



BALANCING PURPOSE AND PROFIT

*Legal mechanisms to lock in social mission
for “profit with purpose” businesses across the G8*

DECEMBER 2014



ACKNOWLEDGEMENTS

Orrick, Herrington & Sutcliffe LLP is immensely grateful to UnLtd for setting the bar so high in exploring profit with purpose businesses. Orrick has been a leading participant in the impact finance market since 2007 when this concept first emerged, and we greatly appreciate this opportunity to apply our legal expertise to this very important initiative that we believe has the power to transform the lives of so many who are at the bottom of the economic pyramid. By collaborating with clients, such as UnLtd, and through our robust legal partnership with organizations such as Trust Law, we are able to make a substantial impact. Hopefully, this work will lead governments to further innovate and consider new approaches to corporate forms that can be developed to further promote the triple bottom line.

In particular, Orrick recognizes the following dynamic team that diligently and tirelessly researched and wrote the different country reports that form the basis of this work:

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DISCLAIMER

The contents of this Guide are for information purposes and to provide an overview only. This Guide does not provide legal information on how to and whether to choose a particular corporate form in each of the eight jurisdictions discussed. The Guide also does not purport to discuss all corporate forms available in each jurisdiction, though those it does discuss are current as at 1 August 2014 only. Although we hope and believe the Guide will be helpful as background material, we cannot warrant that it is accurate or complete, particularly as circumstances change after publication. Moreover, the Guide is general in nature and may not apply to particular factual or legal circumstances. This Guide is intended to convey only general information, therefore it may not be applicable in all situations and should not be relied or acted upon as legal advice. This Guide does not constitute legal advice and should not be relied on as such. Readers seeking to act upon any of the information contained in this Guide are urged to seek individual advice from legal counsel in relation to their specific circumstances.

This Guide does not reflect the personal views of any of the attorneys or clients of Orrick, Herrington & Sutcliffe LLP.

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FOREWORD

At the Thomson Reuters Foundation we champion social enterprises and their innovative efforts and market-based solutions to solve some of the world's most pressing social and environmental problems.

Since the launch of TrustLaw, the Foundation's global pro bono service, we have supported hundreds of social enterprises with access to the best lawyers around the world. From organisations producing solar powered lamps to companies basing their business on landmine-seeking rats, we have worked with a wide range of extraordinary individuals. We have given social enterprises free legal assistance as well as how-to guides on legal structures. In addition, we have also organised events and training with the aim to help these entrepreneurs achieve their social mission more efficiently and sustainably. I have profound admiration for the social enterprises we worked with through the powerful TrustLaw network.

'Balancing purpose and profit' is the result of a partnership between TrustLaw, leading global law firm Orrick, and UnLtd.

The report analyses the legal frameworks across the G8 for businesses that seek to distribute profits while pursuing social impact, known as "profit-with-purpose businesses" ("PPBs"). It looks at specific corporate structures that can be used by PPBs, the mechanisms to lock in or demonstrate social purpose, and identifies areas for legal reform in each G8 country. The report covers the legal frameworks of Canada, France, Germany, Italy, Japan, Russia, the United Kingdom and the United States.

We are proud to have facilitated the creation of this report, and expect its impact to go far beyond the G8 countries, to achieve further support worldwide for forward-thinking businesses who put social impact ahead of profit.

A handwritten signature in blue ink that reads "M. Villa". The signature is written in a cursive style and is underlined with a thin blue line.

MONIQUE VILLA
CEO, Thomson Reuters Foundation

INTRODUCTION

Across the world, attitudes are changing. Old certainties about tightly defined roles for government, civil society and business are dissolving. Charities and non-profits are becoming more business-like, and business is looking ever more to delivering sustainable value. The Deloitte Millennials Report in 2013 showed that young people believe that the number one purpose of business is to benefit society, and the 2014 report showed that fifty per cent want to work for a business with ethical practices.¹

A number of countries have already created the legal mechanisms to allow for an intermediate type of enterprise, trading for social mission and with most or all profit reinvested into that social mission. Sometimes called social enterprises² or solidarity enterprises³, these businesses are delivering social impact in exciting ways.

A growing number of for-profit companies are focusing on social impact, and are prepared to report on their progress. We welcome these trends, and the work of investors to scale up the impacts they create.

We now see a further step as entrepreneurs create a new style of business: fully profit-distributing, and committed long term to achieving and reporting on their social impact. We refer to these as profit-with-purpose businesses.⁴ At present, there are few countries with the legal set up or market tools for profit-with-purpose businesses to demonstrate

1 www.deloitte.com/MillennialSurvey

2 For the purposes of this report, 'social enterprise' refers to a business with a primary social mission, which has partial or full restrictions on the use of its assets and/or profits in line with that social objective. It is distinguished from a traditional non-profit or charity in that it generates a substantial proportion of its income through trading rather than through grants and donations. It may or may not be associated with a particular legal form, depending on the country.

3 For the purposes of this report, 'solidarity enterprise' refers to the category of businesses that qualify as 'entreprise solidaires' in France. It is roughly equated with 'social enterprise', but has various alternative qualification criteria including those related to the proportion of employees that have particular challenges in accessing the labour market; democratic governance; salary ratios of the highest- and lowest-paid employees, etc. Amendments to the legislation that governs these criteria are currently being considered.

4 For the purposes of this report, 'profit-with-purpose business' refers to a business which has a primary social mission and may have restrictions on amendments to that mission, but has no restrictions on the use of its assets or profits. We describe the defining characteristics in more detail in this report.

or lock in their social mission, but the energy and opportunities for the future are substantial.

We believe that profit-with-purpose businesses will add substantially to social impact and social investment. Building additional legal, contractual and market frameworks will encourage more entrepreneurs to commit to social value and deliver social impact. And their profit-distributing status will encourage more investors to provide the early stage risk capital, and the growth investment, for them to achieve their full potential. Profit-with-purpose businesses are at the junction of impact and investibility.

We believe that there could be at least as many profit-distributing, impact-focused businesses as there are social/solidarity enterprises and trading non-profits, and that they will be much more investible, particularly at the early and growth stages of the enterprise journey.

We believe that there is good evidence that a substantial number of entrepreneurs, investors and customers are already on this path. Profit-with-purpose business will be a major part of the future.

It is also important to offer routes for countries which still have no intermediate form between non-profit and commercial business, and which may not yet feel it appropriate to adopt profit-with-purpose business, to allow for social enterprise or solidarity enterprise as their next step. Four of the G8 countries currently have no intermediate form of this kind.

This report provides an analysis of the starting point for legal and regulatory systems in each of the G8 countries. We are deeply grateful to Orrick, Herrington & Sutcliffe for providing pro-bono legal services to create this vital foundation upon which new developments can be built to improve the opportunities for profit-with-purpose businesses. Our profound thanks go to all the lawyers who participated in this exercise across the 8 countries, and also to TrustLaw at the Thomson Reuters Foundation for their brokerage and for publishing the compiled reports.

We hope that these country by country analyses will help speed up the development of the social economy across the G8 – and in turn, create the sustainable social impacts that we all wish to see.

CLIFF PRIOR

CEO, UnLtd: The Foundation for Social Entrepreneurs

EXECUTIVE SUMMARY

Across the G8, increasing emphasis among entrepreneurs and investors on businesses that set out to generate profits while achieving a social or environmental purpose coupled with increasing consumer demand for products and services that reflect their personal values, has highlighted the challenges facing those seeking to establish businesses with a social purpose. One such challenge is legal recognition of this “triple-bottom line”¹, which can conflict with fundamental business law principles in many jurisdictions. This has prompted some advocates to call for greater flexibility in applicable business organisation law and for reforms to recognise expressly for-profit businesses that adopt a social purpose.

In this Report, businesses that conduct profit-generating activities with the right to distribute some or all of their profits to their owners but also operate to fulfil a social purpose are referred to as “profit-with-purpose businesses” (“**PPBs**”). Aside from having no restrictions on profit distribution, PPBs have three defining characteristics. First, they expressly espouse a mission to advance the common good. This may take the form of a general social purpose (i.e., a beneficial impact on society and/or the environment as a whole), a specific social purpose (i.e., a more tailored mission to advance a particular goal, such as providing products or services to underserved communities, preserving particular aspects of the environment or promoting economic opportunity) or both a general and specific social purpose. Second, the duties of those making management decisions for a PPB, such as its directors or officers, should include a duty to further the social purpose of the business. Third, the PPB should evaluate and report on its success in achieving its social purpose using a standard means of measurement. This could take the form of an impact assessment standard promulgated and/or verified by an independent third party.

This Report examines how and to what extent legal regimes in the G8 countries permit the formation of PPBs with the key characteristics described above as well as other traits that could serve to protect the social purpose. All of the G8 countries have corporate forms that allow for the integration of a primary or secondary social purpose into one or

¹ A “triple bottom line” refers to businesses with both a conventional bottom line to measure their financial profit/loss and which aim to measure their performance in terms of positive social and/or environmental impact (for which there is no GAAP equivalent).

more for-profit entities, while still ensuring the full or partial distribution of profits. There are thus no legal prohibitions to creating PPBs. However, in a first set of countries, the absence of a specific type of corporate form for PPBs makes the enforceability of social purpose clauses in, for example, the corporate governance documents, a potential risk since such clauses are at odds with the profit maximisation principle that applies to for-profit corporations. Given the absence of a clear regulatory framework, and a lack of precedent cases for corporations that seek a "triple bottom line", there is real legal uncertainty regarding the extent to which PPBs will gain full respect and enforcement in the legal system. This is likely why PPBs are not prevalent in these countries.

A second set of countries also do not have any corporate forms specifically designed for PPBs. However, the corporate legal principles in these countries allow for the social purpose to be embedded in the definition of the corporate purpose in the articles of association, and there is greater certainty that those non-economic purposes will be enforced, at least in comparison to the situation in the first set of countries.

In the remaining G8 countries, there are many legal structures that a PPB can adopt. In each of these countries, legal forms have been legislated that are specifically designed for PPBs and which permit entities to further a social purpose while also allowing for full or partial profit distribution. In addition, conventional legal structures can be used by any business, whether or not it has a social purpose. However, in these countries, it is unclear whether decisions of directors or managers would survive legal scrutiny if they prioritised the social purpose of the company at the expense of profit maximisation. Even where the law does not impose legal barriers to the inclusion of a social purpose into the constitution of a for-profit entity, notwithstanding that its constitution contemplates the distribution of profits, the directors of such entities will, have to balance the promotion of such social purpose against the numerous other factors which it is part of their statutory and fiduciary duties to the entity (and its members) to consider when determining to adopt any course of action.

A few key trends also emerge from this cross-country analysis:

- Tax relief for businesses and investors correlate with assets/profits lock. Generally, governments only make tax relief available to organisational forms in which the social mission is paramount and which do not seek to return profits to interest holders. In most jurisdictions, there are bright lines between for-profit entities, which are subject to tax, and not-for profit or charitable entities, which are not. One of the main barriers to tax relief for PPBs are concerns over the potential for abuse. As a result, most legal forms that have been specifically designed for PPBs do not qualify for tax relief.
- Third party rights to enforce the social purpose of a PPB are limited or non-existent. In those G8 countries, including those which have developed new legal forms for PPBs, non-owner stakeholders do not generally have standing to enforce the social purpose of the company or otherwise hold it accountable. Indeed, there are considerable operational and financial risks associated with granting broad enforcement rights to non-owners if a PPB struggled to satisfy its social purpose.

These risks merit consideration in assessing whether broad enforcement rights would benefit the PPB sector.

- New forms of business entities often involve additional legal risks. In the jurisdictions that have legislated new designations for PPBs, the use of these new forms for PPBs carry certain attendant legal risks to the extent they represent modifications to existing corporate law. This risk is heightened in common law jurisdictions where key legal principles, such as the notion of shareholder value maximisation, are articulated in judicial precedent rather than statutory law. In a claim for breach of fiduciary duty against directors of one of these new entities, there is uncertainty as to whether existing legal precedents would apply. In addition, some commentators have suggested that an express statutory directive to consider other interests common among PPB legislation creates an unhelpful distinction between PPBs and traditional companies and may unnecessarily and unintentionally restrict the exercise of conventional fiduciary duties.

Significantly, PPBs are attracting the attention of legislators as is reflected by proposed or possible legislative developments in many countries. In 2012, the European Commission presented a proposal for a European Foundation Statute in order to facilitate the cross-border activities of public benefit purpose foundations and to make it easier for them to support public benefit causes across the EU. It remains to be seen if, when, and to what extent this and various national initiatives will become effective. However, what is clear is the need for legislative reform should be studied by each country. The examples of recent legislative activity in this sector warrant further review and analysis.

Our Reports highlight the key legal issues facing PPBs and, where relevant, describe the reforms that have been enacted or which are contemplated in each G8 country. The Reports focus on whether for each country, the relevant legal system has developed specific corporate legal structures for PPBs. In particular, the reports include the legal impediments to establishing a business seeking to distribute profits while pursuing a social impact, whether directors and managers can consider the interests of groups other than the owners, and whether and how the directors and managers can be held accountable for furthering the social purpose of the business. For an overview of the legal framework applicable to PPBs in each G8 country, please see the following table.

–ORRICK, HERRINGTON & SUTCLIFFE LLP

Have legal forms been created specifically for PPBs?

CANADA YES.

One province has passed legislation to allow for-profit companies to be created specifically to act in the public interest and another is close to taking a similar step:

- In British Columbia, Community contribution companies (**C3s**)
- In Nova Scotia, Community interest companies (**CICs**) may become law soon

NB. "B Corps" are certified by B Lab as a benchmarking tool, for profit entities only. They are not recognised by Canadian Federal Law as corporate legal entities.

FRANCE NO.

However, all conventional companies can be utilised by PPBs.

GERMANY NO SPECIFIC LEGAL FORM. Among others, the following forms are most appropriate for PPBs:

- Cooperative (**Genossenschaft**) (social purpose can only be ancillary purpose)
- Foundaton (**Stiftung**) (heavily regulated)
- Limited liability company (**GmbH**). A charitable GmbH can use the business name "gGmbH" (but see commercial restrictions).

ITALY NO SPECIFIC LEGAL FORM. Pursuant to a special regime on "social enterprises," all of the forms below can be utilized provided that certain requirements are met:

- Joint stock companies (**Società per Azioni**)
- Limited liability company (**Società a responsabilità limitata**)
- Partnership limited by shares (**Società in accomandita per Azioni**)
- Simple partnership (non commercial) (**Società semplice**)
- General partnership (commercial) (**Società in nome collettivo**)
- Limited partnership (**Società in accomandita semplice**)
- Cooperative company (**Società cooperativa**)
- Non-corporate forms: incorporated or unincorporated associations (**Associazioni riconosciute e non riconosciute**)
- Foundations (**Fondazioni**)

JAPAN NO.

Forms of "commercial" entities (where "commercial" herein means an ultimate purpose of making and distributing profits to its equityholders) generally are available to profit-with-purpose businesses. Forms of commercial entities most widely used by profit-with-purpose businesses and by business enterprises in general include:

- Stock corporation (**kabushiki kaisha**); and
- Limited liability company (**godo kaisha**).

Because the fundamental purpose of commercial entities is to make and distribute profits to its equityholders, such entities must, in general, maximize the interests of their equityholders. Nevertheless, such principle is not absolute and does not preclude such entities from adopting social purposes even if such purposes may not on their face promote the maximization of equityholder interests.

Thus, it is generally thought of as permissible for a commercial entity to adopt primary or secondary purposes to create a social or environmental benefit, and for directors/managers of such entities to consider interests of groups other than the equityholders and to further social purposes of such entities' business.

RUSSIA NO.

However, PPBs can be established in form of a non-profit organisation or a commercial company, subject to certain limitations applicable to the relevant legal form.

The PPB concept is still very new in Russia. A working group of representatives of legislative bodies is actively looking at draft laws to facilitate social entrepreneurship. Generally, the non-profit sector is not very developed either.

UNITED KINGDOM YES.
 - Community Interest Companies (CICs)
 - Community Benefit Societies (CBSs)
 CICs were introduced in 2005 and now there are over 8000 registered. They feature asset and profit locks and are subject to separate regulation by the CIC Regulator.

UNITED STATES YES, varies by state.
 - Low-profit limited liability company
 - Flexible purpose corporation
 - Social purpose corporation
 - Benefit corporation
 - Benefit LLC.

Can a PPB be created by contract using traditional legal forms?

CANADA YES.
 Provided no conflict with the statutory requirements of the entity's structure. Social purpose can be incorporated into by-laws etc.

FRANCE YES.
 But French Civil Code can be problematic as it provides that (i) a company cannot fully exclude the shareholders from the profits and that (ii) an act that does not seek profit-making for the company could trigger liability for directors and could also be voidable.

GERMANY YES.

ITALY YES.
 However, pursuant to special regime on "social enterprises," the PPB's articles of association must comply with specific rules, e.g., profit distribution constraint, specification of the non-profit purpose pursued.

JAPAN YES.

RUSSIA YES.
 However, no mechanisms to enforce because Russian law does not interfere with the social purpose of a company

UNITED KINGDOM YES.
 Traditional legal forms incorporating various legal tools, e.g., "golden shares" and weighted voting rights may "entrench" certain provisions of the articles of a company.

UNITED STATES YES.
 A social purpose can be embedded in governing documents and legal rights, such as consent rights, supermajority voting and transfer rights, can be contractually agreed to protect the social purpose.

Does the legal system encourage heightened transparency standards?

CANADA YES.
 Varies by jurisdiction and form.
 Additional transparency measures may include:
 - third-party verification
 - annual social impact reporting
 - publicly available reports

FRANCE NO.
 French Corporate Law applies to PPBs incorporated as conventional companies in the same way as to any other companies.

GERMANY	YES. Certain mandatory requirements and some voluntary. Disclosure requirements can be stipulated in the articles of association.
ITALY	YES. In special regime on social enterprises: <ul style="list-style-type: none"> - annual reporting, including specific “social” financial statements - corporate documentation - publicly available reports
JAPAN	NO. No more transparency standards simply because a corporate entity chooses to operate as a profit-with-purpose business.
RUSSIA	NO. Certain reporting requirements apply to non-profit organisations to ensure compliance of activities with the purpose.
UNITED KINGDOM	YES. <ul style="list-style-type: none"> - annual reporting - accounting records - CICs must produce an annual community benefit report
UNITED STATES	YES. Varies by state and form. Additional transparency measures may include: <ul style="list-style-type: none"> - annual social impact reporting - publicly available reports - evaluating social impact against a third party standard - current reporting (Flexible purpose corporation only) - designated benefit director or officer

Does the law restrict the disposition of assets of a PPB?

CANADA	YES with respect to Community contribution companies in British Columbia.
FRANCE	NOT during the life of the PPBs nor at its dissolution when incorporated as conventional companies.
GERMANY	YES. However, it is mandatory only for a charitable corporation and foundation. Profits lock may be required for a PPB, depending on its charitable status.
ITALY	YES. e.g., a social enterprise cannot be controlled by for-profit entities.
JAPAN	NO special restrictions due to a commercial entity being a profit-with-purpose business
RUSSIA	Certain restrictions may apply if PPBs are organised as a non-profit or a commercial entity, and will depend on the chosen legal form.
UNITED KINGDOM	Statutory asset lock is mandatory only for a CICs and CBSs.
UNITED STATES	Only for the social purpose corporation following the Model Approach.

Does the law restrict distributions of profit of a PPB?

CANADA	YES. C3s in British Columbia can pay out 40% of its profits p.a. (plus any carried forward from prior year).
FRANCE	NO , but provisions of the articles of association of a PPB incorporated as a conventional company could limit the distribution of profit as long as it does not fully exclude the shareholders from the profits.

GERMANY	YES, if the PPB is a charitable entity. Maybe done through the articles of association.
ITALY	YES. Social enterprises are subject to strict profit distribution constraints.
JAPAN	NO special restrictions due to a commercial entity being a profit-with-purpose business
RUSSIA	Generally not applicable. However, if PPB is organised in form of a non-profit organisation, the distribution of profit will be restricted.
UNITED KINGDOM	Statutory restrictions on profit distributions are applicable only to CICs and CBSs (but imminent changes to the rules will relax the restriction for CICs – will be able to distribute up to 35% of profit). Traditional form companies may only make distributions if they have sufficient distributable reserves.
UNITED STATES	NO.

Does the law restrict the ability to change the social purpose of the PPB?

CANADA	NO. Even with C3s, there is ultimately no mission lock.
FRANCE	NO; but provisions of the articles of association of a PPB incorporated as a conventional company could, to some extent, restrict the ability to change the social purpose.
GERMANY	YES, for a foundation. Otherwise, can only be accomplished through the articles of association.
ITALY	NO.
JAPAN	The public welfare association (<i>koueki shadan houjin</i>) and non-profit organisation with entity status (<i>tokutei hieiri katsudou houjin</i>) are limited in their purpose by law. Association (<i>ippan shadan houjin</i>) and stock corporation (<i>kabushiki kaisha</i>) are not mission locked.
RUSSIA	NOT APPLICABLE. The law does not provide for social purpose for a commercial entity.
UNITED KINGDOM	Statutory restrictions are applicable to CICs and CBSs only. Contractual restrictions can be added to other legal forms e.g. CICs must pass the community interest test. CBSs must be run for the benefit of people who are not members and must be in the interests of the community at large.
UNITED STATES	YES. Primarily in the form of supermajority voting rights relating to a change in the social purpose.

Do third parties have the right to enforce the social purpose of a PPB?

CANADA	NO.
FRANCE	NO.
GERMANY	NO. Only through de facto enforcement by the respective entity's management and shareholders. Special regulatory regime for foundations.
ITALY	YES. The Government monitors compliance of the special regime applicable to social enterprises, with power of inspection and disqualification.
JAPAN	YES. The Government monitors compliance of public welfare association (<i>koueki shadan houjin</i>) and non-profit organisation with entity status (<i>tokutei hieiri katsudou houjin</i>).
RUSSIA	NO.
UNITED KINGDOM	NO. And even a shareholders' derivative claim is difficult.
UNITED STATES	NO, except benefit corporations are permitted, but not required, to grant standing to third parties to enforce the duty to consider stakeholder interests.

Does the law protect the social purpose in the event of a change of control of the PPB?

CANADA	Potentially, through corporate mechanisms, e.g., change of control clause.
FRANCE	NOT for PPBs incorporated as conventional companies, but it is possible through articles of association or other contractual arrangements between shareholders.
GERMANY	YES. Mechanisms exist, for example, golden shares, unanimity requirements and a change-of-control clause in a financing agreement.
ITALY	YES (only applicable to social enterprises)..
JAPAN	NO.
RUSSIA	NO. Save to the extent the activities of the relevant PPB must be conducted in accordance with its foundation documents and law.
UNITED KINGDOM	Statutory protection is applicable to CICs. Contractual protections can be added to other legal forms.
UNITED STATES	With the exception of the L3C statutes which do not restrict change of control, most of the PPB corporate statutes require the approval of 2/3 of each class of shares in connection with change of control transactions.

Are tax incentives available for PPBs?

CANADA	NO. C3s are not charities and are not exempt from income tax.
FRANCE	Generally NO.
GERMANY	Apart from tax privileges for a charitable corporation, association or foundation (which have strict pre-requisites), NO.
ITALY	NO.
JAPAN	Apart from tax privileges for non-profit organisation with entity status (tokutei hieiri katsudou houjin) and association (ippan shadan houjin) satisfying certain conditions, NO.
RUSSIA	NO.
UNITED KINGDOM	NOT CURRENTLY, but a social investment tax relief has been inserted into the Finance Bill 2014. This is expected to be implemented in July 2014. First of its kind. Mirrors EIS in many ways but it also allows tax relief for debt (provided it is unsecured and lowest ranking) as well as equity. Applies to asset locked bodies and SIBs.
UNITED STATES	NO.

CANADA



CANADA

1 INTRODUCTION

The Canadian province of British Columbia has established a specific corporate form for profit-with-purpose business (“**PPB**”) that allows for the partial or full distribution of profits to private owners. In British Columbia, a PPB can be formed as a community contribution company (“**Community Contribution Company**” or “**C3**”).¹ In Nova Scotia, legislation has been passed, but is not currently in force due to the absence of approved regulations, to implement the corporate form of a community interest company (“**Community Interest Company**” or “**CIC**”).² Especially with the new corporate form that British Columbia has developed, PPBs may operate at least in that province in a way that maximises financial return and furthers a double or triple bottom line either as a primary or secondary purpose and without any legal uncertainty. The directors of a C3 must consider the interests of groups pursuant to the respective community purpose outlined in the relevant governing document.

PPBs in Canada can also be created through the use of traditional corporate forms, and by embedding a social purpose in the articles of incorporation and/or bylaws. Whether those forms would be recognised by a court in Canada remains untested.

2 COUNTRY OVERVIEW

The Canadian legal system is based on a combination of both English common law and French civil law. Canada is a federal jurisdiction that consists of a federal government, ten provinces and three territorial governments (for the purposes of this analysis, the three territories shall be treated as provinces). The laws of the Province of Québec are derived from French civil law, while the laws of all other Canadian provinces are based on English common law.

In Canada, a business can be created under the broad categories of a sole proprietorship, partnership, joint venture, franchise, co-operative or a corporation.³ For

1 See BC Center for Social Enterprise, http://www.centreforsocialenterprise.com/C3_BC.html (last visited April 21, 2014). See also British Columbia Legislature, Finance Statutes Amendment Act, Bill 23 (2012) available at http://www.leg.bc.ca/39th4th/1st_read/gov23-1.htm (last visited April 21, 2014).

2 Nova Scotia Legislature, Community Interest Companies Act, Chapter 38 of the Acts of 2012, available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/b153.htm (last visited April 21, 2014).

3 See Elizabeth A. Gillis, *Advanced Corporate Legal Procedures*, Bernard Sandler et al., 2nd ed. (2011). See also <http://www.canadabusiness.ca/eng/page/2853/> (last visited May 29, 2014).

the purposes of this discussion, the focus will primarily be on the corporate form.⁴ Prior to selecting a structure, a business must first decide whether to subject itself to federal jurisdiction or provincial jurisdiction. While federal and provincial law may apply to certain aspects of a business, it may only be incorporated under one or the other.

In Canada, a business wishing to incorporate itself as a share capital corporation can choose to do so federally or provincially. The federal and provincial business corporation statutes are quite similar in most respects, but there are some differences which may affect the decision to incorporate federally or provincially.⁵ Federal corporations are governed by the [Canada Business Corporations Act](#). The [Canada Business Corporations Act](#) provides the basic corporate governance framework for many small and medium-sized businesses as well as many of the largest corporations operating in Canada.⁶ Alternatively, a business can be governed by a provincial corporate law statute. For example, in Ontario, corporations may be governed by the [Ontario Business Corporations Act](#).

A federally or provincially incorporated business may do business anywhere in the country, although additional steps may be required. For example, even though a federally registered corporation will have business name protection throughout Canada, a provincially incorporated company would have to take additional steps to do the same. Regardless of whether incorporated federally or provincially, a business will need to be registered in any province in which it does business (other than the province in which it is incorporated). Once a business has determined whether to organise provincially or federally, it may then select an appropriate form. A business in Canada seeking to distribute some or all of its profit can be organised as: (a) a share capital corporation; or (b) a profit-with-purpose corporation at least in British Columbia.⁷ This is not an exhaustive list of the different types of corporate forms available in Canada, but only these two forms are applicable for the purposes of this paper. Please note that share capital corporations can be organised⁸ on a federal and provincial level, while at the

4 In Canada, a corporation is commonly referred to as a “company”. The term “corporation” and “company” will be used interchangeably throughout this paper.

5 For example, ease and timeliness of incorporation, flexibility in carrying out corporate proceedings, licensing requirements, fees and taxes, minimum number of resident Canadian director requirements, the capacity to operate in the provinces without extra-provincial registration and the rules regarding unanimous shareholder agreements.

6 See Corporate, Insolvency and Competition Law Policy, http://www.ic.gc.ca/eic/site/cilp-pdci.nsf/eng/h_cl00022.html (last visited May 24, 2014).

7 See Elizabeth A. Gillis, *Advanced Corporate Legal Procedures*, Bernard Sandler et al., 2nd ed. (2011). See also <http://www.canadabusiness.ca/eng/page/2853/> (last visited May 29, 2014). The not-for-profit corporation cannot distribute any profits and thus is not discussed in this report as an option for corporate form. Specifically, a not-for-profit corporation does not issue share capital, and is formed to promote a social, community, or charitable purpose. Similar to not-for-profit corporations, not-for-profit charitable corporations also do not issue share capital, but both models can generate income. Not-for-profit corporations and not-for-profit charitable corporations that generate income through a related or unrelated business are considered to be a form of social enterprise in Canada. See Elizabeth A. Gillis, *Advanced Corporate Legal Procedures*, Bernard Sandler et al., 2nd ed. (2011). See also <http://www.canadabusiness.ca/eng/page/2853/> (last visited May 29, 2014).

8 In Canada, a social enterprise is not governed by a federal or provincial statute. It can be loosely organised as discussed in Section 4.4 of this paper. See Robert Walkulak and Nabil Dhirnai, *Primer on Social Enterprise in Ontario* (2013) (unpublished manuscript) (on file with the OBA Institute).

moment, legally recognised PPBs can only be organised on a provincial level in the province of British Columbia.

- (a) **SHARE CAPITAL CORPORATION** – A share capital corporation is equivalent to a limited liability corporation in the United States since they share similar characteristics. They are both akin to being legally recognised as a separate legal entity, they have the ability to allow limited liability for shareholders, and they are also formed for the purposes of generating profit.
- (b) **PROFIT-WITH-PURPOSE CORPORATION** – Two Canadian provinces have legally recognised PPB structures in order to respond to a demand for socially-focused investment options. In the last two years, the provinces of British Columbia and Nova Scotia have respectively amended and enacted provincial legislation to create their own versions of a PPB form by broadening the scope of the traditional share capital corporate structure. As stated above, the legislation in British Columbia has been duly authorized, while the legislation in Nova Scotia still requires regulatory approval.

In this regard, we note that the umbrella of PPBs, which are not a legal, official or recognized corporate form, may also be broadly described as social enterprises. A social enterprise is understood in Canada to mean “any organization or business that uses the market-oriented production and sale of goods and/or services to pursue a public benefit mission.”⁹

2.1 DO SPECIFIC LEGAL FORMS FOR PPBS EXIST UNDER APPLICABLE LAW?

To date, there is one legally recognised way in which a PPB structure can be formed under applicable law in the province of British Columbia – as a Community Contribution Company. Further, a Community Interest Company may become available as a PPB option in the province of Nova Scotia.

- (a) **COMMUNITY CONTRIBUTION COMPANY** – A C3 is a legally recognised PPB structure that is currently available in the province of British Columbia. The [British Columbia Business Corporations Act](#) was amended on May 14, 2012¹⁰ to provide Canada with its first legally recognised PPB structure. The amendment was a result of consultations with members of the BC Social Innovation Council, as well as expert stakeholders from the social enterprise community. The amendment was finalised on February 28, 2013 and it came into effect July 29, 2013.¹¹

9 See Mobilizing Private Capital for Public Good: Canadian Task Force on Social Finance (Dec. 7, 2010), <http://www.marsdd.com/app/uploads/2011/02/MaRSReport-socialfinance-taskforce.pdf> (last visited July 21, 2014).

10 David C.K. Tang, Community Contribution Companies: Canada’s First Purpose-Built Social Enterprise or Social Entrepreneurship Organizational Structure, <http://www.gowlings.com/KnowledgeCentre/article.asp?pubID=2818>, (last visited May 22, 2014)

11 Ibid.

- (b) **COMMUNITY INTEREST COMPANY** – A CIC is a legally recognised PPB structure that is recognised under the [Community Interest Companies Act](#) in the province of Nova Scotia. Although this legislation was enacted in 2012 and received Royal Assent on December 6, 2012, it is not yet in force. It is unclear when the CIC will come into force. The CIC model is similar to British Columbia's Community Contribution Company model aside from a few differences that will be highlighted in this paper.¹² In order to form a CIC, a business will first have to be incorporated under the [Companies Act](#), and then be designated as a CIC under the [Community Interest Companies Act](#).

2.2 ARE THERE ANY PROPOSALS TO LEGISLATE NEW FORMS FOR PPBS?

In 2009–10 the House of Commons Standing Committee on Industry, Science and Technology conducted a statutory review of the [Canada Business Corporations Act](#) and published a report that recommended, among other things, that the Canadian government consult on new rules to facilitate the incorporation of a PPB structure on a federal level.¹³ Public consultations were recently conducted by Industry Canada and submissions were invited on the utility of such enterprises in the Canadian context, and the extent to which the current [Canada Business Corporations Act](#) incorporation provisions facilitate the creation of such structures.

2.3 HOW CAN AN ENTERPRISE LEGALLY DEMONSTRATE ITS COMMITMENT TO A SOCIAL PURPOSE?

Within the Canadian provincial legal framework, C3s (and when and if approved, CICs) can demonstrate a commitment to a specific social purpose by holding general annual meetings and by publishing annual reports in order to substantiate the implementation of the entity's social mission. British Columbia (and if passed, Nova Scotia) have their own guidelines and enforcement methods. For example:

- (a) **COMMUNITY CONTRIBUTION COMPANY** – In addition to publishing an annual report prior to its annual general shareholders meeting, outlining how the company has met its community objective, a C3 must also state its social purpose in its Notice of Articles, along with a prescribed statement as provided by the [British Columbia Business Corporations Act](#).¹⁴ A C3 must also have the words "Community Contribution Company", "C3", or "B.C. Community Contribution Company Ltd." as part of its name.¹⁵

¹² See Brent Randall, *How to Structure Community Interest Corporations*, <http://drache.ca/articles/charities-article-archive/how-to-structure-community-interest-corporations/> (last visited May 24, 2014).

¹³ See S. Comm. on Industry, Science and Technology, *Statutory Review of the Canada Business Corporations Act* (R.S.C., 1985, c. C-44), available at <http://www.parl.gc.ca/HousePublications/Publication.aspx?DocId=4591866&Language=E&Mode=1&Parl=40&Ses=3&File=24#review> (last visited May 29, 2014).

¹⁴ *Business Corporations Act*, Chapter 57, Part 2.2, §§51.911, 51.921 & 51.96 (2002) available at http://www.bclaws.ca/civix/document/id/complete/statreg/02057_00 (last visited May 29, 2014).

¹⁵ *Ibid.*

(b) **COMMUNITY INTEREST COMPANY** – In addition to producing at or before the date in each year by which the annual general meeting is held, a “Community Interest Report”¹⁶ that contains a fair and accurate description of the manner in which the CIC’s activities during that financial year benefited society or advanced the community purpose of the CIC,¹⁷ would have to be provided to the shareholders and also to the Registrar of Community Interest Companies.¹⁸ A CIC would also be required to have the words “Community Interest Company”, “Société d’intérêt Communautaire” or the abbreviation “C.I.C.”, “CIC”, “S.I.C.” or “SIC” as the last part of its name to signify that it is a CIC.¹⁹ In addition, a CIC would be required to have the following statement in the CIC’s Memorandum of Association:

*This company is a community interest company, and as such, has a community purpose. This company is restricted, in accordance with the [Community Interest Companies Act](#), in its ability to pay dividends and to distribute its assets on dissolution or otherwise.*²⁰

Please refer to Section 3.1 of this paper for a detailed consideration of CICs.

Although discussed in later sections of the paper, it is crucial to note that one of the major differences between a C3 and a CIC is regulation. While CICs’ formation and operation will be overseen by a government-appointed registrar, C3s are not. C3s are regulated and held accountable by the public and respective shareholders.

In addition to the legally recognised PPB structure under the provincial laws of British Columbia, businesses can also demonstrate a commitment to a social purpose in three distinct ways. Unless otherwise specified, please note that the following methods are not regulated by Canadian federal or provincial legislation, and can be grouped under the broad category of PPBs or social enterprise.

First, a traditional business may elect to establish a social mission through its articles of incorporation, bylaws or through a unanimous shareholders’ agreement. However, it is uncertain whether having a social purpose, albeit explicitly stated in the constituent documents or a unanimous shareholders’ agreement, would be adequately enforceable.

Second, a business may choose to certify itself as a Certified B Corporation (“**Certified B Corporation**” or “**B Corp**”). Certification is provided by B Lab, a Pennsylvania-based non-profit organisation, which allows a share capital corporation to demonstrate its commitment to social values by meeting criteria. Significant to note is the fact that a B

16 Nova Scotia Legislature, Community Interest Companies Act, Bill 153, Chapter 38 of the Acts of 2012, §§21-22 (2012) available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/b153.htm (last visited April 21, 2014).

17 Ibid.

18 Kate Lazier, Nova Scotia Introduces the Community Interest Company, <http://www.millerthomson.com/en/publications/newsletters/charities-and-not-for-profit-newsletter/2012-archives/december-2012/nova-scotia-introduces-the-community-interest> (last visited May 23, 2014).

19 Ibid.

20 Nova Scotia Legislature, Community Interest Companies Act, Bill 153, Chapter 38 of the Acts of 2012, §9 (2012) available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/b153.htm (last visited April 21, 2014).

Corp is not a business form at all. Although B Corps do not carry any legal significance under Canadian law, many Canadian corporations attain certification as a B Corp to demonstrate a commitment to prescribed community and social values within a transnational context.

Lastly, a business can be established as a co-operative corporation on a federal level under the [Canada Cooperatives Act](#), or under applicable provincial legislation. Under this model, co-operatives would qualify as a PPB because the organisation’s focus is on the needs of its members and the development of its communities. The members of a co-operative share equally in the governance of the organisation and any profits are either generally distributed amongst the members, donated to the community, or reinvested in the co-operative to improve services for the co-operative’s members.

Therefore, as noted above, Canadian federal and provincial corporate law does not explicitly restrict a business in pursuing a social purpose. Alternative structures are available to traditional companies. By allowing traditional companies, along with co-operatives, C3s and when and if Nova Scotia formally approves use of CICs, to have a primary or secondary purpose to generate a social or community benefit, the directors, managers and/or members of these organisational forms may further social and community interests.

3 LEGAL FOUNDATIONS FOR PPBS

3.1 CAN A BUSINESS BE FORMED UNDER APPLICABLE LAW WITH THE FOLLOWING CHARACTERISTICS OF A PPB?

Forming a business with the key characteristics of a PPB is possible under applicable corporate law and also by legally recognised PPB structures. As noted above, under the traditional business model, a share capital corporation may be formed with the characteristics of a PPB if structured with a social mission embedded in a share capital corporation’s governing documents, such as the articles of incorporation, bylaws, through an unanimous shareholders’ agreement, or subsequently by amending governing documents to reflect a commitment to social purpose. However, the enforceability and impact on directors’ duties has not been tested in court.

The following discussion specifically addresses the formation of a Community Contribution Company and a Community Interest Company solely under provincial laws of British Columbia and Nova Scotia respectively, recognizing that the necessary regulations in Nova Scotia to allow for the creation of a CIC have not yet passed.

(a) Social Purpose

In order for a business to qualify as a C3 or once the regulations in Nova Scotia pass for a CIC, it must have a “community purpose”²¹ and C3s must specifically include “purposes beneficial to society”²² in their Notice of Articles (in the case of C3s) and/or Memorandum of Association (in the case of CICs). The [British Columbia Business Corporations Act](#) and Nova Scotia’s [Community Interest Companies Act](#) both define a “community purpose” as a purpose that is beneficial to society at large, or to a segment of society that is broader than the group of persons who are related to the C3 or CIC. Such persons include directors, officers, shareholders of the C3 or CIC, and also those belonging to an affiliate company, or the affiliate company itself. In addition, “community purpose” also implies one where health, social, environmental, cultural, educational or other services are provided.²³

One key difference between the C3 and the CIC model is that in the latter, a political purpose does not qualify as a valid community purpose. The [British Columbia Business Corporations Act](#) does not explicitly prohibit nor allow for a political purpose to be considered as a community purpose for C3s.

As noted above, in the case of C3s, the community purpose must be prescribed in a C3’s Notice of Articles. With respect to CICs, the community purpose will have to be provided in the CIC’s Memorandum of Association. In both cases, a statement of confirmation must be included in the company’s governing documents demonstrating that the company is in fact either a C3 or a CIC.²⁴

(b) Duties

The provincial C3 and CIC statutes supplant traditional fiduciary duties under traditional corporate statutes such as the [Canada Business Corporation Act](#) and the [Ontario Business Corporation Act](#).

- (i) **COMMUNITY CONTRIBUTION COMPANY** – Under the [British Columbia Business Corporations Act](#), the directors and officers of a C3 have a duty to act in good faith by upholding the C3’s community purpose and ensuring that the C3 is in compliance with applicable legislation. Section 51.93(2) of the [British Columbia Business Corporations Act](#) allows the directors or officers of a C3 to act with a view to the community purposes of the

21 Nova Scotia Legislature, [Community Interest Companies Act](#), Chapter 38 of the Acts of 2012, §9(1) (2012) available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/b153.htm (last visited April 21, 2014).

22 British Columbia Legislature, [Finance Statutes Amendment Act](#), Bill 23 §51.911 (2012) available at http://www.leg.bc.ca/39th4th/1st_read/gov23-1.htm (last visited May 28, 2014).

23 Nova Scotia Legislature, [Community Interest Companies Act](#), Chapter 38 of the Acts of 2012, §9(1) (2012) available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/b153.htm (last visited April 21, 2014).

24 David C.K. Tang, [Community Contribution Companies: Canada’s First Purpose-Built Social Enterprise or Social Entrepreneurship Organizational Structure](#), <http://www.gowlings.com/KnowledgeCentre/article.asp?pubID=2818>, (last visited May 22, 2014).

company when exercising the powers and performing the functions of a director or officer.²⁵

- (ii) **COMMUNITY INTEREST COMPANY** – Similar to C3s, a CIC will also have a duty to ensure that the community purpose prescribed in a CIC's Memorandum of Association is implemented. Section 12 of the [Community Interest Companies Act](#) states that a director or officer shall, when exercising the powers and performing the functions of a director or officer of a CIC, act in accordance with the community purpose of the CIC set out in its governing documents.²⁶

Therefore, with respect to C3s (and when and if implemented, the CICs), the directors of each structure must consider the interests of groups pursuant to the respective community purpose outlined in their relevant governing documents. In addition to the minimum director and report requirement as provided for by C3s and CICs, each director of the CIC will also be required to report on the company's activities and spending on an annual basis. The submitted report must also provide an explanation of how the activities of the CIC from the previous year have benefitted the community and society.

Failure to comply with the applicable legislation in each province allows for the PPB to be dissolved. The process varies in both of the provinces. When and if the [Community Interest Companies Act](#) is in force in Nova Scotia, CICs will be regulated by the Registrar of Community Interest Companies, while in British Columbia, a similar specific government regulator is not provided. Rather, accountability for C3s in British Columbia is achieved by publishing an annual public report and through the vigilance of the public and the shareholders of a C3.

(c) **Transparency Regarding Achievement of Social Impact Purpose**

- (i) **COMMUNITY CONTRIBUTION COMPANY** – In order to ensure transparency regarding a C3's achievement of their prescribed community purpose, C3s must annually publish a "Community Contribution Report"²⁷, which must include a description of the C3's activities that benefitted the community, the remuneration of a position held by each person in the C3 who made more than \$75,000, the C3's annual financial statements, and the amount of dividends declared on all classes of shares.

The Community Contribution Report must be kept at the C3's corporate records office, and if the C3 has a website, the Community Contribution

25 British Columbia Legislature, Finance Statutes Amendment Act, Bill 23 §51.93(2) (2012) available at http://www.leg.bc.ca/39th4th/1st_read/gov23-1.htm (last visited May 28, 2014).

26 Nova Scotia Legislature, Community Interest Companies Act, Chapter 38 of the Acts of 2012, §12 (2012) available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/bi53.htm (last visited April 21, 2014).

