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(d) Possible Future Work in the Area of Private Law and Development

(ii) Guidelines for a legal framework for social enterprises (or for a certain type of social enterprise)

(Memorandum prepared by the Secretariat)

<i>Summary</i>	<i>Consideration of possible future work in the area of private law and development: guidelines for a legal framework for social enterprises (or for a certain type of social enterprise)</i>
<i>Action to be taken</i>	<i>Authorising of the commencement of work on the preparation of guidelines for a legal framework for social enterprises (or for a certain type of social enterprise)</i>
<i>Mandate</i>	<i>Drawing up of future Work Programme</i>
<i>Priority level</i>	<i>To be determined</i>
<i>Related documents</i>	<i>(C.D. (88) 7 Add. 6); C.D. (88) 17.</i>

Background to the preliminary study

1. This project for guidelines for a legal framework for social enterprises (or for a certain type of social enterprise) is presented in partnership with the International Development Law Organization (I.D.L.O.), an intergovernmental Organisation based in Rome, which works to strengthen the state of law and sound governance with a view to sustaining social and economic development and reducing poverty.¹

¹ Since its establishment in 1983, I.D.L.O. has been working on the promotion of legal, regulatory and institutional reform for the social and economic development of developing countries and transition economies, covering fields such as commercial and investment law, environmental and land law, access to justice and legal and judicial reform and human rights. Its activities include training (through seminars and distance learning), the giving of advice and research (www.idlo.int). The UNIDROIT Secretariat has worked with I.D.L.O. on different occasions in the past.

2. In a letter addressed to the Secretary-General of UNIDROIT on 17 April 2009, Mr William Loris, Director of I.D.L.O., expressed I.D.L.O.'s interest in exploring with UNIDROIT the possibility of a joint project between the two Organisations for the preparation of a legal regimen governing social enterprises. He stressed that the usefulness of such a legal framework was clearly evidenced by the considerable discussion that this question had given rise to in various international fora and that social enterprises – which, whilst aiming to produce surpluses, do so for the purpose of achieving their social objective – regularly highlight the difficulties that they experience in functioning within the legal frameworks currently available.

3. At its 88th session, held in Rome from 20 to 23 April 2009, the UNIDROIT Governing Council looked at this proposal in the context of a general discussion of possible future work in the area of private law and development, in the light of a memorandum prepared by the UNIDROIT Secretariat.² It recalled the repeated appeals that had been made over the previous years for UNIDROIT to give adequate consideration to the needs of developing countries when formulating recommendations for the UNIDROIT Work Programme to the General Assembly. The Council agreed that the broad terms of reference of UNIDROIT in the private law field offered a wide range of opportunities for the Institute to contribute to the achievement of the development goals agreed upon by the international community. Opening a line of work specifically devoted to the interplay between private law and social and economic development - in particular in the area of legal aspects of social enterprises - might also permit the exploring of possible synergies with other intergovernmental Organisations and the development of joint projects with some of these. Consequently, the Council invited the Secretariat to carry out feasibility studies in the areas concerned, in consultation with the relevant international Organisations, designed to identify possible directions in which work might be developed, with a view to laying such studies before the Governing Council at its following session.³

4. The study carried out by the UNIDROIT Secretariat presents preliminary considerations by way of illustration of the special nature of social enterprises (in particular “social entrepreneurship” or “social business”, the concept promoted by Mohammed Yunus, the 2006 Nobel Peace Prize winner), which are organisations (or initiatives) which combine a social objective and an entrepreneurial dimension. The term “social enterprise” may cover different types of structure, from certain traditional third sector organisations (such as associations and foundations) or certain forms of co-operative to organisations incorporated as traditional commercial companies but working for social causes. This study will spell out the special legal features of these forms of enterprise in relation to the traditional corporate model - not-for-profit organisations and the classic commercial company - and report on both the growing institutional, conceptual and practical recognition of such enterprises and those national laws having established special legal frameworks for this type of enterprise. It concludes by suggesting that there is a case for guidelines for a legal framework for social enterprises (or for a certain type of social enterprise) and formulating proposals for the methodology that might be employed in the development of such guidelines.

5. On the basis of exchanges between the Secretariats of the two Organisations, it has been agreed that the I.D.L.O. Secretariat would launch an enquiry with its network of *alumni* for the purpose of completing the study carried out by the UNIDROIT Secretariat, through concrete information regarding possible new legislative initiatives and needs in the field in a certain number of developing countries and transition economies. I.D.L.O., moreover, is conducting preliminary research into the identification of donors who might be willing to fund any work to be undertaken for the development of guidelines for a legal framework for social enterprises.

² C.D. (88) 7 Add. 6.

³ C.D. (88) 17 – Report on the session, paragraph 98.

Introduction

6. All over the world, organisations which are part neither of the traditional commercial sector nor of the public sector but are part rather of civil society or of the third sector⁴ supply varied types of service to vulnerable communities and groups of individuals. The inspiration for these efforts originates in ideas of mutual assistance and solidarity. These organisations support the process of human and social development and take part in efforts to eradicate poverty and improve living standards. These organisations take different forms and have multiple appellations, such as associations, foundations, general interest corporations, community groups, not-for-profit companies, non-governmental organisations and co-operatives. The features of this sector, its weight in the economy and society, the broad variety of the players involved, its institutional recognition and the general framework within which it operates, as well as the instruments employed to facilitate its development, are the product of national and local identities, which have profound historical, cultural, social and economic roots.

7. At a time when States find themselves with fewer and fewer means to deal with the huge needs of human development, the organisations of the third sector have a unique potential for supporting public policy in the social field and working for implementation of the Millennium Development Goals (M.D.G.), centred, as these are, on the eradication of extreme poverty and hunger, the improvement of education and health possibilities, in particular for children and women, environmental protection and the development of a global partnership for development.⁵ At the same time, initiatives launched at the highest level, such as the United Nations Global Compact,⁶ invite private sector firms to involve themselves in the pursuit of humanitarian and social goals. It is against this background, and having regard to the importance of having a legal environment favourable to the full realisation of the potential of the different parties involved in the social and productive sectors, that this idea of guidelines for a legal framework for social enterprises, that combines economic development and social justice, is submitted.

1. CORPORATE BODIES AND SOCIAL FUNCTIONS

8. Alongside public communities and public law corporate bodies carrying out public functions, every legal system recognises a large variety of legal forms for the structured management of the provision of services, the production of goods intended for trade or consumption or the achievement of other goals which are useful or necessary for life in the community.

9. Law has traditionally drawn a clear distinction between, on the one hand, those private sector bodies the principal goal of which consists in the carrying out of an economic activity designed to earn a profit for their owners or shareholders and, on the other, those bodies the goal of which is the pursuit of an activity of general interest rather than the earning of an economic profit.

⁴ This sector is given different names according to the theoretical approach followed, with variations in content that are sometimes quite significant: the not-for-profit sector, the social economy (or solidarity) sector and non-governmental Organisations; the concept of the third sector is generally used to cover those bodies which are involved in the different approaches.

⁵ United Nations Millennium Summit, 2000 (www.endpoverty2015.org/)

⁶ United Nations Global Compact, 1999 (www.unglobalcompact.org/)

1.1. The Roman-Germanic legal tradition

10. In the countries of the Roman-Germanic legal tradition, the majority of which more or less recognise a distinction between "civil" and "commercial" law, this general division was reflected in the establishment of different types of organisation for corporate bodies depending on whether their activities were "commercial" or "civil" in character.

1.1.1. Commercial corporate bodies

11. These are organised in different ways, of which the joint stock company – typically, the public limited company – is the classic example. Apart from the limited liability of the members, which provides security for the personal assets of the investors, a common principle underlying the concept of a commercial company is that the participation of its members in its capital gives them certain rights in return: the right to recover the amount of their initial contribution in the event of the winding-up of the company, the right to share in the profits during the company's life or in the net surpluses in the event of winding-up and the right to participate in the decisions of the company, through voting at the meetings of members.

12. Each State lays down in its domestic law the contents of these rights and the manner in which they are acquired, lost, transmitted and exercised among the members themselves, taking account of the rights of creditors and third parties, while leaving members a broader or lesser margin of discretion in arranging their rights under the constitution. Members may agree on the date for the sharing out of profits, on the amounts to be put aside by way of reserves or to be paid out and on an unequal distribution of profits. In this context, the choice may be made of directing the company towards a specific social goal, to establish certain criteria for the taking of strategic decisions concerning the company (in particular priorities between the interests of stakeholders and rates of return) and to devote a large share of – or perhaps all – the profits from the company's activity to the company's goal. More often than not, these agreements are not subject to any external supervision and may be modified by the members during the life of the company, as by the new owners in the event of the company being taken over. In the event of the company being wound up, shareholders are entitled to a share of the surplus. These features, together with the fiscal regimen, highlight a fundamental distinction between the commercial company and non-commercial firms, the objectives and assets of which are protected to preserve the purpose which they were originally given.

