 1 (i.e. Deductible Gift Recipient Status 1)                                   |      |      |             |

|  |   |
|--|---|
| Status? (Please select all that apply)   | DGR 2 (i.e. Deductible Gift Recipient Status 2) |
|  | None of the above                               |
| Q.4.3 Do you have ownership or governance links with any other organisations? If so please describe. [E.g. legal links such as with a parent, subsidiary or sister organisation; contractual links that affect your ownership or governance arrangement's how do you describe your organisational structure, with reference to subsidiaries, holding company, operating/trading companies, conglomerate, branches, departments etc.] | Parent  |
|  | Subsidiary                                      |
|  | Sister  |
|  | Other   |
| Q.4.4 If your organisation is owned or governed by another organisation (a parent organisation), what role does the parent organisation in deciding: <ul style="list-style-type: none"> <li>• how your enterprise operates</li> <li>• How any financial surplus your organisation makes is used?</li> </ul>  | [Text Entry]                                    |
| OPTIONAL: Would you like to make any additional comments on your responses above?  | [Text Entry]                                    |
| <b>SECTION 5: Please identify your organisations current ownership and governance structure.</b>   |   |
| Q.5.1 Governance and ownership structure:  | [Text Entry]                                    |
| What is the governance ownership structure?  | [Text Entry]                                    |
| Who owns the organisation?   | [Text Entry]                                    |
| Who is represented on the board?   | [Text Entry]                                    |
| How are members, clients and workers involved?   | [Text Entry]                                    |
| Q.5.2 What are the main advantages of this structure?  | [Text Entry]                                    |
| Q.5.3 What are the main disadvantages of this structure?   | [Text Entry]                                    |
| Q.5.4 Have you changed your organisation structure since you started operations. If so, how and why?   | Yes / No – [Text Entry]                         |
| Q.5.5b At what stage of your organisational life cycle did the change occur?   | Start-up  |
|  | Growth  |
|  | Maturity  |
|  | Decline   |
| Q.5.6 Are you currently thinking of changing your  | Yes / No – [Text Entry]                         |

|  |  |
|--|--|
| governance/ownership in future? If so, why and how?  |  |
| OPTIONAL: Would you like to make any additional comments on your responses above?  | [Text Entry]   |
| <b>SECTION 6: The next set of questions addresses regulation and relations with government.</b>  |  |
| Q.6.1 Who are your regulators? (Please select all that apply)  | Australian Charities and Not-for-Profits Commission    |
|  | ASIC   |
|  | Office of Fair Trading                                 |
|  | Registrar of Co-operatives                             |
|  | Australian Tax Office                                  |
|  | Other  |
| Q.6.2 Do you have any funding or other contractual links with local, state and Commonwealth Government?  | Local<br>State<br>Commonwealth                         |
| Q.6.2a What links do you have with the local government?   | [Text Entry]   |
| Q.6.2b What links do you have with the state government?   | [Text Entry]   |
| Q.6.2c What links do you have with the Commonwealth government?  | [Text Entry]   |
| OPTIONAL: Would you like to make any additional comments on your responses above?  | [Text Entry]   |
| <b>SECTION 7: The next set of questions addresses enterprise activity and financing.</b>   |  |
| Q.7.1 Based on the accounts for your organisation (other than for donations of time); please estimate the resources you rely on for your day-to-day operations? If your answer is not based on the organisation's accounts, please explain the basis of your estimate. | Trading and business activities                        |
|  | Donations of money from members or the community       |
|  | Donations of time from members or the community        |
|  | Government grants or other forms of government support |
|  | Other (please specify)                                 |

|  |                     |                       |                                 |
|--|---------------------|-----------------------|---------------------------------|
| Q.7.2 Based on the accounts for your organisation (other than for donations of time); please estimate your main trading and business activities? Please provide estimates of details of turnover, change over the last three years, future growth prospects, for each of activity. If your answer is not based on the organisation's accounts, please explain the basis of your estimate.            | \$ Turnover         | Growth last 3 years % | Estimated growth next 3 years % |
| Activity 1   |                     |                       |                                 |
| Activity 2   |                     |                       |                                 |
| Activity 3   |                     |                       |                                 |
| Activity 4   |                     |                       |                                 |
| Q.7.3 Who do you employ? Please specify how many.  | Full time           |                       |                                 |
|  | Part time           |                       |                                 |
|  | Casual              |                       |                                 |
| Q.7.4 What assets does the organisation own?   | [Text Entry]        |                       |                                 |
| Q.7.5 How did you finance your operation at the time it started operating?   | [Text Entry]        |                       |                                 |
| Q.7.6 Have you used outside finance in the form of debt or equity (Shares)?  |                     |                       |                                 |
| Debt   | Yes/No – Text Entry |                       |                                 |
| Equity   | Yes/No - Text Entry |                       |                                 |
| OPTIONAL: Would you like to make any comments on your responses above?   | [Text Entry]        |                       |                                 |
| <b>SECTION 8: Relationship between enterprise activity and overall mission.</b>  |                     |                       |                                 |
| Q.8.1 Please describe how you balance private benefit (e.g. to employees and/or investors) and public benefit (to the community) in how your organisation operates, especially in relation to:<br><br>a. the goods or services you produce; and<br><br>b. the way you deal with surplus funds from your activities. [E.g. are profits used for profit sharing schemes, reinvested in community etc.] | [Text Entry]        |                       |                                 |
| Q.8.2 Has this changed over time?  | [Text Entry]        |                       |                                 |

