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# Social Enterprises: How Should Company Law Balance Flexibility and Credibility?

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**Abstract**
*In recent years, many countries have introduced special regimes to facilitate the organisation of social enterprises. Many of these include company law rules which may either provide for a special corporate form for social enterprises, or are part of a certification scheme for such enterprises. This article analyses how these company law issues have been addressed. It focuses on the US benefit corporation, the UK Community Interest Company and the recently proposed Danish certification regime for social enterprises. An analysis is made of how the different systems aim to find the right balance between flexible rules that are sufficiently attractive to entrepreneurs and (social) investors, and rules which ensure that the designation of 'social enterprise' is credible. It is pointed out that the three systems balance these requirements quite differently, and the advantages and disadvantages of each are discussed. One of the key elements in the governing of social enterprises is the regulation of how assets can be transferred from these enterprises. It is concluded that a certification scheme seems preferable to a new corporate form, and several recommendations are made as to how to find a system that is more credible than the US solution and more flexible than the UK and Danish solutions.*

**Keywords:** social enterprise, duty of management, statement of purpose, asset locks.

## 1. INTRODUCTION

Both the US and several European Union Member States have introduced special legal frameworks for social enterprises. The solutions range from amendments to companies legislation, through to certification schemes and to new corporate forms. What all these solutions have in common is that they allow certain undertakings to benefit from the designation of 'social enterprise' provided they fulfil a number of conditions set out in the legislation. Regardless of which solution is chosen, a number of questions of company law should be considered, in particular the special regulation of the duties and responsibilities of management, requirements as to the purpose of the company, special rules on the use of the company's assets, disclosure requirements, etc. Thus, the regulation of social enterprises is also a matter for company law.

One of the major challenges in regulating social enterprises is to find a solution that is both flexible and credible. On the one hand, it is necessary to ensure that companies that are designated 'social enterprises' do indeed pursue social goals. This may call for specific requirements for qualification as a social enterprise, as well as restrictions on what companies may do as long as they are classified as social enterprises. On the other hand, the regulations should be sufficiently flexible, so that the social enterprise regime is not solely for those whose activities have a

purely charitable aim. The aim is to provide a regime which is also attractive to those who want to make a profit *as well as* pursue social purposes.

This article aims to analyse how social enterprises are regulated in various countries and to evaluate the different solutions adopted. The main focus is on a comparison of the US benefit corporation,[1] the UK community interest company (CIC) and the newly proposed Danish rules on registered social enterprises.[2] There is an examination of the similarities and differences between the different regimes, and a discussion of the advantages and disadvantages of the different solutions. Furthermore, the article evaluates whether the right balance has been achieved between credibility and flexibility.

This article is limited to dealing with the company law issues associated with social enterprises. There will often be other regulatory or policy measures aimed at promoting social enterprises, including special tax regimes.[3] However, these are not dealt with here due to lack of space. As will be seen below, the Danish scheme in particular allows many different company forms the possibility of being registered as a social enterprise. It is not possible here to deal with the special company law problems associated with all corporate forms that may be eligible to become social enterprises, so this analysis focuses on social enterprises that use the form of either public limited company or private limited company.

The article is structured such that section 2 gives the background to the introduction of special rules for social enterprises. This is followed by a review of the methods used for establishing the framework for social enterprises (section 3). Section 4 looks at the problems associated with the formation or certification of a social enterprise, and in section 5 there is a review of the areas where special company law solutions may be needed for the operation of social enterprises. Section 6 contains a review of the findings and some conclusions.

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[1] As explained below, benefit corporations have been introduced in a number of US states, but rather than looking at the legislation of each state, we have based our review on the Model Legislation. See the Model Benefit Corporation Legislation, available at: <http://benefitcorp.net/storage/documents/Model_Benefit_Corporation_Legislation.pdf>. This Model Legislation was not drawn up by the American Bar Association (ABA), but by the private organisation B Lab.

[2] The proposal governing so-called 'social economic enterprises' was submitted to the Danish Parliament on 26 February 2014, L 148 (*Forslag til Lov om registrerede socialøkonomiske virksomheder*) (hereinafter 'draft law'). The proposal is based on a report submitted by the Working Group on Social Economic Enterprises that gave its recommendations in September 2013. The report of the Working Group can be found at: <http://www.sm.dk/Temaer/velfaerdsudv/socialokonomiske-virk/udvalg/Sider/default.aspx>. The Working Group's recommendations differ from the proposal on a few interesting points, which will be highlighted below.

[3] There are already corporate forms, such as the low-profit limited liability company (L3C) in the US, based on tax incentives. This is not yet the case with the UK CIC, but there has just been a consultation on the suitability of introducing a 'social investment tax relief', see: <https://www.gov.uk/government/consultations/consultation-on-social-investment-tax-relief>.

## 2. WHY IS THERE A NEED FOR SOCIAL ENTERPRISES?

The background to the introduction of rules recognising the particular needs of social enterprises is that the social economy is growing. The term 'social economy' covers a range of different activities which may lie in between commercial, profit-oriented activities and activities for social purposes that are non-profit oriented. This middle ground encompasses public-private cooperation, companies oriented towards corporate social responsibility, charitable trusts involved in commercial activities, cooperatives, and so on. What is common to these operators is that their commercial activities are conducted in whole or in part with a social purpose.[4] The European Commission has defined a social enterprise as 'an operator in the social economy whose main objective is to have a social impact rather than make a profit for their owners or shareholders'.[5] This definition signals that it concerns undertakings that give higher priority to social considerations than to profit. As is discussed below in section 5.2, this definition has implications for the regulation of social enterprises, as some countries have introduced rules regulating how such companies can use their assets, including how much profit may be distributed, etc.

However, there is considerable disagreement over how to define 'social economy', including 'social enterprises'. For example, the term 'social enterprise' is defined as 'the use of market-based strategies to promote the public good'.[6] Another commonly used definition is 'an organization or venture that achieves its primary social or environmental mission using business methods, typically by operating a revenue-generating business'.[7] These definitions seem to indicate that the main feature of social enterprises is that they run a commercial activity for a social

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[4] For a more detailed discussion of the definition: Robert Esposito, 'The Social Enterprise Revolution in Corporate Law: A Primer on Emerging Corporate Entities in Europe and the United States and the Case for the Benefit Corporation', 4 *William & Mary Business Law Review* (2013) p. 639; Matthew F. Doeringer, 'Fostering Social Enterprise: A Historical and International Analysis', 20 *Duke Journal of Comparative and International Law* (2010) p. 291; and Kari Kostilainen & Pekka Pättiniemi, 'Evolution of the Social Enterprise Concept in Finland' (2013), available at: <http://www.finsern.fi/site/files/1313/6068/8265/5_Harri_Kostilainen_Pekka_Pttiniemi.pdf>.

[5] Communication from the Commission, 'Social Business Initiative Creating a Favourable Climate for Social Enterprises, Key Stakeholders in the Social Economy and Innovation', COM(2011) 682 final, at p. 2; in the United Kingdom, the Department of Trade and Industry (DTI) uses a very similar definition as it has described a social enterprise as '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'; see DTI, *Social Enterprise: A Strategy for Success* (2002), at p. 7, available at: <http://webarchive.nationalarchives.gov.uk/+/http://www.dti.gov.uk/socialenterprise/strat_success.htm>.

[6] See Briana Cummings, 'Benefit Corporations: How to Enforce a Mandate to Promote the Public Interest', 112 *Columbia Law Review* (2012) p. 578.

[7] See Robert A. Katz and Antony Page, 'The Role of Social Enterprise', 35 *Vermont Law Review* (2010) p. 59, at p. 85.

purpose and are less focused on how they use their profits. Looking at the regulation of social enterprises in the three countries we have examined, it is characteristic that Denmark and the UK have chosen a regulatory method that focuses on how the profits of the enterprise are spent. It therefore seems that the Commission's definition is more in line with the regulation in the UK and Denmark as it seems to focus on how the profit is spent instead of on how the company is run.

As there is no precise definition of what constitutes a social enterprise, a more fruitful way of delimiting the concept could be to compare how social enterprises are related to the efforts to promote corporate social responsibility (CSR) and the attempts to make general company law more sustainable.

Social enterprises have some points of contact with efforts to promote CSR, but differ when it comes to optionality. The aim of CSR is that undertakings should *voluntarily* incorporate social responsibility in the conduct of their business, so it is up to each undertaking to decide the extent of their social responsibility (if any). In contrast, social enterprises have an *obligation* to take account of social considerations, and according to the Commission's definition, they should even have a social purpose as their primary purpose, outweighing the aim of creating profit for their owners. Finally, a social enterprise can be distinguished from operators that have a purely social purpose or philanthropy by the fact that it carries on some commercial activity and that it, to some extent, fulfils the owners' expectations regarding the payment of profit.[8]

In recent years, there has been a discussion on how to make company law more sustainable. Part of the discussion has focused on whether and how the shareholder value doctrine, which is predominant in common law jurisdictions,[9] can be softened or modified to allow for companies to be directed in a more stakeholder-oriented way. Some argue that it is not enough to allow the company to focus on creating stakeholder value (and not only shareholder value); it should also be run in a sustainable way.[10] Social enterprises go beyond the issue of stakeholder value since they are *required* to have a social purpose. It is not enough that the company is run

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[8] The terms 'social enterprise', 'CSR' and 'philanthropy' do not have clear definitions, and defining the borders between them can be difficult; see Thomas Kelley, 'Law and Choice of Entity on the Social Enterprise Frontier', 84 *Tulane Law Review* (2009-2010) p. 337.

[9] See further the discussion in section 3.2.3.

[10] See, for instance, Beate Sjåfjell, 'Regulating Companies As If the World Matters - Reflections from the Ongoing Sustainable Companies Project', 47 *Wake Forest Law Review* (2012) pp. 113-134; Jure Zrilic, 'Conference Report: Towards Sustainable Companies – Identifying New Avenues', 9 *European Company Law* (2012) pp. 151-157. Many have expressed doubts about such a requirement, see, for instance, Min Yan, 'Why Not Stakeholder Theory?', 34 *Company Lawyer* (2013) pp. 148-158; Surya Deva, 'Sustainable Development: What Role for the Company Law?', 8 *International and Comparative Corporate Law Journal* (2011) pp. 76-102, and University of Oslo Faculty of Law Research Paper No. 2010-04, available at SSRN: <http://ssrn.com/abstract=1712794>; and Janet Dine, in Nina Boeger, Rachel Murray and Charlotte Villiers, eds., *Perspectives on Corporate Social Responsibility* (Cheltenham, Edward Elgar 2008).

such that it takes due care of all stakeholder interests including the surrounding society, as the social enterprise will normally have a more specific and ambitious social agenda. Also, as mentioned with respect to the UK and Denmark, social enterprises are expected to use part of their profit for social purposes, and running the company in a responsible way is not enough.[11] Therefore, social enterprises will normally be for those entrepreneurs/investors that are more committed to a social purpose than may be expected by the majority of entrepreneurs/investors. Consequently, the solutions adopted for social enterprises will likely be too radical for the majority of companies.

According to the Commission, the social economy is growing strongly. It employs no fewer than 14.5 million people in the EU, corresponding to 6.5% of the workforce.[12] The development of the social economy is not only seen in the EU but also globally, not least in the US, where there has been a wave of initiatives to promote social enterprises.[13]

There appears to be increasing interest, among both entrepreneurs and investors, in operating and investing in such enterprises. The growth in the number of social enterprises, especially in the United Kingdom, suggests that they are of interest to entrepreneurs.[14] Danish research shows a similar picture. In 2012, the authors sent a questionnaire to Danish undertakings set up in 2009.[15] They were asked whether they would consider changing their undertaking/company into a corporate form which has the aim of creating value not only for the owners but also for society at large. There was a total of 1,850 replies. Many of the respondents said that any change of corporate form was not at all relevant. If the respondents who did not wish to change the form of their undertaking are eliminated, and only those who would contemplate changing it are considered, 65% of the latter replied that it could be an interesting possibility, and only 35% rejected the use of such a corporate form. Since the question asked was relatively open, this cannot be taken as a definitive measure of the demand for a special corporate form for social enterprises, but it

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[11] However, the borderlines are blurred by the initiative in India whereby larger Indian companies should spend at least 2 per cent of the company's average net profits made during the three immediately preceding financial years on CSR activities. If the company fails to spend this amount on CSR, the board must disclose the reasons in its annual report. See Companies Act 2013 (no. 18), available at: <http://www.indiacode.nic.in/acts-in-pdf/182013.pdf>.