27 British Columbia Legislature, Finance Statutes Amendment Act, Bill 23 §51.96(1) (2012), available at http://www.leg.bc.ca/39th4th/1st_read/gov23-1.htm (last visited May 28, 2014).

Report must also be accessible online in order to increase transparency and accountability to the public.²⁸

- (ii) **COMMUNITY INTEREST COMPANY** – In order to ensure transparency regarding a CIC's achievement of their prescribed community purpose, a CIC will be required annually to publish, prior to holding an annual general meeting, a "Community Interest Report".²⁹ The report will have to include a description of the manner in which a CIC's activities benefited society, as well as the CIC's assets, including the amount of money transferred in order to further the prescribed community purpose, and in doing so, provide an explanation for which the transfer of assets were made. In addition, the Community Interest Report will also have to include the amounts of any dividends that were declared during the financial year, as well as any redemptions or purchase of shares or other reductions of capital.

On completion of the Community Interest Report, it will first have to be approved by resolution by the CIC's board of directors. It will then have to be submitted to the shareholders of the CIC at the annual general meeting and a copy will also have to be submitted to the Registrar of Community Interest Companies, along with a copy of its financial statements.

3.2 WOULD APPLICABLE CORPORATE LAW RESPECT A SOCIAL PURPOSE IF AN ENTERPRISE WERE TO ADOPT ONE?

Federal and provincial corporate laws may respect a social purpose if an enterprise were to adopt one because of two reasons.

First, as noted above, there are no legal barriers under traditional corporate law (e.g., corporations incorporated under the [Canada Business Corporations Act](#) or [Ontario Business Corporations Act](#)) that explicitly restrict the structuring of a traditional business model with a social purpose. It must be mentioned, however, that it is uncertain given the absence of precedent whether courts in Canada would enforce such a purpose.

Second, by allowing a business to structure itself as a Community Contribution Company in British Columbia, and the likelihood that the Province of Nova Scotia will allow a business there to structure itself as a Community Interest Company, these provinces have created or will soon allow for the creation of different avenues through which a business can promote a social purpose.

²⁸ See Brendan Burns, British Columbia Community Contribution Company Update, <http://www.millerthomson.com/en/publications/newsletters/charities-and-not-for-profit-newsletter/april-2013/british-columbia-community-contribution> (last visited May 24, 2014).

²⁹ Nova Scotia Legislature, Community Interest Companies Act, Chapter 38 of the Acts of 2012, §21(1) (2012) available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/bi53.htm (last visited April 21, 2014).

3.3 CAN A SOCIAL PURPOSE BE EMBEDDED IN THE ORGANISATION’S GOVERNING DOCUMENTS?

Possibly. A social purpose can be embedded in the organisation’s governing documents under two circumstances.

First, as stated above, a social purpose may be embedded in a traditional business organisation’s governing documents if preferred. However, it is uncertain whether this would be enforceable.

Second, in the case of PPBs, C3s and CICs are legally required under the [British Columbia Business Corporations Act](#) and will be required under Nova Scotia’s [Community Interest Companies Act](#) to include a community purpose (see Section 2.1(a)) within an organisation’s governing documents.

4 LEGAL FORMS ARE AVAILABLE FOR PPBS

4.1 OVERVIEW OF LEGAL FORMS OF ORGANISATION AVAILABLE TO PPB STRUCTURES

A Community Contribution Company can currently be formed in the province of British Columbia. In Nova Scotia, the [Community Interest Companies Act](#), passed by the legislature, has not yet come into force, and thus at the time of the writing of this paper, a Community Interest Company cannot be currently formed in Nova Scotia.

- (a) **COMMUNITY CONTRIBUTION COMPANY** – Under the [British Columbia Business Corporations Act](#), C3s are recognised as corporate forms that allow for-profit businesses to pursue social goals through their corporate structures. The purpose of the Act’s amendment was to invite socially conscious investment and to provide an alternate mode for PPB structures to operate.³⁰ Please note that a C3 may have a political purpose as it is not specifically restricted by the [British Columbia Business Corporations Act](#).
- (b) **COMMUNITY INTEREST COMPANY** – Under Nova Scotia’s [Community Interest Companies Act](#), CICs would be for-profit corporate forms that would allow businesses to embrace a community purpose.³¹ By complying with the provisions of the [Community Interest Companies Act](#), CICs would be able to advance a profit and community-based purpose.

30 See Brendan Burns, British Columbia Community Contribution Company Update, <http://www.millerthomson.com/en/publications/newsletters/charities-and-not-for-profit-newsletter/april-2013/british-columbia-community-contribution> (last visited May 24, 2014).

31 Nova Scotia Legislature, Community Interest Companies Act, Chapter 38 of the Acts of 2012, §52(c) and 4(d) (2012) available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/b153.htm (last visited April 21, 2014). See generally New Opportunities for Social Entrepreneurs, <http://novascotia.ca/news/release/?id=20121128010> (last visited May 29, 2014).

4.2 WHAT LEGAL FORMS OF ORGANISATION ARE AVAILABLE TO BUSINESSES GENERALLY THAT COULD BE USED TO FORM A PPB STRUCTURE?

Please refer to the chart below to illustrate the legal form of organisation generally available to businesses to form a PPB structure.

Share Capital Corporations

OWNERSHIP	<p>Since a share capital corporation is owned by its shareholders, it is considered to be a separate legal entity.</p> <p>A share capital corporation can be formed by one or more individuals, who are either natural or legal persons.</p>
GOVERNANCE	<p>Under federal and provincial law, a share capital corporation is governed by its Articles of Incorporation (or Notice of Articles as provided in the province of British Columbia) and also by its bylaws.</p> <p>On a federal level, the governing legislation is the Canada Business Corporations Act.</p> <p>On a provincial level, each province has a form of corporate legislation in place.</p>
OBJECTS	<p>The object of a share capital corporation is to increase shareholder value in a lawful form by maximising profit.</p>
SOCIAL PURPOSE	<p>There are no legal barriers for a share capital corporation to have a social purpose. It may do so by providing for it in the Articles of Incorporation, or in its Notice of Articles if incorporated in the province of British Columbia.</p>
LIMITED LIABILITY FOR OWNERS	<p>Shareholders of a share capital corporation have limited liability since the corporation is deemed to be a separate legal entity.</p>
TRANSFERS OF OWNERSHIP	<p>When transferring ownership of a share capital corporation, shareholder consent may be required.</p>
DEBT FINANCING	<p>A share capital corporation is eligible for debt financing. Directors may authorise debt financing unless the incorporating documents or a unanimous shareholders' agreement restricts them in doing so.</p>
EQUITY FINANCING	<p>Equity financing is available for share capital corporations.</p>

There are no barriers in assigning minimum or maximum amount of share capital that a share capital corporation is allowed to issue, unless otherwise specified in its incorporating documents.³²

TAX TREATMENT

A share capital corporation can be taxed on a federal and provincial level.

Currently, on the federal level, the effective federal tax rate is 15 per cent, after taking into account a reduction in rate that partially offsets the impact of provincial taxation.³³

Provincial tax rates vary depending on the province and the type of income earned by the province.³⁴

Please see below for the provincial corporate rates, which are classified as a lower or higher rate. The lower rate is for corporate income that meets the federal small business deduction threshold, while the higher rate is for all other corporate income.³⁵

Provincial and Territorial Lower and Higher Tax Rates not Including Quebec and Alberta

PROVINCE OR TERRITORY	LOWER RATE (%)	HIGHER RATE (%)
NEWFOUNDLAND AND LABRADOR	4	14
NOVA SCOTIA	3	16
PRINCE EDWARD ISLAND	4.5	16
NEW BRUNSWICK	4.5	12
ONTARIO	4.5	11.5
MANITOBA	nil	12
SASKATCHEWAN	2	12
BRITISH COLUMBIA	2.5	11
YUKON	4	15
NORTHWEST TERRITORIES	4	11.5
NUNAVUT	4	12

32 See Doing Business in Canada, <http://www.blakesfiles.com/DBIC/index.html> (last visited May 22, 2014).

33 See Doing Business in Canada, <http://www.blakesfiles.com/DBIC/index.html> (last visited May 22, 2014).

34 Ibid.

35 See Canada Revenue Agency Corporation Tax Rates, <http://www.cra-arc.gc.ca/tx/bsnss/tpcs/crprtns/rts-eng.html> (last visited May 23, 2014).

36 Ibid.

DISSOLUTION

Under the [Canada Business Corporations Act](#), a federal corporation may apply for dissolution when it has no property or liabilities. However, a bankrupt corporation cannot apply for dissolution.³⁷

If a federal corporation has property or liabilities and wishes to apply for dissolution, then it may do so once the shareholders pass a resolution authorizing the directors to distribute any property and discharge any liabilities in accordance with the articles of the corporation and the requirements under the [Canada Business Corporations Act](#).³⁸

CHARITABLE STATUS

Share capital corporations are not eligible for charitable status.

REGULATORS

A share capital corporation’s activities are regulated by various ministries, commissions, and legislation on a federal and provincial level.

REPORTING REQUIREMENTS

Under the [Canada Business Corporations Act](#), corporations are required to annually file a Federal Annual Return (Form 22) within 60 days of the anniversary of a corporation’s incorporation. Corporations that are “distributing corporations” (meaning generally widely held or publicly listed) may have additional reporting obligations.

ADVANTAGES

The following are advantages of having a share capital corporation:

1. **PERPETUAL EXISTENCE** – a corporation does not die with the death of one shareholder or a change in the purpose for which the corporation was created since it is recognised as a separate legal entity;
2. **LIMITED LIABILITY** – as a separate legal entity, the corporation is responsible for its own debts and claims separate and apart from its shareholders; and
3. **TAX TREATMENT** – corporate income is taxed at the level of the corporation. The corporation files a tax return separate and distinct from its shareholders. This allows

37 See Industry Canada Dissolving a Corporation, http://www.corporationscanada.ic.gc.ca/eic/site/cd-dgc.nsf/eng/h_cs03935.html (last visited May 24, 2014).

38 Ibid.

corporations to take advantage of reduced tax rates depending on the nature of the activity the corporation carries on. The ability to 'dividend' is another tax advantage.

DISADVANTAGES

The following are disadvantages of having a share capital corporation:

1. **COST COMPARED TO OTHER BUSINESS STRUCTURES** – Corporations are more expensive to set up as compared to the cost of sole proprietorships or general partnerships;
2. **TAX TREATMENT** – Corporations require separate tax returns to be filed; and
3. **LACK OF INCENTIVE IN MAINTAINING A SOCIAL PURPOSE** – Corporations face challenges in locking in a social purpose. For example:
 - (a) Since corporations have a responsibility to shareholders to maximise profit, it may be difficult for a corporation to justify allocating portions of profit to socially responsible initiatives; and
 - (b) Corporations do not receive preferential tax treatments, unlike registered charities.

4.3 WHAT LEGAL FORMS OF ORGANISATION, IF ANY, HAVE BEEN SPECIFICALLY DESIGNED FOR PPB STRUCTURES?

The chart below provides an overview of legally recognised PPB structures. In British Columbia, the option to form a Community Contribution Company is currently available, while the Community Interest Company model in Nova Scotia still requires the passage of regulations to be put into force legally and the timetable for the passage of these regulations is uncertain.

Community Contribution Company (“C3”)	Community Interest Company (“CIC”)
<p>OWNERSHIP</p> <p>A C3’s form of ownership is akin to a corporation. It is owned by its shareholders, and it is considered to be a separate legal entity. A C3 can be formed by one or more individuals, who are either natural or legal persons.</p>	<p>A CIC’s form of ownership is akin to a corporation. It is owned by its shareholders, and it is considered to be a separate legal entity. A CIC can be formed by one or more individuals, who are either natural or legal persons.</p>
<p>GOVERNANCE</p> <p>A C3 is governed by its Notice of Articles prescribed under the British Columbia Business Corporations Act.</p>	<p>A CIC will be governed by its Memorandum of Association prescribed under Nova Scotia’s Community Interest Companies Act.</p>
<p>OBJECTS</p> <p>A C3’s object must be to enforce a community purpose. For a more comprehensive discussion on a C3’s community purpose, please see below, along with Sections 1.3, and 2.1(a) of this paper.</p>	<p>A CIC’s object must be to enforce a community purpose. For a more comprehensive discussion on a CIC’s community purpose, please see below, along with Sections 1.3, and 2.1(a) of this paper.</p>
<p>SOCIAL PURPOSE</p> <p>A C3’s social purpose is one where the C3 operates to benefit society at large, or a segment of society that is broader than the group of persons who are related to the C3. The C3’s community purpose can provide health, social, environmental, cultural, educational or other services.</p> <p>Under the C3 structure, a political purpose or a prescribed purpose may constitute a social purpose.</p> <p>The community purpose must be provided in the C3’s Notice of Articles.</p>	<p>A CIC’s social purpose is one where the CIC operates to benefit society at large, or a segment of society that is broader than the group of persons who are related to the CIC. The CIC’s community purpose can provide health, social, environmental, cultural, educational or other services.</p> <p>Under the CIC structure, political purpose or a prescribed purpose does not constitute a social purpose.</p> <p>The community purpose must be provided in the CIC’s Memorandum of Association.</p>
<p>LIMITED LIABILITY FOR OWNERS</p> <p>Shareholders of a C3 have limited liability since the corporation is deemed to be a separate legal entity.</p>	<p>Shareholders of a CIC have limited liability since the corporation is deemed to be a separate legal entity.</p>
<p>TRANSFERS OF OWNERSHIP</p> <p>A C3 is allowed to transfer its assets without restriction to charities and community service co-operatives. In addition, it may also transfer its assets to any other entity that registered charities are permitted to under federal income tax legislation, including First Nations and aboriginal groups.</p> <p>The reasoning behind a C3’s allowance to transfer ownership of its assets is primarily because charities and community service co-operatives are similarly subject to asset locks. Therefore, there is an assurance that a C3’s assets will be utilised to advance a community purpose rather than being transferred to shareholders of a C3 even if ownership is transferred.</p>	<p>Under Section 13(1) of the Community Interest Companies Act, a CIC is not allowed to transfer any of the CIC’s assets unless it is to a “qualified entity”³⁹ for fair market value and in furtherance of the CIC’s community purpose.⁴⁰ A “qualified entity” is defined as a non-profit association, a society incorporated under the Societies Act, or a registered charity.⁴¹</p>

39 Nova Scotia Legislature, Community Interest Companies Act, Chapter 38 of the Acts of 2012, §13(1)(b) (2012), available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/b153.htm (last visited May 29, 2014)

40 Ibid. at 13(1)(a)(c).

41 Nova Scotia Legislature, Community Interest Companies Act, Chapter 38 of the Acts of 2012, §13(1) (2012) available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/b153.htm (last visited May 29, 2014).

DEBT FINANCING	Debt financing is available for C3 structures, but a C3 is prohibited from paying a rate of interest that is related to the C3’s profit unless authorised by and in accordance with applicable regulations. ⁴²	Debt financing is available for CICs, but a CIC is prohibited from paying a rate of interest that is related to the CIC’s profits unless authorised by and in accordance with applicable regulations. ⁴³
EQUITY FINANCING	<p>Equity financing is available for C3s. Similar to any other company, C3s are subject to compliance with the registration and disclosure requirements outlined in the Securities Act unless the C3 meets the exemptions as outlined in the said legislation.</p> <p>If a C3 is exempt, then a C3 will be able to raise capital without issuing a prospectus, but only under certain circumstances, (e.g. offering memorandum exemption, accredited investor exemption, minimum investment exemption, and family, friends and business associates exemption).⁴⁴</p>	Equity financing is available for CICs, but a CIC is prohibited from making a payment to redeem or purchase the CIC’s own shares, or in any way reduce the CIC’s capital attributable to shares unless the payment is authorised by applicable regulations and in accordance with the CIC’s articles of association and the Companies Act . ⁴⁵
TAX TREATMENT	A C3 is not exempt from paying income taxes ⁴⁶ because a C3 is a profit-making company, which utilises its profits for community purposes. ⁴⁷	A CIC is not exempt from paying income taxes because a CIC is a profit-making company, which utilises its profits for community purposes. ⁴⁸
DISSOLUTION	<p>When a C3 is dissolved voluntarily, 60 per cent of the C3’s assets must be transferred to charitable organisations or other asset-locked entities.</p> <p>When a C3 is dissolved involuntarily, for example, in the case for failing to file annual reports, any assets still owned by the C3 would be automatically turned over to the government.⁴⁹ These assets would be returned to the C3 once the C3 meets regulatory standards by being restored to the corporate register.</p>	<p>Under Section 18 of the Community Interest Companies Act, upon dissolution, all or a prescribed percentage of the CIC’s distributable assets will be transferred to qualified entities in accordance with directions prescribed in the CIC’s Memorandum of Association or by a special resolution passed by the CIC’s shareholders.</p> <p>Prior to distributing the CIC’s assets, confirmation from the Registrar of Community Interest Companies to ensure that the qualified entities are in fact eligible by being either a non-profit association, a society incorporated under the Societies Act, or a registered charity.⁵⁰</p>

42 British Columbia Legislature, Finance Statutes Amendment Act, Bill 23, §51.94 (2012) available at http://www.leg.bc.ca/39th4th/1st_read/gov23-1.htm (last visited May 29, 2014).

43 Nova Scotia Legislature, Community Interest Companies Act, Chapter 38 of the Acts of 2012, §16 (2012) available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/b153.htm (last visited April 21, 2014).

44 See Questions and Answers Community Contribution Companies, <http://www.fin.gov.bc.ca/prs/ccc/caq.htm> (last visited May 22, 2014).

45 Nova Scotia Legislature, Community Interest Companies Act, Chapter 38 of the Acts of 2012, §17 available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/b153.htm (last visited April 21, 2014).

46 See David C.K. Tang, Community Contribution Companies: Canada’s First Purpose-Built Social Enterprise or Social Entrepreneurship Organizational Structure, <http://www.gowlings.com/KnowledgeCentre/article.asp?pubID=2818>, (last visited May 22, 2014).

47 See Questions and Answers Community Contribution Companies, <http://www.fin.gov.bc.ca/prs/ccc/caq.htm> (last visited May 22, 2014).

48 Nova Scotia Legislature, Community Interest Companies Act, Chapter 38 of the Acts of 2012, available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/b153.htm (last visited April 21, 2014).

49 See Questions and Answers Community Contribution Companies, <http://www.fin.gov.bc.ca/prs/ccc/caq.htm> (last visited May 22, 2014).

50 Nova Scotia Legislature, Community Interest Companies Act, Chapter 38 of the Acts of 2012, available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/b153.htm (last visited April 21, 2014).

CHARITABLE STATUS

A C3 does not have charitable status under applicable law because it is not a charity or a “qualified donee”⁵¹ under the [Income Tax Act](#) and cannot issue income tax receipts for gifts or donations to it.⁵²

Similar to a C3, a CIC does not have charitable status under applicable law because it is not a charity or a “qualified donee”⁵³ under the [Income Tax Act](#) and cannot issue income tax receipts for gifts or donations to it.⁵⁴

REGULATOR

The formation and continuation of a C3 is not overseen by a regulator.

A CIC is regulated by the Registrar of Community Interest Companies who is appointed under Section 4 of the [Community Interest Companies Act](#) and in accordance with the [Civil Services Act](#).⁵⁵

REPORTING REQUIREMENTS

A C3 is required to annually publish a Community Contribution Report as prescribed by the [British Columbia Business Corporations Act](#). In addition to other requirements, the report must include a C3’s annual financial statements and the amount of dividends declared on all classes of shares.

The Community Contribution Report must be kept at the C3’s corporate records office, and if the C3 has a website, it must also be accessible online in order to increase transparency and accountability to the public.⁵⁶

CICs are required to produce an annual Community Interest Report as prescribed by Section 21 of the [Community Interest Companies Act](#).⁵⁷

Under Section 22 of the [Community Interest Companies Act](#), CICs are required to annually file a copy of its financial statements with the Registrar of Community Interest Companies.⁵⁸

In addition, under Section 25 of the [Community Interest Companies Act](#), a CIC is required to provide any information that satisfies the Registrar of Community Interest Companies in allowing a CIC to continue operating as a CIC.⁵⁹

51 [Income Tax Act](#), R.S.C., c. 1 (5th Supp.), (1985) (amended 2014), available at <http://laws-lois.justice.gc.ca/eng/acts/I-3.3/page-262.html#h-89> (last visited May 29, 2014).

52 See David C.K. Tang, [Community Contribution Companies: Canada’s First Purpose-Built Social Enterprise or Social Entrepreneurship Organizational Structure](#), <http://www.gowlings.com/KnowledgeCentre/article.asp?pubID=2818>, (last visited May 22, 2014).

53 [Income Tax Act](#), R.S.C., c. 1 (5th Supp.), (1985) (amended 2014), available at <http://laws-lois.justice.gc.ca/eng/acts/I-3.3/page-262.html#h-89> (last visited May 29, 2014).

54 See David C.K. Tang, [Community Contribution Companies: Canada’s First Purpose-Built Social Enterprise or Social Entrepreneurship Organizational Structure](#), <http://www.gowlings.com/KnowledgeCentre/article.asp?pubID=2818>, (last visited May 22, 2014).

55 Nova Scotia Legislature, [Community Interest Companies Act](#), Chapter 38 of the Acts of 2012, available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/b153.htm (last visited April 21, 2014).

56 See Brendan Burns, [British Columbia Community Contribution Company Update](#), <http://www.millerthomson.com/en/publications/newsletters/charities-and-not-for-profit-newsletter/april-2013/british-columbia-community-contribution> (last visited May 24, 2014).

57 Nova Scotia Legislature, [Community Interest Companies Act](#), Chapter 38 of the Acts of 2012, available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/b153.htm (last visited April 21, 2014).

58 Nova Scotia Legislature, [Community Interest Companies Act](#), Chapter 38 of the Acts of 2012, available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/b153.htm (last visited April 21, 2014).

59 Nova Scotia Legislature, [Community Interest Companies Act](#), Chapter 38 of the Acts of 2012, available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/b153.htm (last visited April 21, 2014).

ADVANTAGES

The following are advantages of having a C3:

1. DUAL PURPOSE – A C3 is able to carry on with the benefits of increasing profits for its shareholders without limiting the pursuance of a community purpose;
2. BENEFITS OF INCORPORATION – Please refer to Section 3.2 of this paper;
3. FIRST NATIONS – Under the C3 model, First Nations and aboriginal groups will be recognised as "qualified entities"⁶⁰ as prescribed by the Income Tax Act. This means that they may receive transfers of dividends or other assets (including outright gifts) from a C3, without the same restrictions that apply to transfers to other transferees⁶¹;
4. EQUITY INVESTMENT – C3s allow social enterprises to receive equity investment⁶²; and
5. EASE IN CREATING A C3 – Registering as a C3 or converting to a C3 is a simple process.

The following are advantages of having a CIC:

1. DUAL PURPOSE – A CIC is able to carry on with the benefits of increasing profits for its shareholders without limiting the pursuance of a community purpose;
2. BENEFITS OF INCORPORATION – Please refer to Section 3.2 of this paper;
3. EQUITY INVESTMENT – CICs allow social enterprises to receive equity investment⁶³; and
4. EASE IN CREATING A CIC – Registering as a CIC or converting to a CIC is deemed to be a simple process since it is similar to the process involved in creating a C3. However, since the [Community Interest Companies Act](#) is not yet in force, it is difficult to determine the lack of difficulty or ease involved.

DISADVANTAGES

The following are disadvantages of having a C3:

5. REGULATOR – C3s are not overseen by a government-appointed regulator. Rather, C3s are regulated by the public and also by a C3's shareholders; and
6. POLITICAL PURPOSE – Since the [British Columbia Business Corporations Act](#) does not explicitly prohibit a political purpose from being used as a C3's community purpose, it may be allowed.

The following are disadvantages of having a CIC:

7. PROPERTY ACQUISITION RESTRICTION – A CIC may not acquire any property, whether real or personal in joint tenancy. It may only hold property as tenants in common⁶⁴; and
8. MERGER RESTRICTION – A CIC can only amalgamate with another CIC.⁶⁵

60 Income Tax Act, R.S.C., c. 1 (5th Supp.), (1985) (amended 2014), available at <http://laws-lois.justice.gc.ca/eng/acts/I-3.3/page-262.html#h-89> (last visited May 29, 2014).

61 See Questions and Answers Community Contribution Companies, <http://www.fin.gov.bc.ca/prs/ccc/caq.htm> (last visited May 22, 2014).

62 Ibid.

63 Ibid.

64 Nova Scotia Legislature, Community Interest Companies Act, Chapter 38 of the Acts of 2012, available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/bi53.htm (last visited April 21, 2014).

65 Nova Scotia Legislature, Community Interest Companies Act, Chapter 38 of the Acts of 2012, available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/bi53.htm (last visited April 21, 2014).

4.4 WHAT HYBRID STRUCTURES ARE OR COULD BE USED TO ESTABLISH A BUSINESS WITH THE KEY CHARACTERISTICS OF A PPB?

As stated above, the Community Contribution Company available in British Columbia is a hybrid structure that could be used to establish a business with the key characteristics of a PPB.

In addition, and to be complete, the following are two concepts embedded in Canadian law that related to the concepts of a PPB. It is important to note that these are not corporate forms regulated by Canadian legislation.

- (a) **SOCIAL ENTERPRISE** – Social enterprises are not a legally recognised business structure under Canadian law. Reference to social enterprises as a hybrid structure is solely for the purpose of providing a comprehensive overview of possible PPB options.

The concept of a social enterprise is unclear.⁶⁶ This is primarily because there is no consensus, legal or otherwise, on what constitutes a social enterprise.⁶⁷ Various definitions, consisting of broad to narrow populate the different views on social enterprise. This section will consider the concept of social enterprise on a general basis and also within the Canadian context.

Generally, a social enterprise is a broad umbrella under which an organisation can operate as a business but also pursue social, cultural or community-oriented goals.⁶⁸ Therefore, and for example, under this definition, a cooperative can be formed to generate revenue and to also promote social, cultural or environmental objectives.

A social enterprise is not specifically limited to the corporate structure. A partnership may also qualify as a social enterprise. This is primarily because under Canadian partnership law, there are no statutory restrictions on the ways in which profits and losses of a partnership can be allocated.⁶⁹ Therefore, through the partnership agreement, partners may choose to allocate a portion of their profits to a community or social purpose.

- (b) **B CORP CERTIFICATION** – B Corps are not a specific corporate form and do not carry any legal significance under Canadian law. They are referenced in this paper to provide a thorough review of an additional avenue available to businesses interested in demonstrating a commitment to a social purpose.

66 See Robert Walkulak and Nabil Dhirnai, *Primer on Social Enterprise in Ontario* (2013) (unpublished manuscript) (on file with the OBA Institute).

67 Ibid. See also, Pauline O'Connor, *The New Regulatory Regime for Social Enterprise in Canada* (2014), available at <http://www.afpnet.org/Foundation/FoundationNewsDetail.cfm?ItemNumber=24761> (last visited May 29, 2014).

68 Pauline O'Connor, *The New Regulatory Regime for Social Enterprise in Canada* (2014), available at <http://www.afpnet.org/Foundation/FoundationNewsDetail.cfm?ItemNumber=24761> (last visited May 29, 2014).

69 See Alison Manzer, *A Practical Guide to Canadian Partnership Law*, (Carswell 1994).

As noted in Section 1.3 of this paper, certification of a business as a Certified B Corporation is provided by B Lab, which is Pennsylvania-based non-profit organisation. B Lab has a unique partnership with the MaRS Centre for Impact Investing, which is a social financial hub and project incubator for mobilising private capital for social purposes. Through its partnership with B Lab, the MaRS Centre for Impact Investing is internationally recognised as the Canadian B Corp Hub.

The process of attaining certification as a B Corp involves evaluation by B Lab of a business' candidacy by considering certain criteria, such as, environmental performance, accountability and transparency.⁷⁰ The evaluation criteria vary depending on the company's industry and size.⁷¹

Once a company is certified as a B Corp, it is listed online. B Lab's online listing allows individuals, and socially conscious investors to review a B Corp's profile, reports and statistics in order to measure and evaluate their impact on the specified community objective.⁷²

5 OTHER METHODS OF IMPLEMENTATION

5.1 WILL APPLICABLE LAW RESPECT CONTRACT TERMS ESTABLISHING AND/OR PROTECTING A SOCIAL PURPOSE?

The [Canada Business Corporations Act](#) will respect contract terms given that they do not conflict with the statutory requirements or governing documents of the entity's structure. As stated herein, there is no express prohibition under federal or provincial law that would restrict an organisation's decision to incorporate a social purpose into its governing documents. However, whether such a purpose would be enforceable and whether pursuit of such a purpose would conflict with the fiduciary duties of directors, as traditionally interpreted, is not clear.

Applicable provincial legislation will also respect contract terms establishing and/or protecting a social purpose given that the contract terms establishing and/or protecting a social purpose comply and do not conflict with the definition of social purpose as defined in the respective legislation. Please refer to Sections 1.3 and 2.1(a) of this paper for a more comprehensive discussion on a C3 and CIC's community purpose.

70 See Certified B Corporation, <https://www.bcorporation.net/become-a-b-corp/why-become-a-b-corp/protect-your-mission> (last visited May 29, 2014)

71 B Lab established a five-step process for forming and maintaining a B Corp. See Certified B Corporation, <https://www.bcorporation.net/become-a-b-corp/why-become-a-b-corp/protect-your-mission> (last visited April 21, 2014).

72 See <http://b-analytics.net/> (last visited May 29, 2014).

6 ADDITIONAL CONTROLS OVER PPB STRUCTURES

6.1 WHAT OTHER LEGAL OBLIGATIONS OR CONTROLS OVER THE SOCIAL PURPOSE APPLY TO PPB STRUCTURES UNDER APPLICABLE LAW? ARE THESE REQUIREMENTS MANDATORY OR PERMISSIVE?

In addition to the legal obligations mentioned above, the following also apply to a legally recognised PPB structure under applicable provincial law.

(a) Additional Transparency Measures

- (i) **COMMUNITY CONTRIBUTION COMPANY** – In addition to the transparency measures outlined in Section 2.1(c) of this paper, the [British Columbia Business Corporations Act](#) restricts a C3 from amalgamating or merging into other jurisdictions. This is primarily due to two reasons. First, there is lack of assurance in determining whether or not asset lock provisions, or notice requirements as set out by the [British Columbia Business Corporations Act](#) will be preserved in other provincial jurisdictions.⁷³ Second, the [British Columbia Business Corporations Act](#) seeks to maintain the heightened level of transparency required for a C3 structure.
- (ii) **COMMUNITY INTEREST COMPANY** – In addition to the transparency measures outlined in Section 2.1(c), a CIC, if and when approved in Nova Scotia, would be subject to the following two measures. First, a CIC would only be able to declare dividends in accordance with the regulations and the [Companies Act](#). Second, a CIC would also be restricted from giving away assets for less than fair market value, unless the recipient of the assets is a registered charity, a society under the [Societies Act](#) (Nova Scotia) or a non-profit association under the [Cooperative Associations Act](#) (Nova Scotia). These two requirements would encourage accountability and transparency within the CIC structure.

(b) Asset Lock

- (i) **COMMUNITY CONTRIBUTION COMPANY** – A C3 can pay dividends to its shareholders, but it is subject to an asset lock requirement in order to ensure that the assets and profits of a C3 are dedicated to the C3's prescribed community purpose.

Under the asset lock obligation, there is a strict limit on the amount of dividends that can be paid out to shareholders. The cap on the amount that can be paid in dividends is 40 per cent of a C3's annual profits.⁷⁴

⁷³ See David C.K. Tang, *Community Contribution Companies: Canada's First Purpose-Built Social Enterprise or Social Entrepreneurship Organizational Structure*, <http://www.gowlings.com/KnowledgeCentre/article.asp?pubID=2818>, (last visited May 22, 2014).

⁷⁴ See *Questions and Answers Community Contribution Companies*, <http://www.fin.gov.bc.ca/prs/ccc/caq.htm> (last visited May 22, 2014).

In addition, there is also a limit on the amount of assets shareholders may receive if the business is dissolved.⁷⁵ Therefore, in the case of a voluntary dissolution, 60 per cent of the C3's assets must be transferred to qualified entities (i.e. charitable organisations or other asset-locked entities)⁷⁶, while the other 40 per cent of assets may be distributed to the shareholders of a C3.⁷⁷

In the case of an involuntary dissolution, all assets owned by a C3 would be transferred to the government and would only be returned to the C3 if it would be able to rectify and restore its status to the corporate register.⁷⁸ The purpose of the asset lock measure is to confirm that the profits and assets are in fact being directed to the company's community objectives.⁷⁹ This is one of the major differences between a C3 and a traditional business company.

- (ii) **COMMUNITY INTEREST COMPANY** – A CIC would also be subject to an asset lock requirement. A dividend could not be declared unless authorised by applicable regulations and the Nova Scotia [Companies Act](#).⁸⁰ Furthermore, upon dissolution, a prescribed percentage of the CIC's distributable assets would be required to be transferred to one or more "qualified entities." Qualified entities are defined as non-profit associations, societies incorporated under the [Societies Act](#), registered charities or prescribed entities.

(c) Profits Lock

- (i) **COMMUNITY CONTRIBUTION COMPANY** – A C3 is subject to a profits lock requirement. Under this obligation, the majority of a C3's profits must either be: (a) directed to the C3's community purpose as outlined in the C3's notice of articles; or (b) be "transferred to a qualified entity, such as a charity."⁸¹
- (ii) **COMMUNITY INTEREST COMPANY** – Similar to a C3, a CIC would also be subject to a profits lock requirement, where profits of a CIC would be required to be directed to the community purpose outlined in the CIC's Memorandum of Association.

75 Business Corporations Act, Chapter 57, Part 2.2, §51.95 (2002) available at http://www.bclaws.ca/civix/document/id/complete/statreg/02057_00 (last visited May 29, 2014).

76 Ibid.

77 Ibid. See also <http://www.lexology.com/library/detail.aspx?g=90f8b239-6aea-46c4-b585-6630f28886fb> (last visited May 29, 2014).

78 British Columbia Legislature, Business Corporations Act, Chapter 57, Part 2.2, §51.91(1) (2002) available at http://www.bclaws.ca/civix/document/id/complete/statreg/02057_00 (last visited May 29, 2014).

79 Ibid.

80 Nova Scotia Legislature, Community Interest Companies Act, Bill 153, Chapter 38 of the Acts of 2012, §15(1) (2012) available at http://nslegislature.ca/legc/bills/61st_4th/3rd_read/b153.htm (last visited April 21, 2014).

81 British Columbia Legislature, Finance Statutes Amendment Act, Bill 23, (2012) available at http://www.leg.bc.ca/39th4th/1st_read/gov23-1.htm (last visited May 28, 2014).

(d) Mission Lock

C3s and (if CICs are adopted) are not subject to a specific mission lock requirement. A company can abandon its mission at any point in time without facing any repercussions. Specifically, when a C3 company is incorporated, one or more of the primary purposes of a Community Contribution Company must be community purposes and those community purposes must be set out in its articles. A company can make amendments to its articles of incorporation which would therefore allow a company to reflect different or additional community purposes.

(e) Enforcement Mechanisms

- (i) **COMMUNITY CONTRIBUTION COMPANY** – Since the [British Columbia Business Corporations Act](#) does not provide for a regulator, the appropriate enforcement mechanisms to monitor a C3 are the shareholders and the public.
- (ii) **COMMUNITY INTEREST COMPANY** – When and if the regulations are approved, a CIC would be monitored by the Registrar of Community Interest Companies, who has the power to dissolve a CIC if it fails to meet applicable regulatory standards.

(f) Change of Control:

- (i) **COMMUNITY CONTRIBUTION COMPANY** – A C3 may transfer its assets without any restriction to registered charities, community service co-operatives, and also to any organisations that registered charities are allowed to transfer their assets to under federal income tax legislation (i.e. First Nations and aboriginal groups).⁸²
- (ii) **COMMUNITY INTEREST COMPANY** – A CIC would be permitted to transfer its assets to a qualified entity (either a not-for-profit or a charity) only for fair market value in order to further the CIC's community purpose given that the change in control meets the standards of applicable law. A CIC would not be permitted to transfer its assets or control by way of financial assistance unless it is in accordance with Section 13 of the [Community Interest Companies Act](#).

⁸² British Columbia Legislature, Finance Statutes Amendment Act, Bill 23 §51.931 (2012) available at http://www.leg.bc.ca/39th4th/1st_read/gov23-1.htm (last visited May 28, 2014).

7 ACCESS TO INVESTMENT CAPITAL

7.1 TAX INCENTIVES

As noted in Section 3.3, C3s (and when and if CICs are authorized) are not exempt from paying income taxes since they are both forms of a profit-making company. C3s (and CICs) are subject to the same regulations and requirements under the [Income Tax Act](#) as other profit-generating companies.

Under the [Income Tax Act](#) with respect to a corporation formed under the [Canada Business Corporations Act](#) with a social mission in its articles and bylaws, it is permitted to deduct up to 75 per cent of annual income provided the income is appropriated as charitable donations.⁸³

7.2 INVESTMENT STRUCTURES

C3s (and when and if CICs are authorized), along with share capital corporations, are subject to the registration and disclosure requirements outlined within the [Securities Act](#) should they choose to offer shares to the public. Unless a C3 (or a CIC when and if authorized by Nova Scotia) falls within one of the various exemptions provided by the [Securities Act](#), they will both be subject to the same investment structures that are available to share capital corporations. The [Securities Act](#) exemptions allow a company to raise capital without issuing a prospectus in certain circumstances. Therefore, a socially conscious investor seeking to protect the deployment of its investment capital for intended purpose would primarily rely on contractual restrictions on the use of funds and business activity of a PPB structure.

7.3 BARRIERS TO ACCESSING INVESTMENT

There are no apparent barriers in terms of accessing investment for C3s (and when and if CICs are authorized by Nova Scotia) since they are eligible for financing structures akin to share capital corporations. However, there may likely be an issue concerning the management of potentially competing interests among investors and socially conscious requirements prescribed under applicable legislation. It may lead to a restriction pertaining to investment in new entity forms that aim to produce both social and financial returns because of the perception that a double bottom line will conflict with profit-maximisation.

⁸³ [Income Tax Act](#), R.S.C., c. 1 (5th Supp.), §256 (1985) (amended 2014), available at <http://laws-lois.justice.gc.ca/eng/acts/I-3.3/page-262.html#h-89> (last visited May 29, 2014).

7.4 RISK

The risk associated with structuring a business as a C3 (or if approved, a CIC) is significantly low. This is primarily because C3s (and if approved CICs) are not subject to a mission lock requirement. A company can abandon its mission at any point in time without facing any repercussions. However, there may likely be a risk associated with attracting investment. Socially conscious investors will likely invest in a PPB structure over a traditional share capital corporation. However, in balancing the likelihood of socially conscious investor trends with investors who are interested in solely maximising their investment, it is difficult to discern the actual level of risk and implications.

FRANCE



FRANCE

1 COUNTRY OVERVIEW

French law does not provide for a specific legal form designed for profit-with-purpose businesses (“**PPB**”) and there is currently no public proposal to legislate new specific corporate forms. However, there is no legal barrier under French law that prevents the integration of a social purpose into the for-profit entities that a PPB may utilize in France. In particular, although a for-profit entity in France must be created with the aim of sharing profits or savings between its shareholders, it is not required to be operated in a way that maximizes its financial return to its shareholders or owners. Specifically, a for-profit entity in France may have a primary or secondary purpose to create a social or environmental benefit as long as such purpose is embedded in the definition of the “corporate purpose” in its articles of association. The directors or managers can then take into account the interest of groups other than the shareholders or owners and could be held accountable whenever they act in a way that goes against the corporate purpose defined in the articles of association.

The law n°2014-856 relating to the social and solidarity economy (the “**SSE Law**”) that seeks to further promote the social sector through a more robust legal framework was adopted by the French Parliament on July 31, 2014. This SSE Law, however, focuses only on associations, foundations and cooperatives, and does not consider any new legal forms. It amends the current legal framework applicable to these three enterprises considered to be part of the social and solidarity economy to promote further access to financing of these businesses and their ability to scale successfully and efficiently.

Some authors suggest legal developments and in particular the introduction of a new corporate form: a company of social interest, in French, **SOCIÉTÉ D’INTÉRÊT SOCIAL** or “**SIS**”. An **SIS** could take various conventional legal forms but would guarantee the social purpose of its founders. Such a company could help promote the social sector by being very reassuring for investors interested in promoting a double or triple bottom line. Daniel Hurstel, in *La nouvelle économie sociale, Pour reformer le capitalisme*, proposes that the law should not require specific governance terms, but should instead grant the founders of the business the choice of the most suitable methods to promote the business’ social mission.

In general, a PPB can choose between:

- **COOPERATIVES**, and
- **CONVENTIONAL FOR-PROFIT CORPORATE FORMS** as French law does not prohibit PPBs from choosing any suitable legal form.⁸⁴

⁸⁴ The foundation, association and the mutual aid company are not-for-profit structures, and are, therefore, outside the scope of the Report and not discussed herein.

In this respect, it is worth noting that businesses pursuing certain social purposes are differently regulated in order to guarantee the quality of the service provided. Some social activities are thus subject to prior approval of the competent public authorities and a range of additional legal requirements. They are called "*activités réglementées*" ("regulated activities"). For example, home care services are subject to such legal rules.

- (i) **COOPERATIVES**, regulated by Act n°47-1775 dated as of 10 September 1947 on the statute of cooperation, are subject to limitations with respect to their purpose, and also have strict limitations on profit distribution.

The purpose of a cooperative is to produce or furnish less expensive or better quality products for its members. Its governance is based on the principle of "one shareholder, one vote". The shareholders can only receive ownership interest in an amount corresponding to their participation in the business, at a rate capped by the applicable legal rules. In addition, the profits of a cooperative can only be distributed pro rata based on the amount of work performed by each member (usually in the form of discounts). Further, any excess capital remaining at the time of dissolution cannot be returned to the shareholders. A new form of cooperative, called the collective interest cooperative, was introduced by Act n°85-703 dated as of 17 July 2001. This company must produce goods or furnish services that benefit the collective interest or respond to needs that are not satisfactorily addressed by the free market. This cooperative form has a broader purpose than conventional cooperatives. The profit lock for this type of cooperative is the most stringent, as no less than 50% of the cooperative's profits are subject to a mandatory statutory reserve that is not capped in any way.

Neither the cooperative nor the collective interest cooperative company is therefore an ideal fit for a PPB when the goals for the entity include flexible governance rules, no restriction on corporate purpose and freedom to distribute all profits.

- (ii) **CONVENTIONAL FOR-PROFIT LEGAL FORMS** are, in contrast to the cooperatives, the most flexible for implementing the double or triple bottom line of a PPB. In practice, it has long been recognised that a for-profit company could be part of the social and solidarity economy when (i) having specific social purpose and (ii) following some governance principles, without seeing their validity being challenged by these purpose or requirements. However, because these companies were not designed to promote a social purpose, it is important to recognize that French law provides that a for-profit company is created by two or more shareholders who aim at sharing profits or savings between them. Nevertheless, the creation of such a company is governed by the freedom to contract principle that allows its founders to shape their business the way they prefer. Therefore, a company that seeks to implement a double or triple bottom line must clearly express its social and/or environmental purpose in its corporate governance documents. Moreover, the law provides that directors must seek to further the company's interest. The company's

interest is the subject of doctrinal debate as it is not defined by the law itself. One could consider that it is nothing but the interest of the company itself, different from the personal interest of its shareholders. The company’s interest can then be confused with the company’s purpose stated in the articles of association. The directors would therefore be able to consider the interest of the third parties who would benefit from the business achieving its double or triple bottom line, in contrast to exclusively serving the interest of the shareholders themselves. Under this situation, where social purpose is clearly defined in the corporate governance documents, the shareholders could hold the directors accountable for failing to follow their mandate.