|   |                        |                                     |                       |
|---|------------------------|-------------------------------------|-----------------------|
| Q.8.3 What is the balance (allocation of time and resources) between your trading/business activities and your community activities?  | [Text Entry]           |                                     |                       |
| OPTIONAL: Would you like to make any comments on your responses above?  | [Text Entry]           |                                     |                       |
| <b>SECTION 9: Decision-making process</b>   |                        |                                     |                       |
| Q.9.1 Why did you decide to adopt your current legal form?  | [Text Entry]           |                                     |                       |
| Q.9.2 What type of advice have you received in planning your operations? [E.g. about legal issues and organisation form; accounting issues; business structure; business planning etc.]             | Legal Advice           |                                     |                       |
|   | Accounting             |                                     |                       |
|   | Business structure     |                                     |                       |
|   | Business planning      |                                     |                       |
|   | Financial planning     |                                     |                       |
| Q.9.3 What outside advice or professional assistance do you receive now?  | [Text Entry]           |                                     |                       |
| Q.9.4 How influential to your choice of legal form were:  | [Text Entry]           |                                     |                       |
| The ability to promote your mission   | Not at all Influential | Neither Influential nor Influential | Extremely Influential |
| Taxation considerations   | Not at all Influential | Neither Influential nor Influential | Extremely Influential |
| Methods of financing your organisation  | Not at all Influential | Neither Influential nor Influential | Extremely Influential |
| The policy of a funding source (government or private sector)   | Not at all Influential | Neither Influential nor Influential | Extremely Influential |
| Q.9.5 If your organisation has a parent organisation, why did the parent decide your activities should be done through a separate organisation? What were the reasons for the choice of legal form? | [Text Entry]           |                                     |                       |
| Q.9.6 Has the form changed since the organisation was first set up? If so, how and why?   | Yes / No – Text Entry  |                                     |                       |
| Q.9.7 Are you thinking of changing it in future? If so,   | Yes / No – Text Entry  |                                     |                       |

|   |                       |
|---|-----------------------|
| how and why?  |                       |
| Q.9.8 Who within the organisation was involved in the decision about legal form?  | [Text Entry]          |
| Q.9.9 Were any other options considered? If yes, which ones and why were they rejected?   | [Text Entry]          |
| Q.9.10 What are the benefits of your current legal form?  | [Text Entry]          |
| Q.9.11 Who benefits most from these advantages?   | [Text Entry]          |
| Q.9.12 What are the disadvantages of this legal form?   | [Text Entry]          |
| Q.9.13 Who is most disadvantaged by this?   | [Text Entry]          |
| Q.9.14 Did you base the legal form on any other organisation? [If yes, please specify which organisation and why you followed it]                             | Yes / No – Text Entry |
| Q.9.16 If you do not have charitable status, have you considered this option? If yes, why was this not pursued? Is this something you may consider in future? | [Text Entry]          |
| OPTIONAL: Would you like to make any comments on your responses above?  | [Text Entry]          |
| <b>SECTION 10: Future Regulation</b>  |                       |
| Q.10.1 What changes to regulation or legislation would you like to see?   | [Text Entry]          |
| Q.10.2 What would be your ideal legal organisational form? Why? Based on Australian and international legal forms.  | [Text Entry]          |
| Q.10.3 What changes in your operations especially funding and financing, would the changes your nominated in Q10.1 make to you?                               | [Text Entry]          |
| Q.10.4 What changes in the funding or financing environment would you like to see?  | [Text Entry]          |

## Recruitment Email

Dear,

We are writing to request your participation in the Legal Forms for Social Enterprise Project.

The legal models working group is one of a number of SIEE Alliance working groups exploring aspects of social enterprise. It is looking at whether the existing legal framework and its regulation in Australia makes it harder than it should be to start and operate successful social enterprises, and whether changes are needed to take account of the special features of this type of organisation.

A crucial part of this work is to draw on the experiences of existing organisations. To do this, we are asking for help from pioneering social enterprises such as yours.

Our working group is conducting a survey that will help us understand your enterprise, how it is structured and operates, and how it has made decisions about legal and regulatory issues. Results from the study will be used to formulate recommendations to Government and to identify specific assistance that new and existing social enterprises can benefit from.

This is social enterprise directed research therefore – by and for social enterprise – with the aim of expanding the development paths for social enterprises. Participating in this key research project will influence and open up new directions that social enterprise can choose to take in future. The potential benefits of the research are seen as to include not only a broader range of business models and legal structures to choose from in future, but encouragement to social investors and social entrepreneurs to invest in and create a more diverse range of social enterprises.

So we need your help to make sure the group's work is informed by the experiences of those who have started and operated social enterprises. Please take the time to give us the benefit of your experience.

We are asking each respondent to commit to completing an online survey (20 minutes) in November. You will have a 3 week window in which you can complete the survey.

If you agree to be part of the study we will need to confirm a few details:

- Firstly, an email address where the email survey link can be sent
- Secondly, confirm your position within your organisation

If you are interested in studying and debating the research reports of similar exercises undertaken within the social enterprise movement overseas, these can be supplied to assist. We are especially keen to expand the 'knowledge base' in this area.

In the meantime, if you require further information please contact:

Stephen Bennett, Researcher, the Centre for Social Impact, University of NSW, [s.bennett@unsw.edu.au](mailto:s.bennett@unsw.edu.au)

Thank you for your participation, it is greatly appreciated.