[12] European Commission, 'Social Economy and Social Entrepreneurship' (March 2013), at p. 45. The report is available on the Commission's website.

[13] Overviews of the various initiatives are provided in Esposito, *supra* n. 4; Doeringer, *supra* n. 4; and Jacques Defourny and Marthe Nyssens, 'Social Enterprises in Europe: Recent Trends and Developments', 4 *Social Enterprise Journal* (2008) p. 202.

[14] In the spring of 2013, there were more than 8,000 Community Interest Companies; see Office of the Regulator of Community Interest Companies, Operational Report, 1st Quarter 2013. The report is available at: <http://www.bis.gov.uk/cicregulator>.

[15] Mette Neville and Karsten Engsig Sørensen, 'Styrkelse af iværksætteri - en ny selskabsretlig dagsorden?', *Nordisk Tidsskrift for Selskabsret* (2012) p. 18.

does show that there is some interest in social enterprises and thus potentially for a special framework for them.

It must be assumed that particularly undertakings with few owners form the target group for such a corporate form. Companies with larger and more dispersed ownership would presumably find it difficult to reach agreement on converting into a social enterprise and serving social purposes.[16] However, it is not impossible that larger undertakings could be interested, as a conversion into a social enterprise would give access to the growing group of institutional investors that are interested in sustainable investment.[17]

When looking at the reasons for the increased interest in social enterprises, many point to the financial crisis as one of the most important causes.[18] This is confirmed by the Danish government's Action Plan for the Social Responsibility of Business Undertakings 2012-2015, which points out that the crisis has increased the need to focus on the responsibilities, including social ones, of undertakings, investors, consumers and public authorities in relation to the challenges of climate change, the limits to natural resources and respect for human rights.[19]

Another explanation for the growing interest in social enterprises is the 'business case'. Briefly, this means that it is good business for undertakings to pay attention to their social responsibilities. Even if there are costs for helping solve society's problems and reporting on this, in theory these costs will be balanced by a number of potential benefits.[20] First, it is assumed that the market will react posi-

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16 J. William Callison, 'Putting New Sheets on a Procrustean Bed: How Benefit Corporations Address Fiduciary Duties, the Dangers Created, and Suggestions for Change', 2 *American University Business Law Review* (2012) p. 85, at p. 102.

17 According to the Social Investment Forum, the market for sustainable investments in the US has grown from USD 639 billion in 1995 to USD 3,069 billion in 2010, see *2010 Report on Socially Responsible Investing Trends in the United States*, available at: <http://www.ussif.org/files/Publications/10_Trends_Exec_Summary.pdf>, at pp. 9-10. There is a similar trend in Denmark, where most of the biggest investors pursue responsible investment policies, see Dansif, 'The Current State of Responsible Investment in Denmark', Dansif 2012 Study, December 2012, available at: <http://www.dansif.dk>.

18 E.g., Celia R. Taylor, 'Carpe Crisis: Capitalizing on the Breakdown of Capitalism to Consider the Creation of Social Business', 54 *New York Law School Law Review* (2009/2010) p. 743.

19 See p. 4 of the Action Plan, under the heading 'Ansvarlig vækst', available at: <http://www.evm.dk/~/media/oem/pdf/2012/pressemeddelelser-2012/26-03-12-ansvarlig-vaekst.ashx>.

20 See the analysis in Oliver De Schutter, 'Corporate Social Responsibility European Style', 14 *European Law Journal* (2008) p. 203; and Jan Wouters and Leen Chanet, 'Corporate Human Rights Responsibility: A European Perspective', 6 *Northwestern University Journal of International Human Rights* (2008) p. 262. See also the Commission's ideas on how undertakings' social responsibilities can help improve their competitiveness in six parameters: (1) cost structure; (2) human resources; (3) customer perspectives; (4) innovation; (5) risk management; and (6) reputation management; see the Commission's *European Competitiveness Report* 2008, at pp. 106-121, available at: <http://bookshop.europa.eu/en/european-competitiveness-report-2008-pbNBAK08001>.

tively to the fact that an undertaking is socially responsible. This means it will be easier for undertakings to find trading partners and investors, and it must be assumed that some customers will prefer products from socially responsible undertakings. Second, there can be internal benefits for undertakings, for example, in the form of more loyal employees and the ability to attract better qualified staff. Another internal effect is that, by protecting the environment, undertakings may be able to save on energy costs, waste disposal, etc. It is not yet possible to prove empirically that social responsibility benefits an undertaking's bottom line,[21] but the business case has often been used in support of developing more socially aware undertakings.[22] Also, it is not the intention here to indicate that there needs to be a business case for social enterprises to emerge. Many social entrepreneurs are probably motivated not only by making profits but also by fulfilling the social purposes adopted by the enterprise.

The EU is working to strengthen the social economy. In 2011, the Commission put forward its initiative 'Creating a Favourable Climate for Social Enterprises', in which it proposed various measures to promote social enterprises, including EU financing. It also proposed to set up a public database of labels and certifications available to social enterprises in Europe. The Commission's ambitions in the area of company law are more modest.[23] It was proposed that an attempt should be made to simplify the rules applicable to European Cooperative Societies, as well as to adopt a Statute for a European Foundation.[24] However, the initiative also stated that, in time, the Commission will consider proposing a European Statute for social enterprises.[25] Thus, while the EU may adopt company law measures in this area in the longer term, this cannot be expected soon, so it can make sense for different Member States to consider introducing their own company law rules. Consequently, the lesson that can be learnt from the comparative analyses below will most likely benefit the Member States.

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[21] Quite some efforts have been made to find empirical evidence of this 'business case', but the results are not clear; see the recent attempts of Urs von Arx and Andreas Zeigler, 'The Effect of CSR on Stock Performance: New Evidence for the USA and Europe', Working Paper, CER-ETH 08/85 (May 2008); and Oliver Salzmann, Aileen Ionescu-Somers and Ulrich Steger, 'The Business Case for Corporate Sustainability: Literature Review and Research Options', 23 *European Management Journal* (2005) p. 27. See also the review in the Commission's European Competitiveness Report 2008, *supra* n. 20, at pp. 106-121.

[22] The business case was used in Denmark as a reason for adopting a law in 2008 obliging larger Danish undertakings to report on their corporate social responsibility.

[23] COM(2011) 682 final (Communication from the Commission), *supra* n. 5.

[24] While there is Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE), it was only in 2012 that the Commission put forward a Proposal for a Council Regulation on the Statute for a European Foundation (FE) (COM(2012) 35 final).

[25] See COM(2011) 682 final (Communication from the Commission), *supra* n. 5, at p. 12.

## 3. GENERAL CHOICE OF METHOD TO PROMOTE SOCIAL ENTERPRISES

Both the US and several EU Member States have sought to satisfy the need for a proper framework for social enterprises, balancing consideration of profit for the owners against the pursuit of social purposes. As will appear from the following, the solutions chosen reflect very differing approaches to providing such a framework.[26] The methods range from amendments to company law, so as to introduce direct authority for a company's management to pursue interests other than those of the shareholders, through to certification (under either a public or private regime, see section 3.2) and to new corporate forms (see section 3.1).

There are both advantages and disadvantages to the different solutions. These are analysed below. The focus is on the US, the UK and Denmark. It should be noted that these three jurisdictions differ substantially, and in some cases these differences may explain why the jurisdictions have chosen to approach the regulation of social enterprises differently. For instance, it is clear that the US system is much less inclined to have public interference where it is possible to leave it to private initiative. And it is less likely that the US would adopt a public certification system if a private certification system may emerge. Also, as described in section 4 below, it is very telling that the monitoring mechanism in the US is mainly left to the market, whereas the UK relies on state intervention. Both the UK and Denmark have a much stronger tradition for setting up monitoring systems anchored by public authorities. Another difference between the Anglo-Saxon and the Continental European company law tradition is that the Anglo-Saxon tradition is more shareholder value-oriented than the European one. Finally, it can be noted that, in the US theory, there is a stronger tradition to view companies as a nexus of contracts, where the company's main purpose is to serve as a nexus of a set of relational contracts between the participants.[27] Therefore, the main purpose of US company law is to provide for regulation of the relationship between shareholders and between shareholders and the company, while European company law also strongly emphasises the protection of creditors and even, to some extent, other stakeholder interests, e.g., through rules on worker participation in boards. Even though some of these differences may be explained by more fundamental differences, it is still possible to compare them and to try to outline the pros and cons of different solutions.

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[26] For different methods, see J. Haskell Murray, 'Choose Your Own Master: Social Enterprise, Certifications and Benefit Corporation Statutes', 2 *American University Business Law Review* (2012) p. 1, also available at SSRN: <http://ssrn.com/abstract=2085000>.

[27] See, e.g., C. Jensen and W.H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure', 3 *Journal of Financial Economics* (1976) p. 3; and Joseph A. McCahery and Erik P.M. Vermeulen, 'Conflict Resolution and the Role of Courts: An Empirical Study', in Mette Neville and Karsten Engsig Sørensen, eds., *Company Law and SMEs* (Copenhagen, Thomson 2009) p. 212.

When we make recommendations, however, we are probably more inclined to look for solutions that are likely to work in a European context.

### 3.1 **A new corporate form for social enterprises**

Several countries have introduced a special corporate form for social enterprises. In the US, the new 'benefit corporation' form has been introduced. It was first launched in 2010 and by March 2013 it had been adopted in 28 US states. The United Kingdom has also introduced a special form of social enterprise, i.e., the Community Interest Company (CIC). However, there are major differences between the two types of company, as discussed below.

#### 3.1.1 *The benefit corporation*

The benefit corporation is a new type of corporation designed for 'for profit' undertakings that also wish to take account of social and environmental considerations.[28] So far, about 300 benefit corporations have been set up. The introduction of the benefit corporation was originally initiated by a private corporation, B Lab, which issues certifications, as explained below. The background was that in some states there was uncertainty about the scope for an undertaking's management to take account of social purposes.[29]

Benefit corporations differ from traditional corporations in particular as regards their purposes, their transparency, and the regulation of management accountability. The purpose must be to 'create general public benefit', which is defined as having 'a material positive impact on society and the environment'. A corporation can also have 'special public interest purposes' (see section 4.2). There is no obligation to reinvest profits, nor are there limits to the distribution of profits, as the legal requirement for creating a 'general public benefit' can be met through the operation of the undertaking, by having regard for its employees and for the environment,

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[28] See Justin Blount and Kwabena Offei-Danso, 'The Benefit Corporation: A Questionable Solution to a Non-Existent Problem', 44 *St. Mary's Law Journal* (2013) p. 617; and Dana Brakman Reiser, 'Benefit Corporations – A Sustainable Form of Organization?', 46 *Wake Forest Law Review* (2011) p. 591.

[29] Interview with William H. Clark Jr, of the DrinkerBiddle law firm, who has drafted the legislation of a number of states regarding benefit corporations. See William H. Clark Jr and Elizabeth K. Babson, 'How Benefit Corporations Are Redefining the Purpose of Business Corporations', 38 *William Mitchell Law Review* (2012) p. 815; and William H. Clark Jr and Larry Vranka (principal authors), 'The Need and Rationale for Benefit Corporations: Why It Is the Legal Form That Best Addresses the Needs of Social Entrepreneurs, Investors, and, Ultimately, the Public' (2013), White Paper, available at: <http://benefitcorp.net/storage/documents/Benecit_Corporation_White_Paper_1_18_2013.pdf>.

etc.[30] In addition to the special provisions on the corporation's purposes and management's duties and reporting obligations, the general rules of company law apply.

### 3.1.2 *The Community Interest Company (CIC)*

In 2005, the CIC was introduced in the United Kingdom. Companies limited by guarantee and companies limited by shares can be re-registered as CICs.[31] This innovation must be considered a success, since by early 2013 more than 8,000 CICs had been registered. In order to be registered as a CIC, an undertaking must state how it will benefit society (the community interest) (see section 4.2).

If a company is limited by guarantee, it has no owners and its profits must either be reinvested in the company or be used for social purposes. A CIC that is a company limited by shares has a dual purpose, i.e., to create a profit for the shareholders as well as to pursue social purposes. However, the company will be subject to restrictions regarding the payment of dividends, and rules on asset locking have been introduced to bind capital investments (see section 5.2).

CICs are regulated by the CIC Regulator, which is an office under the Registrar of Companies. The Regulator's duties are to screen companies that seek registration as CICs and to monitor the activities of CICs.