1.1.2. Civil corporate bodies

13. Generally, in Civil law countries, the categorisation of a corporate body as civil in character is based on the formation of such bodies according to certain specific legal forms, the two principal examples of which are the association and the foundation, which are regulated in the Civil Code or in special legislation.⁷

14. An association is created by a contract between its members, drawn up for the realisation of a project or activities in the interest of its members (mutual benefit organisations) or directed towards a general interest (public benefit organisations), which is specified in its constitution. A foundation is a body irrevocably endowed with funds, property or capital for the pursuit of a common benefit. Some foundations finance projects which are carried out by other bodies, whereas other foundations carry out their own projects. These organisations acquire their legal capacity through a procedure consisting in a simple declaration or registration with a public authority. A preferential regimen - in particular in the fiscal sphere – is applicable to those organisations which obtain recognition of their public utility (or some other similar concept) by a competent authority,

⁷ Or in a special law, as in France, the Law on associations (*contrat d'association*) of 1 July 1901.

which subjects them to a control procedure designed to ascertain that they carry out their activities in conformity with the protected objects.

15. An essential feature of these organisations is the fact that, typically, neither the founders nor the members seek to make a profit thereby. This principle is reflected in different ways: a prohibition on the distribution of the proceeds derived from the activity of the organisation in the form of property, profits or dividends among the members, founders, employees, donors or other persons involved with the organisation, including in indirect or disguised form, for example in the form of salaries, preferential terms or other personal advantages. In the event of the winding-up of the organisation, such persons are not entitled to a share of the assets (subject to special rules dealing with the recovery of contributions made) and these devolve on another not-for-profit body designated in the constitution or by a competent authority. Surpluses must be allocated to the goals pursued by the organisation.

1.1.3. Cases where the distinction between commercial corporate bodies and civil commercial bodies is attenuated

16. The traditional distinction between corporate bodies of a "civil" and a "commercial" character is, however, not applied strictly, certain types of company established for the pursuit of an economic activity being classified as "civil" more by virtue of classic notions (agricultural sector, professional firms) than by the absence of the profit motive.

17. An additional variation consists in the acceptance of the carrying out of a certain amount of economic activity, provided that such activity is accessory to the organisation's principal goals. In fact, the area in which non-commercial organisations operate has typically been considered as non-trading activities – involving the supply of goods or services on a complimentary or quasi-complimentary basis – and from this point of view civil law organisations enjoy limited legal capacity – for example, to acquire property. Such organisations have progressively earned recognition of their right to carry out economic activities and to obtain the income earned by these activities, however in a more or less restricted manner (in general, such activities must be provided for in the constitution, must be directed toward realisation of the organisation's principal goal and must not constitute a preponderant part of the organisation's overall activity), above all where they enjoy fiscal benefits.

18. Co-operatives and mutual societies are hybrid bodies, in the sense that they essentially have in common both the economic function of a company and the not-for-profit goal. A co-operative is an autonomous association of persons coming together voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically controlled enterprise.⁸ Mutual societies are based on similar principles, in particular that of providing services to their members, solidarity and mutual assistance and democratic management, but the members pay subscriptions and do not own the society's capital. Co-operatives and mutual societies have been around for a long time and are known all over the world.

19. Generally, the members of a co-operative have a dual capacity: they are both financial shareholders – a subscription to the capital being a condition of their membership – and users of the co-operative, as suppliers, customers or employees. Their principal advantage lies in this last-mentioned capacity, through the direct income that they earn from their co-operation or the savings or rebates that they receive in proportion to their participation in the co-operative activities. On the other hand, their primary objective is not that of earning a profit on their contribution. If they are able to earn a return, this is normally limited. Such surpluses as may be

⁸ Definition of the International Co-operative Alliance (www.ica.coop).

produced are essentially allocated to the co-operative, in particular as reserves, which – at least in part – may not be shared out and remain among the assets of the co-operative itself, *inter alia* in the case of its winding-up. Democratic management by the members (the right to vote being exercised on the basis of one vote per person and not according to the amount of capital contributed) and the preservation of the independence of the co-operative are fundamental principles of the co-operative ideal.

20. As regards legal form, some countries lay down a general special legal regimen, as also (or sometimes only) special rules for certain types of co-operative. In many countries co-operatives come under the general rules governing corporate bodies – of a civil or commercial character – subject to certain adaptations in order to take account of the co-operative principles. In particular, the characteristic feature of the corporate body concept – traditionally conceived as the profit-seeking objective pursued by members – has been broadened, whether by case-law and *doctrine* or in the legal rule which defines a corporate body,⁹ in order to reflect the special interest which the members of a co-operative derive from their participation.

21. In a certain number of countries belonging to the Roman-Germanic legal tradition, the demarcation between civil and commercial law has become blurred in favour of a broader concept of business law, bringing together the different forms of business.¹⁰ Moreover, we are seeing the development of a phenomenon in certain countries which are closer to the traditional distinctions – following in the tracks of a certain body of legal opinion which sees the central role of the subjective concept of profit-making in the commercial corporate body as being relative – in the shape of special types of corporate body with a social calling, to which the pursuit of profit may be – or is – totally alien, which has further broadened the concept of the corporate body, in particular the French public interest co-operative (*société coopérative d'intérêt collectif (S.C.I.C.)*), the Belgian social purpose company (*société à finalité sociale*) and the Italian social company.¹¹

1.2. The Common law legal tradition

22. Common law systems recognise a similar distinction between corporate bodies the essential purpose of which is the carrying out of an economic activity for the benefit of its members – the corporation being the classic example – and activities serving rather the goal of public benefit,¹² such as the different types of charity and other not-for-profit organisations. The absence of a dogmatic distinction between “civil” and “commercial” law, however, makes the demarcation between the two more flexible, which means that the fact that a corporate body works in the public interest is frequently the result of an external act rather than the form in which the organisation is incorporated.

⁹ See, for example, in French law, Article 1832(1) of the Civil Code: “a company is set up by two or more persons who agree by contract to allocate assets or to put their own efforts to a common enterprise with a view to sharing any profits *or profiting from any savings* that may result therefrom”.

¹⁰ For example, in Germany, the form of enterprise which is neither a classic *Verein* nor a classic *Gesellschaft* but includes the not-for-profit goal of the former and the capacity to carry out trading activities of the latter.

¹¹ See *infra*, paragraphs 61, 65 and 68. The introduction of the Belgian social purpose company made it necessary to amend the definition of “company” laid down in the Civil Code: the new Article 1832 of the Belgian Civil Code provides that “the goal of” a company “is to obtain for members a direct or indirect profit on its assets *except where, in the cases provided by law, the constitutive documents provide otherwise*”.

¹² For example, the Charities Act of 2006 of the United Kingdom explicitly includes public benefit in the definition of a charitable purpose. This concept is fully explained in the Act and in the instruments for the implementation of the Charity Commission. Cf. www.charity-commission.gov.uk.

23. In fact, from the point of view of form, differently incorporated organisations may pursue such goals,¹³ such as voluntary associations, societies or corporate bodies incorporated as limited liability companies the constitutions of which provide for a protected object (in particular a charitable object) and the absence of any personal profit for members,¹⁴ or, in the United Kingdom and the countries the legal systems of which derive from English law, companies limited by guarantee, the members of which contribute only a small amount – which is usually nominal – to cover outstanding debts following a potential liquidation, or other types of company without share capital or the share capital of which is subject to restrictions on transfers. Other bodies are based on the allocation of funds dedicated to a charitable object (for example, foundations and charitable trusts). Each type of body is subject to the rules applicable to the legal form chosen – in particular as regards formation and the acquisition of corporate status (more often than not through registration or incorporation), except as regards the special rules deriving from its charitable purposes.

24. The questions of public benefit or public purpose, the organisation's character as a charity and charitable purposes are treated differently from country to country (and even within individual countries) according to the organisation concerned. They may be defined by flexible concepts, indicating the scope of the activities of the organisation, broadened beyond the members thereof (public good, public benefit, community benefit) and/or by goals which are specified more precisely (for example, charitable, social, cultural). Certain objects may be expressly excluded (for example, those of a political character). On the other hand, certain sectors may be specifically targeted (such as the educational, health, social and environmental sectors). Another criterion is the support given to special groups of people (vulnerable groups of people or people in difficulty), for example by supplying work integration opportunities with a view to getting people back into the community.

25. These nuances apart, there are, typically, two corollaries to the pursuit of a public benefit or purpose, namely that the founders or the members have no interest at stake in the initiative, meaning that they receive no economic advantages – whether direct or indirect – from the activity carried out by the organisation (which, at the same time, does not, as a rule, exclude the payment of reasonable rewards for services rendered). Earned income activities are authorised but subject to restrictions: as a general rule, such activities must be directly related to, and be in furtherance of the charitable object – either exclusively or essentially – this last-mentioned criterion being assessed, for example, according to the share of the total resources. A general body of criteria has been developed in each country for establishing whether the economic activity is not a business: for example, the fact that it is essentially carried out by volunteers, the sale price of products in relation to the cost of their production and the means at the disposal of the recipients or the availability of comparable goods on the market. Projects or programmes directed toward particular social objects, such as getting people back into work or the economic development of poorer regions, may also be subjected to the rules governing not-for-profit organisations.¹⁵

¹³ By way of example, the Nonprofit Organisations Act of 1997 of South Africa defines a not-for-profit organisation as meaning a "trust, company or other association of persons established for a public purpose, and the income and property of which are not distributable to its members or office bearers except as reasonable compensation for services rendered".