Against this background, this Report describes the legal framework applicable to PPBs incorporated as conventional for profit businesses.

2 LEGAL FOUNDATIONS FOR PROFIT-WITH-PURPOSE BUSINESSES

A business can be formed under French law with the characteristics of a PPB. However, French corporate law does not specifically protect the social purpose of a PPB incorporated as a conventional company. In addition, French corporate law may limit the extent to which a PPB can fulfil its social purpose.

(a) Social purpose

A conventional for-profit legal entity can seek to have social impact provided that this purpose is not contrary to public policy or morality, and to the extent applicable, complies with all other regulations, for example, such as for a home care services business.

French law does not require profit maximization to the exclusion of other corporate purposes, including social and/or environmental impact. On the contrary, French law tends to consider the company’s interest itself, driven by the purpose of the company that could depart from the interest of the shareholders. The company is its own entity that must be guided by its articles of association. That would include promoting a social and/or environmental purpose if that is specified in the articles of association. However, pursuant to article 1832 of the French Civil Code, the essence of a company is to share profits and savings among its shareholders, without which no valid company could exist. As a result, French courts could require a conventional, for-profit company with a sole or primary social and non financial purpose to be converted into an association. This risk, however, is seen as being highly theoretical by the majority of the French doctrine. They also tend to consider that, today, the essence of a company could also be found in the sharing of losses among its shareholders. The rule provided for in the French Civil Code only prohibits corporate activity that does not seek any profit for the company (such as a donation or any other selfless act), which would be contrary the company’s interest,

and as such, voidable or likely to give rise to director liability. In addition, pursuant to article 1844-1 of the French Civil Code, shareholders cannot be fully excluded from the company's profits. Clauses excluding the shareholders from the profits at the company's dissolution have been, however, ruled valid by the courts since 1900.

The social purpose of a PPB must therefore be embedded in the definition of the corporate purpose in the articles of association. Corporate law then provides rules and remedies to ensure that management complies with the corporate purpose. For example, except in the case of limited liability companies such as the “**SOCIÉTÉS PAR ACTIONS SIMPLIFIÉE**” and “**SOCIÉTÉS À RESPONSABILITÉ LIMITÉE**”, the company is not bound by the directors' acts which fall outside the corporate purpose as defined in the articles of association, and therefore, which fall outside the social purpose in the specific case of a PPB. Therefore, the drafting of the company's purpose within the articles of association cannot be taken lightly by the founders of a PPB as it is precisely that drafting that would allow the company to further its social impact consistent with French law.

(b) Duties

No distinction is drawn between the duties of directors of conventional for-profit companies and PPBs. The law only provides that the powers of the directors are to represent the company and perform any act that is in the company's interest but does not specifically provide for the directors' duties. As a result, the directors' duties are governed by the decision of the French courts that imposes a general duty of loyalty. The directors draw their powers from the articles of association. Therefore, they have to conduct their management with care, diligence and loyalty and act within the scope of the articles of association. When the company's purpose seeks to consider the interest of groups other than the shareholders and/or furthering the social purpose of the business, the directors are responsible for this. Underlying this principle is the fact that the shareholders agreed to such a management prerogative when setting up the business and adopting the articles of association. Consequently, directors may be liable where management fails to carry out the company's interest or breaches the articles of association. A director who does not respect the corporate purpose is then very likely to be found in breach of the duties owed to the shareholders. The corporate law allows shareholders to remove directors for wilful misconduct, mismanagement and/or impose liability when they do not follow their mandate as the company's director. However, such legal action is usually not easily implemented since it could be difficult to bring proof of mismanagement to the courts.

(c) Transparency regarding achievement of social impact purpose

PPBs that are incorporated as a conventional legal form and that are not conducting an “*activité réglementée*” or regulated activity, are not legally required to prepare periodically a report of the performance of the business using an impact measurement standard. However, their shareholders may hold different kinds of rights that ensure a certain degree of transparency regarding achievement of the social purpose as specified

in the articles of association. Moreover, when a company employs a certain number of employees and profit targets, it is subject to more stringent obligations for disclosure in the company’s annual report.

3 LEGAL FORMS ARE AVAILABLE FOR PROFIT-WITH-PURPOSE BUSINESSES

3.1 OVERVIEW OF LEGAL FORMS OF ORGANISATION AVAILABLE TO PROFIT-WITH-PURPOSE BUSINESSES

Any conventional legal form may be used for PPBs, subject to the limitations of French corporate law discussed above.

The great latitude given by the “**SOCIÉTÉ PAR ACTION SIMPLIFIÉE**” makes it the preferred legal form for social entrepreneurs. First, this legal form, introduced in France in 1994, allows the corporate governance mechanisms to be largely determined in the articles of association rather than by law. The “**SOCIÉTÉ PAR ACTIONS SIMPLIFIÉE**” has gained wide-spread acceptance as its contractual nature allows for a tailor-made organisation. For instance, the articles of association of the “**SOCIÉTÉ PAR ACTIONS SIMPLIFIÉE**” may include provisions limiting the powers of the company’s managers. Such provisions could, in the absence of prior approval of the shareholders or an ad hoc body, prohibit decisions by managers that interfere with the promotion of the social and/or environmental purpose. The “**SOCIÉTÉ PAR ACTIONS SIMPLIFIÉE’S**” articles of association can also provide for a statutory body, either a board of directors or a committee, in which investors and shareholders can be assigned a role by the company’s management and thus be responsible for and control the implementation of the social purpose. Furthermore, the articles of association can provide different rights (whether financial or non-financial) to different stakeholders (i.e., founders, investors etc.) to ensure that the social purpose is met. Second, the legal form of the “**SOCIÉTÉ PAR ACTIONS SIMPLIFIÉE**” provides for a structure in which shareholder liability is limited to each shareholder’s financial contribution.

3.2 WHAT LEGAL FORMS OF ORGANISATION ARE AVAILABLE TO BUSINESSES GENERALLY THAT COULD BE USED TO FORM A PROFIT-WITH-PURPOSE BUSINESS?

NB: The following are not included in this chart:

- the “**SOCIÉTÉ ANONYME**”, which offers the same advantages as the “**SOCIÉTÉ PAR ACTIONS SIMPLIFIÉE**” but is not as flexible. It must comply with rules that are rather cumbersome and require at least seven (7) shareholders and a € 37,000 minimum share capital; and

- the "SOCIÉTÉ EN COMMANDITE PAR ACTIONS" which is similar to the "SOCIÉTÉ EN COMMANDITE SIMPLE" but subject to more onerous rules of operation that require at least four (4) shareholders and a € 37,000 minimum share capital.

BALANCING PURPOSE AND PROFIT
LEGAL MECHANISMS TO LOCK IN SOCIAL MISSION FOR “PROFIT WITH PURPOSE” BUSINESSES ACROSS THE G8

	SOCIÉTÉ CIVILE	SOCIÉTÉ EN NOM COLLECTIF	SOCIÉTÉ EN COMMANDITE SIMPLE	SOCIÉTÉ À RESPONSABILITÉ LIMITÉE	SOCIÉTÉ PAR ACTIONS SIMPLIFIÉE
OWNERSHIP	<ul style="list-style-type: none"> - At least two (2) shareholders - No limitation on their identity 	<ul style="list-style-type: none"> - At least two (2) shareholders - No limitation on their identity 	<ul style="list-style-type: none"> - Two (2) types of shareholders: <ul style="list-style-type: none"> » the “<i>commandités</i>” who run the company, and » the “<i>commanditaires</i>” who are the capital providers. - At least two (2) shareholders of each type - No limitation on their identity 	<ul style="list-style-type: none"> - At least one (1) shareholder (in this case, the company is called the “<i>entreprise unipersonnelle à responsabilité limitée</i>” or “<i>EURL</i>”), maximum one hundred (100) shareholders - No limitation on their identity, except for the shareholder of the “<i>EURL</i>” who cannot be another “<i>EURL</i>” 	<ul style="list-style-type: none"> - At least one (1) shareholder - No limitation on their identity
GOVERNANCE	<ul style="list-style-type: none"> - Managed by one or several managers, no limitation on their identity - The shareholders general meetings make the collective decisions that exceed the powers of the managers. The articles of association freely set the terms and conditions of the shareholders’ meetings 	<ul style="list-style-type: none"> - Managed by one or several managers, no limitation on their identity. All shareholders are managers unless otherwise provided for in the articles of association - At least an annual shareholders general meeting has to be held. Shareholders decisions to be made unanimously, unless otherwise provided for in the articles of association as regards to certain but not all types of decisions 	<ul style="list-style-type: none"> - Managed by one or several managers who are either “<i>commandités</i>” or non-shareholders. All “<i>commandités</i>” shareholders are managers unless otherwise provided for in the articles of association - At least an annual shareholders general meeting has to be held to approve the financial statements. Articles of association free to determine the majority rules - Decisions involving amendment to the articles of association are taken during extraordinary general meeting with the consent of all the “<i>commandités</i>” and a majority in number and capital of the “<i>commanditaires</i>” 	<ul style="list-style-type: none"> - Managed by one or several managers, whether shareholders or not, natural or legal persons - At least an annual shareholders general meeting has to be held to approve the financial statements (simple majority) - Decisions involving amendment to the articles of association are taken at extraordinary general meeting by two thirds (2/3) of the votes 	<ul style="list-style-type: none"> - Freely determined by the articles of association - Some decisions have to be taken collectively by the shareholders (in general meeting or by other means): approval of accounts and profits distribution, change of share capital, merger, dissolution of the company, transformation of the company into another form of company, etc., as well as decisions that require the unanimous agreement of the shareholders (such as any increase in the commitment of the shareholders)
OBJECTS	Its purpose has to be “civil”, meaning a purpose to which the law does not assign another qualification because of its form, nature or object. For example, it may not be to perform any of the commercial activities listed in the Commercial Code (mainly agricultural and liberal professions such as doctors or lawyers)	Any kind of activities, except for some (such as doctors or lawyers)	Any kind of activities, except for some (such as doctors or lawyers)	Any kind of activities, except for some (such as doctors or lawyers)	Any kind of activities, except for some (such as doctors or lawyers)
SOCIAL PURPOSE	No social purpose requirement	No social purpose requirement	No social purpose requirement	No social purpose requirement	No social purpose requirement

BALANCING PURPOSE AND PROFIT
 LEGAL MECHANISMS TO LOCK IN SOCIAL MISSION FOR “PROFIT WITH PURPOSE” BUSINESSES ACROSS THE G8

	SOCIÉTÉ CIVILE	SOCIÉTÉ EN NOM COLLECTIF	SOCIÉTÉ EN COMMANDITE SIMPLE	SOCIÉTÉ À RESPONSABILITÉ LIMITÉE	SOCIÉTÉ PAR ACTIONS SIMPLIFIÉE
PROFITS	Distribution among the shareholders	Distribution among the shareholders	Distribution among the shareholders	<ul style="list-style-type: none"> - Distribution among the shareholders - Legal reserve of 10% of the share capital required 	<ul style="list-style-type: none"> - Distribution among the shareholders - Legal reserve of 10% of the share capital required
LIMITED LIABILITY FOR OWNERS	Unlimited liability for shareholders	Several and joint liability for shareholders	<ul style="list-style-type: none"> - Several and joint liability for “<i>commandités</i>” - Limited liability for “<i>commanditaires</i>” 	Limited liability for shareholders	Limited liability for shareholders
TRANSFERS OF OWNERSHIP	The ownership of the entity can be transferred separately from the assets	<ul style="list-style-type: none"> - The ownership of the entity can be transferred separately from the assets - Notwithstanding any contrary provisions of the articles of association, the shares cannot be sold, even between the shareholders themselves, without a unanimous decision of the shareholders 	<ul style="list-style-type: none"> - The ownership of the entity can be transferred separately from the assets - The shares cannot be sold, even between the shareholders themselves, without a unanimous decision of the shareholders, unless otherwise provided for in the articles of association 	<ul style="list-style-type: none"> - The ownership of the entity can be transferred separately from the assets - The shares cannot be transferred to third parties (non-shareholders) without the consent of the majority of shareholders representing at least half of the shares, the articles of association can provide for a higher majority - The transfers of shares between shareholders, spouses, parents and children are free but the articles of association may provide for the same restrictions that apply to external transfers 	<ul style="list-style-type: none"> - The ownership of the entity can be transferred separately from the assets - The shares are freely transferable, unless otherwise provided for in the articles of association
DEBT FINANCING	Yes	Yes	Yes	Yes	Yes
EQUITY FINANCING	Yes	Yes	Yes	Yes	Yes

BALANCING PURPOSE AND PROFIT
 LEGAL MECHANISMS TO LOCK IN SOCIAL MISSION FOR “PROFIT WITH PURPOSE” BUSINESSES ACROSS THE G8

	SOCIÉTÉ CIVILE	SOCIÉTÉ EN NOM COLLECTIF	SOCIÉTÉ EN COMMANDITE SIMPLE	SOCIÉTÉ À RESPONSABILITÉ LIMITÉE	SOCIÉTÉ PAR ACTIONS SIMPLIFIÉE
TAX TREATMENT	<ul style="list-style-type: none"> - No tax at the corporate level (“fiscal transparency”) - Option for corporate tax possible. - Could trigger tax reclassification of the activity of the company in commercial operation 	<ul style="list-style-type: none"> - No tax at the corporate level (“fiscal transparency”) - Option for corporate tax possible. 	<ul style="list-style-type: none"> - The “<i>commandités</i>”: no tax at the corporate level; income tax on the share of social profits (distributed or not), corresponding to its rights in company - The “<i>commanditaires</i>”: no tax at the corporate level; corporate tax on the share of social profits (distributed or not), corresponding to its rights in company 	<ul style="list-style-type: none"> - Corporate tax (33%) - Option for income tax subject to certain conditions 	<ul style="list-style-type: none"> - Corporate tax (33%) - Option for income tax subject to certain conditions
DISSOLUTION	The proceeds of the sale of the assets are shared among the creditors first and then, any remaining amount, is shared among the shareholders according to the provisions of the articles of association	The proceeds of the sale of the assets are shared among the creditors first and then, any remaining amount, is shared among the shareholders according to the provisions of the articles of association	The proceeds of the sale of the assets are shared among the creditors first and then, any remaining amount, is shared among the shareholders according to the provisions of the articles of association	The proceeds of the sale of the assets are shared among the creditors first and then, any remaining amount, is shared among the shareholders according to the provisions of the articles of association	The proceeds of the sale of the assets are shared among the creditors first and then, any remaining amount, is shared among the shareholders according to the provisions of the articles of association
CHARITABLE STATUS	No charitable status	No charitable status	No charitable status	No charitable status	No charitable status
REGULATOR	No government or independent regulator responsible for regulating the entity	No government or independent regulator responsible for regulating the entity	No government or independent regulator responsible for regulating the entity	No government or independent regulator responsible for regulating the entity	No government or independent regulator responsible for regulating the entity
REPORTING REQUIREMENTS	No specific reporting requirements	No specific reporting requirements	No specific reporting requirements	No specific reporting requirements	No specific reporting requirements

	SOCIÉTÉ CIVILE	SOCIÉTÉ EN NOM COLLECTIF	SOCIÉTÉ EN COMMANDITE SIMPLE	SOCIÉTÉ À RESPONSABILITÉ LIMITÉE	SOCIÉTÉ PAR ACTIONS SIMPLIFIÉE
ADVANTAGES	<ul style="list-style-type: none"> - No requirement of minimum share capital - Governance freely determined by its article of association 	<ul style="list-style-type: none"> - No requirement of minimum share capital. - Stability of the managers (unanimously dismissed, or if the manager is not named in the articles of association, to another majority). - Opportunity to "close" the company (transfer of shares decided unanimously) 	<ul style="list-style-type: none"> - No requirement of minimum share capital. - Facilitates the association between: <ul style="list-style-type: none"> - People who "have ideas or know-how" and are willing to take risks in exchange for relative freedom of action, and - people who have capital and want to limit their liability while having a right to control management. - Stability of managers (unanimous decision of the members) 	<ul style="list-style-type: none"> - No requirement of minimum share capital - Liability limited to the capital contributions - Evolving structure facilitating partnership 	<ul style="list-style-type: none"> - No requirement of minimum share capital - Contractual flexibility: freedom for the shareholders to determine the rules of operation and transfer of shares - Liability limited to the capital contributions. - Evolving structure facilitating partnership - Ability to grant options to subscribe for or purchase shares to officers and / or employees of the company - Credibility vis-à-vis stakeholders (bankers, customers, suppliers)
DISADVANTAGES	<ul style="list-style-type: none"> - Limitations on its object - Unlimited liability of the shareholders 	<ul style="list-style-type: none"> - Several and joint liability of its shareholders - Operational constraints (collective decisions) - Difficulty to leave the company 	<ul style="list-style-type: none"> - Complex tax system. - Joint and several liability of the "commandités" - Restrictions on transfer of shares 	<ul style="list-style-type: none"> - Operational constraints. - Restrictions on transfer of shares 	<ul style="list-style-type: none"> - Care to drafting of the articles of association

3.3 WHAT LEGAL FORMS OF ORGANISATION, IF ANY, HAVE BEEN SPECIFICALLY DESIGNED FOR PROFIT-WITH-PURPOSE BUSINESSES?

No legal form has been specifically designed for PPBs in France.

3.4 WHAT HYBRID STRUCTURES ARE OR COULD BE USED TO ESTABLISH A BUSINESS WITH THE KEY CHARACTERISTICS OF A PROFIT-WITH-PURPOSE BUSINESS?

There is no *per se* hybrid form that combines for-profit, not-for-profit entities and/or social enterprises within an organisational structure in French law. However, it is worth mentioning the corporate foundation, governed by the Act n°87-571 of 23 July 1987, that is a philanthropic tool for economic actors.

The corporate foundation is created for a specified period that cannot be less than five years and no funding partner can exit from the foundation before having paid in full the sum it committed to pay to the foundation. The corporate foundation is intended to consume all its resources. The money and property remaining unexpended at the dissolution of the foundation cannot be returned to the founders or transferred to another corporate foundation. In case of dissolution, the remaining resources are assigned by the liquidator to one or more public or recognised public charities whose activity is similar to the one previously pursued by the dissolved corporate foundation.

The SSE Law provides for two measures that seek to facilitate foundations' access to financing. First, corporate foundations are now able to receive donations from the shareholders, the executive officers, or the adherents of the founding company or of the companies belonging to the same group. Second, foundations have now the right to issue bond securities called "*titre fondatif*", a kind of equity-type loan, the regime of which is the same as the "*titre associatif*" issued by French associations.

4 OTHER METHODS OF IMPLEMENTATION

The founders of a company or, subsequently, its shareholders, can specify the social purpose or impact in its articles of association and/or in a shareholder agreement. The amendments to the articles of association are subject to a decision of an extraordinary meeting of the shareholders in most legal forms that require, in the example of the "*société à responsabilité limitée*", a majority of two thirds (2/3) of the votes. An amendment to a shareholders' agreement would require the consent of all the signatories. Significantly, the breach of provisions of the articles of association could result in the nullity of the action causing the breach whereas a breach of a shareholders' agreement merely gives rise to a claim for damages.

In this regard, it should be emphasized that some legal forms (such as the “*société par actions simplifiée*”) are more flexible than others when it comes to specifying a social purpose. Using the “*société par actions simplifiée*”, means that the shareholder’s agreement is no longer required to organise the company. In this regard, rights and obligations of the company can be shared between the articles of association and the shareholders’ agreement. As noted above, the “*société par actions simplifiée*” is generally the preferred legal form for a PPB to ensure that its social purpose can be achieved.

(a) Additional transparency measures

The articles of association, a shareholders’ agreement or an investment contract can provide for any transparency measures considered suitable for the operation of the PPB.

(b) Asset lock

The articles of association can restrict the sale or disposition of the company’s assets, within the limits of the applicable law. The shareholders’ agreement can specify the terms and conditions for sale or disposition of the company’s assets and, for instance, submit the decision to the approval of one or more shareholders. The shareholders must, however, recognise that the legal requirements applicable under insolvency proceedings will prevail over the stipulations of the articles of association and/or shareholders’ agreement.

(c) Profits lock

The articles of association can limit the right of the shareholders to the profits of the company. Corporate law imposes one limit, already described above. Pursuant to article 1844-1 of the French Civil Code, a shareholder cannot be fully excluded from the profits of the company. The shareholders’ right to the dividends or to a proportion of the liquidation surplus can thus be limited but cannot be, in any case, eliminated.

(d) Mission lock

As stated above, the social mission of the company, if any, would be embedded within the definition of the corporate purpose in the articles of association. A change in the mission would require an amendment to the articles of association of the company. The shareholders’ agreement could further organise the decision-making process for such a change. In any case, the way to best ensure that the social impact of the company will be continued is to require a unanimous shareholder vote to change the corporate purpose. However, a refusal to approve such a change could be considered to be a breach of fiduciary duty of the shareholders who refuse to act in the interest of the company. Such a breach could lead to damages and/or in certain cases the nullity of the decision or to a decision issued by the courts.

(e) Enforcement mechanisms

Any shareholder, the company itself or any third party having an interest in taking legal action and under certain conditions could seek to hold liable the directors for mismanagement or breach of the articles of association. The shareholders hold, as owners of the company, rights that allow them to challenge the way the business is pursued and to remove directors. In contrast, third parties would have to demonstrate a direct, personal and definite harm to take legal action in respect of an act of a company. Therefore, most if not all third parties will lack standing to challenge how the business is pursuing its social purpose as a failure in the implementation of the company's social purpose does not cause them harm but only deprives them of a potential benefit.

However, the company can exercise internal control regarding how the company's directors fulfil its social purpose. The social purpose of a PPB incorporated as a conventional company is essentially controlled by the shareholders who approve annually the management of the directors and who have the ability to remove its directors in case of breach of their mandate. In addition, the articles of association could, to some extent and depending on the legal form selected, provide for enforcement or control mechanisms.

(f) Change of control

Change of control can be limited and controlled through different mechanisms provided for in the articles of association or the shareholders' agreements.

On one hand, the articles of association and the shareholders' agreements can organise and/or restrict the transfer of shares. In that regard, it is worth mentioning that in a "*société par actions simplifiée*," share transfers are freely organised by the articles of association, and any transfer that constitutes a breach of the articles of association is void. Plus, the articles of association may require a shareholder to sell its shares under certain circumstances.

On the other hand, the increase in share capital is a decision that modifies the articles of association and the rules governing such kind of amendments apply.

5 ADDITIONAL CONTROLS OVER PROFIT-WITH-PURPOSE BUSINESS

5.1 THE CONVENTIONAL LEGAL FORMS

There is no additional legal obligation or control over the social purpose that applies to PPBs incorporated under a conventional legal form. However, as discussed above, some social purposes are subject to the control of public authorities if they are "*activités réglementées*".

5.2 THE RECOGNISED “ENTERPRISE OF THE SOCIAL AND SOLIDARITY ECONOMY”

Pursuant the SSE Law, an enterprise may qualify as an “enterprise of the social and solidarity economy” if (1) its purpose does not consist in the sole sharing of profits, (2) it implemented a democratic governance organized by its articles of associations providing for the information and participation of the shareholders, employees and stakeholders to the development of the enterprise, and (3) its management complies with the following principles: (i) profits are principally dedicated to the development and maintenance of the activities of the enterprise, and (ii) as a general rule, the minimum reserves, which cannot be shared, may not be distributed.

Is eligible to become an “enterprise of the social and solidarity economy”, any enterprise that exists under a traditional form of the social economy (i.e. any cooperative, mutual company or union governed by the French Mutuality Code or mutual insurance company governed by the French Insurance Code, foundation or association). Are also eligible conventional for-profit commercial corporations which, pursuant to their articles of association, (1) meet the above-mentioned criteria, (2) seek a social utility, (3) meet certain restricting rules in terms of distribution of profits and comply with a prohibition to conduct a decrease of the share capital that is not prompted by losses.

Being recognised as an “enterprise of the social and solidarity economy” provides advantages in terms of access to diverse funding. These businesses may receive solidarity funds managed by specialised investors. In addition, it is possible for an “enterprise of the social and solidarity economy” to make an application to be granted a “solidarity enterprise of social utility” label when complying with some further requirements, essentially relating to need for a social utility, and restrictions in terms of remuneration, in order to be legally considered as such. These two labels give access to certain special types of financing facilities and/or certain tax reliefs. The enterprises become, for instance, eligible for the financing of the Public Investment Bank (*Banque Publique d'Investissement*), dedicated to enterprises of the social and solidarity economy.

6 ACCESS TO INVESTMENT CAPITAL

6.1 SPECIFIC FINANCING INSTRUMENTS

There is no specific financing instrument for the financing of a PPB incorporated as a conventional legal form. PPBs use the very same instruments as any other French company, whether equity or debt financing.

Today, there are two primary groups that engage in impact investing in France⁸⁵:

- the socially-committed finance, in French the “*finance solidaire*,” which is basically solidarity-based savings from natural persons in specific savings plans where the funds are invested in projects designed to promote a positive social impact (either in banks or in companies); and
- the socially responsible investment (the “**SRI**”), in French the “*investissement socialement responsable*”, constituted by, inter alia, the socially responsible investment funds and the ethical funds. These funds build a portfolio, taking into account, in addition to financial criteria, the environmental, social or societal and corporate governance of the companies they invest in.⁸⁶ These funds operate in the same way as the more traditional investment funds and are subject to further information requirements about their investments and the funds they manage as to the criteria they apply when buying or selling securities⁸⁷.

The public support for these investments is deepening through the Public Investment Bank, which is planning to create a fund that will target the enterprise of the social and solidarity economy as defined in the SSE Law and a type of loan aimed at facilitating access to debt financing⁸⁸.

What is interesting to note is the recent regulation of crowd funding. Crowd funding is a very popular medium used by PPBs to start their businesses or finance their growth. The regulation adopted by the Council of ministers on 30 May 2014 seeks to add a new exception to the banking monopoly that would allow natural persons to grant an interest-bearing loan to a company seeking a limited investment amount from any individual not exceeding €1,000, with the aggregate loan to the business not to exceed €1,000,000. The operation would be submitted to the control of an intermediary specialised in participatory funding⁸⁹. The regulation will become law after publication of several decrees and rules issued by the French “*Autorité des marchés financiers*”.

6.2 TAX INCENTIVES

Except for the solidarity-based savings, there is no specific tax incentive granted to investors that invest in PPBs that are non-charitable and for-profit (as it is inevitably the case for PPBs), or in socially responsible investment funds. When investing in solidarity-based savings, the investors can benefit from income tax relief for the invested amounts and the added value gained when investing and/or a reduction of the solidarity tax on wealth depending on the type of instrument that is used.

85 L’impact investing pour financer l’économie sociale et solidaire ? Une comparaison internationale, Commissariat général à la stratégie et à la prospective, Camille Guézennec and Guillaume Malochet, p. 23

86 www.economie.gouv

87 Finance alternative : quels fonds d’investissement pour quelles aspirations ?, Revue de Droit bancaire et financier n°3, Mai 2013, 28, Isabelle Riassetto

88 <http://www.senat.fr/rap/l13-084/l13-0843.html>

89 Livre blanc FinPart

However, as stated above, the “solidarity businesses” recognised as such can benefit from specific schemes providing for a reduction of the solidarity tax on wealth and for a reduction of the income tax. They also benefit from the quota of 5 % to 10 % reserved to such enterprises in the social savings funds capacity.

6.3 INVESTMENT STRUCTURES

Mission lock-in is possible for investors through various means. When the investors are granting debt financing, the financing agreement could provide for a wide range of conditions aimed at ensuring that social benefit is realised, these conditions could be of different forms such as conditions precedent to the drawdown of funds, information undertakings, loan prepayment or even events of default. When the investors are investing in equity, they can use all of the corporate instruments presented in Section 4.1 above.

6.4 BARRIERS TO ACCESSING INVESTMENT

There is currently no separate legal or regulatory regime in France for raising capital for PPBs. Companies seeking to raise funds by issuing equity or debt securities must comply with all relevant legislation, in particular the prohibition against offering shares or securities to the public without required disclosures and procedures, and in particular the drafting of a prospectus submitted to the Financial Market Authority, in French the “*Autorités des Marchés Financiers*”.

6.5 RISK

Risks are the same for PPBs as for any other companies. The company shareholders share in all risks and rewards of the company, but their liability is capped at their equity investment in the limited liability companies such as the “*société par actions simplifiée*” or the “*société anonyme*”.

6.6 EXIT

The exit of a company may be provided by sale of shares. An IPO is an option for a company. In addition, the principle governing PPBs and especially the enterprise recognised as such by the relevant applicable law or by rules contemplated by the Bill seem hardly reconcilable with the laws governing listed companies and, in particular, with the expectations of the markets regarding their profitability and operation since part of their profit are locked into mandatory reserves and their director’s compensation are capped.

A photograph of a white wall densely covered with hundreds of bicycles of various colors and models, including road bikes, mountain bikes, and vintage-style bikes. The bicycles are mounted in a somewhat chaotic but organized manner, filling the entire wall. In the center, a man in a blue shirt is looking out from a window. The scene is set in a building with several windows, some of which are partially obscured by the bicycles. The overall atmosphere is one of a unique and artistic display of cycling culture.

GERMANY

GERMANY

1 COUNTRY OVERVIEW

German law does not provide for a specific legal form addressing specifically the interests and needs of profit-with-purpose businesses (“PPBs”).

A PPB may be generally operated in Germany in any legal form open for for-profit businesses. Due to several reasons there are, however, three primary legal forms most appropriate for a PPB in Germany: the Limited Liability Company (*GmbH*), the Foundation (*Stiftung*) and the Cooperative (*Genossenschaft* or *eG*) and we shall concentrate on those and make reference to other forms only at specific points.

Other legal forms available for for-profit activities may also be used to operate profit-with-purpose businesses, but there will typically be impediments or inefficiencies compared with the three aforementioned.

A legal form targeted at pursuing charitable or social purposes is the Registered Association (*eingetragener Verein* or *e.V.*). However, such association must primarily be a non-commercial entity (it may operate a business as an ancillary activity only). Therefore, it will often not be suitable for a PPB.

The exclusive and direct pursuit of charitable, benevolent or church purposes (*ausschließliche und unmittelbare Verfolgung gemeinnütziger, mildtätiger oder kirchlicher Zwecke*) by any of the aforementioned corporations, associations or foundations is privileged by German tax law. An entity including any PPB complying with such “charitable” requirements that is tax-privileged shall be called a “**CHARITABLE CORPORATION**”. Charitable tax requirements are strict and, in fact, limit substantially the pursuit of commercial activities. Within these strict boundaries, a **CHARITABLE CORPORATION** may operate a for-profit business, but may, *inter alia*, (i) not mix commercial and non-commercial financial spheres (e.g., no loss absorption by non-commercial assets), (ii) not distribute profits to members or shareholders, but rather (iii) use business profits and other means for its Charitable purposes within a short to medium term. So the room for a PPB in the form of a **CHARITABLE CORPORATION** will often be small or non-existent.

A **CHARITABLE CORPORATION** is exempt from income taxes and certain other taxes as regards their non-commercial sphere. Their non-commercial sphere includes (i) administration of wealth (to the limited extent it is compliant with the charitable status), (ii) business operations intrinsically linked to and crucial for the charitable purpose, e.g. a workplace for handicapped people, but excludes (iii) any further commercial business.

1.1 OUTLOOK

In the autumn of 2013, the new German governing coalition announced in its Coalition Agreement that it intends to support social businesses and that a suitable corporate form shall be established in order to minimize bureaucracy. However, it is not entirely clear whether this initiative is targeted at all PPBs or just small sized undertakings based on civic engagements which are expressly referenced in the Coalition Agreement.

2 LEGAL FOUNDATIONS FOR PPBS

2.1 CAN A BUSINESS BE FORMED UNDER APPLICABLE LAW WITH THE FOLLOWING CHARACTERISTICS OF A PPB?

(a) Social purpose

Legal forms available to PPBs in Germany allow social purpose to be embedded as one of several or the only object of the respective entity. Respective governing documents may stipulate a general social purpose supported by a limited or unlimited list of particular fields of activity or other supporting objects. Social purpose may also be equally ranked among other objects or be of a subordinate nature.

Note that in a Cooperative, specifically, support and promotion of its members must remain the primary object. Hence, social purpose may be an ancillary but not the primary purpose of a Cooperative, unless the members of the Cooperative pursue social purposes themselves and the Cooperative is intended to promote their socially purposed activities.

(b) Duties

Respective governing bodies of PPBs have the duty to further (and comply with) the entity's objects and must, therefore, manage the entity in line with its objects. A breach of this duty will result in liability for losses and damages towards the entity. Hence, respective governing bodies of PPBs can be held accountable for furthering the social purpose of the entity to the extent stipulated in the respective governing documents. Specific duties may be stipulated in the respective governing documents, service agreements or by-laws.

Regardless of the legal form there is no general legal requirement under German law for a PPB to be operated in a way to maximize its financial return to its shareholders or members to the detriment of the social purpose. The weighting of the objects to be pursued by a PPB and the relationship between them is determined by the governing documents and binding upon the respective governing bodies.

(c) Third party interests

Unless so provided for in the Articles of Association or directed by the shareholders' meeting, managers of a **GmbH** may only consider the interests of stakeholders other than the shareholders to the extent those interests correspond with the well understood interest of the **GmbH** and its objects (e.g. general corporate social responsibility activities that improve a **GmbH**'s standing).

Management board of a Foundation is strictly bound by the purpose(s) stipulated in the Articles of Foundation and may not consider other interests without – if at all possible – prior adjustment of the Articles.

Management board of a Cooperative is bound to pursue the promotional purpose of the Cooperative and the ancillary social purpose to the extent provided for by the governing documents of the Cooperative, including general corporate social responsibility activities.

(d) Transparency regarding achievement of social impact purpose

Corporations, cooperatives and foundations are subject to general accounting obligations which vary from legal form to legal form.

Additionally, a **CHARITABLE CORPORATION** would be required to prepare an annual record or statement evidencing that its funds were used for tax-privileged purposes (*Mittelverwendungsrechnung*).

Further reporting and disclosure is voluntary. However, since public funding institutions, private investors and other concerned parties make their support of PPBs conditional on comprehensive reporting and disclosure, voluntary preparation of annual impact reports have become common practice in Germany.

Governing documents of PPBs may stipulate the duty of the respective governing bodies to periodically prepare and disclose certain information.

3 LEGAL FORMS ARE AVAILABLE FOR PPBS

3.1 OVERVIEW OF LEGAL FORMS OF ORGANISATION WHICH ARE AVAILABLE TO PPBS.

(a) *Stiftung* (Foundation)

A legal form which is commonly associated with charitable or social goals is the **FOUNDATION** (*Stiftung*). It is a legal form of asset administration endowed for a particular purpose by its founder either *inter vivos* or *mortis causa*. The **FOUNDATION** is subject to supervision by the competent state authority with the objective to ensure that the intended purpose is pursued. A **FOUNDATION** may also operate a business. Its purpose

may only be changed if and to the extent allowed by the Articles of Foundation or if the initial purpose becomes impossible to achieve and the change is consistent with the presumed will of the founder. Otherwise the **FOUNDATION** has to be wound-up (mission lock). Once the **FOUNDATION** is approved, its management board is only bound by statutory provisions and the Articles of Foundation, particularly the purpose stipulated therein. Articles of Foundation may reserve for the founder or a third party the right to appoint board members or the right of veto or to a say in administration matters. Beyond that the founder has no influence on the administration of the **FOUNDATION**. Amendment or alteration of the Articles of Foundation by the management board is only possible if required to achieve the purpose of the Foundation.

(b) Limited Liability Company (GmbH)

Besides the Foundation, the classical legal form commonly used by PPBs in Germany is the **GmbH** (Limited Liability Company). A **GmbH**, a corporate body with distinct legal personality managed by managing directors, requires only one (1) shareholder and a minimum capital of one (1) EURO to be incorporated⁹⁰. Shareholders are not liable for its debts. Articles of Association may be amended by the shareholders' meeting with a majority of three quarters of the votes cast. The objects of a **GmbH** are not limited and it may also or exclusively pursue charitable or social objects. The shareholders are free to use company assets and appropriate its profits, subject to capital maintenance requirements and the company's objects, and to draft the Articles of Association accordingly. Articles of Association may provide for a full or partial asset and/or profits lock.

A GmbH that meets charitable requirements may adjust its business name to **gGmbH**. Since the Articles of Association of a Charitable or **gGmbH** have to comply with certain tax law requirements with impact on its internal structure, the **CHARITABLE** or **gGmbH** is addressed separately in the following chart.

(c) Genossenschaft (Cooperative)

GENOSSENSCHAFT or **eG (COOPERATIVE)** is a corporate body of at least three (3) members intended to primarily promote its members' economic activities or social and cultural interests through a communal business establishment. Hence, unlike in other business entities, members of a **COOPERATIVE** benefit not through profit distribution but through a communal pursuit of their objects (self-promotion). Governing documents of a **COOPERATIVE** may also allow persons who are not expected to benefit from the SCE's communal activities to become investor members. However, investor members may not form the decisive power in the **COOPERATIVE**. Since member promotion is the distinctive feature of the **COOPERATIVE** pursuit of social purposes is only possible as an ancillary object.

⁹⁰ As long as the share capital of a GmbH is between 1.00 EUR and 25,000 EUR, there are increased capital maintenance obligations and the company must be called Entrepreneurial Company with Limited Liability (Unternehmergesellschaft (haftungsbeschränkt) or UG (haftungsbeschränkt)).

The **COOPERATIVE** is governed by a managing board and a supervisory board. Both boards must consist of representatives from the **COOPERATIVE**'s members (self-governance). The general meeting resolves on expressly assigned core matters and has no right to issue directives to the management or the supervisory board.

(d) Societas Cooperativa Europaea (European Co-operative Society)

SOCIETAS COOPERATIVA EUROPAEA or **SCE (EUROPEAN CO-OPERATIVE SOCIETY)** is a European legal form introduced in 2006 and intended for cross-border co-operation of its members. However, the **SCE** does not have to carry out its activities cross-border. Foundation of a **SCE** requires at least two (2) members or at least five (5) members if natural persons are involved. **SCE** is a corporate body with distinct legal personality and a minimum share capital of 30,000 EUR. Members' liability is limited unless otherwise provided for by the governing documents. Founders of a **SCE** may decide between a one-tier and a two-tier governance system; the latter having a supervisory board in addition to a management board.

In many respects the **SCE** is similar to the **COOPERATIVE** under German law. One distinctive feature is that the **SCE** may extend the benefits to non-members if provided for by its governing documents. If this is the case third-party benefit may be pursued as the primary object of the **SCE**.

Due to the fact that only few **SCEs** have been established in Europe so far the **SCE** is not included in the chart below.

(e) Outlook: Fundatio Europaea (European Foundation)

In February 2012, the European Commission presented a proposal for a European Foundation Statute in order to facilitate the cross-border activities of public benefit purpose foundations and to make it easier for them to support public benefit causes across the EU. The proposal particularly identifies high legal advice costs founded from the foundation's assets to be one of the key obstacles for cross-border activities of foundations in Europe.

After discussing several options the European Commission decided in favour of a Statute for a European Foundation with automatically applied non-discriminatory tax treatment ("Statute"). The Statute shall be passed as a European Regulation directly applicable in the EU Member States.

Key features of the **EUROPEAN FOUNDATION ("FE")** according to the proposal are:

- **FE** shall be an entity with public benefit purpose(s) conclusively enumerated in the Statute.
- **FE** shall be allowed to engage in economic activities as long as the profit is exclusively used in pursuance of its public benefit purpose(s); additionally **FE** shall be allowed to carry out unrelated economic activities in the amount of up to 10 % of the annual turnover.

- FE shall have legal personality and full legal capacity in all EU Member States.
- The liability of the FE shall be limited to its assets.
- Founding assets of a FE shall be equivalent to at least 25,000 euro.
- The assets shall be irrevocably dedicated to the purpose(s) of the FE and no benefit may be distributed to any founder.
- FE shall be formed ex nihilo or by way of a merger or a conversion of existing national public benefit purpose entities.
- FE shall carry out its activities or have the objective to carry out its activities in at least two Member States.
- FE shall be subject to a robust supervision by the competent national authorities, including approval rights and the right to intervene in the management of the FE.
- FE shall be governed by a governing board of at least three members, which may nominate managing directors responsible for day-to-day management of the FE.
- Governing documents of the FE may provide for a supervisory or an advisory board.
- FE shall draw up and disclose audited annual accounts and an annual activity report.
- FE shall automatically be regarded as equivalent to national public benefit purpose entities and, therefore, be subject to an automatic application of national tax benefits.

In July 2013, the European Parliament supported the proposal suggesting several modifications. Former German government and the Federal Council of Germany rejected the proposal as being unnecessary and requiring disproportionate implementation effort. The reactions among the scholars in Germany are divided. Due to the requirement for unanimity to pass the Regulation, it is uncertain if and when this initiative will become binding and effective.

3.2 WHAT LEGAL FORMS OF ORGANISATION ARE AVAILABLE TO BUSINESSES GENERALLY THAT COULD BE USED TO FORM A PPB?

The former summary and the following chart only address legal forms commonly used for PPBs in Germany. Therefore, it is important to note that other forms not described herein exist and thus this list is not exclusive:

- AKTIENGESELLSCHAFT or AG (JOINT STOCK CORPORATION), SOCIETAS EUROPAEA (EUROPEAN CORPORATION), inflexible and regulated, primarily intended for public enterprises;
- VERSICHERUNGSVEREINE AUF GEGENSEITIGKEIT (MUTUAL INSURANCE COMPANIES);
- Partnerships such as the GESELLSCHAFT BÜRGERLICHEN RECHTS or GbR (PRIVATE PARTNERSHIP), OFFENE HANDELSGESELLSCHAFT or OHG (COMMERCIAL PARTNERSHIP) and KOMMANDITGESELLSCHAFT or KG (LIMITED PARTNERSHIP), intended for enterprises with active members, may not be CHARITABLE CORPORATIONS.

As mentioned, the **EINGETRAGENER VEREIN** or **e.V.** (**REGISTERED ASSOCIATION**) and the **GEMEINNÜTZIGE GmbH** or **gGmbH** (**CHARITABLE LIMITED LIABILITY COMPANY**), are very much limited when it comes to carrying out economic activities. Therefore they are typically not appropriate for PPBs.