### 3.1.3 *New corporate form – the way forward?*

There are both advantages and disadvantages to the introduction of a new corporate form. It means that social entrepreneurs have to choose the new corporate form if they want to obtain the designation 'social enterprise', and that existing companies have to reincorporate as a social enterprise if they want to make use of the designation. This is doubtless a major decision associated with significant costs.

A new corporate form can be introduced in several ways: either as an entirely new form, unconnected with existing company law, or as a new category (or variety) of the existing corporate forms, regulated by the prevailing rules for ordinary corporate forms apart from a few special rules.

If it is decided to launch a new corporate form, a company will not only have to arrange its purposes, dividend payments, and restrictions on the transfer of assets in accordance with the new legislation, but must also comply with a whole new general set of company rules, which will be very costly. Existing companies will also incur 'switching costs', due to which they might choose not to reincorporate as a

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[30] Clark Jr and Babson, *supra* n. 29, at p. 842; Clark Jr and Vranka (principal authors), *supra* n. 29.

[31] The primary legislation containing detailed rules on the CIC is the Community Interest Company Regulations 2005. For a full account of the regulatory framework as well as the guidelines prepared on CICs, see: <http://www.bis.gov.uk/cicregulator>.

social enterprise.[32] There will also be a number of 'network externalities'[33] associated with existing corporate forms that will not be linked to the new corporate form, including 'network benefits' and 'learning benefits'.[34] Network externalities, for example, in the form of established case law interpreting the legislation and paradigms, reduce the legal costs of using a corporate form. The same applies to advisers' prior experience with the corporate form, existing legal scholarship, collections of precedents, etc. These typically do not exist when an entirely new corporate form is launched. This too can be a barrier to adopting a new corporate form.

Finally, the status quo bias effect can be an obstacle to adopting a new corporate form.[35] Tests have shown that people tend to stick to the status quo, even if there are better alternatives.[36]

Some of the disadvantages referred to can be minimised by introducing a new category of known existing corporate forms, rather than launching an entirely new form. This approach has been used for both US benefit corporations and UK CICs, as special rules relating to the undertaking's character as a social enterprise have been adopted for them, while otherwise these corporate forms are subject to the ordinary rules of company law. If this option is chosen, the many undertakings that already use an existing corporate form can be re-registered without incurring great costs, and new undertakings can benefit from the network and learning benefits associated with the use of known corporate forms.

There are of course also benefits to the introduction of a new corporate form for social enterprises. For example, in the case of a new corporate form it is easier to adopt special conditions for the corporate purposes, use of profits, and restrictions

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[32] Marcel Kahan and Michael Klausner, 'Standardization and Innovation in Corporate Contracting (or, "The Economics of Boilerplate")', 83 *Virginia Law Review* (1997) p. 713.

[33] In economic theory, the term 'network externalities' usually refers to the situation where a product's value depends on how many other people use it.

[34] The terms 'network benefits' and 'learning benefits' are closely related. Network benefits are the advantages that a user of a product (e.g., a contractual clause) obtains when others use the same product. Learning benefits are the advantages obtained by a user of a contractual clause that has previously been used by others. On network benefits, see Michael Klausner, 'Corporations, Corporate Law, and Network Contracts', 81 *Virginia Law Review* (1995) p. 757; Larry E. Ribstein, 'Statutory Forms for Closely Held Firms: Theories and Evidence from LLCs', 73 *Washington University Law Quarterly* (1995) p. 369; and Larry E. Ribstein and Bruce H. Kobayashi, 'Choice of Form and Network Externalities', 43 *William & Mary Law Review* (2001-2002) p. 79.

[35] Russell B. Korobkin, 'The Status Quo Bias and Contract Default Rules', 83 *Cornell Law Review* (1998) p. 608; and Russell B. Korobkin, 'Inertia and Preference in Contract Negotiations: The Psychological Power of Default Rules and Form Terms', 51 *Vanderbilt Law Review* (1998) p. 1583.

[36] A number of tests have shown that if people are presented with a choice between several options, they tend to stick with the status quo. This creates a potential 'lock-in' effect; see William Samuelson and Richard Zeckhauser, 'Status Quo Bias in Decision Making', 1 *Journal of Risk & Uncertainty* (1988) p. 7; and Daniel Kahneman, Jack Knetsch and Richard Thaler, 'Experimental Tests of the Endowment Effect and the Coase Theorem', 98 *Journal of Political Economy* (1990) p. 1325.

on the transfer of assets, and with a new corporate form it is possible to establish a firm brand for social enterprises.[37]

However, sanctioning failure to comply with the special provisions can be difficult if a new corporate form is regulatorily separate from the existing forms. For example, cancelling the registration of a company as a social enterprise would require its conversion into a wholly different corporate form. If, instead, a social enterprise is based on existing company law (for example, a public or private company limited by shares), the imposition of a sanction will be less drastic as the company will be able to re-register as an ordinary public or private company.

### 3.2 **Certification schemes**

Another method whereby a company can obtain the desired designation of social enterprise is through a certification scheme managed by either a public or a private undertaking.[38] There are a number of certification schemes,[39] but here we focus on two, one public and one private.

#### 3.2.1 *The Danish scheme for registered social enterprises*

In September 2013, a working group appointed by the Danish government published its proposal for a certification scheme for social enterprises. In February 2014, the Danish Government proposed a draft law to the Danish Parliament.[40] This proposal is expected to be adopted as law in the spring of 2014.

Under this proposal, all undertakings that are carried on in the form of a company will be able to be certified and bear the designation *Registreret Socialøkonomisk Virksomhed* (RSV - Registered Social Enterprise). However, registration requires fulfilment of a number of conditions, and, in particular, the undertaking must have a social purpose beyond the important element of operating a business (see section 4.2). All undertakings that are registered as RSVs will be subject to a number of special requirements for their management as well as to restrictions on the distribution of their profits (see section 5). If an undertaking does not comply

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[37] See on the benefits of introducing a new company form, Joseph A. McCahery, Erik Vermeulen, Masato Hisatake and Jun Saito, 'The New Company Law: What Matters in an Innovative Economy', in Joseph A. McCahery, Levinus Timmerman and Erik P.M. Vermeulen, eds., *Private Company Law Reform – International and European Perspectives* (T.M.C. Asser Press 2010) pp. 71-119. On the importance of credibility, Judith Freedmann's research in 1994 showed that the credibility and prestige of using the corporate form was a significant reason for the choice of form. Judith Freedman, 'Small Businesses and the Corporate Form: Burden or Privilege?', 57 *Modern Law Review* (1994) p. 555.

[38] See Haskell Murray, *supra* n. 26.

[39] E.g., the US Green Seal Business Certification and the Sustainable Farm Certification.

[40] See *supra* n. 2.

with the requirements of the law, the Danish Business Authority will be able to remove it from the register (see § 2(3) of the draft law).

### 3.2.2 *B Lab's 'Certified B Corporation'*

In the US, a number of private organisations issue various 'social certificates'. One of these is the not-for-profit organisation B Lab, and companies that have obtained its certification can designate themselves as 'Certified B Corporations'.[41] The aim is to help social enterprises pursue the dual purpose of making a profit and serving public purposes (in a broad sense) under the existing legislation. Because of restrictions under US law, B Lab recommends that undertakings should register in states that have introduced 'constituency statutes' (see section 3.2.3). B Lab also advises undertakings on how best to amend their articles of association in order to be able to pursue social purposes.

In order to obtain certification as a 'Certified B Corporation', an undertaking is subjected to an impact assessment, examining the undertaking as a whole, i.e., its management, suppliers, employees, social and environmental impact, to judge whether it fulfils B Lab's requirements for certification. This involves a visit to the undertaking and completion of a questionnaire dealing with four main areas:[42]

1. Governance: standards for the corporate mission, the board and transparency;
2. Community: conditions of employment,[43] supply chain relations, and social service;
3. The environment: the undertaking's standards in relation to the environment;[44]
4. Beneficial business models: standards for how the undertaking can contribute to society and to environmental protection.

Undertakings are rated on a scale from 0 to 200 and must score at least 80 points in order to be certified. The certification requirements are laid down by two independ-

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[41] The scheme started in 2007 and by October 2012 there were about 700 Certified B Corporations with a collective turnover of USD 4 billion. See Steven Munch, 'Improving the Benefit Corporation: How Traditional Governance Mechanisms Can Enhance the Innovative New Business Form', 7 *Northwestern Journal of Law & Social Policy* (2012) p. 170, at p. 183.

[42] It also includes a questionnaire with a long list of topics, such as weapons trading, animal testing, child labour, etc.

[43] Points are given for, e.g.: payment of bonuses to non-management employees over the previous year; cover for at least some of the health insurance premiums for part-time and flex-time employees; whether more than 5% of the company is owned by non-executive employees, etc.

[44] Points are given for, e.g.: active recycling of at least one output material; working with at least one facility that meets green building standards; using printed materials that have more than 75% recycled paper content, FSC-certified paper or soy-based inks; reducing energy usage in proportion to revenues; generating renewable energy on site; receiving more than 25% of the revenue from products that have gone through a life-cycle assessment in the last three years; more than 25% of the transport or outsourced fleet being clean or low-emission vehicles.

ent Standards Advisory Councils.[45] Corporations must also change their articles of association to make clear that they will consider the interests of other stakeholders in their decision making. There is no requirement for part of the profits to be reinvested in the undertaking, nor are there asset lock rules or restrictions on the distribution of dividends. What matters only is that the undertaking should act responsibly in the areas mentioned.

### 3.2.3 *Does companies legislation need amending in order to introduce certification schemes?*

A condition for the operation of a certification scheme is that companies can adapt the articles of association so as to comply with the requirement regarding the company's purpose and the special duties that the certification scheme may impose on the management. In particular, with traditional corporate forms the question arises whether it is possible to decide that the company's purpose – and thus the management's task – is no longer primarily to generate a profit but to pursue other goals, and that there may also be restrictions on how much can be distributed to the shareholders.

Whether corporations can be organised so that their primary aim is to serve purposes other than generating profit has been the subject of much debate in the US, and to some extent also in the UK. The background to this is the strong common law tradition whereby a company's management can only have regard for 'shareholder wealth maximisation'. This was expressed in *Dodge* v. *Ford Motor Co* in 1919.[46] It has since been more[47] or less[48] generally accepted that 'shareholder

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[45] On B Lab, see: <http://www.csrwire.com/blog/posts/496-becoming-a-b-what-is-the-difference-between-a-b-corporation-and-a-benefit-corporation#sthash.qXoR5rAM.dpuf>.

[46] 170 N.W. 668 (Mich. 1919).

[47] See Edward B. Rock, 'Corporate Law Through an Antitrust Lens', 92 *Columbia Law Review* (1992) p. 497, at p. 546; Aaron A. Dhir, 'Realigning the Corporate Building Blocks: Shareholder Proposals As a Vehicle for Achieving Corporate Social and Human Rights Accountability', 43 *American Business Law Journal* (2006) p. 365, at pp. 369-70; Stephen M. Bainbridge, 'In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green', 50 *Washington & Lee Law Review* (1993) p. 1423; and Henry Hansmann and Reinier Kraakman, 'The End of History of Corporate Law', 89 *Georgetown Law Journal* (2001) p. 439. For English law, see Jingchen Zhao, 'Promoting More Socially Responsible Corporations Through UK Company Law After the 2008 Financial Crisis: The Turning of the Crisis Compass', 22 *International Company and Commercial Law Review* (2011) p. 275.

[48] Some legal writers have accepted that there is nothing to prevent US corporations from having the dual purpose of making profits and serving social purposes, at least as long as the shareholders agree; see the American Law Institute, *Principles on Corporate Governance*, § 2.01 Reporter's Note 6 (1994), which states: '[T]here is little doubt that (restrictions on the general profit-making objective) would normally be permissible if agreed to by all the shareholders. Such an agreement might be embodied in the certificate of incorporation, or not.' See also Dana Brakman Reiser, 'Theorizing Forms for Social Enterprise', Brooklyn Law School Legal Studies, Research Paper No. 310 (2012) p. 5, available at SSRN: <http://ssrn.com/abstract=2166449>.

wealth maximisation' is the primary goal of companies: see *eBay Domestic Holdings, Inc*. v. *Newmark*,[49] where the Delaware Chancery Court ruled that a non-financial goal which 'seeks not to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders' was contrary to the directors' fiduciary duties. However, company directors enjoy a high level of protection from liability under the business judgement rule,[50] although as regards takeovers management has much less margin for discretion: see the decision of the Delaware Supreme Court in *Revlon, Inc.* v. *MacAndrews & Forbes Holdings, Inc.*,[51] where the Court stated that the board's only duty was to maximise shareholder value.[52]

This legal position, whereby it was not possible to organise a company such that the pursuit of social purposes was placed on the same level as, or even above, the pursuit of profit, meant that US corporations were not always able to obtain certification under the private certification schemes mentioned above. A number of states therefore decided to introduce 'constituency statutes' which permit company managements to have regard for the interests of stakeholders other than the shareholders in their business decisions.[53]

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Likewise, closely held corporations can of course pursue social purposes where there is agreement between owners and management.