¹⁴ See, for example, Section 25 of the Companies Act of 1956 of India and Section 28 of the Companies Act of 1994 of Bangladesh; such companies must obtain a licence from the Government and may omit the term "limited" from their company name.

¹⁵ By way of example, see the different restrictions imposed in Canada on trading activities for registered charities (which may be organised as unincorporated associations, corporations or trusts) and charitable foundations (organised under the form of either corporations or trusts) under the restrictions contained in the Income Tax Act, by virtue of legal acts of the provinces and the Common law. Cf. T.S. CARTER and T.L.M. MAN, "Business Activities and Social Enterprise: Towards a New Paradigm", the *Canadian Bar Association/Ontario Bar Association, 2009 National Charity Law Symposium*, 7 May 2009, pp. 5-28.

26. The decision to recognise that an activity is of public utility or to grant a particular status (for example, that of a charity) falls, as a rule, to be taken by a public or independent authority; it may also result from conformity with the criteria laid down by the revenue authorities, which exercise controlling functions.¹⁶ Recognition, as a rule, enables the organisation – or the activities concerned or else the persons who participate in the financing of such activities – to be entitled to certain fiscal exemptions or relief and other advantages, such as access to financing or guarantees from public institutions and the possibility to take part in tenders for public contracts. It may also be a requirement laid down by private donors. An organisation which is recognised as serving a public purpose has to account for its activities and its finances to the controlling authority.

2. NEW ROLES FOR TRADITIONAL TYPES OF ORGANISATION

2.1. Expansion of the economic activities of third sector organisations

27. The last three decades have seen traditional third sector or not-for-profit organisations take a more and more active role in economic trading activities, according to the most diverse of forms and using the most diverse methods, including sometimes cases where such activities are not accessory to the overall activities of an organisation that has a social object or where they are not specifically directed towards implementation of the social object. These new needs have become widespread in different regions of the world, where the withdrawal of the State from the provision of social services has led to an increase in social needs, at the same time as a reduction in the subsidies available for civil society organisations.

28. A large number of countries have given these organisations the means to take a more active role in the economic field, enabling them to be less dependent on traditional sources of funding, that is the subscriptions of members, public subsidies and private donations; furthermore, such activities are used to provide support to employment and getting marginalised parts of the community into work and back into the community. In such cases, these bodies replace or complement public social support programmes. These organisations have not only reinforced their activity in the field of social cohesion and human development but they have in the process earned recognition as essential players in the field of economic development both at a local and at a global level, displaying an ability to adapt to the new market conditions which in some cases may be considered superior to that of the traditional commercial companies.¹⁷

29. In a certain number of cases, above all in developing countries or those countries with transition economies, reforms have been undertaken concerning the general status of civil society organisations in the context of the process for the strengthening of legal institutions and the promotion of the rule of law. In many cases, these reforms draw their inspiration from general principles or guidelines seeking to provide modern terms of reference, reflecting generally accepted international practices.¹⁸

¹⁶ Thus, in the United States of America, the organisations which meet the criteria set by Section 501(c)(3) of the Internal Revenue Service, to wit, “a corporation, and any community chest, fund, or foundation ... organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, educational purposes, to foster national or international amateur sports competition, for the prevention of cruelty to children or animals”.

¹⁷ See, for example, the conclusions reached in in-depth studies carried out in a European context: the study *L'économie sociale dans l'Union européenne* carried out by R. CHAVES AVILA and J.L. MONZON CAMPOS, of the International Center of Research and Information on the Public, Social and Co-operative Economy (C.I.R.I.E.C.) for the European Economic and Social Committee (E.E.S.C.) – No. CESE/COMM/05/2005, pp. 108 *et seq.*; cf. also the study *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* carried out by the European Research Network (E.M.E.S.) for the United Nations Development Programme (U.N.D.P.) in 2008.

¹⁸ By way of example, one might mention the Guidelines for Laws Affecting Civil Organizations (Open Society Institute / International Center for Not-for-Profit Law). Cf. www.icnl.org.

30. In other cases, what is involved is a global process for the modernisation of the law governing corporate bodies, including profit-making organisations.¹⁹ Several countries have recently carried out more or less wide-ranging reforms or are in the process of doing so.²⁰ Many other initiatives are, on the other hand, more limited in scope and concern specific types of organisation, with a view to reinforcing their ability to take part in the economic sector (in particular for associations) and/or supporting the social side of their activities (in particular for certain types of co-operative the emphasis of which is more on providing public services than on providing services to members).²¹ These reforms are frequently accompanied by the taking of economic, fiscal and regulatory policy measures, for example, to provide such organisations with access to funding (by, for instance, the issuing of bonds or shares) and to permit their raising and management of equity capital, with, on the other hand, a corresponding reinforcing of the auditing and transparency requirements demanded of such organisations.

31. In some countries, the outstripping by not-for-profit organisations of the role traditionally allocated to them in the sphere of economic activities is such that one can talk about the “commercial transformation” of the not-for-profit sector.²² As a general rule, where such activities fall outside the strict framework which provides the legal basis for their protected status, in particular fiscal exemptions – justified by the fact that the social and environmental costs are absorbed internally and do not, as a result, fall on society as a whole (the public and private sectors) – these organisations are subject to the rules (which may be either general or for the activities concerned) applicable to profit-making businesses. However, the complexity of these rules and of their application sometimes causes organisations from the traditional private sector operating in the same market to raise the issue of unfair competition.

2.2. Social concerns of commercial businesses

32. The development of the economic role of third sector organisations has coincided with the emergence of the concept of the “social responsibility” of businesses belonging to the traditional commercial sector, involving recognition that such businesses are not only responsible for looking after the interest of the owners – the maximisation of profits – but also need to pay attention to the impact on society (such as human rights, workers’ rights, the situation of consumers, suppliers, the impact of the business on the community as a whole and its effects on the environment) of the business’ activity and adapt their goals and operational methods.

33. The calls for a strengthening of the social responsibility of businesses are, broadly, taken up by civil society and stakeholders. Among these, investors also demand respect for ethical values and several national laws have begun introducing this concept for the benefit of certain categories

¹⁹ By way of example, on 26 May 2006, Japan passed a general law on foundations and not-for-profit associations, as well as an accompanying law regulating their fiscal aspects, as part of an overall reworking of the legal regimen applicable to all corporate bodies, whether of a public character or of a commercial character. In the United Kingdom, the Charities Act of 2006 has modernised the rules applicable to charities and the Company Act of 2006 has introduced a general reform of the law governing companies. For more information on national law and those reforms either passed recently or underway, see, in particular, the work of the International Center for Not-for-Profit Law (www.icnl.org) and the International Center for Civil Society Law (www.iccsl.org).

²⁰ For example, the Government of Australia has commissioned an in-depth study into the not-for-profit sector, the aim of which is, in particular, to eliminate obstacles standing in the way of its growth and its contribution to society. This study has just become available. Cf. www.pc.gov.au/projects/study/not-for-profit.

²¹ See *infra*, paragraphs 61-63.

²² B.A. WEISBROD, *To Profit or Not to Profit. The Commercial Transformation of the Non-profit Sector*, Cambridge 1998.

of person, in particular employees or business partners²³ – or in particular areas of economic activity, for example by obliging the funds which manage savings from salaries – in particular, institutional investors such as pension funds and mutual funds – to report on the business' social and environmental policy. Multilateral agencies are heavily involved in studies and programmes designed to support the participation of commercial enterprises in sustainable development²⁴ and some attempts are underway by Governments with a view to acting on these concerns, without, however, up to now embarking on the establishment of a binding legal framework. Certain enterprises anxious to anticipate the impact of their image on the public are becoming involved in voluntary programmes, based on codes of conduct or ethical charters. A whole range of initiatives have taken off for the drawing up of criteria or indicators designed to give an objective shape to the concept of social responsibility.²⁵

34. Those enterprises of the traditional private sector which implement socially responsible practices do not, however, give up their core profit-earning objective: in fact, if the concept of "social interest" is nowadays conceived as involving parameters which are more flexible than they were in the past (in particular the long-term view), it remains subject to complicated interpretations which do not always protect directors from being sued for breach of their fiduciary duties by shareholders, on the ground that their financial interests are prejudiced. It remains true, nevertheless, that the recognition of the social responsibility of enterprises forms part of a global trend toward the introduction of ethical considerations in the running of business and, more and more, toward seeing the functions of social development and economic growth as being not only compatible but also indissociable.