	STIFTUNG (FOUNDATION)	GmbH (LIMITED LIABILITY COMPANY)	GENOSSENSCHAFT (COOPERATIVE)
OWNERSHIP	No owners, separate legal form of asset administration	No shareholding by charitable entities	At least three (3) members
GOVERNANCE	<ul style="list-style-type: none"> - Managing board - optional: appointment of an advisory/supervisory board 	<ul style="list-style-type: none"> - Managing director(s) subject to shareholders’ directives - optional: appointment of an advisory/supervisory board 	<ul style="list-style-type: none"> - Managing and supervisory board must consist of members’ representatives - general meeting with core competences
OBJECTS	No limits, shall only not endanger public welfare	No limits	<ul style="list-style-type: none"> - Promotion of its members’ economic activities or social and cultural interests through a communal business establishment
SOCIAL PURPOSE	Required to gain tax privileges	Yes, not required	Yes, not required, may not be primary object
LIMITED LIABILITY FOR OWNERS	n/a	Yes	Possible
TRANSFERS OF OWNERSHIP	No	Yes, restrictions in the Articles of Association possible	No, change of members by withdrawal and joining subject to the Cooperative’s approval N.B. members hold interest in the Cooperative but are technically not the “owners”
DEBT FINANCING	Yes, subject to certain tax law requirements	Yes, according to general rules	Yes, if directed on promoting the members
EQUITY FINANCING	Minimum initial assets of 50,000 EUR generally required	Yes, minimum share capital of 1 EUR	Yes, no minimum share capital required

	STIFTUNG (FOUNDATION)	GmbH (LIMITED LIABILITY COMPANY)	GENOSSENSCHAFT (COOPERATIVE)
TAX TREATMENT⁹¹	Tax privileges possible	No tax privileges (by definition)	Tax privileges possible, but rare
DISSOLUTION	<ul style="list-style-type: none"> - by management board resolution or by the competent authority's decision - net assets are distributed among beneficiaries - further restrictions apply if a Charitable Corporation 	<ul style="list-style-type: none"> - by a members meeting resolution - net assets are distributed among the members 	<ul style="list-style-type: none"> - by a general meeting resolution - by a court order upon application by the competent state authority if the Cooperative ceases to promote its members' interests - net assets are distributed among the members
CHARITABLE STATUS	Possible	No	Possible, but rare
REGULATOR	<ul style="list-style-type: none"> - Tax authorities verify charitable status - Competent state authority monitors continuing ability to pursue foundation's purposes 	General corporate rules	<ul style="list-style-type: none"> - biannual audit by a special auditing association - competent state authority monitors if the Cooperative is directed to promote its members
REPORTING REQUIREMENTS	<ul style="list-style-type: none"> - State law dependent - regulator must be notified of certain events - if substantial business activities: commercial ac-counting, possibly audit, disclosure - if tax privileged: records evidencing the use of funds 	<ul style="list-style-type: none"> - proper commercial record keeping and accounting - size-dependent requirements for audit and disclosure 	<ul style="list-style-type: none"> - proper commercial record keeping and accounting - size-dependent requirements for audit and disclosure
ADVANTAGES	<ul style="list-style-type: none"> - commonly associated with social goals - partial limited liability of board members - long term mission lock 	<ul style="list-style-type: none"> - direct influence by the majority shareholder - limited liability for shareholders - flexible financing - full access to capital markets - low founding costs - no official supervision - flexible Articles of Association 	<ul style="list-style-type: none"> - flexible profit distribution - coexistence of benefit members and investor members - admission of new members upon discretion of the Cooperative (general meeting or management board)
DISADVANTAGES	<ul style="list-style-type: none"> - limited by initial purpose - inflexible Articles of Foundation - limited possibility of continuous control of the management - assets are locked - official approval required - subject to official supervision - comparably high founding costs 	<ul style="list-style-type: none"> - not associated with social goals - no tax privileges - not accessible for funding by charitable entities - risk of mission drift - no permanent subordination to a non-shareholder - accounting requirements 	<ul style="list-style-type: none"> - only limited pursuit of third-party benefit allowed - no subordination to an investor member - one member, one vote with few exceptions - no member-independent management - inflexible governing documents

91 Cf. further explanations as to tax in secs. 1 and 6.

3.3 WHAT LEGAL FORMS OF ORGANISATION, IF ANY, HAVE BEEN SPECIFICALLY DESIGNED FOR PPBS?

There are currently no legal forms specifically designed for PPBs. The Coalition Agreement of 2013 only contains a statement of intent to adopt a specific form for PPBs without stating any details.

3.4 WHAT HYBRID STRUCTURES ARE OR COULD BE USED TO ESTABLISH A BUSINESS WITH THE KEY CHARACTERISTICS OF A PPB?

De jure there are no hybrid structures for PPBs in Germany. However, it is possible to create a *de facto* hybrid structure through language drafted in the Articles of Association of a [GmbH](#). It is common to implement features of a Cooperative such as promotional purpose and of a Foundation such as mission and profits lock into a [GmbH](#) (so called [STIFTUNGS-GmbH](#) or [GENOSSENSCHAFTLICHE GmbH](#)). The advantage of such entities is that they are not subject to supervision by authorities and may be easier adjusted if required.

4 OTHER METHODS OF IMPLEMENTATION

4.1 WILL APPLICABLE LAW RESPECT CONTRACT TERMS ESTABLISHING AND/OR PROTECTING A SOCIAL PURPOSE?

For mission lock in the governing documents, see 5 (d).

A mission lock in any other contract or agreement will be binding and valid *inter partes*. Actions in breach of such contractual mission lock would be valid in relation to third parties, but give rise to legal sanctions between the contract parties and would allow for enforcement of mission lock in court.

4.2 COULD OTHER CORPORATE LAW TOOLS BE ADAPTED TO ESTABLISH/PROTECT A PPB?

There are several tools which may be adapted to protect pursuit of social purposes by a PPB. **NB:** The internal structure of a [FOUNDATION](#) *per se* guarantees the pursuit of the stipulated purpose. Hence, no additional protective measures are required.

(a) Duty of loyalty

All shareholders of a [GmbH](#) and all members of a [COOPERATIVE](#) have the duty of loyalty towards each other and the respective entity. In particular, each shareholder or member has to contribute to any measure and participate in any decision of particular

importance to the promotion of the entity's objects. A violation of the duty of loyalty may result in the respective shareholder's or member's liability towards the entity.

(b) Shareholders' agreement

Shareholders of a **GmbH** and members of a **COOPERATIVE** may enter into an agreement undertaking to take all necessary measures to further and to refrain from all acts that might endanger the pursuit of the set objects of the entity. However, such agreement is only binding upon its parties and a violation will only result in liability towards the other shareholders or members.

(c) Golden share / decisions by unanimity

Articles of Association of a **GmbH** may stipulate a golden share for a shareholder (e.g. that is regarded to be the "guarantor" to preserve the social purpose) by making specific decision (e.g. change of purpose, transfer of assets/shares or entity's dissolution) subject to his consent. Please note that such measures are subject to the duty of loyalty of the golden share member. **NB:** Stipulation of a golden share is not possible in a **COOPERATIVE** due to its general voting rule of "one member, one vote".

Respective Articles of a **GmbH** and of a **COOPERATIVE** may stipulate the requirement for unanimity in order to alter the Articles with respect to certain matters (e.g. mission, asset or profits lock). Such requirement may itself be only altered by a unanimous decision.

(d) Voting agreements

Voting agreements with other shareholders/members or third parties are effective under German law. However, such agreement is only binding upon its parties and has no effect vis-à-vis the entity; i.e. voting in breach of a voting agreement is generally valid and is not contestable by the other party.

5 ADDITIONAL CONTROLS OVER PPBS

What other legal obligations or controls over the social purpose apply to PPBs under applicable law?

(a) Additional transparency measures

Charitable Corporations are required to provide records evidencing the use of its funds for tax-privileged purposes. Beyond that, there are no mandatory transparency measures in addition to the general requirements on reporting applicable to PPBs. However, many PPBs which are not subject to mandatory disclosure make their annual reports and other relevant information available to the public on a voluntary basis.

Transparency measures are also promoted by publicly respected institutions which certify PPBs as "trustful to support" only if they undertake certain degree of disclosure. Recently a private uniform Social Reporting Standard (SRS) was developed for PPBs in order to facilitate their disclosure to the public and their contributors.

(b) Asset lock

A full asset lock applies to a **FOUNDATION**. With the exception of a so called "**EXPENDING FOUNDATION**", the assets of a Foundation must be preserved in their current state. A partial asset lock applies to a **GmbH**. Its statutory share capital must be maintained in the interest of creditors. Same applies to a **COOPERATIVE** if its Articles stipulate a minimum share capital.

German corporate law allows for stipulating an asset lock in the respective Articles of Association of a **GmbH**. It should be noted, however, that under German corporate law shareholders of a **GmbH** retain the ultimate power to alter the Articles of Association and, therefore, may not be legally prevented from abolishing the asset lock. However, asset lock may further be secured by granting a "trusted" shareholder the preferential right to block any change of the Articles of Association or by unanimity requirement.

An asset lock is a pre-requirement to become a **CHARITABLE CORPORATION**. Upon liquidation of such entity, only funds equivalent to the nominal share value and contributions in kind may be distributed to the shareholders or members. Exceeding assets must be utilized for tax-privileged purposes. The asset lock must be stipulated in the entities' Articles of Association. A violation of the asset lock results in a retroactive loss of all tax privileges.

(c) Profits lock

Again, German corporate law allows for stipulating a profits lock in the respective Articles which may be altered by the shareholders/members, but secured by preferential rights of "trusted shareholders" or by unanimity requirement.

A full statutory profits lock applies to **CHARITABLE CORPORATION**. As an exception, a **FOUNDATION** may pay up to one third of its earnings to support the founder or his close relatives. However, a violation of the profits lock only results in the loss of those tax privileges.

(d) Mission lock

A statutory mission lock only applies to the **FOUNDATION** and to some extent to the **COOPERATIVE**. Management board of a **FOUNDATION** is bound by the initial purpose given by the founder and may only alter the purpose in limited circumstances. A **COOPERATIVE** must retain the object to promote its members' activities and might be dissolved if this object is not pursued.

Again, German corporate law allows for stipulating a mission lock in the respective Articles of Association of a **GmbH** which may be altered by the shareholders, but secured by preferential rights of "trusted shareholders" or by unanimity requirement.

CHARITABLE CORPORATION must stipulate a mission lock in their Articles of Association. In case of an abrogation of the mission lock by the shareholders, a **CHARITABLE CORPORATION** will lose its tax privileges.

(e) Enforcement mechanisms

Maintenance of the social impact purpose in **CHARITABLE CORPORATIONS** is subject to de facto enforcement by the respective entity's management and shareholders due to the potential risk of loss of tax privileges.

Where the social impact purpose is stipulated in the entity's governing documents, its pursuit may only be enforced internally by the shareholders/members vis-à-vis the entity's governing bodies and between the shareholders/members. Contractually stipulated social impact purpose (e.g. in voting or shareholders' agreements) may be enforced by the respective party concerned through taking legal action, including interim legal protection. In particular, under German law voting according to a voting agreement may be legally enforced.

Third parties outside the entity and respective agreements have no standing to legally enforce social impact purpose stipulated therein.

(f) Change of control

There are several mechanisms feasible to provide for continuation of the mission of PPBs upon a sale of control. In particular, golden shares for established socially conscious shareholders or members and approval rights for shareholders or an advisory board are commonly used. It is also possible to stipulate a change-of-control clause in the respective debt financing agreement providing the investor with an approval or a cancellation right. However, approval rights and other restrictions of transferability of shares are easier to implement if the beneficiary holds some equity interest in the entity.

In a **COOPERATIVE** and a **SCE** admission of new members is by law subject to approval by the general meeting or the management board of the **COOPERATIVE**. Governing documents of a **SCE** may also make the admission of new members subject to conditions related to the objects of the **SCE**.

6 ACCESS TO INVESTMENT CAPITAL

6.1 TAX INCENTIVES

(a) Investments into non-Charitable PPBs

For a private (non-Charitable) investor including any non-Charitable PPB, there are no tax incentives for investing into an (other) non-Charitable PPB.

A **CHARITABLE CORPORATION** may, to the (limited) extent compliant with Charitable status, invest in a non-Charitable PPB and potentially generate tax-free returns from such investment. Administration of wealth is however limited by the Charitable requirement of principally using any means of the **CHARITABLE CORPORATION** for its Charitable purpose within the short to medium term (subject to exceptions). Further, any sub-market return investments may taint the Charitable status (and tax privileges) of the investing **CHARITABLE CORPORATION**; this is especially relevant if the recipient is not a **CHARITABLE CORPORATION** itself.

(b) Investments into Charitable Corporations

There are no tax incentives for the investor specifically for investing into a **CHARITABLE CORPORATION**. A **CHARITABLE CORPORATION** may only to a limited extent take out debt financing. It may issue equity shares, but not make profit distributions to its equity holders during its lifetime or upon liquidation. A **CHARITABLE CORPORATION** may raise donations and grant a certificate to a donor which provides for tax relief at the donor's level under certain conditions.

6.2 INVESTMENT STRUCTURES

KfW (Kreditanstalt für Wiederaufbau) is a government-owned development bank and provides equity funding to PPBs. Funds are accessible for all PPBs regardless of their legal form, however, funding by KfW requires a *pari passu* partner investor and is subject to strict criteria.

In Germany there are two well-known Venture Capital Funds specialized in funding of PPBs (Social Venture Fund and BonVenture). Investments in PPBs may be structured through these funds. Due to the fact that BonVenture is a tax privileged charitable entity itself its capital is only accessible for tax privileged charitable entities.

Social Venture Fund and the *KfW* require the PPB to have proven itself on the market and do not provide equity capital for the foundation of PPBs. Mission lock is possible for investors through contractual or corporate means, depending on the instrument.

When (other) investors are granting debt financing, the financing agreement could provide for a wide range of conditions aimed at ensuring that social benefit is realised.

These conditions could be of different forms such as conditions precedent to the drawdown of funds, information undertakings, prepayment or even event of default.

When the investors are investing in equity, they can contractually lock-in the mission, the assets or the profits through the Articles of Association, the shareholders' agreement or any investment agreement.

6.3 BARRIERS TO ACCESSING INVESTMENT

There is currently no separate legal regime in Germany for raising capital for PPBs and no regulatory regime specifically directed at them. For limitations for a Charitable Corporation with respect to its Charitable status of (i) raising debt and equity capital or (ii) granting capital to another PPB, see sec. 6.1 above.

6.4 RISK

Investments into a PPB are not secured by means outside the PPB (unless any third party grants collateral on an individual basis).

Investments by a PPB are not treated favourably under German enforcement and insolvency regimes.

Internal risk allocation between different investors can be arranged flexibly on a contractual basis or, depending on the circumstances, in the articles of association (liquidation preferences, etc.).

6.5 EXIT

There are no special legislative rules for exiting a PPB.

ITALY



ITALY

1 COUNTRY OVERVIEW

1.1 GENERAL INTRODUCTION

Italian law does not provide for a specific legal form designed for pursuing a profit-with-purpose business (**PPB**).

Entities willing to achieve a PPB can either:

- incorporate an ordinary for-profit legal entity pursuant to the Italian Civil Code, committed – as a secondary purpose – to accomplish a social (or environmental) benefit; or
- set-up a non-profit organisation or incorporate an ordinary for-profit legal entity in the form of a “social enterprise” as regulated by an *ad hoc* legislation, committed – as a primary purpose – to accomplish a social and/or environmental benefit.

1.2 FOR-PROFIT ENTITIES ESTABLISHED PURSUANT TO THE ITALIAN CIVIL CODE, AND COMMITTED TO A SOCIAL PURPOSE

Under Italian law, entities willing to achieve a profit purpose generally opt for the organisational form of the company, as opposed to other forms legally tailored as “non-profit”, such as associations and foundations. In this case, the creation of profits is the essence of the agreement which lays at the basis of the company itself.⁹²

In fact, the general definition of companies provided by Section 2247 of the Italian Civil Code outlines the essential elements which must be held by those organisations of persons and means, namely:

- (i) investments
- (ii) shared involvement of the economic activity
- (iii) profit purpose.

Notwithstanding the fact that companies are normally incorporated with the purpose of maximising the financial return to their shareholders/owners, it cannot be excluded that an ordinary for-profit form can commit itself to a secondary social purpose and dedicate part of its activity or financial resources to the fulfilment of the latter, by introducing this in its by-laws:

⁹² Such “profit” does not necessarily entail the creation of financial flows, but of other economic benefits, as it happens, for instance, for the cooperative companies.

- (i) a social purpose within the company’s activities; and
- (ii) the obligation for the company itself to allocate part of its profits to carrying out social activities.

By choosing this type of structure:

- (i) there would be no barrier to profit distribution (at least partial); and
- (ii) the company’s directors would be held accountable for furthering the social purpose of the company itself on the basis of the by-laws.

Recently, Italian law shifted towards the company model in order to pursue goals, including social goals, other than mere profit maximisation.⁹³

However, it is worth pointing out that, according to recent case law,⁹⁴ the possibility that part of the company’s profits are destined to further a social purpose cannot prejudice (as to quantity or other reasons) the profit goal of the company itself, which must thus always prevail over any other goal.

This principle entails the shareholders’ right to challenge the company’s decision and/or pursue an action for liability against the company’s directors that can undermine the prevalence of the profit purpose of the company.

In light of the above, and in the absence of an *ad hoc* legislation, it is still preferable to pursue a social goal either through direct funding of charities or the establishment of a foundation or a charitable organisation.

In sum, although there is no legal barrier that prevents the targeting of a (secondary) social purpose by profit entities, it is rare to see this in practise, and thus the legal field is not developed in any way in this in Italy. Therefore, our report focuses on social enterprises only. **Please note that the latter’s special regulation, which currently provides for a strict distribution constraint, might be subject, in the near future, to changes that should allow for a partial distribution of profits to shareholders.**

1.3 THE SOCIAL ENTERPRISE MODEL PROVIDED BY LAW NO. 118 OF 13TH JUNE 2005

PPBs can only opt to acquire the status of “social enterprises” under a particular regime. However, in order to qualify as a social enterprise, they will have to give up their ability to share the profits amongst the owners/shareholders and will be subject to other restrictions, definitely turning into non-profit entities.

Law no. 118 of 13th June 2005, and implementing measures (above all, Legislative Decree of 24th March 2006, no. 155; hereinafter, the “**Decree**”) introduced the so-called

⁹³ For example, as from 1996 (on the basis of Law no. 586 of 18th November 1996) sports societies can pursue a profit maximisation purpose (and hence distribute profits to their shareholders).

⁹⁴ See Court of Cassation decision of 11th December 2000, no. 15599.

“SOCIAL ENTERPRISE” (IMPRESA SOCIALE) into the Italian legal system,⁹⁵ and provided for a systematic set of rules to be applied to such new enterprise.

The Decree provides for a legal qualification of “SOCIAL ENTERPRISE” that applies to both non-profit (i.e. associations, foundations), and profit-driven (i.e. partnerships, joint-stock companies, limited liability companies, partnerships limited by shares, cooperative companies, and consortia) legal entities.

Therefore, under the current framework, a social enterprise can be defined as an organisation:

- (i) established as a non-profit organisation (i.e. an association, a foundation or a partnership company), which cannot distribute profits to, inter alia, its shareholders, directors and employees, and it must use any operating income for its own operations or for the purpose of increasing its assets;⁹⁶
- (ii) pursuing goals of “general interest”;
- (iii) carrying out, on a stable and prevalent basis, an economic activity for the production and exchange of goods or services of social benefit (“di utilità sociale”);
- (iv) applying a non-discretionary principle with regard to members’ admission or expulsion⁹⁷;
- (v) characterised by a mandatory involvement of its employees and service recipients in the management of the social enterprise itself.⁹⁸

It is important to note that law provisions that apply without distinction to any kind of legal entity are likewise applicable to social enterprises, provided that they do not conflict with the rules governing the latter.

Moreover, the by-laws and articles of association of a legal entity organised as a social enterprise must specify:

- (i) denomination as a “social enterprise”;
- (ii) indication of the business purpose, which must fall within one or more sectors of social benefit listed in the Decree (see paragraph 2.1(a) below);
- (iii) specification of the non-profit purpose pursued;
- (iv) prohibition to distribute profits and obligation to distribute, in the event of liquidation, all the liquidated entity’s assets to non-profit organisations.⁹⁹

Nevertheless, so far, the social enterprise regime outlined by the Decree has proved to be unattractive, mainly due to:

⁹⁵ It is worth preliminarily pointing out that at present under Italian law there is no legal form equivalent to, for instance, the UK CICs or L3C-low profit limited liability company set up under US law.

⁹⁶ Sections 1 and 3 of the Decree.

⁹⁷ Section 9 of the Decree.

⁹⁸ Sections 12 and 14 of the Decree.

⁹⁹ Section 5 of the Decree.

- (v) the absence of fiscal and other support policies adopted by the Italian Government;
- (vi) the existence of barriers to access investments;
- (vii) a slow implementation of the Decree by local administrations;¹⁰⁰
- (viii) the circumstance that the Decree has not repealed existing provisions of law, which apply to different kinds of non-profit entities, thereby creating a dishomogeneous legal framework for this sector.

As a result, representative organisations of non-profit entities have been reluctant to promote the recourse to the legal form of social enterprise introduced by the Decree. Therefore, persons wishing to establish a legal entity that pursues a social objective continue to resort, at present, to the well-established form of **SOCIAL COOPERATIVE** ("COOPERATIVE SOCIALI").

In order to address the pitfalls of the current legal framework for social enterprises, by introducing a legal model specifically dedicated to social enterprises, on May 13th the Italian Prime Minister Matteo Renzi presented the guidelines for the drafting of a substantial reform of the relevant legislation. Mr. Renzi then opened a one-month-online-consultation on the subject matter during which 762 e-mails were sent by the Italian citizens.

After the online consultation had been closed and the e-mails had been processed and analyzed, on July 10th the Italian Government presented a bill addressed to the Parliament indicating the final guidelines for the drafting of a *Legge Delega*.¹⁰¹ According to the bill of *Legge Delega*, within 12 months from the date of entry into force of the *Legge Delega*, the Government shall approve one or more Legislative Decrees implementing the provisions of the *Legge Delega*.

The timing of the legal procedure leading to the approval and promulgation of an ordinary law (such as a *Legge Delega*) may vary depending on the complexity of the subject and the cohesion within the two Chambers of the Parliament, therefore it is not an easy task to predict the date of the final approval of the suggested reform.

In promulgating the new legislation, the following key guiding principles of the bill of *Legge Delega* shall be taken into account:

- (i) the extension of the scope of activities that can be carried out by a social enterprise and the provision of limits of compatibility with commercial activities other than those of social purpose;
- (ii) the provision of ways of distribution of profits in accordance with predetermined limits and conditions;

¹⁰⁰ In particular, there are delays in the setting-up of the special sections of the Register of Companies competent for territory dedicated to social enterprises, which are managed by local administrations.

¹⁰¹ In the Italian legal system, a *Legge Delega* is an ordinary law, approved and promulgated by the Parliament, investing the Government with the political duty and power to enact - within the time limit indicated therein - a Legislative Decree which implements the principles and directives included in the *Legge Delega*.

- (iii) the qualification of social enterprises as private enterprises with a purpose of general interest having as primary objective the achievement of measurable, positive social impacts, achieved through the production or exchange of goods or services of social value;
- (iv) the rationalization of disadvantaged worker categories, taking account the new forms of social exclusion;
- (v) the possibility for private enterprises with a profit objective and for the government to take up office in the administration of social enterprises, except for the prohibition to assume direction and control;
- (vi) the provision of tax benefits, aimed at encouraging investments and users' choice in favour of these enterprises;
- (vii) the possibility of collecting risk capital through online portals.

2 LEGAL FOUNDATIONS FOR SOCIAL ENTERPRISES

2.1 CAN A BUSINESS BE FORMED UNDER APPLICABLE LAW WITH THE FOLLOWING CHARACTERISTICS OF A SOCIAL ENTERPRISE?

(a) Social purpose

Business can be qualified as a social enterprise if it is engaged in carrying out activities of social benefit on a stable and prevalent basis according to the following criteria.¹⁰²

Firstly, a business purpose will be deemed "of social benefit" if it falls within one or more of the following areas:

- (a) general social assistance;
- (b) healthcare services;
- (c) socio-medical services;
- (d) education, instruction and training;
- (e) protection of the environment;
- (f) safeguarding of cultural heritage;
- (g) social tourism;
- (h) graduate and post-graduate education;
- (i) research and supply of cultural-related services;
- (j) extracurricular education;
- (k) other ancillary activities instrumental to the social enterprise.

¹⁰² Section 2 of the Decree.

Secondly, regardless of the actual exercise of the above social activities, organisations carrying out business activity aimed at providing employment to disadvantaged workers or workers with disabilities may qualify as social enterprises.

Finally, the social activity must be conducted "*on a stable and prevalent basis*", which means that a social enterprise can also pursue a non-social purpose beside its social one, provided that the latter does not prevail over the former. Such "prevalence" requirement is deemed to be met:

- (i) in case a company qualifies as a social enterprise due to its social activity, when 70% of its operating income derives from the above activity; or
- (ii) in case a company qualifies as a social enterprise due to the goal of employing disadvantaged or disabled workers, the number of such workers must not be lower than 30% of the total number of employees.¹⁰³

(b) Duties

The Decree does not envisage an obligation upon directors (or officers) of a company qualifying as a social enterprise to further the social purpose of the latter, and no liability is set forth in the applicable law upon directors (and officers) for diversion of the business from its social purpose.

Under the Italian Civil Code, directors are in charge of the management of the company and they are therefore responsible for carrying out all operations needed to achieve the corporate purpose of such company. In case of breach of their duties as provided by law or under the company's articles of association (including diversion of the company's activity from its business purposes), company's directors may be subject to a corporate action for liability.

(c) Transparency regarding achievement of social impact purpose

General Italian company law rules provide for many tools to be used by stakeholders in order to supervise the activity carried out by a social enterprise.

Directors are in charge of keeping the company's accounts in good shape, as well as of drafting the annual report and financial statements to be approved by the shareholders' meeting, which also have to assess whether the directors have made good use of the company's assets in furtherance of the business purpose of the latter.

Once the shareholders' meeting approves the company's annual report, a copy thereof must be filed by the directors with the competent Register of Companies.

However, there is no provision of law currently in force, which sets forth measurement standards of the social impact of a social enterprise, nor forms of mandatory reporting of the business performance.

¹⁰³ An implementing decree setting forth the rules relating to the principle of prevalence mentioned above was co-signed by the Ministry of Economic Development and the Ministry of Welfare, and issued on 24th January 2008.

3 LEGAL FORMS ARE AVAILABLE FOR SOCIAL ENTERPRISES

3.1 OVERVIEW OF LEGAL FORMS OF ORGANISATION AVAILABLE TO SOCIAL ENTERPRISES

Under Italian law, there is not one single legal form of organisation available to social enterprises.

The most common forms are associations and foundations. Although their actual purpose may vary (i.e. social, cultural, religious, scientific, sports related, recreational, etc.), they are all characterised by a non-for-profit goal. Such organisations are nonetheless allowed to carry out economic activities (trading or business activities), yet with the aim of raising capital to support their non-profit purpose.

In particular, on the one hand, associations can be recognised (i.e. incorporated) or non-recognised (i.e. unincorporated), depending on whether they have or not their own legal personality.

While incorporated associations are independent legal entities holding the privilege of perfect proprietary autonomy (with the consequence that, during the life of the association, its members cannot claim the distribution of the association's assets among them nor to receive a portion thereof in case they decide to leave),¹⁰⁴ unincorporated associations are characterised by an imperfect proprietary autonomy: accordingly, creditors of the association could seek satisfaction from the assets of its individual members.

On the other hand, foundations are private autonomous non-profit organisations consisting of organised assets for the purpose of achieving a goal, either private or public, established by the founder.

Therefore, whilst the main feature of an association is the personal element (e.g. a sport organisation composed by all volleyball players of a certain geographical area), in a foundation the property element is predominant (i.e. an organised complex of assets and persons dedicated to charitable or cultural activities).

The above forms of organisation are relatively simple to run, as their governing rules can be adapted to cover a wide range of legal situations and they do not have to comply with specific transparency requirements. Their main source of funding are commonly represented by membership fees and personal assets of their individual members.

Moreover, there are several forms of profit-making enterprises, which is described in detail below, as they represent available options to establish an PPB under the current Italian legal framework.

Despite the continuous calls of scholars and practitioners for a simplified regulation of PPBs (also asking for a limitation to one form of organisation only), the law proposal

¹⁰⁴ Section 37 of the Italian Civil Code.

currently under discussion before the Italian Parliament does not envisage any restriction in the range of legal forms available for classification as PPBs.

3.2 WHAT LEGAL FORMS OF ORGANISATION ARE AVAILABLE TO BUSINESSES GENERALLY THAT COULD BE USED TO FORM A SOCIAL ENTERPRISE?

As anticipated above, all legal forms of profit-making enterprises qualifying as “SOCIAL ENTERPRISE” (“IMPRESA SOCIALE”) and complying with the requirements set forth by the applicable law could be used to establish a PPB.

Nevertheless, such freedom of choice of the legal form to be used is limited by some constraints: namely, (i) the prohibition to distribute profits, (ii) non-discretionary principle with regard to members’ admission or expulsion, (iii) the obligation to involve workers and stakeholders in the decision-making process (under the so-called “*multistakeholder management*”).

In light of the foregoing, the legal forms available to businesses that could be used to form a PPB can be summarised as follows:

(a) PARTNERSHIPS AND CORPORATIONS – General remarks

PARTNERSHIPS (“SOCIETÀ DI PERSONE”) and CORPORATIONS (“SOCIETÀ DI CAPITALI”) represent the two main categories of legal entities which may be incorporated under Italian law.

Partnerships may be set up in three different forms: namely, SIMPLE PARTNERSHIPS (“SOCIETÀ SEMPLICI”), GENERAL PARTNERSHIPS (“SOCIETÀ IN NOME COLLETTIVO”) and LIMITED PARTNERSHIPS (“SOCIETÀ IN ACCOMANDITA SEMPLICE”).

Partnerships’ assets and liabilities are segregated from the assets and liabilities of their members as:

- (i) the latter cannot sell the assets they contributed to the partnership’s capital at their own discretion, as such assets belong to the partnership itself and no longer to its partners individually considered;
- (ii) should the partnership’s assets not be sufficient to pay off its creditors, the partners are deemed personally liable for the unfilled obligations.¹⁰⁵

Assuming that the partnership deed does not provide otherwise, each unlimited partner is by default director of the partnership.

Finally, partnership members cannot freely transfer their quota to third parties

¹⁰⁵ A limited partnership differs from the afore-said general rule for there are two categories of partners: (a) general partners, who are severally liable without limits for partnership’s obligations, as well as responsible for the management of the company, and (b) special partners, who are liable to the extent of the amount of assets contributed to the partnership yet deprived of management powers. In so far as they are compatible, the provisions on general partnerships also apply to limited partnerships.

at their own discretion: the unanimous consent of all partnership members is in fact required unless the partnership deed otherwise provides.

Corporations may be set up in three different forms: namely, joint stock companies ("**SOCIETÀ PER AZIONI**"), limited liability companies ("**SOCIETÀ A RESPONSABILITÀ LIMITATA**") and partnership limited by shares ("**SOCIETÀ IN ACCOMANDITA PER AZIONI**").

Corporations have legal status, which means that they can enter into agreements, own and dispose of property, incur liabilities and pay taxes like a natural person, remaining legally separate from their quotaholders or shareholders, as well as from their directors/managers. As a result, only the company can be held liable for its obligations vis-à-vis third parties up to the amount of its assets, and the quotaholders or shareholders are generally shielded from liabilities beyond their investment in the company.

Moreover, the company's directors cannot hold company's quotas or shares. The latter are freely transferable, though the company's by-laws can envisage lock-up periods.

- (b) **COOPERATIVE COMPANIES** – Cooperative companies are characterised by the pursuance of a mutual purpose, which mainly consists in carrying out activities in favour of their own members, consumers or service recipients, whilst enjoying the economic benefit of lower prices or higher salaries than those available on the market. Nevertheless, it is still possible to carry out commercial activities vis-à-vis third parties, thus pursuing a profit-making goal alongside with the mutual purpose envisaged in the company's by-laws.

The company's capital is not pre-established by law in its amount, and the participation thereto is represented either by quotas or shares. In so far as they are compatible, law provisions governing joint stock companies are also applicable to cooperative companies.

LEGAL FORMS OF BUSINESS AVAILABLE TO SOCIAL ENTERPRISE:

	JOINT STOCK COMPANIES (<i>SOCIETÀ PER AZIONI</i>)	LIMITED LIABILITY COMPANY (<i>SOCIETÀ A RESPONSABILITÀ LIMITATA</i>)	PARTNERSHIP LIMITED BY SHARES (<i>SOCIETÀ IN ACCOMANDITA PER AZIONI</i>)	SIMPLE PARTNERSHIP (NON COMMERCIAL) (<i>SOCIETÀ SEMPLICE</i>)	GENERAL PARTNERSHIP (COMMERCIAL) (<i>SOCIETÀ IN NOME COLLETTIVO</i>)	LIMITED PARTNERSHIP (<i>SOCIETÀ IN ACCOMANDITA SEMPLICE</i>)	COOPERATIVE COMPANY (<i>SOCIETÀ COOPERATIVA</i>) ¹⁰⁶
OWNERSHIP	<ul style="list-style-type: none"> - Natural or legal persons - Public bodies - Associations - Foundations 	<ul style="list-style-type: none"> - Natural or legal persons - Public bodies - Associations - Foundations 	<p>General partners can be:</p> <ul style="list-style-type: none"> - Natural persons (with requirements provided by law for directors) <p>Special partners can be:</p> <ul style="list-style-type: none"> - natural or legal persons - corporations (under certain conditions) - associations - foundations 	<ul style="list-style-type: none"> - Natural persons - Corporations (under certain conditions) - Other partnerships (There must be at least two members) 	<ul style="list-style-type: none"> - Natural persons - Corporations (under certain conditions) - Other partnerships (There must be at least two members) 	<ul style="list-style-type: none"> - Natural persons - Corporations (under certain conditions) - Other partnerships - Associations - Foundations (There must be at least two members) 	<ul style="list-style-type: none"> - There must be at least nine members (three natural persons when the company complies with the provisions laid down for limited liability companies)
GOVERNANCE	<p>Traditional system:</p> <ul style="list-style-type: none"> - Sole director or Board of directors (management of the company) - Board of auditors (supervisory powers) <p>One-tier system:</p> <ul style="list-style-type: none"> - Board of directors (management of the company) - Committee for management supervision (appointed within the Board of directors with supervisory powers) <p>Two-tier system:</p> <ul style="list-style-type: none"> - Management board (management of the company) - Supervisory board (which, <i>inter alia</i>, appoints (and removes) the members of the management board, and approves the company's financial statements) 	<ul style="list-style-type: none"> - Sole director or board of directors (entrusted with the management of the company, unless otherwise provided in the articles of association) - Board of auditors (its appointment is mandatory only under certain circumstances provided by law) 	<ul style="list-style-type: none"> - Board of directors (management of the company is conferred to general partners by operation of law) - Board of auditors (supervisory powers) 	<p>Unless otherwise provided, each partner is severally entrusted with the duty to manage the company</p>	<p>Each partner is severally entrusted with the duty to manage the company</p>	<p>The management of the partnership and the power of representation can only be conferred upon general partners</p>	<ul style="list-style-type: none"> - Board of directors (management of the company) - Board of auditors (its appointment is mandatory only under certain circumstances provided by law) <p>With some exceptions, most cooperatives are governed on a strict “one member, one vote”, basis irrespective of the quotaholdings held by each member</p>

¹⁰⁶ Cooperative companies are regulated by Law of 31st January 1992, no. 59.

BALANCING PURPOSE AND PROFIT
 LEGAL MECHANISMS TO LOCK IN SOCIAL MISSION FOR “PROFIT WITH PURPOSE” BUSINESSES ACROSS THE G8

	JOINT STOCK COMPANIES (<i>SOCIETÀ PER AZIONI</i>)	LIMITED LIABILITY COMPANY (<i>SOCIETÀ A RESPONSABILITÀ LIMITATA</i>)	PARTNERSHIP LIMITED BY SHARES (<i>SOCIETÀ IN ACCOMANDITA PER AZIONI</i>)	SIMPLE PARTNERSHIP (NON COMMERCIAL) (<i>SOCIETÀ SEMPLICE</i>)	GENERAL PARTNERSHIP (COMMERCIAL) (<i>SOCIETÀ IN NOME COLLETTIVO</i>)	LIMITED PARTNERSHIP (<i>SOCIETÀ IN ACCOMANDITA SEMPLICE</i>)	COOPERATIVE COMPANY (<i>SOCIETÀ COOPERATIVA</i>) ¹⁰⁶
OBJECT	Exercise of an economic activity for the purpose of sharing the profits deriving therefrom	Exercise of an economic activity for the purpose of sharing the profits deriving therefrom	Exercise of an economic activity for the purpose of sharing the profits deriving therefrom	Exercise of an economic activity (yet limited to a non-commercial one) for the purpose of sharing the profits deriving therefrom	Exercise of an economic activity for the purpose of sharing the profits deriving therefrom	Exercise of an economic activity for the purpose of sharing the profits deriving therefrom	Mutual purpose
SOCIAL PURPOSE	No specific requirement	No specific requirement	No specific requirement	No specific requirement	No specific requirement	No specific requirement	No specific requirement
LIMITED LIABILITY FOR OWNERS	Limited liability to the extent of the shareholders' contribution to the company itself.	Limited liability to the extent of the shareholders' contribution (under certain circumstances, when the company belongs to one person only, the latter is liable without limitations)	At least one of the partners must have limited liability and at least one must be general partner. - General partners: severally liable without limits for the partnership's obligations - Special partners: liable to the extent of their contribution	Partners are jointly and severally liable for the partnership's obligations.	Partners are jointly and severally liable for the partnership's obligations.	At least one partner must have limited liability equivalent to his/her contribution and one must be general partner, with full liability for the company's obligations. - General partners: severally liable without limits for partnership obligations - Special partners: liable to the extent of their contributions	Limited liability for their members to the extent of their contribution

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	JOINT STOCK COMPANIES (<i>SOCIETÀ PER AZIONI</i>)	LIMITED LIABILITY COMPANY (<i>SOCIETÀ A RESPONSABILITÀ LIMITATA</i>)	PARTNERSHIP LIMITED BY SHARES (<i>SOCIETÀ IN ACCOMANDITA PER AZIONI</i>)	SIMPLE PARTNERSHIP (NON COMMERCIAL) (<i>SOCIETÀ SEMPLICE</i>)	GENERAL PARTNERSHIP (COMMERCIAL) (<i>SOCIETÀ IN NOME COLLETTIVO</i>)	LIMITED PARTNERSHIP (<i>SOCIETÀ IN ACCOMANDITA SEMPLICE</i>)	COOPERATIVE COMPANY (<i>SOCIETÀ COOPERATIVA</i>) ¹⁰⁶
TRANSFERS OF OWNERSHIP	It is possible to transfer ownership separately from the company's assets (e.g. transformation, merger or demerger)	It is possible to transfer ownership separately from the company's assets (e.g. transformation, merger or demerger)	It is possible to transfer ownership separately from the company's assets (e.g. transformation, merger or demerger)	It is possible to transfer ownership separately from the company's assets (e.g. transformation, merger or demerger)	It is possible to transfer ownership separately from the company's assets (e.g. transformation, merger or demerger)	It is possible to transfer ownership separately from the company's assets (e.g. transformation, merger or demerger)	It is possible to transfer ownership separately from the company's assets under certain conditions (transformation is allowed: from a cooperative company with no prevailing mutual assistance to a for-profit company; and from a corporation to a cooperative company)
DEBT FINANCING	The issuance of debt securities is available	The company may issue debt securities if it is contemplated in the articles of association	The issuance of debt securities is available	<ul style="list-style-type: none"> - Partnerships are barred from issuing debt securities. - Other forms of debt are available (e.g. short-term or long-term loans from partners). 	<ul style="list-style-type: none"> - Partnerships are barred from issuing debt securities. - Other forms of debt are available (e.g. short-term or long-term loans from partners). 	<ul style="list-style-type: none"> - Partnerships are barred from issuing debt securities. - Other forms of debt are available (e.g. short-term or long-term loans from partners). 	The issuance of debt securities is available (under certain conditions), together with other forms of debt (credit lines and loan facilities)
EQUITY FINANCING	<ul style="list-style-type: none"> - Equity financing is available by allocating shares to investors. - IPOs is also possible for joint-stock companies 	Equity financing is available by allocating quotas to investors	Equity financing is available by allocating shares to investors	<ul style="list-style-type: none"> - Partnerships cannot issue shares to investors. - Equity financing mainly originates from personal assets of the partners 	<ul style="list-style-type: none"> - Partnerships cannot issue shares to investors. - Equity financing mainly originates from personal assets of the partners 	<ul style="list-style-type: none"> - Partnerships cannot issue shares to investors. - Equity financing mainly originates from personal assets of the partners 	Equity financing derives from: <ul style="list-style-type: none"> - Initial conventional (obligatory) cooperative membership fees - allocation of shares and other financial instruments (when so provided by the by-laws) to members or external investors. Specific limitations exist in this regard

	JOINT STOCK COMPANIES (<i>SOCIETÀ PER AZIONI</i>)	LIMITED LIABILITY COMPANY (<i>SOCIETÀ A RESPONSABILITÀ LIMITATA</i>)	PARTNERSHIP LIMITED BY SHARES (<i>SOCIETÀ IN ACCOMANDITA PER AZIONI</i>)	SIMPLE PARTNERSHIP (NON COMMERCIAL) (<i>SOCIETÀ SEMPLICE</i>)	GENERAL PARTNERSHIP (COMMERCIAL) (<i>SOCIETÀ IN NOME COLLETTIVO</i>)	LIMITED PARTNERSHIP (<i>SOCIETÀ IN ACCOMANDITA SEMPLICE</i>)	COOPERATIVE COMPANY (<i>SOCIETÀ COOPERATIVA</i>) ¹⁰⁶
TAX TREATMENT	<ul style="list-style-type: none"> - Net annual profits: subject to IRES (corporate tax) with 27, 50% rate on the taxable net profit; - Net value of production: subject to IRAP (regional tax on productive activities); - “Tax transparency” (<i>opzione per la trasparenza fiscale</i>): the taxable income is attributed to shareholders, regardless of the actual perception, in proportion to their respective shares of participation to profits (available only for company controlled by corporations with certain requirements) - VAT (Value Added Tax) for transactions, and - IMU (unified municipal tax) for properties owned 	<ul style="list-style-type: none"> - Net annual profits: subject to IRES (corporate tax) with 27, 50% rate on the taxable net profit; - Net value of production: subject to IRAP (regional tax on productive activities); - “Tax transparency” (<i>opzione per la trasparenza fiscale</i>): the taxable income is attributed to shareholders, regardless of the actual perception, in proportion to their respective shares of participation to profits (available only for company controlled by natural persons or corporations with certain requirements) - VAT (Value Added Tax) for transactions, and - IMU (unified municipal tax) for properties owned 	<ul style="list-style-type: none"> - Net annual profits: subject to IRES (corporate tax) with 27, 50% rate on the taxable net profit; - Net value of production: subject to IRAP (regional tax on productive activities); - “Tax transparency” (<i>opzione per la trasparenza fiscale</i>): the taxable income is attributed to shareholders, regardless of the actual perception, in proportion to their respective shares of participation to profits (available only for company controlled by corporations with certain requirements) - VAT (Value Added Tax) for transactions, and - IMU (unified municipal tax) for properties owned 	<p>The company is fiscally an autonomous entity with respect to shareholders and must submit its own income tax return; the taxable income is subject to:</p> <ul style="list-style-type: none"> - IRPEF (personal income tax), which is attributed to partners in proportion to their respective shares of participation to profits, regardless of the actual perception. - VAT (Value Added Tax) for transactions, and - IMU (unified municipal tax) for properties owned 	<p>The company is fiscally an autonomous entity with respect to shareholders and must submit its own income tax return; the taxable income is subject to:</p> <ul style="list-style-type: none"> - IRPEF (personal income tax), which is attributed to partners in proportion to their respective shares of participation to profits, regardless of the actual perception. - IRAP (regional tax on productive activities), for the value of production - VAT (Value Added Tax) for transactions, and - IMU (unified municipal tax) for properties owned 	<p>The company is fiscally an autonomous entity with respect to shareholders and must submit its own income tax return; the taxable income is subject to:</p> <ul style="list-style-type: none"> - IRPEF (personal income tax), which is attributed to partners in proportion to their respective shares of participation to profits, regardless of the actual perception (losses exceeding the capital can be imputed only to general partners). - IRAP (regional tax on productive activities), for the value of production - VAT (Value Added Tax) for transactions, and - IMU (unified municipal tax) for properties owned 	<p>A privileged tax regime is provided for cooperatives “with a prevalence of mutual aid”¹⁰⁷:</p> <ul style="list-style-type: none"> - IRES (corporate tax): non-taxability of a quota of the company net annual profit; - IRAP: admissible deductions from income (the reimbursement made in favour of the members of a part of the cost of goods and services purchased or as retribution for services – <i>ristorni</i> – can be deducted by the cooperative) - passive interest accrued on sums which individuals confer to the cooperative or to other members is deductible up to a limit set forth by the law. - Special tax regimes are provided for specific types of cooperatives, e.g. agricultural and small fishery cooperatives, worker and production cooperatives, social cooperatives, cooperative credit banks, etc.