[49] C.A. No. 3705-CC (Del. Ch. Sept. 9, 2010).

[50] See Bainbridge, *supra* n. 47; and Antony Page and Robert A. Katz, 'Freezing Out Ben & Jerry: Corporate Law and the Sale of a Social Enterprise Icon', 35 *Vermont Law Review* (2010) p. 211.

[51] 506 A.2d 173 (Del. 1986). The case concerned Pantry Pride's hostile takeover bid for Revlon. Besides Pantry Pride, the Forstmann company also bid for Revlon. The Revlon board had decided to sell the company, which only left the question of to whom and at what price. The board chose to accept the lower bid from Forstmann, because, among other things, it was believed that Forstmann would offer better protection to some 'note holders' (persons, banks or organisations that have lent money, e.g., in the form of mortgages or bonds). The Court ruled that the board was in breach of its duty to Revlon's shareholders by not having sold to the highest bidder. Among other things, the Court stated: 'A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders. However, such concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder.'

[52] The introduction of constituency statutes seems originally to have been a reaction to the *Revlon* case; see Charles Hansen, 'Other Constituency Statutes: A Search for Perspective', 46 *Business Lawyer* (1991) p. 1355, at pp. 1361-1369; Stephen M. Bainbridge, 'Interpreting Non-shareholder Constituency Statutes', 19 *Pepperdine Law Review* (1992) p. 971, at pp. 973-974, who states on p. 973: 'In the wake of the 1980s' merger mania, the corporate social responsibility debate resurfaced [as constituency statutes].'; and Deposito, *supra* n. 4.

[53] A large number of US states have introduced such legislation, including: Massachusetts, Minnesota, Missouri, Nebraska, Nevada, New Jersey, New Mexico, New York, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, Vermont, Virginia and Wisconsin. On constituency statutes, see John Tyler, 'Negating the Legal Problem of "Having Two Masters": A Framework for L3C Fiduciary Duties and Accountability', 35 *Vermont Law Review* (2010) p. 117; and Eric W. Orts, 'Beyond Shareholders: Interpreting Corporate Constituency Statutes', 61 *George Washington Law Review* (1992) p. 14.

However, there is no obligation to consider the interests of stakeholders,[54] nor to make public any social measures taken.

As mentioned above, 'shareholder wealth maximisation' also has a strong rooting in the UK, even though also in the UK it has been assumed by some legal writers that a company's management can take account of other stakeholder interests in its decision making. In the UK, in the framework of the major reform of the Companies Act 2006, direct authority was introduced for a company's management to take account of other considerations (see Section 172 on directors' duties). Under Section 172 of the Companies Act, creating shareholder value is still the primary task of management, but it now also has a duty to have regard to various stakeholder interests in connection with the company's long-term interests. In Section 172, stakeholders are categorised as internal stakeholders, such as employees, and external stakeholders, such as creditors, customers and suppliers, as well as the environment, the local neighbourhood, etc. This reform has been referred to as the 'enlightened shareholder' theory and it seems to allow companies to deviate from the pure pursuit of shareholder value.[55] In UK legal theory it has been discussed whether the new wording of Section 172 actually changes the state of the law, as some writers assume that also before the 2006 amendment management could include stakeholder interests in its decision making.[56]

Since 2009, the reformed Danish Companies Act has left no doubt that shareholders may decide that part of the profits may be used for purposes other than the payment of dividends to the shareholders. This means that, as long as they agree, the shareholders may decide to change an undertaking from a 'for profit' into a 'not for profit' undertaking. There is disagreement among legal writers as to whether the management of an ordinary company may, on its own initiative, decide to safeguard stakeholder interests and thus deviate from maximising shareholder value.[57] How-

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[54] However, some states, such as Arizona, Connecticut and Idaho, have introduced such an obligation; see Gary von Stange, 'Corporate Social Responsibility Through Constituency Statutes: Legend or Lie?', 11 *Hofstra Labor & Employment Law Journal* (1994) p. 461.

[55] See Zhao, *supra* n. 47. For a more critical view as to whether there is such a development in the US and the UK, see Andrew Keay, 'Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value, and All That: Much Ado About Little?', available at SSRN: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1530990> (since 4 January 2010).

[56] See Elaine Lynch, 'Section 172: A Ground-Breaking Reform of Director's Duties, or the Emperor's New Clothes?', 33 *Company Lawyer* (2012) p. 196.

[57] Some legal writers see the company's interests as being divided between a combination of shareholder and stakeholder interests: see Erik Werlauff, *Selskabsmasken* (Copenhagen, DJOEF Publishing 1992), at p. 589. Other legal writers consider that the company's interests are the same as the shareholders': see Søren Friis-Hansen and Jens Valdemar Krenchel, *Dansk Selskabsret – Kapitalselskaber* (Copenhagen, Karnov Group 2011), at pp. 50-52. Paul Krüger Andersen, *Aktie- og anpartsselskabsret – Kapitalselskaber* (Copenhagen, DJOEF Publishing 2013), at p. 69 et seq., and Jan Schans Christensen, *Kapitalselskaber – Aktie- og anpartsselskabsret* (Copenhagen, Thomson 2009), at pp. 249-50, argue that shareholders' interests must take priority, and that other stakeholders' interests are best provided for under other legislation. For further details, see Karin

ever, there is little doubt that if the shareholders amend the statement of the company's purposes in the articles of association, thus enabling the company to pursue social purposes, the management will be required to take account of these purposes.[58]

However, the proposed Danish certification scheme (as described above) will cover not only companies governed by the Danish Companies Act, but also other types of firms. It is not clear whether other types can register social purposes that benefit stakeholders other than their owners, and this seems especially problematic for cooperatives and limited liability partnerships (*kommanditselskaber*). It will presumably be necessary to introduce direct authority for these kinds of companies so as to allow them to include a purpose in their constitution that qualifies them to be certified under the new scheme.[59]

It thus appears that companies legislation should be amended to enable some types of companies to be certified as a social enterprise. The need for this will depend on an analysis of the companies legislation of each jurisdiction.

### 3.2.4 *Certification schemes – the way forward?*

Certification schemes have some clear advantages. They can be used by all corporate forms, provided the companies legislation allows the pursuit of social purposes. Certification does not require reincorporation as a new form of company (which can entail significant costs). Also, the rules that apply to the corporate form used by the enterprise will continue to apply, and thus most learning and network benefits associated with that form of company will be retained (see above). Moreover, as with new corporate forms, certification schemes make it possible to lay down clear conditions as to the company's purposes, how the profits can be used, etc. If certification is administered by a public authority, with power to supervise and to apply sanctions, 'greenwashing' (where green PR or green marketing is deceptively used to promote the perception that an organisation's products, aims and/or policies are environmentally friendly) can, to a large extent, be avoided.[60] Imposing sanctions can be simpler with a certification scheme than with a new corporate form, as it is

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Buhmann, Kim Østergaard, Rasmus Kristian Feldthusen, et al., 'Mapping of Danish Law Related to Companies' Impact on Environment and Climate Change', Nordic & European Company Law Working Paper No. 10-36 (2013), available at SSRN: <http://ssrn.com/abstract=2257750>.

[58] See Mette Neville, 'The Many Roles of Boards in SMEs', in Hanne Birkmose, Mette Neville and Karsten Engsig Sørensen, eds., *Boards of Directors in European Companies; Reshaping and Harmonising Their Organisation and Duties* (Alphen aan den Rijn, Kluwer Law International 2013) pp. 179-217; and Buhmann, Østergaard, Feldthusen, et al., *supra* n. 57.

[59] See Mette Neville and Karsten Engsig Sørensen, 'Socialøkonomiske virksomheder: ny virksomhedsform for de hellige eller 'greenwashers' paradise'?', *Nordisk Tidsskrift for Selskabsret* (2013) p. 121.

[60] The same can be achieved in principle if a scheme is administered by a private undertaking.

easy to revoke certification, while a similar sanction applied to a new corporate form requires the company to be converted or, in the worst case, be compulsorily wound up.

## 4. How to become a social enterprise

Regardless of whether it is decided to introduce a new corporate form or a certification scheme, there must be some regulation governing the statement of social purposes with which an undertaking must comply in order to be registered as a social enterprise. It should also be decided how a company may become a social enterprise.

### 4.1 Registration as a social enterprise

An undertaking can either be registered as a social enterprise from the start, or an existing undertaking can be changed to be become a social enterprise.[61] If it is decided to introduce a new corporate form for social enterprises, the approaches will differ. For a certification scheme there will, in principle, be no difference in how new and existing undertakings obtain certification.

A key issue is which corporate forms should be able to become social enterprises. If the aim is to spread social enterprises as widely as possible, then as many different corporate forms as possible should be given the opportunity to become a social enterprise. The US, the UK and Denmark differ as to openness of access where it concerns becoming a social enterprise.

The most restrictive approach is found in the jurisdictions where a separate corporate form has been introduced for social enterprises. There, only a limited number of corporate forms can reincorporate as the new corporate form. This is the case in the US, where a benefit corporation can be formed by converting an ordinary corporation or an LLC.[62] Under the UK CIC arrangement, the right to become a CIC is a little less restrictive, and companies limited by shares, companies limited by guarantees and charitable trusts can convert into CICs.[63]

In principle, certification schemes can be open to all kinds of companies. The Danish proposal for a certification scheme has chosen the approach whereby all legal

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61 Newly established companies can of course seek certification.

62 See William H. Clark Jr, 'How to Switch to Being a Benefit Corporation' (2012), available at: <http://www.drinkerbiddle.com>.

63 Office of the Regulator of Community Interest Companies: Information and Guidance Notes, Chapter 4: 'Creating a Community Interest Company' (CIC) (April 2013). These notes are available at: <http://www.bis.gov.uk/cicregulator/guidance>. The guidelines refer to the possibility of Industrial and Provident Societies being reincorporated as CICs, but this would first require incorporation as a limited company.

persons that fulfil certain basic requirements with regard to their purposes, independence from public authorities and registration as a business entity can be certified.[64]

### 4.1.1 *Minority protection*

If an existing undertaking that is carried on as a company is to be reconstructed or registered as a social enterprise, there is the question of whether special minority protection should be provided in that case, since the profits which the owners could obtain if the company were operated 'for profit' may be less when the undertaking becomes a social enterprise. This will affect the fundamental rights of the owners. The question of minority protection has been tackled in different ways under different schemes.

The Model Legislation for benefit corporations stipulates that the transformation into a benefit corporation requires a two-thirds majority.[65] The UK CIC can be operated in various corporate forms, so that transformation into a CIC will not involve a conversion but will merely be a decision that is taken in compliance with the special rules governing CICs. This requires a 75% majority of the shareholders. Minority shareholders who oppose the change can refer the matter to the courts within 28 days, with a view to blocking the decision.[66]

The Danish proposal for a certification scheme does not regulate how the company decides to be registered as an RSV. This will therefore depend on the rules that apply to the corporate form in question. In the case of companies limited by shares (whether public or private), registration as a social enterprise will imply that the shareholders will surrender part of the company's profits (see section 5.2). For companies governed by the Danish Companies Act the decision will have to be taken by a 9/10 majority.[67] For other kinds of companies, e.g., a partnership, such a decision will require unanimity.

Thus, it is clear that restructuring or certification as a social enterprise will require a wide measure of support from the owners. The Danish requirements are so high that, in practice, obtaining the necessary majority in companies with large and dispersed ownership may be difficult.

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[64] § 4(2) of the draft law, *supra* n. 2. The draft law does not allow registration of single person enterprises or joint ownership (*sameje*) because such undertakings do not make a clear distinction between the assets of the undertaking and those of the owners.

[65] Model Benefit Corporation Legislation, Section 103. It seems strange that there are no inbuilt guarantees for shareholders who vote against reincorporation; see Callison, *supra* n. 16, at p. 93. According to the Model Benefit Corporation Legislation, Section 104, a benefit corporation can be formed through a merger.

[66] Office of the Regulator of Community Interest Companies: Information and Guidance Notes, Chapter 4: 'Creating a Community Interest Company' (CIC) (April 2013), section 4.2.2.