35. It is these combined principles which are advanced by national and international public policy in order to promote sustainable enterprises, capable of providing decent jobs and of promoting social justice and sustainable development, enterprises from the private sector – in particular small - and medium-sized enterprises – whose motive role in bringing about social and economic development at the local level is recognised, making them natural partners of and, where necessary, players alongside those third sector organisations the primary vocation of which is social action.

3. NEW FORMS AND NEW CHALLENGES

3.1. Social goals and return on capital

36. The limitations to which the traditional organisations of the third sector are subject in the carrying out of commercial activities and the need for them, as they develop their activities and the range of areas in which they operate, to raise amounts of funding which exceed the means normally available from the public purse or philanthropic sources cause such organisations frequently to diversify the ways in which they operate. Legal, organisational and practical considerations may justify commercial activities being structured along traditional company lines with company profits being transferred to an organisation which has a social object. Such a choice

²³ This is the case of Germany and Japan. In the United Kingdom, Section 172 of the Companies Act of 2006 specifically refers to the company director's duty also to take into consideration the impact of the company's operations on the community and the environment, the desirability of the company maintaining a reputation for high standards of business conduct, and the need to act fairly as between members of the company.

²⁴ Particularly worthy of mention in this connection within the United Nations is the Global Compact of 2000; the tripartite declaration of the International Labour Organization (I.L.O.) on the principles concerning multinational enterprises and social policy; also the guiding principles of the Organisation for Economic Co-operation and Development (O.E.C.D.) for multinational enterprises (2000).

²⁵ Thus, the Global Reporting Initiative (www.globalreporting.org) has drawn up common assessment protocols – Sustainability Reporting Guidelines (G3) - used by a large number of socially responsible investment groups and funds.

will often be made in the framework of groups in which organisations subject to different regimes co-operate for the carrying out of common projects.

37. For the direct carrying out of projects with a social character, the choice of the structure of the traditional commercial company has the drawback that such a company may not claim the preferential fiscal status that a not-for-profit organisation could have access to. On the other hand, it gives greater freedom of manoeuvre for the structuring of capital and the development of any type of economic activity the economic profitability of which will enable the enterprise to grow and to develop social activities. It also opens up the possibility of reinforcing the company's financial, and thus its operational, capabilities, by paying out, where appropriate, a return on funding – whether this be in the form of debt or equity.

38. There are different ways of looking at the paying of a return to investors. Some consider it vital to attract funding from the classic commercial sector, in the case of needs that may not be adequately met by purely philanthropic funding, by reason of the insufficiency of such funding and its contingent and unforeseeable nature. So as, however, to avoid the pursuit of the sort of excessive levels of profitability that may be earned by certain activities with a high social-added value (by advancing the principle of "doing well by doing good"), and to protect the essentially social object, there is broad support for the idea that the earning of income may be allowed but that such income must be limited. However, there is another school of thought which would exclude the possibility of a return being earned on the capital invested and, rather, allow the overall surpluses resulting from the economic activity to be re-employed in the social cause. This last approach counts on the company being able to call on financial partners activated solely by the social cause and confident that their support will be effectively and exclusively employed for such a cause.

39. In this context, the form of a commercial company may bring up the fact that a social project may not be limited in time. During the life of a company, and particularly when it starts doing well and generating profits, the risk arises that the members may decide to alter the business of the enterprise, its priorities, the manner in which profits are allocated or, more traditionally, that new owners may make different choices from those made by the company's founders. It is with a view to responding to such concerns that the principle has developed of including a company's social object in its corporate identity and locking its assets in such a way as to ensure that they will only (or mainly) be employed for its social object, as happens with the traditional third sector organisations. It is, furthermore, with a view to building confidence around a social project that a distinctive form of social enterprise is advocated, thus giving it a label associated with guarantees for funders and the different stakeholders in a social project.

3.2. The development of new forms of funding for social activities

40. Another side of the question of the level of return to be earned on capital invested is the different types of funding available for organisations having a social vocation, typically third sector organisations but also companies incorporated as commercial companies. Recent years have seen a strengthening of the classic instruments and the appearance of a new market of social funding. The philanthropic institutions that traditionally operated through donations are getting more and more involved in formulae involving loans and the taking of shareholdings as a means of supporting projects or activities with a high level of risk, as part of strategies that often involve the provision of assistance and follow-up. Financial infrastructure has been reinforced through many initiatives - in particular in the context of public policy - involving the granting of public guarantees in respect of funding provided by private operators and the market has developed new financial products adapted to different needs - in particular long-term financing, in the form of equity investment or quasi-equity investment, or else loans. A whole array of financial products offering

different rates of return attracts savings from a public committed to ethical causes and concerned for their fellow men. Combinations of different sources and types of funding make it possible to tap into more substantial amounts of credit, at limited cost.²⁶

41. The increased involvement in the economic field of organisations with a social calling and the involvement of new players in the funding of such organisations have had the effect of subjecting such enterprises to stricter requirements regarding management, operational rules and transparency. They have also had the effect of requiring that such enterprises account for their activities in terms of effectiveness or, for example, social or environmental impact. A whole series of instruments for assessing the performance of such enterprises from these points of view has been developed and these provide investors with information to help them in making their choice.

3.3. Partnerships and participation of stakeholders

42. Support for the development of enterprises with a social purpose comes from the natural partners for the pursuit of such a purpose to be found in the public and private sectors. The programmes developed by such enterprises are frequently in line with social objectives established by governmental agencies, above all for assistance to disadvantaged persons or support for employment in areas particularly affected by the economic recession. In this way, such enterprises have access to funding by way of subsidies or operate on a contractual basis. Their role is also important in the assessment and establishment of public policy.

43. The strategic needs of the enterprise with regard to (public and private) external financing raise special issues: the necessary partners, the co-operation of which is also encouraged for the supply of technical know-how, which sometimes goes beyond even financial services; at the same time their participation must remain subordinated to the principles and objectives of the project: this feature determines conditions such as the maximum shareholding that may be held in the enterprise, the return on capital invested, the transfer of shares and participation in the decision-making bodies.

44. On the other hand, a feature which is widely recognised as characteristic of the new types of enterprise with a social purpose is the range of participation therein: such enterprises seek to involve as members or in other ways extended groups concerned by their activity, such as salaried workers and volunteers, users, public authorities and the community, and to involve them in the taking of decisions.

4. THE INSTITUTIONAL RECOGNITION OF SOCIAL ENTERPRISES

45. Over and above the transformations that have been seen in the role of the traditional third sector organisations, everywhere we see another dimension to the concept of the social enterprise, namely the absence of a single definition of the concept, which is rather the result of a combination of conceptual formulations, institutional recognitions and practical experiences, some of the more significant features of which are highlighted below.

²⁶ Among the new social finance instruments, particular mention should be made of micro-finance, as an instrument which enables populations excluded from the classic financial markets to gain access to loans – and other financial services – which are primarily intended for the acquisition of means of production. The financial support (in different ways) of micro-finance institutions that has developed on a very large scale in the world is a typical example of a “socially responsible” use of private – or public – funds. For a panorama of the instruments developed in the context of social finance, cf. (*inter alia*) M. MENDELL and R. NOGALES, “Social Enterprises in OECD Member Countries : What are the Financial Streams?” in : *The Changing Boundaries of Social Enterprises*, edited by A. Noya and published by the O.E.C.D. in 2009, pp. 89-138.

4.1. Social enterprises as players in the social economy

46. In the context of the vast areas of study covered by the “social economy”,²⁷ the concept of the social enterprise, which took shape at the beginning of the 21st century, fits within a new conceptual framework, which spells out through a certain number of criteria both the notion of “business” - a continuous activity for the production of goods and services, a high level of autonomy, a significant level of economic risk-taking and a minimum level of paid employees - and that of its “social” object - the explicit objective of providing service to the community, an initiative coming from a group of citizens, decision-making power not being based on the holding of capital, a participatory dynamic of stakeholders and a limitation on the distribution of profits.²⁸

47. This concept of the social enterprise is not limited to accounting for the transformation that the classic third sector organisations have known over the past two decades but goes beyond that to describe organisations animated by a “new entrepreneurial spirit”, which plays an innovative part in social activities.²⁹ The new legal frameworks which have been brought in - in particular in European countries - to support these businesses, whether this be by adapting traditional forms of the social economy - for example, those co-operatives the object of which is specifically social³⁰ - or by conceiving a special new statute,³¹ are mentioned as benchmarks of the innovative character of social enterprises.

48. Within the European Union, the Community authorities are resolutely engaged in the establishment of a global, articulated policy directed toward the increased recognition and promotion of the social economy in the construction of Europe. Following up on various measures already taken - in particular the adoption of the Statute for a European Co-operative Society³² - the resolution on the social economy passed by the European Parliament on 19 February 2009 fits into this trend: it invites the Commission in particular to defend “the social economy’s concept of ‘a different approach to entrepreneurship’, which is driven primarily not by a profit but by social benefit motive”, to establish European statutes for associations, foundations and mutual societies and to establish clear rules to identify which entities can operate legally as social economy enterprises and to ensure that they can operate on a level playing field with other such undertakings.³³

²⁷ The social economy approach was developed – originally in Europe – in recognition of the activity and participation in society and in the global economy of associations, foundations, co-operatives, mutual societies and other similar organisations. It emphasises the primacy of the individual and the social object over capital, the freedom to become a member, democratic management by members, the compatibility of the interests of user-members and the public interest, the implementation of the principles of solidarity and responsibility, independence from the public authorities and the fact that surpluses may not be distributed. Cf. the Charter of the principles of the social economy, promoted by the European Standing Conference of Co-operatives, Mutual Societies, Associations and Foundations (C.E.P.-C.M.A.F.).