107 The cooperatives have prevalence of mutuality in the event:

- a) they perform their activity mainly for their members, consumers or beneficiaries of their goods and services;
- b) their revenues from the sale of goods and supply of services to their members exceeds 50% of their aggregate revenues;
- c) the cost of the labour of the members of the cooperatives exceeds the 50 % of the total labour cost;
- d) they do not distribute dividends in a percentage on the capital really disbursed exceeding the maximum interest rate on the postal bonds increased of 2 points;
- e) the loans granted by the member of the cooperatives to the company receive a remuneration not exceeding that of point d) al.;
- f) while existing, they do not distribute reserves to their members;
- g) in case of dissolution, the entire patrimony of the cooperative (net of social capital disbursed and of new payable dividends) is assigned to mutuality funds for the promotion and development of cooperation.

BALANCING PURPOSE AND PROFIT
LEGAL MECHANISMS TO LOCK IN SOCIAL MISSION FOR “PROFIT WITH PURPOSE” BUSINESSES ACROSS THE G8

	JOINT STOCK COMPANIES (<i>SOCIETÀ PER AZIONI</i>)	LIMITED LIABILITY COMPANY (<i>SOCIETÀ A RESPONSABILITÀ LIMITATA</i>)	PARTNERSHIP LIMITED BY SHARES (<i>SOCIETÀ IN ACCOMANDITA PER AZIONI</i>)	SIMPLE PARTNERSHIP (NON COMMERCIAL) (<i>SOCIETÀ SEMPLICE</i>)	GENERAL PARTNERSHIP (COMMERCIAL) (<i>SOCIETÀ IN NOME COLLETTIVO</i>)	LIMITED PARTNERSHIP (<i>SOCIETÀ IN ACCOMANDITA SEMPLICE</i>)	COOPERATIVE COMPANY (<i>SOCIETÀ COOPERATIVA</i>) ¹⁰⁶
DISSOLUTION	Directors must ascertain the occurrence of a cause of dissolution provided by law and the shareholders’ meeting appoints the liquidators, who pay all creditors, and distribute the residual assets to the shareholders	Directors must ascertain the occurrence of a cause of dissolution provided by law and the shareholders’ meeting appoints the liquidators, who pay all creditors, and distribute the residual assets to the shareholders	Directors must ascertain the occurrence of a cause of dissolution provided by law and the shareholders’ meeting appoints the liquidators, who pay all creditors, and distribute the residual assets to the shareholders	Directors must ascertain the occurrence of a cause of dissolution provided by law and the company’s members can negotiate terms and conditions to distribute the remaining assets. In case of disagreement, members can appoint one or more liquidators	Directors must ascertain the occurrence of a cause of dissolution provided by law and the members can negotiate terms and conditions to distribute the remaining assets. In case of disagreement, members can appoint one or more liquidators	Directors must ascertain the occurrence of a cause of dissolution provided by law and the members can negotiate terms and conditions to distribute the remaining assets. In case of disagreement, members can appoint one or more liquidators	Directors must ascertain the occurrence of a cause of dissolution provided by law and the shareholders’ meeting appoints the liquidators, who pay all creditors and distribute the residual assets to the shareholders
CHARITABLE STATUS	N/A	N/A	N/A	N/A	N/A	N/A	N/A
REGULATOR	<ul style="list-style-type: none"> - Judicial authority (supervisory powers on companies’ management) - Italian Securities and Exchange Commission (<i>CONSOB</i>) for listed companies. - National Competent Authority (i.e. <i>CONSOB</i>, Insurance Supervisory Authority (<i>IVASS</i>) or the Bank of Italy with regard to companies operating in regulated markets (i.e. financial, banking and/or insurance markets) 	Not provided	Judicial authority (supervisory powers on companies’ management)	Not provided	Not provided	Not provided	<ul style="list-style-type: none"> - Ministry of Economic Development and Ministry of Labour and Social Welfare (supervisory powers and other controls required by special laws)¹⁰⁸ - Judicial authority (supervisory powers on companies’ management)

¹⁰⁸ Legislative Decree of 14th December 1947, no. 1577.

BALANCING PURPOSE AND PROFIT
LEGAL MECHANISMS TO LOCK IN SOCIAL MISSION FOR “PROFIT WITH PURPOSE” BUSINESSES ACROSS THE G8

	JOINT STOCK COMPANIES (<i>SOCIETÀ PER AZIONI</i>)	LIMITED LIABILITY COMPANY (<i>SOCIETÀ A RESPONSABILITÀ LIMITATA</i>)	PARTNERSHIP LIMITED BY SHARES (<i>SOCIETÀ IN ACCOMANDITA PER AZIONI</i>)	SIMPLE PARTNERSHIP (NON COMMERCIAL) (<i>SOCIETÀ SEMPLICE</i>)	GENERAL PARTNERSHIP (COMMERCIAL) (<i>SOCIETÀ IN NOME COLLETTIVO</i>)	LIMITED PARTNERSHIP (<i>SOCIETÀ IN ACCOMANDITA SEMPLICE</i>)	COOPERATIVE COMPANY (<i>SOCIETÀ COOPERATIVA</i>) ¹⁰⁶
REPORTING REQUIREMENTS	Several documents need to be filed with the Companies Register (e.g. articles of association, appointment of directors, financial statements)	Several documents need to be filed with the Companies Register (e.g. articles of association, appointment of directors, financial statements)	Several documents need to be filed with the Companies Register (e.g. articles of association, appointment of directors, financial statements)	Articles of association must be filed with the Companies Register	Some documents must be filed with the Companies Register (e.g. articles of association, appointment of directors)	Some documents must be filed with the Companies Register (e.g. articles of association, appointment of directors)	Directors must keep the company's accounts properly and draft the yearly financial statements
ADVANTAGES	<ul style="list-style-type: none"> - Limited liability of shareholders for the company's obligations - Most suitable legal structure for raising capital (debt or equity) - Possibility of going public. 	<ul style="list-style-type: none"> - Limited liability of members for the company's obligations - Minimum stock capital equal to Euro 10,000,00 or Euro 1 in certain circumstances - Significant management, governance, distribution and ownership flexibility 	Suitable legal structure for raising capital (debt or equity)	No minimum capital required for the establishment of the company	No minimum capital required for the establishment of the company	No minimum capital required for the establishment of the company	<ul style="list-style-type: none"> - Limited liability of members for the company's debts - No minimum capital required and members can freely join or leave without the need to amend the by-laws
DISADVANTAGES	<ul style="list-style-type: none"> - Complex formation process - Minimum stock capital equal to Euro 120,000,00 - Need to comply with some formalities in the company's management 	<ul style="list-style-type: none"> - Incorporation and management formalities are required - Participations to the company's capital cannot be represented by shares nor object of an offer to the public. 	<ul style="list-style-type: none"> - Shareholders can be held personally liable for the company's obligations - This form of company is very rare in practice, and is defined as a joint stock company characterised by the presence of partners liable without limitations. In so far as they are compatible, law provisions laid down for joint stock companies are also applicable to partnerships limited by share. 	<ul style="list-style-type: none"> - Full liability of all partners for the company's obligations - Exercise of non-commercial activities only 	All members are considered general partners, with full liability and management responsibility.	Full liability for all partners	A limit is generally provided by the by-laws on the proportion of profits that can be distributed to company's members. Distribution of reserves is prohibited and at least 30% of the company's net annual profits must be attributed to legal reserve

3.3 WHAT LEGAL FORMS OF ORGANISATION, IF ANY, HAVE BEEN SPECIFICALLY DESIGNED FOR SOCIAL ENTERPRISES?

The law provisions governing social enterprise (“*impresa sociali*”) concern, in particular, the social enterprise’s institutional structure, governance and activity, and impose some limitations with regard to corporate purpose, ownership structure, transfer of quotaholding or shareholding and the ability to assets’ disposal. Such limitations outweigh the rules on the traditional legal forms described under paragraph 3.2 above.

SOCIAL ENTERPRISE (“S.E.”) (IMPRESA SOCIALE)	
OWNERSHIP	Assets locked in (shareholders do not have any claim on the company’s assets). <ul style="list-style-type: none"> - For-profit entities and public bodies do not have any control, management and co-ordination power over the S.E.¹⁰⁹ - Admission to or exclusion from the S.E. must be carried out according to a strict non-discrimination principle.
GOVERNANCE	<ul style="list-style-type: none"> - The rules governing the underlying legal entity must apply with the above limitations. - Mandatory multi-stakeholder governance structure: forms of involvement (i.e. information, consulting or participation) of workers/service recipients must be provided by the company’s articles of association or by-laws.¹¹⁰ - In case the S.E. is established in the form of an association, the appointment of the management cannot be reserved to third parties outside the S.E. itself. - One or more statutory auditors must be appointed when two of the following thresholds are exceeded: a) net worth assets over Euro 4,400,000.00; b) revenues over Euro 8,800,000.00; c) number of employees over 50.¹¹¹
OBJECTS	A S.E. can only choose a social purpose falling amongst those provided by the law. No restriction is provided as to the object for S.E.s with at least 30% of employees represented by disadvantaged people.
SOCIAL PURPOSE	Eligibility criteria for classifying as a S.E.: <ul style="list-style-type: none"> - Carrying out a “social activity” falling amongst those provided by the law, and covering at least 70% of the total income; or - Employing disadvantaged workers accounting for at least 30% of all employees.
LIMITED LIABILITY FOR OWNERS	<ul style="list-style-type: none"> - The rules regarding the underlying entity will apply, when such entity is a company, a partnership or a cooperative company. - When the entity’s equity overcomes Euro 20.000 limited liability.
TRANSFERS OF OWNERSHIP	The entity can be transferred separately from its assets. Extraordinary transactions (such as transformation, merger, demerger, transfer of going concern) are regulated so as to guarantee that the resulting legal entity maintains its non-profit status and its general social purpose.
DEBT FINANCING	The rules regarding the underlying entity will apply.
EQUITY FINANCING	The rules regarding the underlying entity will apply.

109 Section 4, paragraph 3, of the Decree.

110 Section 12 of the Decree.

111 Section 11 of the Decree.

SOCIAL ENTERPRISE ("S.E.") (IMPRESA SOCIALE)	
TAX TREATMENT	Organisations already benefiting from special tax treatment ¹¹² (i.e. <i>ONLUS</i> , Non-Profit Organisations of Social Utility) maintain their status.
DISSOLUTION	The rules regarding the underlying entity will apply. In the event of insolvency, the S.E. undergoes a forced administrative liquidation procedure (<i>liquidazione coatta amministrativa</i>), except for religion-driven S.E.s. ¹¹³ Upon dissolution of the S.E., the latter's residual assets must be allocated to non-profit organisations, associations, committees, foundations or religious entities.
CHARITABLE STATUS	No automatic classification is provided.
REGULATOR	Ministry of Labour and Social Welfare
REPORTING REQUIREMENTS	No direct form of reporting is provided. The S.E. must notify the Ministry of Labour and Social Welfare of any extraordinary transactions concerning the S.E.
ADVANTAGES	n/a
DISADVANTAGES	<ul style="list-style-type: none"> - No tax incentives - Complex administrative requirements for setting up - Obligation to draft a social financial statement

¹¹² Those complying with the requirements laid down by Legislative Decree of 4th December 1997, no. 460.

¹¹³ Section 15 of the Decree.

3.4 WHAT HYBRID STRUCTURES ARE OR COULD BE USED TO ESTABLISH A BUSINESS WITH THE KEY CHARACTERISTICS OF A SOCIAL ENTERPRISE?

The social cooperative is an hybrid structure that has so far represented the most common type of social enterprise in Italy.¹¹⁴

The social cooperative is a particular form of company aimed at fostering the integration of disadvantaged people (minor, disabled, and elderly people, former prison inmates, former drug addicts, etc.) into society. It can carry out two main activities:

- (i) **CARING ACTIVITIES** (e.g. management of socio-medical or educational services, social housing, residential care for people at risk, babysitting, cultural or environmental protection activities); or
- (ii) **TRAINING ACTIVITIES** (labour force integration, creating employment opportunities for disadvantaged workers).

While social cooperatives are subject to the general rules envisaged in the Italian Civil Code for other cooperatives, especially as far as organisational criteria are concerned (i.e. setting-up and liquidation, requirements for membership, management, budget process, limited profit distribution), they are also subject to a special framework legislation,¹¹⁵ according to which:

- (i) social cooperatives can have up to 50% of unpaid (volunteer) members, who are exempted from standard requirements applicable to worker members;
- (ii) when the activity is aimed at providing employment opportunities for disadvantaged people, the disadvantaged workers must account for a minimum of 30% of the total work force;
- (iii) they enjoy a variety of tax advantages such as: **a)** reduction of the valued added tax on sales of services and other incentives originated from their fiscal status as non-profit organisations (e.g. services generally subject to VAT with a 4% tax rate);¹¹⁶ **b)** partial or total exemption from the employer’s contributions in connection to the salary of disadvantaged workers; **c)** reduction up to ¼ of the cadastral and mortgage taxes relating to real estate properties serving the social cooperative’s activity.

¹¹⁴ “Since the adoption of the law introducing the social cooperatives, the latter have registered an annual growth rate ranging from 15 to 30 percent. In 2003, there were about 6,500 – 7,000 social cooperatives in the country, employing about 200,000 workers (i.e. more than 1 percent of total employment), and benefitting 1.5 million people”. (United Nations Development Programme (UNDP) - EMES European Research Network project, *Social Enterprise: A new model for poverty reduction and employment generation: An examination of the concept and practice in Europe and the Commonwealth of Independent States*, Report 2008, page 21).

¹¹⁵ Law of 8th November 1991, no. 381.

¹¹⁶ Section 41-bis, List A, Part II, of Presidential Decree 26th October 1972, no. 633.

In the event that their by-laws also complies with the requirements set out in the Decree regarding the drafting of financial statements,¹¹⁷ as well as the involvement of the employees in the cooperative’s governance,¹¹⁸ they are also subject to the rules described in paragraph 3.3., above.

4 OTHER METHODS OF IMPLEMENTATION

4.1 WILL APPLICABLE LAW RESPECT CONTRACT TERMS ESTABLISHING AND/OR PROTECTING A SOCIAL PURPOSE?

No. In fact, there is no need to implement further tools to preserve the social purpose of a social enterprise.

The Decree’s provisions setting out eligibility criteria prevail over general law provisions.

5 ADDITIONAL CONTROLS OVER SOCIAL ENTERPRISES

5.1 WHAT OTHER LEGAL OBLIGATIONS OR CONTROLS OVER THE SOCIAL PURPOSE APPLY TO SOCIAL ENTERPRISES UNDER APPLICABLE LAW? ARE THESE REQUIREMENTS MANDATORY OR PERMISSIVE?

The Decree sets forth a number of rules concerning governance, which are specific to non-profit legal entities.

(a) Additional transparency measures

Every year, a social enterprise must approve specific “social” financial statements and file them with the competent Companies Register. Such financial statements must be drafted according to the guidelines provided by the Ministry of Labour and Social Welfare “so as to represent the compliance with the social purpose by the social enterprise”.¹¹⁹

Together with the financial statements, the social enterprise must file all documents specifying the information in order to qualify as a social enterprise, such as: (i) the type

¹¹⁷ Section 10, paragraph 2, of the Decree.

¹¹⁸ Section 12 of the Decree.

¹¹⁹ Section 10 of the Decree. An implementing decree laying down the rules for drafting the social financial statements was jointly issued on 24th January 2008 by the Ministry of Economic Development and the Ministry of Labour and Social Welfare.

of social activity carried out; (ii) the 70% threshold of revenues coming from the social activity; or (iii) the 30% threshold of disadvantaged workers employed.¹²⁰

In the event that a social enterprise does not comply with the 70% threshold requirements, it must inform the Ministry of Social Welfare and the competent offices of the Companies Register within 30 days from the approval of the financial statements.

Articles of association and all other documents concerning the social enterprise that must be filed with the Companies Register can be accessed at any time by the Ministry of Labour and Social Welfare for monitoring and surveillance purposes.

(b) Asset lock

A social enterprise can never be controlled by for-profit entities. Although private for-profit enterprises or public bodies can participate to the capital of a social enterprise, they cannot exercise any power of direction and control over the latter's management.¹²¹ In this respect, a direction and control is deemed to be exercised when the articles of association grants to the stakeholder at issue the right to appoint the majority of the social enterprise's managing bodies.

Any resolution approved with the majority of votes or with the decisive vote of private for-profit enterprises or public bodies is voidable and can be challenged within 180 days from the adoption thereof by the interested persons pursuant to the applicable law.

In an association qualifying as a social enterprise, the appointment of the majority of the management board cannot be reserved to third parties (i.e. external to the association itself), save as otherwise provided. Persons appointed by for-profit entities or public bodies cannot manage a social enterprise.¹²²

In the event of dissolution of a social enterprise, the residual assets must be allocated to non-profit entities, associations, foundations or religious entities, according to the social enterprise's by-laws.¹²³

Extraordinary transactions (i.e. conversion, merger, demerger or transfer of going concern) relating to a social enterprise are monitored by the Ministry of Labour and Social Welfare. Therefore, the latter must be notified in advance by the management of the social enterprise of the intention to carry out any of the above transactions, unless the beneficiary thereof is another social enterprise. The efficacy of the transaction is subject to the authorisation of the Ministry, having heard the Agency for the Non-Profit Organisations of Social Utility (*Agenzia per le organizzazioni non lucrative di utilità sociale*).

¹²⁰ Section 3 of the above-mentioned ministerial Decree, which sets forth the rules to determine the 70% threshold and other rules.

¹²¹ Section 4 of the Decree.

¹²² Section 8 of the Decree.

¹²³ Section 13, paragraph 3, of the Decree.

(c) Profits lock

Social enterprises are subject to a strict profit distribution constraint. Indeed, the distribution of profits, operating surplus, funds and reserves is prohibited, also through indirect forms of distribution such as:

- (i) remuneration to directors higher than those generally paid by businesses operating within the same sectors and at the same conditions;
- (ii) compensation to employees higher than those provided for by collective bargaining instruments for the same professional qualification;
- (iii) remuneration of financial instruments other than shares or quotas to persons with the exception of banks or authorised financial intermediaries¹²⁴.

However, the above indirect distribution constraint has two major exceptions:

- (i) a maximum 20% increase of the directors' remuneration is allowed in case the social enterprise requires specific professional figures; and
- (ii) a remuneration higher than the one provided for by collective bargaining instruments is allowed in relation to those employees bringing specific (and justified) professionalism to the enterprise.

(d) Mission lock

There is no provision restricting the faculty to change or abandon the social mission of the business at issue.

Such a change would however imply an amendment of the social enterprise's by-laws, with the consequence that, from then onwards, only general rules applicable to social enterprises will continue to apply¹²⁵.

(e) Enforcement mechanisms

The Ministry of Labour and Social Welfare is in charge of monitoring the compliance of the regulation on social enterprises¹²⁶. In pursuance of its duties, it can also engage with the Agency for the Non-Profit Organisations of Social Utility, workers' unions and entrepreneurs' organisations, government agencies and research entities on which it extends control.

Moreover, the Ministry of Labour and Social Welfare has a general power of inspection, which is carried out through its local offices, and can result in different kinds of sanctions:

¹²⁴ Section 3, paragraph 2, of the Decree.

¹²⁵ By way of example, in a company limited by shares, such an amendment would give rise to the right of dissenting (i.e. shareholders may withdraw from the company).

¹²⁶ Section 16 of the Decree.

- (i) initially, the Ministry can send a formal notice to the social enterprise intimating to regularise the enterprise's position;
- (ii) in case of non-compliance with the above notice, or of infringement of the main rules concerning the social enterprise (namely, those provided for by Sections 1, 2, 3 and 4 of the Decree), the Ministry can disqualify the company/entity in question as social enterprise.

Furthermore, the Ministry has ad hoc monitoring powers in the event of dissolution of a social enterprise.

(f) Change of control

Any conversion, merger or demerger involving a social enterprise must be carried out with an eye to safeguard its non-profit purpose, that is the extraordinary transaction at issue must result in the creation of a non-profit entity.

Moreover, any transfer of the social enterprise must be carried out so as to guarantee that the transferor maintains the general interest of the enterprise's activity¹²⁷.

To be effective, any of the above extraordinary transactions must be first approved by the Ministry of Social Welfare. Accordingly, Social enterprises must notify in advance the Ministry of their intention to proceed with an extraordinary transaction, and file therewith the relevant documentation¹²⁸.

6 ACCESS TO INVESTMENT CAPITAL

6.1 TAX INCENTIVES

No provision of the Decree sets forth tax incentives or other forms of tax relief for social enterprises and its investors. However, the Decree preserves the applicability of the special tax regime on ONLUS to entities already benefiting from it.

The law proposal currently being discussed in the Italian Parliament envisages the following forms of tax incentives:

- (i) automatic eligibility of entities qualifying as social enterprises to the ONLUS tax regime;¹²⁹
- (ii) tax advantages for investors in social enterprises (created under the form of companies) under the new regulation of innovative start-ups.¹³⁰

¹²⁷ Section 13 of the Decree.

¹²⁸ An implementing decree jointly issued by the Ministry of Economic Development and the Ministry of Social Welfare on 24th January 2008 provides specific rules in relation to the authorisation application procedure to the filing and timing.

¹²⁹ However, in this case, a strict distribution constraint will apply.

¹³⁰ Such a regime was introduced by Sections 25 and following of Law Decree 18th October 2012, no. 179 (*Decreto Crescita 2.0*), converted into Law 17th December 2012, no. 221.

6.2 INVESTMENT STRUCTURES

So far, Italian social enterprises have been financing their own growth and development through self-financing mechanisms, as well as through revenues deriving from their business activities.

Usually, socially responsible investors do not invest in a social enterprise through the acquisition of equity therein. Rather, social enterprises have access to financial resources through:

- traditional forms of fundraising;
- public funds;
- banking foundations;
- financing facilities provided by banks specialising in “socially responsible investments” (e.g. *Banca Etica*, *Banca Prossima*); and
- new figures of venture capitalists.

6.3 BARRIERS TO ACCESSING INVESTMENT

The rules set forth by the Decree have proved not be attractive for fund raising purposes both from private investors and the general public, mainly due to:

- (i) prohibition to return the social enterprise’s profits to investors;
- (ii) prohibition for a profit entity to exercise any direction and control power over the social enterprises; and
- (iii) substantial absence of tax benefits.

6.4 RISK

No specific rule in respect thereof is provided by the Decree. General rules governing the different forms of social enterprise will apply, including those concerning the above-mentioned segmentation of the social enterprise’s assets amongst equity shareholders.

6.5 EXIT

No specific rule in respect thereof is provided by the Decree. General rules governing the different forms of social enterprises will apply. For instance, in case of a joint-stock company, an investor can exit the company by recurring to **i**) right of withdrawal provided for the by-laws (e.g. change of the company’s business purpose), **ii**) put-option to be negotiated with other shareholders, or **iii**) launch of an IPO.

JAPAN



JAPAN

1 COUNTRY OVERVIEW

Japanese law does not presently provide for a form of primarily for-profit entity that is tailored to profit-with-purpose businesses (“PPBs”). While there are various entity types that specifically contemplate social activities and purposes¹³¹, they are subject to various limitations such as being narrow in scope, subject to strict restrictions and/or operationally inflexible or subject to certain asset or profit lock. Thus, in practical terms, PPBs in Japan must avail themselves of the traditional, generally available “commercial” entity forms, where “commercial” herein means having an ultimate purpose of making and distributing profits to its equityholders. The typical “commercial” entity forms, the representative types of which are the stock corporation (*kabushiki kaisha*) (“KK”) and the limited liability company (*godo kaisha*) (“GK”), have no provisions designed for PPBs, though there is also no bar that would prevent these entities from promoting double or triple bottom line impacts.

This relative lack of entity form infrastructure correlates with the relatively small number of enterprises in Japan with social purposes. According to data cited during governmental roundtable discussions in 2010, there were approximately 40,000 NPOs in Japan at such time, but only 15% of such NPOs had operations larger than JPY 30 million. Also, in comparison with the United Kingdom, whose population is roughly half that of Japan, the governmental roundtable also cited data that, notwithstanding the GDP of Japan being almost twice of the United Kingdom’s as of such time, there were approximately 55,000 entities with social purposes in the United Kingdom with market value in the magnitude of JPY 5.7 trillion in the aggregate, compared to approximately 8,000 of such entities and JPY 240 billion in Japan.

While, recently, various social and political concerns have compelled the Japanese government to evaluate the establishment of novel legal entities that are tailored to social purpose enterprises, including the social business entity (*shakai jigyou houjin*) and the non-commercial stock corporation (*hieirigata kabushiki kaisha*), such entities contemplate profit locking and thus are inconsistent with PPBs; at present, the Japanese government is not in the process of evaluating any entity forms that are tailored to PPBs.

¹³¹ Such entities include, e.g., (i) the social welfare corporation (*shakai fukushi houjin*), which is a type of entity that operates welfare facilities for, e.g., disabled persons and elderly persons, child care facilities, hospitals and clinics; (ii) the rehabilitation corporation (*kousei hogo houjin*), which is a type of entity whose operations are related to assisting rehabilitation of criminal offenders; (iv) the public welfare association (*koueki shadan houjin*), which is a type of entity that is limited to primarily carrying out certain public welfare activities; (v) the non-profit organization with entity status (*tokutei hieiri katsudou houjin*), which is a type of entity that primarily carries out non-profit activities; and (iii) the foundation (*zaidan houjin*).

2 LEGAL FOUNDATIONS FOR PPBS

2.1 CAN A BUSINESS BE FORMED UNDER APPLICABLE LAW WITH THE FOLLOWING CHARACTERISTICS OF A PPB?

(a) Social purpose

Commercial entities such as Kks and Gks may adopt social purposes. Adopting social purposes generally does not confer any special characteristics or treatment from a legal point of view, and does not alter the ultimate purpose of commercial entities to make and distribute profits to its equityholders. Thus, notwithstanding a commercial entity adopting social purposes, it remains the case that such entity must generally maximize equityholder interests and full or partial distribution of its profits is contemplated. Nevertheless, such general principle is not thought to operate at an absolute level and is not thought to necessarily require the distribution of an entity's profits to the maximum extent possible. In other words, such general principle is not interpreted to preclude commercial entities from adopting social purposes; PPBs may pursue its social purposes even if such pursuit may lead to instances where equityholder interests are not maximized.

Furthermore, it is not thought of as required that social purposes be secondary purposes of commercial entities – social purposes may be primary purposes, so long as the adoption of such purposes does not lead to a result that completely contravenes the general principle of maximizing equityholder interests, e.g., a result where the entity is completely asset and profit locked.

(b) Duties

To the extent commercial entities adopt social purposes and provide for such adoption in their organizational documents, it can be considered that the governing bodies of such entities would then be generally bound to act consistently therewith, although it is unclear to what extent such adoption could be compelled.

Here, consistent with the notion that commercial entities are not precluded from adopting social purposes that may not always promote the maximization of equityholder interests, it is generally thought of as permissible for the governing bodies of commercial entities that adopt social purposes to consider the interests of groups other than the equityholders, and, so long as such governing bodies do not act in complete contravention of equityholder interests or otherwise extreme extent, it is likely difficult for them to be deemed in violation of, e.g., their fiduciary duties simply for furthering social purposes of an entity's business.

(c) Transparency regarding achievement of social impact purpose

Commercial entities are not subject to additional reporting or disclosure requirements by virtue of any adoption of social purpose. Reporting or disclosure of social purposes or aspects thereto would be to the extent relevant to the matters otherwise reportable or disclosable by such entities under generally applicable laws (e.g., reporting and disclosure documents of publicly traded Kks generally).

3 LEGAL FORMS AVAILABLE FOR PPBS

3.1 OVERVIEW OF LEGAL FORMS OF ORGANISATION AVAILABLE TO PPBS.

PPBs must avail themselves of a typical commercial entity form such as a Kk or a Gk. A Kk is analogous to a “corporation” as conventionally understood under US law and a “limited company” as conventionally understood under UK law, while a Gk is analogous to a “limited liability company” as conventionally understood under US law. Commercial entities may adopt any social purpose, have the freedom to issue equity and may have transferrable equity. A business operated by a commercial entity is, however, subject to a fundamental requirement that the business is operated in accordance with being a “commercial” enterprise (i.e., it is operated on the premise of generating and distributing profits to its equityholders). Such fundamental requirement manifests in, for example, the limitation that a commercial entity may not be completely profit locked – a commercial entity may not be operated such that both its surplus and its residual assets are locked from its equityholders.

Among the forms of commercial entities, by far the most commonly used by PPBs as well as generally is the Kk. We discuss the Kk in more detail below.

3.2 WHAT LEGAL FORMS OF ORGANISATION ARE AVAILABLE TO BUSINESSES GENERALLY THAT COULD BE USED TO FORM A PPB?

KK	
OWNERSHIP	<ul style="list-style-type: none"> - No limitations on the identity of shareholders (i.e., natural persons as well as juridical persons, residents as well as non-residents, may be shareholders). - No limitations on the number of shareholders.
GOVERNANCE	<ul style="list-style-type: none"> - In general, the general assembly of shareholders (kabunushi soukai). - If a board of directors (torishimariyakukai) is put in place, then powers of the shareholders are reduced and the board of directors would govern generally.
OBJECTS	<ul style="list-style-type: none"> - Commercial¹³² activity (eiri katsudou). - To maximize shareholder profits. Accordingly, it is expected to generally carry out for-profit businesses (shuueki jigyou).
SOCIAL PURPOSE	Possible, but not required.
LIMITED LIABILITY FOR OWNERS	Limited liability.
TRANSFERS OF OWNERSHIP	Possible.
DEBT FINANCING	Possible.
EQUITY FINANCING	Required.
TAX TREATMENT	Treated as an ordinary corporate entity (futsuu houjin) from a tax perspective. All of its income is subject to corporate income tax (houjin zei).
DISSOLUTION	Surplus assets are generally distributed to shareholders (the articles of incorporation may provide otherwise to a certain extent, but cannot render it such that shareholders receive no dividends of surplus and no distribution of residual assets).
CHARITABLE STATUS	No.
REGULATOR	None specifically designated in relation to social purpose elements.
REPORTING REQUIREMENTS	None specifically designated in relation to social purpose elements.
ADVANTAGES	<ul style="list-style-type: none"> - Perception of creditworthiness (in particular, when seeking loans from financial institutions, when entering into commercial transactions, etc.). - Can obtain funding readily by issuing shares.
DISADVANTAGES	Because the premise of these entities is to maximize shareholder profits and are used by businesses in general, it is difficult to make the public aware of social purposes or goals held by a particular enterprise.

¹³² “Commercial” as used herein means an ultimate purpose of making and distributing profits to the entity’s equityholders.

3.3 WHAT LEGAL FORMS OF ORGANISATION, IF ANY, HAVE BEEN SPECIFICALLY DESIGNED FOR PPBS?

Presently, Japanese law does not provide for a corporate form specifically designed for PPBs.

3.4 WHAT HYBRID STRUCTURES ARE OR COULD BE USED TO ESTABLISH A BUSINESS WITH THE KEY CHARACTERISTICS OF A PPB?

Presently, no hybrid structures are available.

4 OTHER METHODS OF IMPLEMENTATION

4.1 WILL APPLICABLE LAW RESPECT CONTRACT TERMS ESTABLISHING AND/OR PROTECTING A SOCIAL PURPOSE?

While it is possible for equityholders to enter into contracts such as voting agreements or shareholder agreements providing for obligations of the parties to perform in accordance with and take actions consistent with and in furtherance of social purposes, such contracts would not be enforceable to the point of specific performance. For example, equityholders cannot be compelled to vote in accordance with a voting agreement.

5 ADDITIONAL CONTROLS OVER PPBS

5.1 WHAT OTHER LEGAL OBLIGATIONS OR CONTROLS OVER THE SOCIAL PURPOSE APPLY TO PPBS UNDER APPLICABLE LAW? ARE THESE REQUIREMENTS MANDATORY OR PERMISSIVE?

(a) Additional transparency measures

It would generally be permissible for KJs to provide voluntary disclosures or reports of their socially oriented aspects of their businesses, provided that such disclosures or reports are in compliance with generally applicable laws and regulations.

(b) Asset lock

With respect to KJs, as discussed above, pursuant to the fundamental requirement that a KJ's business be a "commercial" enterprise, an asset lock would be permissible so long as there is not a complete lock on all of its profits and assets to the shareholders.

(c) Profits lock

With respect to Kks, as discussed above, pursuant to the fundamental requirement that a Kk’s business be a “commercial” enterprise, a profit lock would be permissible so long as there is not a complete lock on all of its profits and assets to the shareholders.

(d) Mission lock

Kks are not mission locked.

(e) Enforcement mechanisms

While it is possible to use contractual means to create contractual obligations to maintain and further social purposes of Kks, such obligations would not be able to be specifically enforced – cannot be compelled. Recourse with respect to breach of such obligations would be limited to monetary remedies. Also, while it is possible to provide for social purposes in the organizational documents of Kks, the degree of enforceability of such provision is unclear. To our knowledge, enforcement action with respect to the foregoing has never been instituted in Japan concerning a social mission imbedded in a Kk.

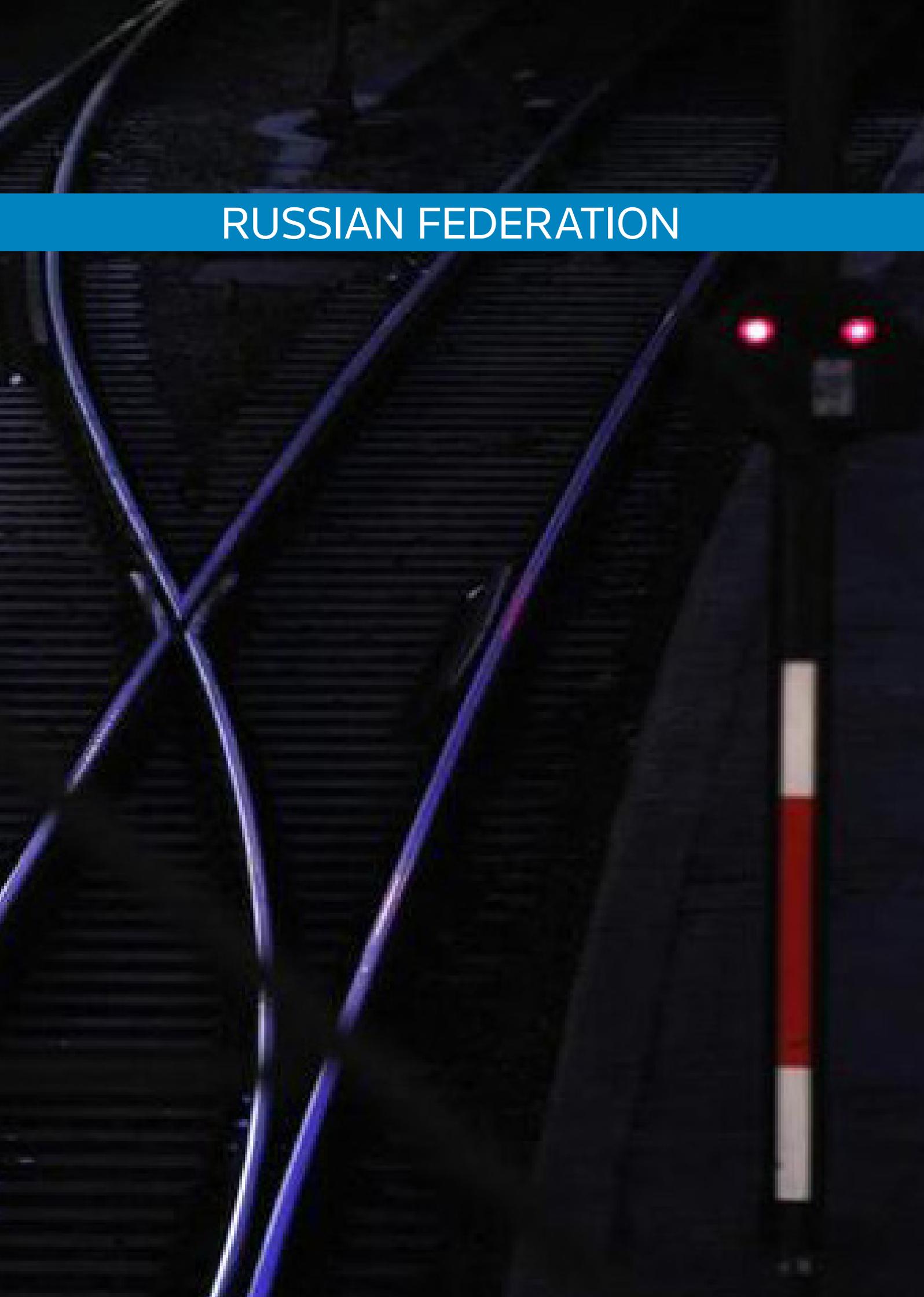
(f) Change of control

Similar to the discussion in Item (e) above, while it is possible to use contractual means to bind transferees to maintain the social purposes of the transferred Kk target, such obligations would not be able to be specifically enforced – cannot be compelled. Recourse with respect to breach of such obligations would be limited to monetary remedies. And, similarly, to our knowledge such enforcement action has never been instituted in Japan concerning a social mission imbedded in a Kk.

6 ACCESS TO INVESTMENT CAPITAL

As Japanese law does not presently provide a for profit corporate form specifically designed for PPBs, the only types of entities capable of conducting PPBs (as primarily for-profit enterprises) as well as having “investors” in the conventional sense are the typical commercial corporate forms such as the Kk. Issues related to access to investment capital are thus those applicable to commercial entities generally; there are no unique aspects raised by social purposes.

RUSSIAN FEDERATION



RUSSIAN FEDERATION

1 COUNTRY OVERVIEW

Russian law does not define “social enterprise” and does not provide for any specific legal forms designed specifically for profit-with-purpose businesses (“PPBs”).

While there is no particular legal form designed specifically for the PPBs, various existing legal forms can be used for the purposes of social enterprise. There are two major categories of business entities – commercial entities and non-profit entities.

The main difference between the two categories is the purpose of formation of the entity: (1) the main purpose of the commercial entities is generating profit and (2) the main purpose of the non-profit entities is pursuing social, cultural or other permissible non-economic goals.

Since the main purpose of formation of a commercial entity is generation of profit, commercial entities are not required to adhere to any social purpose. However, a commercial entity may choose to specify a social purpose in its foundation documents or adopt a separate policy relating to social responsibility.

Russian law is silent with respect to social purpose and social responsibility of the commercial entities and there are virtually no benefits or special tax treatment.

The board members and officers of the commercial entity have a duty to act in the interests of the company. Russian law does not define what constitutes interests of a company and whether such interests are strictly financial or could include social responsibility. Arguably, specifying social purpose in foundation documents could mitigate the risks that furthering of the social purpose (as opposed to maximising profit) would be viewed as acting not in the interests of the company. However, even if social purpose is not spelled out in the foundation documents, it is not clear whether or not actions of the directors and officers furthering the social purpose would be viewed as contrary to the interests of the commercial entity. There is no relevant court practice.

If the investors expect to receive distribution of the profit and any return upon exit, then a PPB should be organized as a commercial entity.

A non-profit organisation is an organisation that uses its revenues to achieve the goals, including social purposes, specified in its foundation documents rather than distributing them as profit or dividends. Certain types of non-profit companies are authorised to conduct commercial activities directly or through commercial subsidiaries if such activities are aligned with the social goals and are within the scope of the purposes defined in the foundation documents. However, there are no tax benefits applicable

to commercial activities of non-profit organisations, and distribution of profit to the participants is usually restricted by law.

Generally, the non-profit sector is not very developed in Russia. The management of the non-profit organisations often lacks business skills and private sources of funding are very limited. The financing options for the non-profit sector are largely limited to governmental support. There are, however, some major corporations that set up non-profit subsidiaries financed by the parent company. However, since non-profit organisations must primarily be a non-commercial entity, we will not focus further on it in this report since the focus is on organizations that allow for distribution of profit.¹³³

There are also various hybrid options that could be used to further social purpose. However, the concept of social entrepreneurship is new to the Russian business market and there is no solid market practice or laws regulating it.

PBB concept is very new in Russia and it is expected that the legislation in this area will be changing rapidly and substantially in the near future. A working group created by the Russian legislative bodies is working on a draft law that would provide for a detailed definition and criteria for social entrepreneurship and establish framework and benefits for PBB activities. It is not clear whether new legislation will be a separate framework law or amendments to the existing laws that would regulate PBB and provide for special treatment and benefits for socially responsible businesses as opposed to the strictly commercial entities.

2 LEGAL FOUNDATIONS FOR PBBS

2.1 CAN A BUSINESS BE FORMED UNDER APPLICABLE LAW WITH THE FOLLOWING CHARACTERISTICS OF A PBB?

(a) Social purpose

Russian law provides for one type of legal entity that allows for distribution of full or partial profits: commercial.

The main purpose for creation of the commercial entities is generation of profit. Russian law does not prevent a commercial entity from specifying a social purpose in its foundation documents; however, there are no benefits or consequences for the owners and investors because social responsibility of commercial entities is not currently addressed in Russian laws. Thus, there are no recognised rules or mechanisms to ensure that a social mission is carried out.

¹³³ The only exception is a non-profit entity organized in the form of consumer cooperative which distribution of profit among its members, see Part 5 of Article 116 of the Civil Code.

(b) Duties

Russian law does not provide for any specific duties of directors and officers of a PBB to further social purpose of the business.

In general, the directors and officers of a legal entity in Russia must act reasonably, in a good faith and in the best interests of the company. The directors' or officers' bad faith and unreasonableness are presumed if such director or officer knew or should have known that his/her actions or inactions were not in the best interests of the company.

Directors' and officers' actions are viewed in light of the duty to generate profit and to achieve objectives stated in the foundation documents of the legal entity.

Duties to further social purpose are not mentioned in the current legislation. However, there is no legislation or court practice stating that furthering social purpose is contrary to the interests of the company. Thus, actions by directors and officers that further a social purpose and that prevent maximization of financial return to the shareholders are not necessarily against the interests of the company, especially, if the foundation documents of the company specify social purpose as one of the objectives of the company. However, no definite conclusion can be drawn with respect to this issue since the court practice relating to directors' liability in Russia is very scarce and there are virtually no cases addressing this issue.

(c) Transparency regarding achievement of social impact purpose

All legal entities in Russia are subject to financial reporting requirements. There are no specific reporting requirements in connection with achievement of social purposes or evaluation of the performance of a PBB and its social impact.

3 LEGAL FORMS ARE AVAILABLE FOR PBBS

3.1 OVERVIEW OF LEGAL FORMS OF ORGANISATION THAT ARE AVAILABLE TO PBBS.

There are no special organisation forms designed specifically for PBBs. However, there are various commercial (and non-profit organisation forms) that could be used to set up a PBB.¹³⁴

¹³⁴ Discussion in this report is limited primarily to commercial entities given the request to focus on corporate entities that can distribute profits.