[67] Danish Companies Act, § 107(2)(1). Shareholders who oppose the decision have the right to have their shares redeemed.

### 4.2 Statement of purposes, and control thereof

The special characteristic of a social enterprise is that, in addition to providing, to a certain extent, for the interests of the owners in obtaining a share of the profits, it also pursues social purposes. This raises the question of the requirements regarding the statement of purposes to be met by a company that aims to be designated as a social enterprise.

There are differences between the various schemes in how they formulate the requirements for the statement of purposes. The most liberal requirements can be found in the US. Benefit corporations must state that they pursue a 'general public benefit', which is a very wide concept; the Model Legislation describes it as 'a material positive impact on society and the environment, taken as a whole'.[68] However, the purpose must be defined in accordance with a recognised third-party standard for defining, reporting and assessing the corporation's social and environmental performance. The Model Legislation also stipulates who can draw up such third-party standards, but it is up to the corporation's owners to decide which approved standards they will follow.[69] This means that there is no common norm to which all corporations must adhere, and this can make supervision and sanctioning more difficult. Also, the authorities do not control whether a corporation fulfils its statement of purposes, apart from checking that there is a reference to a third-party standard.[70]

In the UK, in order to be registered as a CIC, an undertaking must fulfil the requirements of the law governing the statement of purposes; if these are not met, registration will be refused.[71] The statement of purposes must satisfy a 'community interest test', requiring that 'a reasonable person might consider that its activities

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[68] Model Benefit Corporation Legislation, Section 201. According to this provision, a benefit corporation can also have one or more 'specific public benefits' as its aims. According to Section 102, these include the following: (1) providing low-income or underserved individuals or communities with beneficial products or services; (2) promoting economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business; (3) protecting or restoring the environment; (4) improving human health; (5) promoting the arts, sciences or advancement of knowledge; (6) increasing the flow of capital to entities with a purpose to benefit society or the environment; and (7) conferring any other particular benefit on society or the environment.

[69] For a more detailed review of these standards, see Clark Jr and Babson, *supra* n. 29, at p. 842. Legal writers have argued that the fact that corporations are obliged to formulate a more general social purpose may be a restriction for some corporations. If a corporation has a very specific purpose, such as supporting the local environment, it may be difficult to establish a suitable general standard; see Callison, *supra* n. 16, at p. 98. However, the authors have been unable to confirm that this really is a problem, as the regulation of benefit corporations seems to allow the serving of a narrow purpose which is covered by the general public benefit adopted by the corporation.

[70] This has also been criticised by Brakman Reiser, *supra* n. 28, at p. 611.

[71] See the Community Interest Company Annual Report 2009-10, at p. 7, stating that in the period under review 1,572 applications were received, but only 1,298 were accepted. The report is available at: <http://bis.ecgroup.net/Publications/CommunityInterestCompaniesRegulator/AnnualReports>.

are being carried on for the benefit of the community'.[72] The content of this test has been defined by the British authorities in a set of guidelines. According to these guidelines, the pursuit of political aims, including support for specific political campaigns, does not satisfy the requirements.[73] It is also established that a purpose which provides for members of a specific organisation or employees of a specific employer does not meet the requirements of the law either. This does not mean that advantages cannot be granted to shareholders (dividends) or employees of the company (salaries, etc.), but a company cannot have this as its sole purpose. Still, it is possible to favour specific social groups, provided they are 'genuine' sectors of society and not, for instance, just members of the owner's family. For example, the residents of a particular town may be favoured, the establishment of a museum may be supported, contributions to research may be made, etc.[74]

Under the requirement for certification in the Danish proposal, a company must have a social purpose.[75] The text of the draft law does not further define the requirements for the purpose, but some clarification can be found in the preparatory documents for the draft law. First, it is stated that 'social purpose' should be understood as meaning that the undertaking has social, employment, health, environmental or cultural aims. This is a very broad definition. The comments in the preparatory documents also indicate that a company could be working either *for* a specific target group or cause, or *with* a specific target group/cause. The first would be the case if an enterprise worked to improve the conditions for a group (for instance, drug abusers) or cause (the environment) by, e.g., making products that benefit drug abusers or the environment, by running the business in a special way, or by using part of the profit for the benefit of the target group/cause. To work *with* a group or cause could, e.g., involve employing or educating persons with a specific disability.

While the US approach has a certain inbuilt flexibility, the UK requirements have a common standard which must be met. The latter require greater supervision by the authorities to ensure that the statements of purposes comply with the demands of the law. Since some forms of social purposes are not accepted, a common

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[72] Companies (Audit, Investigations and Community Enterprise) Act 2004, Section 35.

[73] Office of the Regulator of Community Interest Companies: Information and Guidance Notes, Chapter 4: 'Creating a Community Interest Company' (CIC) (April 2013), section 4.6.

[74] Office of the Regulator of Community Interest Companies: Information and Guidance Notes, Chapter 2: 'Preliminary Considerations' (November 2012), section 2.3.

[75] Beyond this there are a number of other requirements for certification, see § 5. First, the company must be commercially operated. This does not mean that the majority of the undertaking's income must derive from commercial activities, but it is required that the commercial activities should be a significant element. Next, the company must be independent of public authorities. The purpose of this requirement is that the designation of 'social enterprise' must be reserved for undertakings that are mostly private. Thus, if a public authority owns a majority of the voting rights in a company, or otherwise has a decisive influence, it cannot be registered. Finally, the draft law stipulates that it is a condition for registration that the undertaking should incorporate social purposes and responsibilities in its activities.

standard can have the disadvantage of excluding certain undertakings from being social enterprises. But the advantage is that it ensures that undertakings that are designated social enterprises all have a social purpose that satisfies the same requirement. This is important if social enterprises are to obtain positive recognition, and it prevents ineligible undertakings from trying to present themselves as social enterprises so as to draw on the corresponding benefits vis-à-vis their customers, trading partners, etc.[76] It is not clear whether the Danish solution will prove to be closer to the US or UK solution. The definition of 'social purpose' is very broad and the preparatory documents do not mention any firm minimum standards. On the other hand, the draft law does allow for the authorities to deny registration if the requirements for registration are not fulfilled, and the authorities may therefore formulate stricter standards when implementing the new regime. The term 'social purpose' is clearly open to interpretation.

### 4.3 *Special company designation*

If an undertaking is to be able to brand itself a 'social enterprise', it should have an exclusive right to use the designation that reflects this brand. Thus, each of the three schemes discussed here provides for a special designation the use of which is exclusively restricted to social enterprises. However, the rules for using the special designation vary slightly from country to country.

According to the Danish proposal for a certification scheme, certified undertakings will have the exclusive right to use the designation *Registreret Socialøkonomisk Virksomhed* (RSV - Registered Social Enterprise).[77] The very first paragraph of the draft law explains that the purpose of the registration scheme is to form the basis for a joint identity. The law ensures that those registered comply with some minimum standard and this can be communicated to the relevant trading partners by the sole right to use the RSV designation. Thus, it is clear that this right is central to the whole scheme. The Working Group which made the initial proposal suggested that, in the longer term, consideration could be given to introducing a new certification mark or logo for social enterprises to indicate more clearly (than the use of RSV) what kind of undertaking they are.[78] This idea is probably inspired by B Lab, which has introduced a certification mark for undertakings certified by it.

In those jurisdictions where it has been decided to introduce a new corporate form, companies using that form naturally have the exclusive right to use the designation for that kind of company. In the UK, this exclusive right is also an obligation

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[76] Many American writers question whether the benefit corporation will obtain strong branding, given the model chosen. Several point out that the UK solution seems better; see Callison, *supra* n. 16, at p. 109; Kelley, *supra* n. 8, at p. 361; and Brakman Reiser, *supra* n. 28, at p. 622.

[77] See § 3 of the draft law, *supra* n. 2.

[78] See the Report of the Working Group, *supra* n. 2, at p. 26.

to use the designation.[79] However, this is not the case with the benefit corporation in the US, where the articles of association must state that the company in question is a benefit corporation but there is no obligation to use the designation as part of the name of the company.[80]

## 5. Special requirements for the operation of social enterprises

The introduction of a special framework for social enterprises raises the question of whether there should be special rules for the management of such undertakings to ensure their dedication to the company's social purpose, and whether there should be special restrictions on the use of its profits. Especially the use of profits is a key issue since both the UK and the Danish system require that a large part of the profit be used for social purposes. To this end, a wide range of issues need to be regulated, including the distribution of profits, hidden distributions and, finally, distribution in the event of a wind-up. Finally, the question of how social enterprises should report on their activities should probably be addressed. These topics are discussed in the following sections.

### 5.1 **The duties and organisation of management**

#### 5.1.1 *The formulation of management duties*

As mentioned above, it is generally accepted that it is the duty of a company's management to serve the interests of the shareholders and to create profit. The scope for a company's management to pursue social purposes in parallel with the pursuit of profit has been debated in a number of countries (see section 3.2.3).

Whether it is necessary to introduce special rules on the duties of the management of social enterprises depends on how clearly the social purposes to be pursued have been defined. If these have been clearly defined, it will hardly be necessary to reformulate the management's general duties, as they will be derived from the statement of purposes. However, without special provisions on the company's purposes, provisions on the management's duties will need to be formulated in order to create clear authority so that the management can and must pursue both profits and social considerations.

Section 301(a) of the Model Legislation for the US benefit corporation contains a very long list of stakeholder considerations which the management must take into

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[79] According to the Companies (Audit, Investigations and Community Enterprise) Act 2004, Section 33, a company that is *not* a 'public limited company' must call itself a 'community interest company' or 'c.i.c.', while a company that *is* a 'public limited company' must call itself a 'community interest public limited company' or 'community interest p.l.c.'.

[80] Section 103 of the Model Benefit Corporation Legislation.

account in its decision making.[81] Section 301(b) states that taking account of such considerations does not constitute a breach of the applicable corporation law.[82] While there is a very long list of stakeholder interests which the management is required to consider in its decision making, no provision exists on how it should prioritise/balance the different interests in relation to each other, nor is there a requirement for the management to state how it sets its priorities. There is also no requirement for a certain proportion of the profits to be used in the pursuit of social purposes (see section 5.2). The broad right to pursue stakeholder interests and the absence of guidelines on how the undertaking will 'do good' has prompted the criticism that the provision can act as a shield against management's liability if its decisions are not profitable. For example, it has been said that '[p]erversely, while this standard seeks to make stakeholder interests more potent in the board room, it may simply give fiduciaries license to do whatever they want'.[83] The broad formulation of the duty to take account of stakeholder interests and the application of the business judgement rule, which is part of US law, make the management more or less immune from civil suits (see section 5.1.3 below).[84]

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[81] The management: '(1) shall consider the effects of any action or inaction upon: (i) the shareholders of the benefit corporation; (ii) the employees and work force of the benefit corporation, its subsidiaries, and its suppliers; (iii) the interests of customers as beneficiaries of the general public benefit or specific public benefit purposes of the benefit corporation; (iv) community and societal factors, including those of each community in which offices or facilities of the benefit corporation, its subsidiaries, or its suppliers are located; (v) the local and global environment; (vi) the short-term and long-term interests of the benefit corporation, including benefits that may accrue to the benefit corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the benefit corporation; and (vii) the ability of the benefit corporation to accomplish its general public benefit purpose and any specific public benefit purpose; and (2) may consider: (i) the interests referred to in [cite constituencies provision of the business corporation law if it refers to constituencies not listed above]; and (ii) other pertinent factors or the interests of any other group that they deem appropriate; but (3) need not give priority to the interests of a particular person or group referred to in paragraph (1) or (2) over the interests of any other person or group unless the benefit corporation has stated in its articles of incorporation its intention to give priority to certain interests related to its accomplishment of its general public benefit purpose or of a specific public benefit purpose identified in its articles.'

[82] The provision states the following: '(b) The consideration of interests and factors in the manner required by subsection (a) (1) does not constitute a violation of [cite provision of the business corporation law on the duties of directors generally]; and (2) is in addition to the ability of directors to consider interests and factors as provided in [cite constituencies provision of the business corporation law].'

[83] Brakman Reiser, *supra* n. 48, at p. 15; Haskell Murray, *supra* n. 26. On English law, see Lynch, *supra* n. 56.

[84] Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* (Cambridge, Harvard University Press 1991), at p. 38, stating: '[A] manager told to serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither'; Lucien A. Bebchuck, 'Federalism and the Corporation: The Desirable Limits on State Competition Law', 105 *Harvard Law Review* (1992) p. 1435, at p. 1493; and Haskell Murray, *supra* n. 26.