²⁸ C. BORZAGA and J. DEFOURNY (Ed.), *The Emergence of Social Enterprise*, Routledge, 2001, 15 *et seq.*

²⁹ The concept of the “new social entrepreneurship” is based on the theory developed by J. Schumpeter in 1934, according to which economic development flows from a process involving the implementation of new combinations in the production process, concerning, for example, products, means of production, markets and the legal form of the organisation. Cf. Borzaga & Defourny, *ibid.*, 11.

³⁰ See *infra*, 5.1.1.

³¹ See *infra*, 5.1.2 and 5.1.3.

³² Council Regulation (EC) No. 1435/2003 of 22 July 2003 on the Statute for a European Co-operative Society and Council Directive 2003/72/EC of 22 July 2003 supplementing the Statute for a European Co-operative Society with regard to the involvement of employees.

³³ See also the opinion of the European Economic and Social Committee on the “Diverse forms of enterprise” (2009/C 318/05), calling on the European Commission “seriously [to] consider drawing up a policy for social enterprises”.

49. The social economy approach is recognised in other parts of the world: although relating to multiple realities, it is recognised in Québec and in Latin America, where the aspect of solidarity is emphasised.³⁴ A regional conference held in Johannesburg in 2009 also made the social economy concept the centre-piece of a vast Plan of Action for the promotion in Africa of social economy enterprises, including “social enterprises”.³⁵

4.2. The social enterprise: the United Kingdom approach

50. The Government of the United Kingdom has been a pioneer in giving institutional support to social enterprises. Already in 2002 it set up a special Social Enterprise Unit within the then Department of Trade and Industry, which has developed an action programme³⁶ designed to create an enabling environment, to make social enterprises better businesses and establish the value of social enterprise. The Social Enterprise Coalition is the organisation which acts as a focal point, promotes and supports the overall social enterprise movement.

51. “A social enterprise is a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners.” The main part of their income comes from commercial activities - and not donations - and surpluses are used for the social objective: these are the factors which are specific to social enterprises in relation both to not-for-profit organisations and to the traditional commercial company.

52. Those enterprises fitting this definition may be set up using different legal models: charities, industrial and provident societies or other forms of commercial company (companies limited by shares or by guarantee). However, so as to give social enterprises an additional legal status, conceived with their special characteristics in mind, and to give them a recognised identity, a law was passed in 2004 on the Community Interest Company (C.I.C.).³⁷

4.3. Social enterprises, social entrepreneurs and social entrepreneurship

53. A different approach which has been developed in the United States of America and is becoming well known is that referred to as “social entrepreneurship”:³⁸ it is based on the innovative character of the project developed by a “social entrepreneur”, who employs entrepreneurial methods, with a view to realising social changes on a large scale. Microcredit is emblematic - and at the root - of this concept. Central features of this approach are the dynamic

³⁴ NESST (Nonprofit Enterprise and Self-sustainability Team) is a not-for-profit organisation which works to solve critical social problems in emerging markets (in Latin America and Eastern Europe) by supporting the development of social enterprises, seen as businesses that strengthen a not-for-profit organisation’s financial sustainability and maximise its social impact; cf. www.nesst.org.

³⁵ International Labour Organization Regional Conference on “The Social Economy – Africa’s response to the Global Crisis”, Johannesburg, 19/21 October 2009.

³⁶ www.cabinetoffice.gov.uk/media/cabinetoffice/third_sector/assets/se_strategy_2002.pdf.

³⁷ See the summary of the C.I.C., *infra*, paragraph 66.

³⁸ Having originally made its mark through the success of individual experiences, it is broadly recognised, *inter alia* as the harbinger of a new theoretical approach. A growing number of studies is devoted to the economic, sociological and legal aspects of social entrepreneurship. See in particular A. NICHOLLS, *Social entrepreneurship: new models of sustainable social change*, Oxford 2006.

The Social Enterprise Alliance (www.se-alliance.org/) is an organisation which brings together at the national level a large number of “social enterprises”, which it defines as organisations or ventures that achieve their primary social or environmental mission using business methods - including both not-for-profit organisations that use business models to pursue their mission and for-profit organisations the primary purposes of which are social. A social mission is primary and fundamental; the organisational form will depend on what best advances the social mission.

and strategic aspect of the setting up of the social project, in particular as regards the raising and rationalisation of resources and the effectiveness of the methods employed in the service of the social objective. Social entrepreneurship is very actively supported by organisations which are at the origin of the concept and which encourage the world-wide development of initiatives carried forward by new social entrepreneurs.³⁹

54. In the context of social entrepreneurship, choice of the instruments to support the operational structure is made on the basis of an assessment of effectiveness or appropriateness: a traditional not-for-profit organisation, a form of commercial company or a combination of the two. The concept does not necessarily imply the financial autonomy of the project. On the other hand, neither does it preclude the possibility of investors obtaining a financial return: according to one idea, the blended value proposal,⁴⁰ financial performance is intrinsically linked to social and environmental performance. This idea brings out the importance of being able to measure the economic, social and environmental impact precisely.

55. The hybrid nature of these organisations has led certain commentators to see the emergence of a “fourth sector”, situated at the crossroads between the commercial (profit-making) sector and the (not-for-profit) non-commercial sector, the individual characteristics of which are such as to merit the adoption of a specific legal framework.⁴¹ Among the different proposals which have been put forward, a new form of company known as the “Low profit limited liability company” or L3C has been the subject of legislation adopted by the State of Vermont in 2008, followed by similar initiatives in other States.⁴²

4.4. Social business

56. The concept of social business was developed by Mohammed Yunus⁴³ to designate a particular type of enterprise falling within the general category of social entrepreneurship but differing therefrom by the fact that it has to achieve full financial sustainability; social business refers to a social cause-driven, self-sustainable organisation, making profits to expand the company’s reach, where the investors/owners can gradually recoup the money invested but cannot take any dividend beyond that point. Under a variant on this formula, a business may also be classified as a social business if it is owned by the beneficiaries (groups of a targeted population), in which case the profits work directly to achieve the social objectives of the business. This is the concept at the base of the Grameen Bank, as well as a whole number of businesses operating in Bangladesh in different fields, for example microcredit and financial services, health and food services, renewable energy, access to information technology. Social business has already been implemented abroad and attracts growing attention from economic and financial circles the world over.

57. Social business is proposed as a new economic form of enterprise which may act efficiently in a systemic manner for the eradication of poverty and the construction of a more just and more prosperous world; to assure its efficiency, Mohammed Yunus advocates the development of a

³⁹ In particular, the Ashoka network (www.ashoka.org), the Schwab Foundation (www.schwabfound.org) and the Skoll Foundation (www.skollfoundation.org).

⁴⁰ J. EMERSON, *The Blended Value Map: Tracking the Intersects and Opportunities of Economic, Social and Environmental Value Creation*, 2003; cf. www.blendedvalue.org.

⁴¹ Cf. for example The Aspen Institute, *The Emerging Fourth Sector, A new sector of organizations at the intersection of the public, private, and social sectors* – developing the features of what might be a “for-benefit organization”. Cf. also T.J. BILLITTERI. *Mixing Mission and Business : Does Social Enterprise Need a New Legal Approach ? Highlights from an Aspen Institute Round Table Discussion*, January 2007.

⁴² See the summary of the L3C, *infra*, paragraph 67.

⁴³ M. YUNUS, *Creating a World Without Poverty – Social Business and the Future of Capitalism*, New York Times Bestseller, 2007.

whole series of instruments: a tool for assessing the social performance of such businesses, a system for certifying the accounts and annual reports, a world regulation and information agency, a network of social finance attracting the philanthropic sector and the private sector, the setting up of a social stock exchange, the development of public support policies, in particular through fiscal exemptions. The adoption at Government level of a protected name with definitions of goals - and thus of a specific legal framework - and independent agencies in charge of carrying out impact studies is seen as necessary for the promotion of social business.⁴⁴

5. THE ADOPTION OF SPECIFIC LEGAL FRAMEWORKS FOR THE SOCIAL ENTERPRISE

58. The establishment of a specific legal framework for social enterprises is one feature of the institutional recognition of these types of enterprise. Each piece of national legislation is part of a particular context bringing together issues relating to the legal tradition, the different forms of organisation available and the regimen applicable thereto - in particular at the fiscal level, as well as the associated duties - and a whole series of key environmental elements relating to these enterprises, in particular regarding their access to financing devices and the measures of support which accompany the setting up and operation of social enterprises.