(a) Commercial entities

- **LIMITED LIABILITY COMPANY** – the most common form of legal entity used by foreign and Russian investors. A PBB can be organised in form of a legal liability company following a rather simple registration procedure. Participation interest in the limited liability companies is not considered to be a security and there are no registration formalities. Limited liability company is the most common organisation form for investments in a variety of fields.
- **JOINT-STOCK COMPANY** – (open joint stock companies and closed joint stock companies): Joint stock companies are subject to registration of securities requirements and the share registers shall be maintained by the professional registrars. Generally, joint-stock companies are subject to more reporting requirements than limited liability companies. Shares of the open joint stock companies may be traded publicly.
- **ECONOMIC PARTNERSHIP** – a relatively new and simple organisation form designed mainly for the technology sector and allows more flexibility for governance structure than limited liability companies or joint stock companies. Economic partnerships cannot hold participation interest or securities in other legal entities and cannot be used as a holding company in a joint venture.
- Civil Code provides for certain other organisation forms of legal entities, such as limited partnership and additional liability company; however, these forms are never used in practice.

(b) Legislative Initiatives

Currently there are discussions regarding potential new legislation that would define social entrepreneurship and provide for criteria for the existing organisation forms to qualify as a PBB or creation of the new organisation forms designed specifically for PBBs. However, there is no clarity at the moment when such new legislation will be introduced and how it would affect the existing legal framework.

3.2 WHAT LEGAL FORMS OF ORGANISATION ARE AVAILABLE TO BUSINESSES GENERALLY THAT COULD BE USED TO FORM A PBB?

	LLC	JSC	ECONOMIC PARTNERSHIP
OWNERSHIP	<ul style="list-style-type: none"> - Cannot be owned by another legal entity which is owned by a single legal entity or individual - If the number of participants exceeds 50, the company shall be reorganised into the open joint stock company or production cooperative 	<ul style="list-style-type: none"> - Cannot be owned by another legal entity which is owned by a single legal entity or individual - If the number of shareholders of a closed joint-stock company exceeds 50, the company shall be reorganised into the open joint stock company 	<ul style="list-style-type: none"> - Cannot have less than two participants - If the number of shareholders of a closed joint-stock company exceeds 50, the company shall be reorganised into the open joint stock company
GOVERNANCE	<p>Three-tier structure:</p> <ul style="list-style-type: none"> - General participants meeting: the major decisions of the company are made by the general participants meeting. - Board of directors: supervises the general activities of the company (not mandatory). - General Director or a management company: daily management of activities. 	<p>Three-tier structure:</p> <ul style="list-style-type: none"> - General shareholders meeting: the major decisions of the company are made by the general participants meeting. - Board of directors: supervises the general activities of the company (mandatory for the open joint stock companies with more than 50 shareholders). - General Director or a management company: daily management of activities. 	<ul style="list-style-type: none"> - Director manages business activities of the economic partnership. - Governance structure is subject to Management Agreement and the requirements are flexible.
OBJECTS	No restrictions, subject to licensing requirements.	No restrictions, subject to licensing requirements.	Prohibited from owning shares/interest in other legal entities, issuing bonds and other emissive securities, advertising.
SOCIAL PURPOSE	Not required.	Not required.	Not required.
LIMITED LIABILITY FOR OWNERS	<ul style="list-style-type: none"> - Limited by the charter capital contribution. - Corporate veil can be pierced in certain cases, for example if instructions of the participants lead to insolvency of the company. 	<ul style="list-style-type: none"> - Limited by the charter capital contribution. - Corporate veil can be pierced in certain cases, for example if instructions of the participants lead to insolvency of the company. 	<ul style="list-style-type: none"> - Limited by the charter capital contribution. - Corporate veil can be pierced in certain cases, for example if instructions of the participants lead to insolvency of the company.

BALANCING PURPOSE AND PROFIT
 LEGAL MECHANISMS TO LOCK IN SOCIAL MISSION FOR "PROFIT WITH PURPOSE" BUSINESSES ACROSS THE G8

TRANSFERS OF OWNERSHIP	<ul style="list-style-type: none"> - Participants can sell their participation interest to another participant or to a third party investor, subject to pre-emptive rights of the existing participant - In certain circumstances an LLC has to buy-out participation interest from the participant at its actual value - The foundation documents of an LLC can vary the statutory provisions - Subject to notarisation 	<ul style="list-style-type: none"> - No restrictions on transfer of shares of the open joint stock company - Transfer of the shares in the closed joint stock company is subject to pre-emption rights by other shareholders and the foundation documents may provide for pre-emption rights of the closed joint stock company itself 	<ul style="list-style-type: none"> - Transfer to other participants without restrictions, unless there are special provisions in the Management Agreement - Transfer to third parties is subject to consent of all participants and pre-emptive rights of the remaining participants
DEBT FINANCING	Available.	Available.	Available.
EQUITY FINANCING	<ul style="list-style-type: none"> - Equity financing is available in form of monetary or in-kind contributions by participants. - Increase of the charter capital requires amendments to the foundation documents. 	<ul style="list-style-type: none"> - Equity financing is available by purchase of shares, including issue of additional shares. - Increase of the charter capital requires amendments to the foundation documents. 	<ul style="list-style-type: none"> - Cash and in-kind contributions, except securities other than certain bonds.
TAX TREATMENT	<p>The applicable tax regime depends on the complexity and type of business activities of the company and applicable tax system:</p> <ul style="list-style-type: none"> - General taxation: main taxes include payment of VAT, profit tax, property tax and tax on personal income. - Simplified taxation: income tax and property tax are replaced by a single unified amount, VAT does not apply. - Imputed taxation: single tax applied to certain entities providing services listed in Article 246.26 of the Tax Code. 	<p>The applicable tax regime depends on the complexity and type of business activities of the company and applicable tax system:</p> <ul style="list-style-type: none"> - General taxation: main taxes include payment of VAT, profit tax, property tax and tax on personal income. - Simplified taxation: income tax and property tax are replaced by a single unified amount, VAT does not apply. - Imputed taxation: single tax applied to certain entities providing services listed in Article 246.26 of the Tax Code. 	<p>The applicable tax regime depends on the complexity and type of business activities of the company and applicable tax system:</p> <ul style="list-style-type: none"> - General taxation: main taxes include payment of VAT, profit tax, property tax and tax on personal income - Simplified taxation: income tax and property tax are replaced by a single unified amount, VAT does not apply. - Imputed taxation: single tax applied to certain entities providing services listed in Article 246.26 of the Tax Code.
DISSOLUTION	Voluntary upon decision of participants of the company: a cumbersome procedure requiring audit by tax authorities and notification of creditors	Voluntary upon decision of shareholders of the company: a cumbersome procedure requiring audit by tax authorities and notification of creditors	Voluntary upon decision of participants of the company: a cumbersome procedure requiring audit by tax authorities and notification of creditors

BALANCING PURPOSE AND PROFIT
 LEGAL MECHANISMS TO LOCK IN SOCIAL MISSION FOR “PROFIT WITH PURPOSE” BUSINESSES ACROSS THE G8

CHARITABLE STATUS	No	No	No
REGULATOR	Federal Tax Authority	Federal Tax Authority Central Bank	Federal Tax Authority
REPORTING REQUIREMENTS	- Certain standard financial reporting requirements	- Certain standard financial reporting requirements - Open joint stock companies are subject to annual audit requirement and certain public disclosure requirements.	- Certain standard financial reporting requirements.
ADVANTAGES	<ul style="list-style-type: none"> - No limitation with respect to the type of activities, except for specific activities that may be conducted only by non-profit organisations (for example, in education field). - Limited liability of owners. - Profit distribution among participants. - Compensation upon exit or liquidation of the company. 	<ul style="list-style-type: none"> - No limitation with respect to the type of activities, except for specific activities that may be conducted only by non-profit organisations (for example, in education field). - Limited liability of owners. - Profit distribution among participants. - Compensation upon exit or liquidation of the company. 	<ul style="list-style-type: none"> - No requirement with respect to the minimal charter capital or assets . - Flexible governance structure. - Limited liability of owners. - More flexible profit distribution among participants, not necessarily in proportion to the contributed assets. - Compensation upon exit or liquidation of the company. - Maximum flexibility and minimum reporting requirements.
DISADVANTAGES	<ul style="list-style-type: none"> - Statutory requirement with respect to the minimal charter capital. - Limitation with respect to some types of activities available only for non-profit organisations (for example, in education field). 	<ul style="list-style-type: none"> - Various reporting requirements and other bureaucratic formalities. The reporting requirements for public disclosure are less stringent for closed joint stock companies. - Statutory requirement with respect to the minimal charter capital. - Limitation with respect to some types of activities available only for non-profit organisations (for example, in education field). - Share registration formalities. - More requirements with respect to management and governance structure. 	<ul style="list-style-type: none"> - A relatively new form, so there is some associated uncertainty. - Not allowed to own shares or participation interest in other entities and cannot be used as a holding company. - Advertising activities are not allowed.

3.3 WHAT LEGAL FORMS OF ORGANISATION, IF ANY, HAVE BEEN SPECIFICALLY DESIGNED FOR PBBs?

There are no forms of organisations designed specifically for PBBs at the moment. The concept of social entrepreneurship is not defined.

Currently, a working group created by the Russian government is working on draft legislation that would define "social entrepreneurship," adopt legal framework for PBB's activities, and provide for the benefits, including tax benefits, and specific criteria and requirements applicable to the PBBs. However, the scope of the proposed legislation is unclear at the moment.

It is expected that the new legislation would provide for commercial and non-commercial structures and individual entrepreneurs that would qualify as PBBs (per definition and criteria of such new legislation).

There are discussions that in the future specific corporate structures or types of companies may be designed specifically for the PBB activities.

3.4 WHAT HYBRID STRUCTURES ARE OR COULD BE USED TO ESTABLISH A BUSINESS WITH THE KEY CHARACTERISTICS OF A PBB?

Russian law¹³⁵ provides that non-profit organisations can participate in commercial entities within the boundaries of the social purpose specified in the foundation documents of the parent non-profit organisation. While combination of non-profit and commercial organisations is allowed by law, it is not very common in practice due to lack of sophistication and business orientation of the non-profit sector. Such hybrid structure of a PBB allows for separate accounting for profit from the commercial activities and prevents any potential unfavourable tax consequences.

Another example of a PBB arrangement found in Russia is establishment of a non-profit subsidiary by a major commercial entity or donations to PBBs by major commercial businesses. This allows a non-profit organisation to receive financing from the parent company or via donation and promote its social purposes for which it was created using support of the commercial entities.

Some hybrid structures include group of companies, some of which are non-profit organisations promoting social purposes and some are commercial entities offering related additional commercial services. However, this form is not very common in Russia due to novelty of the PBB concept.

¹³⁵ Article 24 of the Law on Non-Profit Organisations.

4 OTHER METHODS OF IMPLEMENTATION

4.1 WILL APPLICABLE LAW RESPECT CONTRACT TERMS ESTABLISHING AND/OR PROTECTING A SOCIAL PURPOSE?

The activities of the commercial entities can be regulated by the foundation documents, including shareholder agreements and agreements between participants of the limited liability companies. However, it is hard to predict whether the Russian courts would enforce such contractual provisions as there is no relevant court practice.

Investors can in theory enter into contractual arrangements that promote socially responsible business activities, if such contracts comply with the requirements of the Russian law; however, such arrangements are rare if at all.

Currently various experts are discussing that adoption of the reform specifically addressing social enterprise and associated financing (as opposed to amendments to the existing laws) is premature because social entrepreneurship is very new in Russia and the law would fail to address all the important aspects of the relationship with the investors due to lack of the market practice.

5 ADDITIONAL CONTROLS OVER PBBS

What other legal obligations or controls over the social purpose apply to PBBs under applicable law? Are these requirements mandatory or permissive?

(a) Additional transparency measures

There are general reporting requirements applicable to all companies in Russia regardless of social purposes, such as financial reporting and audit.

There are no specific reporting requirements applicable to the social impact of the commercial entities.

(b) Asset lock

During the lifetime, a commercial entity is entitled to dispose of its assets. Certain restrictions apply to the minimal amount of assets and the special corporate approval procedures may apply to disposition or acquisition of assets if they constitute a major transaction for the company.

Upon liquidation, participants or shareholders of a commercial entity are entitled to the part of assets of the company that are left after settlement of liabilities with other creditors.

(c) Profits lock

The profit of a commercial entity is distributed among its participants or shareholders. A limited liability company distributes profit among its participants proportionally to their participation interest. The profit of a joint stock company is distributed among its shareholders in form of dividends. The profit of the economic partnership is distributed pursuant to the foundation documents and is not necessarily proportionate to the capital contributions of the participants.

Distribution of the profit among members of the non-profit organisations is not permitted by law and should be solely used for the purposes provided for in the foundation documents.¹³⁶ The only exception is the consumer cooperative, the profit of which can be distributed among its members.¹³⁷

(d) Mission lock

There are no requirements applicable to the mission of the commercial entities, so any mission can be altered at any time.

The purpose of a non-profit organisation shall be specified in the foundation documents. Certain requirements may apply to amendment procedures of the foundation of non-profit organisations, for example, foundation documents of funds may be amended only by court.

(e) Enforcement mechanisms

The enforcement of the social impact purpose would not apply to a commercial entity since the law does not provide for social purpose for a commercial entity. Currently, social responsibility of a commercial entity is voluntary and is regulated by internal corporate policies.

Arguably, if the charter specifies social purpose as an objective of the commercial company, actions by the directors and officers contrary to such social purpose could be viewed as actions against the interests of the company. However, there is no relevant legislation or court practice.

(f) Change of control

There are no specific statutory requirements with respect to continuation of the mission of the business that apply to the change of control or sale of a legal entity, except that the activities of the relevant commercial entity or non-profit organisation shall be conducted in accordance with the foundation documents and law.

¹³⁶ Part 1 of Article 50 of the Civil Code.

¹³⁷ Part 5 of Article 116 of the Civil Code.

6 ACCESS TO INVESTMENT CAPITAL

6.1 TAX INCENTIVES

The “social entrepreneurship” is not defined in the Russian law and there are no PBBs per se at the moment. There are certain tax benefits for the activities of the non-profit organisations. However, such tax benefits do not extend to the commercial activities of the non-profit organisations.

Currently, the Russian government is working on the legislation introducing concept of social entrepreneurship and discussing potential benefits, including special tax regimes that would apply to such category of business. The main concern voiced by the Russian government associated with such tax benefits is the risk of the potential abuse by the business owners for tax evasion purposes.

The tax treatment of commercial entities and non-profit organisations in Russia differs significantly and a detailed tax analysis shall be conducted taking into account the size of the enterprise, type and volume of its business activities, objectives of the investors and other relevant factors.

6.2 INVESTMENT STRUCTURES

In Russia, one of the main characteristics of the PBBs is its self sufficiency resulting from commercial activities and generated profit that is used to promote the social purpose of the PBBs.

The main support for PBBs in Russia is currently provided by the government in form of various grants, subsidies and contributions. However, such financial assistance by the government is mainly targeted to non-profit companies. Order No. 223 of the Ministry of Economic Development dated 23 April 2012 provides for certain criteria used by the government to allocate subsidies to small commercial entities pursuing socially responsible activities.

Donations and sponsorship of the PBBs by private businesses and individuals have not existed until recently and are still at an early stage of development.

The PBBs can try to obtain financing from third party creditors, however, it is often prohibitively expensive for a PBB. Third party creditors, such as banks, are often reluctant to lend money to PBBs due to insufficient security and orientation towards social purpose as opposed to generation of profit.

6.3 BARRIERS TO ACCESSING INVESTMENT

There are no particular barriers accessing investment if a PBB is organised as a commercial entity. Russian laws are quite flexible and subject to limitations specific to particular organisation form, a PBB does not have any barriers.

However, governmental support of the PBBs is provided mostly to non-profit organisations.

Generally, the difficulty accessing investment by a PPB is associated with lack of sufficient legal and tax expertise and insufficient assets to provide security acceptable to the third party lenders.

6.4 RISK

The risks of the equity holders depend on the organisation form chosen for a PBB. There is no specific liability attributable to the social purpose itself. Generally, the liability of shareholders and participants of the commercial entities is more limited than liability of the members of non-profit organisations.

6.5 EXIT

There is no specific exit mechanism for investors in the PBBs. The exit mechanism and consequences will depend on the particular organisation form of a PBB.

An investor in a commercial entity can transfer ownership by selling shares or participation interest to the remaining owners of the business or to a third party investor, subject to the statutory and contractual limitations. In addition, if the participant of the limited liability company or partner in the economic partnership is exiting, he is entitled to receive the actual value of its participation interest.

Shareholders of the joint stock company are not entitled to exit and request repayment of value of the shares, except when the law authorises shareholders to request buy-out of their share at the market price.

Exit through an IPO is available only to the open joint stock companies, but not to other types of commercial entities or non-profit organisations. Some commercial entities can be reorganised in an open joint stock company and after completion of these formalities, prepare for an IPO. However, it is a cumbersome and expensive exit option, especially for a PBB.

UNITED KINGDOM



UNITED KINGDOM

INTRODUCTORY NOTE: In accordance with the instructions of the Mission Alignment Working Group this report does not consider charities but focuses on for-profit businesses, in particular on privately held companies, given that the complexity of the rules applicable to the maintenance of and fund-raising by listed companies, and the attendant costs, means that they are unlikely to be the preferred legal form and the number of such entities is insignificant for the purposes of this review.

1 COUNTRY OVERVIEW¹³⁸

There are many legal structures which a profit-with-purpose business can adopt under UK law. Some of these are general legal structures which can be used by any business, whether or not it has a social purpose. Within the spectrum the most commonly used structure is that of a private company, either limited by guarantee (“**CLG**”) or limited by shares (“**CLS**”).

However, there are also legal forms which are specifically designed for profit-with-purpose businesses. These include community interest companies (“**CICs**”) and community benefit societies (“**CBSs**”). In view of the existence of these available legal forms (which have been the subject of both recent modifications and current proposals for further modifications), there are no current proposals to introduce in the United Kingdom any specific additional legal forms for profit-with-purpose businesses.

In our view, UK law does not impose legal barriers to the integration of a social purpose into the constitution of a for-profit entity, notwithstanding that its constitution contemplates the full or partial distribution of profits. The directors of such entities will, however, have to balance the promotion of such social purpose against the numerous other factors which it is part of their statutory and fiduciary duty to the entity (and its members) to consider when determining to adopt any course of action.

The following questions were posed in relation to for-profit entities by the Mission Alignment Working Group:

- (a) is it subject to a legal requirement that it be operated in a way that maximises its financial return to its shareholders/owners, such that would restrict its pursuit of a social purpose?

¹³⁸ This report covers the legal jurisdictions of England, Wales, Scotland and Northern Ireland. Although there may be some technical differences between the applicable law in each jurisdiction, the overall position is broadly similar and, accordingly, for the sake of simplicity, we will refer in this report to the umbrella term of “UK law”. It should be noted that the report has been drafted by solicitors qualified solely in England and Wales. We are grateful, however, to Shepherd & Wedderburn LLP for their review and input to identify those few areas where Scots law departs.

- (b) can it have a (primary or secondary) purpose to create a social or environmental benefit?
- (c) can its directors/managers consider the interests of groups other than the shareholders/owners?
- (d) can its directors /managers be held accountable for furthering the social purpose of the business?

We consider that the answer to (a) is that there is no such legal requirement in relation to any of CLGs, CLSs, CICs or CBSs.

We consider that the answer to (b) is that in relation to any of CLGs, CLSs, CICs or CBSs it is permitted to have a (primary or secondary) purpose to create a social or environmental benefit.

We consider that the answer to (c) is that in relation to any of CLGs, CLSs, CICs or CBSs it is permitted for its directors/managers to consider the interests of groups other than the shareholders/owners to the extent that such interests are germane to the success of the entity. Whilst, in the case of a company without a social purpose, the success of the company is to be gauged by reference to the benefit of its members as a whole, the law contemplates the substitution of the achievement of the company's stated purposes where such purposes constitutionally include purposes other than or additional to the benefit of its members.

We consider that the answer to (d) is that in relation to any of CLGs, CLSs, CICs or CBSs the directors/managers can potentially be held accountable for furthering the social purpose of the business if such social purpose is appropriately embedded, whether in the constitutional documents or contractually (in a shareholders' agreement for example). However, a determination by a director as to what is conducive to the success of the company (which in the case of a profit-with-purpose entity equates to furtherance of its social purpose) is a subjective determination, to be arrived at by the directors in good faith, in respect of which the courts are loathe to substitute their own judgement. Moreover, the mechanisms for enforcing directors' duties may prove difficult to action, as the duties are owed to the company itself and only in limited circumstances may individual members initiate derivative actions on the company's behalf.

The key characteristics of CLGs, CLSs, CICs and CBSs are set out in the table appearing in Section 3 and the basis for the conclusions stated above is discussed in greater detail in section 2.

2 LEGAL FOUNDATIONS FOR PROFIT-WITH-PURPOSE BUSINESSES

2.1 CAN A BUSINESS BE FORMED UNDER APPLICABLE LAW WITH AN EMBEDDED SOCIAL PURPOSE?

A business can be formed under UK law with a social purpose. A CIC may be used where the profit-with-purpose business wants specifically to use its profits for a community purpose. However, conventional CLSs and CLGs can also be used under UK law to further a social purpose.

- (a) A profit-with-purpose business organised as a company (whether a CLS or a CLG) may wish to consider inserting a social purpose into its constitutional documents, for example by way of an objects clause. Such purpose could be expressed either with a high degree of specificity or in more general terms to give greater flexibility. A more specific description might be seen as providing assurance to investors as to the application of their funds, subject to the risk that the narrow focus may become outmoded and then be difficult to adapt.

A social purpose can be incorporated in a company's articles of association in the form of restrictions to the company's objects and, if desired, express provision of certain powers, thereby creating a "mission lock", to a limited extent (as discussed in section 4.1 below).

The company could also or alternatively introduce a special class of share, a "golden share", in its articles to embed a social purpose. This is a share which has special rights attached to it. Such rights may include a requirement that the holder of the golden share needs to consent to any changes in the company's social mission, or to any other specified changes in the articles. Consent may also be required for other actions, such as new share issues and any change of control. The same restrictions and powers could also be included in an agreement among all investors in the profit-with-purpose company, thereby providing contractual protection (and recourse) in the event that the company, through its directors, disregards those restrictions (as discussed in section 4.2 below).

- (b) **CICs**

CICs are companies which have special additional features, and are created for use by people who want to conduct a business or other activity for community benefit and not purely for private advantage. The primary purpose of a CIC is to benefit the community and not just its shareholders, directors or employees.¹³⁹

¹³⁹ For more detailed information regarding the characteristics of a CIC please refer to section 3.1 of the "Guide to Establishing a Social Enterprise in England and Wales" published by Morrison & Foerster (UK) LLP and Trustlaw in April 2012 (the "Trustlaw Report") and to <https://www.gov.uk/government/organisations/office-of-the-regulator-of-community-interest-companies>.

An enterprise intending to register as a CIC must complete a form CIC 36 giving a short description of the community which it is intended that the CIC will benefit and an indication of how it is proposed that the CIC's activities will benefit the community, or section of the community.

CICs are not charities and are not subject to regulation by the Charity Commission¹⁴⁰ and, accordingly, have greater flexibility than charitable organisations in terms of the activities they can undertake.¹⁴¹ There are now over 8000 CICs on the public register and the total number of CICs registered during March 2014 was 241.¹⁴²

CICs can be private or public (including listed) companies either limited by guarantee or structured as a conventional company limited by shares. One of the main features of each type of CIC is that its articles of association must contain a statutory 'asset lock'. This requires that the CIC shall not transfer any of its assets other than for full consideration, except where the transfer is to another asset-locked entity or otherwise where the transfer is made for the benefit of the community. CICs may also adopt asset-lock rules which are more stringent than the statutory requirements above.

In the case of a CIC limited by shares, the constitution may provide either for the payment of dividends solely to a specified asset locked entity or for a payment of dividends to the CIC's shareholders generally. In the latter case the level of dividend which can be paid is currently doubly capped:

- (i) at the level of each individual share (namely 20% of the paid up par value of that share, for shares issued on or after 6 April 2010, and 5% above the Bank of England base rate of the paid up value of a share, for shares issued from 2005 to 5 April 2010); and
- (ii) in aggregate, at a level of 35% of distributable profits (determined in accordance with normal principles of UK company law under the Companies Act 2006 (the "[UK Companies Act](#)")).

Following a consultation process launched by the Regulator of Community Interest Companies (the "[CIC Regulator](#)") in 2013, it is intended that restriction (i) above will be abolished on the grounds that it has proved complex to calculate and a disincentive to the adoption of the CIC model, without being found to be really necessary to preserve the focus on service and benefit to the community, having regard to the retention of the overall 35% cap.

As at the end of 2013, only around 22% of CICs were limited by shares (with the rest being limited by guarantee), split as to 12% whose constitution contemplated the payment of dividends to private investors and 10% whose constitution contemplated the payment of dividends

140 The Scottish Charity Regulator in Scotland.

141 It is not possible for a company to be both a charity and a CIC. Upon application for registration as a CIC, an existing company must sign a declaration that it is not a charity.

142 www.gov.uk/government/uploads/system/uploads/attachment_data/file/300173/companyListMonthly_Mar.csv/preview

only to other asset locked entities. Currently, therefore, it is only a small percentage of all CICs which will benefit from the proposed liberalisation but the hope is that the new ability to distribute up to 35% of profits will allow CICs to attract much more privately sourced equity investment and that this will make the CIC (and, in particular, the form of CIC which is limited by shares) the "best practice" model for social entrepreneurs. The rationale is, in part, because investors attracted to invest on the basis of such an expected level of return will demand a high level of accountability, which will in turn contribute to the development of rigorous measurement of the CIC's performance in relation both to its social mission and its financial outcomes.

CICs are also subject to constraint as to the level of performance related interest they can pay on debt instruments. This form of fund raising is particularly relevant to that 78% (approximately) of existing CICs which are currently limited by guarantee and hence unable to offer investors a real equity return. Currently, such interest is capped at 10% of the average amount of the CIC's debt or sums outstanding under a debenture issued by it during the 12 month period immediately preceding the date on which such interest fell due.

As a result of the same consultation process it is now also intended that the cap will be increased to 20% as it was considered that such loans are meant to be relatively long term "patient capital", with equity characteristics, and, as such, 10% was an inadequate return, which was proving a disincentive.

The CIC Regulator is seeking parliamentary time for these changes to be debated and approved, with a view to these changes becoming effective from 1 October 2014.

(c) **CBSs**

CBSs are a variant of an industrial and provident society, intended to operate for the benefit of the community at large as opposed to operating solely for the benefit of the members of such society, as would a co-operative society. (Pursuant to the Co-operative and Community Benefit Societies and Credit Unions Act 2010, any such society registered after 1 August 2014 must be registered as either a co-operative or community benefit society.) This means that a CBS must have an overarching community purpose that reaches beyond its membership (for example, housing, energy supplies, childcare, adult education). An applicant enterprise must also have a "special reason" for being a community benefit society rather than a company, such as wanting to have an asset lock or democratic decision-making built into its structure. CBSs are registered with the Financial Conduct Authority and, to the extent that they carry out activities regulated under the Financial Services and Markets Act 2000 ("FSMA") (e.g. accepting deposits or providing insurance) are regulated by the Prudential Regulation Authority. Some CBSs have charitable status.

Although a CBS has the power to pay limited interest on members’ share capital, it cannot distribute surpluses to members in the form of dividends.

A CBS need not include in its constitution an asset lock but, if it opts to have a statutory asset lock, requiring residual assets on dissolution to be transferred to another body with similar objects (absent which, those assets must be used for similar charitable or philanthropic purposes), such asset lock must be expressed in the terms set out in the Community Benefit Societies (Restriction on Use of Assets) Regulations 2006, so giving that asset lock the same strength as the asset lock for a charity and for a CIC¹⁴³.

A CBS generally has a share capital, but the shares are not conventional equity shares which appreciate or fall in value with the success of the company. Rather they are par value shares, which may only be redeemed/withdrawn (if permitted by the CBS’s rules) at face value. Voting is on a “one member one vote” basis. The profits and losses of the CBS are thus the common property of the members and must be applied towards the community benefit for which the CBS was established. The withdrawable share capital should be cheaper to raise than a typical equity fund raising for a CLS as it is exempt from certain regulations applicable to conventional share issues regarding the publication of a prospectus.¹⁴⁴ The maximum individual withdrawable shareholding, which may only be withdrawn subject to specified conditions, has been increased with effect from 6 April 2014 to £100,000.¹⁴⁵

2.2 WOULD APPLICABLE CORPORATE LAW RESPECT THE EMBEDDED SOCIAL PURPOSE?

UK corporate law would respect a social purpose if this were to be included in a company’s constitutional documents as referred to above.¹⁴⁶ Directors of a profit-with-purpose company would be under a duty to promote the success of the company having regard to the achievement of those social purposes contained in its constitutional documents.

The directors of the company are bound to act on behalf of the company in accordance with those objects but note that, by statute, the validity of an act done by a company cannot be called into question by reason of anything in

¹⁴³ For more information regarding CBSs please refer to the Practitioner’s Guide to Community Shares published by Co-Operatives UK Limited in 2011.

¹⁴⁴ The Legislative Reform (Industrial & Provident Societies and Credit Unions) Order 2011 removed the limit for non-withdrawable shares with effect from January 2012.

¹⁴⁵ See the Industrial and Provident Societies (Increase in Shareholding Limit) Order 2014 (SI 2014/210).

¹⁴⁶ Companies that are charities, for example, need to restrict their objects.

the company's constitution¹⁴⁷. Consequently, if a profit-with-purpose business that is a company operates outside the scope of any "mission lock" in the form of restrictions in its constitution, any third parties dealing with the company in good faith would nonetheless be entitled to enforce any such contract or commitment against the company, despite its incompatibility. The company and its shareholders may have recourse against the directors for breach of duty in those circumstances (as discussed in section 4.2 below). Although this might afford limited practical relief, especially after the breach had occurred, the risk of such recourse ought to act as a deterrent to any director minded to act other than in accordance with the "mission lock".

2.3 CAN THE DUTIES OF DIRECTORS EXTEND TO PROMOTING A SOCIAL PURPOSE?

Under the UK Companies Act directors owe certain duties to the company that they serve. These duties are as follows:

- (i) the duty to act within the company's constitution and their powers;
- (ii) the duty to act in a way which is most likely to promote the success of the company;
- (iii) the duty to exercise independent judgment;
- (iv) the duty to exercise reasonable care, skills and diligence;
- (v) the duty to avoid conflicts of interest;
- (vi) the duty not to accept benefits from third parties; and
- (vii) the duty to declare an interest in a proposed transaction or arrangement.

Under section 172 of the UK Companies Act, when considering a decision, a director must act in a way that he or she considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. The UK Companies Act provides a non-exhaustive list of factors which a director should have regard to when making a decision. These include:

- (i) the likely consequences of any decision in the long term;
- (ii) the interests of the company's employees;
- (iii) the need to foster the company's business relationships with suppliers, customers and others;
- (iv) the impact of the company's operations on the community and the environment;
- (v) the desirability of the company maintaining a reputation for high standards of business conduct; and
- (vi) the need to act fairly as between members of the company.

¹⁴⁷ s. 39 of the UK Companies Act.

The UK Companies Act caters for the situation where a company's purposes consist of or include purposes other than those for the benefit of its members. In that situation, the overarching duty to promote the success of the company has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those particular purposes. Companies are therefore able to adopt other purposes in their constitutional documents. The Explanatory Notes to the UK Companies Act note that this addresses the question of altruistic, or partly altruistic, companies and gives examples of charitable companies and community interest companies. However, the notes accept that it is possible for a company to have objectives that are "unselfish" which prevail over the "selfish" interests of members. Where purposes exist that may not be considered in the interests of members, s172 (1) allows these purposes to promote the success of the company.¹⁴⁸

"Success" is not defined anywhere in the Companies Act and where the purpose of the company is something other than the benefit of its members, it will be a matter of good faith judgment for the directors to determine what constitutes success. Except for insolvency situations, there is relatively little case law in which companies have pursued directors for breach of their duties.

Although s172 has not been extensively tested in the UK courts, it appears that s172 has been interpreted as subjective and will be a matter for the good faith judgment of directors. The courts would not impose their own views as to whether the decisions made by the directors were in the best interests of the Company.¹⁴⁹ Likewise, "it is a matter for the good faith judgement of the director as to what those purposes are, and, where the company has objectives which are partially for the benefit of its members and partly for other purposes, the extent to which those other purposes apply in place of the benefit of the members".¹⁵⁰

During debates concerning s172 in Parliament, Lord Goldsmith remarked "the starting point is that it is essentially for the members of the company to define the objective they wish to achieve. Success means what the members collectively want the company to achieve. For a commercial company, success will usually mean long-term increase in value. For certain companies, such as charities and community interest companies, it will mean the attainment of the objectives for which the company has been established."¹⁵¹ Therefore, it appears that success must be examined on a case by case basis with reference to a particular company's objectives. For profit-with-purpose businesses, success would need to be assessed by examining the particular

148 ICSA Guidance on Directors' General Duties <https://www.icsa.org.uk/assets/files/pdfs/080110%20Directors'%20General%20Duties.pdf>

149 *Cohen Investments Ltd v RWM Lanport Ltd* [2008] EWHC 2810 (Ch)

150 Explanatory Note to the Companies Act 2006 at para 330

151 Lord Goldsmith, Lords Grand Committee, 6 February 2006, column 255,

purpose that the company was trying to achieve and its directors could be held accountable for any breach of their duties if they fail to act in a way which promotes the success of the company.

2.4 TRANSPARENCY REGARDING ACHIEVEMENT OF SOCIAL IMPACT PURPOSE

(a) Accounts and Companies House Filings

Each director of a company has a personal responsibility to deliver certain statutory documents to Companies House in accordance with the UK Companies Act. In particular, these include accounts, annual returns and notifications to changes of directors and secretaries, registered office or accounting reference date. Annual returns must be submitted to Companies House at least once every 12 months.

All companies must keep accounting records and all limited companies must submit accounts for each accounting period to Companies House. In certain circumstances, a private limited company's accounts may be exempt from the need to be reviewed and confirmed by an independent accountant. Where a company is not a subsidiary, it may qualify for the exemption under section 477 of the UK Companies Act in the following circumstances:

- (i) if the company's financial year ends on or after 1 October 2012, it may qualify for an exemption if it meets 2 of the following:
 - (a) it has an annual turnover of no more than £6.5 million;
 - (b) it has assets worth no more than £3.26 million; and/or;
 - (c) it has 50 or fewer employees on average.

Notwithstanding the above, a company must have an audit if at any time in the financial year if it has been:

- a public company (unless it is dormant);
- a subsidiary company (unless it qualifies for an exemption (see above));
- an authorised insurance company or carrying out insurance market activity;
- involved in banking or issuing e-money;
- a Markets in Financial Instruments Directive (MIFID) investment firm or an Undertakings for Collective Investment in Transferable Securities (UCITS) management company; or
- a corporate body and its shares have been traded on a regulated market in a European state.

A qualifying small company can choose to disclose less information than medium and large sized companies on the public record. Its accounts will need to comply with the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008. A qualifying company is able to send shorter accounts called abbreviated accounts to

Companies House and the accounts will not need to be audited. The company can also choose not to file a copy of the director’s report.

The accounting standards with which the accounts will comply will be determined by the company, working with its accountant.

It should be noted, however, that the company must still send full ‘statutory’ accounts to its shareholders and to the tax authorities with its tax return.

All information submitted to Companies House is public and can be downloaded by payment of a small fee by any member of the public.

- (b)** The regime for CICs requires that, in addition to complying with the above requirements which pertain to all companies, a CIC must prepare an annual community interest report, which requires to be filed with Companies House at the same time as the accounts. The Regulator has provided template reports¹⁵², which should set out how the CIC is delivering to the community. The report does not have to be detailed, but should identify key highlights to showcase the CIC’s activities. The CIC Regulator also looks for the inclusion in the annual report of details about any funding the CIC has received. The report is placed on a public register so it offers a level of transparency above that offered by ordinary companies. The CIC Regulator encourages CICs to use the report as an opportunity to showcase their activities and the social impact they have made. Cumulatively, the reports also provide evidence for the CIC Regulator of how the CIC structure has been used.

3 LEGAL FORMS AVAILABLE FOR PROFIT-WITH-PURPOSE BUSINESSES

3.1 OVERVIEW OF LEGAL FORMS OF ORGANISATION AVAILABLE TO PROFIT-WITH-PURPOSE BUSINESSES

The tables below set out four potential legal forms for a profit-with-purpose business. Although other legal forms exist, these forms represent the best options for a profit-with-purpose business which wishes to have access to investment capital and to make distributions to its members.

¹⁵² The report is submitted by way of a Form CIC34. A detailed and a simplified template of this are available at <https://www.gov.uk/government/publications/form-cic34-community-interest-company-report>

TRADITIONAL LEGAL FORMS

	COMPANY LIMITED BY SHARES (CLS)	COMPANY LIMITED BY GUARANTEE (CLG)
OWNERSHIP	Owned by its members	Owned by its members
GOVERNANCE	Generally governed by the board of directors, but ultimately by its members	Generally governed by the board of directors, but ultimately by its members
CONSTITUTION/ OBJECTS	Articles of Association – may be amended with the approval of holders of 75% of shares	Articles of Association – may be amended with the approval of 75% of members
SOCIAL PURPOSE	No statutory requirement, but can be included in the constitution	No statutory requirement, but can be included in the constitution
LIMITED LIABILITY FOR OWNERS	Liability is limited to the amount (if any) unpaid on shares	Liability is limited to the amount guaranteed (usually a nominal sum)
TRANSFERS OF OWNERSHIP	Ownership can be transferred by transferring shares	Membership is generally not transferable
DEBT FINANCING	Available	Available
EQUITY FINANCING	Available	Not available, although a fee can be charged for membership
DISTRIBUTIONS TO INVESTORS	Dividends can be paid to members, subject to profits being available and there being no restrictions in the articles of association	Dividends can be paid to members, subject to profits being available and there being no restrictions in the articles of association
LIQUIDITY	Shares can be transferred to another person (subject to any restrictions in the articles or any shareholder agreement) Liquidity depends on there being willing transferors and transferees	Difficult for membership to be transferred meaning liquidity is non-existent, but as membership only involves a liability on insolvent liquidation this is not an issue
TAX TREATMENT	Companies are charged corporation tax (21%) on their profits	Companies are charged corporation tax (21%) on their profits
DISSOLUTION	Can be wound up in various ways. If a solvent liquidation, assets will be returned to shareholders	Can be wound up in various ways and assets may or may not go to members depending on the articles
CHARITABLE STATUS	Can apply for charitable status with the Charity Commission but rare	Can apply for charitable status with the Charity Commission
REGULATOR	None, but must comply with applicable company law including the Companies Act 2006	None, but must comply with applicable company law including the Companies Act 2006
REPORTING REQUIREMENTS	Annual return and annual accounts; Event driven returns i.e. for appointment of directors	Annual return and annual accounts; Event driven returns i.e. for appointment of directors
ADVANTAGES	Cheap, quick and easy to incorporate A time-tested and inherently flexible structure A trusted investment vehicle allowing for easy profit sharing	Cheap, quick and easy to incorporate A trusted and familiar structure
DISADVANTAGES	Commercial reputation may deter certain investors	More difficult to raise finance Structure less suitable for investment and profit sharing

LEGAL FORMS SPECIFIC TO PROFIT-WITH-PURPOSE BUSINESSES

	INDUSTRIAL PROVIDENT COMMUNITY BENEFIT SOCIETY (CBS)	COMMUNITY INTEREST COMPANY (AS A COMPANY LIMITED BY SHARES OR A COMPANY LIMITED BY GUARANTEE) (CIC)
OWNERSHIP	Owned by its members	Owned by its members
GOVERNANCE	Governed by its members and directors, subject to its rules	Generally governed by the board of directors, but ultimately by its members
CONSTITUTION/ OBJECTS	Society rules	Articles of Association
SOCIAL PURPOSE	Must be run for the benefit of people who are not members of the society and must be in the interests of the community at large	A company must pass the “community interest test”: that a reasonable person might consider that its activities are being carried on for the benefit of the community
LIMITED LIABILITY FOR OWNERS	Liability is limited to the amount (if any) unpaid on shares	See relevant answer for company limited by shares or guarantee
TRANSFERS OF OWNERSHIP	Investor shares are transferable	See relevant answer for company limited by shares or guarantee
DEBT FINANCING	Available, but interest rates are restricted to the lower of commercially available rates and rates offered from high-street banks	See relevant answer for company limited by shares or guarantee
EQUITY FINANCING	Available via special Investor Shares Withdrawable shares subject to a current statutory limit of £100,000 ¹⁵³	See relevant answer for company limited by shares or guarantee.
DISTRIBUTIONS TO INVESTORS	Distributions may be made to holders of Investor Shares, as provided for in the CBS’s rules	Dividends to private financial investors are subject to a cap. Following a consultation process with the regulator, the current cap is due to be uplifted shortly. Statutory asset lock prevents the transfer of assets for less than full consideration except in specified circumstances
LIQUIDITY	Shares can be transferred to another (subject to any restrictions in the articles or any shareholder agreement) Liquidity depends on the number of available market participants and will be limited by the £100,000 statutory limit on equity financing	See relevant answer for company limited by shares or guarantee
TAX TREATMENT	No special tax treatment Subject to corporation tax on profits at 21%	No special tax treatment See relevant answer for company limited by shares or guarantee
DISSOLUTION	Can be wound up in the same manner as a company	See relevant answer for company limited by shares or guarantee

¹⁵³ Increased from £20,000 with effect from 6 April 2014 by the Industrial and Provident Societies Act (Increased Shareholding Limit) Order 2014. NB. If the rules of a particular CBS state a lower figure that lower limit will stand unless varied.

CHARITABLE STATUS	Can apply for charitable status with the Charity Commission	Cannot be a charity
REGULATOR	Financial Conduct Authority, and (depending on activities undertaken), the Prudential Regulation Authority	Office of the Regulator of Community Interest Companies
REPORTING REQUIREMENTS	Annual return, accounts and auditor's report	See relevant answer for company limited by shares or guarantee. Must also file an annual community interest report with Companies House
ADVANTAGES	<ul style="list-style-type: none"> - Mission lock is strict - Separate legal entity - Limited liability 	<ul style="list-style-type: none"> - Mission lock is strict - Separate legal entity - Limited liability
DISADVANTAGES	Asset lock restricts distributions to investors. Excessive regulatory burden from the FCA	Subject to the forthcoming regulatory review, the asset lock would restrict distributions to investors

3.2 WHAT HYBRID STRUCTURES ARE OR COULD BE USED TO ESTABLISH A BUSINESS WITH THE KEY CHARACTERISTICS OF PROFIT-WITH-PURPOSE?

The hybrid structures discussed below offer some advantages to a profit-with- purpose business; often enabling the business to integrate favourable features of different legal forms in one group. However, the increase in complexity will add to the regulatory burden involved in running such a profit-with-purpose business.

(a) CHARITY PARENT WITH FOR-PROFIT ENTITY AS WHOLLY-OWNED SUBSIDIARY

This common structure incurs tax benefits in so far as the trading subsidiary "Gift Aids" its profits to its parent. The amount donated is then deducted from the income of the subsidiary, thereby removing liability to Corporation Tax.

External investors are able to provide investment into the subsidiary. However, such investment should be in the form of debt as all distributable profits of the subsidiary (potential dividends for shareholders) will be donated to the parent. If this is done it will limit the capacity of the subsidiary to repay the capital element of the loan so profits will need to be retained (and taxed).

A further question for consideration is the suitability from the point of view of the parent as a charity of outside investment into its subsidiary.

(b) FOR-PROFIT PARENT WITH NON-PROFIT SUBSIDIARY

This structure would allow a for-profit company to use some of its profits for a related social aim. As such, there must be a clear demarcation of the for-profit parent business and the non-profit subsidiary entity.