The UK regulations governing CICs do not contain any special provisions on the duties of management, but they do state that the company shall pursue community interests and state how it will achieve this aim (see section 5.1.3). This is an implicit obligation to pursue social purposes.[85] Also, the rules that apply to the management of CICs are the same as those governing the management of other companies covered by the Companies Act.[86] The absence of special guidelines for management should presumably be seen in the context that the UK CIC is subject to rules on asset locks and restrictions on the right to distribute profits.

The proposed Danish certification scheme contains several provisions on the duties of management. First, it emphasises that the highest management body is responsible for the information given on registration as an RSV and for the subsequent annual reporting. Next, there is an obligation to de-register an undertaking which no longer meets the conditions for registration.[87] The effect of these provisions is that management is under the obligation to pursue social purposes. In addition, the highest management body must ensure that the payment of fees does not exceed what is customary according to the nature and extent of work carried out and what may be regarded as reasonable given the undertaking's social purposes (see further on this in section 5.2.2).

None of the three schemes contains very precise guidelines on how management must pursue the social purposes, and this may well not be possible. Stipulating requirements as to the statement of purposes is probably the best way of ensuring that the management pursues those purposes. It is clear that if there are no asset locks, it may be difficult to make sure that management does in fact comply with its duties (see section 5.1.3). However, the introduction of an obligation to disclose various matters (see section 5.3 below) will, to some extent, force management to consider these issues and to formulate a policy in that respect.

### 5.1.2 *The composition of management*

A company's management has the task of managing the company within the framework of the law and the articles of association, including balancing the rights of the shareholders and those of other stakeholders. The management can easily be caught in a dilemma, in which case it is more likely that it will favour the shareholders' interests.[88] It might thus be necessary to make sure that a company's social

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[85] Office of the Regulator of Community Interest Companies: Information and Guidance Notes, Chapter 9: 'Corporate Governance', at p. 4.

[86] Stuart R. Cross, 'The Community Interest Company: More Confusion in the Quest for Limited Liability?', 55 *Northern Ireland Legal Quarterly* (2004) p. 302.

[87] § 7(1) and (2).

[88] Blount and Offei-Danso, *supra* n. 28, express the dilemma by reference to the Bible (Matthew 6:24): 'No man can serve two masters: for either he will hate the one and love the other; or else he will hold the one and despise the other. Ye cannot serve God and mammon.'

purposes are pursued, for example, by requiring stakeholder interests to be represented in the management.

Some US states have introduced a requirement for benefit corporations to appoint a 'benefit director'.[89] The benefit director monitors, on a continuing basis, whether the company complies with its obligation to 'pursue or create public benefit or a specific public benefit', and if it does not, this must be noted in the company's annual report (see section 5.3). However, there is not usually any liability to pay compensation in connection with this obligation.[90]

Direct stakeholder representation in the company's management may also be considered. Such an arrangement is not unknown: for example, many countries, including Denmark, have rules on employee representation on the boards of larger companies.[91] While, at first sight, such a solution seems obvious in relation to social enterprises, it may be difficult to precisely identify the stakeholders concerned. With the introduction of the CIC in the UK, various models accommodating stakeholder interests were considered, including requiring companies to consult their stakeholders annually. However, the latter proposal was abandoned because it could be difficult to identify the relevant stakeholders if the company's purposes are broadly formulated.[92] The problems do not diminish by allowing stakeholders into the boardroom. The more broadly the social purposes are drafted, the more difficult it is to implement stakeholder representation.[93] Also, some entrepreneurs might be deterred from registering as a social enterprise if people who are not elected and

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[89] Benefit directors are mandatory in Hawaii, New Jersey and Vermont; see Brakman Reiser, *supra* n. 28, at p. 604. The Model Legislation for benefit corporations made provision for there to be a mandatory benefit director; see Section 302: 'Benefit director. (a) General rule. – The board of directors of a benefit corporation that is a publicly traded corporation shall, and the board of any other benefit corporation may, include a director, who: (1) shall be designated the benefit director; and (2) shall have, in addition to the powers, duties, rights, and immunities of the other directors of the benefit corporation, the powers, duties, rights, and immunities provided in this [*subchapter*].'

[90] Brakman Reiser, *supra* n. 28, at p. 605.

[91] Under § 120(2) of the Danish Companies Act there is a possibility for others than shareholders to have a right to appoint to the board.

[92] DTI, *Enterprise for Communities: Proposals for a Community Interest Company. Report on the Public Consultation and the Government's Intentions* (October 2003). See also Cross, *supra* n. 86, at p. 312. Instead, it was decided merely to include a provision requiring the management to state in its annual report whether it had consulted its stakeholders in the course of the year, and if so, how (see section 5.3).

[93] This is reflected in international regulations governing social enterprises which typically contain provisions on stakeholder representation on the board. In international regulations of cooperative companies, where the statement of purposes is not so narrowly defined, examples can be found of requirements for stakeholders to be involved in the management. A specific example is Greek Limited Liability Social Cooperatives Law 2716/99, which provides for the socio-economic integration of physically handicapped people. The law provides that membership must be composed of 35% handicapped people, 45% people employed in the sector and 20% private organisations.

who have no financial risk in the company have influence on it.[94] This opposition corresponds largely to the resistance in the UK to employee representation.

### 5.1.3 *Enforcement of management duties*

The dual purpose of social enterprises raises the question of how the management of a social enterprise is to be sanctioned if it does not ensure that the undertaking fulfils its social purposes. The argument can be made that sanctions are necessary in order to prevent dilution of the social enterprise 'brand'.[95] Even though sanctions may be helpful in enforcing the management's duties, it is not easy to devise a model which allows for the enforcement of the duty to consider stakeholders' interests.

#### 5.1.3.1 Shareholders' scope for enforcing management's duties

In companies, shareholders can make their influence felt in varying degrees at the general meeting. Their specific scope for doing so depends on the powers conferred on shareholders in companies' legislation. In some jurisdictions, shareholders have limited power and do not have authority to be involved in management decisions.[96] This is the case with the German *Aktiengesellschaft*. In other jurisdictions, including Denmark, shareholders have the right to involve themselves in most management decisions. Also, shareholders are normally entitled to bring claims for compensation against the management if it acts irresponsibly. The question is whether special provisions are needed to enforce management duties in social enterprises. The US has decided this is necessary, while in the UK and in Denmark the opposite is the case.

In US benefit corporations, shareholders have direct authority to bring proceedings claiming that the management has not pursued its 'general or specific public benefit purposes', or has not had regard for the various interests of stakeholders as listed in the law, or has not fulfilled the requirement for transparency. Special 'benefit enforcement proceedings' have been introduced, under which the management cannot be liable for financial losses. Thus, the courts cannot require manage-

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[94] Legal writers have also rejected this solution; see Brakman Reiser, *supra* 48, at p. 30.

[95] Thus, Section 172 of the UK Companies Act has been criticised, e.g., for not being enforceable in practice; see D. Fisher, 'The Enlightened Shareholder – Leaving Stakeholders in the Dark: Will Section 172(1) of the Companies Act Make Directors Consider the Impact of Their Decisions on Third Parties?', 20 *International Company and Commercial Law Review* (2009) p. 10; and Lynch, *supra* n. 56. The latter concludes that 'a right without a remedy is worthless', and the remedy does not exist as long as the only people who can enforce it are the shareholders.

[96] Brakman Reiser, *supra* n. 48, at p. 24. For a comparison of the authority of general meetings in different European jurisdictions, see Andreas Cahn and David C. Donald, *Comparative Company Law* (CUP 2010), at pp. 476-483; and Adriaan Dorresteijn, Tiago Monteiro, Christoph Teichmann and Erik Werlauff, *European Corporate Law*, 2nd edn. (Alphen aan den Rijn, Kluwer Law International 2009), at pp. 157-202.

ment to pay compensation but can only oblige it to live up to the obligations which the company has voluntarily undertaken. The background to this limitation of liability is the wish to relieve management of the concern that it might be financially liable for its actions on the basis of a very broad statement of purposes, and the consequent uncertainty about where to draw the line for incurring liability.[97]

On this point, the UK CIC is governed by the rules of the Companies Act on shareholders' proceedings against the management. Thus, the UK has not provided for restrictions on management liability. Given that there are very clear rules on what can and cannot be characterised as 'community interest', and seeing that various 'asset locks' are included, management duties are more clearly defined for CICs than for benefit corporations, so it is less questionable that management can incur liability to pay compensation.

Since the Danish proposal for a certification scheme both includes asset locks and restricts the right to distribute profits, there does not appear to be a need to limit management liability in Denmark either, and it is indeed not limited in the Danish draft law.

#### 5.1.3.2 Other stakeholders' scope for enforcing management's duties

When an undertaking's primary purpose is of a social nature, this raises the question of whether the stakeholders whose interests the undertaking has to serve should be able to sue the company if their interests are not upheld in accordance with the company's purposes.

Regarding the US benefit corporation, the Model Legislation provides that the management does not have any fiduciary duties other than to the shareholders, so that other stakeholders do not have a right of action.[98] The rationale behind this rule is that expanded liability would discourage some from choosing a benefit corporation as the framework for their business.[99]

In the UK, stakeholders cannot sue a CIC, but they can complain to the Regulator (see section 5.1.3.3).

In line with US and UK law, the Danish draft law does not confer a right of action on stakeholders. This seems the correct decision. The broader the statement of purposes, the less precise will be the requirements that can be made regarding a company's pursuit of its social purposes, and the less appropriate it is to give stakeholders a right of action. With a very broad statement of purposes and without very strict guidelines on how such social purposes are to be fulfilled, it will be difficult

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[97] Clark Jr and Babson, *supra* n. 29, at p. 848.

[98] Section 301(d) of the Model Benefit Corporation Legislation.

[99] Clark, Jr and Vranka (principal authors), *supra* n. 29. As stated by Brakman Reiser, *supra* 48, at p. 30, one can equally ask whether stakeholders will have the necessary incentive to bring expensive proceedings against small companies for their failure to fulfil their social purposes.

to identify stakeholders who have a right of action and, thus, there will be considerable uncertainty about the risk of liability. One can also question the value of such a right of action in relation to the wish to eliminate greenwashing. Not many stakeholders will be prepared to bear the costs of proceedings, especially if there is substantial doubt about how far the management has fulfilled its obligations.

#### 5.1.3.3 Enforcement of management's obligations by public authorities

It might be more effective for public authorities to enforce management's obligations. Very different solutions have been chosen regarding this point.

With the US benefit corporation there is no public authority that monitors whether a company complies with the law's requirements as to purposes.[100] As stated above, the law only contains a broad list of those stakeholders whose interests should be served, and since there is no obligation to prioritise nor a requirement as to the use of profits, etc., trying to enforce this duty would create major problems.

On the other hand, in the UK, it has been decided that a public authority (the Regulator) should monitor whether companies comply with the law. In addition, stakeholders, shareholders, etc., can complain to the Regulator,[101] which can take further steps to examine the complaints or demand information, evidence, etc., from the company in connection with these complaints. The Regulator also has the authority to appoint an auditor.

The Regulator has also been given the power to impose a number of special sanctions. For example, it can, on behalf of the company, bring proceedings against the management for failure to fulfil its obligations if the shareholders have not taken such a step. Moreover, the Regulator can appoint, suspend or dismiss members of the board of directors where: (a) there is misconduct or mismanagement; (b) it is necessary to protect the assets of the company; (c) the company does not meet the 'community interest' test (see section 4.2); or (d) the company does not carry on any activities in pursuit of its social purpose.[102] The Regulator also has the power to 'vest in trust the property of the CIC', and, finally, it can institute proceedings with a view to winding up the company. Appeals against any of the measures taken by the Regulator can be made to the Appeal Officer.[103]

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[100] However, in relation to charitable organisations, state attorney generals have some supervisory powers regarding compliance with statements of purpose.

[101] However, there are limits to what can be complained about.

[102] Section 31 of the Companies (Audit, Investigations and Community Enterprise) Act 2004. In addition, the Regulator can determine the management's payment.

[103] According to the Office of the Regulator of Community Interest Companies: Information and Guidance Notes, Chapter 11, '[t]he Appeal Officer is a statutory office holder appointed by the Secretary of State for the Department for Business, Innovation and Skills'. See: <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/211751/13-714-community-interest-companies-guidance-chapter-11-the-regulator.pdf>. The Appeal Officer is independent of both the government and the CIC Regulator.