59. Far from offering an exhaustive panorama of legislative developments in the field of social enterprises or organisations which might be qualified as such,⁴⁵ the following summaries highlight certain significant examples of initiatives founded on legal, social and economic realities particular to each country but which, nevertheless, illustrate approaches, at times differing and at others shared, on the matters traditionally regulated in frameworks governing corporate structure.

5.1. The different categories within which social enterprises may be classified

60. These different instruments may be grouped together in three main categories.⁴⁶ The first two are based on an existing model, which is adapted to the social goals being pursued: those of the co-operative and the commercial company. The third category represents a neutral approach applicable to a variety of legal forms of organisation, given a special name, "social enterprise".

5.1.1 *Co-operatives with a social object*

61. The statute of a co-operative includes the function of an enterprise. However, in view of the large variety of co-operatives, specific pieces of legislation provides statutes for certain particular types. In 1991, Italy adopted a law on social co-operatives (Law No. 381 of 8 November 1991), which served as a model for the laws having a similar purpose passed in other countries (which is also a significant point in the emergence of the concept of the social enterprise in Europe), namely in Portugal (the Law of 22 December 1997 on social solidarity co-operatives) and France (Law No. 624 of 17 July 2001 on public co-interest operatives (S.C.I.C.)); mention may also be made of Spain (the Law of 16 July 1999 on co-operatives for social initiatives) and Québec (the Law of June 1997 on solidarity co-operatives).

⁴⁴ *Ibid.*, p. 174 *et seq.* See also www.muhammadyunus.org.

⁴⁵ Noteworthy in this connection, for example, are the laws passed in Lithuania (on the social enterprise) in 2004, in Poland (on social co-operatives) in 2006, in the Czech Republic (on the public benefit company) and in Slovenia (on the not-for-profit private institution). Cf. *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, op. cit., supra*, footnote 17.

⁴⁶ Cf. F. CAFAGGI and P. IAMICELLI, "New Frontiers in the Legal Structure and Legislation of Social Enterprises in Europe: a comparative analysis" in *The Changing Boundaries of Social Enterprises*, edited by A. Noya and published by the O.E.C.D. in 2009, whose classification in three categories is followed here and who propose a comparative analysis with a view to suggesting some possible approaches for the preparation of new legislation.

62. All the questions which are not specifically contemplated in the special statute devised for these social co-operatives are subject to the general regimen governing co-operatives of national law and, where appropriate, the applicable company law.

63. The distinctive characteristics of social co-operatives are as follows:

- their object: the social object is described in different ways - it may imply a certain quality of services (public interest, social utility) or particular areas of activity (such as health and education); in general, it relates to the exercise of any type of activity directed toward helping particular classes of disadvantaged or marginalised person to find employment. Generally, it is also exercised in the interest of a wider class of person than just the members of the co-operative;

- the purpose of the assets and the distribution of surpluses: the co-operative principle generally works on the basis that there is a limited distribution of surpluses, both for the shares held by members and for the external funding to which the co-operatives have access in the different countries. On the other hand, some laws (Portugal) exclude any form of distribution. Reserves constitute the assets of the co-operative and cannot be shared out. In the event of winding up, the net assets devolve on another organisation pursuing similar objectives;

- participation and management: an original feature of social co-operatives is their multi-stakeholder membership: this consists in the participation of various private partners (in particular salaried workers, including those who are in the process of getting back into work; volunteer workers; beneficiaries of the activities) as well as (private or public) corporate bodies, that support the co-operative. This multi-stakeholder feature strengthens the democratic character of the way in which this type of enterprise operates, with the convergence of individual interests toward the achieving of a common interest. Participation in decision-taking corresponds to the general rule of co-operatives, namely "one voice one vote" (subject to special regimes for certain classes of member, in particular regarding financiers or volunteer members). The democratic structure of a co-operative is reflected in the appointment and composition of the management;

- the duties regarding information disclosure, accountability and responsibility: these are more or less strict, depending on the country – leaving aside the internal control exercised by members within the management bodies, the general rules are applicable in respect of the duties and the formal requirements by which all co-operatives are bound; social co-operatives are, furthermore, subject to the supervision of an authority, to which they must report concerning the conformity of their operation with their statute and their social object, which is governmental in nature or is independent of, and approved by such a governmental body.

5.1.2. *Companies with a social purpose*

64. Several countries have selected the commercial company as the legal form for the social enterprise - which enables it principally to exercise commercial activities - while making the necessary adaptations to fit the social objects pursued. Failing special provision, all the rules applicable to the form of company chosen at the time of transformation are applicable (for example, regarding capital formation, the operational rules of the decision-making bodies, provisions relating to accounting or those dealing with the liability of directors, administrators and managers).⁴⁷

⁴⁷ Also worthy of note is the Spanish law of 13 December 2007 on insertion enterprises, which designates as such commercial companies or co-operatives which carry out any commercial activity for the production of goods and services, and the social object of which seeks to bring socially marginalised persons into the community and to give them social and professional training. A minimum of 80% of the surpluses standing to the credit of the enterprise at the end of the financial year is to be reinvested in the enterprise. Such enterprises are subject to supervision by the Ministry of Employment. The law specifies the relevant aspects of

65. **The social purpose company (“société à finalité sociale”) (S.F.S.) was introduced in Belgium in 1995** (Articles 661-669 of the Company Code) as a designation in the context of the consolidated laws on commercial companies, which may be used for the different classic commercial companies (such as the co-operative society, the private company limited by shares and the public limited company).

- It is characterised by the pursuit of a social goal (which is “internal” when it concerns the workers or “external” when it covers broader projects) and the absence of any profit-making goal on the part of members. The latter may obtain a limited profit from the assets of the company (determined by reference to a specific official rate) or no profit from the assets. Profits and reserves must be allocated in accordance with the social goal of the company, just like net assets in the case of the winding up of the company (with the exception of the refunding to members of the amount contributed by them to the capital). Members of staff have the option of becoming members. There is a cap of 10% of the company capital (20% in the case of staff members) on the voting rights of each member within the General Assembly.

- Directors and managers have the duty of drawing up a report (*inter alia* on financial matters) each year on the manner in which the company has taken steps to realise the social goal. External control of the operation of the S.F.S. in accordance with its designation is exercised by the judicial authorities at the request of a member, an interested third party or the public prosecutor: the directors and managers may be liable, as also beneficiaries where they know of the irregularity concerning sums paid out in their favour. If appropriate, the court may declare the company dissolved.

- It is possible under the law for a not-for-profit association to convert itself into an S.F.S. without affecting its legal personality. An S.F.S. is not subject to a specific fiscal regimen: it is subject to the fiscal status of companies or corporate bodies depending on the nature of the activities it carries out.⁴⁸

66. **The Community Interest Company (C.I.C.) of the United Kingdom** was established as a new legal form for social enterprises by the Companies (Audit, Investigations and Community Enterprise) Act of 2004 (C.A.I.C.E. Act of 2004). It is governed by the Community Interest Company Regulations of 2005 (as amended in 2009), and is subject to the general rules of company law (the Companies Act of 2006).⁴⁹

The C.I.C. form aims to meet the needs of organisations which trade (producing goods or services) with a social purpose or carry on other activities which benefit the community. It was intended as a valuable addition to the existing forms, providing more flexibility within the relative freedom of the familiar limited company framework, with a variety of capital structures available to meet the needs of members and the organisation. The basic structure of a C.I.C. is that of a limited liability company (company limited by guarantee) or that of a public or private company limited by shares. However, a charity may apply to register a C.I.C. as a subsidiary company.

the employment agreements to be made by such enterprises with workers and grants those enterprises qualifying as insertion enterprises a series of different types of public financial aid.

⁴⁸ Generally speaking, S.F.S.’s would seem to have had modest success (approximately 500 S.F.S.’s have been set up, the majority of which are co-operatives). A draft reform was launched in 2007, the effect of which would, in particular, be, first, to increase, under certain conditions, the rate of dividends paid out, secondly, to widen participation by workers (by enabling them to participate in the management, independently of their financial participation), and, thirdly, to provide that an S.F.S. that is in breach of its duties forfeits its qualification as a company with a social object and is no longer just dissolved.

⁴⁹ For Community Interest Companies – Information and Guidance Note, see www.cicregulator.gov.uk.

The primary purpose of the C.I.C. is to provide benefits to the community, rather than to its members (owners, directors, employees). A C.I.C. carrying on a business will need to generate surpluses to support its activities, maintain its assets and make its contribution to the community; it may, however, also pay out a dividend to its investors, although subject to a cap established by the Regulator. In other cases, it is the activity itself which directly provides a benefit to the community. A C.I.C. may apply for grants or donations to achieve these ends.