It is possible to set up the subsidiary as a registered charity or as a simple

CIC or CLG. If the subsidiary is a registered charity, external investors would only be able to receive a return from the parent.

4 OTHER METHODS OF IMPLEMENTATION

4.1 COULD OTHER TOOLS, SUCH AS THE USE OF CONTRACTUAL SANCTIONS, DIFFERENT CLASSES OF SECURITIES, GOVERNANCE PRACTICES, VOTING AGREEMENTS, INVESTMENT CONTRACTS, ETC. BE ADAPTED TO ESTABLISH/PROTECT A PROFIT-WITH-PURPOSE BUSINESS?¹⁵⁴

- (a) The structure of any debt investment could be structured to ensure the social purpose of the company is realised. Investors could include terms such as early repayment of a loan or penal rates of interest in the event of breach of the social purpose as incentives to encourage compliance.
- (b) For equity investments, investors could include provisions in the shareholders’ agreement that certain matters cannot be undertaken by the company without investor consent. Such matters could include amending the articles of association and changing any rights of any shares (including any rights of golden shares).
- (c) Ordinarily any provision of a company’s articles of association – including any objects – that is not entrenched can be varied by special resolution (75% of the members or of a class of the members). The UK Companies Act enables shareholders to “entrench” certain provisions of the articles of a company.¹⁵⁵ This means that a special resolution (requiring the approval of 75% of the members or of a class of members, as applicable) alone would not be enough to amend those provisions. A higher threshold of shareholder consent can be required. To protect the mission/social purpose, additional approval requirements can be included in the constitution.
- (d) A “golden share” is a form of entrenchment. The golden share carries differential voting rights that entitle its holder (typically a trust or government body) to veto any changes to the company’s articles that could remove or render ineffective the mission, for example, or changes to its articles of association generally, or to any material disposals of assets, a change of control, voluntary winding-up etc.
- (e) Weighted voting rights can be used as an alternative to class rights in order to give shareholders protection over certain matters. Additional votes are granted to a shareholder to give them the number of votes necessary to pass or defeat a particular resolution.

¹⁵⁴ Linklaters LLP have undertaken work covering this ground in a parallel work stream. See Linklaters LLP, Social Business Frontier – Analysis of Social Mission Lock “Tools” in the United Kingdom (draft date: March 2014).

¹⁵⁵ s. 22 UK Companies Act 2006. Note: s 22(2) is not yet in force. Implementation has been delayed by BIS.

- (f) As a practical matter, embedding the mission within the constitution may have disadvantages if the drafting is too restrictive or if the lack of flexibility impedes evolution of the mission of the profit-with-purpose business in the light of changing circumstances.
- (g) Note that, if a provision is entrenched in a company's articles by requiring a third party's consent to its amendment, s 22(3)(a) of the UK Companies Act allows any provision for entrenchment to be overridden by unanimous consent of the shareholders thereby defeating the third party consent rights.

4.2 WILL APPLICABLE LAW RESPECT CONTRACT TERMS ESTABLISHING AND/OR PROTECTING A SOCIAL PURPOSE?

- (a) Rather than using one of the legal forms that have set characteristics of a profit-with-purpose business by law, private parties may organise a profit-with-purpose business with those characteristics pursuant to a contract between those parties (for example, by way of a shareholders' agreement). Assuming the particular contract does not offend the rules, such as illegality or public policy, which may make a contract void or unenforceable, then applicable law should respect such contract terms. Contractual terms offer greater flexibility to address specific needs of a particular profit-with-purpose business and to design a bespoke regime.

(b) Enforcement mechanisms

In the absence of express contractual provisions, it may be difficult to enforce a social purpose if directors were not complying with their duties. Duties are owed to the company, and if a director were in breach of his or her duties, it would be the company who would need to bring an action to enforce the duties.

In certain limited circumstances, shareholders can bring derivative actions on the company's behalf. This may extend to an alleged breach of any of the directors' general duties under the UK Companies Act. However, there are a number of procedural obstacles that a member would need to overcome to bring a claim. A court must refuse permission for a member to bring a derivative claim where it is satisfied that either a person acting in accordance with the duty to promote the success of the company would not seek to continue the claim or the act or omission giving rise to the cause of action has been authorised or ratified by the company.

5 ADDITIONAL CONTROLS OVER PROFIT-WITH-PURPOSE BUSINESSES

5.1 WHAT OTHER LEGAL OBLIGATIONS OR CONTROLS OVER THE SOCIAL PURPOSE APPLY TO PROFIT-WITH-PURPOSE BUSINESSES UNDER APPLICABLE LAW? ARE THESE REQUIREMENTS MANDATORY OR PERMISSIVE?

(a) CORPORATE SOCIAL RESPONSIBILITY

Corporate social responsibility (“**CSR**”) – by which we mean responsible corporate decision-making that considers the broad impact of corporate actions on people, communities and the environment. CSR is essentially voluntary in the UK but there is a body of law and regulation which provides a framework for CSR, particularly as regards reporting e.g.:

- (i) UK Corporate Governance Code which applies to companies with a premium listing of equity securities;
- (ii) Companies Act 2006 directors duties (See Section 2.3 above);
- (iii) Companies Act 2006 (Strategic Report and Directors Report) Regulations 2013 under which all companies other than those under the small companies regime, must produce an annual strategic report;
- (iv) Anti-corruption legislation and policies; and
- (v) Various investor group guidelines.

Many companies have seriously committed to devising, pursuing and reporting on their CSR strategy. Public scrutiny of corporate practices generally, particularly of large multinationals, is on the rise.

(b) BENEFICIAL OWNERSHIP

On 21 April 2014, the Government published its response to a discussion paper published by BIS on “Transparency & Trust: Enhancing the transparency of UK company ownership and increasing trust in UK business”¹⁵⁶. The Government intends to implement many of the proposals contained in the discussion paper including the creation of a central registry of company beneficial ownership information (the proposal is for a beneficial owner to be defined as a person who ultimately holds 25 per cent. of a company’s shares or voting rights or who otherwise exercises control over the management of a company). Once implemented, the requirement to obtain, hold and file beneficial ownership information at Companies House will apply to all UK bodies corporate that are currently required to file information at Companies House. There is no commentary to suggest that this new requirement would act as a disincentive to invest in profit-with-purpose businesses.

¹⁵⁶ Please see the Government response at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/304297/bis-14-672-transparency-and-trust-consultation-response.pdf

(c) **ASSET LOCK**¹⁵⁷

An asset lock is mandatory for a CIC (as discussed in section 2.1(b) above).

For a non-CIC company, assets are generally under the control of the directors. In the absence of any restrictions in the articles of association or any shareholders agreement, provided the terms of a proposed disposal are in the company's best interests and consistent with the directors statutory and common law duties, the directors can dispose of assets. If the terms are of questionable commercial benefit the directors would obtain prior shareholders approval. Quoted companies are subject to the continuing obligations under the Listing Rules (or the AIM Rules for AIM companies) which, depending on the value of the assets the subject of the transaction relative to the size of the company, or to the identity of the purchaser (related parties), may require prior shareholder approval and/or public disclosure of the terms of any disposal of assets.

(d) **PROFITS LOCK**¹⁵⁸

A CLS proposing to make a distribution of profits to its members must satisfy two basic rules under the UK Companies Act:

- » it must have "profits available" to make the distribution.¹⁵⁹
- » the distribution must be justified by reference to "relevant accounts"¹⁶⁰

The directors of a CLS must also have regard to their statutory and common law duties before recommending any form of distribution.

There are additional requirements for public companies. Please refer to the tables at Section 3.1 above for the position in relation to CLGs.

(e) **CHANGE OF CONTROL**

Can generally be achieved through the articles of association for a company or contractual arrangements between shareholders.

¹⁵⁷ Guidance Note: An "asset lock" is a restriction on sale or disposition of its assets, either during the life of the business or upon liquidation.

¹⁵⁸ Guidance Note: A "profits lock" is a restriction on the making of distributions from the profits of a social impact business, either during the life of the business or upon liquidation.

¹⁵⁹ S 830(i) of the UK Companies Act.

¹⁶⁰ Ss 836 and 839 of the UK Companies Act.

6 ACCESS TO INVESTMENT CAPITAL

6.1 TAX INCENTIVES

- (a) Until 2014, profit-with-purpose businesses which were not charities were only able to benefit from tax reliefs if their mode of operation allowed them to be qualifying enterprises for the purposes of the regimes relating to Venture Capital trusts, Enterprise Investment Schemes or Seed Enterprise Investment Schemes. In June 2013 the Government issued a paper entitled “Consultation on social investment tax relief”; discussing the existing regulated organisations which trade for social purposes, namely CICs, CBSs and charities, the paper explicitly linked (in relation to CICs and CBSs) their eligibility for such potential new tax relief and the fact that both have a “community interest test” and asset locks.
- (b) Following that consultation, the Finance Act 2014 will (once it receives the Royal Assent expected to be in July 2014) introduce a new part into the Income Tax Act 2007, which will provide for (i) income tax relief (“SITR”) at the rate of 30% to qualifying individuals making qualifying investments (up to an annual maximum of £1,000,000) in **qualifying social enterprises**; (ii) hold-over relief of capital gains if the gain is invested in debt or equity investments which qualify for SITR relief; and (iii) an exemption from capital gains tax on the disposal of such qualifying debt or equity investments.

Qualifying social enterprises:

- The relief will be available for private investment only in charities, CICs and CBSs, and, in relation only to social impact bonds, where the special purpose vehicle is a company limited by shares.¹⁶¹ (Note that companies limited by guarantee are not eligible).
- Qualifying social enterprises may engage in a wider range of trading activities – for example, nursing and care homes – than was eligible for tax relief under the Enterprise Investment Scheme but there remains a long list of excluded activities which are regarded as considered too distant from the goal of fostering profit-with-purpose businesses to be eligible.
- Only unquoted organisations with 500 or fewer employees and a maximum of £15 million gross assets will be eligible
- Investment in the form of simple debt will be eligible where the debt is unsecured and has certain other features

¹⁶¹ In the Social Investment Roadmap published in January 2014 the Government stated:

“Social impact bonds (SIBs) would be eligible for SITR where the special purpose vehicle is a company limited by shares. SIBs wishing to use SITR will need to be accredited through a scheme administered by the Cabinet Office. The accreditation scheme will ensure that social impact bonds receiving investment under the relief fulfil the eligibility criteria in the legislation. The Government will be consulting the social enterprise sector informally about the criteria in early 2014. The accreditation scheme will be established in Finance Bill 2014 and in secondary legislation laid in Parliament before summer. New social impact bonds that meet the criteria will be able to apply to be accredited in summer 2014 once legislation has been enacted.”

- The minimum investment period is 3 years
- Indirect investment can take place via a 'nominee' fund but not via a separate legal body
- Investments may not currently exceed a maximum of €200,000 per investee organisation. The Government is consulting with the European Commission regarding an increase in this cap.

(c) In addition to SITR, Community Investment Tax Relief ("CITR") has been available since 2002 but has a more restricted ambit. It provides relief at a rate of 25% spread over five years to individuals or companies who invest either debt or equity into accredited Community Development Finance Institutions ("CDFIs"), which are intermediary organisations which then invest (directly or indirectly) in enterprises in or serving disadvantaged communities.

CDFIs may take a range of forms including:

- community loan funds, which make capital available to community regeneration initiatives and businesses
- micro-finance funds, which make very small loans, usually at near-market rates of interest, to the smallest businesses, e.g. sole traders, and
- social banks - profit-seeking financial service providers or subsidiaries, dedicated to social or environmental objectives.

In view of the more limited tax relief available and the tight controls surrounding its availability, it is questionable how much use will be made of this relief and the 2013 consultation document relating to SITR noted that the Government is considering the value of operating both schemes simultaneously.

6.2 BARRIERS TO ACCESSING INVESTMENT

There is currently no separate legal or regulatory regime in the UK for raising capital for non-charitable profit-with-purpose businesses. Companies seeking to raise finance by issuing equity or debt securities must comply with all relevant legislation, including the prohibition under the UK Companies Act on the public offer of private shares, the disclosure and financial promotion requirements and restrictions in the FCA Handbook and the requirement under section 85 of FSMA to publish a prospectus (or satisfy themselves that an exemption is available). The cost of compliance with mainstream financial services regulation is often prohibitive and prevents or delays much social finance/investing taking place. Commentators suggest there is a need to balance investor protection (a critical element of the financial services regulatory regime) against the need for investor enablement. The pendulum is currently weighted towards protection and arguably needs to swing more towards enablement if a flourishing international marketplace for social investment is to develop.

It is interesting to note the comments in the FCA's recent Policy Statement PS14/4¹⁶² setting out its regulatory approach to crowdfunding over the internet, and the promotion of non-readily realisable securities by other media at paragraph 2.20 regarding social investments: "At present, if an investment activity falls within FCA scope, our rules apply to firms carrying on regulated activities or communicating promotions in relation to investments labelled as "social investments", "ethical investments" and "environmental investments" just as they would in relation to any other designated investment. We do not consider an investment's social or other non-financial objective to be a reason to reduce consumer protection when the same risks or potential capital losses and illiquidity can apply. However, consideration will be given to commenting on this sector further after the scope of the government's planned social investment tax relief is known."

6.3 RISK

Company shareholders share in all risks and rewards of the company, but downside risk is capped at equity investment.

6.4 EXIT

An investor can transfer (by sale or gift) his shares in a company subject to any restrictions in the articles of association and (in the case of a sale) to there being a willing buyer at the price. An IPO would only be an exit for shareholders in a public company, if the company met the eligibility criteria and was able to comply with the Listing Rules (including the continuing obligations), Prospectus Rules and Disclosure and Transparency Rules, and could meet the market's expectations regarding profitability, for example. As such, an IPO is a theoretically possible exit but is unlikely to be practicable for a profit-with-purpose business.

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June 2014

162 <http://www.fca.org.uk/your-fca/documents/policy-statements/ps14-04>.

UNITED STATES



UNITED STATES

1 COUNTRY OVERVIEW

In the United States, state law, rather than federal law, provides both the statutory framework and common law governing the formation and operation of business entities. As a result, while broadly consistent across the fifty states, state laws governing business entities do vary meaningfully. Delaware is the preferred state for incorporation due to the ease of incorporating, low corporate tax rates and a well-developed body of corporate law¹⁶³. This report will not provide a detailed survey of the law in each of the fifty states but will instead focus on broad principles of corporate law with general applicability, unless otherwise noted¹⁶⁴.

Relative to some jurisdictions, the legal framework in the United States, based on the principle of freedom of contract, is flexible and permissive. With some exceptions, statutory law generally establishes a set of default rules that will apply unless specifically disclaimed. As a result, there are few limitations on permissible business activity and few mandatory legal requirements with which companies must comply. The primary forms of organisation for traditional for-profit businesses are partnerships (both general and limited), limited liability companies (“**LLCs**”) and corporations. Of these, corporations are subject to the most mandatory legal requirements and are therefore arguably the least flexible. Because many of the terms governing these various forms can be determined by contract, they can all be adapted for use by profit-with-purpose businesses to varying degrees.

Use of these forms by profit-with-purpose businesses, in particular, the corporation, is limited in some important respects. First and most importantly, corporate law imposes fiduciary duties on directors, including an obligation to act in the best interests of shareholders. A corollary to this principle of “shareholder primacy” is the maxim that corporate directors must act to maximise shareholder value. The conventional wisdom equating shareholder primacy with profit maximisation has cast doubt on whether directors could make decisions in furtherance of a social purpose at the expense of short-term profit without violating their fiduciary duties. Constituency statutes, which have been enacted in a majority of states, protect the ability of directors to consider other interests, such as those of customers, employees and creditors, but do not

¹⁶³ According to the Delaware Secretary of State, Delaware is home to 50% of publicly traded companies and 64% of the Fortune 500, About Agency – Delaware Divisions of Corporations, <http://corp.delaware.gov/aboutagency.shtml> (last visited Apr. 30, 2014).

¹⁶⁴ Because the various state statutes employ different terminology to refer to the same underlying concepts, to avoid confusion, we use generic terms in lieu of language that conforms to each state statute. For example, we refer to “articles of incorporation” and “shareholders” although a particular state statute may use the terms “certificate of incorporation” and “stockholders”.

expressly extend to the full panoply of interests and considerations directors of a profit-with-purpose business may wish to consider. In addition, while there is considerable judicial deference to the rational and unconflicted decisions of directors, there is greater scrutiny of board decisions in the change of control context. In those situations, the ability of directors to consider other factors is less clear. It is worth noting that fiduciary duties also apply to general partners and to managers of LLCs, but in these contexts the duties are more readily modified, or in some cases, eliminated entirely, by contract.

A second and related issue in adapting traditional legal forms to suit profit-with-purpose businesses is the means of enforcing of the social purpose. Because corporate directors only owe duties to the company and its shareholders, other stakeholders do not have the right to sue for breach of those duties even if they are impacted by the decision. In a profit-with-purpose business, non-owner beneficiaries would not typically have standing to bring suit against the corporation for failing to satisfy its stated social objectives. Indeed, this would be an unusual right in the absence of privity between a company and its non-owner stakeholders.

It is against this backdrop that a majority states have enacted legislation creating new legal forms of enterprise. These new legal forms are intended to permit businesses wishing to adopt the so-called “triple-bottom line” of profits with purpose to advertise that fact in their choice of legal form, to obtain certain attendant legal protections to further the social purpose of the business and to unlock underutilised sources of investment capital.

Four new forms have emerged from these efforts: the Low-Profit Limited Liability Company (“**L3C**”), the Benefit Corporation, the Flexible Purpose Corporation (“**FPC**”) and the Social Purpose Corporation (“**SPC**”). An L3C is an analogue of the limited liability company (“**LLC**”) and the others are analogues of a corporation. Most states have followed the Model Benefit Corporation Legislation (“**MBCL**”) advocated by the non-profit organisation B Lab, while others, such as Delaware and Colorado, have made significant modifications to the MBCL approach¹⁶⁵. Where these distinctions are meaningful, this report will contrast the “Model Approach” with the “Delaware Approach”. California and Washington, by contrast, have crafted their own corporate analogues for profit-with-purpose businesses – the FPC¹⁶⁶ and SPC, respectively. We

¹⁶⁵ Compare B Lab, Model Benefit Corporation Legislation (hereinafter “MBCL”) http://benefitcorp.net/storage/documents/Model_Benefit_Corporation_Legislation.pdf (Apr. 10, 2013), with Del. Code Ann. tit. 8 § 361 et seq. with Colo. Rev. Stat. § 7-101-500 et seq. Delaware and Colorado refer to “public benefit corporations” rather than “benefit corporations”.

¹⁶⁶ At the time of writing a bill currently pending in the California State Assembly would rename the FPC a “social purpose corporation” and make other changes to the FPC statute, such as requiring the directors to consider other interests, provide for dissenters’ rights in the case of some mergers or conversions to other business entities, require supermajority shareholder approval for certain reorganisations, modify the information requirements of the special purpose management discussion and analysis and remove an exemption from such requirements for companies with fewer than 100 shareholders, among other changes. See S.B. 1301, 2013-2014 Leg., Reg. Sess. (Cal. 2014), available at http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb_1301-1350/sb_1301_bill_20140630_amended_asm_v95.html.

refer specifically to the applicable provisions of California and Washington law when describing the characteristics of those entities.

The defining characteristics of profit-with-purpose businesses – namely (i) a commitment to a social purpose, (ii) a duty to consider the social purpose when making business decisions and (iii) transparency regarding achievement of the social purpose – are present in varying degrees in the legal forms designed for profit-with-purpose businesses.

(a) L3Cs

- Primary purpose must track charitable or educational purposes within the meaning of the US Internal Revenue Code (the "IRC")
- No statutory duties to consider the social purpose but such duties could be implemented by contract
- No specific reporting requirements but such requirements could be imposed by contract

(b) Benefit Corporations – Model Approach

- Required to pursue a general social purpose, i.e. a positive impact on society and the environment, or permitted to adopt one or more specific social purposes
- Mandatory obligation of directors to consider constituencies other than shareholders, impact on the community and ability to achieve a public benefit
- Must produce an annual report addressing achievement of the social purpose measured against a third party standard

(c) Benefit Corporations – Delaware Approach

- Required to pursue a specific social purpose
- Directors must balance the economic interests of shareholders with the interests of constituents materially affected by the business and with the specific social purpose
- Must produce a statement addressing the social impact at least biennially

(d) FPCs

- Required to pursue a specific special social purpose that is either charitable or benefits the business' constituents, society or the environment
- Directors have discretion to consider all relevant factors including the social purpose of the business, in discharging their duties
- Annual report must include a special purpose management discussion & analysis ("MD&A") section; FPCs are subject to a current reporting requirement

(e) SPCs

- Required to pursue a general social purpose that benefits the business' constituents, the community or the environment

- Directors may, but are not required to, consider the social purpose in discharging their duties
- Must publish an annual report addressing achievement of the social purpose

With the exception of the L3C, these new legal forms were largely enacted to address the perceived shortcomings of the traditional corporate form as applied to profit-with-purpose businesses. One of the principle arguments for the creation of specific legal forms for profit-with-purpose businesses in the United States is that the fiduciary duties applicable to directors and officers of for-profit corporations are construed too narrowly and prioritise profit maximisation above other interests – especially in certain takeover scenarios¹⁶⁷. Under the laws governing these new legal forms, corporate directors are expressly permitted to consider other interests when taking decisions and directors who act in furtherance of the social purpose of the company are typically insulated from liability. A key advantage in organising a profit-with-purpose business as one of the new corporate forms, therefore, is the expanded protections for directors who act to foster the social purpose of the company.

None of these new legal forms confer standing on non-owner stakeholders to enforce the social purpose of the company or otherwise hold it accountable. The Model Approach permits, but does not require, benefit corporations to grant enforcement rights to other stakeholders. Some commentators have criticised these new forms as unnecessary by questioning whether the presumption of shareholder value maximisation is an accurate reflection of corporate law principles¹⁶⁸. Others have suggested that the express statutory directive to consider other interests common among profit-with-purpose business legislation creates an unhelpful distinction between profit-with-purpose businesses and traditional companies and may unnecessarily and unintentionally restrict the exercise of conventional fiduciary duties¹⁶⁹.

With an increasing number of states adopting new legal forms to meet the demands of social entrepreneurs and impact investors it remains to be seen to what extent the business community embraces these innovations and how courts respond to the interpretive questions they pose.

167 See William H. Clark, Jr. & Larry Vranka, et al. *The Need and Rationale for the Benefit Corporation: Why It Is the Legal Form that Best Addresses the Needs of Social Entrepreneurs, Investors and, Ultimately, the Public*, (version of Jan. 18, 2013), http://benefitcorp.net/storage/documents/Benefit_Corporation_White_Paper_1_18_2013.pdf.

168 See Jessica Chu, *Filling a Non-Existent Gap: Benefit Corporations and the Myth of Shareholder Wealth Maximization*, 22 *S. Cal. Interdisc. L.J.* 155, 187-88, 2012-2013.

169 See Mark A. Underberg, *Benefit Corporations vs. “Regular” Corporations: A Harmful Dichotomy*, the Harvard Law School Forum on Corporate Governance and Financial Regulation, (May 13, 2012). <https://blogs.law.harvard.edu/corpgov/2012/05/13/benefit-corporations-vs-regular-corporations-a-harmful-dichotomy/>.

2 LEGAL FOUNDATIONS FOR PROFIT-WITH-PURPOSE BUSINESSES

2.1 CAN A BUSINESS BE FORMED UNDER APPLICABLE LAW WITH KEY CHARACTERISTICS OF A PROFIT-WITH-PURPOSE BUSINESS?

Profit-with-purpose businesses may be organised using either traditional corporate forms intended for all for-profit businesses or, in some states, using new forms designed specifically for profit-with-purpose businesses. Both the traditional and new forms can reflect the key characteristics of profit-with-purpose businesses to varying degrees. Adapting traditional legal forms for profit-with-purpose businesses requires including specific provisions in the governing documents that obligate (i) the company to pursue a social purpose, (ii) managers to consider the social purpose when discharging their duties and (iii) the company to provide reports to shareholders and/or the public evaluating the company's success in achieving its social purpose.

2.2 CAN AN ORGANISATION ADOPT A GENERAL SOCIAL PURPOSE TO CREATE A SOCIAL OR ENVIRONMENTAL BENEFIT AND/OR A SPECIFIC SOCIAL PURPOSE?

(a) Traditional legal forms

All profit-with-purpose businesses, regardless of how they are organised, may adopt a social purpose in their governing documents. In a partnership agreement or LLC operating agreement, an obligation to pursue a general and/or specific social purpose would likely be upheld to the same extent as other contractual provisions. Applicable law generally affords the partners or members considerable freedom to define the terms of their business arrangement including the purposes for which the business is formed. Accordingly, a partnership or LLC could adopt a social purpose and set limits (such as consent rights) to safeguard the social purpose.

There are no legal prohibitions against forming a corporation with either a primary or secondary social purpose. In Delaware, for example, a corporation's articles of incorporation need only contain a general statement of purpose that they are formed to engage in any lawful act or activity for which corporations may be organised under Delaware law¹⁷⁰. Because the corporation's articles of incorporation are considered a contract between the corporation, the shareholders and the state, contract principles generally apply and shareholders are presumed to have acceded to the rights and limitations set forth in the articles of incorporation upon acquiring stock¹⁷¹. Courts generally apply contract principles to the interpretation of corporate articles and are

¹⁷⁰ Del. Code Ann. tit. 8 § 101, 102.

¹⁷¹ See 18 Am. Jur. 2d Corporations § 82.

likely to uphold the provisions of the articles unless they contravene applicable law or otherwise violate public policy. There is, however, an open question as to whether and to what degree a social purpose embedded in the articles or bylaws of a traditional corporation could be enforced, as discussed in 5.1(e) below.

(b) New legal forms

By contrast, a profit-with-purpose business that elects one of the new legal forms must identify a general and/or specific public purpose in its organisational documents. The specific requirements for each of the four new forms are discussed in further detail below.

- (i) **L3C** – An L3C’s primary purpose must be either charitable or educational within the meaning of Section 170 of the IRC. An L3C must also disclaim in its articles of organisation **(A)** any significant purpose for the production of income or appreciation of property and **(B)** any political or legislative purpose¹⁷².
- (ii) **BENEFIT CORPORATION** – Model Approach benefit corporations must pursue a “general public benefit”, defined as “a material positive impact on society and the environment, taken as a whole, assessed against a third party standard, from the business and operations of the benefit corporation”¹⁷³. The Model Approach also permits, but does not require, benefit corporations to identify a specific public benefit, which supplements but does not limit the general public benefit¹⁷⁴. The Delaware Approach, by contrast, eschews an express general public benefit requirement in favour of a requirement that the company identify a specific public benefit in its articles of incorporation. Nonetheless, under the Delaware Approach, benefit corporations must operate “in a responsible and sustainable manner” by balancing the interests of those materially affected by the corporation’s conduct with the shareholders’ pecuniary interest and the stated public benefit purpose(s) of the corporation¹⁷⁵.
- (iii) **FPC** – California law requires an FPC to include a statement of purpose in its articles of incorporation which includes at least one “special purpose”. The special purpose may be either **(1)** charitable or public purpose

172 See Robert T. Esposito, *The Social Enterprise Revolution in Corporate Law: A Primer on Emerging Corporate Entities in Europe and the United States and the Case for the Benefit Corporation*, 4 *Wm. & Mary Bus. L. Rev.* 639, 683 (2013).

173 MBCL § 102.

174 See MBCL § 201(b). A specific public benefit includes serving disadvantaged communities, promoting economic opportunity, protecting the environment, promoting arts and sciences, facilitating financing for entities that benefit society or the environment and other societal and environmental benefits. *Id.* § 102.

175 See Del. Code Ann. tit. 8 § 362; Colo. Rev. Stat. § 7-101-503. Both Delaware and Colorado have termed their benefit corporations “public benefit corporations”. Other states use the term “public benefit corporation” to refer to state-owned or controlled enterprises, such as public authorities. We use the term “benefit corporation” generically to refer to the legal entity designed for profit-with-purpose businesses to avoid confusion.

activities that a non-profit public benefit corporation is authorised to carry out or (2) the purpose of promoting positive, or minimising adverse, short-term or long-term effects of the FPC’s activities upon its employees, suppliers, customers, and creditors; the community and society; or the environment¹⁷⁶.

- (iv) **SPC** – The SPC must designate at least one general social purpose, defined as the promotion of positive or minimisation of adverse short- or long-term effects on any or all of (1) the company’s employees, suppliers or customers, (2) the local, state, national or world community; or (3) the environment, and may also designate a specific social purpose. Washington law also imposes an additional obligation on SPCs to expressly state in their articles of incorporation that the mission of the SPC is “not necessarily compatible with and may be contrary to maximising profits and earnings for shareholders, or maximising shareholder value in any sale, merger, acquisition or other similar actions of the corporation”¹⁷⁷.

2.3 WHAT LEGAL DUTIES DO MANAGERS/DIRECTORS HAVE UNDER APPLICABLE LAW AND TO WHAT EXTENT DO THESE DUTIES EXTEND TO NON-OWNER STAKEHOLDERS?

(a) Traditional legal forms

State corporate law recognises two primary duties of directors of a corporation: the duty of care and the duty of loyalty. The directors owe their duties to the company and the shareholders, not to any other stakeholder. These duties stem from the segregation of ownership and control inherent in the corporate form, whereby shareholders entrust the directors with the responsibility of managing the assets of the business. The duty of care refers to the directors’ obligation to make informed decisions on the basis of all material information reasonably available to them. This duty encompasses an obligation to act in good faith, make reasonable inquiries and take decisions after due deliberation. The duty of loyalty is a duty to abstain from conflicts of interest. Specifically, directors may not use their position of trust and confidence to further their private interests. In addition, directors have related duties of oversight and disclosure. The duty of oversight obliges directors to ensure that they have access to material information about the operations and conduct of the business. The duty of disclosure obliges directors to inform shareholders of all relevant material information when seeking shareholder approval on a matter. Courts afford directors’ decisions considerable deference and will generally overturn a decision only if there is no rational basis for it. In partnerships and LLCs, general partners and managers owe similar duties to the limited partners and

¹⁷⁶ Cal. Corp. Code §§ 2602(b)(2), 2603(a)(6).

¹⁷⁷ Wash. Rev. Code. § 23B.25.020 - 040.

members, respectively, though some states will permit parties to expressly override these fiduciary duties in non-corporate legal forms¹⁷⁸. Because partnerships and LLCs are considerably more flexible, the issues that fiduciary duties pose are primarily concerns for corporations.

These fiduciary duties reflect the principle of shareholder primacy embedded in US corporate law that privileges shareholders above other stakeholders, such as employees, creditors or communities. The duty to act in the best interest of shareholders is often construed as duty to maximise shareholder value on the assumption that shareholders are primarily interested in maximising their return on investment¹⁷⁹. This norm is reinforced in certain change of control situations to which Revlon duties apply. When directors have made the decision to sell or breakup the company, they have a duty to maximise shareholder value in the short-term. The application of the Revlon standard, however, is very limited in scope and does not apply to day-to-day managerial decisions or even to all change of control transactions. More importantly, corporations are not legally bound to maximise profits, nor are they legally prohibited from considering other interests and there is little, if any, case law imposing liability on directors for doing so¹⁸⁰.

In a majority of states, directors are also expressly permitted to consider interests of other stakeholders (typically employees, creditors, customers and communities) pursuant to state constituency statutes. Constituency statutes were adopted as a takeover defence and typically apply in sale of the company situations, but a number of such statutes apply more broadly¹⁸¹. In states with constituency statutes, directors have additional protections against claims for breach of fiduciary duty on the basis that their decisions failed to maximise shareholder value. Constituency statutes do not confer standing on other stakeholders to challenge director decisions, and as result, may afford directors wide latitude to evaluate competing interests and thereby justify decisions that do not maximise shareholder value without any accountability to stakeholders in whose interest they are purportedly acting¹⁸². Another significant limitation of these statutes is that they generally do not encompass the full scope of interests that profit-with-purpose

178 See 51 Am. Jur. 2d Limited Liability Companies §11

179 See Justin Blount & Kwabena Offei-Danso, *The Benefit Corporation: A Questionable Solution to a Non-Existent Problem*, 44 St. Mary's L.J. 617, 636 (2012-13).

180 See J. William Callison, *Putting New Sheets on a Procrustean Bed: How Benefit Corporations Address Fiduciary Duties, the Dangers Created, and Suggestions for Change*, 2 Am. U. Bus. L. Rev. 85, 105 (2012-13); Underberg, *supra* n.7. Notably, the U.S. Supreme Court has recently reinforced the idea that for-profit corporations are not required to maintain an unswerving commitment to pursue profit at all costs. See *Burwell v. Hobby Lobby Stores, Inc.*, 573 U.S. ___ (2014) at 23 ("While it is certainly true that a central objective of for-profit corporations is to make money, modern corporate law does not require for-profit corporations to pursue profit at the expense of everything else, and many do not do so.").

181 See Alissa Mickels, *Beyond Corporate Social Responsibility: Reconciling the Ideals of a For-Benefit Corporation with Director Fiduciary Duties in the U.S. and Europe*, 32 Hastings Int'l & Comp. L. Rev. 271, 290 ("Although states enacted constituency statutes primarily to give directors another defensive tactic following the explosion of takeovers in the late 1980's, these statutes may also allow directors to consider stakeholder interests when making day-to-day decisions."). Notably, Delaware does not have a constituency statute.

182 See Steven Munch, *Improving the Benefit Corporation: How Traditional Governance Mechanisms Can Enhance the Innovative New Business Form* 7 Nw. J.L. & Soc. Pol'y 170, 180-82 (2012).

businesses pursue, such as society at large and the environment. Because the case law interpreting these statutes is limited, it is not clear to what extent directors of profit-with-purpose businesses could rely on these laws to defend their decisions in the face of challenges from shareholders.

Perhaps the most significant feature of existing corporate law that would enable a profit-with-purpose business to pursue its social mission is the generous protection afforded to director decisions under the business judgment rule. The business judgment rule presumes that directors act in good faith and in the best interests of the corporation. As a result, courts will uphold decisions of directors if they have a rational basis¹⁸³. The business judgment rule reflects courts' unwillingness to intercede in the private affairs of a corporation. Some commentators have argued that this deferential standard effectively renders any responsibility to maximise shareholder value that may exist unenforceable¹⁸⁴. More importantly, as a practical matter, directors do make decisions that take other interests into account¹⁸⁵. Nonetheless, the conventional wisdom that the purpose of a traditional corporation is to maximise shareholder value may discourage directors from considering other interests, or, in the case of profit-with-purpose businesses, pursuing policies that further the social purpose but which do not maximise profits.

(b) New legal forms

One of the primary arguments in favour of the alternative corporate forms for profit-with-purpose businesses is that the profit-maximisation norm hampers the pursuit of a social purpose by leaving directors exposed to potential liability¹⁸⁶. As a result, one of the key features of these new corporate forms are provisions that specifically permit, or, in the case of the benefit corporation, require, directors to consider non-shareholder interests. The criticisms applicable to constituency statutes, however, also apply to some of the expanded protections afforded to directors of the new corporate forms – namely, that they offer limited guidance to directors in how to evaluate competing interests and limit the accountability of boards. The specific modifications to directors' duties for each of the new corporate forms are described in further detail below. Unlike the new corporate forms, the L3C statutes do not impose specific duties on managers or members of L3Cs to uphold the social purpose stated in the articles of organisation. The duties of L3C members and/or managers are those of LLCs generally, namely, they have flexibility to impose or remove fiduciary duties by contract.

183 See 18B Am. Jur. 2d Corporations §1470. The business judgment rule will not apply, and director decisions will receive enhanced scrutiny, if the director has a conflict of interest.

184 See Blount & Offei-Danso, *supra* note 17 at 659.

185 See Jessica Chu, *Filling a Non-Existent Gap: Benefit Corporations and the Myth of Shareholder Wealth Maximization*, 22 S. Cal. Interdisc. L.J. 155, 182 (2012-13).

186 Callison, *supra* n. 18 at 105.

- (i) **BENEFIT CORPORATION** – In states following the Model Approach, directors must consider the impact of their decisions on numerous constituents and factors, including shareholders, employees, subsidiaries, suppliers, customers, the community, the environment, and the short- and long-term interests of the benefit corporation and its ability to achieve its social purpose. Directors are not personally liable for failure to achieve a public benefit or for considering these other interests if they act in accordance with their fiduciary duties¹⁸⁷. The Delaware Approach mandates that directors of a benefit corporation balance shareholders' economic interests with the best interests of constituencies materially affected by the business and the specific benefit specified in the certificate of incorporation. Directors are deemed to satisfy their fiduciary duties when balancing these interests if their decisions are "informed and disinterested and not such that no person of ordinary, sound judgment would approve"¹⁸⁸.
- (ii) **FPC** – California law grants FPC directors significant discretion to consider all relevant factors when discharging their duties. This specifically includes the short- and long-term prospects of the FPC and purposes of the FPC as set forth in its articles of incorporation. When acting in accordance with the statute, including by taking these additional factors into account, directors are insulated from liability and the FPC may eliminate the director's liability for money damages and indemnify them in actions for breach of fiduciary duty to the same extent as other California corporations¹⁸⁹.
- (iii) **SPC** – Shareholders in an SPC have considerable flexibility in determining whether and to what extent directors and officers consider the company's social purpose in managing the business. The Washington statute permits, but does not require, directors of SPCs to give weight to the company's social purposes specified in the articles of incorporation by default; however shareholders may either require or expressly prohibit this in the company's articles of incorporation¹⁹⁰.

187 See MBCL §§ 301(a)(1), (c).

188 Del. Code Ann. tit. 8 §§ 362(a), 365(b); Colo. Rev. Stat. §§ 7-101-503, 506(2)(b).

189 Cal. Corp. Code §§ 2702(b)-(d), 5600.

190 See Wash. Rev. Code. §§ 23B.25.050-060; Peter J. Smith, Washington's Social Purpose Corporation, The APEX Law Group LLP (Apr. 16, 2013), http://www.spcwa.com/wp-content/uploads/2013/06/Washingtons_Social_Purpose_Corporation.pdf.

2.4 DOES A PROFIT-WITH-PURPOSE BUSINESS HAVE AN OBLIGATION TO REPORT ON THE ACHIEVEMENT OF ITS SOCIAL PURPOSE AND IF SO, THE ASSESSMENT REQUIRED TO BE MADE IN REFERENCE TO VERIFIABLE THIRD PARTY STANDARDS?

(a) Traditional legal forms

Business entity law does not impose any obligation on a profit-with-purpose business organised as one of the traditional legal forms to periodically assess or report on the social impact of the business or its success in achieving its corporate purpose. Financial reporting obligations are, however, common features of the organisational documents of traditional for-profit businesses. Managers are typically required to report to owners on the financial performance of businesses at least quarterly and, in some circumstances, monthly. Applicable law is sufficiently flexible to permit equity holders to contract for additional reporting obligations akin to what the new corporate statutes require (as discussed in Section 2.4(b) below), or if desired, to impose more stringent reporting obligations on the company. The primary risks of this approach involve the interplay of these self-imposed reporting obligations with applicable securities laws and the potential liability for material inaccuracies that may result from public disclosure in connection with the offering or sale of securities. The new legal forms are equally vulnerable to these risks and have less flexibility in some cases to avoid public disclosure of statutorily mandated reports.

(b) New legal forms

The L3C statutes follow the freedom of contract approach consistent with existing LLC law and do not expressly address any specific social impact reporting obligations. Legislation enacting the new corporate forms, by contrast, attempts to address transparency concerns by requiring the company to make some assessment of its social impact and periodically provide this information to shareholders. The substance of these statutorily mandated reports varies as do the distribution obligations as set forth in greater detail below.

- (i) **BENEFIT CORPORATION** – Under the [Model Approach](#), benefit corporations must prepare an annual benefit report that describes the ways the company has pursued the general social purpose (and any specific social purpose, if applicable) and the extent to which the social purpose was achieved. The report should also assess the company's overall social and environmental performance against a third party standard and describe how and why that standard was selected. To the extent there are any changes in the methodology used to evaluate performance, including a change in the standard itself, the report should explain why the changes were made. The benefit report must also (1) identify the benefit director and/or officer, if any has been appointed, (2) disclose director compensation and (3) disclose any connection between the third party

standard setting organisation and the company or any of its directors, officers or 5% shareholders¹⁹¹.

Under the [Delaware Approach](#), benefit corporations must provide shareholders with a statement describing how the company has promoted its specific social purpose(s) at least every two years. The statement must identify (1) the objectives, as determined by the board of directors, to promote the social purpose of the company, (2) the standards the company has adopted to measure its success in achieving those objectives, (3) objective factual information based on the standards regarding the company's success in achieving those objectives and (4) an assessment of the company's performance in meeting those objectives. As discussed in Section 5.1(a) below, shareholders have the flexibility to adopt additional transparency measures, but these are not required by law¹⁹².

- (ii) **FPC** – FPCs are subject to statutory reporting requirements that include the obligation to include a special purpose MD&A section in their annual reports to shareholders and to provide current reports within 45 days of a triggering event. Both reports must be published on the company website unless confidentiality restrictions apply.

The special purpose MD&A must include a discussion of (1) the short-term and long-term objectives relating to the special purpose(s) and any changes made in those objectives; (2) the material actions taken to achieve the special purpose objectives and an assessment of their impact; (3) expected material actions to be taken and their expected impact; (4) the financial, operating, and other measures used to evaluate achievement of the social purpose; (5) material expenditures incurred and expected to be incurred in furtherance of the social purpose, including the extent to which the expenditures serve purposes other than the social objectives; and (6) other information reasonably necessary to understand the FPCs efforts in respect of its social purpose¹⁹³.

The current reporting requirement is triggered by board or management action in respect of (1) expenditure(s) in furtherance of the social purpose not included in the annual report and which have a material adverse impact on results; (2) any decision to withhold expenditures in furtherance of the social purpose that was likely to have a material positive impact in furthering the social purpose objectives; or (3) any determination that the social purpose has been satisfied or should no longer be pursued¹⁹⁴.

If the FPC has fewer than 100 shareholders, the FPC can waive the special purpose MD&A and certain current reporting obligations with the approval of 2/3 of the shareholders¹⁹⁵.

191 See MBCL § 401.

192 Del. Code Ann. tit. 8 §366. Colorado's reporting requirements for benefit corporations track the Model Approach including the third party assessment requirement and the publication requirement. See Colo. Rev. Stat. § 7-101-507.

193 Cal. Corp. Code §3500(b).

194 Cal. Corp. Code §3501(b)-(c).

195 Cal. Corp. Code §3501(h).

- (iii) **SPC** – SPCs must publish annually a social purpose report on their websites that includes a narrative discussion of the social purpose of the corporation and the SPCs’ efforts to promote it and may include a discussion of (1) the SPC’s short- and long-term objectives relating to the social purpose; (2) material actions the SPC has taken and expects to take to achieve the social purpose; and (3) the measures the company uses to evaluate its performance in achieving its social purpose¹⁹⁶. Unlike other corporate reform statutes, Washington law gives SPCs greater flexibility to determine the contents of the report.

3 LEGAL FORMS AVAILABLE FOR PROFIT-WITH-PURPOSE BUSINESSES

3.1 OVERVIEW OF LEGAL FORMS OF ORGANISATION AVAILABLE TO PROFIT-WITH-PURPOSE BUSINESSES.

There are three primary forms of business entity in most states – partnerships, limited liability companies and corporations. All three forms can be used to form a profit-with-purpose business with appropriate contractual adaptations to embed the key characteristics of profit-with-purpose businesses in their organisational and governing documents¹⁹⁷. In addition, non-profit forms of organisation are available that provide tight controls over the charitable mission, but because their tax-exempt status imposes strict limits on the use of funds, these forms are not compatible with businesses seeking to return profits to private investors.