The Danish draft law contains no provisions for monitoring and enforcement. The draft law makes it clear that an enterprise which does not comply with the requirements of the law can be deregistered, and a fine may be imposed if a social enterprise uses its profits in a way not provided for under the asset lock (section 5.2). How the enforcement should be conducted and who can initiate it is not specified. It is only indicated that some sort of control will take place on registration, as it is made clear that the company seeking registration will have to submit documentation proving that the conditions for registration are complied with. The preparatory documents moreover state that spot checks will be made to investigate whether the restriction on dividend distribution has been observed. The Danish working group that submitted its recommendations in September 2013 had suggested that the issue of monitoring and sanctions be referred to as a separate issue to be dealt with in a future report. However, it seems that the Danish government decided to go forward with the draft law without such a report and thus, evidently, did not consider additional enforcement mechanisms necessary.

The shareholders of a social enterprise may not have a sufficient interest in bringing proceedings against the management as long as the management serves their profit interest, albeit at the cost of fulfilling its social purposes, and as the stakeholders do not have a right to take action, some sanctioning mechanism seems necessary in order to prevent greenwashing of the social enterprise 'brand'. Sanctioning failed compliance might be left to market forces, but judging by CSR experience, this is unlikely to be enough to counter the risk of greenwashing. There is thus much that favours some public authority being responsible for monitoring and sanctions, along the lines of the UK approach. If such monitoring is to guarantee protection of the 'brand', ongoing supervision and effective sanctions must be in place.

In addition to monitoring by the authorities, stakeholders should have the right to complain. The experience of the US B Lab (see above in section 3) shows that certified undertakings keep a watch on each other's fulfilment of the requirements for certification. A large proportion of the complaints that B Lab deals with comes from other certified undertakings.

#### 5.1.3.4 Sanctioning by market forces

In all three jurisdictions, an obligation exists (or has been proposed) to give information to the market (see section 5.3) and all three offer the possibility of sanctions being imposed by market forces. As seen above, in the UK and Denmark, these are supplemented by other kinds of sanctions, while sanctions regarding the US benefit corporation are left entirely to the market.[104]

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[104] Information provided by William H. Clark.

### 5.2 Restrictions on the transfer of assets (asset locks)

A social enterprise must both serve its social purposes and be able to attract investors. This means that it must have some possibility of paying dividends to its owners. This raises the question of whether it should be up to the owners to decide how much of the profits should be used to pay dividends and how much should go to social purposes, and whether this should be regulated by law. On this point, too, different approaches have been taken.

In the case of the US benefit corporation, the law provides no guidelines on how much can be paid in dividends and how much should be spent on social purposes. Thus, benefit corporations may pay dividends under the same conditions as apply to ordinary corporations.[105] However, a benefit corporation must report on how it pursues its social purposes (see section 5.3 below). This system offers great flexibility but at the same time provides no certainty that the corporation will really pursue its social purposes, and the benefit corporation is sometimes criticised for allowing greenwashing.[106]

A radically different approach has been chosen in the UK and Denmark, in the form of a number of legislative restrictions on how a social enterprise can use its profits. In the UK, this restriction on the transfer of assets is referred to as 'asset lock'. The rules impose restrictions on the payment of dividends and other disbursements, and on the disposal of assets in the event of winding up or reincorporation as an ordinary company. The rules are intended to prevent shareholders from freely deciding to pay the company's profits to themselves while the company is a CIC. This prevents greenwashing and protects the social enterprise 'brand'. However, if asset locking is too strict, investors may be scared off.

One could consider whether there are ways to ensure that social enterprises pursue their social purposes other than by asset locking or similar mechanisms. For example, is it necessary to restrict payment of dividends if the company takes account of social considerations in its operations, such as taking on handicapped employees, using environmentally responsible production methods, etc.? In principle, the latter seems sufficient to be able to qualify as a social enterprise. In fact, it is difficult to formulate a company law solution which will guarantee that a social enterprise serves its stated social purposes when conducting its business. It is much easier to ensure a certain measure of social engagement by limiting the right to pay out dividends, which is also easier to monitor and sanction. A restriction on the right to pay out dividends may also promote social purposes, since such a rule may make shareholders less inclined to think about their personal profits. Thus, even though asset locking is a somewhat indirect way of promoting social purposes, it is probably the easiest regulatory method to administer.

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105 The shareholders can of course regulate this in the articles of association.

106 See Munch, *supra* n. 41, at p. 189; and Brakman Reiser, *supra* n. 28, at p. 612.

### 5.2.1 *Dividends*

Both the UK and the Danish rules set limits on how much can be paid out in dividends.

The UK rules originally provided that a CIC could only pay its shareholders a maximum dividend of 5% over the Bank of England base rate. As in recent years the base rate has been very low, this was effectively a ceiling of just over 5%. In a reform in 2010, this rule was amended so that now a dividend can be paid of up to 20% of the paid-up amount for the shares. In a report from December 2013, the CIC Regulator has announced that the cap will be removed.[107] In addition, the Act provides that no more than 35% of the company's profits may be paid out as dividends.[108] There are no plans to remove this cap.

The first proposal for Danish rules provided that owners were only permitted to receive a total return corresponding to their original investment plus a reasonable annual return on it. This was evidently open to interpretation and consequently criticised.[109] The subsequent draft law proposed by the government introduces two upper limits to indicate what constitutes a reasonable annual return. First of all, the annual interest per share can be no higher than 15% above the base rate, and no more than 35% of the profits may be paid out as dividend. These limits have evidently been inspired by the UK rules, except for the fact that the Danish government has chosen not to mirror the relaxation of the cap on the dividend per share just announced.

Both the UK and the Danish rules state that if dividends are not paid in one year, the amount payable can be carried forward and be used in the distribution of profits in the following year.[110]

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[107] See the Report *Changes to the Dividend and Interest Caps for Community Interest Companies* (10 December 2013), available at: <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/264664/CIC-13-1333-community-interest-companies-response-on-the-cic-consultation.pdf>.

[108] Under Section 30 of the Companies (Audit, Investigations and Community Enterprise) Act 2004, the Regulator has authority to determine the limits for dividend payments and other disbursements, and this authority is laid down in the Community Interest Company Regulations 2005, which were supplemented in 2009. The rules on dividends, etc., discussed here can be found in Section 17 ff. of these Regulations. See also Office of the Regulator of Community Interest Companies: Information and Guidance Notes, Chapter 6: 'The Asset Lock' (March 2013), section 6.3.

[109] For a critical discussion of this proposal, see Neville and Engsig Sørensen, *supra* 59.

[110] An investor who has invested early in the enterprise may be in a different position than one who has invested at a later stage. If there were years in which the allowed maximum dividend was not paid, the first investor may be allowed a larger dividend. However, in company law, all shareholders are entitled to the same dividend, and in order to ensure flexibility it may be necessary to have different classes of shares for different investors, which would allow for different dividends.

Thus, the Danish as well as the UK rules set narrow limits for investors' financial rewards. Even though a dividend corresponding either to 15 or 20% above base rate of a capital investment may be sufficient for investors in some kinds of company, there will presumably be companies where investment is associated with high financial risk and where risk-tolerant capital can only be attracted if investors have the prospect of receiving a greater share of the profit. Against this background, one may ask whether the chosen solutions are too restrictive. The decision to remove the cap per share in the UK seems to be the right choice. However, it may still be questioned whether the overall cap of 35% of the profits may be too restrictive. Perhaps it would be enough to provide that a maximum of 50% or even 75% of the profits could be paid out as dividends.[111] Such a rule would still ensure that some of the company's profits go to social purposes, but would not prevent the owners from receiving a significant share of the profits in companies that are making good profits. This could both make it easier to attract social entrepreneurs and offer social entrepreneurs more room to attract capital from a wider circle of investors.

Another option could be to require that, each year, a part of the profits *must* be used for social purposes. The problem with this is that it would prevent companies from making necessary financial consolidations or investments which would improve their earnings potential in the longer term. Ultimately, an obligation to put a given proportion of the profits to social use might conflict with the management's obligation to ensure that the company has sufficient financial resources.[112] An alternative solution could be to require that a payment be made for social purposes if the shareholders decide to pay themselves a dividend. This would ensure that the shareholders also contribute to any necessary consolidation or investment.

### 5.2.2 *Other disbursements*

The above restrictions on the payment of dividends creates a risk that the owners will seek to extract resources from the company by other means. Both Danish and UK law seek to prevent this by restricting certain other kinds of disbursements.

In the UK, the following restrictions have been introduced:[113]

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[111] In connection with the adoption of the Act setting up CICs, a debate took place about the possibility of allowing certain shares to be issued without being subject to restrictions on the amount of dividends that could be paid. However, this idea was rejected as being contrary to the whole idea; see Cross, *supra* n. 86, at p. 312.

[112] See the obligations of the board of directors, in § 179(2) of the Danish Companies Act, to ensure that payment of dividends does not exceed what is reasonable in relation to the company's financial position.

[113] See the more detailed review in the Office of the Regulator of Community Interest Companies: Information and Guidance Notes, Chapter 6: 'The Asset Lock' (March 2013), section 6.4 and 5, and Chapter 9: 'Corporate Governance', section 9.3. See also the Community Interest Company Regulations 2005, Section 21 et seq.

- First, there is a restriction on the level of interest that can be paid on a loan where payment is dependent on the company's profits. Following the 2010 reform, the maximum interest payable corresponds to 10% of the principal. This is to prevent owners from providing loans instead of buying shares so as to avoid limits on dividends.
- CICs can only buy back shares at a price corresponding to what was paid for them.
- In connection with a reduction of capital, a CIC may not pay out on shares that have not been fully paid up, and the maximum that can be paid out is equal to a fully paid-up share.
- The authorities monitor whether the directors of a CIC only receive 'reasonable' salaries or fees.[114] Without such a provision, there would be a risk that directors' pay would be adjusted such that the CIC would never make a profit and would thus be unable to pursue its stated social purposes. The authorities have not laid down a mathematical formula for what constitutes reasonable pay, nor have they indicated the criteria for setting levels of pay.[115]

The Danish draft law contains the following provisions on other disbursements:

- According to the preparatory documents for the draft law, the restrictions on the value of dividends that can be paid pursuant to § 5(1) and (2) apply to any form of profit distribution. It is stated that profit sharing termed as a loan is also covered. This could indicate that payment of interest on loans which is profit-dependent is included in the cap on distributions.
- A capital reduction must be executed within the limits for dividend payments pursuant to § 5(1) and (2), i.e., original investment plus a reasonable annual return (see § 10(2)).
- The highest management body must ensure that the payment of fees does not exceed what is customary, given the nature and extent of work carried out, and what may be regarded as reasonable in relation to the company's social purposes (see § 9). In particular this last provision is interesting as it implies that those who work for social enterprises may have to be satisfied with a lower level of payment.

There is clearly some overlap between the rules. Both sets of rules refer to fees and capital reductions. There are gaps in the Danish regulations in that they do not state that the payment of interest on loans which is profit-dependent is not permitted

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114 The authority for this is laid down in the Community Interest Company Regulations 2005, Section 30.

115 Office of the Regulator of Community Interest Companies: Information and Guidance Notes, Chapter 6: 'The Asset Lock' (March 2013), section 9.3.6.

(although this may be implied in the preparatory documents), nor are there provisions imposing limits on a company's acquisition of its own shares. These gaps should (clearly) be closed as otherwise it will be relatively easy to circumvent the other asset locks.

The UK experience shows that it is difficult to enforce rules whereby salaries paid by social enterprises must be 'reasonable'. It is obvious that similar problems could arise in Denmark, as there is no real indication in the draft law as to how this will be decided. By indicating that in setting the amount of payment the company's social purposes and character must be taken into consideration, the Danish rules seem to raise more questions than they answer.

While it is relatively easy to see that a company has made a capital reduction, it can be difficult to constantly monitor whether the other kinds of distributions are being made. It is thus necessary to consider how this should be monitored. In most cases, the model chosen is based on the requirement that the company should give information on how much is paid in dividends and other potential distributions (see below section 5.3).

### 5.2.3 *De-registration, conversion and winding up*

If it were possible for a social enterprise to simply opt out of the scheme and again become a 'for profit' company, there would be a risk that the owners would take possession of the assets created while the company was operating as a social enterprise. Both Denmark and the UK have introduced rules to prevent this.