A C.I.C. has the following special features:

- the community interest test: the activities of the C.I.C. must ultimately be directed toward the provision of benefits for the community, or a section of the community, this test being assessed according to the judgment of a reasonable person;
- the "asset-lock" principle: this is designed to ensure that the assets of the C.I.C. (including any profits or other surpluses generated by its activities) are retained within the company to support its activities or otherwise used to benefit the community (or another asset-locked body); the asset-lock principle does not bar a C.I.C. from using its assets for normal business activities, for instance as collateral;
- the cap on dividends: a C.I.C. may be allowed by its constitution to pay out dividends to private investors but these will be subject to a cap. A similar cap applies to interest payments on loans; and
- an independent Regulator of Community Interest Companies supervises the formation and operation of C.I.C.'s so as to ensure that they meet their obligations in accordance with their goal and the rules of law. In the event of the C.I.C. defaulting on its debts, the Regulator has extended powers of intervention, from the appointment of directors to the transferring of assets for the purpose of safeguarding the same; the Regulator may also bring proceedings against the directors in the interest of the members of the C.I.C. and, where appropriate, request the dissolution of the C.I.C. This independent supervision assures an organisation using the form of the C.I.C. and its members of the necessary degree of certainty and transparency regarding its goals and structure.⁵⁰

67. The Low-Profit Limited Liability Company (L3C) of the United States of America: this is a variant on the limited liability company (L.L.C.) which combines business methods and charitable purposes in a for-profit entity organised to engage in socially beneficial activities. L3C legislation was first enacted by the Vermont legislature in May 2008 and since then other States (and communities) have passed or are considering the passing of an L3C law.⁵¹

The primary goal of the L3C is to achieve socially beneficial purposes: however, an L3C is rather like a regular business and is profitable. According to the law, the company "A - (i) significantly furthers the accomplishment of one or more charitable or educational purposes within the meaning of Section 170(c)(2)(B) of the Internal Revenue Code of 1986 (26 U.S.C. 170(c)(2)(B) (that is in the fields of, for example, education, preservation, job creation and economic

⁵⁰ The number of enterprises registered to date (almost 3500, 1000 of which have been registered in the last 12 months) bears witness to the success of the C.I.C. form. Even though it does not enjoy fiscal exemption in respect of its activities, it would appear to offer a suitable structure for the carrying out of social projects. Furthermore, the concern of guaranteeing the funding levels necessary to attract investors may be seen in the raising of the ceilings on earnings with effect from April 2010 (the rate of which is henceforth fixed and no longer indexed to the base rate of the Bank of England). The strong support provided by the Regulator (as regards the information given in respect of, and the constitution of enterprises) and the control that it exercises are probably important factors in inspiring confidence in this form of enterprise.

⁵¹ Illinois, Michigan, Missouri, Utah and Wyoming, as also the communities of the Crow Indian Nation and the Oglala Sioux Tribe (as of 20 February 2010). For more information regarding legislative developments in respect of the L3C see www.americansforcommunitydevelopment.org.

development); and "(ii) would not have been formed but for the company's relationship to the accomplishment of charitable or educational purposes".

Since it is designed to match the federal tax authorities' requirements relating to a certain type of financing, Programme Related Investments (P.R.I.'s) by foundations – which must distribute 5% of their capital each year for charitable purposes (P.R.I.'s qualifying to meet the 5% requirements) – this new form of enterprise should attract philanthropic funding. The capital ownership of the L3C could be structured in a way that such philanthropists would invest taking the highest risk at little or no return, with the rest of the investment becoming more attractive to commercial investment by lowering the risk and raising potential rates of financial return on investment. Members of L3C's can be any assortment of individuals, Government agencies, not-for-profit organisations and commercial companies, that have made different types of contribution in exchange for their membership and are willing to accept different levels of risk.

As a limited liability company (L.L.C.), the L3C provides limited liability to its owners/ members and easy transferability of ownership. Members file the constitutive documents of the company (the name of which has to include the designation L3C) with the competent State Government office. The members agree by contract on an operating agreement, which, first, should clearly state the charitable purpose of the L3C and how it will be implemented, secondly, may provide for the inalienability of the assets and their specific allocation for the social object and, thirdly, will be tailored to meet their particular needs regarding powers and privileges, including management issues and profits. As a limited liability company, an L3C does not benefit from tax exemptions.⁵²

5.1.3. *Neutral forms applicable to a variety of legal structures*

68. The laws passed by Italy (summarised below) and Finland⁵³ may be classified in this category.

In Italy, Decree law No. 155 of 24 March 2006 on the "social enterprise" establishes a new company name that may be taken by a whole series of not-for-profit organisations (in particular associations)⁵⁴ but also by all bodies incorporated as companies, subject to the need to bring themselves into line with the special conditions relating to the objects of the enterprise, with the rule on the non-distribution of surpluses and with the limitations on capital structure and the control of the enterprise; the general rules applicable to the basic legal form are applicable to all those questions not specifically regulated. Public administrations and

⁵² What is seen as the primary advantage of L3C's is the way in which they are adapted to the fiscal requirements relating to Programme Related Investments: however, the revenue authorities have not yet made their views known. Some doubts have been voiced as to the lack of any structure whereby a check might be carried out on the extent to which L3C's will carry out their activities in accordance with their stated aims.

⁵³ In Finland, Law No. 1351/2003 of 30 December 2003 on social enterprises applies to any organisation carrying out a commercial activity for the production of goods and services the social object of which is to support the employment and reinsertion of the disabled and the long-term unemployed, seeing that these constitute at least 30% of the overall personnel. Social enterprises have to be registered in a registry deposited at the Ministry of Employment, which exercises supervisory functions. The main purpose of the law (which was revised in 2007) is to determine the conditions for the allocation of the public subsidies to which social enterprises are entitled; the special regimen to which the organisation is subject depending on its form is applicable in respect of any matter not dealt with in the law (such as, for example, the question as to the manner in which surpluses that have accumulated at the end of a financial year should be applied and governance).

⁵⁴ This sector has been the subject of several sets of rules over the past 15 years, designed to facilitate participation in economic activities or to reinforce the social exploits of the different organisations concerned: all may carry out commercial activities but - except in the case of the social co-operatives introduced by Law No. 381 of 1991 – in a subsidiary or accessory manner or else with a view to the performance of their social goal (Law No. 266 of 1991 on voluntary organisations; Law No. 383 of 2000 on social promotion associations; Legislative decree No. 460 of 1997 on not-for-profit organisations of social utility). The new law on social enterprises is, in particular, designed to consolidate these different sets of rules.

those private entities the activities of which are solely reserved to members and not to the community are excluded.

A social enterprise has the following features:

- it carries out, on a permanent basis and as its primary activity, an economic activity organised with a view to the production or exchange of goods or services of social utility which is designed to achieve goals of general interest. Social utility is defined by reference to 70% of the income generated by activities being carried out in certain defined sectors (such as social and medical assistance and education) and/or by the goal of the enterprise being to get disadvantaged workers into employment (as a proportion of at least 30% of the overall labour force);
- it is a not-for-profit organisation: surpluses must be used for those activities covered by the constitutive documents of the enterprise or allocated to the assets of the enterprise. The principles of a social object and the absence of a profit motive are safeguarded in the event of a change in, or a transfer of the ownership of the enterprise. In the event of the enterprise ceasing to operate, the assets devolve on organisations having a similar character. Any distribution in favour of members or directors is prohibited. There is a cap of 5% above the official rate on the return on financial instruments issued by banks and financial intermediaries, on condition that these are not shares;
- it is subject to special rules on registration in the company register, on accounts and concerning bankruptcy;
- it is subject to specific rules regarding the holding of shares and control: private profit-making enterprises and public administrations cannot hold a controlling interest (understood as the ability to appoint a majority of the governing bodies) nor be represented on the board of directors;
- it must provide means for the participation of workers and the beneficiaries of the activities in such a way as to enable them to exercise influence on the decisions of the enterprise, in particular such decisions as directly concern working conditions and the quality of the goods and services provided;
- it is subject to a certain number of rules regarding public notice and transparency: documents (constitutive documents, statutes and balance-sheets), as also the social balance-sheet (reporting in particular on the internal participatory process of the enterprise), must be filed with a public authority (the Ministry of Social Solidarity). This authority exercises control over the extent to which the social enterprises act in conformity with their particular statute.

5.2. First conclusions concerning certain typical characteristics of the social enterprise

69. The preceding summaries bring out a certain number of the issues dealt with in the recent legislation that has introduced particular statutes for forms of enterprise pursuing social objects with commercial means. Each law having special features, these issues are not all necessarily treated in each case and they are sometimes treated differently. Nevertheless, they are indicative of what might be, or what might be considered as the subject-matter of, on the one hand, a more general framework (or possible variants on a basic framework) to be drawn up in the context of an international proposal for social enterprises,⁵⁵ while bearing in mind the objective of encompassing

⁵⁵ Cf. also the conclusions and recommendations of CAFAGGI and IAMICELLI, *supra*, footnote 46, as also the features of a suitable legal environment for social enterprises recommended in the study *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*, *op. cit.*, *supra*, footnote 17, p. 189.

existing organisations fitting certain features, and, on the other, the alternative or additional solution of proposing a new structure for a certain type of specifically (and differently) defined social enterprise.