In addition to the traditional forms, there are relatively new legal entities tailored to profit-with-purpose businesses¹⁹⁸. Vermont was the first state to recognise a specific legal entity for profit-with-purpose businesses with the passage of the nation’s first bill recognising the L3C in 2008¹⁹⁹. Since then, a number of states have adopted legislation that would permit businesses to be organised as profit-with-purpose businesses. As of 1 July 2014, 30 states and the District of Columbia had adopted some form of legislation creating legal forms specifically for profit-with-purpose businesses as set forth in the chart below.

¹⁹⁶ Wash. Rev. Code. §§ 23B.25.150.

¹⁹⁷ A profit-with-purpose business could also be structured as a cooperative, which is an organisation specifically designed to benefit its members and employs a democratic system of governance similar to a corporation. Because economic interests in cooperatives are proportionate to patronage of the members rather than investment, it is not a practical form for raising equity capital and is therefore not addressed in this report.

¹⁹⁸ For a more detailed synopsis of the characteristics of existing and new legal forms for profit-with-purpose business, see generally Morrison Foerster and TrustLaw Connect, *Which Legal Structure is Right for my Social Enterprise? A Guide to Establishing a Social Enterprise in The United States*, http://csi.gsb.stanford.edu/sites/csi.gsb.stanford.edu/files/GuideToSocEnterprise_US.pdf (2013).

¹⁹⁹ See Karla W. Simon, *International Non-Governmental Organizations and Non-Profit Organizations Committee*, 43 *Int’l Law.* 695, 699 (2009).

ENTITY	JURISDICTION
L3C ²⁰⁰	Illinois*, Louisiana*, Maine, Michigan, Rhode Island*, Vermont*, Utah*, Wyoming
BENEFIT CORPORATION ²⁰¹	Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Hawaii, Illinois, Louisiana, Maryland†, Massachusetts, Minnesota, Nebraska, Nevada, New Jersey, New York, Oregon†, Pennsylvania, Rhode Island, South Carolina, Utah, Vermont, Virginia, West Virginia
FPC ²⁰²	California
SPC ²⁰³	Washington

* DENOTES STATES THAT HAVE ALSO ENACTED BENEFIT CORPORATION LEGISLATION.

† DENOTES STATES THAT HAVE ALSO ENACTED BENEFIT LLCs.²⁰⁴

†† FLORIDA HAS ALSO ENACTED “SOCIAL PURPOSE CORPORATION” LEGISLATION BUT IT IS NOT MODELLED AFTER THE WASHINGTON SPC STATUTE. SEE FLORIDA FLA. H.B. 685, 116TH REG SESS. (2014). MINNESOTA

Benefit corporation legislation is pending in an additional 16 states and L3C legislation is pending in an additional 11 states²⁰⁵. Enacted in 26 states plus the District of Columbia, benefit corporation legislation has so far proven to be the most widely adopted legal reform tailored to profit-with-purpose businesses. In the United States,

200 Illinois – 805 Ill. Comp. Stat. 180/1-26 (LexisNexis 2014); Louisiana – La. Rev. Stat. Ann. §12:1302 (2013); Maine – Me. Rev. Stat. Ann. tit. 31, § 1611 (LexisNexis 2014); Michigan – Mich. Comp. Laws Serv. § 450.4102 (LexisNexis 2014); Utah – Utah Code Ann. § 48-2c-102 (2010); Rhode Island – R.I. Gen. Laws § 7-16-2 (2013); Wyoming – Wyo. Stat. Ann. § 17-29-102 (2013). North Carolina had adopted an L3C statute but subsequently repealed it. N.C. Gen. Stat. § 57c-1-01 et seq. (2014) (repealed by S.L. 2013-157, sec. 1, effective Jan. 1, 2014). See also Carter G. Bishop, Fifty States Series: L3C & B Corporation Legislation Table, Suffolk University Law School Legal Research Paper Series, Research Paper 10-11 (Apr. 1, 2014), <http://ssrn.com/abstract=1561783>;

201 Arizona – Ariz. Rev. Stat. § 10-2401 et seq. (LexisNexis 2013) (effective Jan. 1, 2015); Arkansas – Ark. Code Ann. § 4-36-101 et seq. (2014); California – Cal. Corp. Code § 14601 et seq. (Deering 2014); Colorado – Colo. Rev. Stat. § 7-101-501 et seq. (2013); Connecticut – An Act Implementing Provisions of the State Budget for the Fiscal Year Ending June 30, 2015, Conn. H.B. 5597 §§ 140-154, Reg. Sess. (2014) (effective Oct. 1, 2014); Delaware – Del. Code. Ann. tit. 8 § 361 et seq. (2014); District of Columbia – D.C. Code § 29-1301.01 et seq. (LexisNexis 2014); Florida – An act relating to business organizations, Fla. H.B. 685, 116th Reg. Sess (2014); Hawaii – Haw. Rev. Stat. Ann. § 420D-2 (LexisNexis 2013); Illinois – 805 Ill. Comp. Stat. Ann. 40/1 et seq. (LexisNexis 2014); Louisiana – La. Rev. Stat. Ann. § 12:1803 (2013); Maryland – Md. Code Ann., Corps & Ass’ns § 5-6C-01 et seq. (LexisNexis 2014); Massachusetts – Mass. Ann. Laws ch. 156E, § 1 et seq. (LexisNexis 2014); Minnesota – Minn. Stat. § 304A.001 et seq. (2014) (effective Jan. 1, 2015); Nebraska – Benefit Corporation Act, Neb. L.B. 751, 103rd Legis, 2nd sess. (2014); Nevada – Nev. Rev. Stat. Ann. § 78B.010 et seq. (LexisNexis 2013); New Jersey – N.J. Stat. Ann. § 14A:18-1 (West 2014); New York – N.Y. Bus. Corp. Law § 1702 et seq. (Consol. 2014); Oregon – Or. Rev. Stat. § 60.750 et seq. (2013); Pennsylvania – 15 Pa. Cons. Stat. § 3302 (LexisNexis 2014); Rhode Island – R.I. Gen. Laws § 7-5.3-1 et seq (2013); South Carolina – S.C. Code Ann. § 33-38-110 et seq. (2013); Utah – Benefit Corporation Act, Utah S.B. 133, Gen. Sess. (2014); Vermont – Vt. Stat. Ann. tit. 11A § 21.03 (2013); Virginia – Va. Code Ann. § 13.1-782 (2014); West Virginia – W. Va. Code Ann. §Ch. 31F-1-x et seq. (LexisNexis 2014). See also Bishop, supra note 38; Benefitcorp.net, State-by-State Legislative Status, Introduced Legislation, <http://benefitcorp.net/state-by-state-legislative-status> (last visited Jul. 17, 2014).

202 Cal. Corp. Code §§ 2500-2517.

203 Wash. Rev. Code. § 23B.25.005, et seq. (2013).

204 Maryland and Oregon have enacted “Benefit LLC” statutes rather than an L3C statute, which are modelled after the MBCL but applied to LLCs. See Md. Code Ann. Corps & Ass’ns § 4A- 1101 (LexisNexis 2014); 2014 Or. Laws ch. 269. Benefit LLC legislation is based on the MBCL but permit companies to organize as either a corporation or an LLC.

205 See Benefitcorp.net, State-by-State Legislative Status, supra note 39.

profit-with-purpose businesses represent a nascent sector, with only approximately 2100 companies currently organised as one of these new legal forms²⁰⁶. There are approximately 1000 active L3Cs in 9 states as compared to approximately 1000 benefit corporations in 23 jurisdictions. With the rapid adoption of legislation in many states, the number of profit-with-purpose businesses taking advantage of these new forms is expected to grow.

3.2 WHAT LEGAL FORMS OF ORGANISATION ARE AVAILABLE TO BUSINESSES GENERALLY THAT COULD BE USED TO FORM A PROFIT-WITH-PURPOSE BUSINESS?

The table below summarises the key characteristics of traditional legal forms available to profit-with-purpose businesses.

	PARTNERSHIP ²⁰⁷	LLC	CORPORATION ²⁰⁸
OWNERSHIP	At least 2 Persons ²⁰⁹	1+ Persons	1+ Persons
GOVERNANCE	<ul style="list-style-type: none"> - Partners make governing decisions - General partner in limited partnership exercises executive control 	Members make governing decisions, but may delegate authority to managing or other member(s)	Executive authority is vested in the board of directors by statute
OBJECTS	<ul style="list-style-type: none"> - May be any lawful business purpose - Partners may designate specific purposes in the partnership agreement 	<ul style="list-style-type: none"> - May be any lawful business purpose - Members may designate specific purposes in the partnership agreement 	<ul style="list-style-type: none"> - May be any lawful business purpose - Corporation may designate specific purposes in its articles or the bylaws
SOCIAL PURPOSE	Not required; may be included in partnership agreement	Not required; may be included in operating agreement	Not required; may be included in articles of incorporation

²⁰⁶ Approximately 1000 active L3Cs in 9 states (including North Carolina). See interSector Partners, L3C, available at http://www.intersectorl3c.com/l3c_tally.html (last visited Apr. 19, 2014). 31 FPCs created (as of June 28, 2013). See Debra Bowen, Secretary of State of California, Business Programs Divisions, Supplemental Language Report, Budget Letter 12-16; Item 0890-001-0228 (Jun. 28, 2013), <http://www.sos.ca.gov/admin/reports/2013.htm>; Approximately 83 active SPCs as of June 1, 2014. See ,SPC at http://www.spcwa.com/we_are_spc/list-of-spcs/ (last visited Jul. 23, 2014); 982 registered benefit corporations as of July 23, 2014. See Benefit Corp Information Center, benefitcorp.net , <http://benefitcorp.net/find-a-benefit-corp/search> (last visited Jul. 23, 2014).

²⁰⁷ Partnerships can be formed as either general partnerships or limited partnerships. The latter are more suitable for raising capital, however, because financial investors will not accept the risk of general partner liability.

²⁰⁸ Corporations are classified as either "C" Corporations or "S" Corporations under the IRC. C Corporations are the dominant form of corporate organisation and S corporations have largely been replaced by the more flexible LLC. For purposes of this report, where reference is made to a "corporation", it is to a C corporation.

²⁰⁹ "Persons" mean both legal and natural persons.

²¹⁰ Generally the Secretary of State or other state office grants entities their legal status and authorisations but does not actively oversee or regulate business entities.

LIMITED LIABILITY FOR OWNERS	General Partner – No Limited Partner – Yes	Yes	Yes
TRANSFERS OF OWNERSHIP	Requires partner consent	<ul style="list-style-type: none"> - Member consent may be required - Transfers may be subject to rights of other shareholders to participate in transaction 	<ul style="list-style-type: none"> - Shareholder consent may be required - Transfers may be subject to rights of other shareholders to participate in transaction
DEBT FINANCING	Debt financing is available	Debt financing is available	Debt financing is available
EQUITY FINANCING	Limited – Equity investors must be admitted as partners and will have operational control in proportion to their interest	Available	Yes – Ownership and control are separated in the corporate structure; companies can raise funds through equity while retaining operational control
TAX TREATMENT	<ul style="list-style-type: none"> - By default partners are taxed on their share of business income regardless of whether they receive distributions - May elect corporate tax treatment 	<ul style="list-style-type: none"> - By default, members are taxed as a partnership - A single member LLC is treated as a disregarded entity for tax purposes (i.e. not distinct from its owner) - LLC may elect corporate tax treatment 	<ul style="list-style-type: none"> - Shareholders taxed on dividends at capital gains rates - Corporation taxed on income
DISSOLUTION	<ul style="list-style-type: none"> - By agreement of the partners - May be dissolved by law on death or departure of a partner 	<ul style="list-style-type: none"> - Voluntarily with member consent - May be dissolved by law on departure of a member unless otherwise specified in organisational documents - By merger/consolidation 	<ul style="list-style-type: none"> - Voluntarily with shareholder consent - By merger/consolidation
CHARITABLE STATUS	None	None	None
REGULATOR²¹⁰	None	None	None
REPORTING REQUIREMENTS	Varies by state	Varies by state	Annual report filed with Secretary of State
ADVANTAGES	<ul style="list-style-type: none"> - Easy and inexpensive to start up - Tax transparent - Flexible asset allocation - Flexible governance mechanics 	<ul style="list-style-type: none"> - Limited liability - Flexibility to tailor fiduciary obligations - Greater ability to customise ownership, control and profit allocation - Flexible tax treatment - Few start-up costs and formalities 	<ul style="list-style-type: none"> - Limited liability - Perpetual existence and easily transferrable equity - Best form for raising equity capital - Ability to use equity to incentivise employees - Preferred vehicle for certain investors such as private equity and venture capital funds
DISADVANTAGES	<ul style="list-style-type: none"> - Joint and individual liability for general partners - Dispute resolution among partners can be complex and difficult - Profit sharing - Difficult to raise outside capital or transfer interests 	<ul style="list-style-type: none"> - Limited ability to compensate employees with equity - Ownership, control and distribution mechanisms can be complex - More difficult to access outside capital 	<ul style="list-style-type: none"> - Higher start-up costs - Double taxation on corporate income - Additional recordkeeping and corporate formalities - Subject to more mandatory legal requirements (e.g. fiduciary duties of directors)

3.3 WHAT LEGAL FORMS OF ORGANISATION, IF ANY, HAVE BEEN SPECIFICALLY DESIGNED FOR PROFIT-WITH-PURPOSE BUSINESSES?

	LOW-PROFIT LLC	BENEFIT CORPORATION	FLEXIBLE PURPOSE CORPORATION ²¹¹	SOCIAL PURPOSE CORPORATION
OWNERSHIP	Same as an LLC	Same as a corporation	Same as a corporation though some requirements may be waived if <100 shareholders	Same as a corporation
GOVERNANCE	Same as an LLC	<ul style="list-style-type: none"> - Same basic governance as a corporation - Some states require an independent benefit director and/or benefit officer responsible for overseeing and managing the public benefit 	Same as a corporation	Same as a corporation
OBJECTS	<ul style="list-style-type: none"> - Generally as determined by members - No political or legislative purpose 	As set forth in the articles of incorporation	As set forth in the articles of incorporation	As set forth in the articles of incorporation
SOCIAL PURPOSE	<ul style="list-style-type: none"> - Charitable or educational purpose (as defined by the IRC) - Production of income or appreciation of property is not a significant purpose 	<ul style="list-style-type: none"> - Model Approach corporations must recognise a general social purpose and may also recognise a specific social purpose - Delaware Approach corporations must recognise a specific social purpose and balance interests of those materially affected by business - 2/3 shareholder vote to terminate benefit corporation status or merge with non-benefit corporation 	<ul style="list-style-type: none"> - Must designate at least one “special purpose” - 2/3 shareholder vote required to remove special purpose 	<ul style="list-style-type: none"> - Must designate a “general social purpose” (similar to special purpose of SPC) - May designate a specific social purpose - Must include statement that social purpose may not be compatible with profit maximisation - 2/3 shareholder vote required to remove special purpose or to convert
LIMITED LIABILITY FOR OWNERS	Yes	Yes	Yes	Yes
TRANSFERS OF OWNERSHIP	Same as an LLC	Same as a corporation, but market may be more limited	Same as a corporation, but market may be more limited	Same as a corporation, but market may be more limited

²¹¹ See note 4, supra, regarding proposed changes to the Corporate Flexibility Act of 2011 establishing FPCs in California.

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DEBT FINANCING	Same as an LLC	Same as a corporation, but market may be more limited	Same as a corporation, but market may be more limited	Same as a corporation, but market may be more limited
EQUITY FINANCING	Same as an LLC	Same as a corporation, but market may be more limited	Same as a corporation, but market may be more limited	Same as a corporation, but market may be more limited
TAX TREATMENT	<ul style="list-style-type: none"> - Same as an LLC; - Contributions are not tax-deductible 	Same as a corporation	Same as a corporation	Same as a corporation
DISSOLUTION	<ul style="list-style-type: none"> - Same as an LLC - L3Cs may lose designation in some states automatically if fail to operate in accordance with their social purpose 	Same as a corporation	Same as a corporation	Same as a corporation
CHARITABLE STATUS	None	None	Possible to designate a charitable purpose but not to obtain “tax-exempt” charitable status	None
REGULATOR¹¹	None	None	None	None
REPORTING REQUIREMENTS	All requirements applicable to LLCs generally	<ul style="list-style-type: none"> - Model Approach: Annual benefit report to shareholders must include a description of efforts to further the social purpose and an assessment of its achievement measured against a third party standard - Delaware Approach: Biennial benefit statement to shareholders 	<ul style="list-style-type: none"> - All requirements applicable to corporations generally - Annual report must include special purpose management discussion and analysis - Special purpose current report to shareholders - Certain reporting requirements may be waived if FPC has <100 shareholders 	<ul style="list-style-type: none"> - All requirements applicable to corporations generally - Annual social purpose report must discuss social purpose and the SPC’s efforts to promote it - Social purpose report must be published on the company website

212 Generally the Secretary of State or other state office grants entities their legal status and authorisations but does not actively oversee or regulate business entities.

BALANCING PURPOSE AND PROFIT
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ADVANTAGES

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|---|--|---|---|
| <ul style="list-style-type: none"> - Advantages of LLCs generally - Ability to advertise social purpose - No statutory limitations on change of control transactions | <ul style="list-style-type: none"> - Advantages of corporations generally - Ability to advertise social purpose - Directors are required to consider or balance interests other than those of shareholders - Protection for boards that consider other interests - Model Approach requires publication of benefit reports assessed against a third party standard and designated benefit director - Benefit enforcement proceedings give shareholders an express right to enforce social mission | <ul style="list-style-type: none"> - Advantages of corporations generally - Ability to advertise social purpose - Protection for boards that consider other interests - Mandatory reporting requirements with shareholder enforcement mechanism | <ul style="list-style-type: none"> - Advantages of corporations generally - Ability to advertise social purpose - Protection for boards that consider other interests - Few statutory requirements maximise flexibility |
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DISADVANTAGES

- | | | | |
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| <ul style="list-style-type: none"> - Same disadvantages of LLCs generally - Less flexible than traditional LLCs - Profit motive is secondary - Possible automatic de-designation as L3C could endanger financing - Absence of IRS guidance qualifying L3Cs as PRI investments generally - Limited market for financing via PRI | <ul style="list-style-type: none"> - Same disadvantages of corporations generally - Reduced accountability for board decisions - Compliance costs of additional reporting requirements - Supermajority consent rights may limit change of control transactions and/or diminish value - Difficult for existing entities to convert to benefit corporation in Delaware | <ul style="list-style-type: none"> - Same disadvantages of corporations generally - Reduced accountability for board decisions - Compliance costs of additional reporting requirements - Reporting not assessed against third party standard - Supermajority consent rights may limit change of control transactions and/or diminish value - Difficult to modify social purpose | <ul style="list-style-type: none"> - Same disadvantages of corporations generally - Compliance costs of additional reporting requirements - Consideration of other interests is permissive - Reporting not assessed against third party standard; no publication requirements - Supermajority consent rights may limit change of control transactions (including asset dispositions) and/or diminish value - Difficult to modify social purpose |
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3.4 WHAT HYBRID STRUCTURES ARE OR COULD BE USED TO ESTABLISH A BUSINESS WITH THE KEY CHARACTERISTICS OF A PROFIT-WITH-PURPOSE BUSINESS?

Profit-with-purpose businesses could achieve the dual goals of furthering a social purpose and generating profit by creating hybrid structures consisting of multiple legal entities organised in different forms. While many permutations are possible, some hybrid structures involve combining a charitable entity with a for-profit subsidiary or a for-profit company funding and/or controlling a private foundation. Corporations that wish to pursue corporate social responsibility goals through tax-exempt private foundations often use the latter structure. In addition, hybrid structures involving traditional for-profit forms and new legal forms are also possible. Plum Organics, a subsidiary of Campbell’s Soup, recently converted to the benefit corporation form, becoming the first benefit corporation subsidiary of a public, for-profit entity²¹³.

4 OTHER METHODS OF IMPLEMENTATION

4.1 WILL APPLICABLE LAW RESPECT CONTRACT TERMS ESTABLISHING AND/OR PROTECTING A SOCIAL PURPOSE?

Generally courts will uphold the agreement of contracting parties unless the contract was not properly formed or doing so would violate public policy. The degree to which the freedom of contract will be respected varies by jurisdiction. The statutes governing organisational forms in the various states tend not to prescribe mandatory rules for business entities, but give the equity interest holders considerable flexibility to set the terms of their enterprise by contract. As a result, existing contractual mechanisms used to protect the economic interests of equity holders could be adapted for profit-with-purpose businesses, including those organised in traditional legal forms. These mechanisms include:

- (i) **DIFFERENT CLASSES OF SECURITIES** – Companies can allocate different sets of rights to investors with different preferences through the use of multiple classes of securities. This is particularly useful in the corporate form where the company cannot allocate preferential rights to security holders within the same class. High vote stock, for example, can be used to give one group of shareholders greater control over governance decisions, and, in a profit-with-purpose business, could be granted to shareholders whose primary interest is protecting the social purpose of the company relative

213 See Aman Singh, *Campbell Becomes America’s First Public Company to Acquire a Public Benefit Corporation: In Conversation with Plum Organics’ Cofounder*, CSRwire Talkback, (Sept. 9 2013).<http://www.csrwire.com/blog/posts/1005-campbell-becomes-america-s-first-public-company-to-acquire-a-public-benefit-corporation-in-conversation-with-plum-organics-cofounder>.

to traditional profit-maximising investors. By contrast, a company could grant preferential dividend or distribution rights to traditional, return-seeking investors.

- (ii) **VOTING AGREEMENTS** – Voting agreements are a common feature in private companies. They obligate shareholders, for example, to vote together at the shareholder level on matters such as the election of directors, increasing the authorised share capital of a corporation or fundamental transactions. In a profit-with-purpose business, like-minded social impact investors could use voting agreements to protect against actions that could undermine the social purpose²¹⁴.
- (iii) **MANDATORY PUT/CALL RIGHTS** – Put (or call) rights give equity holders the right to sell to (or buy from) other holders equity interests in the company upon the occurrence of certain specified events. Social impact investors could negotiate for put rights to sell shares to the company or other shareholders if the company abandoned or materially changed its social mission.
- (iv) **RETENTION OF DECISION-MAKING AUTHORITY** – In partnerships and LLCs, equity holders have flexibility to allocate governing decisions among themselves. In a limited partnership, the general partner makes management decisions subject to those matters identified in the partnership agreement that require limited partner consent. LLCs managed by a manager offer maximum flexibility to allocate management decisions among the members on the one hand and manager(s) on the other. There is less flexibility to retain decision-making authority in a corporation, but shareholders can retain control over certain matters set forth in the articles or bylaws, or a particular class of shareholders may possess control rights over certain areas of decision-making. In a profit-with-purpose business, imposing restrictions on the decision-making authority of manager(s) of the business could give social impact investors additional oversight over management to ensure the business is operating in a manner that is consistent with the social purpose.
- (v) **SUPERMAJORITY VOTING RIGHTS** – Supermajority voting rights often complement or supplement the reservation of decision-making authority on certain key matters such as approval of fundamental transaction or amendments to the organisational documents. They have the effect of protecting minority interests and rendering changes to the status quo more difficult as a result. Some of the statutes tailored to profit-with-purpose businesses include mandatory or permissive supermajority protections over decisions that would have the effect of eliminating or materially changing the social purpose of the company as described further in Section 5.1(d) and 5.1(e) below. These types of provisions could also be implemented by contract in a profit-with-purpose business organised through a traditional form.

²¹⁴ Corporate law generally prohibits voting agreements from constraining decisions made at the board level in a corporation to the extent it would conflict with the directors' obligation to act in the best interest of the company and the shareholders as a whole.

5 ADDITIONAL CONTROLS OVER PROFIT-WITH-PURPOSE BUSINESSES

5.1 WHAT OTHER LEGAL OBLIGATIONS OR CONTROLS OVER THE SOCIAL PURPOSE APPLY TO PROFIT-WITH-PURPOSE BUSINESSES UNDER APPLICABLE LAW? ARE THESE REQUIREMENTS MANDATORY OR PERMISSIVE?

If formed as traditional for-profit business entities, there are no additional legal requirements imposed on profit-with-purpose businesses except to the extent the entity or its owners may voluntarily impose restrictions in the entity's organisational documents or by contract among themselves. Some states have enacted anti-takeover statutes, which protect corporate shareholders in the event of a change of control and could have the effect of affording similar protections to shareholders of a profit-with-purpose business organised as corporations under similar circumstances. In addition, profit-with-purpose businesses organised in traditional forms are free to adopt measures, such as those described in Section 4.1, that have the effect of protecting the interests of existing owners in the context of change of control transactions. Finally, some states have enacted constituency statutes that expressly give directors the ability to consider third party interests (such as those of employees, customers or the local community) when making strategic decisions. While these statutes are similar in principle to the expansion of the fiduciary duties under the profit-with-purpose business statutes, they may be of limited utility since the recognised constituents may not align with interests related to the social purpose.

(a) Additional transparency measures

- (i) **L3C** – The L3C statutes impose no specific reporting obligations in respect of the organisation's social purpose. Reporting obligations and information rights are those of LLCs generally and are usually set out in the LLC operating agreement.
- (ii) **BENEFIT CORPORATION** – The annual benefit report required under the Model Approach must include a statement addressing the company's compliance with its social purpose, whether directors and officers have satisfied the applicable statutory standards of conduct (described above in Section 2.3(b)(i)) and, if applicable, a description of the ways in which the company or its officers failed to comply with their objectives or standard²¹⁵. The benefit corporation must publish the benefit report on its website, or in the alternative, provide it free of charge upon request, and file the report with the Secretary of State (or other applicable state authority). To the extent the report includes director compensation, financial or proprietary information, this information may be excluded when the report

²¹⁵ MBCL § 302(c).

is made publicly available or filed. The Model Approach also permits companies to have a designated benefit director and/or officer with oversight responsibilities related to compliance with the social purpose that includes responsibility for the preparation of the benefit report²¹⁶. An express requirement that benefit reports be verified or audited by a third party was intentionally omitted from the MBCL due to concerns about the cost burden such a requirement would impose on benefit corporations relative to other corporate forms and because director liability is a deterrent to fraudulent reports²¹⁷.

Under the Delaware Approach, benefit corporations are only required to provide a benefit statement to their shareholders every two years and there is no requirement to make the report publicly available. If desired, Delaware public benefit corporations may elect in their articles or bylaws to provide a benefit statement more frequently than every two years, to make it publicly available, to use a third party standard in connection with the company’s self-evaluation of its achievements in respect of its social purpose or to obtain a third party periodic certification²¹⁸.

- (iii) **FPC** – There are no specific third party standards against which the FPC’s reporting obligations, as described above in Section 2.4(b)(i), are assessed. To the extent that best practices regarding the additional disclosure required of FPCs develops, however, FPCs are incentivised to conform to those standards because compliance will create a presumption that the statutory reporting requirements were satisfied²¹⁹. This presumption can only be rebutted by a showing that the report contained a material misstatement or omission²²⁰.

The annual and current reports FPCs produce must also be published on the company’s website, subject to applicable confidentiality restrictions. If a company fails to timely deliver the reports, the superior court can enforce the obligation and the shareholder can recover expenses if the FPC fails to show just cause for the delay²²¹.

- (iv) **SPC** – The Washington statute does not impose any additional transparency measures on SPCs. It does, however, expressly permit shareholders to elect to impose an obligation on the SPC to provide an assessment of its performance in achieving its social purpose against a third-party standard by inclusion in the articles²²².

216 Id. §§ 302, 304, 402(b)-(d).

217 See William H. Clark, Jr. & Elizabeth J. Babson, How Benefit Corporations Are Redefining the Purpose of Business Corporations, 38 Wm. Mitchell L. Rev. 817, 846-47 (2011-2012).

218 Del. Code Ann. tit. 8 § 366(c). Although Colorado’s reporting requirements track the Model Approach, including the publication requirement, Colorado did not adopt the Model Approach’s additional transparency measures such as a dedicated benefit director or a compliance statement.

219 Cal. Corp. Code § 3502(b).

220 Id.

221 Id., §§ 3500(a), 3501(a), 3502(k)-(l).

222 Wash. Rev. Code. § 23B.25.040(2)(b).

- (v) **ASSET LOCK** – SPCs and benefit corporations following the Model Approach require supermajority shareholder approval in connection with a disposition of substantially all assets of the company. Shareholders holding 2/3 of shares entitled to vote on the transaction must approve the transaction in addition to 2/3 of the outstanding shares of each class²²³. In the case of the SPC, supermajority consent is not required if the acquirer is also an SPC with a social purpose that is not materially different from the selling SPC.
- (vi) **PROFITS LOCK** – Profits locks are inconsistent with the organisation of a for-profit business entity. None of the profit-with-purpose business forms have this restriction.
- (vii) **MISSION LOCK** – Mission locks primarily take the form of supermajority voting rights in respect of decisions that would have the effect of transforming or eliminating the social purpose of the entity.
- (viii) **L3C** – L3Cs must be operated to satisfy the social purpose set forth in the articles of organisation. If an L3C voluntarily, or in some states, involuntarily, no longer satisfies the statutory definition of an L3C, it is required to amend its articles to remove the social purpose and any applicable L3C designation in its name to continue functioning as a traditional LLC. To the extent the L3C is relying on financing from program-related investments (“PRI”), the change in status could come at significant cost through the loss of this source of capital. Given that PRI financing has been slow to flow into L3C vehicles and there is considerable debate as to whether the form provides any tangible benefits over the traditional LLC, the loss of L3C status may prove inconsequential and an insufficient mechanism to ensure the L3C remains committed to the social purpose.
- (ix) **BENEFIT CORPORATION – The Model Approach** permits existing corporations to opt in or out of the benefit corporation designation by amending the articles with the approval of 2/3 of each class of equity securities, regardless of whether they ordinarily have voting rights. This supermajority voting threshold, called a “minimum status vote”, also applies in the context of certain fundamental transactions that would have the same effect as an amendment of the articles to include or eliminate the social purpose, such as a merger of a benefit corporation with and into a traditional corporation with the traditional corporation surviving²²⁴. This requirement does not, however, create an independent obligation to hold a shareholder vote on the transaction if none would otherwise be required²²⁵.

223 Id., § 23B.25.110; MBCL § 105(b).

224 MBCL §§ 104-105.

225 Id. For example, a shareholder vote is not typically required in connection with a short-form or squeeze-out merger of a subsidiary into a parent company, which an acquirer may employ following certain transactions such as a tender offer, to eliminate any remaining public shareholders.

The Delaware Approach parallels the Model Approach with two key distinctions. First, if a traditional corporation wants to amend its articles to become a benefit corporation or a merger or consolidation would result in shareholders holding shares in a benefit corporation, then the applicable threshold for shareholder consent is 90% of the shares of each class. Second, shareholders who do not consent to the amendment or transaction that would result in them holding shares in a benefit corporation are entitled to appraisal rights²²⁶.

- (x) **FPC** – The FPC statute sets a high bar for amending the social purpose of an FPC. Any material change in the social purpose, including a change from one social purpose to another, must be approved by a 2/3 majority of each class of shareholder and by a majority vote of the outstanding shares²²⁷. Shareholders can elect higher thresholds in the articles. Similarly, in order to convert from an FPC to another entity, 2/3 of each class of shareholder must consent. In addition, shareholders of the same class must be treated equally in respect of rights or property received and/or obligations imposed in connection with the conversion²²⁸.
- (xi) **SPC** – Like the other profit-with-purpose businesses, changes to the social purpose of an SPC by amendment to the articles, by merger or by conversion all require approval of 2/3 majority of the outstanding shares of each class of stock, voting as separate classes. In addition, the change must also be approved by holders of 2/3 of the shares entitled to vote on the matter²²⁹. As noted in Section 5.1(b), the protections against changes to the SPC’s mission extend to dispositions of substantially all assets of the company, and SPC shareholders have dissenters’ rights if the SPC converts to another entity or materially changes the SPC’s social purpose²³⁰. In addition, dissenting shareholders who would become shareholders in an SPC by virtue of a merger or transaction are entitled to receive the fair value of their shares.
- (xii) **ENFORCEMENT MECHANISMS** – Third parties generally do not have standing to enforce the social purpose of a profit-with-purpose business. For L3Cs, enforcement mechanisms for resolving member disputes or manager breaches of the operating agreement are likely to be determined by contract. To the extent that fiduciary duties exist under applicable state law and members have not contracted around them, members could bring suit for breach if the L3C were not being operated in accordance with the operating agreement.

The primary enforcement mechanism for all of the corporate forms is a shareholder derivative suit – an action brought by a shareholder in the

226 Del. Code Ann. tit. 8 §§ 363(a)-(b). Colorado requires a 2/3 majority vote for conversions or mergers into a benefit corporation, but otherwise tracks the Delaware approach. See Colo. Rev. Stat. § 7-101-504.

227 Cal. Corp. Code §§ 3000(b) & (d).

228 Cal. Corp. Code § 3301(a)(1) & (2).

229 Wash. Rev. Code. §§ 23B.25.090, 100, 130, 140.

230 Id.. § 23B.25.120.

name of the corporation. In States following the Model Approach, state law specifically permits lawsuits, or “benefit enforcement proceedings”, for failures to enforce the social purpose of a benefit corporation or for failures to comply with other mandatory provisions of the relevant benefit corporation legislation²³¹.

For most forms and in most jurisdictions, third parties do not have rights to bring derivative actions or enforcement proceedings. However, the Model Approach permits benefit corporations to confer this right on other constituencies²³². In other states, such as Washington, non-shareholders are precluded from bringing enforcement actions against SPCs²³³. Shareholders may have difficulty effectively bringing a breach of fiduciary duty claim because the ability to consider factors relevant to the social purpose could further support defences to liability that the directors acted rationally and in good faith under the already deferential business judgment rule.

- (xiii) **CHANGE OF CONTROL** – With the exception of the L3C statutes, which do not restrict change of control transactions, most of the corporate profit-with-purpose business statutes require the approval of 2/3 of each class of shares in connection with change of control transactions. In an FPC and under the Delaware Approach, the supermajority vote applies to mergers and reorganisations that would have the effect of removing or materially altering the social purpose of the entity²³⁴. In an SPC, as described in Section 5.1(d)(iv) above, this requirement applies to a merger or share exchange in which the SPC would not be the surviving corporation unless the acquiring or surviving corporation is also an SPC with a social purpose that is not materially different from the non-surviving SPC²³⁵.

6 ACCESS TO INVESTMENT CAPITAL

6.1 TAX INCENTIVES

Currently, profit-with-purpose businesses receive the same US federal tax treatment as companies taking traditional legal forms. There are no tax incentives for profit-with-purpose businesses or profit-with-purpose business investors in the same way that, for example, charitable contributions are tax deductible under the IRC. In the absence of verifiable third party standards for assessing social purpose compliance and efficacy, it is not likely there will be significant appetite to introduce tax relief for profit-with-purpose businesses given the opportunity for exploitation.

231 MBCL §305(a).

232 MBCL §305(c)(2)(iv).

233 Wash. Rev. Code. § 23B.25.080.

234 Cal. Corp. Code §§ 3000(b)-(d); Del. Code Ann. tit. 8 § 363(c)(2); Colo. Rev. Stat. § 7-101-504(c)(2).

235 Wash. Rev. Code. § 23B.25.100.

In July 2013, legislation was proposed in Congress to amend the IRC to facilitate PRIs by private foundations in for-profit businesses with charitable missions.²³⁶ The bill, the Philanthropic Facilitation Act, would create an IRS review process that would determine whether certain investments qualified for PRI-status. Entities seeking to raise capital from private foundations and other charitable institutions could apply for a ruling that investors could rely on in classifying their investment in the profit-with-purpose business as PRI. In addition, entities that qualify for PRI-status would have to file annual reports with the IRS containing specific information on the uses of funds for charitable purposes and the names of the entity’s PRI investors²³⁷. The bill was drafted by Americans for Community Development, an organisation seeking to promote the use of the L3C form, but if passed, the legislation could also apply to profit-with-purpose businesses organised in other ways, including traditional organisational forms²³⁸. The Philanthropic Facilitation Act is not likely to pass — a version of the legislation was introduced in November 2011 but failed to become law.

6.2 INVESTMENT STRUCTURES

A socially conscious investor seeking to protect the deployment of its investment capital for intended purposes would primarily rely on contractual restrictions on the use of funds and the business activity of the profit-with-purpose business. Depending on the nature of the investment, i.e., debt vs. equity, short-term vs. long-term, and the weight the investor wanted to give to the fulfilment of the social purpose relative to profit-maximisation, controls over the social purpose could be achieved through mechanisms investors currently use to minimise risk and protect their financial return. In addition to the corporate law mechanisms available to equity investors described in Section 4.1, debt investors could rely on various mechanisms to protect the social purpose of the investment such as, for example, negative covenants, consent rights over major business decisions that could impact the social purpose, or requirements that a certain percentage of the proceeds and/or assets of the company be applied to fulfil the social purpose.

236 See Philanthropic Facilitation Act, H.R. 2832, 113th Cong. (2013); govtrack.us, H.R. 2832: Philanthropic Facilitation Act, <https://www.govtrack.us/congress/bills/113/hr2832> (last visited Jul. 17, 2014); Americans for Community Development, Announcing the “Philanthropic Facilitation Act” (H.R. 2832), <http://www.americansforcommunitydevelopment.org/downloads/The%20PFA%20of%202013%20.pdf> (2013) (last visited Apr. 23 2014).

237 David A. Levitt, Philanthropic Facilitation Act Encourages Program-Related Investments Adler & Colvin, Non-Profit Law Matters, <http://www.nonprofitlawmatters.com/2013/08/25/philanthropic-facilitation-act-encourages-program-related-investments/> (Aug. 25, 2013).

238 See supra note 74, Americans for Community Development, Announcing the “Philanthropic Facilitation Act” (H.R. 2832).

6.3 BARRIERS TO ACCESSING INVESTMENT

One key issue facing profit-with-purpose businesses is managing potentially competing interests among investors. Many of the new state statutes are designed specifically to expand the scope of fiduciary duties to explicitly permit profit-with-purpose businesses to espouse a social purpose. While this gives an investor an express statutory basis to bring claims against directors and officers for breach of their fiduciary responsibilities, it does not resolve, *per se*, the question of how or whether directors and officers should balance the social purpose interests of the company with the traditional profit-seeking interests. This leaves room for conflict among investors with diverse investment goals or mandates. To the extent investors with different motivations have board representation or are otherwise able to exercise control over business operations, these competing interests could lead to conflict and/or deadlock. Non-equity capital may also be limited due to both financial and legal uncertainty. Profit-with-purpose businesses may carry more credit risk for lenders and correspondingly higher borrowing costs for borrowers because profitability may compete or conflict with other business goals²³⁹. There is also uncertainty as to how courts will interpret and enforce the expanded scope of fiduciary duties for the new legal forms. Because fiduciary duties shift to creditors when a corporation becomes insolvent, lenders could be reluctant to finance a benefit corporation in the absence of reassurance that the corporation will not prioritise a social purpose at the expense of creditors' rights.

In addition, the lack of clarity around what constitutes PRI poses particular problems for L3Cs, which were designed specifically to facilitate access to PRIs by aligning the statutory purposes of L3Cs with the PRI requirements contained in the IRC. Under the IRC, private foundations are subject to an excise tax if they fail to distribute 5% of their funds annually. Foundations typically make grants and charitable donations to satisfy this requirement, but they may also make PRIs, which are investments in socially beneficial business or purposes that may carry some risk. Due to lack of guidance around which investments qualify as PRIs, foundations have been hesitant to use L3Cs as investment vehicles. As one commentator noted, “L3Cs don't work unless there is a change in federal tax law. In other words, L3Cs are a little like the wonder drug for which there is no known disease²⁴⁰.” Indeed, North Carolina recently repealed its L3C statute as superfluous, because policy makers concluded that the goals of the L3C could be accomplished using the traditional LLC²⁴¹.

Finally, investors may be subject to fiduciary obligations to their clients which may inhibit investment in new entity forms that aim to produce both social and financial

239 See Steven Munch, *Improving the Benefit Corporation: How Traditional Governance Mechanisms Can Enhance the Innovative New Business Form*, *Nw. J.L. & Soc. Pol'y* 7:1, 170 (2012)

240 Kelly Kleiman, 'L3C' Spells 'Caveat Emptor', *Stanford Social Innovation Review*, (Mar. 18, 2011) http://www.ssireview.org/blog/entry/l3c_spells_caveat_emptor (quoting Stuart Levine).

241 Ann Field, *North Carolina officially abolishes the L3C*, *Forbes.com*, (Jan. 11, 2014) <http://www.forbes.com/sites/annefield/2014/01/11/north-carolina-officially-abolishes-the-l3c/>.

returns because of the perception that a “triple bottom line” will conflict with profit-maximisation²⁴². For example, pension funds, which comprise some of the larger sources of institutional investment capital in the United States, are subject to extensive federal regulation under the Employee Retirement Income Security Act (“**ERISA**”), which imposes a fiduciary obligation on pension fund managers to act with the care, skill, prudence and diligence of a prudent person²⁴³. To the extent that a social impact investment could be considered “imprudent” due to factors such as the time-horizon, level of expected return, investment structure or legal risk, it exposes fund managers to potential liability. In addition, under state corporate law principles, private equity and venture capital fund managers, whose funds are typically structured as partnerships, often owe duties to their investors/limited partners, and these investors may be reluctant to make investments that have the risk factors associated with impact investments.

6.4 RISK

For traditional for-profit business, partnerships and traditional LLCs provide the most flexibility to tailor allocations of financial gain and loss. LLCs in particular offer the ability to tranche investments with different levels of expected return. One of the main barriers to achieving similar diversification in a profit-with-purpose business is the relative inability to quantify, and therefore price in, the costs and benefits associated with achieving (or not achieving) the social purpose. To overcome this barrier and enable investors to evaluate social impact across profit-with-purpose businesses, the sector needs to encourage innovative equity structures that align investor returns with impact achievement and develop quantifiable standards of general applicability for measuring impact.

6.5 EXIT

Exit options are of particular concern in structuring a profit-with-purpose business investment through one of the new legal entities because this equity may be relatively illiquid as compared with traditional for-profit entities. Traditional exit options for equity investors include sales of minority interests to other investors, sales of the portfolio company to other strategic or financial investors in a change of control transaction, and initial sales of equity to the public (“**IPOs**”). Liquidity in the new profit-with-purpose business forms could be more limited relative to profit-with-purpose businesses organised in traditional forms due to the provisions designed to protect the social purpose, such as the supermajority voting thresholds and class voting for change of control transactions. These mandatory approval thresholds for the new corporate forms, which may be higher than those required for traditional corporations under applicable

²⁴² See World Economic Forum Investors Industries, *From the Margins to the Mainstream: Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream Investors*, 13, 26, (September 2013).http://www3.weforum.org/docs/WEF_II_FromMarginsMainstream_Report_2013.pdf

²⁴³ See ERISA § 404(a)(1)(B).

state law, could render profit-with-purpose businesses less attractive targets for prospective acquirers by increasing the risk that a change of control transaction would not receive shareholder approval or limiting the acquirer's flexibility to redeploy the assets of the profit-with-purpose business efficiently.

In addition, because of the extensive disclosure required in connection with an IPO under US securities laws and the imposition of liability for any material misstatements or omissions in the offering documents, a profit-with-purpose business IPO involves an additional level of risk relating to the content of the disclosure regarding the social purpose, and, in particular, any quantitative metrics used to measure social impact. Until a set of best practices evolves, an IPO of a profit-with-purpose business could draw enhanced scrutiny from the Securities and Exchange Commission resulting in a longer time to market and additional expense, and may therefore be an unattractive option for investors.

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