Under the rules governing the CIC it is not possible for a CIC to convert into an ordinary company.[116] If the shareholders decide to wind up a CIC, the assets of the company cannot be distributed to the shareholders. The latter may only be paid an amount corresponding to their original capital investment in the company. The remaining assets must be allocated to other CICs. The articles of association may state which CICs should receive the assets in the event of a CIC winding up, otherwise the Regulator will decide.[117]

Just as the rules that restrict the payment of dividends are quite extensive, the rules described here also are very restrictive. It does not seem appropriate to prevent conversion into an ordinary company in this way. It should be enough to stipulate the highest percentage of the company's wealth that the shareholders may

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[116] Office of the Regulator of Community Interest Companies: Information and Guidance Notes, Chapter 10: 'Transfer of Assets and Ceasing to Be a CIC' (March 2013), section 10.5. On the other hand, it is possible for a CIC to be transformed into a charitable trust or an Industrial and Provident Society, and the company's assets will thereafter be entirely devoted to social purposes; see Office of the Regulator of Community Interest Companies: Information and Guidance Notes, Chapter 10: 'Transfer of Assets and Ceasing to Be a CIC' (March 2013), section 10.2 and 3.

[117] Ibid., section 10.4.4; and the Community Interest Company Regulations 2005, Section 23.

receive in the event of conversion or winding up. One could consider having this correspond to the share of the profits that can be paid out as dividends (for example, 50% or 75%, as suggested in section 5.2.1).

The Danish draft law has chosen a slightly different approach, which is, to some extent, linked to the fact that there is a certification scheme for social enterprises instead of a new corporate form. It is thus proposed that upon the winding up of the company there should be a restriction on what can be disbursed to the owners. This corresponds to the restriction on the payment of dividends in § 5(1) and (2). That part of the profits that may not be paid to the shareholders must be given either to other social enterprises registered under the scheme, or to other organisations with a social purpose (see § 10(1)).

The first draft law did not propose any asset locking in the event of a company de-registering. This solution made all the asset-locking provisions meaningless, as an undertaking that wants to pay out more than is permitted should merely remember to de-register before doing so. Consequently, it was easy to criticise this first draft.[118] In the draft law proposed by the Danish government the mistake has been partly remedied. It is suggested that on de-registration the part of the profit made during the time the enterprise was registered as an RSV should only be used in accordance with the asset locks as stipulated in § 5(1) and (2). The problem with this solution is that the asset lock then continues after de-registration, and it may thus be even more difficult to ensure that the restrictions are observed.

The UK rules in particular are in stark contrast to the regulations for benefit corporations, where a two-thirds majority of the shareholders can choose to convert the corporation into an ordinary corporation, without any consequent locking in of the corporation's assets.[119]

Shareholders of a social enterprise can of course at any time sell their shares in accordance with the rules that apply to companies of the kind in question. There are no rules as to the price at which they can be sold, but it is clear that any cap on the payment of dividends will affect the trading value of such shares.[120]

## 5.3 Reporting

The rules governing benefit corporations, CICs and the Danish certification scheme all require undertakings to make special reports to supplement the usual annual accounts. The purpose of these reports is to give shareholders and other stakeholders an insight into how the undertakings seek to serve their social purposes. However, the requirements for the contents of these reports differ.

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[118] See Neville and Engsig Sørensen, *supra* n. 59.

[119] Model Benefit Corporation Legislation, Section 105(a).

[120] For CICs, see Steven Lloyd, 'Transcript: Creating the CIC', 35 *Vermont Law Review* (2010-11) p. 31, at p. 37.

In the case of benefit corporations, the Model Legislation requires the following to be reported:[121]

- A review of the measures taken to accomplish the 'general public benefit purpose' pursued by the corporation. A report should also be provided on any measures taken in relation to the 'special public benefit'.
- The corporation must also report on any circumstances that have prevented it from pursuing its social purpose.
- In addition, the corporation is subject to requirements to give an account of its social and environmental performance in relation to the third-party standard chosen. As referred to in section 4.2, these standards can be set by various organisations that meet the legal requirements. The corporation can choose for itself by which standard it wishes to be measured. If it subsequently changes the standard, it must state the reasons for such change.
- The amounts of the payments made to the directors.
- In corporations that have a benefit director[122] the Model Legislation requires this person to be named and to make an annual compliance statement on whether, during the accounting period under review, the corporation has acted in accordance with its social purposes. Moreover, he must assess whether the directors have lived up to their obligation to take account of various stakeholder interests (see section 5.1.1).[123]

The report is not subject to external auditing.[124]

A CIC also has a reporting obligation. These reports must cover the following points:[125]

- A description of how the company has served the community interest.
- A description of how the company has consulted the interest groups affected by the company's activities, and the results of these consultations.
- Information about payments to directors.
- Information about what has been paid out as dividends (see section 5.2.1).
- Information about payments of interest on loans which are dependent on the company's profitability (see section 5.2.2).
- A review of activities carried out by the company without charging a full fee.

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121 Model Benefit Corporation Legislation, Section 401.

122 On this, see section 5.1.2 above.

123 Model Benefit Corporation Legislation, Section 302(c).

124 Of the corporations certified by B Labs, each year, 10% are subject to a review which covers the corporation's reporting. See: <http://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/performance-requirements>.

125 The Community Interest Company Regulations 2005, Section 26 et seq.

There is no requirement for the report to be audited by an auditor.[126]

The Danish draft law provides that a social enterprise should present an annual report in accordance with the law on annual financial reports. In addition to the annual report, the following information must be provided:[127]

- The total fees, etc., paid to existing and former members of the management, and any payments made to promoters of the company.
- Agreements entered into with closely related parties.
- Cash holdings and other assets that are distributed or paid out of the company's assets.
- How the company has fulfilled its social purposes. The commentary on the draft law states that this should include a report on how the company realises its policies in practice and any expectations for future activities.
- The total dividends received by the shareholders.

There is no requirement for the report to be audited. According to the preparatory documents for the above provision, if a company chooses to include the information in its management report and the company is subject to auditing, this information will be included in the auditor's report.[128] However, since a company can apparently just omit this information from its management report, it can easily avoid being audited.

Even though there are differences in the reporting requirements, their aim is the same, namely, to give the undertaking's stakeholders and the public authorities some insight into how far the undertaking has succeeded in achieving its social purposes. All three kinds of reports also give an insight into how the management is rewarded. However, only the Danish and UK reporting requirements look at how the shareholders provide for themselves. There is no requirement for external auditing. However, in the US, some states must appoint a benefit director who has to provide some guarantee that the report is fair.

One might ask who will read these reports and react to what is reported. If the company's shareholders and other investors have invested in it because it has a social purpose, they will have an interest in seeing that the company pursues its stated purposes.[129] Moreover, the interest groups which are to benefit from the so-

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[126] Office of the Regulator of Community Interest Companies: Information and Guidance Notes, Chapter 8: 'Statutory Obligations' (March 2013), section 8.1.3.

[127] § 6(4) of the draft law, *supra* n. 2.

[128] Commentary on § 6.

[129] One can question whether shareholders really have an interest in the fulfilment of the company's social purposes (especially in the case of benefit corporations), as this will take a larger portion of the profit; see Brakman Reiser, *supra* n. 28, at p. 613, who, however, seems to overlook the fact that those investing in social enterprises must be assumed to think that pursuing social purposes is a good idea.

cial purposes will want to ensure that these are achieved.[130] Other social enterprises, which may aim to protect the social enterprise brand, may also be keen to see that their 'competitors' fulfil their social purposes.[131]

## 6. Conclusion

The introduction of frameworks for the operation of social enterprises raises a number of questions relating to company law. While different kinds of frameworks have been introduced in the jurisdictions examined here - the US, the United Kingdom and Denmark (proposal) - there are similarities between them. All three schemes contain requirements for the social purposes of the undertakings, their management and their reporting. In addition, both the Danish and the UK schemes regulate a number of issues relating to the transfer of assets from social enterprises.

There is the basic question as to whether social enterprises should be promoted by introducing a new corporate form or by providing a certification scheme. On the face of it, a model whereby undertakings wishing to have a social profile can be certified seems the best solution. A certification scheme allows undertakings of many different corporate kinds to carry on a social enterprise with a special branding, without having to convert into some other corporate form (see above for a description of the problems and associated costs). A certification scheme also has advantages in that it maintains network and learning benefits, which, for example, are linked to the use of well-established corporate forms. Also in relation to sanctions, using a certification scheme will be less problematic than having an entirely new corporate form.

Regarding the other aspects of the regulation of social enterprises, it seems difficult to strike a balance between providing sufficient flexibility to allow different types of businesses and entrepreneurs to use the brand, and ensuring that social enterprises are a respected and credible brand. In this article, we have identified a number of factors which we believe are important for striking the right balance between these considerations.

The first question concerning this necessary balance is how strict the requirement for the statement of social purposes should be and how intensive the control thereof. The US benefit corporations are subject to modest requirements for the statement of social purposes, and the only way of checking whether undertakings in fact fulfil the requirements is market control on the basis of the corporation's own

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[130] Research into the reporting by certain CICs has shown a wide variation in the quality of the reports, and thus it may be difficult for other interest groups to use them; see Alex Nicholls, 'Institutionalizing Social Entrepreneurship in Regulatory Space: Reporting and Disclosure by Community Interest Companies', 35 *Accounting, Organisations and Society* (2010) p. 384.

[131] B Lab often receives complaints from B Corporations about other B Corporations which do not live up to their obligations.

information. In contrast to this, the Danish and UK requirements are quite detailed with regard to the statement of social purposes. Even though the Danish and UK rules can exclude certain undertakings from becoming social enterprises, there is little doubt that such rules are most appropriate for ensuring that undertakings do in fact live up to their social obligations, and are thus better suited to protecting such schemes from greenwashing.

In stipulating rules for the establishment of a social enterprise it should be ensured that as many corporate forms as possible can be converted into or certified as social enterprises, and that the rules for such conversion or certification are simple and involve a minimum of costs. The existing rules require agreement from a very large majority of the owners in order for an undertaking to become a social enterprise and, in practice, this probably prevents many undertakings from conversion or certification. On the other hand, a large majority seems necessary, since a decision that the company's future profits will be used, in whole or in part, for social purposes should not be forced upon a minority. It thus appears necessary to accept this barrier to conversion or certification.

The biggest challenge is to develop company law rules that ensure that social enterprises actually pursue their social purposes. It is necessary to consider both rules that restrict the right to dividends and disbursements, and rules that help hold the management to account for fulfilling the social purposes.

If social enterprises are prohibited from distributing all their profits to their shareholders, they will have a direct incentive to take account of their social purposes, both in operating the undertaking and in the subsequent disposal of profits. On the other hand, this leads to the risk of the owners trying to extract money from the company by other means (covert distribution). Rules to prevent this are also needed if restrictions on the payment of dividends are to be effective.

One might ask whether it should not be sufficient for qualification as a social enterprise that the enterprise is operated in a way that is socially responsible, without the need for restrictions on dividend payments. This approach is followed in the US for benefit corporations. However, it is difficult to find an alternative solution which ensures that undertakings actually serve a social purpose, so asset locking is hard to avoid entirely if the risk of greenwashing is to be prevented. However, the Danish and UK rules on asset locking seem too strict on many points. As proposed in section 5.2, less strict asset locks could still guarantee that a significant proportion of the company's profits (and the way in which the company operates) serves social purposes.

It is the management that must ensure that an undertaking is operated so as to fulfil its social purposes. However, consideration should be given to the introduction of special rules to ensure that the management is monitored and sanctioned. It is clear that the shareholders should be able to enforce the management's duty to pursue the company's social purposes. It has been considered whether stakeholders should be able, independently, to guard their interests through representation at board level or by being given the right to initiate court proceedings. As seen in

sections 5.1.2 and 5.1.4, this could cause problems in defining who is a stakeholder, and could well lead to social entrepreneurs deciding not to use the social enterprise form.

Since the shareholders may well lack an interest in suing the management for putting too high a priority on making a profit for the shareholders rather than considering social purposes, other sanctions are needed to prevent greenwashing from diluting the social enterprise brand. Monitoring and sanctions based on market forces are probably not enough to protect the social enterprise brand. It may be more appropriate to introduce an arrangement, like that for the UK CIC, whereby sanctioning is the responsibility of a public authority.

If market mechanisms and monitoring by public authorities are to be used for sanctioning, then social enterprises should report on how they serve general social purposes (see section 5.3). Presumably a social enterprise itself will be interested in providing such reports to ensure the support of its shareholders and other interested parties. If stakeholders, etc., are to have the right to make complaints about undertakings that do not meet their social obligations, a duty to provide information is essential.

To conclude, while the US benefit corporation is very flexible, it does not appear to be an entirely viable solution. The UK and Danish solutions are more workable, but they could benefit from greater flexibility, especially in their regulation of asset locks.