70. One might suggest, *inter alia*, the following features of such a framework as a basis for discussion:

- a statement of the social object and of the entrepreneurial activities for its implementation, as well as the question of their definition;
- the question of capital structure (including becoming a member) and return on capital (shares and financial instruments), with the principle of non-distribution – or limited distribution – of surpluses, the inalienability of the company's equity, in particular in the event of its dissolution, and its use for the purpose of the social object;
- the allocation of decision-making powers (the right to vote and to be represented in the governing bodies) and the means of protection against the taking of control in a way inconsistent with the social object;
- broad representation of stakeholders (and determination thereof) and their participation in the decision-making bodies;
- the duties to provide members, stakeholders and third parties with information; and
- the mechanisms for internal and external control designed to ensure the observance of the social object and operational principles.

71. A first objective might consist in the drawing up of a series of criteria – which might be more or less detailed, where appropriate framed in the form of alternatives – designed to bring out the character of a social enterprise. The possible convergence of a certain number of characteristics in respect of the social enterprise (to be identified in detail and to be defined as to their content) will raise the question of their inclusion in one or more forms of special organisation and, in this case, their relationship with the general rules of law applicable to the body the structure of which is chosen as the basis or to the different bodies to which it might be related.

6. TOWARDS THE PREPARATION OF GUIDELINES FOR A LEGAL FRAMEWORK FOR SOCIAL ENTERPRISES OR A PARTICULAR TYPE OF SOCIAL ENTERPRISE

6.1. The justification for such a proposal

72. The various initiatives taken recently (some of which have been described in this paper) bear witness to the need to reinforce the legal infrastructure of special forms of social enterprise.

73. Besides, we are seeing very broad interest in, and many requests from different players for the establishment in their country – or region – of an appropriate legislative and regulatory framework for social enterprises or organisations corresponding to certain features – depending on the case, through the appropriate recognition of existing forms or by the adoption of a specific framework for a new form of social enterprise. By way of illustration, one might mention:

- a study carried out by the European Research Network (E.M.E.S.), published by the U.N.D.P. in 2008, on social enterprises in Europe and the Commonwealth of Independent States concluded with a series of recommendations, *inter alia* for the establishment at national level of a

legal framework favourable to the development of social enterprises, involving recognition of the different forms of appropriate organisation, in particular so as to ensure that social enterprises are not discriminated against in the market place in relation to other forms of enterprise;⁵⁶

- in Canada, a speech by Rt Hon. Paul Martin, the Prime Minister of Canada, on 8 November 2007 at the Munk Centre for International Studies, entitled "Unleashing the Power of Social Enterprise", underlined, in particular, that " ... there is still a major gap in the way the Government responds to the real world evolution of the social economy, that of social enterprise in its fullest sense";⁵⁷

- in South Africa, a National Conference on the enabling environment for social enterprise development in South Africa (held on 22 and 23 October 2009, under the auspices of the International Labour Organization) adopted a declaration⁵⁸ formulating a number of recommendations for the improvement of the legal and regulatory framework of social enterprises, *inter alia* recommending that "the principles and definition of social enterprise [be] legally codified in order to allow reference to social enterprise across these various pieces of legislation" and encouraging "further exploration of the possibility of specific legislation on social enterprise in the medium term"; and

- in France, a recently published book⁵⁹ recommends the adoption of an optional structure suited to the French environment for companies the members of which have chosen to meet a social need and have opted for the corresponding label.

6.2. The possible benefits of such a proposal

74. Without seeking to prejudge the form that such a proposal might take (principles, recommendations, guidelines, model law, guide or another form of non-binding instrument), two possible objectives might be suggested for work directed toward the drawing up of such a legal framework:

1. the determination of a series of criteria or characteristics for the identification as social enterprises of the organisations meeting such criteria – while recognising the diversity of the organisations concerned (both as regards their form and their roles in the different countries) and/or
2. the development of a specific legal framework for a special form of social enterprise – identified by a specific name,

by means of clear and functional rules, that allow for local or national peculiarities, of a human, social, economic, legal or other character.

⁵⁶ Cf. *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*, *op. cit.*, *supra*, footnote 17, p. 191. The legal framework recommended is described as needing to be sufficiently flexible not to stand in the way of the development of social enterprises.

⁵⁷ Cited in CARTER and MAN, *supra*, footnote 15; the authors conclude their analysis of the legal framework in Canada with a recommendation for the creation of a new legal form for social enterprises regarding which they make a number of suggestions. See also R. BRIDGE and S. CORRIVEAU, *Legislative Innovations and Social Enterprise, Structural Lessons for Canada*, B.C. Centre for Social Enterprise, February 2009, who call for the passing of a federal Community Enterprise Act.

⁵⁸ See www.givengain.com/cause_data/images/2027/Social_Enterprise_Conference_Statement_231009.pdf.

⁵⁹ D. Hurstel, *La Nouvelle Économie sociale. Pour réformer le capitalisme*, Odile Jacob, 2009.

75. A number of potential benefits may be identified at this preliminary stage, as follows:

- for countries which already have forms of organisation corresponding to the characteristics of social enterprises, recognising their common identity as a means of promoting them through the establishment of appropriate public policies at the national level; where appropriate, accommodating an additional type of enterprise with specific characteristics, thus adding to the variety of the available forms of enterprise; for those countries without appropriate forms of organisation combining a social object and commercial methods, facilitating the modernisation of the legal framework applicable to traditional organisations and, where appropriate, offering a possible model for the creation and operation of a particular type of social enterprise;
- the appropriate public policies referred to above will, in particular, include the development of instruments and measures in, *inter alia*, the institutional, financial, fiscal and accounting fields, at the different levels of the national and local administration, centred on a global concept recognised or specifically defined, consisting, for example, in facilitated access to, first, different sources of funding (including through the establishment of criteria for the assessment of the social performance of the enterprise), secondly, public tenders and different forms of co-operation with the public sector and, thirdly, preferential fiscal treatment to compensate for their internal absorption of social costs;
- contributing to the development of social enterprises by offering legal certainty and foreseeability for all stakeholders, permitting the inter-State recognition of the legal framework and facilitating the transnational operations of social enterprises or their co-operation in partnership with similar bodies in other countries.

6.3. Methodological proposals

76. The proposed partnership between UNIDROIT and the International Development Law Organisation for the preparation of guidelines for a legal framework for social enterprises (or a particular type of social enterprise) contemplates a harnessing of the special expertise, spheres of activity and resources of the two Organisations toward this end.

77. In particular, the drawing up of legal rules could take the following form:

- the setting up of a steering committee (composed of a small number of (say, six) specialists in the company law field, and in particular the social enterprise field, from the different regions and legal systems of the world) with the task of confirming the desirability and feasibility of the preparation of a legal framework for social enterprises and with terms of reference which would in particular be to determine:
 - the objectives of the proposed initiative,
 - the features of the intended legal regimen or the possible different options,
 - the form of the instrument or instruments to be prepared and the preparation (over two sessions) of a preliminary draft of such instrument (or a general outline of such a document);
- the setting up of a study group made up of members of the steering committee and (say, six) supplementary members designed to broaden geographical representation, on the basis of a balanced representation of the different legal systems and a broad representation of developing countries, the task of such a study group being to consider the preliminary draft instrument (or general outline of such a document) prepared by the steering committee;

and the adoption (over three sessions) of a final instrument (for example, guidelines), with explanatory notes, or the establishment (over two sessions) of a draft instrument, with explanatory notes (to be laid before a committee of governmental experts)

- if appropriate, the setting up of a committee of governmental experts for the adoption (over two sessions) of a final instrument (for example, a model law).

78. It will be for these different committees to take special account of the experience and expertise of, first, the multilateral agencies active in the field of the promotion of the activities of enterprises, some of which have especial expertise regarding the social economy, both at the multilateral ⁶⁰and the regional level, secondly, research centres (above all operating at the regional level) bringing together academics and social enterprise practitioners and, thirdly, regulatory bodies.

79. The idea would be for the task of preparing guidelines for a legal framework for social enterprises (or for a certain type of social enterprise) as outlined in this document, subject to the UNIDROIT Governing Council approving the undertaking of such work, to be carried out jointly by the UNIDROIT and I.D.L.O. Secretariats, the latter agreeing in particular to raise the necessary funding through an appeal to external donors.

⁶⁰ Particular mention might be made within, first, the O.E.C.D. of the *Local Economic and Employment Development Programme (L.E.E.D.)*, in the context of which studies have been going on for over 10 years into the environment of the different social economy organisations, with especial attention being paid to the social enterprise, as also to the enterprise's role in local development, in both member and non-member States of the O.E.C.D.; secondly, within the I.L.O. of the *Job Creation and Enterprise Development Department (EMP/Enterprise)*, which works in support of stable enterprises and employment and one section of which is, in particular, devoted to co-operatives, and, thirdly, within U.N.D.P., in particular in the context of its unit for Poverty Reduction in Europe and the C.I.S.